



Annual Bonuses: Are They Factored Into Overtime?

Insights

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Many employers question whether annual bonuses must be considered in overtime compensation. Although California law has more protective overtime laws than most states, it sticks with federal law with regard to what is included in the "regular rate" when calculating overtime. Federal law requires "all remuneration" to be included in the regular rate except for seven specified types of payments. Among these excludable payments are *discretionary* bonuses, gifts and payments in the nature of gifts on special occasions, contributions by the employer to certain welfare plans and payments made by the employer pursuant to certain profit-sharing, thrift and savings plans.

California similarly defines remuneration or wages as "all amounts for labor performed by employees of every description, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation." That means that all wages, whether a bonus, incentive, or commission, will be included in the regular rate of pay unless they qualify for one of the exceptions noted above.

Which Is Which?

A common question when paying annual bonuses is whether they are discretionary or non-discretionary. The California Labor Commissioner interprets a bonus as discretionary only when there are "no objective criteria" involved and the bonus is "not routine." This is made more clear by the federal regulations, which provide that a bonus is discretionary only if "both the fact that payment is to be made and the amount of the payment are determined at the sole discretion of the employer at or near the end of the period and not pursuant to any prior contract, agreement, or promise causing the employee to expect such payments regularly." The federal regulation summarizes its analysis as follows:

Bonuses which are announced to employees to induce them to work more steadily or more rapidly or more efficiently or to remain with the firm are regarded as part of the regular rate of pay. Attendance bonuses, individual or group production bonuses, bonuses for quality and accuracy of work, bonuses contingent upon the employee's continuing in employment until the time the payment is to be made and the like are in this category. They must be included in the regular rate of pay.

Many annual bonuses are *non-discretionary* because they are predicated, in whole or in part, on performance criteria, thereby triggering an employer's obligation to include them in the regular rate

calculation when paying overtime. Specific examples for calculating overtime on bonuses are beyond the scope of this article. Among other things, the regular rate for purposes of calculating overtime due on the annual bonus is determined by dividing the bonus amount by the total hours worked during the period for which the bonus applies.

The Bottom Line

Although the regular rate is enhanced by an annual bonus payment for each week of the measuring year when overtime was worked, this does not mean that you must go back and recalculate overtime due for each individual pay period. Rather, what this means in practical terms is that, because the annual bonus is paid only once each year, that bonus payment will have to include an additional overtime premium payment that reflects overtime worked for the bonus period (the bonus year) with an itemized statement just like all other payroll checks.

Questions regarding calculating overtime due on periodic annual bonuses should be handled on a case-by-case basis.

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