Options A Plenty - Creative Ways to Comply with New Overtime Rules

Prepared by:
Quentin Smith
Sheehan & Sheehan, P.A.

September 2016

OPTIONS APLENTY!
Creative Ways to Comply with New Overtime Rules

By: Quentin Smith

I. INTRODUCTION

On May 16, 2016, the United States Department of Labor (DOL) issued its long-anticipated final rule updating the overtime regulations. This is probably the most significant wage and hour legal development in the last decade or longer. The final rule, which goes into effect on December 1, 2016, is intended to either put more money in the pockets of many workers by increasing their salaries or paying them more overtime or to give workers more free time by limiting their work to 40 hours in a week. The final rule is also intended to prevent the future erosion of overtime protections by automatically increasing the salary threshold every three years based on wage growth over time. This article will discuss the requirements of the final rule and set forth several possible options for implementing the rule for an employee who is currently classified as exempt but receiving a salary below the new minimum threshold.

II. NEW OVERTIME RULES

The final rule issued by the DOL will attempt to accomplish its dual goals of putting more money in workers' pockets or giving workers more free time in three ways:

First, the final rule will raise the minimum salary level from $455 per week ($23,660 per year) to $913 per week ($47,476 per year). The new salary threshold is equal to the 40^{th} percentile of weekly earnings for full-time salaried workers in the lowest-wage Census region, which is currently the South. According to the DOL's estimates, this means that 35% of full-time salaried workers will now automatically be entitled to overtime pay based on their current salary. Also, the final rule will raise the total annual compensation to qualify as a highly-compensated employee to the 90^{th} percentile of full-time salaried workers nationally, or from $100,000 to

$134,000. A highly-compensated employee is one who performs office or non-manual work and who, as of December 1, 2016, must be paid total annual compensation of $134,004 or more (which must include at least $913 per week paid on a salary or fee basis) and who must customarily and regularly perform at least one of the duties of an exempt executive, administrative, or professional employee as identified in the standard tests for those exemptions.

Second, the final rule will allow up to 10% of the salary threshold (for those who are not highly compensated employees) to be met by non-discretionary bonuses, incentive pay, or commissions, provided these payments are made on at least a quarterly basis. This means that an employee may receive a weekly salary as low as $821.70 per week ($43,728.40 per year) and the remainder of the compensation to meet the minimum salary threshold can be paid quarterly in the form of bonuses, incentive pay, or commissions totaling almost $1,200 per quarterly. This is a new policy that is intended to recognize the importance these types of non-salary pay have in many companies' compensation arrangements.

Third, perhaps most significantly and for the first time ever, the final rule incorporates automatic updates to the salary threshold. Every three years, starting on January 1, 2020, the minimum salary threshold will automatically increase to the 40th percentile of full-time salaried workers in the lowest-wage Census region. The DOL estimates the new salary threshold will increase to $51,168 in 2020. Also, the new salary threshold for highly compensated employees will increase to the 90th percentile of full-time salaried nationally, which is estimated to be $147,524 in 2020. The DOL will post new salary levels 150 days in advance of their effective date, beginning August 1, 2019. This is a new approach to setting the minimum salary in a manner that will keep up with inflation and overall increases in wages.

Although the DOL had sought comments on whether the duties tests should be adjusted, the final rule does not make any changes to those duties tests. However, the DOL believes that fewer employers and workers will have to worry about the application of the duties tests because the higher salary threshold will mean that more workers will be clearly entitled to overtime pay based just on their salaries. For workers with salaries above the updated salary level, employers will continue to use the same duties test to determine whether or not the worker is entitled to overtime pay.

III. OPTIONS FOR COMPLIANCE

The options for compliance may seem straightforward. An employee who is paid less than the new salary threshold should either be given a salary increase up to $47,476 or be converted to a non-exempt employee who is eligible to receive overtime pay. In reality, though, there may be some other creative yet legal options for complying with the new overtime regulations. Depending on the nature of the position and the employer’s needs, here are seven possible ways to come into compliance with the new overtime rules:

A. Raise Salary to New Minimum Threshold.

The seemingly most straightforward option is to increase the employee’s current salary to the new minimum threshold of $47,476 per year. This may be the most viable option for those employees whose current annual salary is already near the new threshold, such as those who earn between $40,000 and $47,000. The advantages of this option are the ease of implementation—as the position can be maintained as a salaried exempt position without paying overtime—and that the employees who receive the increase will be happy with it. There is one obvious downside and a couple that might not be as obvious. The obvious downside is that labor costs will increase and that increase could be significant if there are many employees who receive salary increases.

One less obvious downside is that arbitrarily increasing the salary of some employees who are currently below the new minimum threshold while keeping the salaries the same for those whose salaries are already slightly above the new minimum threshold might feel unfair to those unaffected employees with more seniority or whose better performance had resulted in them receiving higher salaries. The other less obvious downside is that the automatic threshold escalation means that those employees whose salaries are bumped up to the new minimum threshold will be slated for another (possibly significant) increase in three years.

