

White Paper

Overtime Calculations for Non-Exempt Employees Due to Bonus

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This issue is required by the Department of Labor; however, it appears that not a lot of organizations know how to calculate the additional amount. Calculating the additional overtime due to bonus is not as time consuming or as difficult as one might think. Below you will find a summary of the regulations, what the formulas are and a few examples to help understand the implementation of the regulation.

To begin with, all of the overtime regulations can be found in the Code of Federal Regulations (CFRs) in the 29CFR778 section. There are five regulations that deal specifically with bonuses and two that deal with plans that attempt to circumvent the act. Both issues will be discussed here. This paper will cover each regulation, and help the HR/compensation practitioner understand the meaning and intent for these federal laws.

29CFR778.208 – Inclusion and exclusion of bonuses in computing the “regular rate”

In the first CFR, the groundwork is laid for the following CFRs. In this section the DOL discusses the seven specified types of payments that would be excluded from the regular rate. The seven types are as follows:

- Discretionary Bonuses
- Gifts
- Payments in the nature of gifts on special occasions
- Contributions by the employer to certain welfare plans
- Payments made by the employer pursuant to certain profit-sharing plans
- Payments made by the employer pursuant to certain thrift plans
- Payments made by the employer pursuant to certain savings plans

The CFR also states “Bonuses which do not qualify for exclusion from the regular rate as one of these types must be totaled in with other earnings to determine the regular rate on which overtime pay must be based.” Additionally, the DOL clarifies that bonus payments are any payments that are in addition to the regular earnings of an employee.

29CFR778.209 – Method of inclusion of bonus in regular rate

This CFR contains most of the information for employers dealing with overtime aspects due to bonuses. As a reminder, the DOL states, “Where a bonus

payment is considered a part of the regular rate at which an employee is employed, it must be included in computing his regular hourly rate of pay and overtime compensation.” The CFR separates the re-calculation of overtime into four categories:

- (1) When bonus covers only one weekly pay period
- (2) When the bonus covers several weekly pay periods
- (3) When the bonus cannot be identified with particular workweeks (workweek example)
- (4) When the bonus cannot be identified with particular workweeks (hourly example).

In the first case (where a bonus covers only one weekly pay period), the additional overtime is simple to calculate. In this case the employer would add the bonus amount to the weekly earnings, divide by the total number of hours worked. This calculation will give the employer the new regular rate for overtime purposes.

Example: You have a call center employee that worked 45 hours during the workweek. Since that employee had achieved all of the required times, they receive a \$100 weekly bonus. The employee’s wages are \$10.00/hour or \$400/week.

In order to calculate the new rate for overtime you would take the weekly wage of \$450.00 (45 hours X \$10.00) and add the \$100 bonus amount to get \$550.00. To calculate the new regular rate you would divide \$550.00 by 45 (hours worked) to get the new hourly wage of \$12.22. So the additional amount you would need to include for overtime purposes would be \$30.56 ($\$12.22 \times 5(\text{hours of overtime}) \times 1.5(\text{overtime factor})$). So for the week, your employee would receive a paycheck for \$580.56 ($\$450 [\$10/\text{hour} \times 45 \text{ hours}] + \$30.56(\text{overtime amount due to the bonus}) + \$100(\text{bonus})$).

For the second example, the same process will be used, however, in the second example the bonus would be distributed over several pay periods. The regulation states the following formula, “When the amount of the bonus can be ascertained, it must be apportioned back over the workweeks of the period during which it may be said to have been earned. The employee must then receive an additional amount of compensation for each workweek that he worked overtime during the period equal to one-half of the hourly rate of pay allocable to the bonus for that week multiplied by the number of statutory overtime hours worked during the week.”

Example: You have an administrative assistant who earns a performance bonus for the month of February. The month of February had 4 weeks, and the administrative assistant worked the following hours 40, 42, 40, and 43. She receives a performance bonus of \$200.

To find the additional amount required for overtime, you would take the total amount of the bonus (\$200) and divide by total hours worked (165 hours) to get the bonus hourly rate of \$1.21/hour. According to the regulation, you would then multiply .5 (one half) by the bonus hourly rate (\$1.21) by the number of overtime hours (5) to have an additional payment due of \$3.03 (.5 X \$1.21 X 5).

For the third situation, the DOL states, "it may be reasonable and equitable to assume that the employee earned an equal amount of bonus each week of the period to which the bonus relates, and if the facts support this assumption additional compensation for each overtime week of the period may be computed and paid in an amount equal to one-half of the average hourly increase in pay resulting from bonus allocated to the week, multiplied by the number of statutory overtime hours worked in that week." Basically, the regulation is stating that you can assume the employee earned an equal amount of bonus for each week they were eligible, very similar to option two above.

Example: You have a front line supervisor who earns a performance bonus based on an increase of widgets produced, for a six-month period. The supervisor earns \$15.00/hr and worked about 52 hours overtime during the 6-month period. The performance bonus was \$1,000.

To calculate the additional overtime amount, you would take the amount of the bonus (\$1,000) divided by the number of weeks the bonus was allotted (26 weeks) to get \$38.46/week. This would mean the average hourly increase would be the additional weekly amount (\$38.46) divided by the number of hours worked each week (for this example, we will assume the supervisor worked two overtime hours each week for a total of 42 hours/week) to get an average hourly increase of \$0.92. According to the formula above, you would then multiply the hourly rate (\$0.92) by the overtime factor (.5) by the number of overtime hours (52) to have an additional payment due of \$23.92 (.5 X \$0.92 X 52).

