



Webinar 5 – March 12, 2025

Classification of Employees Exempt vs. Non-Exempt

WEBINAR OUTLINE

INTRO/SETTING THE STAGE

- The Importance of Classifying Employees Correctly
- Consequences for Misclassification

EXEMPT VS. NON-EXEMPT EMPLOYEES

- Exempt Employees Defined
- Non-Exempt Employees Defined
- Salary Basis/Threshold Test
- Duties Test

COMMON PITFALLS FOR EMPLOYERS

HOW TO ENSURE PROPER EMPLOYEE CLASSIFICATION

HRtelligence TIPS

I. INTRO/SETTING THE STAGE

A. The Importance of Classifying Employees Correctly

- Employee classification is the backbone of workforce management, impacting everything from payroll to compliance and employee satisfaction.
- For HR professionals and business owners, keeping up with evolving laws and regulations is crucial to protecting your business and supporting your workforce.

B. Consequences of Misclassification

Misclassification can expose your business to serious risks, including:

- Back wages and benefits: Employers may be required to pay back wages, overtime, and benefits to misclassified workers, which can be substantial.
- Legal disputes: Employees misclassified as contractors may sue for unpaid wages, benefits, or wrongful termination.
- Fines and penalties: Federal and state agencies are increasingly aggressive in auditing businesses for compliance.
- Tax liabilities: Misclassification can result in unpaid payroll taxes, which can lead to significant tax liabilities and penalties from the IRS.
- Reputational damage: Misclassification issues can tarnish your company's public image, deterring talent and clients.

II. EXEMPT VS. NON-EXEMPT EMPLOYEES

The main difference between exempt and nonexempt employees in the U.S. has to do with how they are paid and whether they are eligible for overtime pay.

FLSA Wage & Hour Standards

The FLSA sets out the federal minimum wage, overtime, recordkeeping, and youth employment details; however, New York (and many other states) have promulgated their own wage and hour laws. In such instances, the DOL mandates that employers must apply the minimum wage or overtime rate that is most beneficial to the worker.

A. Non-Exempt Employees Defined

- For the purposes of employee classification, non-exempt employees are not exempt from the FLSA's rules on wages and paid overtime and therefore are entitled to minimum wage protections and additional compensation for overtime hours worked more than 40 hours per week.
- Although nonexempt employees are frequently paid on an hourly basis, they may sometimes be paid a salary.

Salary vs. hourly pay

Pay alone doesn't determine whether an individual is exempt or non-exempt, but it may dictate workplace policies. For instance, employers who have hourly workers must track time and attendance to ensure payroll accuracy. Timekeeping usually isn't as important with salaried employees unless incentives are offered to those who put in extra hours.

Salaried non-exempt employees

Employers should not automatically assume that employees can properly be considered exempt under the FLSA just because they earn a salary. Workers who don't pass the duties test or earn a fixed salary, and make less than the minimum required may be eligible for overtime pay.

Hourly exempt employees

Some industries may have hourly employees who are exempt from overtime pay.

B. Exempt Employees Defined

Employees are eligible for overtime any time they work over 40 hours a week, unless they fit into a specific FLSA exemption. To be exempt from the overtime requirements under the exemptions of the FLSA, employees must satisfy the following three tests:

- The salary basis test (*i.e.*, they must be paid a fixed, predetermined salary that is not reduced because of variations in the quality or quantity of work performed);
- The duties test (*i.e.*, their job duties must primarily involve executive, administrative or professional duties as defined by the FLSA regulations); and
- The salary threshold test (*i.e.*, the amount of salary they are paid must meet or exceed the standard salary level).

Highly compensated employees ("HCEs") will be exempt from the FLSA overtime requirements if they customarily and regularly perform one or more executive, administrative or professional duties, and their total annual compensation meets or exceeds the minimum threshold.

C. Salary Basis/Threshold

New York law generally follows the FLSA duties and salary basis tests for the EAP exemptions but imposes a higher salary threshold for the executive and administrative exemptions.

