

Essential Facts about the new DOL Overtime Exemption Rules

by Samantha Yurman, JD

Editor's Note:

FLSA overtime rule changes will impact most chambers and many member companies. The degree and nature of the impacts will vary by organization. Our goal with this article is not to explore nuance, but instead to provide all ACCE members with a solid foundation of the essential facts about the rule changes. Pending legal challenges and proposed legislative fixes to these rule changes are not addressed in this piece.

In May, the U.S. Department of Labor (DOL) announced the publication of a final rule amending the white collar overtime exemptions to the Fair Labor Standards Act (FLSA). The final rule, published in the Federal Register on May 23, 2016, increases the threshold salary for the exemption to **\$913 per week (\$47,476 per year)**, the standard salary level at the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region (currently the South). The new rule also increases the total annual compensation requirement needed to exempt highly-compensated employees (HCEs) to **\$134,004 per year** and established a mechanism for automatically updating the salary and compensation levels every three years to maintain the levels at the above percentiles and to ensure that they continue to provide useful and effective tests for exemption.

The final rule amends the salary basis test to allow employers to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the new standard salary level.

The final rule makes no changes to the duties tests for both standard and HCE positions.



When does the final rule take effect?

The final rule will be published in the Federal Register and **take effect December 1, 2016**. Initial increases to the standard salary level (from \$455 to \$913 per week) and the HCE total annual compensation requirement (from \$100,000 to \$134,004 per year) will be effective then. Future automatic updates to those thresholds will occur every three years, beginning on January 1, 2020.

What is the intent of the final rule?

Proponents argue that the overtime regulations haven't been meaningfully updated in decades. An exemption from overtime eligibility originally meant only to apply to highly-compensated white-collar employees has applied to certain employees earning \$455 per week or \$23,660 per year since 2004. In addition to the salary threshold, exempt employees must hold a position that passes the "duties tests" within specific exempt classifications defined in the regulations. According to the DOL, 62 percent of full-time salaried workers were eligible for overtime pay in 1975, but today only 8 percent of those same types of workers are overtime pay eligible due to the low salary threshold that has not kept up with inflation and wage growth.

This final rule updates the salary level required for exemption to ensure that the FLSA's intended overtime protections are fully implemented, and to simplify the identification of overtime-protected employees, thus making executive, administrative, and professional exemption tests easier for employers and employees to understand and apply.

What are the basic applications of the FLSA?

Employees classified as nonexempt from the salary and duties tests covered by the FLSA must be paid at least one and one-half times their regular rate of pay for any hours they work beyond 40 in a workweek (or eight hours in a workday in some states). An employer who requires or permits an employee to work

overtime is generally required to pay the employee premium pay for such overtime work. The FLSA establishes minimum wage, overtime pay, recordkeeping, and youth employment standards affecting employees in the private sector and in federal, state, and local governments. Covered nonexempt workers are entitled to a minimum wage of not less than \$7.25 per hour at the federal level. Some states have higher minimum wage rates.

Generally, employees of enterprises that have an annual gross volume of sales made or business done of \$500,000 or more are covered by the FLSA. In addition, employees of certain businesses are covered by the FLSA regardless of the amount of gross volume of sales or business done (enterprise coverage). These businesses include hospitals, businesses providing medical or nursing care for residents, schools (whether operated for profit or not for profit), and public agencies. Even when there is no enterprise coverage, employees are protected by the FLSA if their work regularly involves them in commerce between states (interstate commerce). The FLSA covers individual workers who are engaged in commerce or in the production of goods for commerce.

State and local governments are also subject to the FLSA; domestic service workers (such as housekeepers, full-time babysitters, and cooks) are also normally covered by the law.

What are the white collar exemptions to the FLSA?

The FLSA's white collar exemptions exclude certain executive, administrative, and professional employees from federal minimum wage and overtime requirements. Certain computer professionals and outside sales employees are also excluded from these requirements. The final rule addresses changes in the salary thresholds for the executive, administrative, and professional employee and HCE categories.

