The Top 5 Most Common Wage and Hour Law Mistakes New Businesses Make

Posted in Alert on July 18, 2022

Adding personnel is typically a good indicator of growth for a new or emerging business. However, despite good intentions or attempts to achieve greater efficiency, many new businesses make common mistakes like the ones listed below when it comes to how they pay and classify their employees that can put them at risk for wage and hour lawsuits and hefty penalties.

1. Paying everyone a salary

Why we do this

Many new businesses make this top mistake with the best of intentions/motives. For one, they want to make a statement that "everyone is important" and (mistakenly) believe that "paying everyone a salary" sends this message within the organization. Some other reasons many new businesses make this #1 mistake is that they do not want to "bother people" with having to clock in and out or take the time to research and purchase timekeeping software or a "timecard system" that they believe could make their new business look/feel like "something out of The Flintstones." (Please feel free to Google "The Flintstones" reference.)

Why we shouldn't

The fact is, under federal wage and hour law (the Fair Labor Standards Act), "everyone is NOT the same." **Only 5 groups of employees actually can be paid a set salary regardless of how many hours they work –**

(1) executives (defined by the law as those who spend the majority of their working time supervising at least 2 other employees);

(2) professionals (defined by the law as those who have and are using a professional degree or other specialized training, such as an accountant, an engineer, an attorney, etc.);

(3) administrative employees (these are "not what you think" as far as "any 'administrative/clerical/office employee'" – these employees must indeed be office workers, but they also must "exercise discretion in matters of significance" regarding either the entire company or a department/section of it) (this is the most misunderstood and misused of the 5 groups);

(4) outside salespeople (defined by the law as those who spend a significant amount of their working time literally going "door to door"/outside the company soliciting new work for the company; even in this technology-driven age, these workers cannot go "door to door" virtually/through on-line marketing or solicitations); and

(5) highly compensated employees (defined by the law as those (a) who earn a total annual compensation of at least $107,432, which includes at least $684 per week paid on a salary or set fee basis; (b) whose primary duty includes performing office or other non-manual work; and (c) who customarily and regularly perform at least one of the exempt duties or responsibilities of an exempt executive, administrative, or professional employee, as briefly described above).

The difference this makes – as far as deciding to "treat everyone the same by paying them all a salary regardless of their role with the company" – is that you are actually depriving those who do not fall within one of the 5 groups listed above of overtime pay (i.e., time and a half for any hours worked over 40 in the same workweek). If one or more of these employees discover this, they then can sue your new business – even while continuing to work for you! – for the unpaid overtime. They have up to two (and in some cases three) years from when the unpaid overtime hours are worked to do so.

2. Not asking employees to report their time

Why we do this

The reasons for this second most common mistake are similar to those which motivate mistake #1 above – thinking it will make new employees feel "less than" if some of them have to "clock in" while others do not. New businesses also often justify this practice as allowing them to avoid the administrative headache of having to keep track of every hour people work by instead issuing all employees a paycheck for the same amount every two weeks regardless of how many hours they work. Some new businesses also believe it will build a better culture of teamwork and collaboration if "people are not focused on a timeclock." Statements from

employers who have made this mistake often include comments like the following: “If our employees are enjoying and focused on their work, they shouldn’t care how many hours they are working.” “It takes 100% commitment from everyone to make a new business successful. I don’t want people working here who are worried about punching a clock.”

Why we shouldn’t

As noted under “common mistake #1” above, if an employee who does not truly fall within one of the 5 groups which legitimately can be paid a set salary with no overtime becomes aware of this, they may decide to file a lawsuit against your new business. If this happens, the company will bear the burden of trying to prove how many hours each of these employees actually worked. If you have no records regarding this, there are other ways you can try to “recreate” their working time – if you have security cards they use to enter and leave work, or cameras, computer log-ins, etc. As you can imagine, this is a time-consuming way to try to track when one or more employees worked over the past 2 to 3 years. Plus, most businesses if they use security cards usually have employees use these in order to “enter” (but not “leave”) work. They therefore often have no record of when the employees left or stopped work using this time “recreation” method. This method along with some of the others listed above also will be completely useless if employees are working remotely.

Bottom line is it will leave you a “sitting duck” defense-wise in trying to prove how much time actually was worked if an employee sues you for unpaid overtime and you have no time records reflecting this.

