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New Federal Overtime Rule with Increased Salary Thresholds Takes Effect July 2024

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A new rule from the United States Department of Labor (DOL) is about to extend the guarantee of overtime pay to a lot of employees who are not currently receiving it.

DOL has published its final rule updating the minimum weekly salary required for employees to qualify for exemption from overtime pay under federal law. Effective July 1, 2024, the new salary threshold will result in many currently exempt salaried employees becoming eligible for overtime compensation. An additional increase to the minimum salary level will occur on January 5, 2025, further expanding overtime eligibility. The full text of the rule may be found here (https://www.dol.gov/sites/dolgov/files/WHD/flsa/ot-541-final-rule.pdf).

BACKGROUND

Since 1938, the federal Fair Labor Standards Act (FLSA) has required employers to pay employees overtime compensation at a rate of 1.5 times their regular rate of pay for hours worked beyond 40 in a workweek unless they are exempt. Positions are exempt if specific criteria are met. The current regulations, last revised in 2019, have three requirements for exemption:

1. the position must be salaried ("salary basis test");
2. the position must be paid a minimum of $684 per week ($35,568 annually) ("salary threshold test"); and
3. the position's duties must satisfy either the executive, administrative or professional duties test.

I have discussed these requirements in previous blog posts. Read about the salary basis test here (http://canons.sog.unc.edu/?p=7385), the executive duties test here (http://canons.sog.unc.edu/?p=7464), the administrative duties test here (http://canons.sog.unc.edu/?p=7537) and here (http://canons.sog.unc.edu/?p=7765), and the professional duties test here (http://canons.sog.unc.edu/?p=7812)and here (http://canons.sog.unc.edu/?p=7840).

The new rule makes no changes to the duties tests or any of the other rules regarding compensable time and overtime, except to the salary threshold test. But that change is a big one.

THE NEW MINIMUM SALARY THRESHOLDS

The new final rule establishes a two-phase implementation for the increased salary requirements.

Phase 1: Effective July 1, 2024

Beginning on July 1, 2024, an employee will have to earn a minimum of $844 per week to be exempt from overtime pay (that would be $1,688 on a biweekly basis, $3,658 monthly or $43,888 annualized). That represents the 20th percentile of weekly earnings for full-time non-hourly workers in the lowest wage Census Region, currently the South. Employees currently classified as exempt will lose that status on July 1 if their salaries fail to meet the new threshold. Starting then, employers will have to pay those employees overtime pay for hours over 40.

Phase 2: Effective January 1, 2025

Just six months later, on January 1, 2025, the salary minimum will increase further to $1,128 per week ($58,656 annualized). This new level represents the 35th percentile of full-time non-hourly worker earnings in the South Region. The updated minimum salary regulations will be found at 29 CFR § 541.600(1) and (2) beginning on July 1, 2024 (until that time 29 CFR § 541.600 will reflect the current minimum salary threshold of $684 per week).

The failure to meet the increased salary requirements will by itself result in the loss of exemption status. Any exempt employee not meeting the new weekly minimum will become eligible for overtime compensation, regardless of their duties.

Inclusion of Nondiscretionary Bonuses in the Minimum Salary Calculation

To a limited extent, nondiscretionary bonuses count toward meeting the salary threshold. Under the new rule, employers will still be permitted to count nondiscretionary bonuses and commissions toward up to 10% of the increased minimum salary levels. From July 1, 2024 through December 31, 2024, this 10% cap equals $84.40 per week or $4,388.80 annualized, provided bonuses are paid at least annually. Beginning January 1, 2025, 10% will be $112.80 per week or $5,865.60 annually.

What is a nondiscretionary bonus?

To make use of this provision, employers must understand what constitutes a ***nondiscretionary*** versus ***discretionary*** bonus as defined at 29 CFR § 778.211 (https://www.law.cornell.edu/cfr/text/29/778.211). A discretionary bonus is one which may be given or not in the sole judgment of the employer. It is up to the manager to decide to which employees and in what amount to award a bonus. A nondiscretionary bonus, in contrast, is one which accrues to the employee automatically as a function of policy, such as:

- bonuses announced to incentivize steady and efficient work or retention;
- attendance bonuses;
- individual or group production bonuses;
- bonuses for the quality and accuracy of work; or
- longevity bonuses.

For public employers, longevity pay is the most common form of nondiscretionary bonus. Public employers have traditionally paid longevity bonuses once a year. To make use of longevity payments in meeting the salary threshold, employers must make longevity payments on either a weekly, biweekly or a quarterly basis. A once-a-year payment may not be used in calculating compliance with the salary threshold.

How Does the Inclusion of Nondiscretionary Bonuses Work in Practice?

