Anchin Alert

Anchin, Block & Anchin LLP
Accountants and Advisors

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DOL's final overtime rule brings sweeping changes

The U.S. Department of Labor (DOL) has released a final provision that makes dramatic changes to the determination of which executive, administrative and professional employees — otherwise known as "white-collar workers" — are entitled to overtime pay under the Fair Labor Standards Act (FLSA). The rule will make it more difficult for employers to classify employees as exempt from overtime requirements. In fact, the DOL estimates that over four million salaried workers will become eligible for overtime when they work more than 40 hours in a week.

The changes will have a tax impact as well: Employers' payroll tax cost will increase as they pay overtime to more employees who work in excess of 40 hours a week or pay higher salaries to maintain overtime exemptions.

Current requirements for white-collar exemptions

To qualify for a white-collar exemption from the overtime requirements under current federal law, an employee generally must satisfy three tests:

1. ***Salary basis test.*** The employee is salaried, meaning he or she is paid a predetermined and fixed salary that's not subject to reduction because of variations in the quality or quantity of work performed.
2. ***Salary level test.*** The employee is paid at least $455 per week or $23,660 annually.
3. ***Duties test.*** The employee primarily performs executive, administrative or professional duties.

Neither job title nor salary alone can justify an exemption — the employee's specific job duties and earnings must also meet applicable requirements.

Certain employees (for example, generally doctors, teachers and lawyers) aren't subject to either the salary basis or salary level tests. The current regulations also provide a relaxed duties test for certain highly compensated employees (HCEs) who are paid total annual compensation of at least $100,000 and at least $455 per week.

Significant changes under the final rule

The current rules hadn't been revised since 2004, prompting President Obama to call for an update. The DOL issued a proposed rule in July 2015 and received more than 270,000 comments in response.

The revisions in the final rule, which take effect December 1, 2016, mainly relate to the salary level test. The rule increases the salary threshold for exempt employees to the 40th percentile of weekly earnings for full-time salaried workers in the lowest-wage Census region (currently the South) — $913 per week or $47,476 per year.

In response to what the DOL described as “robust comments” from the business community, the final rule allows up to 10% of the salary threshold for non-HCE employees to be met by nondiscretionary bonuses, incentive pay and commissions, as long as these payments are made on at least a quarterly basis. Thus, an employee’s production or performance bonuses could push him or her over the threshold and into exempt status (assuming the other tests are satisfied).

The rule also updates the HCE threshold above which the relaxed duties test applies. It raises the level to the 90th percentile of full-time salaried workers nationally, or $134,004 per year.

The final rule continues the requirement that HCEs receive at least the full standard salary amount — or $913 — per week on a salary or fee basis without regard to the payment of nondiscretionary bonuses and incentive payments. Such payments will, however, count toward the total annual compensation requirement.

The standard salary and HCE annual compensation levels will automatically update every three years to maintain the levels at the prescribed percentiles, beginning January 1, 2020. The DOL will post new salary levels 150 days before their effective date.

The duties test

The final rule makes no changes to the duties test. In the proposed rule, the DOL had sought comments regarding the effectiveness of the test at screening out workers who aren’t bona fide white-collar workers.

But it determined that the new standard salary level and automatic updating will work with the duties test to distinguish between overtime-eligible workers and those who may be exempt. Moreover, as a result of the revised salary level, employers won’t need to consider the duties test as often — if a worker’s pay doesn’t satisfy the salary level test for exemption, the employer needn’t bother assessing the worker’s duties.

Compliance options

According to the DOL, employers have a range of options when it comes to complying with the changes to the salary level (although it doesn’t require or recommend any method). Options include:

Doing nothing. You might choose to do nothing if your white-collar workers fall short of the new salary level but don’t ever work more than 40 hours per workweek.

Raising salaries. You may want to raise the salaries of employees who meet the duties test, have salary near the new salary level and regularly work overtime. Paying them at or above the salary threshold will maintain their exempt status.

Paying overtime above a salary. You could continue to pay employees a salary covering a fixed number of hours, which could include hours above 40. For example, you might:

- Pay employees a salary for the first 40 hours of work per week and overtime for any hours over 40.
- Pay a straight-time salary for more than 40 hours in a week for employees who regularly work more than 40 hours, and pay overtime in addition to the salary. You will only be required to pay an additional half-time overtime premium for overtime hours already included within the salary, plus time and a half for hours beyond those included.
- Agree with the employee on a fixed salary for a workweek of more than 40 hours, with the salary including overtime compensation under certain conditions. Employees must always be paid based on the hours actually worked during the workweek, though, so salary adjustments may be necessary at times. This will likely work best for employees who consistently work the same amount of overtime every week.
- For employees with fluctuating hours, pay a fixed salary covering a fluctuating number of hours at straight time if certain conditions are met.

And, of course, you might reorganize workload distributions or adjust employee schedules to redistribute work hours in excess of 40 across current staff. You could also hire additional employees to reduce or eliminate overtime hours worked by your current staff.

The big picture

As noted, the cost of the new overtime rules is more than just the increased compensation; it also includes additional payroll tax cost on that compensation, as well as administrative costs to comply. We can help you comply with the new DOL overtime rule and determine the overall impact on your bottom line.

For more information, contact your Anchin relationship partner at 212.840.3456.

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