

New Department of Labor Overtime Rules Affect Compensation and Payroll Practices

On December 1st, 2016, new overtime rules published by the U.S. Department of Labor take effect. The new rules update key provisions of the regulations issued under the Fair Labor Standards Act (the “FLSA”). The new rules, prompted by a 2014 call to action from the White House, seek realignment of the rules in favor of now-exempt, overtime-ineligible workers having salaries on the lower end of the spectrum and working what would otherwise be significant overtime without having materially greater responsibilities than their colleagues who receive overtime pay.



The FLSA was enacted in 1938 to provide a minimum wage and augmented overtime pay for employees who work in excess of 40 hours per workweek. For all hours over 40 worked in one workweek, the FLSA requires employers to pay employees not less than one-and-one-half times the employee’s regular pay rate.

The FLSA has designated certain classes of employees as exempt from the overtime rules, such as executive, administrative and professional employees. This highly regulated and nuanced series of exemptions is known collectively as the “white collar” exemption. Work done by exempted employees is that which cannot easily be measured by the hour or completed by others if requiring more than 40 hours in a week; such work typically entails (depending on the applicable exemption’s language) managing the enterprise, directing the work of other full-time employees, performing office or non-manual work directly related to running or servicing the employer’s business or its customers and exercising discretion and independent judgment on significant matters or performing work requiring advanced knowledge in a field of science or learning.

In addition to such requirements related to primary job duties, qualifying an employee for a white collar exemption from overtime pay requires payment of a minimum salary – currently in the amount of at least \$455 per week. The U.S. Department of Labor places less importance on the primary job duties of employees who are highly compensated employees (“HCEs”) who, currently, earn no less than \$455 per week and at least \$100,000 annually, as this high level of compensation is treated as a strong indicator of exempt status.

The new rules make three critical changes:

1. The salary level for employees under the white collar exemption is increased from \$455 to \$913 per week immediately – an increase to \$47,476 annually – which represents an adjustment to the 40th earnings percentile for full-time salaried workers nationwide.
2. The annual salary level for HCEs under the white collar exemption is immediately increased to \$134,004, which represents an adjustment to the 90th earnings percentile for full-time salaried workers nationwide.
3. A mechanism is created for automatically updating the salary levels on a triannual basis to maintain fixed percentiles of weekly earnings at the 40th and 90th earnings percentile for employees tested against the white collar exemption and for HCEs, respectively.

The first increase above, to a figure more-than-double the previous amount, significantly expands the number of employees to whom augmented overtime pay may be due; the second increase may push HCE status out of range as a useful planning goalpost for small- to mid-sized businesses. Employers have multiple options for adjustments to the changing compensation requirements for employees working overtime, many of whom will no longer be exempt and covered by the white collar exemption. Options cited by the rule include:

1. Paying the overtime premium for the overtime hours worked;
2. Reducing the overtime hours worked by non-exempt employees;
3. Reducing the regular rate of pay (including benefits) so that the weekly compensation to the employee does not change based on the anticipated overtime hours;
4. Increasing salaries to the new exemption salary level; or
5. Creating a solution out of a combination of the above options.

The decision to use one or more of the above options must be made with great care, as each of the above options provide legal and administrative hurdles. For example, reducing the regular rate of pay or benefits for employees is a difficult process as there are many federal and state restrictions on minimum wage and minimum benefits that employers must provide to employees. Likewise, reducing the overtime hours worked by non-exempt employees

may require more employees to be hired – which could cause rapid growth in small businesses to the point of mandating compliance with federal labor regulations, such as the Family Medical Leave Act.

In addition to the changes in federal overtime rules, employers should also consider state overtime rules. Some states, such as Florida and New York, follow the overtime rules set by the FLSA and regulations issued by the U.S. Department of Labor, whereas other states require compliance with state overtime laws separate from, or in addition to, the FLSA. For example, Massachusetts grants exemptions from state overtime pay requirements only to the classes of employees and employers explicitly listed as exempt under Massachusetts law; though the exemptions under Massachusetts law are not contingent on compliance with federal law, employers subject to FLSA should comply with both federal and state rules. On the other hand, Rhode Island overtime rules limit the classes of employees and employers that are exempt from state overtime pay requirements to those explicitly listed under Section 28-12-4.3(a) of the Rhode Island General Laws, in addition to requiring compliance with federal wage and overtime laws.

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