

# Employee Bonuses: Wage & Hour Compliance

Presented by  
Treaver Hodson, Esq.  
Palmer Kazanjian Wohl Hodson

**Palmer Kazanjian**  
Palmer Kazanjian Wohl Hodson LLP Attorneys



Employers wishing to incentivize employees can subject themselves to wage and hour exposure by not classifying bonuses correctly.



Before providing or promising bonuses to employees, employers should make sure they understand how to properly account and provide for bonuses.



In general, incentive compensation can take many forms and includes, commissions, piecework, flat sum bonuses, production bonuses, as well as many other incentive variations.

**Palmer Kazanjian**  
Palmer Kazanjian Wohl Hodson LLP Attorneys



Bonuses and other incentive compensation are primarily contractual in nature. **So, a clear written compensation agreement is strongly recommended.**



Verbal promises, past practices, and other unwritten communications and actions that are relied upon can create a binding promise to provide incentive compensation that is enforceable.



Some incentive compensation must be in writing, such as commissions under Labor Code section 2751. But, all incentive compensation would benefit from a clear writing that protects the rights and interests of the employer.

## Discretionary Versus Nondiscretionary Bonuses

- In general, the term “bonus” is used to identify incentive compensation that is NOT specifically tied to a percentage of a sale (commission) or the number of units produced (piecework).
- Under California and federal law, a bonus can be either discretionary or nondiscretionary. It is important to properly classify the type of bonus because this changes how an employee’s regular rate of pay is calculated.

### Discretionary Bonus:

- Not included in the regular rate of pay
- Does not impact an employee’s overtime rate by increasing the regular rate of pay

### Nondiscretionary Bonus:

- Included in the regular rate of pay
- Impacts an employee’s overtime rate by increasing the regular rate of pay

# How to Identify Bonuses: Discretionary

## Discretionary

Employer has sole discretion to pay the bonus and to determine the bonus amount.

The bonus is not made according to a prior contract, agreement, or promise that would cause an employee to regularly expect a bonus.

Example: A holiday turkey to all employees that is not dependent on hours worked, production, or efficiency.

Discretionary bonuses are EXTREMELY rare – almost non-existent – because they do not provide any meaningful incentive to the workforce.

Any bonus that provides meaningful incentive is non-discretionary

# How to Identify Bonuses: Nondiscretionary

## Nondiscretionary

Any bonus that does not meet the criteria for being a discretionary bonus.

The bonus is usually predetermined and announced to employees in advance, and thus the employee is aware that he or she must meet certain requirements to receive the bonus.

Example: bonuses for quality and accuracy of work, attendance bonuses, and bonuses announced to incentivize employee productivity.

**WARNING:** The label given to the bonus does not determine if it is discretionary or nondiscretionary.

This determination is made based upon the underlying facts of the bonus!

## The Impact of Bonuses on Overtime Pay

Bonuses often become an issue for employers because of the complexity in calculating the regular rate of pay.

The regular rate of pay is used to determine an employee's overtime wage rate.

Therefore, if the regular rate of pay is calculated incorrectly, an employee may receive less overtime pay, which can lead to backpay and wage and hour liability, including class action lawsuits.

# What is the regular rate of pay?



The regular rate of pay is defined as the compensation an employee earns for the work performed, and includes hourly earnings, salary, shift differentials, commissions, piecework pay, and nondiscretionary bonuses.

If a nonexempt employee earns a nondiscretionary bonus, the employer must calculate the employee's regular rate of pay for the entire period covered by the bonus. How the regular rate of pay is calculated depends on if the bonus was a flat sum bonus or not.

**Palmer Kazanjian**  
Palmer Kazanjian Wohl Hodson LLP Attorneys

## California's Unique Rule for Flat Sum Bonuses

In *Alvarado v. Dart Container Corp. of California*, the California Supreme Court adopted a different and more protective overtime calculation formula for flat sum bonuses.

This new formula calculates the increase to the regular rate of pay due to a flat sum bonus by dividing the bonus amount by the regular hours only.

For calculations, the flat sum method requires an overtime factor of 1.5—not 0.5.

