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TAX WATCH

The Department of Labor Proposes Updated Overtime Rule

The Trump administration has released its long-awaited proposed rule to update the overtime exemptions for so-called white-collar workers under the Fair Labor Standards Act. The rule increases the minimum weekly standard salary level for both regular workers and highly compensated employees (HCEs). It also increases the total annual compensation requirement for HCEs that's required to qualify them as exempt. In addition, it retains the often confusing "duties test."

The Trump administration rule generally is more favorable to employers than the Obama administration's 2016 rule, which a federal district court judge in Texas halted before it could take effect. While the latter was expected to make 4.1 million salaried workers newly eligible for overtime (absent some intervening action by their employers), the U.S. Department of Labor (DOL) predicts that the newly proposed rule will make 1.3 million currently exempt employees nonexempt. The DOL estimates the direct costs for employers under the proposed rule will ring in at $224 million less per year than under the 2016 rule. (It's unclear whether these figures take into account payroll tax obligations.)

The current rule

The regulations regarding the overtime exemptions for executive, administrative and professional employees haven't been updated since 2004. Under them, an employer generally can't classify a white-collar employee as exempt from overtime requirements unless the employee satisfies three tests:

1. ***Salary basis test.*** The employee is paid a predetermined and fixed salary that isn't subject to reduction because of variations in the quality or quantity of the 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, doctors, teachers and lawyers) aren't subject to either the salary basis or salary level tests. The current rules also provide an easier-to-satisfy duties test for certain HCEs who are paid total annual compensation of at least $100,000 (including commissions, nondiscretionary bonuses and other nondiscretionary compensation) and at least $455 salary per week.

The Obama administration's proposed rule

The 2016 rule focused primarily on the salary level test, increasing the threshold for exempt employees to $913 per week, or $47,476 per year. The levels would have automatically updated every three years beginning January 1, 2020. At the time, President Obama argued that the overtime regulations had "not kept up with our modern economy."

By more than doubling the salary level test, the rule would have made it unnecessary for employers to even consider an employee's duties in many cases. If the employee's pay fell under the threshold for exemption, the duties would be irrelevant — the employee already couldn't be exempt.

The Obama rule also would have raised the HCE threshold above which the looser duties test applies. It boosted the level to the 90th percentile of full-time salaried workers nationally, or $134,004 per year. The rule would have continued 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. However, such payments would have counted toward the total annual compensation requirement.

The Obama rule was scheduled to take effect on December 1, 2016. On November 22, 2016, however, a district court judge granted a preliminary injunction stopping the implementation. The Fifth Circuit Court of Appeals subsequently declined to review the case until the DOL issued revisions.

The latest proposed rule

The DOL's newly proposed rule would raise the standard salary level threshold to $679 per week, or $35,308 per year. For employees whose salary exceeds this level, overtime eligibility will depend on whether they primarily perform executive, administrative or professional duties. That determination would continue to turn on various checklists of criteria, many of which can seem outdated and not reflective of today's workplace. Moreover, they've long invited litigation by employees challenging their employers' application of the criteria.

The proposed rule raises the total annual compensation requirement for HCEs to $147,414, and HCEs also must make at least $679 per week on a salary or fee basis without regard to the payment of nondiscretionary bonuses and incentive payments. But it would allow employers to use nondiscretionary bonuses and incentive payments (including commissions) that are paid annually or more frequently to satisfy up to 10% of the standard salary level test. This means an employee's production or performance bonuses could push him or her over the threshold and into exempt status (assuming the salary basis and looser duties tests are satisfied).

A catch-up payment is allowed for employees who don't earn enough in nondiscretionary bonus or incentive payments in a given 52-week period to meet the HCE salary threshold and retain his or her exempt status. Within one pay period of the end of the 52-week period, the employer can make a payment of up to 10% of the total standard salary level for the preceding 52-week period. This payment will count toward only the previous year's salary amount — it doesn't count toward the salary amount in the year it's paid.

The duties test isn't the only part of the existing rules that wouldn't change under the proposed rule. No changes are made to the overtime protections for certain categories of employees, including police officers; firefighters; paramedics; nurses; and specified nonmanagement employees, such as production-line employees and maintenance and construction workers.

The proposed rule also leaves out the automatic adjustments to the salary thresholds that were included in the Obama rule. The DOL acknowledges, though, that such thresholds can become "substantially less effective over time." It proposes updates every four years and solicits public comment on how best to implement these future updates.

Not a sure thing

The DOL has solicited public comments on the proposed rule and indicated it expects the finalized rule to take effect on January 1, 2020. Legal challenges are likely from both business and worker groups, though. Some have questioned whether the DOL even has the authority to base overtime eligibility on salary levels. Stay tuned for more developments.

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