

## DEPARTMENT OF LABOR FINAL RULE TO REVISE OVERTIME REGULATIONS

On May 18, 2016, the Department of Labor (DOL) released a final rule that revises regulations governing overtime compensation under the Fair Labor Standards Act (FLSA).<sup>1</sup> Specifically, the final rule increases the salary threshold for employees to be exempt from overtime compensation, impacting an estimated 4.5 million employees in the United States. Highlights of the final rule include:

- Increased minimum salary threshold to be exempt from overtime compensation to \$47,476;
- Automatic updates to salary thresholds every three years; and
- Higher salary thresholds effective December 1, 2016.

### **Background**

In 1938, President Roosevelt signed the Fair Labor Standards Act, which created overtime pay and led to the 40 hour work week. A key goal of this legislation was to ensure workers are paid fairly for their time.<sup>2</sup>

Now, workers who are paid hourly wages or who earn salaries below a certain threshold generally are entitled to time-and-a-half pay for time worked beyond 40 hours in a given week. To be exempt from overtime pay, employees must meet certain tests regarding their job duties and earn a salary above a threshold set by the current DOL regulation. Workers above the wage threshold who perform executive, administrative, or professional duties (including academic and creative) do not qualify for overtime compensation – also known as the “white collar exemption” under the “duties test.”

Historically, the salary threshold has been a fixed amount that did not change with inflation. DOL updated the fixed salary threshold twice in the last 40 years:

- In 1975 the Department of Labor set the threshold below which workers were entitled to overtime pay at \$250 per week.
- In 2004 that threshold was set at \$455 per week, or \$23,660 annually. Today, this amount is below the current poverty line for a worker supporting a family of four, and below 1975 levels in inflation-adjusted terms.<sup>3</sup>

The Obama Administration asserts that the 2004 salary threshold was too low, given the simultaneous changes made to the duties test.<sup>4</sup> After the implementation of the 2004 revised rule, only 8 percent of salaried workers fell below the threshold that would guarantee them overtime protections (compared with 62 percent in 1975). Many of the remaining 92 percent of salaried workers were ineligible for overtime compensation, because their duties qualified them for white collar exemptions.<sup>5</sup> First responders and blue

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<sup>1</sup> “Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees.” Department of Labor. May 18, 2016. <https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-11754.pdf>.

<sup>2</sup> “Everything You Need to Know About Updating Overtime Pay.” Department of Labor. July 8, 2015. <http://blog.dol.gov/2015/07/08/everything-you-need-to-know-about-updating-overtime-pay/>.

<sup>3</sup> “Fact Sheet: Opportunity for All: Rewarding Hard Work by Strengthening Overtime Protections.” White House Press Release. March 13, 2014. <http://www.whitehouse.gov/the-press-office/2014/03/13/fact-sheet-opportunity-all-rewarding-hard-work-strengthening-overtime-pr>.

<sup>4</sup> “Fact Sheet: Final Rule to Update the Regulations Defining and Delimiting the Exemption for Executive, Administrative, and Professional Employees.” U.S. Department of Labor Wage and Hour Division. May, 2016. <https://www.dol.gov/whd/overtime/final2016/overtime-factsheet.pdf>.

<sup>5</sup> “An Updated Analysis of Who Would Benefit from an Increased Overtime Salary Threshold.” Economic Policy Institute. June 26, 2015. <http://www.epi.org/blog/an-updated-analysis-of-who-would-benefit-from-an-increased-overtime-salary-threshold/>.

collar workers that perform physical labor or repetitive operations with their hands are eligible for overtime pay.<sup>6</sup>

### **DOL Final Rule Changes**

The Department of Labor's final rule raises the minimum salary threshold to qualify as exempt from overtime compensation to \$913 per week, or \$47,476 annually. The salary threshold is based on the 40<sup>th</sup> percentile of salaries in the lowest income Census region (South). The final rule also raises the salary threshold for "highly compensated employees" to \$134,004, equivalent to the 90<sup>th</sup> percentile of full-time salaried workers nationally.<sup>7</sup> Bonus and incentive payments will count toward 10 percent of the new salary level. These salary thresholds automatically will be updated every three years to account for inflation and wage growth over time.<sup>8</sup>

The final rule does not include any changes to the duties test, which determines white collar exemptions. Employers use the duties test to determine whether employees earning more than \$47,476 per year, but who have certain job functions, would qualify as exempt from overtime compensation.

