

Employee Benefit ■ Plan Review

Top 10 Ways Employers Can Avoid Regular Rate Wage Mistakes

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When the U.S. Department of Labor’s Wage and Hour Division (DOL) published a final rule (the Rule) on the regular rate in late 2019, it gave employers the freedom to more easily offer perks and benefits to their employees without running afoul of federal wage and hour law. But while the Rule did clarify some issues, it left many employers’ questions unanswered. And this uncertainty has led to compliance challenges which have lingered to this day. In 2022 alone, in fact, the DOL published more than 25 press releases tied to regular rate violations that it investigated or litigated. Given these developments, here is a top 10 list of steps that employers should consider taking to avoid the most common regular rate missteps.

WHAT IS THE REGULAR RATE?

To begin any discussion regarding the regular rate, it is important to remember the basic wage and hour obligations under the Fair Labor Standards Act (FLSA).

- First, employers must pay non-exempt employees at least the minimum wage for all hours worked.
- Second, employees must be paid overtime for each hour worked over 40 in a work-week, and overtime must be paid at one and a half times the “regular rate of pay.”

Generally, most states’ regular rate analysis is similar to that of the FLSA. However, many are silent on the issue and a few have slightly different rules. Employers must remember to verify the state law where they have employees. Whatever methodology provides the most benefit to the employee – state or federal – is the one the employers should follow.

WHAT DOES THE REGULAR RATE INCLUDE?

The regular rate is based on “all remuneration” earned from employment with the exception of eight specific exclusions contained in Section 7(e) of the FLSA. It sometimes comes as a surprise that the regular rate is not simply an employee’s hourly rate of pay or their take home pay.

The regular rate includes all types of compensation – including things like non-discretionary bonuses, commissions, payments for undesirable shifts or duties, and some non-cash payments depending on the circumstances.

The exclusions contained in Section 7(e) are exhaustive. DOL makes that determination on a case-by-case basis, applying the requirements set out in the statute to the specific circumstances, so there are few bright-line rules. The agency cautions that wage supplement payments are still considered compensation for purposes of the regular rate even if they are not

tied to hours worked or employee performance. Ultimately, if it looks like a wage, it likely is, and it should be included in the regular rate.

HOW DO YOU CALCULATE THE REGULAR RATE?

The formula for determining the regular rate under the FLSA is total earnings in a workweek (less excludable payments) divided by the total number of hours worked in the workweek.

The regular rate must be equal to or greater than at least the applicable minimum wage – state or federal – whichever is higher. If the regular rate happens to be higher than the applicable minimum wage, the higher rate must be used to calculate overtime. If an employee's regular rate is less than the applicable minimum wage, then the employee's straight-time earnings must be adjusted upward to conform with the respective minimum wage requirement and the employee must be paid overtime on the basis of one and one-half times that amount.

For example, if an employee's regular rate falls below \$7.25 per hour, the employee's pay will need to be adjusted so that the regular rate is at least \$7.25 per hour, and the employee's overtime will be determined at time and one-half of \$7.25 (i.e., \$10.88 per overtime hour).

A simple example dealing with hourly wages only and no additional compensation is below:

- Jan works 45 hours in a workweek
- Jan's hourly wage rate is \$15 per hour
- 45 hours × \$15 per hour = \$675 total earnings
- Regular rate = \$15 per hour (\$675 / 45 hours)
- Overtime premium = \$37.50 (\$15 per hour regular rate × .5 overtime premium × 5 overtime hours)
- Total compensation due = \$712.50 (\$675 + \$37.50)

The regular rate in this example is the normal hourly wage paid to the employee. However, if that same employee also receives a \$100 non-discretionary production bonus that week, the regular rate is no longer \$15 per hour.

- 45 hours worked × \$15 per hour = \$675 total earnings
- \$100 production bonus
- Total Remuneration = \$775 (\$675 + \$100)
- Regular rate = \$17.22 per hour (\$775 / 45 hours)
- Overtime premium = \$43.05 (\$17.22 per hour regular rate × .5 overtime premium × 5 overtime hours)
- Total compensation due = \$818.05 (\$775 + \$43.05)

A difference of \$2.22 per hour between the \$15 per hour regular rate and the \$17.22 per hour regular rate may not seem significant. But a mistake on this calculation for a large number of employees, over a two-to-three-year period, can quickly become hundreds of thousands of dollars in liability, if not millions.

