

Exempt or Non-Exempt Employee Under U.S. Law? Even U.S. Employers Frequently Get it Wrong

August 24, 2017 – Cross-Border Counselor
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In the United States, employers are required to pay employees overtime (1.5 times the employee's hourly rate) for hours worked over 40 per week. In some states, such as California, employers are required to pay overtime if employees work more than 8 hours in a day.

Like Canada, U.S. employees may be exempt from overtime requirements if they meet certain criteria. However, such exemptions under U.S. law are frequently more complicated than their Canadian counterparts, and even sophisticated U.S. employers frequently get them wrong. In 2016, U.S. employers spent nearly \$700 million on class-action settlements of wage and hour claims. This does not include amounts U.S. employers spent paying judgments and attorneys' fees.

The three major categories of exempt employees under the U.S. Fair Labor Standards Act (which governs overtime pay) are the so-called "executive," "administrative," and "professional" exemptions:

- Similar to the Canadian exemption for managers, U.S. law exempts so-called "**executive**" employees from overtime. Employees must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent to qualify for the executive exemption. Such employees must also have the authority to hire or fire other employees, or the employee's recommendations as to the hiring, firing, advancement, or promotion of other employees must be given particular weight.
- To qualify for the "**administrative**" exemption, an employee's primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers. The employee's duties must be separate from the production of goods or rendition of services that the employer is in the business of providing. Accountants and human resources professionals can fall into this category.
- To qualify for the "**professional**" exemption, the employee must perform work requiring advanced knowledge that is intellectual in character and that usually requires some sort of prolonged course of study. Doctors, attorneys, and accountants with advanced degrees are good examples.

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For each of these exemptions, the employee's job must require the exercise of discretion and judgment regarding matters of significance to the company. The authority to commit the company to large contracts or to spend significant amounts of the company's money are good examples. Also, to qualify for any of these exemptions, employees must be paid a salary of at least \$455 per week.

There are additional exemptions for so-called "creative professionals," "computer employees," and "outside sales employees" as well. U.S. employers frequently misapply these exemptions.

- To qualify for the "**creative professional**" exemption, the employee's primary duty must involve invention, imagination, and originality in a field of artists or creative endeavor. The key to this exemption is the distinction between creativity and technical skill. An employee that makes technical drawings or reproductions would not qualify, but an employee that creates original works of art would.
- The "**computer employees**" exemption is often a trap for employers. The mere fact that an employee uses a computer or is technically proficient with computer hardware or software is not enough. The employee must design, develop, analyze, or create computer software or hardware systems on behalf of the employer. Low-level tech support does not qualify, but computer programmers and systems designers do.
- Another frequently misapplied exemption is the "**outside sales employees**" exemption. Many U.S. employers mistakenly classify their in-house sales staff as exempt. However, to qualify for this exemption, a salesperson has to work primarily on the road, traveling to customers. Employees that primarily work a phone, either at home or at the employer's office, do not qualify.

All of these exemptions often sound clear on paper. The Vice President of Sales, the head of accounting, and the company's in-house lawyer are all clearly exempt. But what about the assistant manager at a retail location? What about a mid-level accounting professional? Many employees fall into a gray area.

The consequences of misclassifying employees can be severe. An employer that misclassifies its force of 50 salespeople could easily end up owing over a million dollars in overtime in a class action suit. These claims are also very expensive to research and litigate. If a company fails to record the hours worked of a misclassified employee, a U.S. Court will start with the presumption that the employee's own testimony regarding his or her hours worked is accurate, and the employer will have the burden of proving otherwise.

Canadian companies looking to operate or acquire businesses in the United States should carefully assess their own and their targets' wage and hour practices and make sure they are consistent with U.S. law.