

The New Overtime Rules: DOL Compliance Guide to the 2019 Fair Labor Standards Act Changes



In September 2019, the U.S. Department of Labor issued long-awaited final regulations that redefined which American workers are eligible for overtime pay. The changes, the DOL says, will make 1.3 million U.S. workers eligible for overtime for the first time. They are scheduled to take effect on Jan. 1, 2020.

The final rule updates the earnings threshold (from \$23,660 to \$35,568) that is necessary to exempt executive, administrative, or professional employees from the Fair Labor Standards Act's minimum wage and overtime pay requirements. Plus, it allows employers to count a portion of certain bonuses (and commissions) towards meeting the salary level.

This publication is a summary of the Department of Labor's guidance on those changes, *Small Entity Compliance Guide to the Fair Labor Standards Act Exemptions*.

MINIMUM WAGE AND OVERTIME: THE BASICS

The Fair Labor Standards Act (FLSA) is the federal labor law that provides basic workplace protections to most workers in the United States, and guarantees them at least the federal minimum wage for every hour they work, and overtime, at one and-one-half times their regular rates of pay, for hours they work beyond 40 in a workweek. The FLSA is enforced by the U.S. Department of Labor's Wage and Hour Division.

The FLSA does not provide an exemption from these requirements specifically for small businesses. Generally, the FLSA applies to employees of enterprises that have an annual gross volume of sales made or business done totaling \$500,000 or more, and to employees individually covered by the law because they are engaged in interstate commerce or in the production of goods for commerce.

The FLSA creates a level playing field for businesses nationwide by setting a floor on wages and a premium for excess work. Individual cities and states, however, may have stronger wage and hour protections than the minimum federal standards established under the FLSA. If a state or city establishes a more protective standard than the provisions of the FLSA, the higher standard applies in that state or city.

EXCEPTIONS TO THE RULE: WHO IS EXEMPT?

While the FLSA applies to the majority of employees in the United States, it does allow employers to claim exemptions from its requirements for certain employees whose jobs meet specific criteria.

Section 13(a)(1) of the FLSA provides an exemption from both minimum wage and overtime requirements for employees employed as bona fide executive, administrative, professional, and outside sales employees. It also exempts certain employees in computer-related occupations. These exemptions are defined in the Department's regulations located at 29 CFR Part 541 (the "Part 541 exemptions").

To qualify for one of these exemptions, employees generally must meet certain tests regarding their job duties and be paid a certain minimum salary. Job titles alone do not determine exempt status, and neither does the receipt of a particular salary. In order for an exemption to apply, an employee's specific job duties and earnings must meet all of the applicable requirements. It is important to note that simply paying an employee a salary does not relieve an employer of minimum wage and overtime obligations to that employee. Unless they meet the criteria of a specific exemption, employees covered by FLSA protections who are paid a salary are still due overtime if they work more than 40 hours in a week.

This guide provides an overview of each of the Part 541 exemptions, and describes the basic tests and requirements to qualify for each. The specific salary levels listed below apply beginning on **January 1, 2020**, which is the effective date of the revised regulations implementing the exemptions.

CLAIMING AN EXEMPTION: THE THREE BASIC TESTS

For an employer to claim an exemption for a particular employee, three tests generally need to be satisfied:

- 1) PAYMENT ON A SALARY BASIS:** The employee must be paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed;
- 2) PAYMENT OF A MINIMUM SALARY LEVEL:** The amount of salary paid must meet a specified minimum amount; and
- 3) A DUTIES TEST:** The employee's job duties must primarily involve those associated with exempt executive, administrative, professional, outside sales, or computer employees.

