Exempt Employees

Employers can run into problems if they incorrectly classify an employee as exempt from federal minimum wage and overtime requirements.

OVERVIEW

Employees who work in a bona fide executive, administrative or professional (EAP) capacity are exempt from the minimum wage and overtime requirements of the federal Fair Labor Standards Act, administered by the U.S. Department of Labor (DOL). Employers must take extreme care to classify employees correctly. If an investigation shows that an employee does not meet the criteria for an EAP exemption, the employee loses his or her exempt status and the employer could owe thousands of dollars in back pay and overtime.

An employee must meet three tests to be considered exempt from the FLSA:

- The employee must be paid at least a minimum salary level.
- The employee must be paid on a "salary basis."
- The employee must pass a duties test.

Note: The rules are different for highly compensated employees (HCEs), defined as those who meet a much higher salary threshold. If an HCE meets the higher salary test, they are generally required to meet only minimal duties tests (see below).

The DOL published a final rule May 23, 2016, outlining new and substantially increased salary-level minimums for employees exempt from the FLSA. The new regulations go into effect Dec. 1, 2016, pending any last-minute legal developments.

*** NOTE: This document will be updated to reflect any legal developments. Check Restaurant.org/Overtime for a more extensive overview the week of Nov. 28, 2016. ***

SALARY TESTS FOR EXEMPT EMPLOYEES

Assuming the new DOL salary levels go into effect on Dec. 1, 2016, employees must meet two salary tests to be considered exempt from the FLSA:

First, an exempt employee must be paid at least a minimum salary level. Starting Dec. 1, 2016, an exempt employee must earn a salary of at least $913 per week ($47,476 per year). The minimum salary level is absolute and applies even if the employee works less than full time. Starting Dec. 1, 2016, the new rules also allow certain nondiscretionary bonuses and incentive payments to be credited up to 10 percent of the new salary levels. (See below.)
After the new salary threshold takes effect Dec. 1, 2016, the threshold will be automatically updated every three years. The first increase would take effect Jan. 1, 2020. The amount of the increase will be based on the 40th percentile of full-time salaried employees in the lowest-wage U.S. Census region (currently, the Southern United States). Based on current data, the DOL estimates that the salary threshold for exempt employees will increase to $51,168 on Jan. 1, 2020.

Under the new DOL rules, employers will for the first time be allowed to meet 10 percent of the salary minimum through non-discretionary bonuses, incentives or commissions as long as they are paid at least quarterly. The DOL’s overtime materials offer extensive information on such payments.

Second, the exempt employee must be paid on a “salary basis.” To be considered as paid on a salary basis:

- The employee must receive a fixed weekly salary.
- The predetermined salary must not depend on or vary with the number of hours the employee works.
- The salary cannot be reduced because of variations in the quality or quantity of the employee's work.
- With narrow exceptions, an employer cannot dock the pay of FLSA-exempt employee for full or partial days. The employee must generally receive his or her full salary for any workweek in which the employee performs any work, regardless of the number of days or hours worked. (Exempt employees do not need to be paid for any workweek in which they perform no work.) If the employer makes impermissible deductions from an employee’s salary, the employee is no longer considered to be paid on a salary basis — and thus loses his or her exempt status.
- As long as the employee is ready, willing and able to work, deductions from the salary amount may not be made for time when work is unavailable during the workweek.

DUTIES TESTS FOR EXEMPT EMPLOYEES

In addition to meeting the salary tests outlined above, employees also must meet a duties test in order to be considered exempt from the FLSA. The duties test will not change under the new federal overtime rule that starts Dec. 1, 2016.

The DOL provides a separate duties test for each category of exempt employees. The three types of exempt employees most commonly found in restaurants include:

- executive/managerial employees
- professional employees
- administrative employees.

It is important to note that an employee’s actual job duties, rather than job title, determine his or her exempt status.
Many restaurant employees are exempt from federal wage and overtime rules because their duties qualify them for the "executive" or "managerial" exemption. To meet the executive/managerial exemption, the employee's primary duty must include:

- managing the business or a recognized division, subdivision or department
- customarily and regularly supervising and directing the work of two or more full-time employees or their equivalent, and
- having authority to hire or fire other employees, or having their recommendations as to hiring, firing, job advancement, promotion or any other change of status of employees be given particular weight.

**PROFESSIONAL EXEMPTION: DUTIES TEST**

Employees with bona fide professional duties are exempt from the FLSA’s wage and overtime requirements under the FLSA’s professional exemption. According to DOL regulations at 29 C.F.R §541.300 the professional exemption covers employees who meet the salary tests and whose primary duty consists of

- work requiring "knowledge of an advanced type in a field of science or learning, customarily acquired by a prolonged course of specialized intellectual instruction" (called the "learned professional" exemption) or
- work requiring "invention, imagination, originality or talent in a recognized field of artistic or creative endeavor" (called the "creative professional" exemption).

