



What the new

# OVERTIME RULES

mean to employers



For years, federal regulations covering overtime pay and who is entitled to receive it have come under fire — from both employers and employees.

Employers claimed that the regulations were too hard to understand and apply. They said it was too easy to mistakenly violate the overtime pay rules. Employees had complaints, too. They felt that the rules contained “loopholes” that allowed employers to avoid paying millions of employees their rightful overtime pay.

## **New Rules Issued**

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To address these concerns, the U.S. Department of Labor (DOL) has made extensive revisions to the rules dealing with overtime pay exemptions. The final regulations go into effect on August 23, 2004.

In some cases, the new rules expand the number of employees who are exempt from overtime pay. In other cases, employees who were exempt from overtime pay in the past will now qualify.

This booklet provides a summary of the new rules and how they apply. However, before acting on anything in this summary, consult with a professional advisor.

## **In General**

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The Fair Labor Standards Act (FLSA) provides that workers are generally entitled to receive time and a half pay for all hours worked over 40 hours a week. However, the law includes some general exceptions for those who perform certain executive, administrative, professional, computer, or outside sales duties. The DOL’s regs explain who qualifies for overtime pay and who is exempt from the overtime rules.\*

Under the FLSA regulations, employees generally cannot be “exempt” unless they are guaranteed a minimum weekly salary *and* perform certain job-

\* Federal law provides minimum standards that may be exceeded, but cannot be waived or reduced. Individual states may impose stricter standards than those provided by federal law, as may collective bargaining agreements. Also, an employer may choose to apply more generous standards on its own.

related duties. The new regulations make significant changes to both requirements.

### The New Regs in a Nutshell

Key provisions of the new DOL rules include:

- Overtime pay exemptions do not apply to manual laborers or other “blue collar” workers.
- Exemptions do not apply to police officers, firefighters, paramedics, and other public safety personnel (so-called “first responders”).
- The prior \$155 a week minimum salary level for exemption increases to \$455 a week. Thus, employees earning less than \$23,660 a year must generally be paid overtime.
- Those earning at least \$100,000 a year will be exempt from overtime pay if they “customarily and regularly” perform at least one of the duties of an executive, administrative, or professional employee.
- Definitions of the exemption categories are simplified, and computer professionals are made a separate category.

## Automatic Qualification for Overtime Pay

Job titles alone do not determine an employee’s exempt status. The status of a particular employee will depend on whether the employee’s salary and duties meet the regulatory requirements.

However, the regs do provide that some workers are *automatically eligible* for overtime pay, no matter how much they earn. These include:

**Manual laborers or other “blue collar” workers** who perform repetitive work using their hands, physical skills, and energy, such as nonmanagement production-line employees and nonmanagement employees in maintenance, construction, and similar occupations.

**Administrative Tip:** Carpenters, electricians, mechanics, plumbers, ironworkers, craftsmen, longshoremen, con-

struction workers and laborers, and similar workers must be paid overtime.

**“First responders”** who perform such duties as preventing, controlling, or extinguishing fires; rescuing fire, accident, or crime victims; conducting investigations or inspections for law violations; and pursuing, restraining, and apprehending suspects.

**Administrative Tip:** Included in this category are police officers, sheriffs, state troopers, police investigators or detectives, corrections officers, park rangers, firefighters, paramedics, and other emergency personnel. These workers are eligible for overtime regardless of rank or whether they also have supervisory duties.

In addition, most workers who *earn less than \$455 a week*, or \$23,660 a year, are automatically qualified for overtime pay.

**Administrative Tip:** An exception to this minimum salary rule applies to certain professional employees. For example, teachers, licensed physicians or lawyers engaged in the practice of medicine or law, and medical interns or residents are not automatically qualified for overtime when earning less than the minimum pay.

## Automatic Exemption from Overtime Pay

Under the new regulations, **highly compensated employees** are generally exempt from the overtime pay rules. An employee who earns total compensation of at least \$100,000 a year (prorated if employment is for less than a year) is highly compensated. The exemption applies if:

- The employee’s total annual compensation includes at least \$455 a week (\$23,660 a year) paid on a *salary or fee basis*, and
- The employee “customarily and regularly” performs *at least one* of the exempt duties and responsibilities of an executive, administrative, or professional employee (as defined later), and
- The employee’s primary duty includes performance of office or nonmanual work.

**Administrative Tip:** Suppose the year is coming to a close and an employer sees that an employee’s total compensation will fall short of the \$100,000 minimum. The regs allow the employer, during the last pay period or within one month after the end of the year, to make one final payment to bring the employee’s total compensation up to the minimum.

## Paid on a “Salary Basis”

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With limited exceptions, employees must be paid on a salary basis to be exempt from overtime. An employee who is regularly paid a preset amount each pay period, which cannot be reduced due to the quality or quantity of work, is paid on a “salary basis.”

In general, the full salary must be paid for any week in which the employee performs any work — regardless of the number of days or hours worked or whether work is or is not available. The new regulations provide some exceptions, however.

- Pay deductions may occur when an exempt employee is absent from work for one or more full days for personal reasons, other than sickness or disability. So, if an employee is absent for personal reasons for a day and a half during a week, the employer can deduct one full day’s pay from the employee’s salary.
- Employers may deduct for absences of one or more full days due to sickness or disability *but only* if there is a bona fide sick pay or disability income plan, practice, or policy in place (either provided by the employer or through a state law).

**Administrative Tip:** Employers may also deduct salary for full-day absences occurring *before* the employee has qualified for a sick or disability pay plan and *after* the employee has exhausted the leave allowance for that plan.

