

HR COMPLIANCE BULLETIN



Including Incentive Payments in the Regular Rate of Pay

On **March 26, 2020**, the U.S. Department of Labor (DOL) issued three new opinion letters to clarify how employer should account for incentive payments and imputed income in an employee's regular rate of pay.

Under the Fair Labor Standards Act (FLSA), an employee must receive one and one-half times his or her regular rate of pay for any hours worked over 40 during a workweek. The regular rate of pay includes all non-discretionary bonuses and incentive payments paid to the employee.

Whether any bonus or incentive pay is included in the calculation of an employee's regular rate of pay depends on whether these payments are discretionary. Discretionary payments carry no expectation of payment, even if paid regularly.

One way to distinguish non-discretionary payments is to evaluate whether these payments have contract-like qualities that provide the employee a legal right to receive them, and whether the employee could bring a lawsuit to enforce payment.

Action Steps

Opinion letters provide the DOL's official opinion on how labor and employment laws apply in specific situations.

Employers that rely on opinion letters may be able to establish a "good faith defense" under the law. As a result, employers that compensate exempt employees on a per-project structure should:

- Become familiar with this DOL guidance; and
- Adjust their payroll practices to make sure they are accounting for bonuses and imputed income accurately.

Highlights

Including Bonuses

- Bonuses must be included if they create a legal right of payment and employees can sue to enforce them.
- Setting eligibility criteria for receiving bonuses can establish contractual-like obligations that create an expectation of payment.

Imputed Income

- Not all imputed income must be included in an employee's regular wage rate calculation.
- Taxable income is included only if it represents remuneration for employment paid to or on behalf of the employee.

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FLSA2020-3: Holiday Bonuses

The FLSA specifically excludes Christmas bonuses and other payments provided for special occasions from the regular wage rate calculation if these payments are not tied to the employee's hours of work, productivity or efficiency. The payments are excluded because they are considered "gifts" or discretionary payments, meaning that employees do not consider them as a regular part of their wages.

However, holiday bonuses must be included in the regular rate if they create an expectation of payment. Setting eligibility criteria for receiving these payments can establish contractual-like obligations that create an expectation of payment. This is particularly true when the criteria are set to require the payment rather than to authorize the payment. For example, in FLSA 2020-3, Christmas bonuses were required by local regulations that established longevity payments for eligible employees. As a result, the DOL took the opinion that these Christmas bonuses must be included in the employees' regular rate of pay.

FLSA2020-4: Referral Bonuses

The FLSA provides an exemption for referral bonuses if:

1. Participation in recruitment activities is strictly voluntary;
2. The employee's efforts do not require a significant amount of time;
3. Recruitment activities are limited to after-hours soliciting among friends, relatives, neighbors and acquaintances as part of the employee's social affairs; and
4. The bonus is not remuneration for employment because the individual is not employed to recruit others.

A common practice for paying referral bonuses is to divide these payments into two installments. Usually, the first installment is provided when a referred candidate is hired. Typically, the second installment is paid some time later to reward lasting recruitment efforts. In general terms, the first installment should not be included in the regular wage rate calculation if all the conditions mentioned above are met.

Whether the second payment should be included depends on whether the employee must meet specific criteria to "earn" the payment. Longevity bonuses are not *per se* non-discretionary, but they can establish a contract-like expectation for the employee to work for a defined period to receive the second bonus installment. The length of the period that the employee must satisfy and whether the employee will receive the bonus only if he or she remains employed by the employer can affect whether there is an expectation of payment.

For example, in FLSA2020-4, the DOL presents the case of a second installment that was payable only after a 12-month period and only if the referring employee still worked for the company. Under these circumstances, the DOL took the opinion that the second installment must be included in the employee's regular wage rate calculation.

FLSA2020-5: Imputed Income

Imputed income is the value of any benefits or services provided to an employee. Imputed income includes the employer's cost (less any amount paid by the employee) of providing group-term life insurance coverage over \$50,000. Under the [tax code](#), employers must include this imputed income as an employee's taxable gross income on the employee's wage statement.

With FLSA2020-5, the DOL is clarifying that not all imputed income must be included in an employee's regular wage rate calculation, and that taxable income is included only if it represents remuneration for employment paid to or on behalf of the employee. Specifically, for imputed income situations, the DOL is reminding employers that the regular rate calculation excludes contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide benefit plan, such as life insurance plans.