To make matters worse, if you consider the potential for collective actions with attorneys' fees, or DOL investigations where liquidated damages may be awarded in addition to back wages, getting the regular rate right is essential.

HOW DOES THE REGULAR RATE WORK FOR A TIPPED EMPLOYEE?

One of the most common questions employers have is how to calculate the regular rate for tipped employees. The regular rate for tipped employees is the amount of their direct cash wage and the amount of any tip credit an employer may be taking.

For example, under the FLSA, the regular rate for a tipped employee is generally \$7.25 per hour, the full current minimum wage. Of course, if a state's minimum wage is higher, then the regular rate for

the tipped employee will be higher. Importantly, though, tips over the allowable tip credit amount do not increase the regular rate for overtime purposes.

Returning to Jan as our example, in her role as a tipped server in a restaurant, she works 50 hours in a workweek and is paid a direct cash wage of \$2.13 per hour and a tip credit of \$5.12 per hour.

Straight Time Pay

- Direct cash wages = \$106.50 (\$2.13 per hour direct cash wage × 50 hours)
- Tips received from customers = \$256 (\$5.12 per hour tip credit × 50 hours)

Total Pay Including Overtime Premium Due

- \$7.25 per hour (full federal minimum wage) × .5 overtime premium × 10 overtime hours = \$36.25 overtime premium due
- Total direct pay owed = \$142.75 (\$106.50 + \$36.25)
- Total compensation due = \$398.75 (\$142.75 direct pay + \$256 tips)

HOW DO END-OF-THE-MONTH/QUARTER/YEAR PAYMENTS FACTOR INTO THE REGULAR RATE?

It is important to understand that the regular rate can change after an employee has already been properly paid for a workweek that has been completed. This often comes up when employees receive commissions and non-discretionary bonuses that impact workweeks that occurred earlier in the year.

As a general rule, to compute the additional overtime that might be due, payments that are paid at the conclusion of a certain period of time (i.e., end of the month, quarter, or year) must be apportioned back over the workweeks during which

they were earned. This is sometimes referred to as a “look-back” calculation.

- Jan’s hourly rate is \$15 per hour
- Jan receives a non-discretionary bonus of \$200 at the end of the month for reaching certain goals during that time period
- During the month, Jan worked the following hours:

Week 1 – 40
 Week 2 – 42
 Week 3 – 40
 Week 4 – 45

Jan’s Look-Back Calculation

To calculate the total additional overtime due related to the bonus, consider the following:

- 167 hours worked at \$15 per hour = \$2,505
- \$200 month-end bonus
- Total Remuneration = \$2,705 (\$2,505 + \$200)
- Regular rate = \$16.20 (\$2,705/167)
- Overtime premium = \$56.70 (\$16.20 per hour regular rate x .5 overtime premium x 7 overtime hours)
- Total compensation due = \$2,761.70 (\$2,705 + \$56.70)

This bonus payment increased the bonus overtime due by \$4.70 (\$56.70 - \$52). The \$52 was the overtime that would have already been paid (\$15.00 per hour base rate x .5 x 7 overtime hours). When the \$200 month-end bonus is paid, the employee needs to pay an additional \$4.70 in overtime. It is important to show this overtime payment as a separate line item on the pay stub so that the DOL and plaintiffs’ attorneys can easily see the overtime was properly paid on the bonus.

WHAT IF AN EMPLOYEE IS PAID AT TWO OR MORE RATES OF PAY?

Another potential area for confusion is when an employee works at

two or more different rates of pay during the workweek. Generally, under the FLSA, employers will need to use the “Weighted Average Method” to calculate the proper regular rate. That method is calculated by taking the total compensation earned during the workweek and dividing it by the total hours of work performed during the workweek.

- Jan works a total of 50 hours, consisting of 40 hours at her ordinary rate of pay of \$25 per hour, and 10 hours at the travel rate of pay of \$15 per hour.
- The weighted average would be calculated as follows:
- \$25 per hour x 40 hours = \$1,000
- \$15 per hour travel rate x 10 hours = \$150
- Jan’s total hourly pay = \$1,150
- Weighted average rate of pay = \$23 per hour (\$1,150 / 50 total hours)
- Overtime premium = \$115 (\$23 per hour x 0.5 x 10 overtime hours)
- Total compensation = \$1,265 (\$1,150 hourly pay + \$115 overtime pay)

THERE’S MORE MATH? ARE THERE ANY SHORTCUTS?

