FLSA-635

November 17, 1980

This letter reflects our opinion concerning whether certain costs incurred by an employer in providing board and lodging for employees in its sheltered workshops may legitimately be characterized as a part of the "reasonable cost" of such facilities under Section 3(m) of the Fair Labor Standards Act (FLSA) and may therefore count toward an employer's minimum wage obligations.

Section 3(m), as you are aware, permits an employer, under specified conditions, to count towards its wage obligation under the FLSA, the "reasonable cost" to the employer of furnishing board, lodging and other facilities to its employees. However, Section 3(m) also authorizes the Secretary to determine the "fair value" of the board, lodging and other facilities "where applicable and pertinent"." The regulations implementing this provision state that if the reasonable cost as computed pursuant to CFR Part 531:

> is more than the fair rental value (or the fair price of the commodities or facilities offered for sale), the fair rental value (or the fair price of the commodities or facilities offered for sale) shall be the reasonable cost (29 CFR section 531.3(c)).

As these provisions make clear, even is the costs you have outlined are part of the "reasonable cost" under section 3(m), it would still be necessary to determine whether the fair rental or fair price of the facilities in question is lower than the reasonable cost. If so, those measures of value rather than the reasonable cost are to be counted towards the employer's wage obligation. We have your data on this point and will forward it to be reviewed with further data to be gathered by the Department's local officials.

Assuming that the actual costs do not exceed the "fair value"," it is our understanding that your questions concern two types of costs: the costs of maintaining on the payroll employees in order to provide board and lodging, and costs associated with property ownership.

1. Costs of Maintaining Employees who Supervise and Purchase Supplies for the Lodging Facilities.

The first question relates to the possibility of claiming a percentage of the salaries of two supervisory personnel whose duties, according to your letter, "include the supervision and operation of the room and board facilities"." Whether or not any of the compensation of these employees may be treated as part of "the reasonable cost" of … furnishing… board, lodging, or other facilities" under section 3(m) depends on facts not yet available to us. If these employees would have been on the payroll at the same salaries even if the facility did not provide room and board, no part of their salaries can realistically be treated as reasonable costs to the employer of board and lodging, and hence no part can be included

as part of the minimum wage. Conversely, if the employer had to take on extra personnel or pay higher salaries to existing employees in order to supervise and administer the meals and lodging, the extra expense incurred is a legitimate "cost of board and lodging" and should be included in the minimum wage. The information we have does not reflect sufficient facts pertinent to deciding this issue, so there will have to be further factual development on this point. We recognize that the standards set forth above, although technically correct, would sometimes be difficult to enforce, because of the difficulty of developing the full facts necessary for a determination. In fact, in our meeting you argued that it would be impossible to prove that some supervisors' salaries have been increased as a result of their responsibility for providing food and lodging. You have asked us, however, to take account of the fact that these tasks are time-consuming and could in some instances, be contracted out. If the employees in fact spend a significant amount of time at these tasks, it is logical to assume, in the absence of information to the contrary, that their salaries reflect these additional duties. Accordingly, absent some showing to the contrary, we will simply prorate the wage cost to the employer of these employees in proportion to the amount of time they spend on these tasks, if the amount of time spent is, in fact, significant. This is a matter which will require further factual development.

In this connection, it should be emphasized that in some situations, an employee's salary will not reflect the added cost of housing or feeding employees. For example, a supervisory employee in a restaurant will probably be paid the same whether or not the staff are provided with meals by their employer. Similarly, an employee who spends very little time performing inconsequential tasks related to providing food or lodging to other employees will probably not be paid more for his efforts. There could be other factual complications as well. For example, in some situations, the tasks involving the food and lodging areas will be so menial compared to other tasks assigned to the employee that it will not be reasonable to prorate the salary in proportion to the time spent. These questions would have to be resolved in individual cases.

A corollary question you have raised is whether the employer's share of Social Security and workmen's compensation taxes made on behalf of these employees may be counted as a "reasonable cost" of providing board and lodging to the same extent that these employees' salaries are counted as a reasonable cost. The fact that an employer is required by the Social Security and workmen's compensation laws to pay these expenses is in our view not relevant to the treatment of these taxes under section 3(m) of the FLSA. Such taxes, admittedly, cannot be counted towards the wage of the employee on whose behalf they are paid (see 29 CFR Section 531.38). However, this restriction does not prevent such taxes from being a part of an employer's actual cost of having certain employees devote all or some of their time to feeding and housing other employees. The regulations allow other taxes, which the employer is required to pay by law, such as property taxes, to count towards the reasonable cost under Section 3(m) (see Section 531.32(c)). We see no objection to treating payroll taxes similarly.

