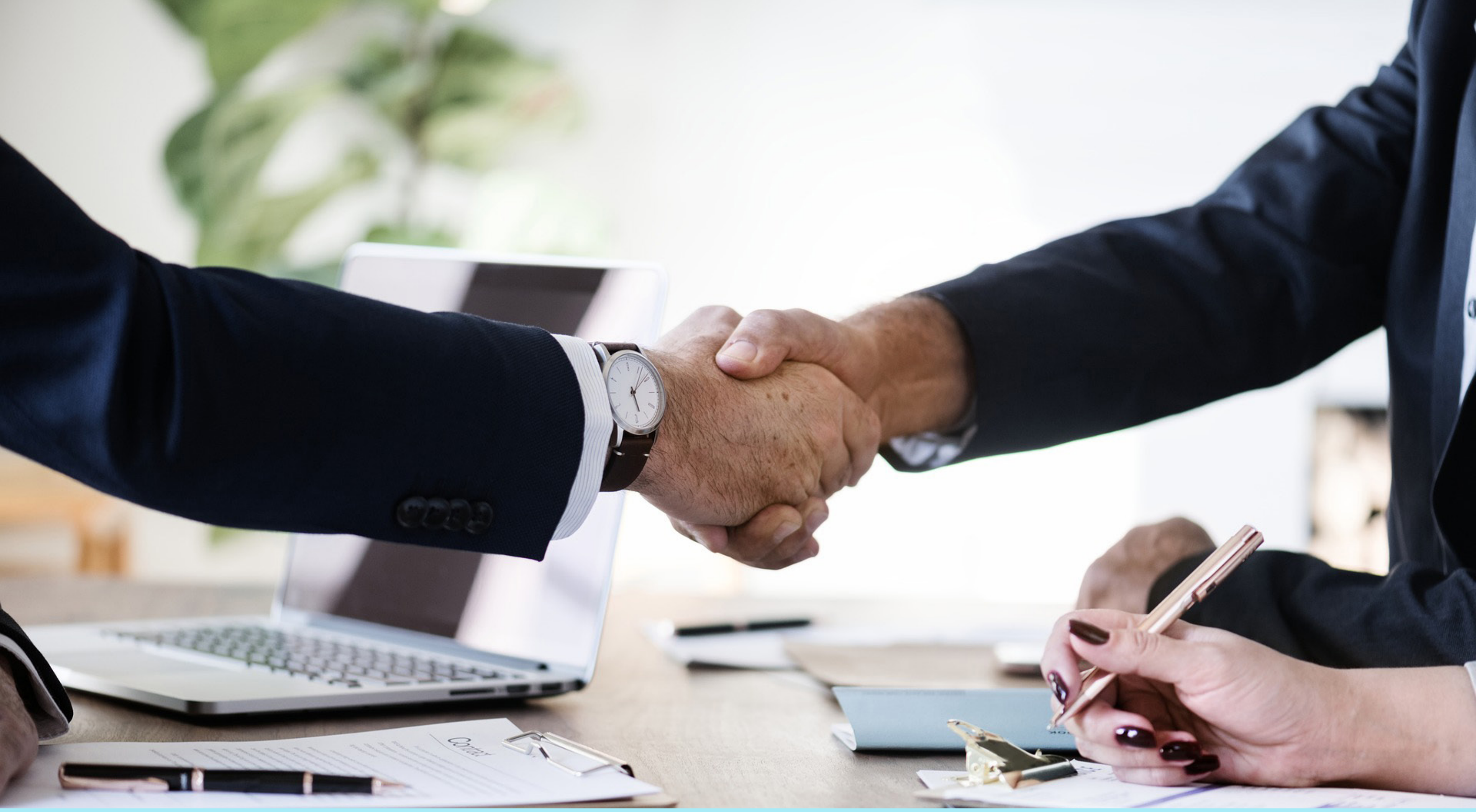

So You Want to Give Your Employee a Bonus?

