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## **Federal Government to Focus on “Exempt vs. Non-Exempt” and “Independent Contractor vs. Employee” Misclassifications**

**By John F. Goemaat**

In his proposed federal budget for the upcoming fiscal year, President Barack Obama has specified a substantial sum of monies to be used by federal agencies for identifying and eliminating misclassification of employees by employers. The President has directed federal agencies to focus on two specific employment related practices: (1) employers who incorrectly classify employees in exempt job classifications under the Fair Labor Standard Act to avoid the payment of overtime compensation for work in excess of 40 hours in a workweek; and (2) employers who incorrectly designate workers as independent contractors and therefore avoid payroll taxes, benefits and other regulatory obligations. Either of these practices can lead to substantial liability for the employers.

### **Fair Labor Standard Act Exemptions**

This federal law regulates, among other things, the payment of minimum wages and overtime pay, at time-and-a-half, for work in excess of 40 hours a week. There are exemptions, and the ones that may apply to most employers are for employees classified as executive, administrative or professional. There are also exempt classifications for certain computer employees and outside sales personnel.

The standards for these classifications are set by detailed Department of Labor regulations, which cover the amount of pay exempt employees must earn, the basis on which they are paid (usually salaried) and the job duties that qualify for the exempt status. There are variations in all aspects of the regulations, covering different types of employees. The job function provisions of the regulations contain standards that many employers may find exclude employees who hold quite responsible jobs in their organizations. Nevertheless, if these standards are not met, overtime pay will be required. The regulations do call for considerable interpretation in applying them to specific jobs.

In determining whether a job’s duties meet the exempt standard, the Department of Labor and the courts do not rely solely on job titles or even the written job descriptions that the employer may have prepared. Rather, through investigation, they determine the actual job functions performed by the employees.

*(cont’d ➔)*

The improper classification of employees as exempt from overtime pay may result in back pay for all hours worked in excess of 40 a week, at time-and-a-half, for a two- or three-year period. An additional amount, equal to the back pay, may be added as liquidated damages.

### **Contractor or Employee**

Certain businesses may find it attractive to have some work performed by individuals they consider independent contractors. Such a classification may be viewed as a way to reduce responsibility for income tax withholding, social security and other employment taxes, employee benefits and exposure to other laws that regulate the employment relationship. Although some exceptions have been applied, most anti-discrimination laws, for example, are drafted to protect employees, job applicants, and former employees, not independent contractors.

Recognizing the attraction for employers of having workers assume the independent contractor status, government enforcement agencies and courts have developed their own tests to determine whether they will accept the employer's designation of contractors, or deem the individual to be an employee. These tests include factors such as: the degree of control the employer has over the manner in which the work is performed; the degree to which worker has the opportunity for profit or loss; whether the employer or the worker provides the investment in the equipment or materials used by the worker; whether the worker maintains an independent business or works only for a single employer; and the duration of the work relationship. Different

agencies may apply additional factors. No single factor is considered decisive in any case, although the extent of the employer's control is significant.

The more the totality of the situation looks like the usual employer-employee relationship, the more likely the worker is to be considered misclassified as an independent contractor. The employer's designation of the individual, and even the individual's own written agreement that he or she is an independent contractor, is given little weight in the agency or the court's analysis.

The liability for classifying an individual as an independent contractor, who is later determined to be an employee, can be varied and severe. There may be liability for unpaid taxes, together with interest and penalties, for unpaid benefits, jeopardy to benefit plans and liability for violation of employee protective laws, such as worker compensation laws.

Given the apparent emphasis of the current administration to attack these misclassification issues, employers should take steps to analyze the validity of the manner in which they determine the overtime exempt and independent contractor status of individuals in their workforce. A self-audit may eliminate or reduce liability, protecting the business from unnecessary expense. If there is any concern, employers should seek appropriate legal advice.



*The information provided here is necessarily general and is not intended as legal advice or a substitute for legal advice. If you have any questions regarding this Alert, please contact John F. Goemaat at [jgoemaat@lindabury.com](mailto:jgoemaat@lindabury.com).*



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