



FLSA Overtime

*Classifying Exempt and
Nonexempt Employees*

Sample Excerpt



SPECIAL REPORT

FLSA OVERTIME

Classifying Exempt and
Nonexempt Employees

Sample Excerpt



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Overview

This special report, written for the final overtime rules effective January 1, 2020, is designed to provide you with an examination of the Fair Labor Standards Act (FLSA) overtime regulations, valuable tips for bringing your workplace into compliance in an affordable manner, and an overall review of who and what the FLSA covers.

The federal Department of Labor (DOL) released final overtime regulations in September 2019. The regulations, effective January 1, 2020, set the minimum salary threshold at \$684 per week (\$35,568 per year) in order to be exempt from overtime pay for any hours worked over 40 in a workweek.

The regulations set the total annual compensation requirement for highly compensated employees (HCEs) at \$107,432 per year. To be exempt as an HCE, an employee must also receive at least the standard salary amount of \$684 per week on a salary or fee basis (without regard to the payment of nondiscretionary bonuses and incentive payments).

The DOL's final rule made no changes to the duties tests required to determine overtime eligibility.

Under the final rule, employers may use nondiscretionary bonuses and incentive payments (including commissions) that are paid annually or more frequently to satisfy up to 10 percent of the standard salary level. If an employee does not earn enough in nondiscretionary bonus or incentive payments in a given year (52-week period) to retain his or her exempt status, the DOL will permit the employer to make a catch-up payment within one pay period at the end of the 52-week period. This payment may be up to 10 percent of the total standard salary level for the preceding 52-week period. This type of catch-up payment will count only toward the prior year's salary amount and not toward the salary amount in the year in which it is paid.

The DOL maintained the special salary level of \$380 per week for American Samoa. The DOL also established a special salary level of \$455 per week for employees in Puerto Rico, the U.S. Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands. In addition, the DOL set the special base rate threshold for employees in the motion picture producing industry at \$1,043 per week (this may be prorated based on the number of days worked).

The DOL intends to update the salary thresholds more regularly in the future through notice-and-comment rulemaking and not by an automatic updating process.

Keep in mind that when a state's wage and hour laws differ from the FLSA, the employer should follow the law that is most beneficial to the employee.

The majority of this special report is devoted to explaining the salary level test; the salary basis test; and the duties tests for the executive, administrative, professional, computer employee, and outside sales exemptions.

In addition, we have included a primer in Appendix III that provides you with an overview of the entire FLSA, as this is essential to bring your workplace into compliance with the law.

The Salary Test and 'White Collar' Exemptions

The FLSA requires that nonexempt employees working in excess of 40 hours per week be paid overtime at a rate of 1½ times their regular hourly rate for those additional hours.

In order to qualify as exempt from the overtime pay requirements under the FLSA, an employee must pass three tests:

- Salary level test
- Salary basis test
- Duties test

The Salary Level Test

Effective January 1, 2020, in order to qualify as an exempt executive, administrative, or professional employee under the FLSA, an employee must earn at least \$684 per week exclusive of board, lodging, or other facilities. A weekly salary of \$684 computes to \$35,568 annually.

Special Cases

- **Computer employees.** It is important to note that computer employees who earn at least \$27.63 per hour may also meet the salary level test. These employees must also meet the special duties test to qualify for the computer professional exemption.
- **Outside sales employees.** There is no salary requirement for outside sales employees. These employees must meet the duties test to qualify for the exemption.
- **Highly compensated employees.** An employee with total annual compensation of at least \$107,432 is exempt if the employee:
 - Customarily and regularly performs any one or more of the exempt duties or responsibilities of an executive, administrative, or professional employee:
 - Earns at least \$684 per week paid on a salary or fee basis; *and*
 - Has the primary duty of performing office or nonmanual work
- The employee's annual compensation may include:
 - Commissions
 - Nondiscretionary bonuses
 - Other nondiscretionary compensation earned
- The employee's annual compensation may not include:
 - Board, lodging, and other facilities
 - Payments for medical insurance

