

## **DOL Proposed Overtime Reforms and the Impact on Nonprofits**

The U.S. Department of Labor has [proposed sweeping new regulations](#) designed to expand overtime protections for millions of workers employed by nonprofits, for-profits, and governments. The draft regulations, which will not go into effect (if at all) until after a period of public comment and analysis, would more than double the minimum salary level that white-collar employees must be paid (from \$23,660 to \$50,400) to exempt them from overtime pay of time and half of wages for hours worked in excess of 40 in any week. The Labor Department is also proposing raising the minimum salary level for “highly compensated employees” from \$100,000 to over \$120,000 per year, and seeking comments on whether the government should establish a mechanism for automatically raising these salary levels in the future.

The National Council of Nonprofits encourages all nonprofits to conduct a mission-based analysis of these proposed regulations. That means answering questions about how the proposed increase in the minimum salary levels would affect operations, resources, and staffing, as well as what impact the draft regulations would have on persons relying on the services and the mission of the nonprofit. Nonprofits should share their answers to those questions with the Department of Labor in the form of [comments to the proposed regulations](#). Comments are due by September 4, 2015.

### **What’s Being Proposed?**

The Department has issued [proposed overtime regulations](#) that would do three things, if implemented after a public comment period and further analysis. The Department proposes:

1. Raising the standard minimum level for salaried workers from \$455 per week (\$23,660 per year) to what amounts to the 40<sup>th</sup> percentile of weekly earnings for full-time salaried workers. This amount for 2016 is estimated to be \$970 per week, or \$50,440 annually.
2. Raising the standard salary minimum for highly compensated employees from \$100,000 a year to the annualized value of the 90<sup>th</sup> percentile of weekly earnings of full-time salaried workers, or about \$122,148 annually.
3. Implementing a mechanism for automatically updating these two minimum salary levels to adjust for inflation and preclude the need to regularly change the levels via future regulatory actions.

### **Background**

Under the Fair Labor Standards Act (FLSA), employees are entitled to wages at or above the federal minimum wage and must be paid time and a half overtime for work after 40 hours in any work week.<sup>1</sup> In enacting the federal wage and hour law, Congress exempted from these standards executive, administrative, and professional employees, and left it up to the Secretary of Labor to define the terms of the exemption.

Persons who are properly classified as executive, administrative, or professional employees are considered “exempt employees.” All others are “non-exempt” and must be paid at least the minimum wage and overtime after 40 hours worked in a week.

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<sup>1</sup> Smaller nonprofits are exempt from the FLSA, if their “business purposes” revenues are less than the general \$500,000 threshold – and importantly, that threshold excludes “charitable, religious, educational, or similar activities of organizations operated on a non-profit basis where such activities are not in substantial competition with other businesses.” See DOL FAQ #5: <http://www.dol.gov/whd/overtime/NPRM2015/faq.htm#5>

Generally, employers have the burden of demonstrating that a worker is exempt from the overtime provisions by satisfying three tests. The *salary basis test* requires that the employee be paid a predetermined salary, rather than on an hourly basis, and that the amount paid is not adjusted based on whether the person worked certain hours. The *duties test* requires that the individual's job duties must primarily involve executive, administrative, and professional duties as defined by the Labor Department regulations. The *salary level test* – which is the subject of the proposed regulations – requires that an employee be paid at or above a minimum specified amount. That amount is currently set in regulations at \$455 per week, or \$23,660 per year, and requires regulatory action by the Department of Labor to change it.<sup>2</sup>

There is a special category in the regulations that exempts “highly compensated employees” if their total annual compensation exceeds \$100,000 and they customarily and regularly perform at least one of the exempt duties or responsibilities of an executive, administrative, or professional employee.

The draft regulations propose changing the two salary levels and implementing a system for annual adjustments that would eliminate the need for the Labor Department to go through the regulatory process to make future changes in the dollar levels.

States have the power to set higher standards for non-exempt and exempt employees. Currently, 29 states have set minimum wage levels [higher than the federal minimum wage](#) of \$7.25 per hour. Likewise, some states, such as California, have set the salary level test at a higher amount than is set in current U.S. Department of Labor regulations.

### **Analysis and Nonprofit Perspective**

There can be little debate that the current salary level test amount of \$455 per week (\$23,660 per year) is low by current standards. By comparison, the federal poverty level in 2015 for a family of four is \$24,250 per year.<sup>3</sup> The poverty level in 2004, when the overtime salary level was last reset, was \$18,850 per year.<sup>4</sup> It is therefore understandable that the Department of Labor would seek to update the standard based on changing costs of living. The real debate is over the details: Are the proposed salary levels for exemptions set correctly and if an automatic mechanism for future increases is put in place, how should it operate?<sup>5</sup>

The proposed regulations call for a more than doubling of the salary level test set eleven years earlier, a period that saw an increase in the federal poverty level of only 25 percent. The change would set the new minimum salary level at the 40<sup>th</sup> percentile of weekly earnings for full-time salaried workers. The Department explains that it believes “a percentile serves as a better proxy for distinguishing between overtime-eligible and exempt white collar workers as it is rooted in the relative distribution of earnings which are linked to the type of work undertaken by salaried workers.” The Department acknowledges that it is taking a different approach than it applied in the 2004 revisions, which set the salary level at roughly the 20<sup>th</sup> percentile of salaried employees in the South region.

