

Exemptions

As a general rule, all employees working for a covered employer are subject to the provisions of the FLSA and any analogous state wage and hour law. Some employees, however, are exempt from the overtime pay, the minimum wage and/or the child labor provisions of the FLSA based on specific exemptions provided by law. The most common and most expensive employer error in relation to wage and hour laws is the misclassification of non-exempt employees as exempt from these laws. The widespread misapplication of these laws has resulted in countless lawsuits against employers. This confusion has also prompted the U.S. Department of Labor to update the regulations that accompany the FLSA in 2004, which constituted the first major changes in decades. Washington employers should bear in mind that Washington State law has not changed, and may contradict the federal regulations.

Contrary to popular belief, employees who are “on salary” are not automatically exempt from the wage and hour laws. A number of conditions must be considered when making the determination that an employee is an exempt employee. The FLSA and WMWA specifically exempt employees working in three main capacities:

- ◆ A bona fide executive, administrative, or professional;
- ◆ Outside salesperson; or
- ◆ Other miscellaneous types of employment such as employees who perform certain computer work.

29 USCA § 213.

Exemptions are narrowly construed against the employer asserting them. Thus, it is the employer’s duty to analyze each employee’s actual duties before assuming that the exemption might apply to the employee. In the event of a wage investigation, the employer has the burden of proof to demonstrate its employees are truly exempt from the provisions of the FLSA. Failure to provide such proof may result in civil liability and additional or punitive damages. Consequently, employers must use great care in the manner in which exemptions are applied and are urged to check with Associated Industries, private counsel, or the DOL/DL&I before proceeding.

A. TESTS USED TO DETERMINE EXEMPT STATUS OF EXECUTIVE, ADMINISTRATIVE AND/OR PROFESSIONAL EMPLOYEES: The DOL has created regulations used to determine the exempt or non-exempt status of an employee. To meet the criteria for exemption, the employee must be compensated at a particular salary level, be paid on a salary basis, and perform certain duties. Washington has similar regulations regarding exemptions and Idaho references the FLSA. The more protective of these laws will be construed to apply. Additionally, where Washington’s law is not adequately detailed, federal guidance will be followed. See *Drinkwitz v. Alliant Techsystems*, 140 Wn.2d 291 (2000). It is important for employers to note that the

employee's duties, not his or her job title, determine an employee's status. The following tests should be analyzed for each position.

1. Salary Level: Exempt employees must first be paid at least the minimum salary level for that exemption. For most exemptions, this amount is \$455 per week. Administrative, professional, or computer employees may be compensated on a fee basis as well, so long as it is the equivalent of \$455 per week. Computer employees may also be compensated on an hourly basis, if paid at least \$27.63 per hour. This requirement does not apply to those employees who fall within the outside sales exemption.

Payment on a "fee basis" refers to payment by the employer of an agreed sum for a single job, regardless of the time required for its completion. This does not typically apply to payment for a series of jobs. To meet the minimum salary level requirement, the employer must consider the time worked on the job and determine whether the payment is at a rate that would amount to at least \$455 per week if the employee worked 40 hours.

2. Salary Basis: An employee is considered to be paid on a "salary basis" within the meaning of the FLSA and its interpretive regulations if the employee receives a predetermined amount per week constituting all or part of his or her compensation, which is not subject to reduction because of variations in the quality or quantity of the work performed. Subject to the exceptions below, the employee must receive his or her full salary for any week in which he or she performs any work without regard to the number of days or hours worked. An employee need not be paid for a week in which he or she performs no work. An employee may be paid additional compensation without jeopardizing the exempt status. 29 CFR § 541.601; WAC § 296-128-532(2).

a. Actions Jeopardizing the Salary Basis: Even where an employee meets the duties test noted below, and should therefore be exempt, this status will be destroyed if the employee is treated as if he or she were "hourly" rather than salaried. *Drinkwitz v. Alliant Techsystems*, 140 Wn.2d 291 (2000); 29 CFR § 541.118; & WAC § 296-128-532. Consequently, employers must use care not to destroy the salary basis status of employees, resulting in the loss of exemption. Most notably, the following practices may destroy exempt status:

- ◆ Exempt employees are required to work hourly quotas with pay deductions for failure to meet those quotas;
- ◆ Deductions are made from the employee's wages for absences of less than one full week which are occasioned by the employer, or by the operating requirements of the business, such as occasions in which employees are sent home due to lack of work;



