

Time Is Money: A Quick Wage-Hour Tip on ... Incorporating Bonuses and Commissions into the Regular Rate of Pay

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Although incorporating nondiscretionary compensation like commissions and (promised or contractual) production bonuses into the calculation of the “regular rate of pay” has been federal law for decades, claims involving that calculation – or lack thereof – have increasingly been brought by California plaintiffs’ lawyers. Even though miscalculations or noncalculations may result in a difference of a few dollars or even pennies lost, plaintiffs’ lawyers litigate these claims in hopes of obtaining penalties that far outweigh any underpayments. Rather than dealing with problematic practices after the fact in a lawsuit where plaintiffs’ lawyers typically demand millions to settle, employers would do well to make sure their existing practices are lawful. The best defense is compliance.

The Basics

As we have previously discussed on this blog, the “regular rate of pay” is a term of art that encompasses all nondiscretionary payments to an employee, and not just hourly wages. Even when some nondiscretionary payments are not paid until weeks or even months after when that nondiscretionary compensation is earned (e.g., commissions, or quarterly bonuses), that compensation must ultimately still be included in calculating the “regular rate of pay” for whatever type of compensation is a function of the “regular rate of pay.”

In other words, if an employee is paid \$20 per hour but also earns a \$100 bonus during the same time period in which those hours are worked, that employee’s “regular rate of pay” is not merely \$20, but a higher amount accounting for the bonus.

The Timing

Paying overtime correctly requires identifying all relevant compensation earned in each workweek, as well as the hours worked in each week, and then performing the necessary premium pay calculation. It is often clear which earnings go with which workweek. Federal law recognizes that, when calculating the regular rate of pay, “[n]o difficulty arises in

computing overtime compensation if the bonus covers only one weekly pay period. The amount of the bonus is merely added to the other earnings of the employee (except statutory exclusions) and the total divided by total hours worked.”^{[1][2]}

However, commissions and nondiscretionary bonuses are often not calculable – and thus not paid – until one or more pay periods after they are earned. And in some instances a payment may compensate for work performed in more than one week, requiring allocation of the payment across multiple workweeks. In those circumstances, when nondiscretionary compensation is paid, employers should determine whether any types of compensation that are functions of the regular rate of pay (e.g., overtime) were earned during the same period that the nondiscretionary compensation was earned, and then make a payment for the difference in wages paid.^[3]

For example, if an employee earns overtime wages in the first week of November, and a nondiscretionary, monthly bonus earned that November – over the entire month, including that first week – is paid out in December, there must be a recalculation of the regular rate of pay in order to determine the overtime wages earned that first week. And in paying out that bonus, a retroactive overtime payment should be made to account for the difference in overtime wages ultimately earned (once calculable upon bonus payout) and the overtime wages that were previously paid. The same would be true for any other type of compensation that is a function of the regular rate of pay that is triggered during that bonus period – e.g., in California, that would be the case for double time, meal and rest period premiums, paid sick leave (in certain circumstances), and reporting time pay.

The Allocation Methods

For purposes of calculating the regular rate of pay, nondiscretionary compensation should be allocated to the workweek(s) in which such compensation is earned. However, when “it is impossible to allocate” a commission or other type of nondiscretionary compensation “among the workweeks of the period in proportion to the amount” of such compensation “actually earned each week,” federal regulations require that “some other reasonable and equitable method of allocation must be adopted.”^[4] Note to California employers: although California is often stricter than federal requirements, California generally looks to federal regulations in terms of regular rate issues.

Federal regulations expressly approve two types of methods: (1) allocating equal amounts of such nondiscretionary compensation to each workweek during the period such compensation was earned (e.g., monthly, quarterly, annually, etc.), or (2) allocating equal amounts of such nondiscretionary compensation to each hour worked during the nondiscretionary compensation earnings period.^[5] Neither appears to be favored over the other. What matters is that the allocation method be “reasonable and equitable.”

The Unanticipated Payroll Budget Nightmare

There is at least one circumstance – specific to California employers – where the second type of allocation should be considered the “reasonable and equitable” method of the two.

Assume an employee making \$20 per hour earned a nondiscretionary monthly productivity bonus of \$1,000 in February (and that February was made up of four workweeks, for simplicity's sake), working 40 hours each week during three of the four weeks. In the other week, the employee reports to work but goes home sick after working only two hours, using 38 hours of paid sick leave for the remainder of that week. Also assume that this monthly productivity bonus cannot be identified as being earned in any particular workweek.

If the equal-amount-to-each-workweek method were used such that \$250 of the \$1,000 bonus were allocated to each week, and if the employer were using the regular-rate-of-pay method for compensating paid sick leave, the value of the 38 hours of paid sick leave would balloon – unreasonably and inequitably – since only two hours were worked in that one week. The regular rate calculation for that workweek would be as follows:

$$(2 \text{ hours} \times \$20 \text{ per hour} + \$250 \text{ allocated bonus}) \div 2 \text{ hours} = \$145$$

Using the equal-amount-to-each-workweek method in this circumstance yields a regular rate of pay that is entirely detached from the employee's base rate. This gets worse with a higher bonus – e.g., a \$2,500 monthly bonus would result in a \$332.50 regular rate(!).

It should be axiomatic that this productivity bonus was not earned in equally in that week when the employee worked only two hours when compared to the other three weeks when the employee worked a full schedule. The equal-amount-to-each-hour-worked method resolves this. Dividing that \$1,000 bonus by the 112 hours actually worked that month results in an allocation of \$8.1967 of bonus attributed to each hour worked. That results in a regular rate calculation for that sick workweek as follows:

$$(2 \text{ hours} \times \$20 \text{ per hour} + 2 \text{ hours} \times \$8.1967 \text{ bonus per hour}) \div 2 \text{ hours} = \$28.20$$

Magnifying the difference between these two methods is how much sick pay (38 hours) is used by the employee in this scenario. Under the equal-amount-to-each-workweek allocation, the employee would receive \$5,510 in paid sick leave alone. That is hardly a “reasonable and equitable” outcome considering the employee's normal wages for working a 40-hour week is \$800. However, under the equal-amount-to-each-hour-worked method, the paid sick leave is \$1,071.60, which is much more consistent with this employee's overall compensation.

Notwithstanding this example of an unanticipated payroll budget nightmare, employers should adopt a method that reasonably and equitably allocates nondiscretionary pay across the workweeks during which that compensation was earned.

ENDNOTES

[1] 29 C.F.R. § 778.209(a).

[2] Note that, in California, for certain types of flat-sum bonuses, the divisor is not “total hours worked” but, rather, the total number of nonovertime hours actually worked.

[3] 29 C.F.R. §§ 778.209(a), -.119.

[4] 29 C.F.R. §§ 778.209(b), -.120.

[5] 29 C.F.R. §§ 778.209(b), -.120.

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