



AVOIDING OVERTIME PENALTIES— EMPLOYERS GRAPPLE WITH CHANGING WAGE/HOUR RULES

The labor-law compliance landscape is getting dicier for owners and managers

By Phillip M. Perry

The regulations surrounding wage-and-hour law have long bedeviled employers. Who's exempt from overtime rules? How do you calculate time-and-a-half when employees work off the clock and fail to record their hours? And how about those remote back-office workers, spending a few minutes here and there tackling business emails?

The wrong answers can lead to costly penalties. "Employers who fail to correctly pay overtime must make up back wages plus 'liquidated damages' equal to an equivalent amount," says Douglas E. Witte, who represents businesses in labor and employment law matters at Boardman & Clark LLC, Madison, WI. "If the Department of Labor (DOL) thinks an employer willfully violated the law, the statute of limitations gets bumped up from two to three

years. And employers may also have to pay attorneys' fees for individuals who have brought successful lawsuits."

The U.S. Department of Labor (DOL), the U.S. Internal Revenue Service (IRS) and state agencies have recently increased audits and lawsuits for wage-and-hour violations. But the latest legal wrinkle is even more troubling: An increase in criminal prosecutions. "The Department of Labor and state prosecutors are devoting more attention to finding that violations of the Fair Labor Standards Act (FLSA) and other wage-and-hour laws constitute criminal acts," says Bob Gregg, co-chair of the Employment Practice Law Group at Boardman and Clark. "Now the Dept. of Justice and state prosecutors are devoting more attention to finding these same matters can also constitute criminal acts. Both employers and managers are facing prosecution, in addition to civil liability. The big difference is that

the company pays most of the civil liability. In criminal cases, the individual gets convicted."

Workplace observers expect compliance to get tougher as the federal government begins tightening regulations. "Part of the (President Joe) Biden agenda is to empower workers," says Ann F. Kiernan, an employment-law attorney and lead trainer at Fair Measures, a management-practices consulting firm in Denver. The result is an increase in the number of investigators and the number of class-action lawsuits brought by employees.

Employers also are watching a proposed increase in the overtime pay thresholds for exempt employees, says Witte. In the fall of 2023 the DOL issued proposed rules that substantially increased the salary level from the previous \$684 per week (\$35,568 annually) to a new \$1,059 (\$55,068 annually). Nondiscretionary bonuses and commissions, paid annually or more often, may be used to satisfy up to 10% of that level. "The DOL also is proposing that the salary thresholds be revisited every three years to keep up with inflation," says Witte. "The rules are currently in the comment phase and it's difficult to know when they might go into effect."

Many states are also passing legislation aimed at protecting and expanding employee overtime.

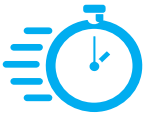
THE EXEMPTION PUZZLE

It follows that all employers should make a point of correctly categorizing each staff member as either exempt or nonexempt from overtime. Businesses with only local traffic often believe that overtime law doesn't apply to them, since the FLSA covers enterprises engaged in interstate commerce. In reality, any local enterprise comes under the FLSA umbrella if it performs seemingly innocuous tasks such as making phone calls or sending emails to vendors or customers in other states, transacting credit card payments with

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distant entities, or receiving goods or services from beyond state borders. “It’s the rare business that is not involved in some way with interstate commerce,” says Matthew C. Heerde, principal at Heerde Law, New York City.

Small businesses may also believe they can ignore overtime law because their revenues come in under the \$500,000 level at which the FLSA normally takes effect. Yet even the smallest operation is covered by the FLSA on a so-called “per-employee basis,” if even a single worker spends a substantial amount of time performing the tasks enumerated in the previous paragraph. Another issue is that state and local overtime laws that mimic FLSA regulations often apply to the smallest of employers, regardless of interstate commerce status.

What’s more, mistakes are common. “Employers most often get into trouble for misclassifying employees as exempt,” says Witte. Ignorance of the law is no excuse, he adds, and wise operators and managers should retain paperwork to document their decisions. “The burden of proving exempt status is on the employer.” Employers must be able to convince regulators that exempt personnel fall into one of the so-called “white-collar categories” labeled executive, professional or administrative. Exemptions also may be granted for some people who are computer professionals, engage in outside sales, or are highly compensated.

Paycheck size alone, though, is not sufficient criteria. “Employers sometimes fail to understand that exemption from overtime requires not only meeting the salary threshold, but also passing the so-called ‘duties test,’” says Heerde. While the duties tests vary by exempt category, they boil down to one essential: The exempt person must exhibit sufficient independent authority to make essential decisions in their daily work. Just being assigned an impressive-sounding job title is not enough.

On the back burner are possible changes in the exemption parameters relating

to the duties tests. “The DOL has stated they are not going to suggest changes in the duties tests at this time, but I wouldn’t be surprised if they revisit them at some point in the future, particularly if President Biden gets re-elected,” says Witte.

JUDGMENT CALLS

Qualifying for exempt status often requires judgment calls—and that’s just where employers often get into trouble. There is a common temptation—conscious or otherwise—to classify people as exempt to avoid the costs of overtime. This is exactly the problem that the Biden administration has stated it wants to address. State and local governments have also tightened regulations and increased inspections to ensure that exempt personnel are really exercising management-level decision-making.

Up for special attention, say workplace observers, is the administrative exemption. “Many times, employees do not really qualify because they do not have sufficient authority or enough qualifiable duties,” says Witte. “This problem has been on the DOL radar for some time. Employees have filed complaints, and there have been class-action lawsuits.”

