

2020 Brings Changes to the Minimum Salary Requirements for Exempt Status Under the Fair Labor Standards Act

By now, you probably have heard that there have been changes to the minimum salary requirements for exempt employees under the Fair Labor Standards Act (FLSA). The Department of Labor recently released the fact sheet for the “Final Rule to Update the Regulations Defining and Delimiting the Exemptions for Executive, Administrative, and Professional Employees” sounds impressive, eh? But what does it mean? To answer that question, let’s take a quick look at the basic tenets of the law and the requirements contained within for exemption testing.

The FLSA was signed into federal law in 1938. Among other things, the act set child labor standards, defined compensatory time, established a federal minimum wage rate, outlined recordkeeping requirements and, most important to our discussion here, defined exempt and non-exempt employees with regards to overtime eligibility and overtime pay requirements.

Typically, our clients refer to their exempt employees as “salaried” and non-exempt employees as “hourly”, even though they might not fully understand why. The definitions of exempt versus non-exempt employees comes directly from the FLSA. Exempt employees are excluded from some of the rights and protections in the FLSA including, most notably, the overtime provisions of the act which require the employee to be paid a rate of one-and-one-half times the employee’s rate of pay, after 40 hours worked in a week.

Generally, determining whether an employee should be classified as exempt or non-exempt relies on three (3) factors outlined in the FLSA:

- The Salary Level Test – how much are they being paid?
- The Salary Basis Test – how are they paid?
- The Duties Test – what kind of work do they do?

To be correctly classified as an exempt employee, all three exemption tests must be met. Diving a little deeper, let’s take a closer look at these three exemption tests.

The Salary Level Test

The Salary Level Test is where the most recent changes to the Act come into play. To meet the Salary Level Test, an employee must be paid at least \$684 per week (\$35,568 annually) to be classified as exempt (this is a significant increase from the previous minimum requirement of \$455 weekly, \$23,660 annually). These changes became effective on January 1, 2020. Any employee earning less than \$684 weekly is considered non-exempt under the new regulations and should be paid on an hourly basis, including eligibility for overtime pay after 40 hours of work in a week.

In addition, the final rule allows non-discretionary bonuses and incentive payments (including commissions), that are paid at least annually, to satisfy up to 10% of the standard salary level (i.e., \$3,557 of the required threshold of \$35,568). If an employee does not earn enough in non-discretionary bonuses or incentive payments in a year to retain their exempt status, the new rules allow the employer to make a “catch-up” payment to bring the employee above the \$35,568 annual salary requirement to retain their exempt status. The catch-up payment must be made within one pay period after the end of the 52-week period that constitutes a year for the employer (i.e., the 52-week period does not necessarily have to be a calendar year).

If they have not already done so, employers should immediately identify all salaried or exempt individuals on their payrolls along with their pay rates. If any of the salaried individuals fall below the \$684 weekly or \$35,568 annual pay requirement, the employer has these options:

- Increase the pay rate above the new minimum requirement to comply with the new rule, or;
- Keep the employee at their current rate, which will change their classification to non-exempt, and pay them on an hourly basis including overtime after 40 hours a week.

The Salary Basis Test

The Salary Basis Test requires that an exempt employee receive a “predetermined” amount of compensation each pay period. Although there are some “permissible” reductions allowed under the FLSA, generally, the exempt employee’s salary cannot be reduced because of variations in the quality or quantity of the employee’s work. The employee must receive their full salary for any week in which the employee performs any work, regardless of the number of days or hours worked.

The Duties Test

There are five categories of exempt employees defined in the FLSA, as well as the duties that they must perform to be classified as exempt under the Duties Test. The five categories are: Outside Sales, Computer Employees, Executive, Professional and Administrative Employees. For the purposes of this article, we will focus only on the Executive, Professional and Administrative categories with regards to the Duties Test.

To satisfy the Duties Test requirements under the Executive exemption, employees must have a primary duty of “managing the enterprise or a department or subdivision of the enterprise; must customarily and regularly direct the work of at least two employees; and must have the authority to hire or fire, or their suggestions and recommendations as to the hiring, firing or changing the status of other employees must be given weight” (29 CFR 541.100-106).

For employees to qualify under the Professional exemption, they must have a “primary duty of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by prolonged, specialized, intellectual instruction and study”, or must specialize in similar, highly specialized fields. (29 CFR 541.300-304).

