

# Legal Brief



## Bonuses: When a Gratuity Creates Liability

When employers grant bonuses to employees they typically do so to reward the employee for past or future service. However, under certain circumstances, granting a bonus to employees can create liability for an employer in the form of overtime compensation.

Employers must carefully analyze bonus payments under the Fair Labor Standards Act (FLSA), which requires certain types of bonuses to be included in calculating the regular rate of pay, which is used to calculate overtime pay. If a bonus payment is the type that must be included in compensation, it will cause an increase in the employee's hourly rate of pay and will result in an increase of total compensation during workweeks in which overtime hours are worked.

Whether a bonus will be taken into consideration in calculating an employee's overtime under the FLSA depends on its purpose and nature. Bonuses that are designed to encourage increased efforts on the part of employees constitute earnings, which must be included in the overtime pay calculations. Bonuses that are rewards for past services rendered by employees, and that are not devised until after the services have been rendered, may be excluded from overtime pay calculations.

### Bonuses That Must Be Used to Calculate Overtime

A bonus that is intended to increase an employee's efforts must be part of their weekly earnings because employees are working for the bonus and they depend upon it to be a component of their wages. Examples of bonuses that must be included in overtime pay calculations are attendance bonuses, production bonuses (both individual and group),

bonuses for quality and accuracy of work, efficiency bonuses, bonuses for the highest number of overtime hours worked, length of service bonuses, bonuses promised to employees at the time of hiring, and bonuses provided for in union contracts.

If a bonus is included in the compensation of an employee's regular hourly rate, such employee's overtime pay also will increase. For example, an employee who gets paid \$10 per hour who works 45 hours and receives a \$50 bonus for a week, will have an hourly rate for that week of \$11.11 per hour ( $(\$450 + \$50) \div 45$  hours). Thus, the employee's overtime pay for that week will be \$41.66 as opposed to \$37.50 ( $\$10 \times 1.5 \times 5$  hours  $\times \frac{1}{2}$ ) since the bonus must be included in calculating overtime.

### Bonuses That Need Not Be Used to Calculate Overtime

If an employer decides to give employees a bonus after the employee has already rendered services, the bonus then is more like a gift. Bonuses that may be excluded from overtime calculations include Christmas bonuses, gift bonuses, bonuses wholly within the employer's discretion, profit-sharing bonuses paid pursuant to a profit-sharing plan and trust, and bonuses based on a percentage of an employee's total wages.

### Percentage of Wages

One of the easiest ways to avoid having a bonus affect an employee's overtime compensation is to grant a bonus based on a percentage of wages. Such bonuses protect an employer from liability for overtime pay since a percentage of both straight time and overtime compensation already compensates

the employee for overtime. However, incentive and production bonuses based on a contract, agreement, or promise, such as attendance bonuses, must typically be included in an overtime pay calculation.

In order to minimize liability when attempting to grant a benefit to employees in the form of bonuses, employers should review the type and nature of the bonuses being paid to make sure they fit within the type of bonuses that are excludable from the overtime pay calculation.

### When Bonuses Create Liability

- Bonuses that are intended to increase an employee's efforts must be used to calculate overtime.
- Bonuses that are given after an employee has rendered services and that are discretionary need not be used to calculate overtime.
- Percentages of wage bonuses are an easy way to comply with the wage-and-hour requirements.

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