2. Costs Associated with Property Ownership.

(a) Interest paid on the mortgage for the building in which the lodging is located.

It has been your position that the interest an employer pays on its mortgage should be allowed as a part of the reasonable cost of furnishing lodging and meals in proportion to the amount of space in the building used for lodging and meals. Assuming that the employer owns the building and that this space would not otherwise be wasted space, 1/ this position is correct.

One question which has risen in this regard is whether the Department's regulations at 29 CFR Section 531.3(c) establish a maximum allowable interest rate at 5-1/2%. As we discussed, the 5-1/2% limitation in that provision applies to the opportunity cost of the depreciated value of capital invested in the building, not to the interest rate of a mortgage. That is, if an employer invests money in lodging instead of in some other area allowing an immediate return on capital, the loss of the opportunity to invest in that other area is, in real economic terms, a "cost" to him. The cost is limited under our regulations to a specific percentage of the capital investment because the employer's actual opportunity cost would be virtually impossible to ascertain. The 5-1/2% figure precludes arguments about opportunity costs based on speculation and hindsight. In contrast, the interest paid on a mortgage may be easily ascertained. It is an actual, ascertainable cost more akin to rent than to an opportunity cost, and is therefore allowable just as rent is.

(b) Interest on depreciated equity.

You have also asked whether the ability of an employer to count up to 5 1/2% interest on depreciated equity towards the "reasonable cost" of furnishing employees with board and lodging is affected in any way by the fact that the employer is a nonprofit organization. We do not believe that this factor has any effect on the issue. As you rightly point out,

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1/ If the space would otherwise be empty, allowing its use as a lodging, cooking and dining area, in no way affects an employer's mortgage expenses. In such a case, no portion of the mortgage interest could be considered a reasonable cost of furnishing board and lodging.

nonprofit organizations invest their money in many of the same ways as for profit organizations. What distinguishes nonprofit organizations is not so much how their money is made, but how it is spent. Accordingly, a nonprofit organization is entitled to count its "lost opportunity cost" as a part of the "reasonable cost" under §3 (m).

However, the exact method of calculating the depreciated amount of capital invested as proposed in your letter is not fully clear to us. We therefore take this opportunity to set forth what we believe to be the proper method of calculation. The current depreciated value of an employer's investment is equal to its cumulative capital investment, less whatever depreciation it has taken over the years. Thus, for example, let us say that as of a given year, an employer has paid a total of $10,000 on its mortgage principal, and $2,000 for capital improvements. It therefore has a $12,000 capital investment. If there has been $2,000 in depreciation on this capital basis for tax purposes over the years, the

depreciated capital investment is $10,000. If 50% of the floor space is devoted to the food and lodging facilities, the employer may credit 5-1/2% of $5,000 ($10,000/2), or $275.00, as one of the components of the "reasonable cost" of furnishing food and lodging. In each succeeding year, of course, the depreciated capital investment will vary because the principal paid on the mortgage and the depreciation taken will both change.

(c) Cost of Liability Insurance and Utilities.

We agree with your position that liability insurance can be treated as a component of the employer's "reasonable cost" in the same manner that fire insurance can. To the extent that the insurance covers the lodging area, it is in fact a cost of furnishing lodging. For the sake of simplicity, this cost should simply be prorated in proportion to the floor space involved. We also agree that the cost of heating should not be apportioned in proportion to the total floor space of the facility where part of the building is not, in fact, heated. It is appropriate to look to the percentage of heated space used for the lodging as the measure of cost.

Finally, you asked about the proper treatment of telephone company charges for the difference between the revenues from the pay phone located in the lodging area and the phone company's standard fee for maintaining a pay phone in that area. We agree that this cost is a legitimate cost of furnishing lodging in this situation. The fact that other people may very occasionally use the telephone would not alter this result.

In light of the general principles set forth above, we believe that the specific issues in the case involving your client can be resolved. We will return our files via the New York regional office to the area office. We understand that you will also submit the data you have put together concerning costs.

You will hear from us regarding the other issues we discussed apart from § 3(m) at some time in the future.

Sincerely,

Henry T. White
Deputy Administrator