Dealing with the new FLSA salary tests in ruby slippers

Employment Alert

23 MAY 2016

By:

News releases echoing the famous mantra from *The Wizard of Oz* – “lions, and tigers, and bears …. Oh my!” – suggested that the Department of Labor (DOL) issued an army of flying monkeys. Not so.

DOL merely finalized new dollar thresholds for the salaried jobs exempt from overtime under the Fair Labor Standards Act. Thus, effective December 1, 2016, the new salary test will be $47,476 ($913 per week) for executive, administrative, and professional employees.

Growing up with Dorothy and her friends teaches many things, including “never panic.” There is always a solution, whether for witches, flying monkeys, or government regulations (as Dorothy illustrated nicely in getting into the Emerald City, which is worth re-watching now).

What questions would Dorothy ask in the face of the new DOL salary standards?

1. Do the jobs on my team that pay less than $47,476 per year have truly exempt duties?

To qualify as overtime exempt, executive, professional, and administrative jobs must clear a double hurdle: the duties test and the salary test. The DOL’s new rules increase the salary threshold but leave the duties test unchanged.

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as

Often, jobs have been classified as exempt in the past without revisiting whether a given job – as it exists today – meets the duties test. There is no point increasing compensation to meet the new salary test unless the duties test can also be satisfied: that is simply throwing money away.

Templates for checking exempt status can easily be built from the regulations or found on the internet if you Google "FLSA exempt questionnaire." That is the easy part. Sitting down to determine actual job content (not merely what is in the job description) requires more effort.

2. For those jobs with the requisite duties, can I meet the $47,476 test by counting bonus or commissions?

This is the good news in the new salary test. For the first time, employers may use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the salary level, so long as such incentive payments are paid on a quarterly basis or more frequently. In those cases, the actual minimum salary can be as low as $42,728.40 (*i.e.*, $821.70 per week, almost $100 under the standard $913 per week).

Some states, however, may not allow bonuses, commissions, and other incentive compensation to count toward the minimum salary requirement under state law (*e.g.*, California). As you will recall (with tears), the FLSA mandates complying with both state and federal law; so, where state law is more favorable to the employee, it must be followed.

3. For jobs that still fall short, should I increase compensation or convert those jobs to nonexempt?

This is a business calculus that will be unique to each employer. Let's think out loud.

There are three key factors:

- Is the job performed on premises or off premises (line of sight rule)?
- Is the job one that likely has high volumes of overtime?
- Is the current salary close or far from the new threshold?

If a job is paid far less (*e.g.*, below $40,000), conversion is probably more economical. If the job is within striking distance, the amount of anticipated overtime and the ease of accurately counting/controlling that overtime ought to be dispositive. For close calls, the line of sight rule is the tie-breaker; jobs performed outside the line of sight of management are often difficult to manage as hourly jobs.

4. Where I am choosing to increase compensation, have I planned to address the ripple effect (*e.g.*, the potential need to increase compensation for higher ranking jobs to maintain internal equity)?

Compensation compression is a problem on multiple levels. First, it is a morale problem. Second, it is a recruiting problem, Third, it is a potential equal pay problem. It is a problem that demands consideration before bumping a job paid at $42,000 per year to $48,000 to maintain exempt status.

Here too, the answers will be unique to each business. Assume assistant managers will go to $48,000 on December 1, 2016. What will need to be done with compensation for the managers to whom those assistant managers report? And, then, what about the general managers? This is the hidden burden in upping salaries to meet the new salary test.

5. For jobs that are being converted, how do I announce/explain that without demotivating my Scarecrows and Tin Woodsmen?

This is art, not law. It is also the most difficult piece of this compliance adventure.

(A) There is a school of thought that employees derive prestige from being salaried. To that extent, there is a temptation to finger point ("twasn't us; this is because of those damn pointy-headed bureaucrats"). Resist. Your organization had the last clear chance: you chose to convert to hourly rather than increase salary to $47,476 (which your Munchkins will soon enough figure out).

(B) If possible, you can sell this as an upside: more money because you are now eligible for overtime in those weeks where extra efforts are required. But, don't say that if your goal is to set an hourly rate (see no. 7,

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as

infra) to make this whole conversion "cost neutral" to your budget.

(C) Where cost neutral is the goal, then that is the message: *i.e.*, "this won't reduce your annual compensation but it is required so that we can comply with both state and federal payroll laws by tracking hours worked." In this context, be very careful that the message is not mistranslated into a guarantee of automatic pay for X hours of OT (which would create a separate nightmare by inflating the regular rate) or into a warning that time worked and reported cannot exceed Y hours (which walks you into serious issues of off-the-clock violations and lawsuits).

6. For jobs that are being converted, should I attempt to take advantage of half-time overtime under the fluctuating workweek (FWW) regulations?

This is far cheaper than the normal overtime (50 percent of the regular rate vs. 150 percent of the regular rate). FWW is permitted if (A) the employee is paid a fixed salary each week that does not vary based on the number of hours worked; (B) the company and the employee have a "clear mutual understanding" that the employer will pay this fixed salary regardless of the number of hours worked; (C) the fixed salary must be sufficiently large to provide compensation that at least equals the minimum wage for all hours worked; (C) the employee's hours must fluctuate from week to week; and (D) the employee receives a 50 percent overtime premium in addition to the fixed weekly salary for all hours worked in excess of 40 during the week. *29 C.F.R. § 778.114*.

Why doesn't everybody use it? It is complicated for payroll administration (because the overtime rate changes with each week's hours: salary/total hours in that week = regular rate). It also requires guaranteeing a salary. Finally, it doesn't work in every state; some (*e.g.*, California, New Mexico, and Pennsylvania) decline to recognize it for purposes of their state versions of the FLSA.

7. For jobs that are being converted, can I set a lower hourly rate?

Let's put this in numbers. Assume a current salary of $40,000 in a job that is being converted to nonexempt. Dividing that salary by 40 hours per week and 52 weeks per year generates an hourly rate of $19.23 per hour. In short, converting at that rate will increase labor costs for every hour of overtime (which will be paid at $28.85 per hour).

Assume that this job averages 5 hours of overtime per week. Assigning an hourly rate of $16.50 makes the conversion almost cost neutral: total annual compensation of $40,755. But, is that legal and is that practical? Reducing an employee's hourly rate pay is perfectly permissible; DOL openly advertises that employer right. The problem is morale. But see no. 5, *supra* on how to handle announcements.

For Dorothy Gayle, getting home to Kansas was a fraught journey, but she persevered. Your journey to adjusting to the new DOL salary standards may be too, but you can follow Dorothy as a role model: it is okay to be afraid, but not to quit (and it is easier to keep going if you have really, really good shoes).

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as