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Written by Bennett L. Epstein – 10/16/17

There are many reasons employers give bonuses to employees. Bonuses are a motivator. They effectively reward past contributions. Bonuses also allow employers to provide additional compensation to the workforce on a one-time basis without baking in wage increases and thus increasing the costs of wage-based benefits such as vacation. Sometimes, employers have an exceptional year and want to share the wealth with the workforce. And occasionally, employers just want to get some additional cash into their employees' hands. While all of these reasons are benign and create good will, sometimes they result in unforeseen consequences.

The Fair Labor Standards Act is the principal federal law regulating the payment of wages and particularly, overtime. The fundamental standard for analyzing wage payments is the regular rate of pay, which may be calculated in a number of ways depending on the terms of payment (i.e. hourly, weekly, piecework, commission etc). For the purpose of the traditional hourly-paid "non-exempt" worker, it is an hourly rate set by the employer for all hours worked during the initial 40-hour workweek. The regular rate generally is determined by dividing the total wages paid to an employee in a workweek and dividing that number by the total hours worked. Calculating the regulate rate is important because non-exempt workers, who are entitled to overtime pay, must receive a premium of one and a half times the regular rate for each hour worked over 40 in a particular week.

But what happens to the regular rate (and overtime payments) if the employer pays a bonus? The answer depends on the type of bonus.

Type I: The Non-Discretionary Bonus: A non-discretionary bonus is a bonus based on criteria such as an employee meeting ascertainable production, sales or other performance standards. It might also be based on the company satisfying a standard (i.e. company production or revenue goals). Across-the-board bonuses paid to groups of employees often are regarded as non-discretionary depending on the circumstances.

Non-discretionary bonuses cause a challenge in determining and calculating the regular rate.

If the employer can determine the precise weeks that the employee earned the bonus, the employer must retroactively attribute the bonus to those weeks. This results in an upward adjustment of the total wages earned during the workweek. If the total wages increase, so does the regular rate, which in turn causes an increase in the amount of the overtime that must be paid during those weeks in which the bonus was earned.

On the other hand, if the employer cannot identify the specific weeks in which the bonus was earned, then the bonus must be allocated across the entire bonus period. If the bonus was earned over a calendar year, the employer must (1) divide the bonus by 52, (2) add that sum to the wages earned during the workweek, (3) recalculate the regular rate, and (4) pay an additional time and a half based on the regular rate for all hours worked over 40.

For example, if an hourly paid employee is granted a year-end bonus of $1000, $19.23 ($1,000/52) must be added to the wages in any workweek in which the employee worked more than 40 hours. The employer must then recalculate the regular rate (and corresponding overtime premiums) for each week, incorporating these revised numbers. While this is expensive because the employer must pay additional overtime based on the bonus and it is an administrative nightmare, the FLSA requires those retroactive payments once the bonus is paid.

Fortunately, there are exceptions.

Type II: Discretionary Bonuses

The FLSA does not require the regular rate to include purely discretionary bonuses. To be regarded as a discretionary bonus:

1. The payment must be made <u>and</u> the amount of the bonus must be determined at the <u>sole discretion</u> of the employer at or near the end of the bonus period, and

2. The payment cannot be pursuant to any prior contract, agreement or promise causing the employee to <u>expect</u> such payment regularly.

Great care must be taken not to announce that there will be a bonus or otherwise to raise the expectation of a bonus, even if the amount of the bonus will not be determined until the end of the bonus period. If so, the employer jeopardizes losing this exemption.

Type III: Gifts

Gifts also are not included in the regular rate. Gifts must be true gifts – totally discretionary and gratuitous. A gift is the equivalent of the employer spontaneously reaching into his or her wallet and just handing out cash. However, the Department of Labor regards holiday gifts, including cash, as a gift, even when the employer has a regular practice of giving holiday gifts, Otherwise, if the payment is expressed or intended to reward conduct, production or any other contribution to the employer’s business, it will not be deemed a gift. And if the payment is not a gift or a true discretionary bonus, it must be factored into overtime.

As the old saying goes, sometimes the best of intentions go astray. When considering giving your employees bonuses or gifts, take care and consider consulting with counsel to ensure that you are properly classifying and accounting for these payments.