Finally, the Administrative exemption requires that the employee have a primary duty of “performing office or nonmanual work directly related to the management or general business operations of the employer or the employer’s customers”, and their “primary duty must include the exercise of discretion and independent judgment with respect to matters of significance”. (29 CFR 541.200)

Without question, the biggest gray area when conducting exemption testing for Administrative personnel occurs with the requirement that an Administrative employee’s “exercise of discretion and independent judgment with respect to matters of significance”. Factors that should be considered when examining the employee’s independent judgment and discretion are outlined in the Code of Federal Regulations, 29 CFR 541.202 (b), and include, but are not limited to these questions:

- can the employee formulate, affect, interpret, or implement management policies or operating practices;
- can the employee carry out major assignments in conducting the operations of the business;
- can the employee perform work that affects business operations or a segment of the business to a substantial degree;
- can the employee commit the employer in matters that have significant financial impact;

- can the employee waive or deviate from established policies and procedures without prior approval;
- can the employee negotiate and bind the company on significant matters;
- can the employee provide consultation or expert advice to management;
- can the employee participate in planning long- or short-term business objectives;
- can the employee investigate and resolve matters of significance on behalf of management; and
- can the employee represent the company in handling complaints, arbitrating disputes, or resolving grievances? (29 CFR 541.202 (b))

In Summary

All three exemption testing criteria must be met for an employee to be considered as an exempt employee under the Fair Labor Standards Act. Misclassifying an employee as exempt when they should have been non-exempt could result in the employer being required to pay the affected employees their owed overtime pay up to a three-year look back from the date of the wage claim and, in some cases, the employee could receive double damages from the employer. If an employer knowingly and willfully misclassifies a non-exempt employee as exempt, the employer could be subject to civil penalties for each violation and could also face criminal prosecution.

When you are talking with your clients about the new changes to FLSA and their exempt employees, the employer should be able to answer these three questions:

- How much are their exempt employees being paid? If it is less than \$684 weekly, they need to utilize the strategies outlined above to ensure correct classification.
- Are the exempt employees being paid a predetermined amount every pay period that is not reduced by quality or quantity of work? If the employee's base compensation fluctuates because of a single factor, or a set of factors, it should warrant additional conversations to be certain the Salary Basis test is being applied and interpreted correctly.
- What are the duties of the exempt employee? The duties of the exempt employee should be clearly defined and should meet the Duties Test for the employee to be able to remain being classified as exempt. If an administrative employee exercises independent judgement and discretion with regards to matters of significance, special consideration should be given to what those duties are and how they satisfy the Duties Test.

Interpreting and applying changes in areas that involve labor laws can be a tricky proposition. Often, an employer's own handbook or operational policies, or lack of policies, play a significant role in the correct application of any changes that might need to be made. It is important that our clients understand that we are here to provide opinions and instruction only and our assistance should not be considered as legal advice. Always recommend that our clients should seek outside counsel for significant matters.

If an employer needs to make changes to an employee's classification for any reason, they should clearly document the issue, the decision-making steps that they took to resolve the issue as well as the solution that was implemented to correct the issue. Again, in the best-case-scenario, the employer should consult with an attorney that specializes in labor law to discuss the issue and the possible solutions prior to acting.

From personal experience, the Michigan Department of Labor (DOL) Wage and Hour Division is another great resource if you or your clients have additional questions. I have found the Wage and Hour Representatives in the state's regional DOL offices to be very friendly, knowledgeable, timely and

thorough in assisting with compliance issues. Also, the DOL website and their Fact Sheet publications are extremely well-organized and make it easy to find information. For your convenience, I have copied links to the relevant fact sheets discussed in this article in the “resources” section below.

As always, you are always welcome to call your SBDC Growth Team Human Resources Professionals if you need further assistance.

Resources:

Final Rule to Update the Regulations Defining and Delimiting the Exemptions for Executive, Administrative, and Professional Employees

https://www.dol.gov/whd/overtime2019/overtime_FS.htm

Fact Sheet #17A: Exemption for Executive, Administrative, Professional, Computer & Outside Sales Employees Under the Fair Labor Standards Act (FLSA)

https://www.dol.gov/whd/overtime/fs17a_overview.pdf

Fact Sheet #17B: Exemption for Executive Employees Under the Fair Labor Standards Act (FLSA)

https://www.dol.gov/whd/overtime/fs17b_executive.pdf

Fact Sheet #17C: Exemption for Administrative Employees Under the Fair Labor Standards Act (FLSA)

https://www.dol.gov/whd/overtime/fs17c_administrative.pdf

Fact Sheet #17D: Exemption for Professional Employees Under the Fair Labor Standards Act (FLSA)

https://www.dol.gov/whd/overtime/fs17d_professional.pdf