- Payments for life insurance
- Contributions to retirement plans
- The cost of other fringe benefits
- If an employee’s total annual compensation does not total at least the minimum amount by the last pay period of the 52-week period, the employer may, during the last pay period or within 1 month after the end of the 52-week period, make one final payment sufficient to achieve the required level. For example, an employee may earn \$100,000 in base salary, and the employer may anticipate, based on past sales, that the employee also will earn \$10,000 in commissions. However, due to poor sales in the final quarter of the year, the employee actually only earns \$5,000 in commissions. In this situation, the employer may, within 1 month after the end of the year, make a payment of at least \$2,432 to the employee. Any such final payment made after the end of the 52-week period may count only toward the prior year’s total annual compensation and not toward the total annual compensation in the year it was paid. If the employer fails to make such a payment, the employee does not qualify as an HCE but may still qualify as exempt under the executive, administrative, or professional exemptions.
- If the employee does not work a full year, the employee may still qualify for the exemption if the employee’s pro-rata portion of salary earned meets the salary requirement.
- **American Samoa.** The DOL maintained the special salary level of \$380 per week for American Samoa for employees other than those working for the federal government.
- **U.S. territories.** The DOL set a special salary level of \$455 per week for employees in Puerto Rico, the U.S. Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands.
- **Motion-picture producing industry.** The DOL set the special base rate threshold for employees in the motion-picture producing industry to \$1,043 per week (this may be prorated based on the number of days worked).
- **Educational establishments.** In the case of academic administrative employees, the compensation requirement may also be met by compensation on a salary basis at a rate at least equal to the entrance salary for teachers in the educational establishment by which the employee is employed.
- **Certain professional employees.** The salary level test does not apply for the following professional employees:
 - Teachers
 - Lawyers
 - Doctors
 - Medical interns or residents
- They will be considered exempt professionals even if they do not meet the salary level test.

- In the medical field, pharmacists, nurses, therapists, technologists, sanitarians, dietitians, social workers, psychologists, psychometrists, or other professions that service the medical profession must meet the salary threshold of \$684 per week.

The Salary Basis Test

In order to qualify as an exempt executive, administrative, or professional employee under the FLSA, an employee must be paid on a salary basis. This occurs if the following conditions are met:

- The employee regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount that makes up all or part of the employee's compensation.
- The amount the employee earns must not be reduced because of variations in the quality or quantity of the work the employee performs.
- The employee must receive the full salary for any week in which the employee performs any work, without regard to the number of days or hours worked.
- The employee need not be paid for any workweek in which the employee performs no work.

Fee Basis

Administrative and professional employees may be paid on a fee basis, rather than on a salary basis. To determine whether the fee payment meets the minimum salary threshold, the amount paid to the employee should be tested by determining the time worked on the job and whether the fee payment is at a rate that would amount to at least \$684 per week if the employee worked 40 hours. For example, an artist who is paid \$500 for a picture that took 20 hours to complete meets the minimum salary requirement for exemption, since earnings at this rate would yield the artist \$1,000 if 40 hours were worked.

Computing Compensation

An exempt employee's earnings may be computed on an hourly, daily, or shift basis, without losing the exemption or violating the salary basis requirement, if the employment arrangement also includes a guarantee of at least the minimum weekly required amount paid on a salary basis regardless of the number of hours, days, or shifts worked, and a reasonable relationship exists between the guaranteed amount and the amount actually earned. The reasonable relationship test will be met if the weekly guarantee is roughly equivalent to the employee's usual earnings at the assigned hourly, daily, or shift rate for the employee's normal scheduled workweek.

For example, an exempt employee guaranteed compensation of at least \$1,000 for any week in which the employee performs any work, and who normally works 4 shifts each week, may be paid \$300 per shift without violating the salary basis requirement. The reasonable relationship requirement applies only if the employee's pay is computed on an hourly, daily, or shift basis. It does not apply, for example, to an exempt store manager paid a guaranteed salary per week that exceeds the current salary level who also receives a commission of one-half percent of all sales in the store or 5 percent of the store's profits, which in some weeks may total as much as, or even more than, the guaranteed salary.