- Employers may deduct for penalties imposed in good faith for infractions of significant safety rules (generally, relating to the prevention of serious danger in the workplace).
- Pay deductions may also be made when an employee is suspended from work for one or more

full days due to a violation of a written workplace conduct rule that applies to all employees.

An employer should be careful not to make improper deductions from an exempt employee’s salary. The employer can lose the overtime pay exemption if the facts show that the employer did not intend to pay an employee on a salary basis. Making improper deductions from an employee’s salary shows that intent.

Note that administrative and professional employees may be paid on a fee basis, rather than a salary basis, and still qualify as exempt. An employee is paid on a “fee basis” if the employee receives an agreed amount for a single job, regardless of the time needed to complete the job. The regs outline a test to ensure that the fee is equivalent to the \$455 weekly minimum salary required for exemption.

## Exemption Categories

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Whether employees with compensation between \$23,660 and \$100,000 are exempt or are required to receive overtime pay requires some analysis of their role in the work force. As noted earlier, the FLSA spells out overtime pay exemptions for those who are employed as bona fide executive, administrative, professional, computer professional, and outside sales employees. Each exemption has its own set of requirements.

### Executive Employee Exemption

To qualify for the executive employee exemption from the overtime rules, an employee must:

- Be compensated on a salary basis at no less than \$455 a week.
- Have the primary duty of managing the enterprise or a recognized department or subdivision of the enterprise.
- Customarily and regularly direct the work of two or more full-time employees or the equivalent.
- Be able to hire or fire other employees, or make suggestions and recommendations as to their hiring,

firing, advancement, promotion, or other change of status that carry particular weight in those decisions.

The executive employee exemption also includes any employee who owns at least a 20% equity interest in the employer's enterprise, whether or not the employee is paid on a salary basis.

### Administrative Employee Exemption

To qualify for the administrative employee exemption from the overtime rules, an employee must:

- Be compensated on a salary or fee basis at no less than \$455 a week.
- Have the primary duty of performing office or nonmanual work directly related to the general business operations or the management of the employer or the employer's customers.
- Be required to exercise discretion and independent judgment with respect to "matters of significance" as part of the primary job duty.

Administrative employees assist with the running or servicing of the business. This category includes, but is not limited to, work in functional areas such as: tax, finance, accounting, and budgeting; insurance; quality control; purchasing; advertising and marketing; personnel management; and similar activities.

**Administrative Tip:** Insurance claims adjusters, certain employees in the financial services industry, executive or administrative assistants to business owners or senior executives of large businesses, and human resource managers are examples listed in the regulations of employees who commonly qualify under the administrative employee exemption.

Administrative duties also include working directly with the management or business operations of an employer's customers. Thus, employees acting as consultants to clients or customers may be exempt.

### Professional Employee Exemption

The professional employee exemption from the overtime rules applies when the following tests are met:

- The employee is compensated on a salary or fee basis at no less than \$455 a week.

- The employee's primary duty is performing work requiring advanced knowledge, defined as work that is predominantly intellectual in character and includes work requiring the consistent exercise of discretion and judgment.
- The advanced knowledge is in a field of science or learning.
- The advanced knowledge is customarily acquired by a prolonged course of specialized intellectual instruction.

Examples of fields of science and learning include: law; medicine; accounting; engineering; architecture; teaching; the various physical, chemical and biological sciences; and other professional areas. The knowledge is typically acquired by receiving the appropriate academic degree. The exception does not apply to occupations where employees generally acquire their knowledge or skill through experience rather than academic instruction.

Generally, teachers from nursery school through college are exempt. As stated earlier, teachers do not have to be paid on a salary basis or be paid the minimum \$455 a week to be exempt.

**Creative Professionals.** The regulations carve out a special exemption for creative professionals. The minimum salary requirement must be met and an employee's primary duty must be to perform work requiring invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor.

### Computer Professional Exemption

The regulations list "computer professionals" as a separate exempt classification under which computer systems analysts, computer programmers, software engineers, and similarly skilled workers are exempt from overtime if they are:

- Compensated *either* on a salary or fee basis at a rate not less than \$455 a week *or*, if compensated hourly, are paid at least \$27.63 an hour.
- Primarily engaged in one or more of several computer-related functions specified in the regulations.

Among the described functions are systems or program design, development, documentation, analysis, creation, testing, or modification.

**Administrative Tip:** The computer employee exemption does not include employees engaged in the manufacture or repair of computer hardware and related equipment.

### Outside Sales Employee Exemption

To qualify for the outside sales employee exemption from the overtime rules, an employee must:

- Have the primary duty of making sales or obtaining orders or contracts for services or for the use of facilities.
- Customarily and regularly be engaged away from the employer's place of business.

An outside sales person typically makes sales at the customer's place of business or home. "Outside sales" do not include sales made by mail, telephone, or over the Internet unless such contact is used together with personal sales calls. Promotional work may or may not be exempt, depending on the situation. The minimum salary requirements do *not* apply to the outside sales exemption.

## Your Next Step

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Once you're familiar with the new overtime pay rules, you need to apply them to your work force. Since the rules are still complicated in many cases, you are well advised to seek the guidance of a professional to help you determine who is exempt from the overtime pay rules — and who is not. Obtaining advice now could avoid significant costs later in back overtime pay and penalties.

Our professionals are available to consult with you on a wide variety of business financial issues, including payroll and overtime pay questions. Contact us today.

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