The rule will go into effect on December 1, 2016. However, there is an exception for some organizations that provide Medicaid-funded services to individuals with intellectual disabilities.<sup>9</sup> The agency will not enforce the updated policy for this small group of organizations until March 17, 2019. DOL has provided a fact sheet and guidance that include more information on how the overtime changes specifically will impact nonprofit employers.<sup>10, 11</sup>

The Administration estimates that the final rule would benefit approximately 4.5 million employees. President Obama stated that updating the overtime regulations is "good for workers who want fair pay, and it's good for business owners who are already paying their employees what they deserve – since those who are doing right by their employees are undercut by competitors who aren't."<sup>12</sup>

The revision of overtime regulations has received a mixed public response. Supporters of the final rule say stronger overtime pay protections will benefit workers and the economy, while others are concerned about the final rule's impact on organizations with tight budgets.<sup>13, 14, 15</sup>

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<sup>6</sup> "Fact Sheet #17A: Exemption for Executive, Administrative, Professional, Computer & Outside Sales Employees under the Fair Labor Standards Act (FLSA)." Wage and Hour Division, U.S. Department of Labor. July, 2008. [http://www.dol.gov/whd/overtime/fs17a\\_overview.htm](http://www.dol.gov/whd/overtime/fs17a_overview.htm)

<sup>7</sup> The revised regulations mean that employees with base compensation of \$913 per week and total annual compensation less than \$134,004 per year may qualify as exempt from overtime protections if employee activities meet certain criteria.

<sup>8</sup> "Fact Sheet: Final Rule to Update the Regulations Defining and Delimiting the Exemption for Executive, Administrative, and Professional Employees." U.S. Department of Labor Wage and Hour Division. May, 2016. <https://www.dol.gov/whd/overtime/final2016/overtime-factsheet.pdf>.

<sup>9</sup> "Non-Enforcement policy for providers of Medicaid-funded services for individuals with intellectual or developmental disabilities in residential homes and facilities with 15 or fewer beds." U.S. Department of Labor Wage and Hour Division. <https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-11754.pdf>.

<sup>10</sup> "Overtime Final Rule and the Non-Profit Sector." U.S. Department of Labor. <https://www.dol.gov/sites/default/files/overtime-nonprofit.pdf>.

<sup>11</sup> "Guidance for Non-Profit Organizations Paying Overtime under the Fair Labor Standards Act." U.S. Department of Labor Wage and Hour Division. May 18, 2016. <https://www.dol.gov/whd/overtime/final2016/nonprofit-guidance.pdf>.

<sup>12</sup> Obama, Barack. "A Hard Day's Work Deserves a Fair Day's Pay." *Huffington Post*. June 29, 2015. [http://www.huffingtonpost.com/barack-obama/a-hard-days-work-deserves-a-fair-days-pay\\_b\\_7691922.html](http://www.huffingtonpost.com/barack-obama/a-hard-days-work-deserves-a-fair-days-pay_b_7691922.html).

<sup>13</sup> Doovere, Edward-Isaac, and Marianne Levine. "President Obama Overtime Rule Could Raise Wages for 5 Million." *Politico*. June 29, 2015. <http://www.politico.com/story/2015/06/obama-overtime-rule-wage-raise-119566.html>.

<sup>14</sup> Sugar, Rachel. "5 Million More Americans Could Soon Be Eligible for Overtime Pay – But Critics Say It Won't Mean Any More Money in the Bank." *Business Insider*. June 30, 2015. <http://www.businessinsider.com/5-million-more-americans-could-be-about-to-be-eligible-for-overtime-pay-2015-6#ixzz3eZUuPogk>.

<sup>15</sup> Deschenaux, Joanne and Beth Mirza. "DOL Announces Long-Awaited Overtime Expansion Proposal." Society of Human Resource Managers, June 30, 2015. <http://www.shrm.org/legalissues/federalresources/pages/dol-announces-ot-changes.aspx>.

## **Implications for Nonprofit Sector**

The first step in determining how this revised rule impacts a nonprofit is to determine the extent to which employees are covered by the Fair Labor Standards Act. Nonprofit organizations or their individual employees must comply with FLSA rules if they meet one of two standards:<sup>16</sup>

1. *Enterprise Coverage* – Employees who work for nonprofits that have “business” revenue of at least \$500,000 are protected under FLSA. This calculation excludes “charitable, religious, educational, or similar activities of organizations operated on a non-profit basis where such activities are not in substantial competition with other businesses.”
2. *Individual Coverage* – For nonprofits that do not meet the threshold for enterprise coverage, their employees may be protected by the FLSA if their work regularly involves commerce between states. Examples of activities that may qualify an employee for individual protection include sending mail to persons located in other states or receiving donations from other states.