Permitted Deductions from the Pay of Exempt Employees

- **Personal leave.** Deductions from pay may be made when an exempt employee is absent from work for one or more full days for personal reasons, other than sickness or disability.
- **Sickness or disability.** Deductions from pay may be made for absences of one or more full days occasioned by sickness or disability, including work-related accidents, if the deduction is made in accordance with a bona fide plan, policy, or practice of providing compensation for loss of salary caused by this type of sickness or disability. [*Note:* You can deduct less than a day's time from an exempt employee's allotted sick time, vacation time, or personal time, but you cannot deduct from an exempt employee's paycheck for less than a day's absence for sickness, disability, or personal leave.]
- **Offset jury fees, witness fees, or military pay.** While an employer cannot make deductions from pay for absences caused by jury duty, attendance as a witness, or temporary military leave, the employer can offset any amounts received by an employee as jury fees, witness fees, or military pay for a particular week against the salary for that week.
- **Safety violations.** Deductions from pay of exempt employees may be made for penalties imposed in good faith for infractions of safety rules of major significance. These include infractions relating to the prevention of serious danger in the workplace or to other employees, such as rules prohibiting smoking in explosives plants, oil refineries, and coal mines.
- **Disciplinary suspensions.** Deductions from pay of exempt employees may be made for unpaid disciplinary suspensions of 1 or more full days imposed in good faith for infractions of workplace conduct rules. The employer must have a written policy applicable to all employees in order to do this. For example, an employer may suspend an exempt employee without pay for 3 days for violating a generally applicable written policy prohibiting sexual harassment or workplace violence.
- **Partial first or last week.** An employer is not required to pay the full salary in the first or last week of employment if the employee does not work the full week.
- **FMLA leave.** An employer is not required to pay the full salary for weeks in which an exempt employee takes unpaid leave under the Family and Medical Leave Act (FMLA).

Prohibited Deductions from Pay

If the following deductions from pay are made, the salary basis test may not be satisfied:

- Any deductions from the employee's compensation for absences caused by the employer or by the operating requirements of the business.
- If the employee is ready, willing, and able to work, any deductions made for time when work is not available.

An employer who makes improper deductions from salary will lose the exemption if the facts demonstrate that the employer did not intend to pay the employees on a salary basis.

According to the FLSA's regulations, an "actual practice" of making improper deductions demonstrates that the employer did not intend to pay employees on a salary basis.

The factors to consider when determining whether an employer has an "actual practice" of making improper deductions include, but are not limited to:

- The time period during which the employer made improper deductions
- The number and geographic location of employees whose salary was improperly reduced
- The number and geographic location of managers responsible for taking the improper deductions
- Whether the employer has a clearly communicated policy permitting or prohibiting improper deductions
- The number of improper deductions, particularly as compared to the number of employee infractions warranting discipline

If an employer has an actual practice of making improper deductions from the pay of exempt employees, the employer will lose the exemption for the entire class of employees in that job classification who work for that manager.

The FLSA regulations emphasize, though, that improper deductions that are either isolated or inadvertent will not result in loss of the exemption, as long as the employer reimburses the employees for improperly deducting from their pay.

Safe Harbor Rule for Improper Deductions from Pay

In addition, the "safe harbor" rule indicates that an employer may prevent the loss of the exemption by:

- Having a clearly communicated policy, which includes a complaint mechanism that prohibits improper pay deductions
- Reimbursing employees for any improper deductions that have occurred
- Making a good-faith commitment to comply with the regulations in the future

But, if the employer willfully violates the policy by continuing to make improper deductions after receiving employee complaints, then the exemption will be lost during the time period in which the improper deductions were made.

The FLSA regulations outline the best evidence of a clearly communicated policy:

- A written policy
- Distributed to employees before the improper pay deductions by:
 - Providing a copy of the policy to employees at the time of hire;
 - Publishing the policy in an employee handbook; *or*
 - Publishing the policy on the employer's intranet.

Special Cases

- **Motion picture producing industry.** The requirement that the employee be paid on a salary basis does not apply to an employee in the motion-picture producing industry who is compensated at a base rate of at least \$1,043 a week, exclusive of board, lodging, or other facilities.
- **Employees of public agencies.** An employee of a public agency who otherwise meets the salary basis requirements will not be disqualified from exemption because the employee is paid according to a pay system established by statute, ordinance, or regulation, or by a policy or practice established pursuant to principles of public accountability, under which the employee accrues personal and sick leave and which requires the employee's pay to be reduced or the employee to be placed on leave without pay for absences for personal reasons or because of illness or injury of less than one workday when accrued leave is not used by an employee because:
 - Permission has not been sought.
 - Permission was denied.
 - The employee chooses to leave without pay.
- **Additional compensation.** An employer may provide an exempt employee with additional compensation without losing the exemption or violating the salary basis requirement, if the employment arrangement also includes a guarantee of at least the minimum weekly required amount paid on a salary basis. For example, an exempt employee guaranteed at least \$684 each week paid on a salary basis may also receive additional compensation of a 1 percent commission on sales. An exempt employee also may receive a percentage of the sales or profits of the employer if the employment arrangement also includes a guarantee of at least \$684 each week paid on a salary basis. Similarly, the exemption is not lost if an exempt employee who is guaranteed at least \$684 each week paid on a salary basis also receives additional compensation based on hours worked for work beyond the normal workweek. Such additional compensation may be paid on any basis, including flat sum, bonus payment, straight-time hourly amount, time and one-half, or any other basis, and may include paid time off.

