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Proper Worker Classification in the Nonprofit Workplace: Avoiding Misclassification Issues

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Just like any workplace, a nonprofit organization has workers who aid the nonprofit in the pursuit of its goals. These workers are the nonprofit's most valuable asset, and their performance will often determine the organization's overall success. However, is a nonprofit's worker an employee or an independent contractor? Is there a difference? Does it matter?

A nonprofit will often treat paid workers as contractors – it is easier and there are less administrative and tax burdens. However, most paid workers are actually employees, and must be paid as such in order to avoid significant legal liability for the organization. This includes payment of overtime and minimum wage.

This article discusses how to determine whether to pay a worker as an employee or an independent contractor, and what the differences are under Georgia and federal law. First, we will review how employee and independent contractor classifications are interpreted by the United States Department of Labor (USDOL), the Internal Revenue Service (IRS), and the Georgia Department of Labor (GDOL). Then, we will examine the Fair Labor Standards Act (FLSA) to help determine whether an employee is exempt from minimum wage and overtime pay requirements. Included within this article are links which lead to USDOL guidelines.

Paid Worker: Employee or Independent Contractor

A paid worker can be either an employee or an independent contractor. An employee can be part-time or full-time, and is typically subject to the direction and control of the employer. If a worker is classified as an employee under the USDOL test, the Fair Labor Standards Act's minimum wage and overtime pay provisions will apply to the worker. The FLSA has a very broad definition of employment. Under the FLSA, workers who are economically dependent on the business of the employer, regardless of skill level, are considered employees. Most workers are employees.

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On the other hand, an independent contractor chooses how and when to perform the agreed work, and is not subject to the employer's direction and control. Under the USDOL's guidelines, workers with economic independence and in business for themselves can potentially be classified as independent contractors.

Different tests are used by the USDOL, the IRS, and the GDOL to distinguish an employee from an independent contractor, with each agency applying its own rules. A number of factors are weighed under each test to determine if a worker is an employee. No one factor in any of the tests determines whether a worker is an employee, but an organization should endeavor to satisfy as many of the factors as possible if it chooses to classify a worker as an independent contractor. Although the three tests are different, a nonprofit can make a reasonable evaluation of the worker's classification by determining to what extent the worker is under the organization's control.

Why is it important?

Although most nonprofits are exempt from income tax, the nonprofit must still withhold income tax from the pay of its employees. In most cases, the nonprofit must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. The nonprofit does not generally have to withhold or pay any taxes on payments to independent contractors.

However, if a nonprofit misclassifies a worker as an independent contractor, the nonprofit can be held liable for the unpaid taxes, plus interest and penalties. It is essential properly to classify workers under the IRS and the GDOL tests to avoid these penalties. In addition, nonprofits are sometimes audited by GDOL when an "independent contractor" files for unemployment, and lists the organization as a source of income, and an organization can become liable for unemployment payments for an individual whom the organization believed was an independent contractor.

Distinguishing employees from independent contractors

Under all three tests used by the various agencies, all facts relevant to the relationship between the worker and the employer must be considered. Although no factor is conclusive, for example, the USDOL will look at these [six factors](#) to classify a worker.

- 1. The nature and degree of control by the employer.** If the employer controls, or has the power to control, the worker through training and ongoing supervision, then it is more likely that the worker is an employee. Additionally, a worker is more likely to be an employee when the employer sets the pay amount, the work hours and determines how the work is performed.
- 2. The extent to which the worker performs an integral part of the employer's business.** If the worker performs work without which the nonprofit would be unable to operate, the worker is likely to be an employee. Work that is needed infrequently

or work that is not essential to the nonprofit's purpose is properly performed by an independent contractor.

