

# New Rules to Make Millions Eligible for Overtime: What Employers Need to Know

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On May 18, 2016, the Department of Labor (“DOL”) announced its long-awaited final overtime rules. In sum, the new rules drastically increase the salary threshold to qualify as overtime exempt to \$47,476, which is more than double the previous threshold of \$23,660. This amount will be automatically updated every three years based on wage growth over time. The new rules, which are expected to affect millions of employees, become effective on December 1, 2016. This article discusses the background and substance of the new rules, as well as implications and options/strategies for employers to ensure compliance by the effective date.

## Background and Substance of the New Rules

The Fair Labor Standards Act (FLSA)—which is a Great Depression-era law first enacted in 1938 and amended several times since then—provides for a federal minimum wage, a standard 40-hour work week, and pay at time-and-one-half for all overtime hours, among other requirements. However, the FLSA also provides for several exemptions from its provisions for certain classes of workers, most commonly referred to as “white collar workers.” These include (1) executive (e.g., managers, supervisors, etc.); (2) administrative (HR professionals, insurance claims representatives, and other employees exercising substantial discretion as to important matters); and (3) professional (e.g., doctors, accountants, and other learned professionals with advanced degrees). Employees falling within these categories are not entitled to premium pay for overtime work, so long as they earn above a compensation threshold.

Today, for the first time since 2004, the DOL significantly increased the compensation threshold for “white collar workers” at the Obama Administration’s direction. Specifically, the DOL increased the compensation threshold from \$23,360 per year to \$47,476 per year. This more than doubles the qualifying amount. Note: in determining whether an employee meets this threshold, employers may not count medical, disability, or life insurance; fringe benefits; retirement benefit contributions; and other things of the like. Employers may, however, count an employee’s bonuses and commissions up to 10% of the threshold, so long as these payments are made on at least a quarterly basis.

Importantly, and for the first time, the DOL will also automatically update the compensation threshold on a regular basis. Specifically, the threshold will be updated every three years to ensure it stays at the 40th percentile of full-time salaries in the lowest income census region of the country. Preliminary estimates suggest that the threshold could increase to \$51,168 in 2020.

Additionally, the DOL increased the level at which workers qualify for the “highly-compensated employee” exemption from minimum wage and overtime requirements from \$100,000 per year to \$134,004 per year. This threshold will too be updated every three years to ensure it stays at the 90th percentile of full-time salaries nationwide. The DOL anticipates this threshold may rise to \$147,524 in 2020.

For both “white collar” and “highly-compensated employee” exemptions, the DOL will post new salary levels 150 days in advance of their effective date, beginning August 1, 2019.

To summarize in a nutshell, depending on the salary amounts currently paid to exempt employees, employers may have to pay substantially more than is currently required under the FLSA to qualify for an overtime exemption.

**Important note: Although the DOL raised the minimum salary level, it is not changing the duty requirements for exempt employees.** As a brief overview, and for context, the following are the criteria to meet each aforementioned exemption under both the previous and new regulations.

- To qualify for the **executive exemption**, the employee must meet three requirements: (1) the primary duty must be management; (2) the employee must customarily and regularly direct the work of two or more employees; and (3) the employee's recommendations about hiring, firing, etc., of these workers must be given "particular weight."
- For **administrative employees**, the primary duty must (1) be performing office or non-manual work directly related to the management or general business operations of the employer or its customers; and (2) include the exercise of discretion and independent judgment of significant matters.
- In general, an exempt **professional employee** must primarily do work (1) requiring advanced knowledge in a field of science or of other high-level learning; or (2) in a recognized field of artistic endeavor.
- To qualify as a **highly compensated employee exemption**, an employee must customarily and regularly perform one or more exempt duties of an executive, administrative, or professional nature.

## Impact on Employers

The DOL estimates that 4.2 million employees will be newly eligible for benefits. Management-side groups predict between 5 and 6 million employees, or even more, will be affected overall. The DOL also acknowledges that there will be considerable costs to employers, although perhaps it underestimates that total at approximately \$677.9 million in the first year. These estimated direct costs include regulatory familiarizations costs, adjustment costs, and managerial costs. Of course, the new rules will also transfer income from employers to employees in the form of higher earnings: The DOL estimates this total at \$1.2 billion per year, and \$12 billion over the next decade.

The new rules are far-reaching: the DOL estimates that most of the affected employees (98%) will become eligible for overtime when they work more than 40 hours (i.e., they will be converted to overtime-eligible status), while others (2%) will receive a raise so that their salaries exceed the new threshold.

The employers that will likely be most impacted by the changes are small businesses with a high number of hourly employees; nonprofits; as well as the retail, restaurant, and manufacturing industries. Indeed, the National Retail Federation estimates that the new rules will impact 2.2 million retail and restaurant employees, which represents 64% of the salaried employees in the industry. Importantly, however, the proposed rules likely affect only employees who work (or will work) more than 40 hours per week.

The DOL released this map estimating the number of workers in each state that will be affected by the new rules:

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## Options and Strategies for Employers to Ensure Compliance

Because the rules become effective on December 1, 2016, it is best practice for employers to immediately review employees who are impacted and develop a compliance strategy for when the new rules become effective. The following are a few options. Which is best will vary by individual business and employee.

- **Option A: Raise Salaries to the Exemption Thresholds.** One option is for employers to raise the salaries of affected employees to meet the new minimum provided for under the rules. This may be the easiest route where currently exempt employees are close to the new salary levels, and if employers can afford it. This would mean that an employer must every three years determine if any exempt employees will fall below the new minimum, which, again, will change every three years.

- **Option B: Re-Classify Affected Employees and Do Not Limit Overtime.** Another option is for employers to re-classify affected employees as non-exempt employees and reverse engineer a straight-time rate that—with typical overtime worked—will equal the affected employee's pre-new rules salary. This may help preserve a company's budget. Choosing this option will likely make the most sense for employees who make far less than the proposed new salary basis, as it is likely preferable to more or less doubling these employees' salaries.
- **Option C: Limit Overtime and Hire More Part-Time Employees.** A third solution is to split job duties between multiple employees who do not work overtime. For example, if one manager is working 60 hours per week, an employer may choose to hire another manager to split the duties between the two at 30 hours per week each.

In determining which option is best, we recommend the following steps: (1) identify the affected employees; (2) closely analyze these employees' hours worked; and (3) perform a cost-benefit analysis to determine which option above makes the most business sense.

It may also be important to consider messaging—i.e., the best way to communicate these changes to employees—to manage employee morale and set expectations. Some employees may be discouraged by the perceived loss in status that accompanies a change from a salaried to an hourly position and consider it a demotion. We recommend that employers focus on the fact that any change should not result in a pay decrease. Rather, the employer is making a concerted effort to maintain pay at approximately the same level (or even slightly increase it). The employer may also wish to note that an employee's new payment structure may take some adjustment during the first few pay periods to ensure that (1) the hourly wage being paid, and (2) the amount of overtime being worked, matches his or her previous salary.

By implementing comprehensive compliance strategies in the short term, employers will be well prepared for the new overtime rules come December 1, 2016.