Basic Requirements for FLSA Exemption

| Exemption | Salary Level Test | Salary Basis Test ¹ | Duties Test |
|------------------------------|--|---|---|
| Executive | <ul style="list-style-type: none"> At least \$684 / week (\$35,568 / year) | <ul style="list-style-type: none"> At least 90% of the salary level (\$616 / week) must be paid on a "salary" basis Up to 10% (\$68 / week) may be satisfied with nondiscretionary bonuses or incentive payments | <ul style="list-style-type: none"> The employee's "primary duty" must be that of an exempt executive employee, as described in the "Duties Tests" section of this guide |
| Administrative | <ul style="list-style-type: none"> At least \$684 / week (\$35,568 / year) "Academic administrative personnel" may qualify with a salary at least equal to the entry salary for teachers at their educational establishment. | <ul style="list-style-type: none"> At least 90% of the salary level (\$616 / week) must be paid on a "salary" <u>or</u> "fee" basis Up to 10% of the salary level (\$68 / week) may be satisfied with nondiscretionary bonuses or incentive payments | <ul style="list-style-type: none"> The employee's "primary duty" must be that of an exempt administrative employee, as described in the "Duties Tests" section of this guide |
| Professional | <ul style="list-style-type: none"> At least \$684 / week (\$35,568 / year); Salary level test does <u>not</u> apply to doctors, lawyers, or teachers | <ul style="list-style-type: none"> At least 90% of the salary level (\$616 / week) must be paid on a "salary" <u>or</u> "fee" basis Up to 10% of the salary level (\$68 / week) may be satisfied with nondiscretionary bonuses or incentive payments These requirements do <u>not</u> apply for doctors, lawyers, and teachers | <ul style="list-style-type: none"> The employee's "primary duty" must be that of an exempt professional employee, as described in the "Duties Tests" section of this guide |
| Outside Sales | <ul style="list-style-type: none"> Does not apply | <ul style="list-style-type: none"> Does not apply | <ul style="list-style-type: none"> The employee's "primary duty" must be that of an exempt outside sales employee, as described in |
| | | | the "Duties Tests" section of this guide |
| Computer | <ul style="list-style-type: none"> At least \$684 / week (\$35,568 / year), <u>or</u> at least \$27.63 / hour | <ul style="list-style-type: none"> At least 90% of the salary level (\$616 / week) must be paid on a "salary" <u>or</u> "fee" basis unless the employee is paid on an hourly basis and receives at least \$27.63 / hour. Up to 10% of the salary level (\$68 / week) may be satisfied with nondiscretionary bonuses or incentive payments | <ul style="list-style-type: none"> The employee's "primary duty" must be that of an exempt computer employee, as described in the "Duties Tests" section of this guide |
| Highly compensated employees | <ul style="list-style-type: none"> \$107,432 per year in total compensation, including payment of at least \$684 / week | <ul style="list-style-type: none"> 100% of the standard salary level (\$684 / week) must be paid on a "salary" or "fee" basis The remainder of the total annual compensation requirement may be paid in nondiscretionary bonuses or incentive payments (including commissions) | <ul style="list-style-type: none"> The employee's "primary duty" must be office or non-manual work Must "customarily and regularly" perform any one or more of the exempt duties or responsibilities of an executive, administrative or professional employee, as described in the "Duties Tests" section of this guide |

THE SALARY BASIS TEST

Generally, for an employer to claim a Part 541 exemption from minimum wage and overtime requirements for an employee, that employee must be paid on a salary basis.

Being paid on a “salary basis” means an employee regularly receives a predetermined amount of money each pay period on a weekly, or less frequent, basis. The predetermined amount cannot be reduced because of variations in the quality or quantity of the employee’s work. Generally, an exempt employee must receive at least the required weekly salary amount (discussed in more detail below under “the salary level test”) for any week in which the employee performs any work, regardless of the number of days or hours worked. Exempt employees do not need to be paid for any workweek in which they perform no work.

Deductions from pay are permissible only:

- when an exempt employee is absent from work for one or more full days for personal reasons other than sickness or disability;
- when an exempt employee is absent from work for absences of one or more full days due to sickness or disability if the deduction is made in accordance with a bona fide plan, policy, or practice of providing paid sick leave;
- to offset amounts employees receive as jury or witness fees, or for military pay;
- for penalties imposed in good faith for infractions of safety rules of major significance; or for unpaid disciplinary suspensions of one or more full days imposed in good faith for workplace conduct rule infractions.

An employer is not required to pay the full salary in the initial or final week of employment, or for weeks in which an exempt employee takes unpaid leave under the Family and Medical Leave Act. If the employer makes improper deductions from an employee’s predetermined salary, that employee is not paid on a “salary basis.” If the employee is ready, willing and able to work, deductions may not be made for time when work is not available.

The salary basis test does not apply to outside sales employees, teachers, and employees practicing law or medicine.

“Fee Basis”

Administrative, professional, and computer employees may be paid on a “fee basis” rather than on a salary basis. If the employee is paid an agreed sum for a single job, regardless of the time required for its completion, the employee will be considered to be paid on a “fee basis.” A fee payment is generally paid for a unique job, rather than for a series of jobs repeated a number of times and for which identical payments repeatedly are made. To determine whether the fee payment meets the minimum salary level requirement, the test is to consider the time worked on the job and determine whether the payment is at a rate that would amount to at least \$684 per week if the employee worked 40 hours. For example, an artist paid \$500 for a picture that took 20 hours to complete meets the minimum salary requirement since the rate would result in \$1,000 if 40 hours were worked.

