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## Exempt Employees: Who Are They Really?

Misclassifying an employee as “exempt” from overtime laws can violate both state and federal laws, and in turn, devastate both a non-profit’s budget and employee morale. Non-profits can avoid those liabilities by auditing whether their employees are truly exempt from the state and federal overtime laws.

Non-profit organizations in California must comply with overtime requirements under the federal Fair Labor Standards Act (“FLSA”) and/or the California Labor Code. The default position is that an employee is non-exempt and entitled to receive overtime compensation. This is because: 1) courts narrowly interpret and apply overtime exemptions; and 2) the employer has to prove that an employee fits the criteria for an overtime exemption. If an employer mistakenly treats an employee as exempt from overtime, the employer faces potential liability for overdue overtime compensation going back two years<sup>1</sup> under the federal FLSA (or three years for willful violations<sup>2</sup>), and/or going back three years for violations of the California Labor Code.<sup>3</sup>

Non-profits may reduce their potential liability for overdue overtime compensation by following three key steps. First, do not rely on assumptions that an employee’s work should be exempt. Second, understand the requirements for the various categories of overtime exemptions, and ensure that the employee meets the requirements of at least one category. Third, periodically conduct internal audits to ensure that exempt employees continue to be exempt, despite layoffs, reorganizations, or reclassifications.

### **Key Issue #1: Do Not Rely on Assumptions**

Employers often misclassify employees based on: 1) a job title, e.g., supervisor or manager; 2) an old job description that indicates the position is exempt; 3) a long-time practice of treating the job as overtime-exempt; 4) the fact that the employee has a college degree or works at a desk in an office area; and/or 4) a high salary rate or on payment on a salary basis. Avoid these assumptions. None of these factors, standing alone, makes employees exempt from receiving overtime.

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<sup>1</sup> 29 U.S.C. § 255(a).

<sup>2</sup> 29 U.S.C. § 255(a).

<sup>3</sup> California Code of Civil Procedure, § 338 (three year limitations period for an action upon a liability created by statute).

## **Key Issue #2: Know the Overtime Exemptions**

Non-profits should also know the requirements of the overtime exemptions, and ensure that their exempt employees actually satisfy the requirements of at least one exemption category.

### **A. Exemptions under the FLSA**

The federal FLSA provides for the following “white-collar” exemptions:

1. Executive
2. Administrative
3. Professional (learned and creative)
4. Computer Professional
5. Highly Compensated
6. Combination Exemption

To qualify for an overtime exemption under the FLSA, the employee must satisfy **both**: 1) the salary basis test; and 2) the duties test.

The two parts of the FLSA **salary test** are (*but note that the higher salary required under California law will apply to non-profit employers*):

1. The employee must receive the minimum salary of \$684 per week (or \$2964 per month or \$35,568 per year), or for the computer professional exemption \$27.63 an hour; and
2. The employee must receive a regular predetermined amount constituting all or part of his/her compensation, which amount is not subject to reduction because of variations in the quality or quantity of work performed.

Under the **duties test**, the employee’s primary duty must meet at least one overtime exemption category. As to any of the following categories, the employee must spend at least 50% of work time on exempt duties to meet the primary duty rule.

Generally, to qualify for the **executive exemption**, the employee’s primary duty must be to: 1) customarily and regularly direct the equivalent of two or more full time employees within a recognized department, unit, or subdivision; **and** 2) have the authority to hire/fire other employees, or to at least give weighty recommendations as to hiring, firing, promotion or other changes to a subordinate’s employment status.

To qualify for the **administrative exemption**, the employee must have a primary duty to: 1) perform office or non-manual work directly related to the management or the non-profit’s general business operations (e.g., tax; finance; accounting, human resources, employee benefits, among other examples); **and** 2) exercise discretion and independent judgment with respect to matters of significance (e.g., formulate, interpret, or enforce the non-profit’s management policies or operating practices).

To qualify for the **learned professional exemption**, the employee's primary duty must be to perform work that requires knowledge of an advanced type in a field of science or learning, and that requires the consistent exercise of discretion and independent judgement. The employee's knowledge must customarily be acquired by a prolonged course of specialized intellectual instruction (e.g., physicians, attorneys, and certified public accountants).

To qualify for the **creative professional exemption**, the employee's primary work must be original and creative in character in a recognized field of artistic endeavor (e.g., music, writing, editing, the theater, or graphic arts), and the result of which depends primarily on the employee's invention, imagination, or talent.

To qualify for the **computer professional exemption**, the employee must have one of the following primary duties: 1) the application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional specifications; 2) 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; or 3) the design, documentation, testing, creation or modification of computer programs related to machine operating systems; or a combination of the aforementioned duties, the performance of which requires the same level of skill.

To qualify for the **highly compensated employee exemption**, the employee must: 1) earn a base salary of at least \$107,432 per year; **and** 2) primarily perform office or non-manual work; **and** 3) customarily and regularly performs any one or more of the exempt duties or responsibilities of an executive, administrative or professional employee (discussed above).

To qualify for the **combination employee exemption**, the employee should have the primary duty of performing a combination of exempt duties from the executive, administrative, professional, and computer professional categories (discussed above).

## **B. Exemptions Under California Law**

California wage and hour law is generally premised on federal law. If California and federal laws differ, however, the law that more favorable to the employee will apply. *This means that non-profit employers must comply with the California law that requires higher salaries for exempt employees.*

There is a salary test and duties test for overtime exemptions under California law.<sup>4</sup>

The **salary test** requires that an exempt employee receive a minimum salary amount **and** be paid on a "salary basis." California law requires an exempt employee be paid a salary of no less than two times the state minimum wage for 40 hours of work per week or the monthly equivalent. On January 1, 2021, the state minimum wage increased to \$14.00 per hour for employers with 26 employees or more and to \$13.00 per hour for employers with 25 employees or less. Thus, exempt employees must receive a predetermined minimum annual salary of \$58,240 for employers with more than 26 employees, and \$54,080 for employers with 25 employees or less. In addition, California law requires that a computer professional employee must receive a salary

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<sup>4</sup> Labor Code, § 515.

of at least \$98,907.70 annually (\$8,242.32 monthly) or an hourly rate of at least \$47.48.

The California Labor Code<sup>5</sup> and the Industrial Welfare Commission wage orders establish **duties test** overtime exemption categories similar to the federal law for executive, administrative, professional, and computer professional employees. To satisfy the duties test under California law, the employee must be “primarily engaged in” exempt activities, meaning that the employee devotes **more than 50%** of daily work time doing exempt work.

**Key Issue #3:** Conduct Internal Audits on Periodic Basis

Lastly, we recommend that non-profit organizations periodically conduct internal classification audits to preempt lawsuits and wage and hour complaints. Layoffs, reorganizations, under-performing employees, and reclassifications can alter a job so that the incumbent no longer qualifies as exempt. Non-profits should review their job descriptions and compare to them to the actual job duties performed by employees. By doing this, non-profits can identify positions that are properly classified as exempt.

By adhering to these three key issues, non-profit employers will reduce their potential liability for overdue overtime compensation. For assistance, please feel free to reach out to our wage and hour experts at Liebert Cassidy Whitmore.

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<sup>5</sup> Labor Code, §§ 515, 515.5, 515.6.