



Classifying And Compensating Employees ©

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Worker or Service Provider?

- Manpower services are provided through efforts of individuals
- An employee is a person performing services under the control of the engaging party
- An independent contractor is a person performing services for the engaging party but under the control of the third party

Attributes of an Employee

- Engaging party controls the manner and means by which the project is accomplished
 - Sets the skill required of the hired party
 - Provides the instruments and tools to be used
 - Determines when and where the work is to be performed
 - Duration of the relationship
 - Assigns additional projects
 - Assigns assistants and other workers to project
- Payment for services is by hour/week rather than project

Attributes of an Independent Contractor

- A business entity, not an individual
- IRS will examine three factors
 - (Department of Labor also will consider similar facts)
 - Behavioral Control
 - Financial Control
 - Relationship of Parties

Behavioral Control

- Right to direct or control how work is to be performed
 - How, what, where, and in what order instructions given to worker?
 - Who supplies the tools/equipment?
 - What and who gives training to the worker?

Financial Control

- Does worker have a significant investment in the facilities, tools, equipment used in performing the services?
- Does worker maintain a separate office or business location, or advertise services?
- Does worker incur unreimbursed expenses?
- Does worker hire and pay assistants?
- Does worker provide, or offer, services to others?
- How is worker paid – flat fee for job or hourly or weekly rate?
- Does worker have ability to make a profit or suffer a loss?

Relationship of Parties

- What was the intent of the parties?
 - Is there a written contract?
 - Is worker provided benefits such as pension or health?
 - Can worker be discharged or leave without cause? If work incomplete is the worker liable for non-performance?
 - Are the worker's services a key component of the employer's business operations?

Consequences of Misclassifying

- Onerous tax consequences
 - FLSA and IRS penalties (up to 100%) (FICA, FUTA and income tax, businesses would have withheld for employee)
 - Back wages plus interest
 - Personal liability for business owner
 - If a Form 1099 was filed the tax penalties (retroactive tax payments and FUTA payments) are reduced



Consequences of Misclassifying

- Liabilities under
 - ERISA
 - COBRA
 - Fair Labor Standards Act
 - Family and Medical Leave Act
 - Immigration Control
- Liability is for prior three years.

Suggestions to Help Avoid Misclassification Include:

1. Signed independent contractor agreement that includes an acknowledgement that the worker is an independent contractor. (Not determinative, but helpful).
2. Pay on a per-project basis.
3. Contractor pays for out-of-pocket expenses themselves (i.e. no reimbursements).

Suggestions to Help Avoid Misclassification Include (cont.):

4. Contractor is responsible for withholdings, has own worker's compensation and pays unemployment.
5. Contractor receives no fringe benefits.
6. Contractor does not hold himself out as an employee of the company (i.e. no business card with company's name).
7. Contractor has great freedom as to the manner of how to perform and schedule work.

Suggestions to Help Avoid Misclassification Include (cont.):

8. Contractor provides his own tools and equipment.
9. The terms for renewal and termination of the project are specified in the contract, including the contractor's right to terminate the relationship.
10. Contractor has its own incorporated business.
11. Contractor provides his own insurance.
12. The duration is not 365 days per year over several years.
13. Little or no supervision over the work.



DOL “Crack Down”

- ❑ DOL recently signed a “memorandum of understanding” with the IRS and other federal agencies and several states.
- ❑ Involves agreement to information share. Coordination of law enforcement involving worker misclassification. Virginia has not yet signed.



IRS “Fresh Start” Initiative

- ❑ Coincides with the DOL crack down.
- ❑ Program designed to increase tax compliance. Eligible employers can obtain substantial relief from federal payroll taxes they may have owed for the past. Must prospectively treat workers as employees.
- ❑ Program is available to tax-exempt organizations and government entities, as well as private sector.



IRS “Fresh Start” Initiative (cont.)

Eligibility Requirements

- ❑ Must have consistently treated workers in past as non-employees.
- ❑ Have filed 1099 forms for workers in the previous three years.
- ❑ Not currently under audit by IRS/DOL/or state agency.



IRS “Fresh Start” Initiative (cont.)

Results if Accepted

- ❑ Pay 10% of the amount of employment taxes that would otherwise have been due on compensation paid for the most recent tax year to the workers.
- ❑ Penalty is calculated under the reduced rates of section 3509 of the IRC.
- ❑ No interest or penalties will be due.
- ❑ The employers will not be audited on payroll taxes related to these workers for prior years.
- ❑ Participating employers will, for the first three years be subject to a six year statute of limitations rather than the usual three.

Can I Have Unpaid Workers?

