



WAYS TO PREPARE FOR THE  
NEW EXPANDED EMPLOYEE  
OVERTIME ELIGIBILITY

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The biggest regulatory change impacting U.S. employers in 2016 is the Department of Labor's (the DOL) new Federal Overtime Rule (New Rule). The New Rule, set to go into effect on December 1, 2016, will broaden the federal government's overtime pay regulations, resulting in overtime eligibility for an estimated 4.2 million additional workers across the country. With this massive change looming, many U.S. employers are wondering what steps they need to take in anticipation of December 1st.

### **Summary of the New Rule**

The New Rule will achieve this massive expansion of employee wages by updating the DOL's existing Fair Labor Standards Act (the FLSA) regulations. As a general rule, the FLSA requires U.S. employers to pay all employees an overtime premium (defined as 1 ½ the workers' "regular rate of pay") for all hours worked in excess of forty (40) per week. However, the FLSA provides employers with statutory "exemptions" to the overtime requirements, including so-called "white collar" exemptions.

To qualify for a "white collar" exemption, the employee must meet three "tests": (1) the employee must be paid a guaranteed, fixed salary; (2) the amount of the salary must meet a minimum specified amount; and (3) the employee's job duties must primarily involve "executive, administrative, or professional" duties (as defined by the regulations). Said another way, to avoid overtime eligibility, the employee must be both salaried and job-duty exempt.

Under the current regulations, the DOL requires an exempt employee to receive a guaranteed weekly salary of at least **\$455 per week (or \$23,660 annually)**.<sup>1</sup> Beginning December 1st, the New Rule raises the minimum salary level for exempt employees to **\$913 per week (or \$47,476 annually)**. The New Rule also increases the total annual compensation required to satisfy the "highly compensated employees" exemption to **\$134,004 annually** (previously set at \$100,000). Additionally, the New Rule establishes a mechanism for automatically updating the minimum salary level every **three (3) years**. Finally, the New Rule allows employers to use nondiscretionary bonuses and incentive payments to satisfy up to 10% of the new standard salary level.

### **How to Prepare for the New Rule**

The DOL estimates that the New Rule will cost private U.S. employers at least \$1.8 billion—in the first year of its

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<sup>1</sup> The DOL's salary requirements do not apply to outside sales employees, teachers, and employees practicing law or medicine. Additionally, exempt computer employees may be paid at least \$455 on a salary basis or on an hourly basis at a rate not less than \$27.63 an hour.

implementation alone. While analysts expect the retail industry, restaurants, non-profits and small businesses to be the hardest hit, the financial impact of the New Rule will be felt by employers of all shapes and sizes. When combined with the DOL's recent announcement of harsher penalties for non-compliance, employers are encouraged to begin evaluating and preparing for the potential impact of the New Rule within their specific organization.

### ***Determining How Workforce Will Be Affected***

The logical first step for employers is to determine if, and how, the New Rule will affect their organization. This analysis should be relatively straightforward. As a starting point, each organization should know how each of its employees are presently classified—that being, hourly/non-exempt, salaried/non-exempt, or salaried/exempt. (If your organization does not have this starting point accomplished, you should contact your labor and employment counsel immediately.) The New Rule will impact the "salaried/exempt" employees within an organization.

Next, for each of its salaried/exempt employees, the employer should determine which exempt employees will be impacted. For this, the employer will need to know each exempt employee's exact "salary" under the DOL/FLSA regulations. For most exempt employees, their salary is simply the guaranteed amount they receive on a weekly basis.<sup>2</sup> For each presently exempt employee earning a guaranteed salary of less than \$913 per week, additional analysis is required.

### **Adjusting Compensation of Affected Employees**

For all identified exempt employees earning less than \$913/week, employers must next determine the best option for each employee for after December 1st. Generally, employers have the following options:

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<sup>2</sup> The exempt employee must earn the minimum salary threshold "free and clear"—that is, "independent of any claimed credit for non-cash items of value that an employer may provide to an employee, such as board, lodging or other facilities."

- **Increase the employee's weekly salary.** Remember, the New Rule did not impact the job duties test of the exemption analysis. So, if an employee was exempt **before** December 1st, that employee will remain exempt **after** December 1st—so long as he/she earns a salary of at least \$47,476/year. The simplest way (from an effort standpoint) to accomplish this is to increase the employee's guaranteed salary to at least \$47,476 annually (or \$913 on a weekly basis).
- **Alternate compensation methods.** Under the current regulations, the DOL prohibits employers from including any alternate compensation methods to reach the minimum threshold. However, under the New Rule, the DOL allows employers to use certain nondiscretionary bonuses and incentive payments to satisfy up to 10% of the minimum threshold (for the first three years, up to \$91.30/week), subject to certain requirements. Under this scenario, an employer need only increase the weekly guaranteed salary to 90% of the threshold (for the first three years, up to \$821.70/week).
- **Reclassify employees/positions earning less than new threshold.** For many employers, increasing the guaranteed salary for some or all of its exempt employees presents too much of a financial burden—especially for small-to-midsized enterprises. If the employer simply cannot increase the employee's salary to \$47,476/year, beginning December 1st, that employee will become non-exempt (despite no change in job duties).

### Important Considerations for a Reclassified Workforce

After conducting the evaluation, if the organization elects to reclassify its previously exempt employees as non-exempt, there are several important considerations to be made:

- **Did the organization account for future overtime premiums?** Now that the affected employees have been reclassified as “non-exempt,” the company is required to pay them the required overtime premium (1 ½ times their “regular rate”) for all hours they work in excess of forty (40) in a workweek. For employees that routinely work in excess of 40 hours per week, this represents a potentially large financial exposure for employers. Organizations must consider this potential overtime “hit” when deciding whether to increase the employee's sala-

ry to the new minimum threshold—as this potential increase can often exceed the necessary salary jump.

- **Is salary still the best option?** To maintain exempt status, an employer must pay the employee on a salaried basis. However, if the company elects to reclassify the employee to non-exempt status, the employer can pay that employee on either an hourly or salaried basis—so long as it complies with the FLSA's minimum wage and overtime requirements.

An employee's overtime premium is calculated based on his/her “regular rate of pay.” For employees paid on an hourly basis, determining the “regular rate,” and overtime premium, are straightforward. When paying a non-exempt employee on a salaried basis however, the “regular rate” is determined by dividing the weekly salary by 40. From there, the employee is entitled to 1 ½ that amount for all hours worked over forty in a given week.

With this in mind, employers may be better served by adjusting reclassified employees to an hourly rate—or, at least adjusting their guaranteed salary to account for the overtime rate.

- **Does the company need to restructure the employee's job duties?** Employers are not required to pay overtime to exempt employees. As a result, many employers do not track exempt employees' hours, or pay attention to when/how exempt employees perform their jobs. However, exempt employees who are reclassified to non-exempt status are now eligible for overtime, and thus, must have all of their hours worked tracked and accounted.

The FLSA does not define the term “work.” However, the DOL takes a broad view of what qualifies as work done on behalf of an employer. This is especially treacherous in the modern workplace. Activities performed by an employee away from the jobsite—such as monitoring work email and conducting work telephone calls on a personal cellphone—can qualify as work performed by an employee. For non-exempt employees, time spent performing these duties may very well be compensable (even overtime compensable).