U.S. Department of Labor Final Overtime Rule[1]

QUESTION 8:

What Are the Options for Changing Pay Plans and How Do I Know Which One Is Best to Use?

There are several. The options for changing pay plans will depend on the affected employee's specific circumstances. Generally speaking, salaried workers will fall into one of three categories:

1. Employees in nonexempt positions who maintain a time record and who are paid a salary plus overtime after working 40[2] hours in a workweek (including employees paid under the Fluctuating Workweek pay plan): **No changes are necessary for these workers.**

2. Employees in positions the employer has designated as exempt from overtime under an Executive, Administrative, or Professional (EAP) exemption who: (a) do not maintain a time record, (b) are paid a salary that is above or below the minimum threshold level of $913 per week, (c) do not receive overtime, and (e) do not meet the duties tests under one of the EAP exemptions: **Changes are necessary since the duties test is not met. The position should be reclassified from exempt to nonexempt.**

3. Employees in positions the employer has designated as exempt from overtime under an EAP exemption who: (a) do not maintain a time record, (b) are paid a salary below the minimum threshold level of $913 per week, (c) do not receive overtime, and (e) meet the duties tests under one of the EAP exemptions: **Changes are necessary to retain the overtime exemption. The salary must be increased to the minimum threshold level of $913 per week with or without a bonus, incentive, or commission offset of up to 10 percent.**

   If the exempt employee currently earns a bonus or commission, one option is to adjust the bonus or commission plan downward to account for the necessary increase to the salary. Of course, depending on the amount of the adjustment, this option can have a negative impact on an employee's desire and motivation to achieve important bonus or commission plan goals.

If you determine that you must reclassify a position from exempt to nonexempt either because the duties tests for a white collar exemption are not met **AND/OR** because it would be too costly to increase the guaranteed salary, there are pay plan options. Unfortunately, all of the options for reclassifying positions will likely result in additional costs and some could impact morale and productivity. For this reason, it is important to carefully consider the pros and cons of each option.

[1] This client advisory is excerpted from the Seawright & Associates May 31, 2016, e-bulletin, "U.S. Department of Labor Final Overtime Rule: Ten Things Every Employer *Must* Know Before Making Changes." To obtain the full content of the e-bulletin, contact Seawright & Associates

[2] Some states require payment of overtime if employees reach a daily threshold. In California, employers must pay overtime after 8 hours per day and double time after 12 hours per day to nonagricultural employees. In Alaska, Nevada, and Puerto Rico, employers must pay overtime after 8 hours per day. In Colorado, employers must pay overtime after 12 hours per day. If these daily thresholds are not met but the employee still works over 40 hours per week, overtime must be paid after 40 hours.

Regardless of the method you choose, keep in mind that employees in positions that are reclassified to nonexempt must maintain a complete and accurate time record. For this reason, before making any pay plan changes, you may want to require employees in positions that are currently classified as salaried exempt to maintain a time record. Armed with several months of accurate time records, you will be in a better position to determine the appropriate rate of pay and the most cost efficient pay plan to use when converting the position to a nonexempt classification.

Here are the most common pay plan options and sample calculations for converting a salaried exempt position to a nonexempt position:

1. **Maintain the current salary and limit the work schedule to ensure that the employee does not work overtime during any week.** Complete, accurate time records are necessary to establish that the employee did not work overtime. If overtime is inadvertently worked, even if it was not authorized, it must be paid according to one of the methods below. If you elect this option, to minimize the potential for overtime, when possible, redistribute predictable and consistent job duties to nonexempt employees.

2. **Convert the salary to an hourly rate that is based on 40 hours of work and pay overtime at a rate of 1.5 times the regular hourly rate.** This option is appropriate for situations where the employee and employer agreed that the salary covered 40 hours per week and/or there was no agreement, but the employee rarely works overtime and is not expected to work much overtime in the future.

   Example: An employee is paid a weekly salary of $600. The regular rate would be $15 per hour ($600/40) and the overtime rate would be $22.50 ($15 x 1.5).

3. **Convert the salary to an implicit hourly rate that is adjusted downward so that when the overtime is paid, the total earnings remain as constant as possible**. This option is appropriate for situations where the employee and employer agreed that the salary covered more than 40 hours per week and/or the employee worked a predictable schedule of more than 40 hours and is expected to do so in the future.

   Thought to be the least attractive option by employees, this method could hurt employee morale and productivity. In addition, if employees in the same position at the same or a different location are paid different salary amounts and work different hours, using this method can result in inconsistent rates of pay for workers in the same position. Also, if the salary amount is low and the hours worked are high, the implicit hourly rate could end up below minimum wage. Since this is not permissible, using this method would make it impossible to reduce the rate of pay to an amount that would offset the cost of paying overtime.

   Example: An employee is paid a weekly salary of $800 for 50 hours of work. A regular hourly rate of $14.50 per hour and an overtime rate of $21.75 would yield an amount close to $800 per week for 50 hours of work. ($580 ($14.50 x 40) + $217.50 ($21.75 x 10) = $797.50)

   If you elect this option and the employee works more or less than the expected amount of overtime hours, you must pay for the actual hours worked during the week at the regular hourly rate and time-and-one-half overtime rate.

4. **Convert the salary to an hourly rate that is between the rates obtained using the methods in #2 and #3 above.** This option is appropriate in situations where the employee regularly works overtime. It is viewed as a middle-of-the-road alternative to options 2 and 3 because it can help minimize the potential for morale and other problems associated with the implicit hourly rate method, yet it is not as costly as paying an overtime rate that is calculated using a 40-hour week.