- ❑ Individuals can not provide services without being paid a minimum wage
- ❑ Private employers can not have volunteer labor
- ❑ Only government and nonprofit organizations may have volunteers
- ❑ Student interns, which may be performing duties on the work premises without the payment of wages, many only do so if their labor is for the benefit of the student (his education) and not the employer. Generally, these internships must be arranged through an educational institution. **The test is who is the beneficiary of the services provided – if it is the employer, the student is an employee.**



Wage and Hour Issues



Wage and Hour Laws (Fair Labor Standards Act)

- ❑ Minimum wage
- ❑ Overtime compensation
- ❑ Child Labor
- ❑ Equal Pay

General Wage Rule

- Employees are required to receive a minimum wage and to be paid overtime for hours worked over 40 in a work week.
- There are exceptions but these are narrowly applied.

Many FLSA Exceptions Both to Minimum Wage and to Overtime

- ❑ Seasonal employees
- ❑ Commissioned retail sales
- ❑ Outside sales
- ❑ Teachers
- ❑ Casual babysitters
- ❑ Companies for aged/infirm
- ❑ Apprentices
- ❑ Political appointees
- ❑ Legislative employees
- ❑ Agricultural workers
- ❑ White collar workers
- ❑ Hospital workers
- ❑ Transportation
- ❑ Disabled employees

“White Collar” Exemptions

- In order to qualify for a “white collar” exemption, an employee must meet the requirements of one of the six “exempt” categories.
 - Executive
 - Administrative
 - Professional
 - Computer
 - Outside Sales
 - Highly compensated employees

Nonexempt Employees

- Generally wage (hourly rate) but could be salaried.
- Pay can be deducted (“docked”) based on quantity or quality of work.
- Overall hourly rate, including deductions, may not fall below minimum wage for any work period.
- Any time over 40 hours/week (overtime) is paid at 1.5 times the hourly rate.

Three Criteria to Meet the White Collar Exemption

- **Salary Level** - \$455 per week (\$23,660 per year) excluding board and lodging.
- **Salary Basis** – guaranteed weekly amount of base pay which can not be reduced based on quality or quantity of work performed.
- **Primary Duty** – the employee's principal, main, major, or most important duty.

Primary Duty Includes the...

- ❑ Importance to the business of the exempt duties.
- ❑ Time spent on performing exempt duties.
- ❑ Employee's freedom from supervision in the exercise of the exempt duties.
- ❑ Employee's salary compared with the compensation paid to nonexempt employees.

Executive Employee: Primary Duty

- Management of the enterprise or a recognized department or subdivision of the enterprise.
 - Must customarily and regularly direct the work of two or more full-time employees/equivalents.
 - Authority to hire/fire or make recommendations of significant weight on such personnel actions.
 - Primary duty must be more than “mere supervision.”

Level of Responsibility over Subordinates

- ❑ Interviewing, selecting, and training employees;
- ❑ Setting rates of pay and hours of work;
- ❑ Maintaining production or sales records (beyond the merely clerical);
- ❑ Appraising productivity; handling employee grievances or complaints, or disciplining employees;
- ❑ Determining work techniques, and the safety and security of the workplace;
- ❑ Planning the work and apportioning it among employees;
- ❑ Determining the types of equipment/materials to be used in performing work;
- ❑ Planning work unit or project budgets;
- ❑ Monitoring work for legal or regulatory compliance.

Administrative Employee: Primary Duty

- Performance of office or non-manual work directly related to the management or general business operations (of employer/ employer's customers)
- Must exercise discretion and independent judgment with respect to matters of significance related to business operations.

Keeping the Business Running

- ❑ This is the most error-prone classification– it is not a clerical position.
- ❑ The employee's primary duty must be supporting the **business**, not making what the business makes, working on the production line or selling a product.
- ❑ Examples: HR/personnel, payroll, finance, tax, accounting, quality control, marketing and advertising (not direct sales), department store buyer.
- ❑ Not secretaries, help desk personnel, answering phones, preparing expense reports, filing.

Practice Tips

- ❑ Does the employee have authority to formulate or interpret company policies?
- ❑ How major are the employee's assignments in relation to the overall business operations of the enterprise (buying office supplies versus buying new enterprise computer servers)?
- ❑ Can the employee sign contracts?
- ❑ Can the employee deviate from company policy without prior approval?

Blue Collar Workers Never Exempt

Non-management employees in production, maintenance, construction, including carpenters, electricians mechanics, plumbers, iron workers, craftsmen and engineers, are entitled to minimum wage and overtime, no matter how highly compensated.

Professional Employee: Primary Duty

- Performance of work requiring “advanced knowledge” in a “field of science or learning” and “customarily acquired by prolonged course of specialized instruction.”
- Non-manual artistic endeavor requiring “invention, imagination, originality or talent.”
- Lawyer, doctor, registered nurse, physician assistant, theologian, chef, artist.

