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EMPLOYMENT LAWSCENE ALERT: NEW FLSA OVERTIME RULES MAY HAVE EMPLOYEE BENEFIT PLAN IMPLICATIONS

The Department of Labor's (DOL's) final overtime rule (the Final Rule) takes effect December 1, 2016. As described in our prior post, the cumulative effect of the Final Rule will be to significantly expand the categories of employees eligible for overtime protection. As part of preparing to comply with the new wage and hour law, employers must also consider whether and how any changes to compensation practices will affect employee benefit plans. This post describes the tax-qualified retirement plan issues that employers should take into account as the December 1 Final Rule deadline approaches.

Classification Changes

To the extent that benefit plan documents condition eligibility on an employee's classification (such as salaried, hourly, exempt, or non-exempt), compensation structures revised to comply with the Final Rule could cause large cohorts of employees to either lose or gain benefits. As an example, if a specific employee is reclassified from hourly to salaried status (or vice versa) in response to the Final Rule, that individual might gain (or lose) the right to participate in an employee benefit plan. Corresponding modifications to the terms of those plans may be necessary to continue to provide current benefit levels and, or, to ensure that retirement plans will continue to satisfy underlying participation requirements in light of resulting eligibility changes.

Compensation Changes

By the same token, FLSA-related compensation adjustments may result in unanticipated changes to overall benefit contribution obligations. This is particularly true for 401(k)s, and similar tax-qualified retirement plans, under which employer contributions are calculated in accordance with a specific plan definition of "compensation." The impact of pay changes on employer retirement plan contributions will vary case by case, but in general, may fluctuate not only to the extent that employee base pay is increased or decreased, but also by whether a given plan's "compensation" definition includes or excludes overtime pay.

Tax-Qualification Compliance Issues

In some cases, plan compensation definitions should be amended as required to attain a result in line with overall benefits and compensation objectives. Although a tax-qualified retirement plan may exclude (or be amended to exclude) overtime pay from its compensation definition, such exclusion is permissible only if the compensation taken into account after the exclusion satisfies annual nondiscrimination testing requirements. Employers that expect a significant increase in overtime wages as a result of compliance with the Final Rule, as well as employers with plans already excluding overtime pay, should determine now whether projected increases in overtime wages could affect their plans' ability to continue to satisfy tax nondiscrimination requirements in light of existing or revised plan terms.

Employers choosing to amend a retirement plan's compensation definition to exclude overtime pay will need to consider other legal and operational issues in addition to nondiscrimination testing. For example, in the case of a "safe harbor" 401(k) plan, the modification may need to be coordinated with the start of a plan year. In addition, time may be needed to update payroll systems and plan administrative processes to properly capture the new pay exclusion.

Proceed with Caution before Reducing Benefits to Offset New Overtime Costs

Some employers may be facing higher compensation costs as part of a strategy for maximizing the available exemption from the overtime rules. While it may be tempting to offset some of these costs by reducing employee benefits spending, it is crucial to consider underlying benefit-related legal requirements as they proceed. In some cases, benefit reductions are limited by law, while in others, unintended consequences may result.

For example, the Affordable Care Act requires large employers (generally 50 employees and above) to either offer "affordable" and "minimum value" health care coverage to certain employees or risk exposure to significant tax penalties. A large employer may incur penalties, without regard to whether an employee is exempt or non-exempt under the Final Rule, if he or she works more than 30 hours per week but is not offered ACA-compliant coverage. A reduction or elimination of an employer premium contribution (or an increase in employee cost sharing) must therefore be carefully analyzed to assess the extent to which it could affect a group health plan's "minimum value" and "affordability" metrics, thereby increasing employer exposure to ACA penalties.

Conclusion

It is no surprise that the Final Rule requires many employers to make extensive changes to their compensation and employee classification practices. What may be more surprising is the extent to which FLSA-related changes promise to impact employee benefit plans, as well. To avoid any benefits cost or compliance surprises, employers should carefully review

whether and how sponsored employee benefit plans will be affected by other changes made to comply with the Final Rule.