THE SALARY LEVEL TEST

(as of Jan. 1, 2020)

Standard salary level

Generally (as of Jan. 1, 2020) an employee must be paid at least \$684 per week to qualify for one of the Part 541 exemptions. Exempt computer employees may be paid at least \$684 per week, *or* on an hourly basis of at least \$27.63 an hour.

The salary level test does not apply to outside sales employees, teachers, and employees practicing law or medicine. Academic administrative employees may qualify for exemption either by satisfying the standard salary level test or, alternatively, being paid on a salary basis at a rate at least equal to the entrance salary for teachers in the educational establishment by which the employee is employed.

Special salary levels

The regulations provide for special salary levels for certain U.S. territories and an updated base rate for employees in the motion picture producing industry. A special salary level of \$455 per week applies to Puerto Rico, the U.S. Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands. A special salary level of \$380 per week applies to American Samoa.

The regulations also establish a special “base rate” threshold for employees in the motion picture producing industry. The base rate is \$1,043 per week, or a prorated amount based on the number of days worked.

Annual compensation requirement for highly compensated employees

Employees who receive total annual compensation of at least \$107,432, referred to as “highly compensated employees” (HCEs), are exempt from the minimum wage and overtime requirements of the FLSA if they meet a more relaxed duties test than is required for employees paid the standard or special salary levels (the HCEs duties test is discussed below in the “Duties Tests” section of this guide). Nondiscretionary bonuses and incentive payments (including commissions) may be counted toward the \$107,432 HCEs total annual compensation requirement, but the employer must pay at least the full standard salary level of \$684 per week on a salary or fee basis to qualify for this exemption. If an employee’s total compensation in a given annual period fails to meet the \$107,432 threshold, an employer may make a “catch-up” payment within one month of the end of the annual period. Any such catch-up payment counts only toward the prior year’s total annual compensation. If such a catch-up payment is not made within the timeframe allotted, the exemption is lost and overtime premium pay must be paid in any week the employee worked more than 40 hours.

Nondiscretionary bonuses and incentive payments

Employers may use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the standard or special salary levels. Thus, for the standard salary level, employers may use such payments to satisfy up to \$68 of the \$684 per week threshold, but must still pay at least \$616 per week on a salary basis.

For employers to credit these payments toward the salary level test, they must be paid on an annual or more frequent basis. The employer may use any 52-week period, such as a calendar year, a fiscal year, or an anniversary of the hire year.

If, by the end of the 52-week period, the sum of the salary paid plus the nondiscretionary bonuses and incentive payments (including commissions) paid does not equal the required salary level for the 52-week period (\$35,568 for the standard salary level for a full-year worker), the employer may make a “catch-up” payment to achieve the required level within one pay period of the end of the 52-week period.

Any such “catch-up” payment counts only toward the prior year’s salary, not toward the salary amount during the 52-week period in which it was paid. If such a catch-up payment is not made within the timeframe allotted, the exemption is lost and overtime premium pay must be paid in any week the employee worked more than 40 hours.

Nondiscretionary bonuses and incentive payments (including commissions) are forms of compensation promised to employees to induce them to work more efficiently or to remain with the company. Examples may include individual or group production bonuses, and bonuses for quality and accuracy of work. Incentive payments, including commissions, are also considered non-discretionary as such payments are generally based on a prior contract or understanding, and employees generally have a contract right to the commission promised.

By contrast, discretionary bonuses are generally paid without prior contract, promise, or announcement, and the decision to provide the bonus and the payment amount is at the employer’s sole discretion. An example would be an “on-the-spot” award made without announcement and at the employer’s sole discretion (*e.g.*, an unannounced year-end bonus). Discretionary bonuses cannot be used to satisfy any part of the salary level requirement.

As noted above, employees who are exempt under the HCEs test must receive at least the standard salary amount (\$684 per week) on a salary or fee basis. The HCEs test does not permit any portion of this amount to be satisfied by nondiscretionary bonuses or incentive payments. Thus, HCEs must receive the full standard salary amount each week on a salary or fee basis.

THE DUTIES TESTS

To qualify for any of the Part 541 exemptions, employees must meet certain tests regarding their job duties. The regulations establish separate duties requirements for executive, administrative, professional, outside sales, and computer employees, respectively.

Most employees who are exempt under the white collar exemptions are subject to the standard duties test. Under the standard duties test, an employee's primary duty must be that of an exempt executive, administrative, or professional employee. "Primary duty" means the principal, main, major, or most important duty that the employee performs. Determination of an employee's primary duty must be based on all the facts in a particular case, with the major emphasis on the character of the employee's job as a whole.