3. Thinking the new business is “too small” to be covered by overtime or other wage payment laws

Why we do this

It is true that some federal laws such as the federal “Family and Medical Leave Act” (FMLA) and even most of the federal anti-harassment and discrimination laws do not apply until a new business has a certain number of employees (50 for the FMLA and 15 for most federal anti-harassment and discrimination laws in case you are curious).

Why we shouldn’t

This is not true regarding federal wage and hour laws, however. These laws apply to businesses with even one employee. Please refer to the “***Why we shouldn’t***” section regarding “common mistake #1” above as to why this matters.

4. Calling all non-owner employees, “independent contractors” and paying them through a 1099 rather than a W-2 (i.e., “not having any ‘employees’”)

Why we do this

Some new businesses do this, again, to try to avoid the administrative “hassle” of setting up required processes such as an unemployment contribution account with the State, finding and paying for workers’ compensation insurance, and/or having to withhold federal Social Security, Medicare, and income taxes from the amounts paid to those who work for them. Many such workers also are happy to agree to this arrangement, as they also “like the sound” of having “no taxes withheld from their pay, etc.” The new business may even have all those who work for them “sign something” saying “they agree they are ‘independent contractors’ and therefore will not receive any benefits from the new business, have any taxes withheld from their pay, etc.”

Why we shouldn’t

As with those who are “all paid a salary,” in the eyes of the law, it is not up to the new business as the “employer” or even the workers to “decide” who is an employee and who is not. As with those who can *lawfully* be paid a salary, the concept of “who is an employee and who is not” is defined *by the law*, not the employer and/or the workers. A true “independent contractor” in the eyes of the law must satisfy an “economic realities test,” which looks at a multitude of factors such as (1) how much control the new business has over the worker’s day-to-day work, (2) how long and/or continuous the worker’s working relationship is with the new business (i.e., does the worker work for several businesses at the same time or exclusively for the new business), and (3) how is the worker paid (per project, by the hour, or a set salary). So, it is not enough as a new business simply “to decide to give all workers a 1099” or even “to ask them all to sign something” agreeing to be an “independent contractor” vs. an “employee.”

If your new business is audited by either the State or the federal government, you could have to pay unemployment contributions and/or unpaid federal taxes along with interest and penalties regarding the same if you have improperly classified “employees” as

"independent contractors."

5. Not paying hourly employees properly

If you have made it this far in this article without having to admit that your new business is making any of the above-referenced common mistakes, CONGRATULATIONS! However, there is still one common mistake even some wage and hour savvy new businesses make.

Why we do it

Like most of the other common mistakes on this list, the primary reason new businesses have issues in this area is simply "not knowing what they don't know." They do not realize, for example, how hourly employees have to be paid if they are traveling for work, or "on call," or attending some type of training program. There also are some other flies in the ointment when it comes to paying overtime during weeks that an hourly employee receives a bonus or other extra pay. Still other new businesses set up "rounding" or "averaging" timecard systems or those which "auto deduct" lunch or other unpaid breaks without fully understanding the ramifications of these systems on the company's compliance with applicable wage and hour laws.

Why we shouldn't

As with the failure to pay overtime discussed in sections #1 and #2 above, failure to properly pay an hourly employee for all hours worked (or the proper "time and a half" rate when paying overtime) also can give rise to wage and hour claims and lawsuits. Your new business could have to pay the unpaid amounts owed plus interest and other penalties along with attorney fees for making these mistakes.

As you may have read between the lines regarding each of these "top 5 mistakes," what makes them so easy to make is that your new business will not be judged on its "intent" – whether you "meant" to make them or not. There also is no "ignorance is bliss defense." Federal wage and hour laws, like federal tax laws, are "strict liability" – meaning your business will be held liable for making them, even if you did so "by accident" or due to simply not knowing what they were.

So, how do you AVOID making these "top 5 mistakes?"

You have already taken one helpful step by reading this article in order to begin "to know what you don't know" in this area of the law. The next step would be to take a few hours to allow a wage and hour attorney to review your current pay practices in order to make sure you are properly classifying and paying your workers.

We Can Help

Please feel free to contact Stacie Caraway or any other member of our Labor & Employment Law Practice Group to discuss questions you may have in this area. We enjoy helping new businesses get started on the right foot and look forward to engaging with you regarding these and other areas of personnel/HR law that you may have questions about.