- ◆ Deductions are made for absences of an employee occasioned by jury duty, attendance as a witness, or temporary military leave (any amounts received by an employee as a jury or witness fee or military pay may be offset);
- ◆ Deductions for partial day absences (unless taken pursuant to the FMLA by an Idaho employer);
- ◆ Deductions are made for absences of a day or more for sickness or disability where there is no bona fide plan, policy or practice of providing compensation for loss of salary occasioned by both sickness and disability; and/or
- ◆ Exempt employees are subject to unpaid disciplinary suspensions of less than a full week (except for major safety violations).

29 CFR § 541.601 & WAC § 296-128-532.

b. Actions that do not Jeopardize Salary Basis: On the other hand, the deductions taken below are lawful and do not jeopardize the salary basis:

- ◆ Deductions of a full week or more, regardless of the circumstances;
- ◆ Deductions for absences of a full day or more for personal reasons other than sickness or disability;
- ◆ Deductions for absences of a full day or more for sickness or disability if the deduction is made in accordance with a bona fide plan, policy, or practice of providing compensation for salary lost due to illness;
- ◆ Deductions of a full day or more where leave is exhausted or the employee has not yet qualified under the plan;
- ◆ Offset of fees received as the result of jury duty or military pay;
- ◆ Suspension of less than a full week for major safety violations;
- ◆ Deductions for the initial or terminal weeks of employment; and/or
- ◆ Partial day absences where leave is taken pursuant to the Family Medical Leave Act (FMLA)¹.

While the law clearly prohibits most partial day absence deductions, it has been less clear about how to treat deductions from leave banks for partial day absences. Any questions remaining regarding the federal approach to salary and leave bank deductions have been clarified by one of the DOL's opinion letters issued January 7, 2005. The letter, in essence, indicates the Department of Labor does not view deductions from a leave bank for partial day absences as a violation of the FLSA so long as certain provisions are met. The employer must have a bona fide paid time off plan (PTO,

¹The WFMLA does not include a similar provision allowing reduced compensation based on a reduced work schedule taken for family and medical leave purposes. Thus employers in Washington are cautioned to avoid reducing an exempt individuals pay in any week in which he or she works.

vacation, sick leave, etc.) and deductions may only be made from the leave bank, not from the employee's salary.

Washington's Department of Labor and Industries also specifically permits deductions from leave banks (not salary) in partial day increments of no less than one hour, where the employee has requested the deduction be made. WAC § 296-128-532(6)(b).

c. Caveat: In spite of the approaches taken by the DOL and DL&I, Washington employers are encouraged to continue to consider the impact of *Drinkwitz v. Alliant Techsystems*, 140 Wn.2d 291 (2000). This case states that even where an employee meets the duties tests and should be exempt, this status will be destroyed if the employee is treated as if he or she were "hourly" rather than salaried by tracking hours worked or missed. Courts view the totality of circumstances surrounding an employer's practices to determine whether the exemption is compromised. Thus, if an employer were to deduct from a sick leave or vacation bank for a partial day absence, both the federal and state agencies would allow the action. So long as this is the only activity the employer engages in that may indicate hourly tracking, there may be little risk of violating the prohibitions set out by *Drinkwitz*.

d. Safe Harbor: The FLSA regulations state that the employer will lose the exemption if it has an actual practice of making improper deductions for salary. Pursuant to the federal law, the exemption is only lost during the time period of the deductions for all employees in the same job classification working for the same manager responsible for the improper deductions. In making the determination as to whether the employer has an "actual practice" of this, the DOL will consider factors such as the number of improper deductions, the time period during which the employer made improper deductions; the number and geographic location of both the employees whose salary was improperly reduced and the managers responsible, and whether the employer has a clearly communicated policy permitting or prohibiting improper deductions. Isolated or inadvertent improper deductions do not result in the loss of exempt status as long as the employer reimburses the employee for the deduction.

Additionally, the DOL regulations provide for a "safe harbor" where the employer:

- ◆ Has a clearly communicated policy prohibiting improper deductions and including a complaint mechanism;
- ◆ Reimburses employees for any improper deductions; and
- ◆ Makes a good faith commitment to comply in the future, the employer will not lose the exemption for any employees unless the employer willfully violates the policy by continuing the improper deductions after receiving employee complaints.