3. **The economic dependence of the worker.** A worker is most likely an employee if the worker depends on the employer for virtually all earnings. However, a worker is more likely to be an independent contractor if the worker provides similar services to the nonprofit as well as a number of other nonprofit or for-profit businesses,
4. **The investments made in facilities and equipment by the worker and the employer.** A skilled worker who invests in his or her own tools and works for a variety of clients is more likely to be an independent contractor rather than an employee. This factor is often irrelevant to office work where few "tools" are needed.
5. **The worker's skill and independent judgment required to perform the work.** Although a worker's skill is not determinative of his or her status, a skilled worker is more likely to be an independent contractor while an unskilled worker is more likely to be an employee. Furthermore, a worker who exercises independent judgment in performing his or her work is more likely to be an independent contractor.
6. **The permanency of the worker's relationship with the employer.** If the worker is working for the employer on a permanent or indefinite basis, the worker is more likely to be an employee. If there is a lack of permanence, such as a project-based engagement, it is likely that the worker is an independent contractor.

Although the IRS uses a different test than the USDOL, the overall analysis is similar under both tests. The IRS looks at three primary elements when classifying a worker: behavioral, financial, and type of relationship. The Georgia Department of Labor follows the IRS rule. The GDOL will accept an IRS determination of contractor status or will apply its own two-part test based on control of the worker and evidence (such as a business license) that the worker is customarily engaged in an independently established trade, occupation, profession, or business.¹

If the worker is properly classified as an independent contractor, the nonprofit can pay the independent contractor at any negotiated rate. While it is a good idea to have a written contract with the independent contractor to establish terms of the contract and to reiterate "contractor" status, an agreement stating that the worker is an independent contractor is not definitive in establishing the relationship. Likewise, the fact that the worker has incorporated a business and/or is licensed by the state has little bearing on classifying the worker. Finally, employee status is not determined by the time of pay or mode of pay.

¹ A non-profit can file a [Form SS-8](#) with the IRS to receive an official opinion regarding the tax classification of its worker as an independent contractor or employee. The benefit of filing a Form SS-8 is that the classification of the worker's status will be valid for both the IRS and the GDOL. However, the risk of Form SS-8 is that an unfavorable opinion will apply to all workers in a similar role not only going forward, but also for the past three tax years. Thus, many employers prefer to review Form SS-8 in their analysis of a worker's status without submitting it to the IRS for an opinion.

If the worker is classified as an employee, the nonprofit must comply with applicable wage laws when paying the employee.

The FLSA: Exempt vs. Non-Exempt Employees

What is the FLSA?

The Fair Labor Standards Act or FLSA is the primary law governing payment and working hours of US employees. It establishes the minimum wage, overtime pay, recordkeeping, and child labor standards affecting full-time and part-time workers. As Georgia has no equivalent state law, the FLSA provides the applicable wage and hour standard in the state. The minimum wage and overtime pay is of particular importance to a non-profit. The minimum wage set by the federal government under the FLSA is currently \$7.25 an hour.

The FLSA assumes that employees are “non-exempt” and are due minimum wage and overtime pay, unless the employee is “exempt” from those standards under rules set by the FLSA. The overtime provision requires employees to be paid an overtime premium for hours worked in excess of 40 in a workweek at a rate of at least time and one-half their regular rate of pay.

Why is the FLSA important?

The FLSA’s [minimum wage](#) and [overtime](#) provisions will apply to your employee, if classified as such under the USDOL test, unless that employee is exempt. The FLSA has significant penalties for violations, including three years of wage payments, doubled as liquidated damages, plus attorney fees. Employees can ask the USDOL to investigate their claim or can file a FLSA suit in court. Employees and independent contractors who have an employment dispute with an organization often find that a FLSA claim is their surest path to recovery.