Currently, to qualify for exemption, a white collar employee generally must meet all of the following tests:

- **Salary Basis Test:** An employee must be salaried, meaning that he or she is paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed.
- **Salary Level Test:** An employee must be paid at least a specific salary threshold, which is \$913 per week (the equivalent of \$47,476 annually for a full-year employee).
- **Duties Test:** The employee must primarily perform executive, administrative, or professional duties, as provided in the DOL's regulations. ▶



Certain professionals are not subject to either the salary basis or salary level tests (for example, doctors, teachers, and lawyers). There is no salary level test required to qualify as an exempt outside sales employee. Finally, the current regulations also contain a relaxed duties test for HCEs who receive total annual compensation of \$134,004 or more paid on a salary basis.

Keep in mind that job titles do not determine exempt status, and the fact that a white collar employee is paid on a salary basis does not alone provide sufficient grounds to exempt that employee from the FLSA's minimum wage and overtime requirements. For an exemption to apply, an employee's specific job duties and salary must meet all of the applicable requirements provided in the DOL's regulations.

What is a highly-compensated employee (HCE)?

An HCE is paid total annual compensation of \$134,004 or more and is deemed exempt under § 13(a)(1) of the FLSA if all of the following apply:

- The employee earns total annual compensation of \$134,004 or more, paid on a salary basis.
- The employee's primary duty includes performing office or non-manual work.
- The employee customarily and regularly performs at least one of the exempt duties or responsibilities of an exempt executive, administrative, or professional employee.

For example, an employee may qualify as an exempt HCE if he or she earns at least \$134,004 annually and customarily and regularly directs the work of two or more other employees, even though the employee does not meet all of the other requirements in the standard test for exemption as an executive.

For HCE exemption under the final rule, employees must earn a minimum of \$913 per week on a salary or fee basis, while the remainder of the total annual compensation may include commissions, nondiscretionary bonuses, and other nondiscretionary compensation.

How are nondiscretionary bonuses and incentive payments included in the salary test?

For other non-HCE employees, the final rule allows nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the standard salary test requirement. This includes nondiscretionary incentive bonuses tied to productivity or profitability, such as profit-sharing, retention or production bonuses, and incentive payments, including commission payments based on pre-set formulas. Under certain conditions, catch-up payments within the quarter may be allowed.

The final rule does NOT allow discretionary bonuses that are awarded irregularly and at the employer's sole discretion to be included as part of the standard salary test requirement, such as spot awards for performance or special projects.

Is there a small business exemption from the FLSA or the DOL's overtime rule for white collar workers?

The FLSA does not provide an exemption for small businesses. Generally, the FLSA and the final rule apply to employees of enterprises that have an annual gross volume of sales made or business done of \$500,000 or more, and certain other businesses (enterprise coverage). Even when there is no enterprise coverage, employees are protected by the FLSA if their work regularly involves them in commerce between states (interstate commerce). The DOL has published a Small Business Guide (www.dol.gov/whd/overtime/final2016/SmallBusinessGuide.pdf) that provides additional information to assist small employers in complying with this rule.

When will annual automatic updates to the salary thresholds be made?

The automatic updates to the standard salary and HCE total annual compensation levels will be made every three years by applying the same method used to set those levels in the final rule. The DOL will update the standard salary level to maintain it at the 40th percentile of weekly earnings of full-time salaried workers in the lowest wage Census Region, and will update the HCE total annual compensation level to maintain it at the annual equivalent of the 90th percentile of earnings of full-time salaried workers nationwide. The first update will take effect on January 1, 2020.

Where do I start when the new rule is implemented?

Although these changes do not go into effect until December 1, start considering your options for compliance now. Options include raising pay to meet the new exemption thresholds, reducing workloads for individual employees who regularly work more than 40 hours per week and whose jobs will be reclassified as overtime eligible to reduce overtime payments, adjusting salary budgets to allow for additional overtime pay, and carefully planning your communications strategy for announcing the changes you will be making. ☐

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Begin your analysis by:

1. Determining exempt positions where employees currently earn less than \$47,476.
2. Identifying your pay strategy and modeling scenarios where you increase the salary of these employees above the new salary level to maintain their positions as exempt, reducing salaries for newly reclassified nonexempt employees, and calculating the additional overtime the newly reclassified nonexempts may be earning.
3. Analyzing work requirements and duties for employees who are reclassified as nonexempt, establishing overtime restrictions and hourly reporting requirements.
4. Analyzing your benefits and paid time off structures to determine whether changes need to be made as the employee transitions from exempt to nonexempt status.
5. Planning your communications strategy so that impacted employees will understand the changes and expectations going forward.

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