

DOL Finalizes Changes to Overtime Exemptions

By Jessica Summers

Take Away: *Effective December 1, 2016, the minimum salary that employees must be paid to qualify for the white collar or the highly compensated exemptions to the FLSA overtime requirements will increase substantially. While many employers will need to make significant adjustments in their workforce to adapt to these increases - the final rule will not be as disruptive as it could have been because DOL did not make any changes to the duties tests associated with these exemptions.*

On May 18, 2016, the Department of Labor (DOL) issued its highly anticipated final rule modifying the exemptions to the FLSA overtime rules for white collar employees (executive, administrative, professional and computing) and highly compensated employees. As we have previously reported, these changes have been in the works since March of 2014 when President Obama issued a Memorandum directing the DOL to “propose revisions to modernize and streamline the existing overtime regulations.”

The key changes embodied in the final rules are as follows:

- **On December 1, 2016, the salary threshold for the white collar exemption will increase 100.7% from the current \$455 per week (or \$23,660 annually) to \$913 per week (or \$47,476 annually).**

This increase is actually less than that which was originally proposed by the DOL. The DOL’s proposed rule would have calculated the new salary threshold based on the 40th percentile of weekly earnings nationally for full-time salaried workers as calculated by the Bureau of Labor Statistics (BLS) at the time the rule was finalized. The DOL estimated that this would be \$970 per week or \$50,440 per year. In response to the concerns raised in the comments to the proposed rules about regional differences, in its final rule the DOL instead calculated the new salary threshold based on the 40th percentile of weekly earnings for full-time salaried workers in the lowest paid Census Region (currently the South) as calculated by BLS. Thus, although the \$913 per week or \$47,476 figures were calculated based on the average salaries in the South, the thresholds will apply to the whole country.

- **On December 1, 2016, the salary threshold for the highly compensated will increase from \$100,000 annually to \$134,004 annually.**

This increase is consistent with the DOL’s original proposal. The \$134,004 figure represents the 90th percentile of weekly earnings nationally for full-time salaried workers as calculated by the BLS. In the final rule, the DOL decided not to make the same regional adjustment to the highly compensated calculation method as it did for the white collar exemptions. Thus, while the new white collar salary threshold was calculated based on the data from the Southern Census Region, the new highly compensated salary threshold was calculated based on national data. This distinction between how the two thresholds are calculated will also apply to future updates (discussed further below).

- **The salary thresholds for the white collar and highly compensated exemptions will be adjusted every three years, with the first change to occur on January 1, 2020.**

The new rule marks the first time that the regulations will have a system for automatically increasing the salary thresholds. Originally, the DOL proposed annual increases but, in light of the comments it received, it ultimately settled on increases every three years. The adjustments will be made based on the BLS data (the DOL asked for comments on whether the adjustments should be made based on the BLS data or the Consumer Price Index and settled on the BLS). Thus, starting on January 1, 2020, and occurring every three years thereafter, the salary thresholds for the white collar exemption will reset at the 40th percentile of weekly earnings for full-time salaried workers in the lowest paid Census Region and the salary for the highly compensated exemption will be set at the 90th percentile of weekly earnings for full-time salaried workers nationally.

- **Under the new rule, employers will be permitted to count non-discretionary bonuses and incentive compensation (including commission) towards up to 10% of the white collar salary threshold as long as the payments are made at least quarterly.**

Prior to the new rules, employers have never been permitted to include any types of bonuses or incentive compensation in calculating whether an employee's compensation meets the white collar salary threshold. The new rule now permits employers to satisfy up to 10% of the new white collar salary threshold through the at least quarterly payment of non-discretionary bonuses or incentive compensation. To account for the fact that an employer may not be able to calculate in advance what an employee's non-discretionary bonus or incentive compensation will be, the new rule also allows employers to make catch-up payments to bring employee's up to the salary threshold as long as the catch-up payments are made no later than the pay period after the end of the quarter. Thus, when the new rules go into effect an employer can pay an employee a base salary of at least 90% of the salary threshold (or \$821.70) and then make up the remaining 10% with non-discretionary bonuses and incentive compensation. If at the end of the 13 week quarter the employee's base salary plus his or her non-discretionary bonuses and incentive compensation are not at least \$11,869 (\$913 x 13 weeks) on the next payday after the end of the quarter the employer can pay the employee the difference between the employee's actual earnings and \$11,869 without the employee losing his or her exempt status.

Prior to the new rules, employers were permitted to include certain types of bonus and incentive payments for the purposes of the highly compensated salary threshold and the new rules do not make any changes to how bonuses and incentive compensation are treated for the purposes of the highly compensated exemption.

- **The new rule will make no changes to the duties tests for the white collar or highly compensated exemptions.**

In its proposed rules, the DOL did not suggest any specific changes to the duties tests but simply asked for comments on whether any changes should be made to the duties tests. Thus, it will be a relief for employers to know that the final rules make no changes to the duties tests for the white collar or highly compensated exemptions.

Therefore combining the preexisting rules with the new rules going forward:

- To be exempt under a white collar exemption, an employee's primary duties must be executive, administrative, professional, or computing (as defined by regulation) and the employee must be paid a salary of at least \$913 a week. Employees in computer-related positions can either be paid a salary of at least \$913 a week or on an hourly basis at a rate of no less than \$27.63 (unchanged by the final rule).

- To be exempt as a highly compensated employee, the employee must regularly and customarily perform one or more of the duties of an executive, administrative or professional employee (as defined by regulations) and the employee must earn at least \$134,004, which includes at least \$913 per week on a salary basis.

While there are bills pending in the House and Senate that would prevent these new rules from taking effect, they do not have sufficient support to override a certain presidential veto. Accordingly, employers should begin to take steps to prepare for the December 1, 2016 effective date.

Employer Considerations: Employers with employees who were previously exempt but who do not earn enough to meet the new salary thresholds will have to decide whether to reclassify these employees as non-exempt (in which case they will be eligible for overtime) or increase their compensation to meet the new thresholds.

From a financial standpoint, this will largely require an employee-by-employee assessment of the amount of overtime that that employee works versus the amount that the employee's salary would need to be increased to meet the new threshold. Employers can, of course, strictly limit the overtime that a newly non-exempt employee works in order to avoid increased payroll costs. However, this will need to be balanced with productivity concerns, particularly where the employee has traditionally worked significantly more than forty hours per week. For employers who do end up reclassifying employees as nonexempt, they will also have to start tracking hours in order to calculate when and how much overtime is due.

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