Currently, employees in executive and administrative positions in NYC, Nassau, Suffolk, and Westchester must be paid at least \$1,237.50 per week, or \$64,350.00 per year.

Employees in said positions in the remainder of the state must be paid at least \$1,161.65 per week, or \$60,405.80 per year.

NY does not currently have a separate salary threshold for the professional exemption, so employees in professional positions need only be compensated at the applicable FLSA salary threshold.

The federal minimum salary required for the exemptions from overtime is \$684 per week, or \$35,568 per year.

D. Duties Test

Executive Exemption

Executive employees are those generally responsible for running an organization. Executives are not just managers; they are high-level decision-makers.

To qualify as an executive employee, you would need to fulfill the following requirements:

- Responsible for managing the business or a division of the business;
- Duties include overseeing and managing at least two other full-time employees;
- Paid a salary (as opposed to an hourly wage); and
- Responsible for hiring and firing decisions.

Executive employee status would probably extend to CEOs, department heads, CFOs, or other high-level executive positions.

Administrative Exemption

Administrative employees are generally involved in the management or general business of the company. These are often employees who are crucial to business operations.

Requirements include:

- Paid a salary;
- Responsible for the management or general business operations; and
- Primary duties include exercising discretion and independent judgment to make significant decisions for the company.

What does “exercise of discretion and judgment” mean?

In general, the exercise of discretion and independent judgment involves the comparison and evaluation of possible courses of conduct and acting or making a decision after consideration of the various possibilities.

Such an employee must have the authority to make an independent choice, free from immediate direction or supervision.

Factors to consider include (but are not limited to):

- Does the employee formulate, affect, interpret, or implement policies or practices? Does the employee carry out major assignments in conducting the business?
- Is the employee's work directly related to management or general business operations to a substantial degree?
- Can the employee commit the employer in matters that have significant financial impact?
- Does the employee have authority to waive or deviate from established policies and procedures without prior approval?

If an employee's decisions are revised or reversed after review, it does not mean that the employee is not exercising discretion and independent judgment. The exercise of discretion and independent judgment must be more than the use of skill in applying well-established techniques, procedures or specific standards described in manuals or other sources.

What does "directly related to management or general business operations" mean?

To meet the "directly related to management or general business operations" requirement, an employee must perform work directly related to assisting with the running or servicing of the business, as distinguished, for example, from working on a manufacturing production line or selling a product in a retail or service establishment.

Administrative employees could include senior managers and higher-level HR employees.

Professional Exemption

Professional employees have the knowledge and experience to provide a unique skill set to the business. There are two types of professionals under the FLSA: learned professionals and creative professionals.

Learned professionals are those who:

- Are paid a salary;
- Have primary duties that are intellectual in nature and use their advanced knowledge in a particular field; and
- Have advanced knowledge in a field of science or learning that was acquired through an extended course of study.

Healthcare professionals such as doctors, nurses, engineers, and accountants might be considered learned professionals under the FLSA.

Creative professionals are those who:

- Are paid a salary; and
- Whose duties involve creativity, ingenuity, or imagination in a recognized artistic or creative field.

Graphic designers, chefs, and composers would likely be considered creative professionals.

Computer Employee

Employees with a computer-based role may be exempt if they meet the following requirements:

- Primary duties are in IT, such as a computer systems analyst, computer programmer, software engineer, or other similarly skilled workers in the computer field
- Primary duties include application of system analysis techniques and procedures, design, development, documentation, analysis, creation, testing, or modification of computer systems or machine operation systems

Outside Sales

Employees that perform outside sales may be exempt if they:

- Work on commission
- Primarily work making sales or obtaining contracts for services or use of facilities
- Primarily work away from the employer's business locations

Highly Compensated Employee

Highly compensated employees must also have at least one duty that falls under the exempt administrative, professional or executive category. These employees are:

- Typically owners
- Perform office or non-manual work
- Paid a total annual compensation of \$107,432 or more, including at least \$684 per week paid on a salary or fee basis

III. COMMON PITFALLS FOR EMPLOYERS

There are several common mistakes that employers make in the classification of exempt employees, including:

- Unclear Job Descriptions

Before hiring you should know whether their role is exempt or non-exempt and the job description should explicitly state the classification. If you are hiring an exempt employee, make sure the job description clearly falls into one of the exempt categories.

