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# Important updates on classifying employees correctly

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**Treating nonprofit employees fairly and legally - or, if you're an employee, being treated that way - is essential to effective, sustainable organizations that serve the public good.**

As a [recent article from the Maine Association of Nonprofits](#) pointed out, "misclassified workers are denied basic workplace protections including rights to minimum wage and overtime pay, making it harder for them to support themselves and their families."

Misclassifying workers is a common mistake made by employers of all kinds - nonprofits included. Doing so can result in serious consequences, including back wages and taxes owed, as well as violations of federal and state employment laws with associated penalties. These mistakes can also result in dissatisfied employees, risking a negative effect on the nonprofit's mission.

**Nonprofit employers will want to be aware of recent court decisions and state law changes** in this arena, and consult their professional advisors if they have any questions.

**Another important development on the horizon: [proposed changes to the federal rules on exemption from overtime](#)** will be released by the U.S. Department of Labor (DOL) this fall. Many people are anticipating increases in the minimum salary threshold and other changes, potentially including to the job duties test, for exempt employees.

**Nonprofits will be invited to provide input to the DOL on [job classification guidance](#).** Not many nonprofits operate in a factory environment, but labor-law guidance doesn't seem to get that. Descriptions of professional and administrative work often don't map neatly onto nonprofit jobs like development positions or volunteer management when it comes to determining whether a job clearly meets the test for overtime exemptions. **See below for information on how you can share your wisdom with us regarding jobs at your nonprofit so we can provide input to the DOL.**

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## **Worker Classification: Federal and state tax enforcement update**

In recent years, both the IRS and state taxing agencies have been stepping up enforcement of employee classification, making it even more compelling for nonprofits to reexamine whether workers are properly classified as employees and independent contractors, and as exempt or non-exempt employees. Our [Classifying Employees Correctly](#) page provides a general discussion of the issue and further resources.

Recent court cases, and updated state laws in California and New Jersey, have clarified how to properly distinguish employees and contractors.

## **Recent Tax Court decisions on worker classification**

The United States Tax Court recently held that the founder of a Section 501(c)(3) organization was an employee rather than an independent contractor. See [\*The Redi Foundation, Inc. v. Commissioner\*](#). In this case, the founder/officer of the organization performed services for the organization and received payment for those services. He was the organization's sole source of revenue and payments to him were the organization's only expenditures. An officer of a corporation (including a nonprofit) is generally classified as an employee for employment tax purposes, but there is an exception for officers that generally do not perform services nor receive any compensation. Under the facts, the Tax Court decided the officer did not meet the independent contractor exception.

In another case decided the same day, the Tax Court held that an at-home health care company misclassified almost 100 workers as independent contractors. See [\*Pediatric Impressions Home Health, Inc. v. Commissioner \(PIHH\)\*](#).

In *PIHH*, the corporation (a for-profit company) contracted with nurses to provide at-home services to children with special needs. The Tax Court determined that the workers were so economically dependent on the business to which they rendered services that, as a matter of economic reality, they were not in business for themselves. Other factors included the control exercised by the company, the relative investments of the worker and the company, the permanency of the relationship, and others.

Another relevant factor is that the employer had previously treated the nurses as employees for federal tax purposes but then began treating them as independent contractors, even though the jobs and services provided remained the same. *Note that where employers change worker classification from employees to independent contractors, there should be a clear explanation of why this was done and how the relationship changed, in order to withstand any potential audit.*

In both cases, the employers were required to pay payroll taxes and penalties for failing to withhold income taxes for the employees.

New worker misclassification statutes in [New Jersey](#) and [California](#) also reinforce the need for nonprofits to pay close attention to whether they classify workers as independent contractors or employees.

## **Another critical worker classification issue: determining whether employees are exempt from overtime**

Currently, the federal Fair Labor Standards Act (FLSA) requires employers, including nonprofits, to pay their non-exempt employees at least \$7.25 per hour and to pay employees time and a half when they work more than 40 hours in a workweek. (State laws can add additional requirements.)

Certain factors, including salaried pay of at least \$684/week, and [specific job classifications](#) can **exempt** employees from the federal overtime pay requirement. Care should be taken in reviewing the requirements when classifying jobs, and revisiting them regularly to ensure exempt employees continue to meet all labor-law criteria.

## **Changes to overtime exemption requirements are in the works - and nonprofits can help inform the rules *in ways that will benefit us all***

Unfortunately for nonprofits, the DOL guidance on the job classifications for exemption is in some ways a relic of the industrial age, and it doesn't always map onto nonprofit jobs. For example, the existing guidance isn't clear on whether certain fundraising/development jobs or volunteer management positions meet one of the duties tests.

This fall, DOL plans to release proposed new regulations on the salary threshold test for exemption from overtime pay. It could also make changes to the duties tests for administrative, executive, and professional employees.

The great news is that Labor Department officials appear open to improving the guidance the Department provides for nonprofit jobs.

***Specifically, the Department of Labor would like to know how their guidance misses the mark and what types of jobs in the nonprofit sector need better guidance.***

**Our ask of our readers:** On which jobs – unique to nonprofits – should the Labor Department provide more precise guidance? We’ve identified **fundraising/development** and **volunteer management** as two examples of jobs unique to the nonprofit sector. But we’d like more examples of jobs where the current guidance is unclear to make the case that nonprofit workplaces deserve and need better guidance from DOL.

**If you have examples of positions at your nonprofit that need more clarity from DOL about whether they meet the duties test for FLSA overtime exemption, [please let us know](#)**

While the nonprofit sector can’t always compete with for-profit employers on compensation alone, we can compete in other ways. Our sector should be scrupulously ethical when it comes to complying with both the spirit and the letter of tax and labor laws. Nonprofit employees value the meaningful work they do, as well as the opportunity for a more positive work culture. Let’s be sure we are delivering for our employees so they can keep delivering for our communities.

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