The Duties Tests

In addition to passing the salary level test and the salary basis test, an employee must also pass the duties tests for either the executive, administrative, professional, computer employee, or outside sales exemptions to be considered exempt from overtime.

It is important to note that the FLSA specifically protects the nonexempt status of several groups of workers:

- Manual laborers or other “blue-collar” workers who perform work involving repetitive operations with their hands, physical skill, and energy
- Police officers, firefighters, paramedics, emergency medical technicians, and similar public safety employees
- Veterans

The following tables represent a breakdown of the duties test for each exemption.

The Executive Exemption

| Table 1 | Duties Test for the Executive Exemption |
|---|---|
| <p>Primary duty consists of management* of the enterprise in which the employee is employed or of a customarily recognized department or subdivision of the enterprise.</p> <p>Customarily and regularly* directs the work of two or more other employees.*</p> <p>Has the authority to hire or fire other employees or whose suggestions and recommendations as to the hiring, firing, advancement, promotion, or any other change of status of other employees are given particular weight.*</p> | |

***Note:** The terms that appear in bold in this table are further defined on the following pages.

Management

The term “management” includes the following job duties:

- Interviewing, selecting, and training employees
- Setting and adjusting the rates of pay and hours of work of employees
- Directing the work of employees
- Maintaining production or sales records for use in supervision or control
- Appraising the productivity and efficiency of employees for the purpose of recommending promotions or other changes in their status
- Handling employee complaints and grievances
- Disciplining employees
- Planning the work of employees
- Determining the techniques to be used
- Apportioning the work among the employees
- Determining the type of materials, supplies, machinery, equipment, or tools to be used or merchandise to be bought, stocked, and sold
- Controlling the flow and distribution of materials or merchandise and supplies

- Providing for the safety and security of the employees or the property
- Planning and controlling the budget
- Monitoring or implementing legal compliance measures

Customarily and Regularly

The term “customarily and regularly” refers to:

- A frequency that is greater than occasional, but may be less than constant
- Includes work normally and recurrently performed every workweek
- Does not include isolated or one-time tasks

Two or More Employees

The term “two or more employees” refers to two full-time employees or their equivalent. One full-time and two half-time employees, for example, are equivalent to two full-time employees. Four half-time employees are also equivalent.

Particular Weight

Exempt executives must have the authority to hire or fire other employees or their suggestions and recommendations as to the hiring, firing, or any other change of status of other employees must be given particular weight. The term “particular weight” is defined by a set of factors to consider, including:

- Whether it is part of the employee’s job duties to make such suggestions and recommendations
- The frequency with which such suggestions and recommendations are made or requested
- The frequency with which the employee’s suggestions and recommendations are relied on by others

Additional Important Issues for the Executive Exemption

Concurrent Duties

The concurrent performance of exempt and nonexempt work does not disqualify an employee from the executive exemption. The regulations allow concurrent duties because, generally, exempt executives make the decision regarding when to perform nonexempt duties and remain responsible for the success or failure of business operations under their management while performing the nonexempt work. In contrast, the nonexempt employee is generally directed by a supervisor to perform the exempt work or performs the exempt work for defined time periods.

For example, an exempt store manager will sweep the floor when the manager desires or needs to do so. A nonexempt janitorial employee, on the other hand, will sweep the floor at the order of the manager.

Business Owners

The exempt executive category includes business owners who are:

- Any employee who owns at least a 20 percent equity interest in the enterprise; *and*
- Actively engaged in a business's management.

The Administrative Exemption

| Table 2 | Duties Test for the Administrative Exemption |
|---|--|
| <p>Primary duty consists of the performance of office or nonmanual work directly related to the management or general business operations* of the employer or the employer's customers; or consists of the performance of administrative functions directly related to academic instruction or training in an educational establishment or department or subdivision of the establishment.</p> <p>Primary duty includes the exercise of discretion and independent judgment* with respect to matters of significance.</p> | |

***Note:** The terms that appear in bold in this table are further defined on the following pages.

Directly Related to Management Policies or General Business Operations

The phrase "directly related to management or general business operations" refers to the type of work performed by the employee. To meet this requirement, an employee must perform work directly related to assisting with the running or servicing of the business. This does not include working on a manufacturing production line or selling a product in a retail or service establishment.

