

# Contractor or Employee? Exempt or Non-Exempt?

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Understanding the Distinctions  
When Classifying Workers

September 2019

EMPLOYEE



CONTRACTOR



# What We'll Cover Today

- How to protect yourself from costly misclassification mistakes and legal issues
- Factors that define the worker relationship, according to the IRS and DOL
- Warning signs that the contractor you're using is actually an employee under the law
- What determines exempt vs. non-exempt status
- Steps to take if a worker is misclassified

# Contractor or Employee?



# Contractor vs. Employee

- Very common for businesses to use independent contractors (ICs) to avoid overhead cost
- But many employers don't realize there is a distinction under the law
- Guidelines are complex, and can vary by state
- It's estimated 30% of businesses who use ICs misclassify (intentional or not)

# What are the Risks?

- State and federal government agencies are watching
- Agencies have bias toward treating workers as employees, rather than contractors
  - Harder to collect employment taxes from IC's
  - ICs are not covered by workers' comp
  - ICs don't benefit from most labor law protections
- Risks include back taxes, back wages, back premiums and lawsuits
- And agencies share information!

# Red Flags Your IC Is an Employee

- Work being done is essential to your core business
- Worker is being micromanaged by an employee
- Worker is given specific work hours
- Worker uses equipment owned by the business
- Relationship is open-ended with no clear scope
- Worker provides a SSN, not a business EIN
- Worker is being paid from a payroll account

# How to Keep an IC Legally Legit

- Work with ICs that have business name and EIN
- Use an Independent Contractor Agreement
  - Define scope of work and deadline up front
- Require IC to use his or her equipment
- Set up as a vendor and pay out of Accounts Payable
- Issue a 1099 at year-end
- Don't use the same IC for indefinite periods
- Use employees for core business functions

# Exempt or Non-Exempt?





# Exempt vs. Non-Exempt

Why should you care? Because even innocent mistakes can lead to **BIG** settlements for FLSA violations. Just ask:

- FedEx - \$240 million
- Walmart & Sam's Club – \$62.2 million
- Met Life - \$50 million
- T.G.I. Fridays – \$19.1 million
- T-Mobile- \$19 million

# Back Wage Recovery Reaches All-Time High

## Wage and Hour Division recovered:

- A record of \$304 million in back wages in 2018
- \$835,000 recovered per day
- Over \$1.3 billion in back wages in the past 5 years

# Let's Look at the Differences

## Non-Exempt (or “hourly”) employees:

- Overtime pay required – at the rate of one and one-half times regular rate – for all hours worked over 40 in a workweek
- Must be paid at least minimum wage for all hours worked
- Accurate time records must be kept

# Let's Look at the Differences Cont'd

## Exempt (or “salaried”) employees:

- Overtime pay not required
- Time records not required
- Paid on a salary basis for all hours worked
- Common examples include executives and high-level managers

# When Can Employees Be Exempt?

To qualify for an exemption, an employee:

- Must be paid on a salary basis
- Must meet the minimum salary threshold (currently \$455/week)
- Must meet a duties test for an exemption

*Employee must meet minimum salary level AND satisfy specific job duties tests to be exempt*

# Types of Exemptions

- White-collar exemptions
  - Administrative
  - Executive
  - Professional
  - Creative
  - Outside sales
- Business owner
- Highly compensated employees

# Test for Executive Exemption

In general, the employee must:

1. Manage a team or department
2. Direct the work of 2 or more employees
3. Have authority to hire and fire

# Test for Administrative Exemption

In general, the employee must:

1. Perform non-manual work
2. Manage “back-office” general business operations
3. Have decision-making authority on significant matters



# Test for Professional Exemption

In general, the employee must:

1. Perform tasks requiring advanced knowledge
2. Have advanced education or specialized training
3. Be specialized in a field of science or learning

# Additional Tests

**Creative Professional:** The employee's primary duty must be work requiring invention, imagination, originality or talent in a recognized artistic or creative field.

**Computer Employees:** The employee's primary duty must deal with systems analysis, development or operations, (e.g. programmers or IT specialists)

**Outside Sales:** The employee's primary duty must be making sales and must do so outside of the employer's business location.

# Remember ...

*Exempt status is determined through two factors: Compensation and Department of Labor (DOL) “job duties” test. The employee must be making the minimum salary and pass every criterion of one of the DOL tests.*

# Exceptions

Some overtime exemptions still exist that do not require a minimum salary; meaning you're not required to pay these employees\* overtime even if they do not meet the minimum salary.

- Lawyers
- Doctors
- Teachers
- Computer employees if paid at least \$27.63/hour
- Outside sales
- Inside/commissioned sales

\*Additional legal tests apply

# If Someone is Misclassified ...

If you have a worker who is classified as exempt and “salaried,” and you realize he/she is misclassified, you should:

- Record payroll status change
- Update job descriptions if necessary
- Consider state/local notification requirements
- Implement or upgrade timekeeping system
- Reevaluate rewards, prizes and incentives; it all counts toward overtime calculations

# Additional Tips

- Conduct an audit of all employees
- Review all of your exempt classifications (no matter how highly paid)
  - Document basis for exemptions
  - Implement and distribute salary deduction policy
  - Update job descriptions to support classifications
- Conduct general compensation analysis and correct pay discrepancies (e.g., Equal Pay Act, Title VII, ADEA)

# ComplyRight HR 101

## Course 3: *Classifying Workers Correctly*

### Course Training Modules Include:

- Determining Exempt or Non-Exempt Status
- Applying the Exemption Tests
- Understanding Employee vs. Independent Contractor
- Setting Up an Independent Contractor Relationship

**Get started at [complyright.com/courses](https://complyright.com/courses)**



# Upcoming ComplyRight Webinar

Ready, Set, Go: Critical Actions Every Employer Should Take with the New FLSA Overtime Rule

Thursday, October 3 at 2 PM ET

Presented by: Jaime Lizotte, HR & Tax Compliance Solutions Manager and Shanna Wall, Esq., Compliance Attorney



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