Computer Professional: Primary Duty

- Salary – Weekly (\$455) or hourly (\$27.63).
- The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications;
- The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;
- The design, documentation, testing, creation, or modification of computer programs related to machine operating systems; or
- A combination of the aforementioned duties, the performance of which requires the same level of skills.

Highly Compensated Employees

- ❑ Office or non-manual work.
- ❑ Total compensation of \$100,000 or more, but salary of at least \$455/week.
- ❑ Customarily and regularly perform at least one duty of exempt executive, administrative or professional employee.
- ❑ Not for people who “perform work involving repetitive operations with their hands, physical skill and energy.”



Do Not Defeat the Exemption By Taking Deductions from Salary

- Taking deductions from an employee's salary can convert an exempt position into a non-exempt position.
- This will result in the employee being entitled to overtime compensation, no matter whether he or she is the CEO or not.

Permitted Deductions for Exempt Employees

- Can deduct from salary for
 - A full day absence for sickness, disability, FMLA, or personal reasons if no accrued PTO, vacation or disability benefits.
 - Compensation for service on a jury, witness fees, and military pay. by the amount of payment an employee receives in the form of jury fees, witness fees, or military pay.
 - Penalty for a violation of a major safety rule.
 - Full day suspension for a violation of a workplace rule – if have written policy.
 - Pro-rated salary adjustments for less than 40 hours worked on first or last week of employment.

Right to Know

- ❑ Proposed Department of Labor “Right-to-Know” Regulation (anticipated later this year): *Employers must notify employees of their status under FLSA, including the basis for treating them as FLSA-exempt workers and independent contractors.*
- ❑ Possible negative presumption of non-exempt status written into rule for employers who fail to perform required analysis of a worker’s status.
- ❑ This is part of the DOL’s new **Plan, Prevent, Protect** strategy.



Right to Know (cont.)

- As many or more than two FLSA claims are filed each week in Virginia Federal Courts.
- The government is encouraging employees with Wage & Hour claims to contact a lawyer – and providing them with the phone number to call!
- The DOL has launched its first application for smartphones, a timesheet to help employees independently track the hours they work and determine the wages they are owed. Available in English and Spanish. It tracks regular work hours, break time and overtime.

Good Records – Training

The Best Defense

- Accurately analyze the job duties
- Document position descriptions, have employees and supervisors review them for accuracy – keep them on file
- Provide written analysis to worker so they assess/agree with classification analysis
- Conduct management training so that managers understand that an exemption can easily be defeated by carelessness and understand the degree of independence required to maintain the exemption



Position Description

- For every employee classified as exempt there should be an accurate position description
- The position description should delineate the essential duties as well as skills and abilities
- The essential duties should be those duties listed as primary under the exemption
- The duties should describe the degree of cognitive, analytical, managerial, etc. responsibility within the tasks listed and the freedom under which they are exercised

Actual Duties Control – DOL Will Do an Audit

- ❑ Actual duties not title control
- ❑ Importance to the business and frequency of the exempt duties play a significant role
- ❑ Amount of independence and judgment regularly exercised also important
- ❑ Difference in salary in comparison to non-exempt employees
- ❑ How comingled are employees duties with those of non-exempt employees



Revise Handbook

- Safe Harbor Policy
- Notice to Employees that if they believe they are improperly classified, there is a reporting and correction process.
- Reimburse employees for improper deductions.

Understanding Litigation Process Matters

- The litigation process requires your classification decision to be clearly and unmistakably right, or your company loses – always.
- You don't want to find out that requirement for the first time when you are sued, and you won't see that requirement in the regulation or exemption tests.
- If you understand how your classification decision will be challenged in litigation, you will make better "up-front" decisions regarding classification. You will no longer make "close-calls" and you will change and strengthen your company's documentation process so that you will be able to minimize your damages in the event of a suit.



Compensation Issues

Calculating Hours Worked



Compensation Myths

- Myth: Salary is based on 40 hours/week
- Myth: Salaried employees are not eligible for overtime

Comp Time

- ❑ Overtime compensation may be provided in the form of compensatory leave in lieu of overtime pay for public sector employees only.
- ❑ Most employees cannot accrue more than 240 hours of compensatory time; law enforcement officers can accrue 480 hours of compensatory time.
- ❑ Cash overtime is the only compensation permitted for overtime hours

Seven-Day Work Period

- Overtime not due until 40 hours are exceeded in a 7-day work period
- Employer is in control of hours worked
- Can schedule adjust during 7-day work period

Compensation Myths

- ❑ Myth: Must pay a premium for working night or weekends
- ❑ Myth: Employee cannot work more than 12 hours a day.
- ❑ Myth: Must give meal or other breaks.
- ❑ Myth: Must offer sick leave, vacation leave and holiday pay.
- ❑ Myth: "Part-time" is 20 hours/week.