•California employers paying flat sum bonuses must ensure they are properly calculating overtime on flat sum bonuses or risk facing wage and hour exposure, including the potential for significant penalties.

**Palmer Kazanjian**  
Palmer Kazanjian Wohl Hodson LLP Attorneys

# Flat Sum Bonuses: Continued

## Flat sum bonus:

- A set bonus amount.
- Does not increase with an employee's additional productivity or effort.
  - \* *Example:* a fixed attendance bonus for working a weekend shift.

## Production bonus:

- Increases with an employee's additional productivity or effort.
- Includes production bonuses, piecework bonuses, and commission bonuses.

## Calculating Production Bonuses: How to calculate the increase to the regular rate of pay due to the bonus

Divide the bonus amount by the total hours worked during the period in which the bonus was earned.

For this calculation, the total hours worked includes all hours during the period in which the bonus was earned, including overtime hours.

The increase to the regular rate of pay is then multiplied by the overtime factor of 0.5 to determine the overtime wages owed on the bonus.

## Example Showing Calculation of Production Bonus

1. An employee works a total of ten days over a two-week pay period for a total of 86 hours: 80 regular hours, 6 hours of overtime.
2. The employee is paid at a base rate of \$15.00 per hour.
3. The employee earns a \$50.00 nondiscretionary production bonus.

**CONCLUSION** □ employee would be entitled to \$1,200.00 in straight time pay, \$50.00 in bonus pay, \$135.00 in overtime based on the regular hourly rate of pay, and \$1.74 in overtime owed on the bonus.

### CALCULATIONS

The employee would be entitled to \$1,200.00 in regular time (80 regular hours at \$15.00 per hour), plus the \$50.00 bonus.

The employee would also be entitled to \$135.00 for the six overtime hours worked (\$15.00 base hourly rate multiplied by the 1.5 overtime rate, equaling \$22.50, which is then multiplied by the six overtime hours).

*This is a nondiscretionary bonus:* the overtime amount does not include the overtime that is owed on the bonus, which must also be calculated.

The increase to the regular rate of pay due to the bonus would be \$0.58 per hour (\$50.00 bonus **divided by the 86 hours worked**).

Thus, the resulting increase to the overtime rate would be \$0.29 (\$0.58 regular rate on the bonus **multiplied by the 0.5 overtime factor**).

Therefore, the employee would be entitled to an additional \$1.74 of overtime compensation due to the bonus (\$0.29 overtime rate on the bonus multiplied by 6 hours of overtime).

## Bonuses and Premium Payments for Meal, Rest, and Recovery Period Violations

- California law requires employers to pay premium payments for meal, rest, and recovery period violations.
- In *Ferra v. Loews Hollywood Hotel, LLC*, the California Supreme Court ruled these premium payments must be paid at an employee's regular rate of pay, and not at the employee's base hourly rate.
- Thus, by increasing the regular rate of pay, a nondiscretionary bonus also increases the amount of a meal, rest, and recovery period premium payment.

**NOTE:** The *Ferra* decision also applies retroactively. Therefore, employers should review their records and take remedial measures to prevent potential litigation.

# Bonuses in Non-Cash Forms



While the most common form of bonus is cash, employers can offer other forms of bonuses that would be treated like cash bonuses.



Gift card or gift certificate bonuses are treated similarly to cash bonuses.

- For example, a gift card given as a bonus would need to be included in the regular rate of pay if the gift card bonus met the criteria of a nondiscretionary bonus.
- Thus—a nondiscretionary gift card bonus would increase the regular rate of pay and overtime would need to be paid on the amount of the gift card.

## Summary of Incentive Compensation

- Incentive compensation can take many forms – all are considered compensation and must be properly classified and accounted.
- Written agreements are strongly recommended and, in some cases, required by law. They should be written to protect employer rights
- Few (if any) bonuses are discretionary; any bonus that offers an incentive to employees is probably NOT discretionary.
- Incentive compensation must be included in the regular rate of pay when calculating overtime and meal/rest period premiums.
- In California, flat sum bonuses affect the regular rate of pay differently than production bonuses.





# QUESTION & ANSWER

# THANK YOU!!