We know . . . all of these calculations are confusing. But help is here. The DOL has published a coefficient table¹ that can be used to easily compute the FLSA half time premium due.

Another Shortcut – the Percentage Bonus Option

Still looking for another way to pay the bonus without all these calculations? The percentage bonus may be the option. You can avoid the calculations by designing a bonus payment which is computed as a predetermined percentage of an employee’s total straight-time and overtime pay for the period over which the

bonus was earned. If the overtime pay is not included, this option will not work.

For example, a plan could provide that employees who hit a certain production goal in four-week period will receive 2% of their total straight time and overtime wages for that period.

Critically, percentages must be predetermined and cannot be subsequently vary downward or upward in response to increases or decreases in hours worked. The plan also may not produce a fixed or set bonus sum which does not vary as the employee’s overtime hours and pay fluctuate. So, for example, it would not be acceptable for an employer to decide at the end of a bonus period to back into a percentage that equals the sum the employer wanted to pay. This would not be a predetermined percentage and would run afoul of the law.

Regular Rate Exclusions

While it is important to understand what is included in the regular rate, it is equally important for employers to understand what is excluded from the regular rate. Section 7(e) of the FLSA contains eight categories of pay that may be excluded from the regular rate.

7(e)(1) – Some Gifts

Sums paid as gifts; payments in the nature of gifts given during holidays or on other special occasions, or as a reward for service, the amounts of which are not measured by or dependent on hours worked, production, or efficiency.

These gifts cannot be promised (or contractually owed), and they cannot be so substantial that an employee would consider it a wage and not a gift. If the gift is paid at a holiday, it may be excluded from the regular rate under Section 7(e)(1) even though it is paid with regularity so that the employees are led to expect it and even though the amounts paid to different employees or groups vary with the amount of the salary or regular hourly rate of such employees

or according to their length of service with the firm. This is so long as the amounts are not measured by or directly dependent upon hours worked, production, or efficiency.

7(e)(2) – Vacation, Holiday, and Similar Pay When No Time Is Worked – and Reimbursements

Payments made for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient work, or other similar cause.

Payments in this category should not be confused with attendance incentive programs, which must typically be included in the regular rate. Legitimate Paid Time Off (PTO) buyback programs may be excluded from the regular rate calculation if they correspond to what an employee would have been paid if they used their PTO. It may not be used to disguise a bonus, however. For example, a buyback program that pays employees three times the value of the PTO is likely not going to pass the “straight face” test and will need to be included in the regular rate.

Paid meal breaks may also fall into this category of exclusions. The pay for bona fide meal breaks may be excluded from the regular rate, unless an agreement or established practice indicates that the employee and employer have treated the time as hours worked. In that case, the payments must be included in the regular rate.

Similarly, reasonable payments for travel expenses, or other expenses incurred while an employee furthers the employer’s interests and that are properly reimbursable by the employer or other similar payments that are not made as compensation for an employee’s hours of employment may be excludable. Although not a bright line rule, DOL generally considers an expense to be per se reasonable if it is at or below maximum amounts permitted for the same type of expenses under the Federal Travel Regulation or within the

reimbursement amounts set forth by the Internal Revenue Service.

7(e)(3) – Discretionary Bonuses, Profit Sharing, and Talent Fees

Sums paid in recognition of services performed during a given period if either, (a) 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; or (b) the payments are made pursuant to a bona fide profit-sharing plan or trust or bona fide thrift or savings plan, meeting the requirements of the administrator set forth in appropriate regulations which he shall issue, having due regard among other relevant factors, to the extent to which the amounts paid to the employee are determined without regard to hours of work, production, or efficiency; or (c) the payments are talent fees . . . paid to performers, including announcers, on radio and television programs

To be considered discretionary, three requirements must be met:

- The employer has sole discretion whether or not to pay;
- The employer has sole discretion to determine the amount of the bonus; AND
- The payment is not made pursuant to a contract, agreement or promise causing employee to expect the payment

Keep in mind that most bonuses are not discretionary and must be included in the regular rate. Commonly employers will have a bonus that is based on a formula that is announced ahead of time and designed to incentivize certain behavior. Such a bonus is not discretionary.

Importantly, labels do not matter. Simply calling a bonus “discretionary” does not determine whether it must be included in the regular

rate. For example, calling the formula-based bonus discussed above “discretionary” does not make it discretionary for purposes of the regular rate. In contrast, a \$50 spot bonus for completing an unexpected rush order may be discretionary and excludable from the regular rate.