Effective January 1, 2025, the amount of nondiscretionary bonus payments that may be credited toward the salary minimum for exemption will be $112.80 per week or $5,865.60 annually (that is, 10% of the salary threshold). Employers may designate any 52-week period as the "year." If undesignated, the year measurement defaults to the calendar year.

Whenever an employer uses nondiscretionary bonuses to meet the salary threshold, it will need to double-check at the end of each year that employees for whom they are claiming exempt status on this basis are in fact being paid the required minimum salary. If they are not, DOL will allow employers to make a “catch-up” payment to bring an employee within the required salary level within one pay period of the end of the 52-week period that comprises the employer’s year.

Here’s how it will work beginning January 1:

1. Each pay period, the employee must receive a salary of at least $1,015.20 (90% of the new $1,128 threshold).
2. At year end, if salary plus nondiscretionary bonuses do not equal $58,656 annually, the employer may make a “catch-up” payment in the next pay period.
3. Any catch-up payment counts only toward the prior year’s salary. It will not count toward the salary amount in the new year in which it ends up being paid out.

An Additional Clarification

Using nondiscretionary bonuses to meet the minimum salary threshold does not change any other aspect of the salary basis or salary threshold tests. As has always been the case under the FLSA, discretionary bonuses, employer contributions to health, disability and life insurance and employer contributions to LGERS and the North Carolina 401(k) Plan may **not** be included in the minimum salary threshold calculation. *See* 29 CFR § 541.602(a)(3) (https://www.law.cornell.edu/cfr/text/29/541.602).

The Highly Compensated Employee Exemption

The salary threshold for the special overtime exemption for highly compensated employees will also increase in two phases, paralleling the standard salary updates. These most highly-paid employees are exempt from the overtime requirement under a simplified duties test.

Phase 1: Effective July 1, 2024

On July 1, 2024, the minimum salary necessary for a position to qualify as exempt under the highly-compensated employee exemption will increase from $107,432 to $132,964 annually. (the 80th percentile of earnings of all full-time employees nationally).

Phase 2: Effective January 1, 2025

On January 1, 2025, the minimum salary threshold for highly-compensated employees will increase from $132,964 to $151,164 annually (the 85th percentile of earnings of all full-time employees nationally).

Under the highly-compensated exemption, an employee need perform *just one of the exempt duties* of the executive, administrative or professional duties tests. The idea behind this exemption is that the very high salary threshold offsets its minimal duties test. Nondiscretionary bonuses and commissions may comprise any portion of compensation toward this threshold, without the 10% limit applied to the standard salary level exemption. Employers can also make a year-end "catch-up" payment within one pay period after the 52-week period.

The two new minimum salary thresholds for highly compensated employees will be found at 29 CFR § 541.601 beginning July 1, 2024.

SCHEDULED FUTURE UPDATES OF THE MINIMUM SALARY THRESHOLD

In the past, the minimum salary threshold has been updated sporadically. The updated regulations establish a process under new 29 CFR § 541.607 for automatically updating all salary thresholds every three years going forward. The next adjustments will take effect July 1, 2027, (and every three years after that) with DOL announcing the new levels at least 150 days prior on February 1, 2027. Employers should calendar these future adjustment dates accordingly.

THE DUTIES TESTS HAVE NOT BEEN REVISED

The new rule does not include any changes to the duties tests.

OVERTIME PROVISIONS THAT WILL NOT CHANGE

The new rule will have a significant impact on public employers, turning many employees who are currently exempt from overtime into nonexempt employees who must be paid overtime. They will now need to be compensated at 1.5 times their regular rate of pay whenever they work more than 40 hours in a workweek. The new rule will not, however, change any of the other FLSA provisions relating to overtime:

- Public employers may continue to use compensatory time-off or "comp time" in lieu of cash overtime. On comp time, see here (http://canons.sog.unc.edu/the-mysteries-of-comp-time-revealed/).
- Public employers may still use the 28-day work cycle of the 207(k) exempt for paying overtime to law enforcement officers and firefighters. On the 207(k) exemption, see here (https://canons.sog.unc.edu/2015/03/the-flsas-overtime-pay-provisions-for-law-enforcement-and-firefighting-employees/).
- The fluctuating workweek will continue to be available as a method of paying overtime to those employees who sometimes work fewer than 40 hours per week and sometimes work more than 40 hours per week. On the fluctuating workweek method, see here (https://canons.sog.unc.edu/2015/01/understanding-the-fair-labor-standards-acts-fluctuating-workweek/).
- Small employers who have fewer than five law enforcement officers on the payroll in any workweek or fewer than five firefighters on the payroll in any workweek continue to be exempt from paying overtime to those officers and firefighters in those workweeks.
- The rules governing what time is compensable and what is not remain the same.

If you want to read more about the new overtime rule, DOL has a Question and Answer (https://www.dol.gov/agencies/whd/overtime/rulemaking/faqs) page devoted to it on its website. Check it out.