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U.S. Department of Labor Final Overtime Rule[1]

QUESTION 5:

How Does the Bonus Provision Work?

By allowing employers to offset a portion of the salary with bonus and commission earnings. But the amount is insignificant . . .

Effective December 1, for the first time, the Department of Labor (DOL) will allow *nondiscretionary bonuses and incentive payments (including commissions)* to satisfy up to 10 percent of the standard salary test requirement if the payment is made on a quarterly or more frequent basis.

Under the Fair Labor Standards Act (FLSA), nondiscretionary and discretionary bonuses are defined as follows:

> **Nondiscretionary bonuses and incentive payments (including commissions)** are forms of compensation that employees are made aware of ahead of time to induce them to work more efficiently or effectively, or to remain with the company. This includes, for example, bonuses awarded to employees for meeting profit, revenue, or production goals; attendance bonuses; and commission payments based on a fixed formula that is a percentage of a sale or service.
>
> **Discretionary bonuses** are not communicated to employees in advance. They function like “surprise” bonuses that are spontaneously awarded. To meet the definition of “discretionary,” the decision to provide the bonus and the payment cannot be in accordance with any preannounced standards. Discretionary bonuses <u>cannot</u> be used to satisfy the standard salary test requirement.

If an employer elects to use the bonus and incentive option and, over the designated period (quarterly or more frequently) an employee fails to earn the amount necessary to bring total earnings up to the minimum required salary amount, employers can make “catch-up” payments to preserve the exempt status of the employee. Catch-up payments are not permitted to be made on an annual basis.

Should it be necessary to make a catch-up payment, employers have one pay period to make up for the shortfall (up to 10 percent of the standard salary level for the preceding bonus period). <u>Any such catch-up payment will count toward the prior bonus period's salary amount only and not toward the salary amount in the bonus period in which it was paid</u>. If the employer chooses not to make the catch-up payment, the overtime exemption is lost and overtime is due to the employee in any weeks during the bonus period that it was worked. *(Of course, neither option is ideal since any necessary catch-up payment indicates an employee’s inability or unwillingness to meet the bonus or commission goal. Under any circumstances, rewarding an employee for a bonus shortfall contradicts the purpose and intent of the incentive plan.)*

The rules pertaining to bonus and incentive payments for HCEs are unchanged. In keeping with prior DOL enforcement practices, the Final Rule clarifies that HCE employees must receive at least the standard weekly salary level of $913 per week on a salary or fee basis, while the remainder of the total annual compensation of at least $134,004 may include commissions, nondiscretionary bonuses, and other nondiscretionary compensation. <u>Employers may not use nondiscretionary bonuses and incentive payments to satisfy the standard salary amount of $913 per week for HCEs, only the difference between this rate annualized ($47,476) and the minimum required salary of $134,004</u>.

[1] This client advisory is excerpted from the Seawright & Associates May 31, 2016, e-bulletin, “U.S. Department of Labor Final Overtime Rule: Ten Things Every Employer *Must* Know Before Making Changes.” To obtain the full content of the e-bulletin, contact [Seawright & Associates]