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Department of Labor Doubles Salary Basis Test for Overtime Exemption

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In 2014, President Obama signed a Presidential Memorandum directing the Department of Labor (DOL) to update the regulations defining which workers are protected by the Fair Labor Standard Act's (FSLA) minimum wage and overtime standards. The DOL had last updated the FLSA's overtime regulations in 2004. The 2004 update set the minimum level for those employees who were *not* entitled to overtime so long as they performed qualifying job duties at $455 per week.

On May 18, 2016, the DOL responded to the Presidential Memorandum by issuing a Final Rule, which set the new standard salary level equal to the 40th percentile of weekly earnings for full-time salaried workers in the lowest-wage Census Region, currently the South. In other words, the Final Rule increases the standard salary level from $455 per week ($23,660 for a full-year worker) to $913 per week ($47,476 for a full-year worker). With limited exception, workers must now earn more than double the prior salary basis standard in order to qualify as exempt from the federal overtime regulations. Employers in retail/hospitality, health care services, professional and technical services, finance and insurance industries are likely to be particularly hard hit. It is estimated that 4.2 million currently exempt workers who earn at least the 2004 salary level of $455 but less than the new salary level of $913 per week will, unless their employers take action, lose their exempt status. The Final Rule takes effect on December 1, 2016.

The DOL did not make any changes to the job duties test, which also must be satisfied in order to establish an employee's exempt status. It did, however, also change the "highly compensated employee" standard. Under the Final Rule, the minimum annual compensation level will be $134,000 annually, which is the annualized value of the 90th percentile of earnings for full-time salaried workers nationally. The current standard for this exemption is $100,000 in annual compensation.

Moreover, in order to prevent the salary level requirements from becoming outdated, the Final Rule automatically updates the salary and compensation levels every three years to maintain them at the percentile levels adopted by the regulations. The first such update is scheduled to take place on January 1, 2020 and then every three years thereafter.

In addition, for the first time, employers will be able to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the weekly standard salary level, provided these payments are made on a quarterly or more frequent basis. The Final Rule also allows employers to make a "catch-up" payment at the end of each quarter.

The increases to the minimum salary thresholds do not go into effect until December 1, 2016. Nevertheless, employers should determine whether and how to respond now. For each employee who currently earns less than $913 per week, employers will need to consider whether to (i) provide a raise to an employee who meets the duties test to at least the new salary level in order to retain his or her exempt status, (ii) pay overtime for any overtime hours worked (because the employee will go from exempt to nonexempt status), (iii) reduce or eliminate overtime hours and, potentially, hire additional hourly workers, (iv) reduce an employee's weekly base salary, but add pay to account for overtime for hours worked so as to structure a steady, weekly pay amount for the employee, or (v) some other approach encompassing these issues.

The particular circumstances of each employee or group of employees likely will impact how employers respond to this Final Rule. Moreover, not every business is subject to the overtime provisions of the FLSA, and state law also can affect the application of the overtime laws. We encourage you to contact a member of the Firm's Labor & Employment Group or your usual Goulston & Storrs attorney for more information on this subject.

This advisory should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult your own lawyer concerning your situation and any specific legal questions you may have.