Coates' Canons Blog: The New Overtime Rule is Here and Effective January 1, 2020

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Article: https://canons.sog.unc.edu/the-new-overtime-rule-is-here-and-effective-january-1-2020/

This entry was posted on September 25, 2019 and is filed under Compensation & Benefits, Employment, Fair Labor Standards Act, General Local Government (Miscellaneous)

On Tuesday, September 25, 2019, the U.S. Department of Labor released the final rule raising the minimum salary an employee must make to be exempt from overtime and, as a result, making more salaried employee eligible for overtime compensation. The rule may be found here. The changes to the rule closely track the proposed rule published last March. The most significant change is, as expected, an increase in the amount an employee must earn to qualify for exempt status. It increases from the current $455 per week to $684 per week –on an annual basis, that's an increase from $23,600 to $35,568. The new salary minimum will be effective January 1, 2020.

Background

Under the Fair Labor Standards Act, an employee is entitled to overtime premium pay of one-and-one-half times their regular rate of pay after working 40 hours in a week, unless an exemption applies. If an exemption applies, the employee is said to be "exempt" and is not entitled to overtime pay no matter how many hours they work in a week. An exemption applies if the employee is salaried and the position meets the requirements of the executive duties test, the administrative duties test, or the professional duties test.

But even if the employee is salaried and the position satisfies one of the three duties tests, the exemption does not apply if the employee is paid less than $455 per week, or $23,660 on an annualized basis. Such a low-paid, salaried employee is entitled to overtime pay after 40 hours.

For an explanation of the salary basis test, see here. For discussion of the executive duties test, see here, the administrative duties test, see here and here, and the professional duties tests, see here and here.

The Final Rule

The final rule deviates from the proposed rule only in detail. In a nutshell, the final rule

- raises the minimum salary necessary for an employee to be exempt from overtime from the current $455 per week ($23,660 annually) to $684 per week ($35,568 annually);
- raises the minimum salary necessary for an employee to be exempt from overtime as a highly-compensated employee from $100,000 annually to $107,432 annually;
- allows employers to include nondiscretionary bonuses in an amount up to 10% of the minimum salary level;
- makes no changes to the duties tests; and
- makes no changes to any of the other rules regarding compensable time and overtime.

The final rule is effective January 1, 2020.

Minimum Salary Threshold of $913 Per Week

The new threshold of $684 per week represents the 20th percentile of earnings for a full-time, full-year salaried worker in the South (the lowest wage region) and/or the retail industry (based on pooled data). This is the same methodology used in setting the 2004 minimum salary threshold of $455 per week. (DOL departed from this methodology when it issued the ill-fated and now defunct 2016 overtime rule, which used the 40th percentile mark to set the minimum salary at $913 per week).

The rule setting forth the new minimum salary threshold will be found at 29 CFR § 541.600 beginning on January 1, 2020.

New! Inclusion of Nondiscretionary Bonuses in the Minimum Salary

One additional change will affect public employers who use longevity pay plans. Like the defunct 2016 rule, the new salary basis test will allow nondiscretionary bonuses and commissions to be included – to a limited extent – in the calculation of an employee's minimum salary. In the final rule, DOL limits the amount of nondiscretionary bonuses and commissions that may be used to satisfy the minimum salary threshold to ten percent of the minimum required salary, that is $68.40 per week or $3,556.80 annually, provided that the bonus or commission is paid annually or more frequently.

What is a nondiscretionary bonus?

To better understand what this provision offers local government employers, let's first discuss what counts as a nondiscretionary bonus. The distinction between discretionary bonuses and nondiscretionary bonuses is explained at 29 CFR § 778.211. A discretionary bonus is one which may be given or not in the sole judgment of the employer. It is up to the manager to decide to which employees and in what amount to award a bonus. A nondiscretionary bonus, in contrast, is one which accrues to the employee automatically as a function of policy or ordinance. Bonuses that DOL considers nondiscretionary are:

- bonuses which are announced to employees to induce them to work more steadily or more rapidly or more efficiently or to remain with the organization;
- attendance bonuses;
- individual or group production bonuses;
- bonuses for quality and accuracy of work;
- bonuses contingent upon the employee's continuing in employment until the time the payment is to be made (longevity pay, for example).

Among public employers, longevity pay is the most frequently used form of nondiscretionary bonus. Public employers have traditionally paid longevity bonuses once a year. To make use of longevity payments in meeting the salary threshold for exempt status, those employers will have to change their practices and make longevity payments on either a weekly or a quarterly basis. A once-a-year payment may not be in calculating compliance with the salary threshold. Relatively few public employers, award nondiscretionary merit bonuses based on meeting productivity metrics and there are few public-sector positions that involve commission-based compensation.

How Will the Inclusion of Nondiscretionary Bonuses Work in Practice?