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<sup>2</sup> See, generally, **Classifying Employees Correctly**, National Council of Nonprofits website; <https://www.councilofnonprofits.org/tools-resources/classifying-employees-correctly>.

<sup>3</sup> Federal Poverty Level, Department of Health and Human Services; <https://www.healthcare.gov/glossary/federal-poverty-level-FPL/>.

<sup>4</sup> The 2004 HHS Poverty Guidelines; <http://www.aspe.hhs.gov/poverty/04poverty.shtml>

<sup>5</sup> This analysis will not address the advisability of whether the Department of Labor should establish a mechanism for automatically revising the salary levels.

The Department proposed adjusting the salary minimum for “highly compensated employees” (HCEs) to the 90<sup>th</sup> percentile of weekly earnings for full-time salaried workers. It applies the same analysis for the standard salary level. The Department goes farther and states that it “believes that the 90<sup>th</sup> percentile of full-time salaried workers is appropriate because it brings the required compensation level more in line with the level established in 2004; therefore, it will ensure that, as in 2004, the HCE exemption covers only those employees who are at the very top of today’s economic ladder and minimizes ‘the possibility that workers in high-wage regions and industries could inappropriately lose overtime protection.’” However, inconsistently with the standard salary level analysis, above, the Department partly justifies the new level by pointing out that it roughly correlates to the level if it were merely adjusted for inflation.

Whether the proposed change to the 40<sup>th</sup> and 90<sup>th</sup> percentiles is appropriate will be the subject of economic and political debates for many months to come. That broad debate does not currently include an analysis of how nonprofit wages and salaries compare to the set of data currently under consideration: the weekly earnings for full-time salaried workers, including for-profit and public sector. Historically, the nonprofit sector pays lower wages and provides higher benefits to its workforce.<sup>6</sup> The application of a fixed percentage based on the national average likely would result in fewer white collar nonprofit employees being treated as exempt. As a result, the proposed regulations, if implemented without revisions, could result in higher costs for nonprofits than their for-profit counterparts.

### **The Need for Nonprofit Input**

The effect of the proposed overtime regulations, if implemented, would vary widely among nonprofit organizations. Larger organizations that regularly compete with for-profit and governmental organizations (e.g., hospitals) would likely experience different challenges than smaller nonprofits that provide services on behalf of governments pursuant to grants and contracts. There likely would also be wide variations in the impact of the proposed regulations on rural versus urban nonprofit operations.

The only assured point here is that the impact on the sector will be defined by academics, bureaucrats, and others based on assumptions and data from other sectors unless individual nonprofits take the time to review the regulations and [offer comments to the Department of Labor](#) prior to the due date of September 4, 2015.

In reviewing the proposed regulations, the National Council of Nonprofits encourages all nonprofits to conduct a *mission-based analysis* of the proposed regulations. That means answering questions about how the proposed increase in the minimum salary levels would affect operations, resources, and staffing, as well as what impact the draft regulations would have on persons relying on the services and the mission of the nonprofit. Below are several questions that can help shape an organization’s analysis.

If the draft regulations were to be implemented as written:

1. What effect – positive or negative – would the proposals have on your organization’s ability to advance its mission? Variables could include the need to raise more money, serve fewer people, or not being able to perform under government grants or contracts, among many others.
2. What effect – positive or negative – would the proposals have on the individuals and communities your organization serves? For example, would higher compensation, if realized,

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<sup>6</sup> [Communiqué #15: Health Care and Nonprofits](#), Lester M. Salamon, Stephanie L. Geller, and Kasey L. Spense, The Johns Hopkins Listening Post Project, 2009.

reduce the number of individuals seeking services from the organization, and thus cut the workload of the organization or enable you to pursue other mission objectives?

3. What fact situations would you ask the Department of Labor to address to reduce confusion and clarify gray areas of the law? The Department has said that it intends to write the final regulations in the question-and-answer format. That approach potentially provides nonprofits the opportunity to generate clear answers to fact situations that may be unique to the nonprofit sector.

And if the Department of Labor is open to further revisions,

4. What substantive changes to the draft regulations would your organization seek? Should there be a separate minimum salary level based on a percentile of nonprofit salaries? If so, should higher education and hospitals be included in such a grouping of salaries?
5. What transition rules do you think would be appropriate for your nonprofit and similarly situated organizations? Should implementation of final regulations be delayed until a certain date, i.e., July 1, 2016, or phased in over a period of time? Should nonprofits with existing government grants and contracts be exempt from the implementation of any new rules until the time that government pays the higher amounts for the higher salary rate?

These are only a few of the questions that nonprofits will be asking in the coming months. We encourage you to [share additional questions, as well as your thoughts](#) on them, with the National Council of Nonprofits.

### **Submitting Comments**

Nonprofits should share their answers to those questions with the Department of Labor in the form of [comments to the proposed regulations](#). Comments are due by September 4, 2015.

### **Additional Resources**

- DOL Notice of Proposed Rulemaking: [Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees](#) (June 30, 2015)
- [DOL Fact Sheet on the Proposed Regulations](#)
- [U.S. Department of Labor Proposes Sweeping Changes to FLSA Overtime Exemption Criteria: The Implications for Nonprofit Employers](#), Venable Law firm (July 2015)
- [Classifying Employees Correctly](#), National Council of Nonprofits website

July 13, 2015