5. **Maintain the current salary that covers more than 40 hours regularly worked and pay overtime in addition to the salary.** This option is appropriate in situations where the employee and employer agreed that the salary covered more than 40 hours per week and/or the employee worked a predicable schedule of more than 40 hours and is expected to do so in the future. The overtime hours that are included within the salary are paid at a half-time rate and any hours worked beyond those included in the salary are paid at time-and-one-half the regular rate.

   > **Example:** An employee is paid a weekly salary of $800 for 50 hours of work. The regular hourly rate is $16 ($800/50), the time-and-one-half rate is $24 ($16 x 1.5), and the half-time rate is $8.00 ($16/2).
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   > In a normal 50-hour week, the employee would receive $800 + $80 ($8.00 x 10 hours over 40) = $880.
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   > If the employee works 60 hours (10 hours more than the normal schedule), he/she would receive $800 + $80 (for the first 10 hours of overtime) + $240 ($24 x 10 additional overtime hours that are not covered by the salary) = $1120.

6. **Pay a salary and adopt the Fluctuating Workweek pay plan to calculate the overtime.** This option is appropriate in situations where the payment of a salary is viewed by the employee as a valuable benefit, when the position is commonly paid by way of a salary within the industry, and when the employee will not qualify for nondiscretionary bonuses or incentives.

   Employers that use the Fluctuating Workweek pay plan must be willing to pay the full guaranteed salary even when the employee runs out of paid time off benefits. Because of this requirement, the Fluctuating Workweek pay plan is not ideal for companies that offer limited time off or for employees with absenteeism or tardiness problems.

   The Fluctuating Workweek pay plan can only be used for nonexempt employees whose hours fluctuate above and below 40 each week and who agree to be paid by this method. Also, it is only permitted in certain states (Florida, for example). The DOL current prohibits employees paid by this method to receive nondiscretionary bonuses and incentives.

   > **Example:** An employee is paid a weekly salary of $800. If the employee works less than 40 hours in a workweek, the full salary must be paid (even if the employee has no paid time off available). In another week, if the employee works 48 hours, the regular hourly rate for the week would be $16.66 ($800/48) and the half-time rate would be $8.33 ($16.66/2). The total amount owed for the week would be $800 + $66.66 ($8.33 x 8 hours over 40) = $866.66.

   Using this method, the regular hourly rate (and, thus, the half-time rate used to calculate overtime) will fluctuate each week based on the hours worked. The greater the number of hours worked, the lower the regular rate for the week. The regular rate cannot be less than the applicable minimum wage (state or federal).

7. **Explore options for other pay plans and overtime exemptions that may or may not involve a change in duties.** For example, if the position can be paid primarily by commissions and your establishment meets the DOL "retail" definition, if your state permits it, the position could possibly be classified as exempt under Section 7(i) of the FLSA.

   As another example: If the salary level is sufficient, but the employee does not meet the duties tests for the Executive exemption; if the position requires the employee to exercise a significant amount of independent judgment and discretion, explore the possibility of applying the Administrative exemption.

As you evaluate the options for reclassifying positions from exempt to nonexempt, keep these important considerations in mind:

- If you have fringe benefits with eligibility criteria tied to exempt/nonexempt classifications, reclassified employees may lose these benefits. To maintain the morale of reclassified workers, eligibility criteria for fringe benefits could be revised so they are based on position titles or a management-level designation.

- To minimize overtime, ensure that employees in nonexempt positions take a meal break each day. In accordance with the FLSA, to deduct a break from work time (and, thus, pay), the break must be at least 30 minutes long and uninterrupted by any work-related duties. Requiring nonexempt employees to take one 30-minute break each day will save to 2.5 hours per week. *(Note: Some states require employees to take a meal break—be certain that your company complies with any such provisions and that reclassified employees are aware of the requirements.)*

- For positions classified as nonexempt, <u>overtime must be paid on all earnings including nondiscretionary bonuses and commissions</u>. If the bonus or commission payment must be delayed in order to calculate it, employers must make a retroactive overtime calculation on the additional bonuses or commissions earned during any weeks in the period where overtime was worked.

- If a reclassified employee works outside of core scheduled hours either from home or remotely using electronic devices, any work time that is beyond a *de minimus* amount (seven minutes or more consecutively or nonconsecutively) must be tracked, recorded, and included in the total hours worked for the week.

- Increasing the minimum salary for employees in EAP exempt positions who meet the duties test can result in **wage compression issues** (situations where the individual who received the increase is now earning a salary at or very close to the rate earned by his or her boss). We recommend carefully evaluating pay rates for the managers of employees who receive an increase in their salary. If the increase creates a compression issue, aside from freezing the employee's pay (which can only be done for three years), the only other solution is to increase the manager's pay. *Needless to say, this can have a costly ripple effect throughout the organization.*

- Employers are <u>not</u> permitted to continually adjust wage rates each week in order to manipulate the regular rate to ensure the employee receives essentially the same amount of earnings each week.

- Nonexempt employees must receive the applicable minimum wage (federal, state, or local) for hours worked up to 40 in a workweek and overtime for hours worked in excess of 40.[3]

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[3] Some states require payment of overtime if employees reach a daily threshold. In California, employers must pay overtime after 8 hours per day and double time after 12 hours per day to nonagricultural employees. In Alaska, Nevada, and Puerto Rico, employers must pay overtime after 8 hours per day. In Colorado, employers must pay overtime after 12 hours per day. If these daily thresholds are not met but the employee still works over 40 hours per week, overtime must be paid after 40 hours.