**ADMINISTRATIVE EXEMPTION: DUTIES TEST**

Other restaurant-company employees may meet the FLSA’s criteria for an administrative exemption. These employees generally perform a restaurant company’s overhead functions. They support a restaurant company’s processes but do not produce the product or service the customers. Examples include employees in the payroll, human resources, finance or information technology departments.

To be considered exempt from the FLSA’s minimum wage and overtime rules, administrative employees must meet the following duties test:

- the employee's primary duties consist of non-manual work directly related to management or general business operations, and
- the employee exercises discretion and independent judgment with respect to matters of significance or importance.

**EXEMPTION FOR HIGHLY COMPENSATED EMPLOYEES**

“Highly compensated employees” (HCEs) are another category of exempt employee. The DOL’s new salary increases scheduled to take effect Dec. 1, 2016, also change the salary levels for this category of employee. To qualify for an exemption from the FLSA’s wage and overtime requirements, a highly compensated employee must meet the following requirements as of Dec. 1, 2016:
• earn total annual compensation of at least $134,004 (up from $100,000 under current rules).
• earn at least $913 a week on a salary or fee basis, with the difference between salary earnings per week and total compensation (no less than $134,004 per year) coming from commissions, nondiscretionary bonuses, etc. If the total compensation within the annual period fails to meet the $134,004 threshold, the employer has one month from the end of the annual period to make the “catch-up” payment or lose the exemption.
• meet a simplified duties test by customarily and regularly performing at least one exempt duty of an executive, administrative or professional employee, and having a primary duty that is non-manual or office work.

The annual salary threshold for these highly compensated employees will automatically be increased every three years, starting Jan. 1, 2020, to reflect the 90th percentile level of full-time salaried employees nationally. The DOL estimates the salary threshold for these HCEs will be $147,524 as of Jan. 1, 2020.

STATE LAWS

Many states have wage-and-hour laws and regulations independent of federal law. Employers in such states must examine both sets of standards to determine which applies to their business. Where federal and state laws vary, the employer must follow whichever provision most benefits the employee.

COMPLYING WITH THE NEW FEDERAL OVERTIME RULES

As the Dec. 1, 2016, implementation date approaches for the new federal overtime regulations, it’s important for employers to take steps to properly classify employees and protect themselves from litigation.

1. Check state laws. As noted above, employers in many states may have to consider both state and federal regulations. Check with your legal counsel to see how your state law on overtime is affected by the new federal regulations.

2. Check your employees’ salary levels. Starting Dec. 1, 2016, make sure you pay exempt employees at least $913 a week ($47,476 a year) on a salary basis. Any employee who earns less than $913 a week is entitled to overtime pay under federal law when they work more than 40 hours in a week, no matter what duties they perform. (Note: These levels will be further updated every three years starting Jan. 1, 2020.) The $913-a-week salary level is not pro-rated for employees who work less than full time.

3. Revise job descriptions, and document whether positions are exempt or non-exempt. Employers should review and revise employee job descriptions to ensure that they reflect the actual duties of employees. When you review a job description, document why a job is considered exempt and which exemption(s) – executive, administrative, professional, etc. – apply. This documentation bolsters an employer’s position if a dispute arises and may help an employer build a good-faith defense that could help limit the amount of damage awards if a court ever rules against the employer.
4. **Look at policies and handbooks.** Employers must establish clear policies on such issues as how the employer records and tracks employee hours of work; this is critical for paying non-exempt employees properly.

5. **Audit your payroll practices.** Exempt employees must be paid on a “salary basis.” This has a very specific meaning. Improper partial-day salary deductions and other practices could jeopardize an employers’ ability to classify employees as exempt. If you discover any problems with your payroll and wage-deduction practices, correct them.

6. **Look at highly compensated employees.** Under the rules, “white-collar” employees who earn at least $134,004 a year are likely to be exempt from federal overtime-pay requirement as long as they “customarily and regularly” perform at least one exempt duty, and have a “primary duty that is non-manual or office work.” Decide whether you need to reclassify any employees as a result of the new regulations.

7. **Make corrections and inform employees.** With DOL’s revisions of the overtime-exemption rules for EAP employees, employers must update the exempt salary requirements to ensure that they comply with the law. Employers should be truthful with employees, explaining that payroll changes are being prompted by implementation of new government rules.

8. **Consult with outside counsel if needed.** You may find you need the help of outside attorneys to adjust to the DOL’s rules. When considering whether to acquire such help, remember that it is better to do so now rather later.

Visit Restaurant.org/Overtime for ongoing information about the rules, including legal developments.