In response to the *Drinkwitz* decision discussed above, Washington's DL&I implemented a regulation in 2003 addressing the window of correction issue pointed out by our Supreme Court. A limited window of correction is now permitted where an improper deduction is shown to be INFREQUENT AND INADVERTENT and the employer immediately takes steps to correct the problem when brought to its attention. The correction is not allowed if the deduction was made for lack of work or if it is part of a larger pattern of improper deductions. WAC § 296-128-532.

3. Duties Test: In addition to meeting the salary basis test, in order to be considered exempt from the provisions of the FLSA and WMWA, the employee's duties must fall within one of the following classifications. Employers may recall the "short" or "long" tests used to make this determination; the FLSA regulations have consolidated these tests into one standard.² Currently, in all of these classifications, the key inquiry is whether the individual holds a position of responsibility.

a. Executives: Employees working in an executive capacity are those employees whose primary duty is management of the business in which the employee works or the management of a recognized department or subdivision. See 29 CFR §§ 541.101 et seq. & WAC § 296-128-510. The employee must:

- ◆ Meet the salary level and salary basis requirements;
- ◆ Customarily and regularly direct the work of at least two or more other full-time employees or their equivalent;³ and
- ◆ Must have the authority to hire or fire other employees, or the executive's suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees must be given particular weight.

"Management" is defined by the DOL as those individuals responsible for as interviewing, selecting, and training of employees; setting and adjusting their rates of pay and hours of work; directing the work of employees; maintaining production or sales records for use in supervision or control; appraising employees' productivity and efficiency for the purpose of recommending promotions or other changes in status; handling employee complaints and grievances; disciplining employees; planning the work; 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

² The Washington law includes a short and long test, but this test is not used where the employee is paid more than \$250 per week. As the federal regulations require a minimum of \$455 per week, the short test is no longer relevant.

³ For example, an equivalent of two full time employees could be comprised of four part time employees or one full time employee and two part time employees.

security of the employees or the property; planning and controlling the budget; and monitoring or implementing legal compliance measures.

The DOL regulations recognize that, in most businesses, even top-level executives may have to obtain final decision-making approval from someone else, such as the company president or owner. Thus, it is sufficient that the final decision maker merely give the executive's recommendations "particular weight." This is distinguished from an occasional suggestion that may or may not be considered. Considerations in weighing the employee's ability to recommend such changes include whether it is part of the employee's job duties to make such recommendations and the frequency with which such recommendations are made, requested, and relied upon. Generally, an executive's recommendations must pertain to employees whom the executive customarily and regularly directs.

b. Administrative Employees: Administrative employees are employees who perform work of substantial importance to the management or operation of the business. See 29 CFR §§ 541.201 et seq. & WAC § 296-128-520. Employers frequently use the administrative employee exemption improperly. The administrative exemption does not refer to administrative assistants, clerical support or secretaries, whose duties do not include advising management, planning, negotiating, representing the entity, purchasing, and promoting sales and research. As mentioned previously, job titles alone do not determine an employee's status. These individuals use a high level of discretion in relation to important decisions affecting the future of the company. This classification does not include people who use their discretion for trivial or small items. Administrative employees must:

- ◆ Meet the minimum salary level and basis tests;
- ◆ Have a primary duty of performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers;⁴ and
- ◆ Have a primary duty including the exercise of discretion and independent judgment with respect to matters of significance.

Primary duty is defined as the employee's main, principal or major duty when viewing the job as a whole. Directly related to management or general business operations includes work in functional areas such as tax; finance; accounting; budgeting; auditing; insurance; quality control; purchasing; procurement; advertising; marketing; research; safety and health; personnel management; human resources; employee benefits; labor

⁴ Also applies to those whose primary duty is performing administrative functions directly related to academic instruction or training in an educational establishment.

relations; public relations; government relations; computer network, internet and database administration; legal and regulatory compliance. The administrative employee may also perform these functions in relationship to the employer's customers (as consultants).