Certain employees can also qualify for exemption under the special test for HCEs. As discussed above, this test applies only to employees who receive total annual compensation of \$107,432, including at least \$684 per week on a salary or fee basis. Under the HCEs duties test, the employee's primary duty must still consist of office or non-manual work, but the employee need only "customarily and regularly" perform one of the exempt duties of a bona fide executive, administrative, or professional employee, as described in the regulations.

The duties requirements for each of the exemptions are described below in greater detail.

Executive exemption

To qualify for the executive employee exemption under the standard test, all of the following job duties requirements must be satisfied:

- The employee's primary duty must be managing the enterprise in which the employee is employed, or managing a customarily recognized department or subdivision of the enterprise;
- The employee must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent (for example, one full-time and two half-time employees are equivalent to two full-time employees); and
- The employee must have the authority to hire or fire other employees, or the employee's suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees must be given particular weight.

Administrative exemption

To qualify for the administrative employee exemption under the standard test, all of the following duties requirements must be satisfied:

- The employee's primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and
- The employee's primary duty must include the exercise of discretion and independent judgment with respect to matters of significance.

Academic administrative personnel whose primary duty is performing administrative functions directly related to academic instruction or training in an educational institution, such as principals and vice-principals responsible for the operation of an elementary or secondary school, department heads at institutions of higher education, academic counselors who perform work such as administering school testing programs, assisting students with academic problems, and advising students concerning degree requirements, and others with similar responsibilities, are eligible for a special alternative salary level that does not apply to employees outside of an educational institution. These academic administrative personnel are exempt from the FLSA's minimum wage and overtime requirements if they are paid at least as much as the entrance salary for teachers at their educational establishment.

Professional exemption

Several different kinds of "professional" employees may qualify for the professional employee exemption. These include "learned professionals," "creative professionals," teachers, and employees practicing law or medicine.

Learned professionals

To qualify as a "learned professional" under the standard test, all of the following duties requirements must be satisfied:

- The employee's primary duty must be the performance of work requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment;
- The advanced knowledge must be in a field of science or learning, including law, medicine, theology, accounting, actuarial computation, engineering, architecture, teaching, various types of physical, chemical and biological sciences, pharmacy, and other occupations that have a recognized professional status and are distinguishable from the mechanical arts or skilled trades where the knowledge could be of a fairly advanced type, but is not in a field of science or learning; and
- The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction, which means specialized academic training is a standard prerequisite for entry into the profession.

Creative professionals

To qualify for the creative professional employee exemption under the standard test, the employee's primary duty must be the performance of work requiring invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor. This includes such fields as music, writing, acting, and the graphic arts.

Teachers

Teachers are exempt if their primary duty is teaching, tutoring, instructing, or lecturing in the activity of imparting knowledge, and if they are employed and engaged in this activity as a teacher in an educational establishment. Exempt teachers include, but are not limited to, regular academic teachers; kindergarten or nursery school teachers; teachers of gifted or disabled children; teachers of skilled and semi-skilled trades and occupations; teachers engaged in automobile driving instruction; aircraft flight instructors; home economics teachers; and vocal or instrument music teachers.

Employees practicing law or medicine

An employee holding a valid license or certificate permitting the practice of law or medicine is exempt if the employee is actually engaged in such a practice. An employee who holds an academic degree for the general practice of medicine is also exempt if they are engaged in an internship or resident program for the profession.

Outside sales exemption

To qualify for the outside sales employee exemption, all of the following duties requirements must be satisfied:

- The employee's primary duty must be making sales or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer. "Sales" includes any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition. It includes the transfer of title to tangible property, and in certain cases, of tangible and valuable evidences of intangible property; and
- The employee must be customarily and regularly engaged away from the employer's place or places of business.

Computer employee exemption

To qualify for the computer employee exemption, the following duties requirements must be satisfied:

- The employee must be employed as a computer systems analyst, computer programmer, software engineer or other similarly skilled worker in the computer field; and

- The employee's primary duty must consist of:
 1. The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications;
 2. The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;
 3. The design, documentation, testing, creation or modification of computer programs related to machine operating systems; or
 4. A combination of the aforementioned duties, the performance of which requires the same level of skills.

Highly compensated employees

An employee with a primary duty of office or non-manual work who meets the HCEs compensation requirements (\$107,432 per year in total annual compensation, with at least \$684 per week on a salary or fee basis) is exempt if the employee customarily and regularly performs at least one of the exempt duties of a bona fide executive, administrative or professional employee, as described in the regulations. An employee who performs such exempt duties only on an isolated or occasional basis will not satisfy this duties requirement.

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