Hours Worked

- “Hours worked” is key concept in compensation
 - All hours the employee must be “on duty,” devoted to the principal work activity or activities that are closely related and indispensable to the principal work.
 - Time “controlled or required by the employer and pursued necessarily and primarily for the benefit of the employer and his business.”
Tennessee Coal, Iron & R.R. Co. v. Muscoda Local No. 123, 321 U.S. 590, 598 (1944).
- All time worked must be recorded on time sheets.



Hours Not Counted as Work

- Non-compensable time
 - time off
 - time away from the job
 - lunch breaks (30 minutes or longer)
 - other breaks (20 minutes or longer)
 - travel to and from work
 - checking in and out of the workplace
 - on-call time

Pre-Shift / Post-Shift

- Pre-shift and post-shift activities generally not compensable – however the general rule is that waiting time is considered hours worked.
- Waiting will be considered “work time” if activity is “integral and indispensable” to the principal activity.
 - Clothes-changing for safety reasons/benefit to employer (“donning and doffing”)
 - Meet at a central location to gather tools, load work vehicles, go together to a work site (“shop time”)
 - Police officer servicing car or caring for police dog while at home
 - Secretary having lunch while being required to answer the phone should it ring
- Compensation (or no compensation) can also be based on contract, custom or practice.

Travel Time

- Traveling during normal work hours is considered compensable work time.
- Traveling from home-to-work travel are not hours worked
- Commuting in an employer-provided vehicle, or in activities performed by an employee that are incidental to the use of the vehicle are not hours worked if
 - the travel is within the normal commuting area for the employer's business
 - the use of the vehicle is subject to an agreement between the employer and the employee/representative.

Breaks

- Federal law does not require lunch or coffee breaks.
- Short breaks (usually lasting about 5 to 20 minutes) count as hours worked
- Not counted as hours worked
 - Lunch period of 30 or more minutes
 - Break period of 20 minutes or more
 - Provided that employee is completely relieved of all duties during that period

On-Call Time

- An employee who is required to remain on call on the employer's premises or so close thereto that he cannot use the time effectively for his own purposes is working while "on call". This time is compensable.
- An employee who is not required to remain on the employer's premises but is merely required to leave word at his home or with company officials where he may be reached is not working while on call, and this time is not compensable.



Payment Issues

Record Keeping

Employer Has Duty to Keep Records

- ❑ Can not delegate to employee.
- ❑ Employees can keep their time, but if not kept accurately by employee, employer is responsible.
- ❑ Even if employees certify that time records are correct, the employer is still liable if they are not accurate.
- ❑ Failure to keep records is a violation on its own.

Record All Overtime Hours

- All hours worked must be recorded
- If employee works overtime and employer knows it, the hours must be recorded
- Can require employees not to work overtime unless “approved” but if directive is disobeyed, hours worked must be recorded.
- It is unlawful to refuse to pay for “unauthorized overtime.”

General Record Keeping

- Found in 29 CFR §516.2(a)
 - Time of day/day of week workweek begins
 - Regular rate of pay for any week overtime compensation is due
 - Basis of pay – per hour, day or week
 - Total hours worked each workday and each workweek
 - Straight time earnings
 - Premium pay

Simplified Recordkeeping

- Employees on fixed work schedules do not have to record time day by day, but can simply check that schedule was followed
- Weeks when deviations in schedule, must record time hour for hour each day

Records for White Collar Employees

- Found in CFR §516.3
 - Time of day/day of week of workweek
 - Total wages paid each pay period
 - Date wages are paid
 - Basis on which wages are paid

Other Pay Record Information

- ❑ Date of birth if under 19 years of age
- ❑ Sex and occupation of each employee
- ❑ Must keep records in central location for three years (some other information for two years)
- ❑ Records to be kept in central location at place of employment
- ❑ Employees have no right to see records

The Failure to Keep Records Has Consequences

- Employee only has to provide a “reasonable inference” that the employee worked a certain number of hours.
- Without records to rebut, employee wins.
- Willful failure to keep the required records or falsification of records is a **criminal offense.**



Payment Issues

Payment of Wages

- Must have regular pay periods
 - Salaried employees – at least once a month
 - Hourly employees – at least once every 2 weeks
- Upon termination of employment must pay all wages/salary due on or before the normal pay date
- No deduction from wages/salary without written and signed consent of employee
- Criminal and civil penalties (\$1,000 per violation) for failure to adhere to payment requirements.



Method of Payment

- Payment of wages or salaries must be in lawful U.S. currency
 - Cash
 - Check payable at face value
 - Electronic automated fund transfer to account in name of employee designated by employee and with consent of employee
 - Prepaid credit or debit card (with consent of employee) or an account where employee can make one withdrawal or transfer per pay period.

Questions? Contact Karen S. Elliott

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