In practice, these two criteria mean that FLSA likely covers a large portion of the nonprofit sector. However, it can be difficult to assess whether a specific activity qualifies as business revenue or interstate commerce under FLSA. Therefore, the Department of Labor released additional guidance to help nonprofit employers determine how to comply with the law.<sup>17</sup>

In addition to these two federal criteria, some state laws indicate that any changes to federal rules apply to almost all employers in that state. Nonprofits may want to consult legal counsel within their states to clarify how FLSA may apply to their organization.<sup>18</sup>

The second step in determining how the final rule may impact a nonprofit is to consider the organization’s staffing needs in conjunction with current finances and employee workload. The DOL guidance for nonprofits outlines several options that employers may want to consider:<sup>19</sup>

- *Reclassify employees* – A larger proportion of full-time nonprofit employees will be reclassified from exempt to non-exempt, becoming eligible for overtime compensation. Bureau of Labor Statistics data indicate that the average and median wages for all full-time nonprofit employees fall below the annual salary threshold of \$47,476, but employees work less than 40 hours per week, on average.<sup>20</sup>
- *Rebase salaries* - For employees that work more than 40 hours per week, employers can replicate current levels of compensation by reducing base salaries to offset increased expenses in overtime compensation.<sup>21</sup>
- *Increase salaries* – For employees with salaries near the threshold, nonprofit employers may prefer to increase their annual salaries above the \$47,476 threshold, which, when combined with the duties test, could make them exempt from overtime compensation.
- *Reduce hours* – Employers can choose to reduce the work hours for new, non-exempt employees to ensure they do not exceed the 40-hour per week threshold that triggers overtime compensation. Employers also may want to restrict the use of electronic devices for after-hours work.

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<sup>16</sup> “Guidance for Non-Profit Organizations Paying Overtime under the Fair Labor Standards Act.” U.S. Department of Labor Wage and Hour Division. May 18, 2016. <https://www.dol.gov/whd/overtime/final2016/nonprofit-guidance.pdf>.

<sup>17</sup> Ibid.

<sup>18</sup> “Automatic Application of Overtime Rules.” National Council of Nonprofits. <https://www.councilofnonprofits.org/trends-policy-issues/automatic-application-of-overtime-rules>.

<sup>19</sup> “Guidance for Non-Profit Organizations Paying Overtime under the Fair Labor Standards Act.” U.S. Department of Labor Wage and Hour Division. May 18, 2016. <https://www.dol.gov/whd/overtime/final2016/nonprofit-guidance.pdf>.

<sup>20</sup> “Nonprofit Establishments: Mean and median hourly, weekly, and annual earnings and mean weekly and annual hours of full-time workers in private industry by work level.” U.S. Bureau of Labor Statistics. 2010. <http://www.bls.gov/ncs/ocs/sp/nctb1507.pdf>.

<sup>21</sup> Barkume, Anthony J. “Some New Evidence on Overtime Use, Total Job Compensation, and Wage Rates.” Working Paper, U.S. Bureau of Labor Statistics. January 2007. <http://www.bls.gov/osmr/pdf/ec070010.pdf>.

- *Hire additional employees* - Employers also could choose to hire additional employees to more equitably distribute the workload and ensure employees work no more than 40 hours per week. Some advocates say this trend may improve the job market for unemployed individuals.<sup>22</sup>

Third, the Department of Labor guidance recommends philanthropic and government funders adjust existing funding agreements with nonprofits to account financial or staffing changes that may result from this revised rule.<sup>23</sup> Nonprofits that will see increased program costs due to revised overtime rule also may want to consider proactively reaching out to philanthropic and government funders to discuss adjusting program goals or funding agreements. For example, if organizations choose to limit employee hours to avoid paying overtime compensation, they may need to discuss with funders reducing anticipated program outputs or outcomes. Conversely, nonprofits also can consider outlining for funders why additional funding for staff may be necessary to meet mutually agreed upon outputs or outcomes.

Finally, all employers may need to reexamine how employees track time to ensure adherence to a 40-hour work week. Nonprofit employers with currently-exempt employees earning salaries between \$23,000 and \$47,476 per year should consider how this final rule will impact their organizations. Employers may want to consider how they may need to adjust their human resource policies and recordkeeping procedures to reflect the larger number of employees eligible for overtime compensation. Employers' analyses should include a review of salaries, work schedules, benefits provisions and primary duties. Specifically, employers may need to:

- *Retrain* supervisors and employees about the new rules to ensure that new, non-exempt employees' workloads comply with the new FLSA rule;
- *Reassess* the recordkeeping systems or technology used to track individual employee work hours to ensure they are in compliance with FLSA; and
- *Reevaluate* the organization's benefit structure to ensure that newly classified exempt employees receive the appropriate benefits (particularly if exempt and non-exempt employees currently have different benefits).

For additional information, please feel free to contact [publicpolicy@independentsector.org](mailto:publicpolicy@independentsector.org).

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<sup>22</sup> Barkume, Anthony J. "Some New Evidence on Overtime Use, Total Job Compensation, and Wage Rates." Working Paper, U.S. Bureau of Labor Statistics. January 2007. <http://www.bls.gov/osmr/pdf/ec070010.pdf>.

<sup>23</sup> "Guidance for Non-Profit Organizations Paying Overtime under the Fair Labor Standards Act." U.S. Department of Labor Wage and Hour Division. May 18, 2016. <https://www.dol.gov/whd/overtime/final2016/nonprofit-guidance.pdf>.