Insights: Alerts

DOL Releases Final Changes to White-Collar Exemption Rule That May Cause Millions of Employees to Become Eligible for Overtime Pay

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After nearly a year of anticipation, the U.S. Department of Labor ("DOL") announced on Wednesday, May 18, 2016, the publication of its final rule instituting changes to the so-called "white collar" exemptions to the Fair Labor Standards Act ("FLSA"), which are set to take effect December 1, 2016. Under the white-collar exemptions, an employee may qualify as an executive, administrative, professional, or computer professional employee exempt from the FLSA's minimum wage and overtime provisions if the employee meets certain duties requirements or "duties tests" and a minimum salary threshold. Before the new rule, the minimum salary requirement was $23,600 annually, or $455 per week. In July 2015, the DOL issued a proposal to update the regulations that would have significantly increased the minimum salary requirement for the first time since 2004. The final changes announced Wednesday more than double the minimum salary requirement to $47,476 annually, or $913 per week.

The New White-Collar Exemption Rule

The new minimum salary threshold is linked to the salary level at the 40th percentile of earnings of full-time salaried workers in the lowest-wage U.S. Census Region (the South Region). The minimum salary included in the final rule is actually less than the proposed increase to $50,440 annually, reflecting a decrease in the South Region salary levels since the proposed rule was issued. The final rule does offer employers some relief from this large minimum salary increase by allowing employers for the first time to use nondiscretionary bonuses and incentive payments, including commissions, to count as up to 10% of the minimum salary threshold; however, the incentive compensation must be paid at least quarterly to be eligible. Employers may also continue to pay employees who qualify under the computer professional exemption at an hourly rate of at least $27.63 in lieu of a salary.

The final rule also increases the minimum compensation necessary to qualify for the highly compensated employee exemption. As with the other white-collar exemptions, a highly compensated employee must satisfy a duties test and meet a minimum compensation threshold, which was previously set at $100,000 annually, to be considered exempt from the FLSA's minimum wage and overtime requirements. The new rule raises the minimum compensation threshold to $134,004 annually, which is tied to the salary of the 90th percentile of full-time salaried workers nationally. While a majority of a highly compensated employee's annual compensation may come in the form of nondiscretionary bonuses or commissions, such employees must still satisfy the new $913 per week minimum salary requirement, and employers may not use nondiscretionary incentive compensation to reach that salary level.

The minimum salary, whether tied to the 40th or 90th percentile, will automatically update every three years beginning on January 1, 2020, based on the then current level of the applicable percentile. The new rates will be posted in the Federal Register at least 150 days before their effective date.

Practical Implications for Employers

The DOL estimates that roughly 4.2 million employees who are currently classified as exempt will no longer qualify without some further action by their employers. Those who fail to take action may face claims of unpaid wages or overtime compensation from employees. As a result, it is imperative that employers act before December 1 to ensure that employees are properly classified under the FLSA. Employers have various options to consider; for example:

- Increase the pay of all exempt employees above the minimum pay threshold;
- Reclassify as non-exempt all employees who fall below the minimum salary requirement and pay them at least the minimum wage and overtime compensation;
- Increase the pay of some class or segment of employees who fall below the minimum pay threshold and reclassify the remaining employees as non-exempt;
- Restructure the workforce using some combination of full-time, part-time, and outsourced or contract labor.

Each of these options carries its own complications. Raising salaries increases overhead and may decrease resources for investment in other areas. Reclassifying workers as non-exempt may require training or retraining employees on proper time-keeping practices and could harm employee morale if employees view the change as a demotion or loss of prestige. For employers who choose to parse between employees, it is important to be mindful that treating similarly situated employees differently can be the basis for a discrimination or retaliation claim, so any employment decisions must be based on legitimate, nondiscriminatory or nonretaliatory criteria. And relying on contract labor can invite issues with the Department of Labor and IRS, which may take the position that the workers should be classified as employees.

Employers should look to the needs of their particular businesses and the feasibility and legality of any given change before beginning to restructure their workforces. The time to start considering changes, and making decisions, is now.

If you have any questions about these issues, please contact the author(s) of this Legal Alert or your existing firm contact.

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