Exempt vs. Non-Exempt

It is possible that the employee can be exempt from the minimum wage and overtime pay requirements of the FLSA. To be exempt, the employee must qualify for one of the FLSA exemptions. Job titles do not determine exempt status. An employee is not exempt unless both parts of a two-part test are met. First, the employee must be paid a guaranteed salary of at least \$684 per week (with exceptions only for lawyers and doctors), without docking for partial days’ absences. Second, the employee’s primary job duties must qualify under a FLSA exemption. There are five exemptions relevant to a non-profit: administrative, professional, executive, creative professional, and computer. While the factors for each exemption are summarized below, the analysis of each exemption is not as simple as it may seem. It is advisable to consult with legal counsel before classifying an employee as exempt.

- [Administrative Exemption](#). This is the most common exemption and likely the most commonly misapplied. To qualify as an exempt administrative employee:

1. The employee's primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and
2. The employee's primary duty must include the exercise of discretion and independent judgment with respect to matters of significance.

This exemption is rarely proper for secretaries, receptionists, schedulers, or entry-level marketers and fund raisers because their duties do not regularly require them to exercise true independent judgment in making important decisions for the organization. Employees with strategic and budgetary responsibility are more likely to qualify.

- **Professional Exemption**. The professional exemption applies to workers with advanced knowledge such as accountants, lawyers, teachers, biologists, psychologists, and those social workers whose jobs actually require a social work degree. To qualify for the professional exemption:
 1. The employee's primary duty must be the performance of work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment;
 2. The employee must have advanced knowledge in a field of science or learning (not mechanical arts or skilled trades); and
 3. The advanced knowledge must be acquired by a prolonged course of specialized intellectual instruction (such as a dedicated four-year degree or master's program).
- **Executive Exemption**. This exemption applies to someone who has full managerial authority over two or more full-time employees (not independent contractors). This is the easiest exemption to identify. To qualify for an executive exemption:
 1. The primary duty of the employee must be managing the nonprofit;
 2. The employee must customarily and regularly direct the work of at least two other full-time employees or the part-time equivalents; and
 3. The employee must have the authority to hire or fire other employees, or give significant input on the hiring, firing, advancement, promotion, or any other change of status of other employees.
- **Creative Professional Exemption**. This exemption applies to employees who are engaged in creative endeavors such as music, writing, acting, or graphic arts. The employee's primary duty must be the performance of work requiring invention, imagination, originality, or talent in a recognized field. Employees who perform routine design work (entry-level designers or technical writers) or whose work

depends on skill and diligence (proofreaders, entry-level draftspeople) will not qualify as exempt creative professionals.

- **Computer Exemption**. This exemption applies to highly complex computer professionals engaged in computer systems analysis and programming such as advanced systems administrators, software engineers, software architects, and data warehouse architects. The computer exemption generally relies on theoretical and analytical skills relating to coding and network design. Desktop support personnel are unlikely to qualify.

What do you do if an employee is non-exempt?

An employee is subject to the minimum wage and overtime provisions of the FLSA if he or she does not meet any of the FLSA exemptions. Make sure to record all hours of work for the non-exempt employee, including time outside of regular work hours, to assure compliance with the overtime provisions. Overtime is calculated on a weekly basis, and overtime from one week cannot be transferred to another week to avoid overtime pay. Take a look at what is credited as a work hour. A break of 20 minutes or less is paid while a meal must be at least 30 minutes to be unpaid. Keep in mind that non-exempt employees are not entitled to meal or rest periods under the FLSA but if they are provided, the rules regarding pay indicated above apply. Finally, when a non-exempt employee is idle during work hours, he or she must be paid during those on-duty times even though no work is available.

Conclusion

Misclassification of a worker may result in severe penalties for a nonprofit. When hiring a new worker, it is important to properly classify the individual for purposes of taxation, minimum wage, and overtime pay. Make sure that a worker is properly classified as an employee or an independent contractor based on the criteria set forth by the USDOL, the IRS, and the GDOL. If a worker is an employee, make sure that this individual is properly classified as either exempt or non-exempt, and is paid minimum wage and overtime according to the FLSA requirements. Be sure to contact Pro Bono Partnership or the organization's counsel for help with worker classifications.