CLIENT ALERT

May 19, 2016

DOL Issues Final Rule More Than Doubling FLSA Minimum Salary Level Required for Overtime Exemptions

SPEED READ

- Based on a new rule issued by the Department of Labor, the minimum salary for most exemptions from the Fair Labor Standards Act's overtime pay requirement will increase from $23,660 per year to $47,476 per year.
- The duties tests, which must also be met to qualify for any exemption, will remain unchanged.
- Most employees who are currently classified as exempt and receive a salary of less than $47,476 per year will need either to be provided with a raise or to be reclassified to non-exempt status, which will entail maintaining time records and paying overtime.
- The new standard goes into effect on December 1, 2016.

Increase in Minimum Salary for Most Exemptions

On May 18, 2016, the Department of Labor (DOL) published its final rule concerning the minimum salary level necessary in most cases for an employer to qualify as exempt from overtime pay under the Fair Labor Standards Act (FLSA). In the absence of an exemption, the FLSA provides that an employee is entitled to receive pay at the rate of time and one-half for all hours worked over 40 in a week. Under the new rule, which goes into effect on December 1, 2016, the minimum salary level for potential application of most exemptions from overtime pay is $47,476 per year ($913 per week). This rate is based on the 40th percentile of pay for full-time salaried workers in the lowest wage Census region, which is currently the South.

By way of background, the most frequently relied upon exemptions from the FLSA's overtime pay standard are the "white collar exemptions," which apply to executive, administrative, professional, computer and outside sales employees, as those terms are defined in FLSA regulations at 29 C.F.R. Part 541. The regulations set forth standards for job duties to satisfy these exemptions and salary standards. The new rule will not affect the duties tests.

With the exception of outside sales employees and certain other limited categories of employees, all employees who meet one of the duties tests under the FLSA must also be paid at a minimum salary level to qualify as exempt. Currently, that minimum salary level is an annual rate of $23,660 ($455 per week). Under the new rule, that minimum threshold will more than double to the new rate of $47,476 ($913 per week) on December 1, 2016. That level will be automatically updated every three years, beginning on January 1, 2020, to equal the 40th percentile of full-time salaried workers' pay in the lowest-wage Census region at the time of the adjustment. The DOL will post the new minimum threshold salary on its website at least 150 days before each adjustment date.

Effect of Bonuses and Incentive Pay

The final rule also makes one change regarding what pay counts in determining if the minimum salary has been met. Currently, only regular salary payments count toward the $23,660 minimum salary. Under the new rule, up to 10% of the new minimum salary level may be satisfied by nondiscretionary bonuses and incentive payments, including commissions, provided that those amounts are paid on at least a quarterly basis. If an earned bonus or incentive payment is not high enough to satisfy the standard, the employer may make a catch-up payment to ensure that the employee does not fall below the minimum salary level. Thus, the minimum salary level for an employee who receives qualifying supplemental payments of at least $1,187 per quarter ($4,758 per year) will be $42,728 per year ($822 per week).

Increased Pay Level for Highly Compensated Employees

The final rule also increases the threshold pay level for being classified as a "highly compensated employee." That classification was introduced in 2004. For employees who meet the pay threshold for the highly compensated employee classification, the duties tests are relaxed, although not eliminated. The minimum annual pay level to qualify as a highly compensated employee will increase from $100,000 per year to $134,004 per year with adjustments. The highly compensated employee minimum salary threshold will be adjusted every three years to match the 90th percentile for full-time salaried employees nationwide, on the same schedule and with the same advance notice from the DOL as applies to the minimum salary.

As is currently the case, the total annual pay may continue to be satisfied by non-discretionary bonuses and commissions (with a catch-up payment if necessary) as well as salary. However, enough will need to be paid in salary to meet the new minimum salary standard of $47,476 per year (without the 10% adjustment discussed above).

Limits on the Effect of the New Rule

Previously existing exceptions to the general applicability of the minimum salary standard take on added importance with the establishment of the new minimum salary level. For example, academic administrative employees may satisfy the salary standard if their pay is at least equal to that of entering teachers in the educational establishment, even if that is below the new generally applicable minimum salary.

Other classifications of exempt employees are not subject to the salary standard. These include the following:

- Outside sales employees
- Teachers
- Doctors practicing medicine
- Lawyers practicing law
- Medical residents and medical interns
- Employees covered by the FLSA's Motor Carrier Act exemption
- Business owners with at least a bona fide 20% vested equity interest in their employer who are actively engaged in management of the employer

In addition, employers should be cognizant that state law may impose further restrictions. For example, California's minimum salary standard for exempt status is set at twice its minimum wage. Due to statutory annual increases, California's minimum salary level for exempt status will exceed the FLSA standard beginning January 1, 2019, with an annual rate of $49,920 ($960 per week).

Next Steps

The new DOL rule will require that some employees either receive salary increases to meet the new standards or be reclassified to non-exempt status. If employees are reclassified to non-exempt status, employers should consider whether to retain salaried status while paying overtime when required or to convert employees to hourly pay.

In those states where it is permissible to do so, employers may want to consider utilizing the "fluctuating workweek" method of payment to control overtime costs for salaried non-exempt employees. Use of this methodology can result in overtime costs of less than one-third the level that would apply to an hourly employee with the same base rate.

Regardless of whether employees who are reclassified as non-exempt remain salaried or are converted to hourly pay status, employers will need to consider what base rate to use, including whether to take expected overtime into account in setting the base rate.

To the extent that employers use bonuses or commissions to help satisfy the minimum salary threshold, they need to ensure that the bonus or commission plan meets the requirements under the new rule.

Employers will also need to ensure that they maintain proper time records for any reclassified employees (as well as all other non-exempt employees). In doing so, employers need to be careful to ensure that all time worked is counted, including off-hours work activities, such as responding to work-related emails.

Finally, employers may also consider steps to restrict overtime work to control overtime pay obligations.

For any questions on the DOL's new rule, please contact a member of Goodwin Procter's Labor & Employment Practice.

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