

# PUBLICATION

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## A Wage and Hour Pitfall: Paying Bonuses to Non-Exempt Employees Can Lead to Trouble

March 10, 2017

**Most employers today recognize that the Fair Labor Standards Act (FLSA) requires that they pay non-exempt employees an overtime premium for working more than 40 hours in any given workweek. What most employers do not recognize, however, is that they may be obligated to adjust a non-exempt employee's overtime rate, known as the "regular rate," based on the payment of "supplemental" compensation. This issue arises most often in the case of commissions and non-discretionary bonus payments paid to non-exempt employees.**

The most common scenario: to boost efficiency, an employer implements a quarterly productivity bonus as a benefit for non-exempt employees. The employer announces the new bonus program to its employees and receives excellent feedback. The following quarter, the employer sees its highest productivity levels in years and is ready to cut the checks to its hard working employees. What could possibly go wrong?

The FLSA requires that overtime pay be calculated based on an employee's "regular rate" of pay, which includes all compensation earned during a workweek. While certain earnings like discretionary bonuses may be excluded from the regular rate of pay calculation, other payments, such as non-discretionary bonuses and commission, must be included in total compensation. The key is identifying which bonus payments are discretionary versus non-discretionary. A discretionary bonus is an unexpected, unannounced payment that is made at the sole discretion of the employer generally in recognition of excellent service, like an unanticipated year-end bonus based on company profits and not on an individual employee's work performance. A non-discretionary bonus, on the other hand, is a promised or predictable payment made on the basis of the employee meeting a certain quality, quantity or efficiency of production. According to FLSA guidance, "[f]ew bonuses are discretionary under the FLSA, allowing exclusion from the regular rate." Based on these definitions, the most obvious concern is how to determine whether a bonus is truly discretionary. While facts associated with each bonus scenario are unique, generally where the employer offers a bonus on a regular basis and an employee recognizes and reasonably expects payment, the bonus is likely non-discretionary.

What is the practical effect for employers who pay non-discretionary bonuses to non-exempt employees? Such bonuses paid to employees must be apportioned back to the workweeks covered by the bonus period. If the non-exempt employee who earned the bonus also worked overtime during any workweek during a period covered by the bonus, the employer must calculate the regular rate to determine the appropriate overtime rate. This calculation is easy if the bonus is paid on a weekly or bi-weekly basis. For example, an employer pays its employees on a bi-weekly basis. If employees work all the hours they are scheduled to work in a pay period, they are paid a \$100 bonus. If the employee also works overtime during that pay period, that bonus must be included in calculating the regular rate of pay. In this scenario, the employer would add half of the bi-weekly bonus (\$50) to the employee's earnings (hourly rate times the total hours worked) for that week. The resulting total compensation would be divided by the total hours the employee worked during that week to determine the regular rate. Assuming here that the employee earned \$12 per hour and worked 56 hours per week during the pay period, the following calculation would be used:

56 hours worked x \$12/hour + \$50 (weekly bonus) =	\$722
\$722 ÷ 56 hours worked =	\$12.89 (regular rate)
\$12.89 (regular rate) x 1.5 =	\$19.34 (overtime rate)
40 (straight time hours) x \$12.89 (regular rate) =	\$515.60 (straight time earnings)
16 (overtime hours) x \$19.34 (overtime rate) =	\$309.44 (overtime earnings)
Total earnings per week =	\$825.04
Total earnings for bi-weekly pay period =	\$1,650.08

These calculations become significantly more challenging with a quarterly, biannual or annual bonus. This is due to the fact that the FLSA is a workweek law, and it is often difficult, if not impossible, to determine exactly which week during a given period that a non-discretionary bonus was earned. Instead of trying to match a bonus paid to the weeks that it was supposedly earned, the FLSA guidance allows for a simple apportionment solution. An example of this issue arises where an employer, looking to attract more qualified personnel, offers a \$2,000 retention bonus to hourly employees after being employed for six months. That retention bonus is non-discretionary and must be included in an employee's regular rate calculation. In this case, the retention bonus was earned over six months or 26 weeks. The weekly equivalent of the bonus is \$76.92 (\$2,000 ÷ 26 weeks). If the employee works overtime during the 26-week period, the increase in the regular rate is calculated by dividing \$76.92 by the total hours worked during the overtime week. The following calculation would be used:

\$76.92 (weekly equivalent of bonus) ÷ 50 hours worked =	\$1.54 (increase in the regular rate)
\$1.54 (increase in regular rate) x ½ =	\$0.77 (increase in overtime rate)
\$0.77 x 10 hours overtime worked =	\$7.70 (increase in overtime earnings due to retention bonus)

This is not a new area of wage and hour law, just one that often is overlooked or misunderstood. It also is not an optional. Failure to re-calculate and pay overtime wages to non-exempt employees at the proper regular rate of pay is a violation of the FLSA, and it is one that plaintiffs' attorneys thrive on. It's also important to be aware that the FLSA, which allows for recovery of unpaid wages plus liquidated damages (i.e., double damages), is not the only wage and hour law to consider. Many states have their own wage and hour laws that oftentimes are patterned after the FLSA, many of which allow for recovery of triple damages.

The benefits of offering non-discretionary bonuses to employees are numerous. Whether an annual, longevity, production or signing bonus, employers must conduct a fact-specific analysis to confirm whether a bonus is discretionary or not. Failure to properly categorize "supplemental" compensation and properly calculate the regular rate for the purpose of overtime payments could lead to costly litigation. Like all other wage and hour issues, simply ignoring the issue does not make it go away. If you are an employer that offers bonuses (or other forms of compensation, such as commissions) to non-exempt employees, make sure you are doing so

correctly. If you are an employer thinking about starting a new bonus program, make sure you understand the facts and implications of such a program before taking the next step.