

# COMPLIANCE OVERVIEW

Provided by Sullivan Benefits

## Bonuses: Discretionary versus Nondiscretionary

The Fair Labor Standards Act (FLSA) requires that covered nonexempt employees in the private sector and in federal, state and local governments receive overtime pay for any hours they work over 40 during a workweek. Overtime pay must be at least one and one-half times the employee's **regular rate** of pay.

For the typical nonexempt worker, the regular rate of pay is determined by dividing the worker's total wages for the workweek by the total number of hours worked. Bonuses can play a big role in determining an employee's wages for the workweek. However, whether the bonus is discretionary or nondiscretionary determines how it affects the employee's regular rate of pay.

This Compliance Overview covers the difference between discretionary and nondiscretionary bonuses, as well as whether bonuses should be included in overtime pay rate calculations.

### LINKS AND RESOURCES

- [FLSA compliance resources](#)
- [Bonuses and overtime pay—illustrations and examples](#)
- [Fact Sheet #23 – Overtime Pay Requirements of the FLSA](#)
- [FLSA Reference Guide](#)

This Compliance Overview is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice.

### HIGHLIGHTS

#### DISCRETIONARY BONUS

Discretionary bonuses are not considered part of an employee's regular rate. A bonus is discretionary if:

- The employee has no expectation of payment
- The employer retains discretion regarding the amount and timing of payment
- The payment of the bonus is not tied to meeting specific standards or goals
- The payment has no effect on overtime rate calculations

#### NONDISCRETIONARY BONUS

Nondiscretionary bonuses are considered part of an employee's total wages. A bonus is nondiscretionary if:

- There is an expectation of payment
- The employer has no discretion regarding the amount and timing of payment
- Payment is tied to employee performance or other specific standards or goals

## OVERTIME PAY

Under the FLSA, employers must determine an employee's regular rate of pay before calculating the employee's overtime pay. The employee's regular rate of pay is different from the employee's contractual pay rate or salary and may change from week to week.

An employee's total wages for the week include all forms of payment or remuneration paid to the employee, except:

- Gifts and monetary awards that are not measured by hours worked, productivity or efficiency, such as discretionary bonuses;
- Irrevocable employee benefit contributions (such as life insurance, health benefits and retirement accounts);
- Paid time off (vacation, illness, holidays and production downtimes);
- Payments for overtime hours, holiday hours or work that falls outside a schedule set by an employment contract or collective bargaining agreement;
- Value or income derived from an employer-provided grant; and
- Value or income from stock option rights or stock appreciation and bona fide stock purchase programs.

## DISCRETIONARY BONUSES

A bonus is discretionary when the employer retains the freedom to decide what should be done with that bonus. Freedom to decide may include the timing and amount of the bonus. Similarly, the bonus may be paid for any specific reason or for no reason at all.

A discretionary bonus should not create an expectation of payment from the employee and it should be seen as arbitrary and almost whimsical. This means that the bonus cannot be due or tied to any prior promise, contract or agreement, or with employee performance (meeting specified goals or standards). To maintain bonuses as discretionary, employers should be careful and avoid any form of advance notice or other cautions that may, in any way, raise the expectation payment.

As mentioned above, discretionary bonuses are excluded from an employee's total earnings when calculating his or her regular rate of pay.

**Referral bonuses** are incentives paid to current employees for recruiting new employees. Referral bonuses are discretionary if all of the following conditions are met:

1. Participation in the referral program is strictly voluntary;
2. Recruitment efforts do not involve significant employee time; and
3. The activity is limited to after-hours solicitation done only among friends, relatives, neighbors and acquaintances as part of the employees' social life.

## NONDISCRETIONARY BONUSES

A bonus is **nondiscretionary** if the employer has created an expectation of payment and is no longer free to determine the timing or amount of payment without breaching legal or contractual agreements with its employees. Nondiscretionary bonuses are often based on employee or group performance. Performance can be measured by meeting a specific goal, including production standards and sales targets.

Generally, employers and employees agree in advance on the method and timing of payment of nondiscretionary bonuses. This is the case for commission wages, sales incentives and other rewards offered in direct correlation to the employees' quantity and quality of work.

Nondiscretionary bonuses are part of an employee's weekly compensation and must be included in the determination of a regular wage rate.

### Examples of Nondiscretionary Bonuses

- Hiring bonuses
- Attendance bonuses
- Individual or group production bonuses
- Bonuses for quality or accuracy of work

## BONUSES AND OVERTIME CALCULATIONS

An employee's nondiscretionary bonuses must be factored into his or her overtime pay calculations for the period covered by the bonus. If the exact weeks that the bonus was earned can be determined, then the bonus is retroactively attributed to those weeks. If the exact weeks cannot be determined, then the bonus must be retroactively allocated across the entire bonus period.

The allocation will result in an increase in the total earnings for the affected weeks. This change will logically increase the employee's regular rate of pay, which, in turn, increases the overtime rate of pay for nonexempt employees.

Type of Bonus	Effect on Overtime Rate Calculation	Calculation
<b>Discretionary</b>	<ul style="list-style-type: none"> <li>• <b>None</b> – The bonus is not included in the employee's regular rate of pay.</li> </ul>	<ul style="list-style-type: none"> <li>• Not applicable</li> </ul>
<b>Nondiscretionary</b> attributed to a specific period of time or workweeks	<ul style="list-style-type: none"> <li>• <b>Regular rate of pay increased</b> – The bonus must be added to the employee's total earnings for the specific bonus period or workweeks.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Bonus per workweek</b> <i>plus</i> earnings for that week (hourly rate <i>times</i> hours worked) <i>equals</i> <b>total earnings for week.</b></li> <li>• <b>Total earnings for workweek</b> <i>divided by</i> total hours worked in that workweek <i>equals</i> <b>regular rate of pay.</b></li> <li>• <b>Regular rate of pay</b> <i>times</i> 1.5 <i>equals</i> <b>overtime rate of pay.</b></li> </ul>

Type of Bonus	Effect on Overtime Rate Calculation	Calculation
<p><b>Nondiscretionary</b> attributed across entire bonus period</p>	<ul style="list-style-type: none"> <li>• <b>Regular rate of pay increased</b> – The bonus must be added to the employee’s total earnings for the specific bonus period or workweeks.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Bonus</b> paid <i>divided by</i> number of weeks in the bonus period <i>equals</i> <b>bonus per week</b>.</li> <li>• <b>Bonus per workweek</b> <i>plus</i> earnings for that week (hourly rate <i>times</i> hours worked) <i>equals</i> <b>total earnings for week</b>.</li> <li>• <b>Total earnings for workweek</b> <i>divided by</i> totals hours worked in that workweek <i>equals</i> <b>regular rate of pay</b>.</li> <li>• <b>Regular rate of pay</b> <i>times</i> 1.5 <i>equals</i> <b>overtime rate of pay</b>.</li> </ul>

## MORE INFORMATION

Please contact Sullivan Benefits for more information on wage and hour laws.