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## **Bonuses: How Bonuses Impact Regular Rate for Non-Exempt Personnel**

As the year comes to a close, many employers are awarding or planning to award bonuses to employees. While bonuses are a great way to attract and retain employees, they can also create complex issues when it comes to non-exempt personnel and their regular rate and overtime pay.

### **Regular Rate**

The *regular rate* is the hourly rate of pay from which the federally-required overtime incentive is calculated. Many confuse the *regular rate* with terms like “base pay,” but they’re two different things. *Regular rate* includes base pay, but it also includes certain premium rates of pay and, as we’ll discuss here, non-discretionary bonuses.

### **Discretionary vs. Non-Discretionary**

The key to determining a bonus's impact on the regular rate lies in its nature: discretionary or non-discretionary.

- ***Discretionary bonuses:*** Just as they sound, discretionary bonuses are awarded at the employer’s discretion and are not tied to pre-established performance criteria. Some examples include spot bonuses, holiday bonuses, year-end bonuses, etc., that are not calculated by formulae.
- ***Non-discretionary bonuses:*** These bonuses are paid in a predictable way and could generally be reduced to a formula. Some examples include bonuses based on attendance, for hitting sales targets, production quotas, evaluation scores, etc. A bonus can be non-discretionary even if it’s not reduced to a written plan or the criteria aren’t published to employees in advance.

Discretionary bonuses are excluded from a non-exempt employee’s regular rate. Non-discretionary bonuses, however, are generally included in the regular rate – which means overtime rates also increase. When a non-exempt employee receives a non-discretionary bonus, it increases the regular rate for each workweek in which the bonus was earned, meaning an employer may even have to make OT payments in arrears.

**Calculating OT Liability After the Award of a Flat Dollar Amount Non-Discretionary Bonus (aka The Hard Way)**

Step	Process	Example
1	Establish or adhere to a non-discretionary bonus program	Acme, a retailer, awards its non-exempt sales associates \$240 for each six-week period in which the store achieves a certain customer satisfaction rating.
2	Divide the bonus by the number of workweeks in which it was earned.	$\$240/6 \text{ weeks} = \$40.$
<i>Perform Steps 3-6 below for each non-exempt employee receiving the bonus for each workweek in which the non-discretionary bonus was earned and OT hours were worked:</i>		
3	Calculate bonus-adjusted regular rate by adding bonus amount to all other types of straight time regular rate compensation previously paid, then dividing by hours worked.	In week 2 of the bonus period, Bob worked 44 hours at a regular rate of \$10/hour. So, the bonus-adjusted regular rate is \$10.90/hour. $[(44 * \$10) + \$40]/44 \rightarrow \$480/44 = \$10.90.$
4	Calculate the bonus-adjusted OT premium (the “half” in time-and-a-half) by multiplying the bonus-adjusted regular rate by 0.5.	$\$10.90 * 0.5 = \$5.45$
5	Calculate bonus-adjusted OT liability for the workweek by multiplying OT hours * the bonus-adjusted OT premium	$4 \text{ hours OT} * \$5.45 = \$21.80$
6	Subtract OT compensation already paid.	In his regular week 2 paycheck, Bob received an OT premium of an additional \$5/hour on his 4 OT hours. $\$21.80 - \$20.00 = \$1.80$
<i>Repeat steps 3-6 for each workweek in which the employee worked OT in the bonus period, then pay the remaining OT differential on the next practicable paycheck.</i>		

**The Workaround**

Fortunately, there’s an easier way to award non-discretionary bonuses to non-exempt employees. That’s to provide the bonus as a percentage of all wages earned (including OT in the bonus period). A sample policy or expression would be an award of 0.5% of employee gross pay for each quarter in which an employee achieves perfect attendance.

## Best Practices

- **Clear communication and bonus criteria:** Clearly communicate and document the criteria for earning or awarding bonuses to avoid confusion. Clear communication about the structure of these bonuses establishes defined expectations and often mitigates any potential dispute.
- **Maintain accurate records:** This probably seems like a no brainer – but keep detailed records of all bonuses paid, the nature of the bonuses (i.e., discretionary or non-discretionary), and calculation methods.
- **Consult with legal counsel:** Bonuses can create complex issues. Seek legal counsel to avoid costly mistakes.

Bonuses can be a valuable tool for employee motivation and retention, but employers should make sure they consider the effects of non-discretionary bonus on overtime pay for non-exempt employees. By following the best practices and seeking legal counsel, employers can better navigate this tricky situation. If you need any assistance or have any questions, we at Lehr, Middlebrooks, Vreeland & Thompson, P.C. are happy to help. Please contact McKenzie Meade at 205-323-9279 or [mmeade@lehrmiddlebrooks.com](mailto:mmeade@lehrmiddlebrooks.com)