The exercise of discretion and independent judgment involves comparison and evaluation of possible courses of conduct and acting or making a decision after such consideration. The employee must have authority to make an independent choice, free from immediate direction or supervision. Considerations include: 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; 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, and other factors set forth in the regulation. This is distinguished from the application of existing techniques, procedures or specific standards described in manuals or other sources.

c. Professionals: Professional employees are those people employed in a position of recognized status that requires the use of professional knowledge acquired through long study. See 29 CFR §§ 541.300 et seq. & WAC § 296-128-530. Professional employees must:

- ◆ Meet minimum salary level and basis requirements;
- ◆ Have a primary duty of performing work requiring advanced knowledge (work which is primarily intellectual and which requires the consistent use of independent discretion and judgment); and
- ◆ The advanced knowledge must be in a field of science or learning;
- ◆ The advanced knowledge must be customarily acquired through a prolonged course of study.

A field of science or learning refers to areas such as law, medicine, theology, accounting, actuarial computation, engineering, architecture, teaching, physical, chemical or biological sciences, or pharmacy. This does not include skilled trades or mechanical arts, or general academic education or apprenticeship.

The regulations recognize a combination of experience and schooling, so long as the field is one in which the employee customarily obtains his or her knowledge through study.



Additionally, the changes specifically address certain occupations such as creative professionals or those who teach or practice law or medicine. Creative professionals might include actors, musicians, composers, soloists, writers, cartoonists, etc. The test for creative professionals is slightly different, requiring that the employee:

- ◆ Meet the minimum salary level and basis requirements; and
- ◆ Perform a primary duty involving invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

Teachers must:

- ◆ Have a primary duty of teaching, tutoring, instructing or lecturing in the activity of imparting knowledge; and
- ◆ Must be employed and engaged in this activity as a teacher in an educational establishment.

d. Outside Salesperson: This exemption refers to employees engaged in sales away from the employer's premises in a "traveling salesperson" capacity may be exempt from minimum wage and overtime provisions of the wage and hour laws.⁵ See 29 CFR §§ 541.500 et seq. & WAC § 296-128-540. Although the federal law does not require that outside sales employees be paid on salary, Washington's law does require that the employee received a guaranteed salary, commission or fee basis of payment. *Id.* An outside salesperson must meet the following requirements:

- ◆ The employee's primary duty must be making sales or obtaining orders or contracts for services the customer will pay for;
- ◆ The employee must customarily and regularly be engaged away from the employer's place or places of business (meaning other duties may not exceed 20 percent of the employee's time in Washington); and
- ◆ "Sales" refers to direct sales, mere delivery of goods will not suffice;

Work must be performed at the customer's place of business or home. This does not include sales generated from within the employer's premises such as by mail, telephone or Internet. 29 CFR §§ 541.502 & 506. Additionally, any fixed worksite, including the employee's own home, used to obtain sales will be considered the employer's place of business and render the position non-exempt.

⁵ Washington's law does not require that the employee only perform sales outside the employer's business, so long as certain requirements are met. WAC § 296-128-540. Federal law, however, provides no such definition, making this portion irrelevant.

e. Computer Related Occupations: Certain employees working in computer-related fields might be exempt from the FLSA and WMWA. 29 CFR § 541.303; WAC § 296-128-535. These employees are computer systems analysts, computer programmers, software engineers or other similarly skilled workers who:

- ◆ Meet the minimum salary level and basis requirements (computer employees may be paid hourly as well);
- ◆ Must be employed as a systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer field performing the duties described below;
- ◆ The employee's primary duties must consist of:
 - The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, and system functional specifications;
 - The design, development, documentation, analysis, creation, testing, or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;
 - The design, documentation, testing, creation or modification of computer programs related to machine operating systems; OR
 - A combination of these duties, the performance of which requires the same level of skills, and who, in the case of hourly employees, are compensated at a rate of not less than \$27.63 per hour.

This exemption does not include employees who manufacture or repair computer hardware or equipment, trainees in entry-level positions, employees who heavily rely on computers, but are not engaged in the duties listed above, or employees who are covered by a collective bargaining agreement. WAC § 296-128-535. No formal educational degree is required to be eligible for this exemption.

In addition, this exemption is only available to Washington employees who meet the tests above but also:

- ◆ Possess a high degree of theoretical knowledge and understanding of computer systems analysis, programming and software engineering;
- ◆ Have the ability to practically apply such knowledge to highly specialized computer fields;
- ◆ Generally attain the necessary level of expertise and skill to qualify for an exemption through a combination of education and experience in the field;
- ◆ Consistently exercise discretion and judgment in the application of their special knowledge as opposed to performing purely mechanical or routine tasks;



- ◆ Engage in work that is predominately intellectual and inherently varied in character as opposed to work that is routinely mental, manual, mechanical or physical.