Effective January 1, 2020, the amount of nondiscretionary bonus payments that may be credited toward the salary minimum for exemption will be $68.40 per week or $3,556.80 annually (that is, 10% of the salary threshold). An employer may designate any 52-week period as a "year" for this purpose. If it does not make a designation, DOL will treat the year as a calendar year. Whenever an employer uses nondiscretionary bonuses to meet the salary threshold, it will need to double-check at the end of each year that employees for whom they are claiming exempt status on this basis are in fact being paid the required minimum salary. If they are not, DOL will allow employers to make a "catch-up" payment to bring an employee within the required salary level within one pay period of the end of the 52-week period that comprises the employer's year. Here's how it will work:

1. Each pay period an employer must pay the exempt salaried employee at least $615.60 (that is, 90 percent of the minimum salary threshold).
2. At the end of the year, if the sum of the salary paid plus the nondiscretionary bonuses and/or incentive payments paid does not equal $35,568 (that is, the minimum salary of $684 per week on an annualized basis), the employer

is allowed one pay period to make up for shortfall.

3. Any catch up payment counts toward only the prior year's salary amount. It will not count toward the salary amount in the year in which it ends up actually being paid.

An Additional Clarification

The inclusion of nondiscretionary bonuses in the minimum salary threshold does not change any other aspect of the salary basis or salary threshold tests. *As has always been the case under the FLSA, discretionary bonuses, employer contributions to health, disability and life insurance and employer contributions to LGERS and the North Carolina 401(k) Plan may* ***not*** *be included in the calculation of whether an employee's salary meets the minimum salary threshold*.

The provision allowing the use of nondiscretionary bonuses and commissions in up to 10% of the amount of the minimum salary threshold will be found at 29 CFR § 541.602(a)(3 beginning on January 1, 2020.

The Highly Compensated Employee Salary Threshold

DOL also increased the minimum salary necessary for a position to qualify as exempt under the special highly-compensated employee exemption from $100,000 to $107,432 annually. The new threshold is set at the 80th percentile of earnings of all full-time employees nationally (the defunct 2016 rule used the 90th percentile of earnings).

Currently, employees can be exempt if they are paid $100,000 annually and perform *just one of the exempt duties* of the executive, administrative or professional duties tests. The idea behind the highly-compensated employee exemption is that the very high salary threshold offsets this exemption's minimal duties test. The current highly-compensated exemption allows for compensation in excess of $455 per week to be in the form of nondiscretionary bonuses or commissions and allows employers to make a final "catch-up" payment to bring the employee's salary up to $100,000 per year within one month after the end of the year.

As before, employers making use of the highly-compensated employee exemption will be able to use nondiscretionary bonuses and commissions in any amount in calculating the minimum salary, provided that the employee makes at least $684 per week (in other words, the ten percent limitation applicable to the standard salary threshold does not apply here). Employers will also be allowed to make a final "catch-up" payment to bring the employee's salary up to $107,432 by the end of 52-week period making up the year.

The new minimum salary threshold for highly compensated employee will be found at 29 CFR § 541.601 beginning January 1, 2020.

No Automatic Update of the Minimum Salary Threshold

In the past, the minimum salary threshold has been updated sporadically. In the defunct 2016 rule, DOL announced its intention to institute a regular, automatic update to the minimum salary threshold every three years. DOL has not included this provision in the 2019 rule. Instead, in the preamble to the 2019 rule, DOL announced its intention to update the minimum salary every four years through regular notice and rulemaking practice.

The Duties Tests Have Not Been Revised

In the proposed rule, DOL floated the possibility of revising the executive, administrative and professional duties tests. The Department expressed concern that the current tests allow exempt employees to performing a disproportionate amount of nonexempt work along with their exempt work. ***The new rule does not include any changes to the duties tests***.

Overtime Provisions That Will Not Change

The new rule will have a significant impact on public employers, turning many employees who are currently exempt from overtime into nonexempt employees. These newly nonexempt employees will now need to be compensated at one-and-one-half times their regular rate of pay whenever they work more than 40 hours in a workweek. The new rule will not, however, change any of the other FLSA provisions relating to overtime:

- Public employers may continue to use compensatory time-off or “comp time” in lieu of cash overtime. On comp time, see here.
- Public employers may still use the 28-day work cycle of the 207(k) exempt for paying overtime to law enforcement officers and firefighters. On the 207(k) exemption, see here.
- The fluctuating workweek will continue to be available as a method of paying overtime to those employees who sometimes work fewer than 40 hours per week and sometimes work more than 40 hours per week. On the fluctuating workweek method, see here.
- Small employers who have fewer than five law enforcement officers on the payroll in any workweek or fewer than five firefighters on the payroll in any workweek continue to be exempt from paying overtime to those officers and firefighters in those workweeks.
- The rules governing what time is compensable and what is not remain the same.

If you want to read more about the new overtime rule, DOL has a Fact Sheet and a Question and Answer section on its website. Check them out.

And if you are an old-hand at the FLSA and want to do a deep dive into some of its more vexing issues, join us for our Advanced FLSA class at the School of Government this December 11 – 12. Registration will open in a few weeks. If you want to be notified as soon as registration is open, sign up here.

Links

- www.dol.gov/whd/overtime2019/overtime_FR.pdf
- canons.sog.unc.edu/?p=7385
- canons.sog.unc.edu/?p=7464
- canons.sog.unc.edu/?p=7537
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- www.dol.gov/whd/overtime2019/overtime_FS.pdf
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- www.sog.unc.edu/courses/advanced-flsa-course-2019-december-11-12-2019-school-government