- **Failing to Ensure Compliance with State Requirements**

Always double-check state salary requirements. Some states, such as New York and California, have stricter requirements than at the Federal level. To make sure you are offering enough compensation to exempt employees, you need to know the state, city, and county salary requirements, since these may differ from federal requirements.

- **Not Abiding by the Duties Test**

A lot of employers assume all managers are exempt. However, in addition to managing at least two full-time employees, managers have to meet the duty and salary requirements discussed above to be exempt. Always use an employee's category, job duties, and salary to determine if they're exempt or not.

- **Not Verifying Where Remote Employees Live Annually**

It's important to verify where your remote workforce lives to make sure you follow their local regulations. Your employees may not update you if they've moved, so it's essential to have your employees verify their address at least annually. You may also find an employee moved to a less restrictive state, allowing you to follow less strict standards if you choose.

- **Not Realizing the Ramifications of Making Someone Exempt**

Some employers only look at the positives of making an employee exempt, such as avoiding overtime pay. However, you must also consider that exempt employees will have certain freedoms and flexibility non-exempt employees.

Note: For example, exempt employees can take a few hours off to go to a doctor's appointment or pick their child up from school and still get paid for the day. Partial days are still paid in full and don't count as sick or vacation days. You may even end up with employees who take a call while they're on vacation and consider it as a working day.

Source: <https://www.bbsi.com/business-owner-resources/avoid-mistakes-classifying-exempt-employees>

IV. HOW TO ENSURE PROPER EMPLOYEE CLASSIFICATION

Incorrectly classifying an employee can result in fines and penalties, which may include payment for back wages. Make sure you adhere to the following best practices to avoid the expensive consequences of employee misclassification:

- Review and understand the rules and regulations outlined by the FLSA and in New York regarding exempt vs. nonexempt classifications.

- Consistently review, update, and use job descriptions to ensure employees performing similar duties are classified consistently. The key functions and responsibilities of a given employee will dictate whether that position can qualify for one of the exemptions that would allow an employer to exempt the employee from overtime under the FLSA.
- Remember, the job title does not determine whether an employee is exempt from the overtime rules. Instead, their job duties, whether they are paid on a salary basis, and whether they meet certain salary thresholds determine whether they are properly classified as an exempt employee.
- To avoid common mistakes resulting in misclassification, business owners should ensure they have put the right process in place.



TRENDS



INSIGHTS



PRACTICAL
GUIDANCE



STRATEGIES

When it comes to classifying employees as exempt or non-exempt, it's more complicated than making them salaried. Properly classifying employees as exempt or non-exempt is crucial because it has an impact on compliance with labor laws and can prevent potential legal issues. Incorrect classification of employees can lead to serious consequences for employers including legal penalties, including back pay and fines for unpaid overtime. Here are some helpful tips:

- **Stay on top of wage and hour laws related to exemptions.** Pay close attention to labor laws in the states where your employees work, especially those with stricter classification standards, such as California, New York, and Illinois. Also stay up to date on FLSA rules and regulations.
- **Conduct a classification audit/exemption analysis:** Regularly review employee and contractor relationships to ensure compliance. Focus on roles with unclear or evolving responsibilities.
- **Reevaluate job descriptions.** Clearly define each role's scope, expectations, and reporting structure. Align job descriptions with job duties test criteria.
- **Train your team:** Equip HR and management teams with the knowledge they need to spot and address potential classification errors.