

On May 18, 2016, the U.S. Department of Labor (DOL) [announced](#) the release of a final rule updating regulations under the Fair Labor Standards Act (FLSA) which exempt executive, administrative, and professional employees from its minimum wage and overtime requirements (often referred to as the white collar exemptions). The rule was published in the May 23, 2016 [Federal Register](#) and goes into effect on December 1, 2016.

While the FLSA provides minimum wage and overtime pay protections for most employees, some workers, including bona fide executive, administrative, and professional employees, are exempt from those protections. For more than a half century, the DOL regulations have generally required each of the following three tests to be met for this exemption to apply:

1. The employee must be paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed (salary basis test);
2. The amount of salary paid must meet a minimum specified amount (salary level test); and
3. The employee's job duties must primarily involve executive, administrative, or professional duties as defined by the regulations (duties test).

The DOL last updated these regulations in 2004, when it set the weekly salary level at \$455 (\$23,660 annually) and made other changes to the regulations, including collapsing the short and long duties tests into a single standard duties test and introducing a new exemption for highly compensated employees.

Highlights of the Final Rule

The final rule focuses primarily on updating the salary and compensation levels needed for executive, administrative, and professional employees to be exempt. Specifically, the final rule:

- › Sets the standard salary level at the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region, currently the South, which is \$913 per week or \$47,476 annually for a full-year worker;
- › Sets the total annual compensation requirement for highly compensated employees (HCEs) subject to a minimal duties test to the annual equivalent of the 90th percentile of full-time salaried workers nationally, which is \$134,004; and
- › Establishes a mechanism for automatically updating the salary and compensation levels every three years to maintain the levels at the above percentiles.

Additionally, the final rule amends the salary basis test to allow employers to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the new standard salary level. Note that the final rule makes no changes to the duties tests.

Standard Salary Level

As stated above, the final rule sets the standard salary level (threshold) at the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage Census Region, currently the South (\$913 per week, equivalent to \$47,476 per year for a full-year worker). The final rule also updates the special salary level for employees in American Samoa (to \$767 per week) and the special “base rate” for employees in the motion picture industry (to \$1,397 per week).

The salary level test does not apply to outside sales employees, teachers, and employees practicing law or medicine. Academic administrative employees may qualify for exemption either by satisfying the standard salary level test or, alternatively, being paid on a salary basis at a rate at least equal to the entrance salary for teachers in the educational establishment at which the employee is employed.

HCE Total Annual Compensation Requirement

The final rule sets the HCE total annual compensation level equal to the 90th percentile of earnings of full-time salaried workers nationally (\$134,004 annually). To be exempt as an HCE, an employee must also receive at least the new standard salary amount of \$913 per week on a salary or fee basis and pass a minimal duties test.

If an employee’s total compensation in a given annual period fails to meet the \$134,004 threshold, an employer may make a “catch-up” payment within one month of the end of the annual period. Any such catch-up payment counts only toward the prior year’s total annual compensation. If such a catch-up payment is not made within the timeframe allotted, the exemption is lost for the prior quarter and the overtime premium must be paid.

Automatic Increases

To prevent the salary levels from becoming outdated, they will be updated automatically every three years. The DOL will publish a notice with the new updated thresholds in the *Federal Register* at least 150 days before those updated amounts take effect. The first update will take effect on January 1, 2020; future automatic updates will take effect on January 1 of 2023, 2026, etc.

Inclusion of Nondiscretionary Bonuses and Incentive Payments

According to the final rule, employers may use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the standard salary level. For employers to credit these payments toward the salary level test, they must be paid on a quarterly or more frequent basis.

Nondiscretionary bonuses and incentive payments (including commissions) are forms of compensation promised to employees to induce them to work more efficiently or to remain with the company. Examples include individual or group production bonuses, and bonuses for quality and accuracy of work. Incentive payments, including commissions, are also considered nondiscretionary as such payments are generally based on a prior contract or understanding, and employees generally have a contract right to the commission promised.

By contrast, discretionary bonuses are generally paid without prior contract, promise, or announcement, and the decision to provide the bonus and the payment amount is at the employer's sole discretion. An example would be an "on-the-spot" award made without announcement and at the employer's sole discretion (e.g., an unannounced year-end bonus). Discretionary bonuses cannot be used to satisfy the salary level requirement.

If an employee does not earn enough of a nondiscretionary bonus or incentive payment in a given quarter to retain his or her exempt status, the DOL permits the employer to make a "catch-up" payment no later than the next pay period after the end of the quarter. If such a catch-up payment is not made within the timeframe allotted, the exemption is lost for the prior quarter and the overtime premium must be paid.

Requirements for Exemptions Under New Final Rule

Exemption	Salary Level Test	Salary Basis Test	Duties Test
Executive	At least \$913 per week (\$47,476 per year).	<ul style="list-style-type: none"> At least 90% of the salary level (\$822 per week) must be paid on a "salary" basis. Up to 10% (\$91 per week) may be satisfied with nondiscretionary bonuses or incentive payments. 	The employee's "primary duty" must be that of an exempt executive employee.
Administrative	<ul style="list-style-type: none"> At least \$913 per week (\$47,476 per year). "Academic administrative personnel" may qualify with a salary at least equal to the entry salary for teachers at their educational establishment. 	<ul style="list-style-type: none"> At least 90% of the salary level (\$822 per week) must be paid on a "salary" or "fee" basis. Up to 10% of the salary level (\$91 per week) may be satisfied with nondiscretionary bonuses or incentive payments. 	The employee's "primary duty" must be that of an exempt administrative employee.
Professional	At least \$913 per week (\$47,476 per year). Salary level test does not apply to doctors, lawyers, or teachers.	<ul style="list-style-type: none"> At least 90% of the salary level (\$822 per week) must be paid on a "salary" or "fee" basis. Up to 10% of the salary level (\$91 per week) may be satisfied with nondiscretionary bonuses or incentive payments. <p>These requirements do not apply for doctors, lawyers, and teachers.</p>	The employee's "primary duty" must be that of an exempt professional employee.
Computer	At least \$913 per week (\$47,476 per year), <u>or</u> at least \$27.63 per hour.	<ul style="list-style-type: none"> At least 90% of the salary level (\$822 per week) must be paid on a "salary" or "fee" basis unless the employee is paid on an hourly basis and receives at least \$27.63 per hour. Up to 10% of the salary level (\$91 per week) may be satisfied with nondiscretionary bonuses or incentive payments. 	The employee's "primary duty" must be that of an exempt professional employee.

Requirements for Highly Compensated Employees (HCEs)

Total Annual Compensation Requirement	Salary Basis Test	Duties Test
\$134,004 per year in total compensation, including payment of at least \$913 per week.	<ul style="list-style-type: none"> 100% of the standard salary level (\$913 per week) must be paid on a "salary" or "fee" basis. The remainder of the HCE total annual compensation requirement may be paid in nondiscretionary bonuses or incentive payments (including commissions). 	<ul style="list-style-type: none"> The employee's "primary duty" must be office or non-manual work. The employee must "customarily and regularly" perform any one or more of the exempt duties or responsibilities of an executive, administrative, or professional employee.