WAC § 296-128-535.

f. Commissioned Sales People Working for Retail Entities: A retail or service employer may elect to exempt commissioned sales staff from overtime requirements if: the entity qualifies as a retail or service establishment; the employee's regular rate of pay exceeds one and one-half times the applicable minimum wage for every hour worked in a workweek in which overtime hours are worked; and more than half the employee's total earnings in a representative period consist of commissions. The representative period for determining if enough commissions have been paid may be as short as one month, but must not be greater than one year. The employer must select a representative period in order to determine if this condition has been met. In order to be a retail or service establishment, 75% of a company's annual dollar volume of sales of goods or services must be recognized as retail sales or services in the particular industry. 29 CFR § 779.301 & RCW § 49.46.130(3). The FLSA does not define the term "services." The DOL noted that although every business might be said to perform a service, all business establishments are not making sales of "services" of the type contemplated by the FLSA. The type of service businesses appropriate for this exemption would include retail service establishments such as the restaurants, hotels, barber shops, repair shops, etc. 29 CFR § 779.314. The DOL further states that many establishments lack a "retail concept." It includes among those entities, for example, automobile wreckers, insurance brokers, agents, and claims adjustment offices, trade associations, and travel agencies. 29 CFR § 779.317.

g. Highly Compensated Exemption: The FLSA regulations have been modified to include an exemption for highly compensated employees. These employees must:

- ◆ Performing office or non-manual work;
- ◆ Earn total annual compensation of at least \$100,000 (which must include at least \$455 per week paid on a salary or fee basis); and
- ◆ Customarily and regularly perform at least one of the duties of an exempt executive, administrative or professional employee

Caveat: Washington does not provide an analogous exemption; thus, Washington employers may not use this exemption. These employees, however, may fit within other exemption categories, and be exempt nonetheless.

h. The Motor Carrier Exemption: The federal Department of Transportation maintains jurisdiction over setting hours for certain interstate motor carriers. As a result, FLSA



does not require overtime compensation for those individuals designated by the Secretary of Transportation. These employees are, however, subject to minimum wage requirements. This broad exemption applies to employees who:

- ◆ Work for a private motor carrier that provides transportation of passengers or property; AND
- ◆ Whose activities are of a character directly affecting the safety of operation of motor vehicles in the transportation on the public highways of passengers or property in interstate or foreign commerce.

Caveat: Washington's overtime provisions are not, however, pre-empted by the federal Motor Carrier Act. Thus, our state's overtime requirements apply to drivers engaged in interstate transport. Where drivers or mechanics work more than forty hours in a week, they are entitled to overtime pay. See *Department of Labor and Industries v. Overnight Transportation Company*, 67 Wn. App. 24 (1992) and *Department of Labor and Industries v. Common Carriers, Incorporated*, 111 Wn.2d 586 (1988).

i. Salespeople, Parts Employees, and Mechanics, Employed by Automobile, Truck, Trailer, Farm Implement, or Aircraft Dealers: Pursuant to 29 USCA § 213 (b)(10)(A) such employees are exempt from the overtime requirements and within the coverage of the other provisions of the FLSA. In such cases, the establishment must be primarily engaged in the business of selling automobiles, trailers, trucks, farm implements, or aircraft to the ultimate purchaser. The exemption applies even if the employees work in physically separate buildings or areas as long as they are part of a department that is functionally operated as part of the dealership. The key is that the salesperson, parts employee, or mechanic must be primarily engaged in selling or servicing automobiles, trailers, trucks, farm implements, or aircraft.

Caveat: Washington's Minimum Wage Act carries no similar provision and thus, the Act's overtime provisions apply unless these individuals are otherwise classified as exempt.

j. Business Owners: Those individuals in sole charge of an independent establishment or a physically separated branch or who own at least a bona fide 20-percent equity interest in the enterprise, regardless of the type of business organization (e.g., corporation, partnership, or other), and who is actively engaged in its management, is considered a bona fide exempt executive. Owners must still earn at least \$455 per week.