Misclassifications can be costly for employers, especially when an exempt individual’s salary has steadily increased over time. Should a DOL inspector issue a violation, the employee’s elevated salary is first broken down into an hourly rate, which is then utilized as the basis for calculating past overtime and penalties. “Sometimes an employer will react to a steadily rising paycheck by saying something like, ‘This person has been starting to work too much overtime—let’s just make them salaried,’” says Bob McKenzie, president of McKenzieHR. “That’s not allowable unless the individual really qualifies for exemption.”

The lesson is clear: Employers should assume nonexemption when classification

is ambiguous. “The law is deferential to workers in wage-and-hour actions,” says Heerde. “The consequences can be costly for an employer who does not have sufficient records to refute an employee’s wage-and-hour claims before an administrative agency or court.”

OFF THE CLOCK

While misclassification is the most common error in wage-and-hour law, employers can also face penalties for allowing work time to go unrecorded. “Employees often fail to report off-the-clock hours,” says Witte. “Maybe they work through their lunch hour, or they come in early or stay late and don’t record it because they’re afraid of getting into trouble with their boss for working overtime. This is an area that the DOL continually receives complaints about.”

While one might suspect that some misguided employers overlook or even encourage off-the-clock labor, the fact is that employees can also be to blame, says Vicki Lambert, director of ThePayrollAdvisor.com. “Sometimes employees will get enthusiastic and think, ‘Well, I’ll just do this job off the clock real quick, and then my boss will be really happy.’ And they end up getting the employer in trouble.”

Other times, employers will allow record-keeping to fall through the cracks. “Problems can arise when an hourly recording system is not sufficiently detailed, or not contemporaneous,” says Heerde. “Later, when an issue arises, the employer has to track down evidence of work hours by sorting through old emails and other records to prove an employee was paid correctly.”

The record-keeping challenge has increased as more people work from home. “One of the most common mistakes is failing to correctly track remote workers’ time,” says Lambert. “Sometimes people will work off the clock for a few minutes—maybe they check their emails over dinner or make a phone call

or two—and the employer thinks that’s OK.”

In fact, employees must be compensated for all time worked, even if off-the-clock labor violates company policy, says Lambert. Employers who wish to discipline employees who put in extra time without permission must use non-financial procedures such as verbal and written warnings, personnel file notations, or terminations if appropriate.

INDEPENDENT CONTRACTORS

Employers aren’t obligated to pay overtime to independent contractors. However, just who qualifies for that status isn’t always clear. “Distinguishing between employee and independent contractor status is an ongoing challenge,” says Heerde. “Because states have different standards from the federal government about where to draw the line, compliance and enforcement issues arise.” Individuals classified as independent contractors will sometimes later file complaints claiming that they were actually employees and are due back overtime. This can lead to costly litigation.

Wage-and-hour attorneys also report recent changes in determining who’s in business for themselves. “Earlier this year the Biden administration tightened the independent contractor test (a move that’s drawn legal challenges), and a lot of states around the country are doing the same,” says Witte.

Additional moves are expected. Until the new regulations are firmed up, attorneys advise employers to play it safe. “I always recommend that employers make sure independent contractors are operating their own businesses and are in positions to make profits or losses based on their own actions,” says McKenzie. “They should also submit

invoices for work done—and their payments should go through the business’s accounts-payable department rather than the payroll account.”

COMMON PITFALLS

Employers can face penalties for errors in other scenarios, including:

- **STAND-BY TIME:** Employees arrive at a workplace in response to a manager’s directive, then they’re told to stand by because they’re not needed for a while. The manager incorrectly fails to record their waiting time as compensable hours.
- **SUBSTITUTE HOURS:** Instead of paying time-and-a-half to an individual who’s due overtime, the employer grants a day off the following week as compensation. This violates the law requiring overtime for any labor that exceeds 40 hours in any single week.
- **PAYCHECK DEDUCTIONS:** A business deducts employees’ wages for such things as uniform costs or shrinkage. Such deductions aren’t allowed if the individual’s compensation would fall below the minimum wage or would reduce their overtime pay. Many state laws also restrict such deductions.


STAYING CURRENT

If payroll in recent years has grown more complicated, employers can expect even greater challenges as regulators at the federal, state and local levels retool wage-and-hour regulations to reflect a greater sensitivity to employee rights. Businesses must skillfully navigate this shifting terrain to avoid errors that lead to costly financial penalties. “Employers are responsible for making sure payroll is done correctly,” says

Lambert. “They must keep up to date with changing laws.”

In a growing number of cases, as stated above, violations can lead to criminal, rather than civil actions. Intentionality is key. “If failure to pay overtime is simply a result of miscalculation or misclassification, that’s a civil action rather than a criminal one,” says Gregg. “In order to be a criminal action, the individual has to show intentionality. Some examples of intentionality are having people work off the clock so the business can avoid overtime, deliberately pocketing the overtime money, or doing a variety of tricks to deliberately avoid paying overtime so that people do not get what they’re due.”

Even wage theft done for good purposes can spark a criminal prosecution. “Economic hardship caused by the pandemic caused a number of business owners to avoid paying wages in order to keep their businesses afloat,” says Gregg. “In some cases they thought, ‘If I can’t pay the rent or utilities and we close down I won’t be able to pay anybody, so everybody will lose their job. Therefore, I will not pay them the overtime, or I won’t pay them what they’re due. Or I will pay them under the table so that we don’t pay the taxes and they don’t have to pay taxes. And we will take the money and we will pay the bills.’ The fact is that even if they didn’t actually stuff the money in their own pockets, the wage theft was an intentional act of breaking the law.”

In other words, flying without an adequate legal radar can result in a crash landing. “Many employers don’t understand wage-and-hour law and make things up as they go along,” says McKenzie. “They think everything will be OK, but sooner or later they get caught.” 

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