



What Is A "Percentage Bonus"?

Insights

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Overtime wages for employees subject to the federal Fair Labor Standards Act's overtime requirement must be based upon the "regular rate" of pay. This is an hourly rate that is normally determined by dividing the total wages paid for a workweek by the total hours worked in that workweek for which those wages are paid.

This computation must include "all remuneration for employment" paid to or on behalf of the employee, with only limited exceptions. That phrase includes most employee bonuses. If the employer fails to take bonus payments into account for FLSA overtime purposes, then the worker has probably received less than the FLSA-required wages.

These calculations can be confusing and administratively burdensome, especially when a bonus is paid for a month, a quarter, or a year. But there is a possible alternative.

Certain Bonuses Can Include Overtime Pay

If a bonus is generated by multiplying a predetermined percentage times an employee's lawfully-computed total straight-time *and overtime* pay for the period over which the payment was earned, then there is no need to calculate additional FLSA overtime on the bonus. The U.S. Labor Department recognizes that a properly-structured "percentage bonus" of this kind is already weighted in correct proportion to the employee's straight-time and overtime hours worked and corresponding wages paid. *See, e.g., 29 C.F.R. § 778.210.*

For example, assume that an employee earns a 5% bonus for her above-standards performance during a measuring period of four complete workweeks. Assume also that her total straight-time *and overtime* wages for that period come to (\$2,400 ST + \$900 OT) = \$3,300. Her resulting bonus of \$165 (5% × \$3,300) arithmetically includes the requisite FLSA overtime premium; it is not necessary to pay more.

Percentage-Based Pool Shares

A variation can be used to distribute properly-proportioned shares of a fixed bonus pool to each non-exempt participating individual. This involves dividing the total straight-time *and overtime* wages of all of the participating non-exempt employees into the total bonus pool to be distributed to them. Each participating employee is then paid a sum equal to the resulting percentage multiplied times his or her total straight-time *and overtime* wages for the bonus period.

Assume, for instance, that a \$500,000 annual-bonus pool is established for non-exempt participants whose straight-time *and overtime* compensation paid for the year equals exactly \$10,000,000. Assume also that a particular employee's straight-time *and overtime* wages for the bonus year total exactly \$45,000. This participant's payment would be:

$$(\$500,000 \text{ Pool}) \div (\$10,000,000 \text{ Total Wages}) = 5\% \text{ Proportion}$$

$$(5\% \times \$45,000 \text{ Participant's Total Wages}) = \$2,250 \text{ Bonus.}$$

An alternative would be to divide the total straight-time *and overtime* wages of each non-exempt participant by the total straight-time *and overtime* wages of all non-exempt participants. A participant then receives a payment equal to his or her percentage so computed multiplied times the bonus pool. The calculation for the hypothetical employee above would be:

$$(\$45,000 \text{ Total Wages}) \div (\$10,000,000 \text{ Total Wages}) = .45\% \text{ Allocation}$$

$$(.45\% \times \$500,000 \text{ Pool}) = \$2,250 \text{ Pool Share.}$$

The Bottom Line

Some employers conclude that one of these percentage-based approaches is a better way to address the FLSA overtime ramifications of bonuses. And there are other features that might be added, such as various ways in which total wages are weighted to take into account factors like length-of-service, attendance, or job classification.

However, management must ensure that such a plan is properly conceived, designed, and maintained. For one thing, USDOL says that the method may be used only for true "bonuses": "The term 'bonus' is properly applied to a sum which is paid as an addition to total wages, usually because of extra effort of one kind or another, or as a reward for loyal service or as a gift. The term is improperly applied if it is used to designate a portion of regular wages which the employee is entitled to receive under his regular wage contract." 29 C.F.R. § 778.502(a).

In addition, one should always evaluate where such a plan stands under the applicable laws of other jurisdictions. It is also important to describe these bonuses accurately, clearly, and completely so as to withstand claims under wage-payment laws, contract law, or other legal theories.