B. Convert to Non-Exempt at Hourly Rate Equivalent to Previous Salary and Pay Overtime Premiums.

Another straightforward option is to convert the employee to a non-exempt position with an hourly rate equivalent to the employee's previous salary. For example, an employee who currently has a salary of $35,000 per year would be converted to a non-exempt employee who is paid $16.83 per hour ($35,000 / 2,080 hours). This might be the most viable option for those employees whose current salary is well below the new threshold and who rarely work more than 40 hours per week. The advantages of this option are the relative ease of implementation, as the overtime calculation is easy and the employees who work more than 40 hours per workweek may be happy to begin receiving overtime premiums. The labor cost increase, though, could be substantial. If the aforementioned employee with a current salary of $35,000 per year typically works 45 hours per week, then her annual pay would likely increase from $35,000 per year to over $41,000 ($25.25 overtime rate X 5 hours per week X 50 weeks = $6,312.50 overtime pay per year). This would be an almost 20% pay increase for the same amount of work.

C. Convert to Non-Exempt and Limit to 40 Hours Per Workweek.

One alternative way to avoid increased labor costs would be convert the employee to a non-exempt position with an hourly rate equivalent to the employee's previous salary and then prohibit that employee from working more than 40 hours per week. This is another viable option for those employees whose current salary is below the new minimum threshold and who rarely work more than 40 hours per week. The advantages of this option are that it allows the employer to control labor costs and the employee will also be happy to receive the same pay for less hours of work. The downside is that an employer may have to make up for the lost productivity from an employee who used to work more than 40 hours per week. Depending on the work performed, the employer may need to shift certain job responsibilities to other employees or even hire additional staff. Also, enforcing a 40-hour limitation can be difficult and the failure to do so may cause liability for unpaid overtime. An employee who violates the work hour restriction should still be paid for the extra time, but may be disciplined for violating the overtime policy.

D. Convert to Non-Exempt with Lower Hourly Rate to Account for Anticipated Overtime Hours Worked.

Yet another alternative way to avoid increased labor costs is to convert the employee to a non-exempt position but set the new hourly rate at a figure that will avoid a pay increase for the same amount of work. This is a viable option for employees who typically work more than 40 hours per week and the extra hours worked are fixed or predicable. For example, instead of setting the hourly rate for the employee with the current salary of $35,000 who typically works 45 hours per week at $16.83 per hour, the employer may set the new hourly rate at $14.17 per hour. This lower hourly rate would result in the employee receiving approximately the same amount of pay for the same amount of work, even though the employee has been converted to non-exempt.[1] The advantage to this option is, assuming the calculations were done correctly, it would allow employers to minimize additional labor costs while maintaining the same hours

[1] The formula for calculating what the modified rate should be is as follows with "R" being the regular rate of pay: ((40 regular hours X R) + (# overtime hours X 1.5 overtime premium X R)) X 52 weeks= Current Annual Salary. For the example above, the formula would be applied as follows: ((40R + (5 X 1.5 X R)) X 52 = $35,000. The regular rate of pay would then be $14.17 per hour.

worked for the employee. The downside is employee morale—employees are likely to be dissatisfied by having to now work a minimum number of overtime hours to receive the same amount of pay and that any reduction in the number of hours worked will result in a pay decrease.

E. Convert to Salaried, Non-Exempt.

An option many employers may not realize exists is that an employee can be classified as salaried, non-exempt, which means the employee is paid a fixed salary for any hours worked up to 40 per week and then she receives overtime pay only if the employee works more than 40 hours in a week. This is a viable option for employees who typically work less than 40 hours per week, such as part-time employees, and who value the stability that comes from having a fixed salary. There is no exception to the minimum salary threshold for part-time employees, but, if an employee never works more than 40 hours in a workweek, then she can be given a fixed salary that is intended to cover all hours worked up to 40.

There are two caveats that an employer should keep in mind. First, the salary must be large enough to satisfy the minimum wage requirement for each week. While it is fine to pay an employee who typically works 20 hours per week a fixed salary of $200 per week, that fixed salary would be insufficient if the employee works 40 hours one week because the effective hourly rate of $5.00 per hour would be below the minimum wage. Second, the employee must still record her hours even if she never works more than 40 hours per week. All non-exempt employees must record their time so that it can be determined whether the employee was paid a minimum wage and did not work any overtime hours.

The primary advantage to this option is that it would allow for an employer to continue to pay the same salary to the employee irrespective of hours worked, which will allow that employee to continue to have the flexibility afforded by the exempt status and the prestige associated with being a salaried employee. The downside is that the employer will have committed to paying the same salary to the employee even in a workweek in which the employee worked just a few hours. The employee would also still be required to record time and, if the employee does work more than 40 hours in a workweek, she would be entitled to overtime pay. The overtime rate would be determined by dividing the weekly salary by 40 hours to determine the regular rate of pay and then overtime hours would be required to be paid at 1.5 times that regular rate of pay.

