

FLSA-1396

November 30, 1984

This is in reply to your letters of October 19 and November 8 on behalf of your client, in which you request an opinion as to whether the firm's method of calculating additional overtime premium pay due on incentive bonuses paid to employees is in compliance with the Fair Labor Standards Act (FLSA).

You state that your client has an employee incentive bonus plan based upon the amount and/or percentage of production target achieved at a plant during the bonus period. At some plants, employees receive bonuses on a quarterly basis. At other locations, employees receive bonuses monthly, annually, or semiannually. Since your client has found incentive bonuses to be popular and effective in stimulating productivity, the firm wishes to expand use of these bonuses. Your client does not believe that percentage of total earnings or discretionary bonuses, or profit sharing, are suitable for its purposes of regarding employee productivity. Therefore, your client proposes an alternative method of bonus payment. Each employee will receive a check for a gross dollar amount (less appropriated taxes), constituting his/her bonus amount, and an amount designated as overtime premium pay due on the bonus amount. The amount designated as overtime premium pay would be a fixed percentage of the gross amount. The percentage figure used to calculate the overtime premium due will vary depending upon the average number of hours worked each week during the bonus period by the employee. Employees working a higher number of hours will receive a higher estimated overtime premium and a correspondingly smaller bonus. The percentage schedule used to calculate the overtime premium pay is as follows:

<u>Average Number of Hours Worked Per Week During Bonus Period</u>	<u>Percentage of Gross Payment Attributable to Overtime Premium</u>
40-45	7.5%
46-50	11.5%
51-55	15.0%
Over 56	20.0%

Your client has conducted research to insure that these percentage figures accurately approximate the amount of overtime premium pay which FLSA requires to be paid on a bonus amount. You state that the estimated overtime premiums payable under the proposed method are consistently higher than those that would be due if the overtime premium due was calculated by the method described in section 778.209 of 29 CFR Part 778.

You state that your client's method has two advantages. First, the calculation of the overtime premium pay due on the net bonus is much simplified. The second advantage is that your client can accurately forecast total expenditures attributable to bonus payments and pay its employees the maximum available. This proposal was developed solely to reduce the burden on administering the bonus system and to increase the predictability of the bonuses' cost. Accordingly, you ask whether this bonus payment plan is in compliance with the monetary requirements of FLSA.

As explained in section 778.107 of Part 778, the FLSA overtime pay standard requires that overtime hours of work be compensated at a rate at not less than one and one-half times the regular hourly rate of pay at which the employee is actually employed. As stated in section 778.109, the regular hourly rate of pay of an employee is determined by dividing his/her total remuneration for employment in any workweek for which the compensation was paid. Also, as stated in section 778.108, the "regular rate" of pay under FLSA cannot be left to a declaration by the parties as to what is to be treated as the regular rate for an employee; it must be drawn from what happens under the employment contract. The Supreme Court has described it as the hourly rate actually paid to the employee for the normal non-overtime workweek for which he/she is employed - an "actual fact" (Walling v. Youngerman-Reynolds Hardwood Co., 325 U.S. 419).

In your client's situation, the employer determines an amount to be paid to employees as bonuses. It appears the total bonus amount per employee will not vary. However, the percentage of the total bonus amount representing either the bonus and overtime premium pay will vary depending upon the applicable "percentage of gross payment attributable to overtime premium" due a particular employee. Although your client's calculation of overtime premium pay may result in employees receiving more overtime premium pay than would result from using the method describe in section 778.209, the excess overtime premium pay occurs at the expense of the bonus amount. Moreover, the premium pay is not based on an hourly rate but on a span of average weekly overtime work hours. As explained in section 778.310, a premium in the form of a lump sum which is paid for work performed during overtime hours without regard to the number of overtime hours worked does not qualify as an overtime premium even though the amount of money may equal or be greater than the overtime premium sum owed on a per hour basis. Therefore, it is our opinion that your client's method of computing overtime premium pay due on incentive bonuses paid to his/her employees would not satisfy the monetary requirements of FLSA.

Although your client believes that a percentage of total earnings' bonus would not be suitable for rewarding employee efficiency or for reducing the burden of administering the bonus system, and would not increase the predictability of the incentive bonuses costs, we believe there are some advantages to the use of the percentage of total earnings' bonus method. This method is simply a way of distributing a total bonus pool among those employees who are to receive a share of the pool without additional overtime pay being required. This is so because the bonus, as a mathematical fact, includes the payment of both straight-time and overtime compensation. In distributing bonus pool shares, it is not necessary for the calculation of shares to be dependent upon employee

total earnings. The use of boosted hours has long been an accepted method of determining percentage of total earnings bonuses. Since your client already maintains a record of employee work hours for the bonus period, it would seem that the firm could easily calculate an individual employee's bonus.

For example, if your client chose to distribute a total of \$50,000 in the form of incentive bonuses at the end of a fiscal quarter to 100 employees at one of its locations, the firm need only make calculations in the following manner. Assume that employees of the firm have worked 52,000 straight-time hours and 13,000 hours of overtime in the quarter. The overtime hours will be boosted by 1.5 (the overtime premium rate) to yield 19,500 hours which, when added to 51,000, totals 71,500. Assume that one employee has worked 520 straight-time hours and 140 overtime hours, or 210 boosted hours ($140 \times 1.5 = 210$), to yield a total of 730 hours. The 730 boosted hours would be divided by 71,500 boosted hours to yield a percentage of 1.02. This percentage would be multiplied times the \$50,000 bonus pool to obtain the employee's share, in this case \$510.00. As explained above, this type of bonus computation is in compliance with the provisions of FLSA.

We trust the above is responsive to your inquiry.

Sincerely,

William M. Otter
Administrator