Questions surrounding sign-on bonuses persist. To be excludable, employers must ensure that they are not subject to any claw-back provision requiring the employee to stay with the company for a certain amount of time before payment and that there is no written plan or collective bargaining agreement promising such payment.

7(e)(4) – Employer Contributions to Retirement and Other Plans

Contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide plan for providing old-age, retirement, life, accident, or health insurance or similar benefits for employees.

Under this exclusion, things like employer contributions to 401k accounts, unemployment, disability plans, and defined benefit pension plans are not part of the regular rate. The contributions must be made in accordance with a specific plan or program adopted by the employer, or by contract as a result of collective bargaining, and communicated to the employees. These plans may be either company-financed or plans where the employer and employees contribute. If the plan does not meet specific criteria to be considered “bona fide,” the employer contributions will be viewed as a bonus, which must be apportioned back over the workweeks of the period during which it may be said to have accrued.

7(e)(5) – Premium Rate for Certain Hours

Extra compensation paid at a “premium rate” for certain hours worked by an employee because such hours are hours worked in excess of eight in a day, or in excess of 40

hours in the week, or in excess of the employee’s normal working hours or regular working hours, as the case may be.

This focuses on work hours that are more than eight in a day, or more than 40 in a week, or more than the normal day or week, as typically set by policy or agreement. While this can be an unwritten understanding or practice, it is always advisable to communicate these types of payments to employees in writing. These payments are one of the three types of pay that may be credited towards overtime.

7(e)(6) – Premium Rate for Certain Days

Extra compensation provided by a premium rate paid for work by the employee on Saturdays, Sundays, holidays, or regular days of rest, or on the sixth or seventh day of the workweek, where such premium rate is not less than one and one-half times the rate established in good faith for like work performed in non-overtime hours on other days.

The key difference from (e)(5) is that this is not focused on hours in a day or a workweek. Rather, it is focused on work performed on week-ends or normal days of rest. Where paid properly, the regulation permits this payment to act as a credit towards the statutory overtime that is due to an employee. If the payment is less than time and one-half, it may not be credited towards overtime unless it qualifies as an overtime premium under 7(e)(5).

7(e)(7) – Premium Rate by Contract or CBA

Extra compensation provided by a “premium rate” under an employment contract or collective

bargaining agreement for work outside of the hours established in good faith by the contract or agreement as the basic, normal, or regular work-day (not exceeding eight hours) or workweek (not exceeding 40 hours).

This exclusion requires a written contract or collective bargaining agreement, and it also requires that the premium rate be paid at a rate not less than one and one-half times the rate established in good faith by the contract or agreement for like work performed during the work-day or workweek. Payments properly made under this exclusion may also be credited towards overtime due.

7(e)(8) – Stock Options and Similar Rights

Any value or income derived from employer-provided grants or rights provided pursuant to a stock option, stock appreciation right, or bona fide employee stock purchase program meeting certain criteria may be excluded from the regular rate.

CONCLUSION

Employers must remember that DOL construes the regular rate exclusions narrowly in favor of employees, so making sure that each criteria for each statutory exclusion is satisfied is critical. Here are the top 10 steps to take:

1. Ensure the regular rate of pay is used for all overtime calculations.
2. Confirm that all earnings are included in the calculations unless the earnings clearly meet one of the above exclusions.
3. Be sure to prorate non-discretionary bonuses and commissions over the appropriate

time period in which they were earned – conduct your look-back calculations.

4. Review policies and practices related to overtime pay and confirm that your real-life practices match your policies.
5. Do not forget to check that all rates of pay have been factored into the regular rate.
6. For employers who take a tip credit, make sure the regular rate of pay for tipped employees is not calculated on just the direct cash wage.
7. Confirm accurate documentation of related timekeeping and payroll records.
8. Review bonus plans and commission plans for correct language and descriptions and that payment practices align with these plans (and remember that simply calling a bonus “discretionary” does not make it excludable from the regular rate).
9. Conduct a “self-audit” – preferably through counsel to utilize attorney-client privilege.
10. Always check state and local law requirements regarding the regular rate – they may provide greater rights or protections for employees than the FLSA. 🌐

NOTE

1. <https://www.dol.gov/sites/dolgov/files/WHD/legacy/files/CoefficientTableWH-134.pdf>.

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