The fourth situation the DOL discusses is when it may not be feasible to assign equal bonus to each workweek. The DOL states, "it may be reasonable and equitable to assume that the employee earned an equal amount of bonus each hour of the pay period and the resultant hourly increase may be determined by dividing the total bonus by the number of hours worked by the employee during the period for which it is paid. The additional compensation due for the overtime workweeks in the period may then be computed by multiplying the total number of statutory overtime hours worked in each such workweek during the period by one-half this hourly increase."

Example: You have a retail store assistant manager who earns an annual bonus based on profit. The assistant manager earns \$17.00/hr and worked a total of 2,340 hours (260 overtime) for the year. The bonus was \$2,500.

For this example, you would take the total bonus amount (\$2,500) and divide by the total number of hours worked (2340) for an additional overtime amount of \$1.07/hour. You would then multiply the amount (\$1.07) by the overtime factor (.5) by the number of overtime hours (260) to have an additional payment due of \$139.10 ($\$1.07 \times .5 \times 260$).

29CFR778.210 – *Percentage of Total Earnings as Bonus*

Occasionally, a bonus may be written as a percent of an employee's wages. If the plan is written so the bonus would include a percentage of both straight time and overtime, you would not need to re-calculate the overtime. The example in the regulation is a performance bonus that pays 10 percent of straight time and 10 percent of overtime earnings. Take note, the regulation states this is an acceptable practice, as long as it is not used to circumvent the overtime requirements of the act.

29CFR778.211 – *Discretionary Bonuses*

According to the regulation, employers would not need to factor in overtime for a true discretionary bonus. The DOL describes a discretionary bonus as:

- The fact that payment is to be made, is determined at the sole discretion of the employer
- The amount of payment is to be made, is determined at the sole discretion of the employer
- Both the above situations are not pursuant to any prior contract, agreement, or promise causing the employee to expect such payments regularly.

The regulation has several examples of situations where the bonus is not discretionary:

- If an employer promises in advance to pay a bonus, he has abandoned his discretion with regard to it.
- An employer who promises to sales employees that they will receive a monthly bonus computed on the basis of allocating 1 cent for each item sold whenever, is his discretion, the financial condition of the firm warrants such payments, has abandoned discretion with regard to the amount of the bonus though not with regard to the fact of payment

29CFR778.212 – *Gifts, Christmas and special occasion bonuses*

For gifts, money paid at Christmas or special occasions, these bonuses may be excluded from the regular rate, therefore excluded from the overtime re-calculation. To qualify for this exclusion, the bonus must actually be a gift or in the nature of a gift. It cannot be measured by hours worked, production, or efficiency. If the payment is geared to wages and hours worked, production, or efficiency, then it is no longer considered a gift and must be included in the regular rate for overtime purposes.

29CFR778.502 – *Artificially labeling part of the regular wages a “bonus”*

The DOL has several regulations pertaining to circumventing the overtime re-calculations. This is one of those regulations. This regulation pertains to when an employer designates a portion of regular wages as a bonus. The employer is not allowed to pursue this practice and the DOL will take action if this practice occurs.

An illustration of how this type of plan works over a three-week period may serve to illustrate this principle more clearly:

1. You have an employee that earns \$400/week without regard to the number of hours worked
2. In the first week the employee whose applicable maximum hours standard is 40 hours, works 40 hours and receives \$400. The books show he has received \$206 (40 hours X \$5.15/hour) as wages and \$194 as bonus. No overtime has been worked so no overtime compensation is due
3. In the second week he works 45 hours and receives \$400. The books show he has received \$206 for the first 40 hours and \$38.63 (5 hours X \$7.73 an hour) for the five hours over 40, or a total of \$244.63 as wages, and the balance as a bonus of \$155.38. Overtime compensation is then computed by the employer by dividing \$155.38 by 45 hours to discover the average hourly increase resulting from the bonus--\$3.45/hour—and half this rate is paid for the five overtime hours--\$8.43. This is wrong. The employee's regular rate in this week is \$8.89 (\$400 divided by 45 hours). Therefore he is owed \$422.28 [(\$8.89 X 40hours) + (\$8.89 X 1.5 X 5 hours)] not \$408.43.
4. In the third week the employee works 50 hours and is paid \$400. The books show that the employee received \$206 for the first 40 hours and \$115.95 (10 hours X \$7.73 an hour) for the 10 hours over 40, for a total of \$321.95 and the balance as a bonus of \$78.05. Overtime pay due on the “bonus” is found to be \$7.81. This is wrong. The employee's regular rate in the week is \$8.00. Therefore is owed \$440 not \$407.81.

29CFR778.503 – *Pseudo “Percentage Bonuses”*

As stated above, an employer does not need to re-calculate overtime if the bonus is a percentage of wages earned. Keep in mind, if using a percentage bonus, the

employer must use the same percentage for both straight time and overtime earned. If the employer does not do this, then the bonus will not be considered a percentage bonus and overtime must be re-calculated.

As noted in the above seven regulations, an employer must be cognizant when paying a bonus to a non-exempt employee, and if the employer does not follow the regulations or attempts to circumvent the regulations the DOL will enforce those regulations. Due to the nature of the non-exempt position, employers, in most cases, will need to re-calculate an overtime factor based on the new regular rate due to the bonus. Please use caution when re-calculating a non-exempt overtime amount due to a bonus to ensure you do it correctly.

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