Published on *The National Law Review* https://natlawreview.com

New DOL Exemption Rule Requires Two-Step Salary Increases Under FLSA for Exempt Employees

Article By:

Richard J. Simmons

Federal law establishes minimum wage and overtime requirements for non-exempt employees. These rules do not apply to individuals who qualify under the executive, administrative, and professional exemptions in the Fair Labor Standards Act of 1938 ("FLSA"). Individuals only qualify as exempt if they meet specified requirements that include a **salary level test**, among other rules.

1. The DOL's Final Rule

On April 23, 2024, the U.S. Department of Labor ("DOL") announced a final rule that dramatically increases the minimum salary level that must be paid to most employees classified as exempt in order to retain their exempt status. The DOL projected that millions of U.S. workers will forfeit their exempt status under the final rule that increases the minimum salaries in **two steps** that will take effect on July 1, 2024 and January 1, 2025. This will, in turn, translate into new overtime, minimum wage, time-keeping and record-keeping obligations for employers who do not adjust salaries to conform to the new standards. It will also result in more collective and class action litigation under federal law. As explained in Chapter 10 of the **Wage and Hour Manual for California Employers** by Attorney Richard J. Simmons of Sheppard, Mullin, California's rules must also be considered.

2. The FLSA Exemptions for Executive, Administrative, and Professional Employees

Employees are exempt from the FLSA minimum wage and overtime protections if they are employed in a bona fide executive, administrative, or professional capacity, as those terms are defined in the DOL regulations at 29 CFR Part 541. To fall within the exemption, an employee generally must satisfy **three tests** under the FLSA:

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 (the "**salary basis test"**);
2. The employee must be paid at least a specified weekly salary level that is the primary focus of the DOL's April 23, 2024 rule (the **"salary level test"**); and
3. The employee's job duties must primarily involve executive, administrative, or professional duties, as defined in the DOL regulations (the **"duties test"**).

The regulations also provide an alternative test for **highly compensated employees ("HCEs")** who are paid a salary, earn compensation above a higher total annual compensation level, and satisfy a minimal duties test. Each of these requirements is reviewed in Chapter 10 of the **Wage and Hour Manual for California Employers** by Attorney Richard J. Simmons of Sheppard Mullin. The book is available through Castle Publications, LLC.

Notably, the federal standards differ from the California rules in several significant respects. For example, California's salary level requirement ($1,280 a week/$66,560 a year in 2024) is materially higher and the California duties test is much more rigid, requiring that employees be "primarily engaged in" exempt activities during *more than* 50% of their work time. In addition, California does not maintain an alternative test for HCEs.

3. The Salary Level Test and New Increases

Under the existing federal rules, the minimum "standard salary level" under the FLSA is $684 per week, which translates to $35,568 per year. The level is $107,432 per year for HCEs under the existing rules, including at least $684 per week paid on a salary or fee basis. The DOL has estimated that 292,000 employees across the country are currently exempt under the HCE test, but will be affected by the new increase unless their employers increase their compensation by July 1, 2024.

On April 23, 2024, the DOL announced its final rule, which will increase these amounts in two steps on July 1, 2024 and again on January 1, 2025. The weekly standard salary level will increase on July 1, 2024 from $684 to **$844 per week**, which is equivalent to **$43,888 per year**. On the same date, the total annual compensation threshold for HCEs will increase from $107,432 to **$132,964 per year**, including at least $844 per week paid on a salary or fee basis.

The standard salary level will increase again on January 1, 2025 to **$1,128 per week**, which is equivalent to **$58,656 per year**. The total annual compensation threshold for HCEs will increase on January 1, 2025 to **$151,164 per year**, including at least $1,128 per week paid on a salary or fee basis. (Surprisingly, although California does not have special HCE exemption standards, this new federal standard exceeds the California salary level rule.)

The final rule also contains a mechanism that provides for updating these earnings thresholds in the future to reflect current earnings data. The final rule calls for additional increases on July 1, 2027, and every three years thereafter.

4. Employers Must Schedule and Budget for Salary Increases

Employers must either adjust salary levels to conform to the new standards or lose the exemptions that millions of workers desire so they can rely on predictable salaries that are not subject to reduction if they arrive late, leave early or work partial days. Many exempt employees also enjoy superior benefit packages and bristle at the notion that, if they become nonexempt, they must punch a time clock or use a different method to accurately and precisely record their worktime.

When coordinating increases in the minimum salary levels paid to employees considered exempt, employers should budget for two changes that will take effect within six months of each other. The first increase from $684 to **$844 a week** ($43,888 a year) will take effect on July 1, 2024. Just six months later, the second increase to **$1,128 a week** ($58,656 a year) will take effect on January 1, 2025. **Strikingly, the increase from $684 to $1,128 is more than 64% from June 30, 2024 to January 1, 2025**. It is hard to imagine the anticipated costs of the changes and the likely effect they will have on prices for goods and services and inflation.

Employees who make less than these minimum thresholds will, absent an exception, lose their exempt status and become eligible for overtime pay under federal law. The DOL estimated that approximately one million employees who earn at least $684 per week but less than $844 per week will be impacted by the initial increase to the standard salary level, and approximately three million employees who earn at least $844 per week but less than the new standard salary level of $1,128 per week will be impacted by the January 1, 2025 change.

5. No Changes to Duties Test or Motion Picture Rule

The final rule does not change the federal duties test necessary to qualify as exempt. According to the DOL's FAQ 11 on the final rule, it did not change the special base rate for employees in the **motion picture industry** that had been proposed. Employers should also prepare for future changes because the earnings thresholds will be updated on July 1, 2027 and every three years thereafter.

There is some speculation that legal challenges to the April 23, 2024 rule will be mounted as they were to the Obama-period changes. Employers should make immediate preparations to discuss and the dissect the final rule with their legal counsel so they can implement changes in a timely manner.

National Law Review, Volume XIV, Number 121