Work directly related to management or general business operations includes work in the fields of:

- Tax
- Finance
- Accounting
- Budgeting
- Auditing
- Insurance
- Quality control
- Purchasing
- Procurement
- Advertising
- Marketing
- Research
- Safety and health
- Personnel management
- Human resources
- Employee benefits

- Labor relations
- Public relations
- Government relations
- Computer network
- Internet and database administration
- Legal and regulatory compliance

Discretion and Independent Judgment

The exercise of discretion and independent judgment involves the comparison and the evaluation of possible courses of conduct, acting, or making a decision after the various possibilities have been considered, and refers to the level of importance or consequence of the work performed.

Factors to consider are:

- Whether the employee has authority to formulate, affect, interpret, or implement management policies or operating practices
- Whether the employee carries out major assignments in conducting the operations of the business
- Whether the employee performs work that affects business operations to a substantial degree, even if the employee's assignments are related to operation of a particular segment of the business
- Whether the employee has authority to commit the employer in matters that have significant financial impact
- Whether the employee has authority to waive or deviate from established policies and procedures without prior approval
- Whether the employee has authority to negotiate and bind the company on significant matters
- Whether the employee provides consultation or expert advice to management
- Whether the employee is involved in planning long-term or short-term business objectives
- Whether the employee investigates and resolves matters of significance on behalf of management
- Whether the employee represents the company in handling complaints, arbitrating disputes, or resolving grievances

The exercise of discretion and independent judgment implies that the employee has the authority to make an independent choice, free from immediate direction or supervision. However, employees can exercise discretion and independent judgment even if their decisions or recommendations are reviewed at a higher level.

The exercise of discretion and independent judgment must be more than the use of skill in applying well-established procedures described in manuals. The use of manuals, guidelines, or other established procedures containing or relating to highly technical, scientific, legal, or financial matters that can be understood or interpreted only by those with advanced or specialized knowledge or skills does not preclude exemption. Such manuals and procedures provide guidance in addressing difficult or novel circumstances and, therefore, would not affect an employee's exempt status.

Note: The exercise of discretion and independent judgment does not include:

- Clerical or secretarial work
- Recording or tabulating data
- Performing other mechanical, repetitive, recurrent, or routine work

Additional Important Issues for the Administrative Exemption

Administrative Employees in Education

Exempt administrative employees also include employees whose primary duty is performing administrative functions directly related to academic instruction or training in an educational establishment or one of its departments or subdivisions. These individuals must earn at least the salary threshold or must be paid on a salary basis which is at least equal to the entrance salary for teachers in the educational establishment where they are employed.

Jobs Generally Not Eligible for the Administrative Exemption

- Jobs relating to building management and maintenance
- Jobs relating to the health of the students
- Academic staff such as social workers, psychologists, lunchroom managers, or dietitians

Note: These positions may be exempt under the other exemptions.

Examples of Generally Exempt Administrative Positions

The regulations outline the following positions as generally meeting the requirements of the duties test for the administrative exemption, though the employer should note that there may be exceptions:

- **Employees who lead a team** of other employees assigned to complete major projects for the employer, such as purchasing, selling, or closing all or part of the business, negotiating a real estate transaction or a collective bargaining agreement, or designing and implementing productivity improvements.

- **Executive assistants or administrative assistants** to a business owner or senior executive of a large business if these employees, without specific instructions or prescribed procedures, have been delegated authority regarding matters of significance.
- **Human resources managers** who formulate, interpret, or implement employment policies.
- **Management consultants** who study the operations of a business and propose changes in the organization.
- **Purchasing agents** with authority to bind their company on significant purchases, even if they must consult with top management officials when making a purchase commitment for raw materials in excess of the contemplated plant needs.
- **Buyers** who evaluate reports on competitor prices to set their employer's prices.

Examples of Administrative Positions that Are Generally Not Exempt

The regulations outline the following positions as not generally meeting the requirements of the duties test for the administrative exemption, although the employer should note that there may be exceptions:

- **Personnel clerks who "screen" applicants** to obtain data regarding their minimum qualifications and fitness for employment. Such personnel clerks will typically reject all applicants who do not meet minimum standards for the particular job or for employment by the company.
- **Examiners or graders**, such as employees who grade lumber, because they usually perform work involving the comparison of products with established standards that are frequently catalogued.
- **Comparison shoppers** for a retail store who merely report to the buyer the prices at a competitor's store.
- **Public sector inspectors or investigators**, such as fire prevention or safety, building or construction, health or sanitation, environmental or soils specialists, because their work is not directly related to the management or general business operations of the employer and does not involve the use of skills and technical abilities in gathering factual information, applying known standards or prescribed procedures, determining which procedure to follow, or determining whether prescribed standards or criteria are met.

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