F. Fixed Salary for Greater than 40 Hours.

Similarly, an employee may be paid a fixed salary for an amount of time that exceeds 40 hours per week. In the previous option—fixed salary for 40 hours per week—the employee is entitled to receive 1.5 times her regular rate of pay for hours worked over 40. But if an employer intends for the salary to compensate for a different amount of hours, it can designate in writing that an employee's salary is intended to compensate for a particular number of hours worked each week and the employee would only be entitled to 0.5 times overtime pay for hours worked over 40 up to that number. The employee would then be entitled to 1.5 times the regular rate of pay for hours worked over the number that the salary was intended to cover. This is a viable option for employees who typically work more than 40 hours per week and who work a fairly steady schedule.

For example, an employee who currently receives an annual salary or $35,000 per year could be given the same salary of $673.08 per week and the employer designates that her salary is intended to compensate for 45 hours per week. The employee would then receive overtime pay at a 0.5 rate for the time worked between 40 and 45 hours. The overtime rate would be calculated by dividing her weekly salary of $673.08 per week by 45 hours, which would result in a regular rate of $14.98 per hour. The overtime rate would then be half of that figure: $7.49 per hour. If the employee worked 45 hours, then she would receive an overtime premium of $37.45 that week. Assuming that the employee works 45 hours per week for 50 weeks, then the annualized overtime premiums would only be $1,875.50, which is a much lower increase in labor costs than simply converting that employee to a non-exempt employee with an hourly rate of pay.

The advantages to this option are that it allows the employer to maintain the employee's current salary without the substantial increased costs that would occur through time-and-a-half pay and it allows for more predictable labor costs. The downside is that it does result in some increased labor costs, and this option certainly does not make sense for any employee who often works more than the amount of hours the salary is intended to compensate. Also, the option can result in some difficult calculations for employees who do not work a predictable number of hours each week.

G. Fluctuating Workweek Method.

Finally, for those employees who work an unpredictable number of hours each week, they could be paid under the fluctuating workweek method. Under this method, an employee may be paid a fixed salary as straight time pay for whatever hours the employee works in a week, whether few or many. The salary must be sufficient to cover the minimum wage for all hours worked. The employee must then receive at least 0.5 times her regular rate of pay for the week (calculated by dividing their weekly salary by the total hours worked for the week) for any time worked over 40 hours. The regular rate of pay will vary based on the number of hours worked. To qualify for this method, the number of hours that the employee works must fluctuate fairly significantly and the employer must have a clear mutual understanding (preferably in writing) with each employee on the pay structure. This is a viable option for employees who may average around 40 hours per week but who work a fluctuating number of hours based on the needs of the business or the season.

As an example for how this works, an employee could be paid $750 per week in salary that is intended to cover the straight time for all hours worked. Then, over a six-week period, she would receive the following overtime premiums:

Week	Hours	Straight Pay	Reg. Rate	OT Premium	Total Pay
1	35	$750	$21.42	N/A	$750.00
2	50	$750	$15.00	$75.00	$825.00
3	40	$750	$18.75	N/A	$750.00
4	56	$750	$13.39	$107.20	$857.20
5	43	$750	$17.44	$26.16	$776.16
6	25	$750	$30.00	N/A	$750.00

For this 6-week period, the employee will have worked a total of 249 hours and would have received total pay of $4,708.36. If this was a typical 6-week average, her annualized pay would be $40,805.79. Under this type of arrangement, her expected overall annual base pay should fall within a narrow range. If she never worked overtime, her annualized pay would be $39,000, and, if she worked an average of 56 hours per week every week (which would be unlikely), her annualized pay would still be only $44,574.40 ($857.20/week X 52 weeks).

The advantage of this option is that it allows for the employee to receive a regular salary even during less busy times and for the employer to not incur substantial overtime expenses during busy times. Since the regular rate of pay decreases as the employee works more hours, then the employer does not have to worry as much about labor costs increasing substantially whenever the employee has to work overtime hours. Plus, the employee has little incentive to work more overtime than the job demands because each additional hour of overtime worked results in a lower marginal pay rate. The downside to this option is that it can be difficult for employees to understand and it can be difficult for employers to calculate (especially if the employee receives other forms of pay, like commissions, which would have to also be included in the regular rate of pay and subjected to the overtime premium). There is certainly an administrative burden associated with calculating pay under this method.

IV. CONCLUSION

The options for complying with the new overtime rule may not be as narrow and limited as employers believe. While the vast majority of affected employees will either be bumped up to the new salary threshold or converted to a non-exempt position and become eligible to receive overtime pay at 1.5 times their new hourly rate, there are other options that an employer might consider that may be more appropriate or advantageous to both the employer and the employee. Some of those other options might allow employers to better control labor costs while also providing affected employees with a similar level of security and prestige that they were previously enjoying when they were classified as exempt employees.