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Bonuses

Who, What, Why . . .

Who does it apply to: You guessed it . . . any employer who chooses to pay a bonus to employees.

What counts as a bonus: There are a lot of ways to describe a bonus. For our purposes, a bonus includes any discretionary or non-discretionary payment or “compensation” to an employee outside of their regular hourly, salary, commission, or piece rate pay. A bonus then includes any prize or award to an employee in addition to traditional “bonus” payments.

What is the difference between discretionary and non-discretionary bonuses: I’m glad you asked. It is one of the key dividing lines in payment of bonuses. If a bonus is discretionary, it does not count toward an employee’s overtime calculation and may not be owed to an employee regardless of that employee’s separation from the company. Non-discretionary bonuses on the other hand count toward overtime and an employer may be responsible for them even if an employee leaves. Of course, if the employee is exempt from overtime this distinction matters less (see the prior EH editions on Overtime and Exemptions from Overtime).

What is a discretionary bonus: You know what is, and is not, discretionary. Of course, what you think is discretionary and what the government thinks is discretionary may differ. To be discretionary in the eyes of the law:

- The employer must control whether a payment is granted at all;
- The amount of the payment must be discretionary;
- Determining the amount and making payment must occur near the end of the period for which the bonus is granted; and
- The bonus must not be subject to a prior contract with the employee or a promise causing the employee to expect payment.

If the employer surrenders control over any of these items, the bonus will become non-discretionary.

How does this break down in layman’s terms: If you tell your employees that you plan to pay a bonus at a particular point in the future, but retain control over the amount, it becomes non-discretionary. If you tell the employees how much a bonus will be (or give them a way to calculate it), but don’t say when it will be granted, the bonus becomes non-discretionary. Examples of non-discretionary bonuses include payments for: attendance, retention to encourage working undesirable shifts, safety criteria met, meeting individual productivity criteria, the company meeting certain criteria, reporting fraud or criminal activity, recruiting bonus and bonuses that may have been discretionary in the past which have become expected through repetition of payment.

How does a non-discretionary bonus affect overtime: Employees who are not exempt from overtime must have all money for non-discretionary bonuses included to determine their overtime rate. To use a simple example, an employee paid a weekly safety bonus of \$100.00 who works 50 hours at \$15.00 would receive overtime of \$92.50 with the safety bonus calculated instead of \$75.00 based on just 1½ his or her hourly rate (See the EH edition on Overtime for more information about how this calculation works). Bonuses paid quarterly would then be spread over the employee’s pay for the entire quarter on a weekly basis and an additional overtime payment would be due for overtime weeks with the bonus.

What if the employee leaves before the bonus is due: For discretionary bonuses, the employee clearly will not be entitled to the bonus. For non-discretionary bonuses, the employee will be entitled to a pro-rata portion of the bonus unless the employee was terminated for good cause or the program providing the bonus specifically states that the employee must be present at the time the bonus is awarded to receive it.

What about prizes and awards: Prizes and awards are generally treated like non-discretionary bonuses which count toward overtime for non-exempt employees, unless: (1) the prize or award is not given for an employment purpose; or (2) the prize or award has no value. Prizes given for activity outside of work and working hours that are beyond the employee’s usual duty and different from what the employee regularly does will meet the exemption requirement. Otherwise, the value of the prize must be included in the employee’s overtime.

Common Situations:

Back in the saddle: Mary takes six weeks unpaid time away from Tom's Tortilla Factory to care for her elderly mother. Mary's time away is covered by the Family Medical Leave Act ("FMLA") (see the EH edition on the FMLA for more information). Mary arrives just in time for payment of the quarterly plant safety bonus to employees, but does not receive her bonus check. Upon inquiry, she is told by Tom that she does not qualify because she was out for a substantial portion of the quarter. Has Tom violated the law? Yes. Because the safety bonus is not tied to Mary's productivity and relates to the overall safety of the plant, Mary is entitled to receive her check. Safety, attendance, and other bonuses related to the activity of all employees fall into this category. That said, Tom may pro-rate the check for the portion of the quarter for which Mary was present.

I'll take that, please: Sadie's Circuit Boards pays handsome bonuses to sales representatives who meet certain sales goals. Joel makes a huge sale to iPod Mobile Music, Inc. and receives a large bonus based on that sale. Months later iPod backs out of the agreement and Sadie appears at Joel's desk with her hand out demanding repayment of the bonus Joel received on the sale. Can Sadie take this approach? It depends. If Sadie has included a claw-back provision in the bonus structure for sales representatives, it is possible she can recoup the money from Joel. Without such an agreement in writing, her demand will not stand up. Claw-back agreements are becoming more common in businesses and raise a large number of issues – especially for executives and officers. IRS Section 409A governing parachute programs and Sarbanes Oxley can come into play if repayment is permitted over time. Check with your employment counsel before implementing a claw-back provision.

Santa Claus is coming to town: Nick has been working on the line at Tawny's Toy Factory for more years than he can count. For as long as he can remember, Tawny gives the employees a "Christmas Bonus" that is not tied to productivity, but has truly come to be expected. Is the bonus subject to overtime? It may be discriminatory, but it is not subject to overtime. Even though the bonus has been given so long that it is no longer truly discretionary under the law, the Department of Labor has specifically excluded "Christmas Bonuses" and bonuses paid solely for longevity with a company from overtime calculations as long as the bonus is not so large as to be considered part of the employee's regular compensation. That said, a bonus of this type tied in any way to productivity would be included in overtime so employers should be careful.

What should I do:

Good: Evaluate any bonus program you have and be sure to pay overtime on bonus amounts for non-discretionary bonuses.

Better: Follow the advice above, plus put non-discretionary bonus programs in writing to be sure everyone is clear on what the rules are and be certain to include a provision that employees must be employed at the time the bonus is awarded to receive it.

Best: In addition to the above, have all employees sign acknowledgements regarding all bonus programs. Be careful to avoid discretionary bonuses becoming non-discretionary by varying the award from year to year and the timing of such award.



Michael Kelsheimer focuses his practice on the employment law needs of Texas businesses and executive employees. He recognizes that the cost and expense of litigation make resolving employment disputes challenging. To help avoid these concerns, he utilizes his experience in and out of the courtroom to prevent or quickly resolve employment disputes through proactive employer planning and timely advice. When a dispute cannot be avoided, Michael relies upon his prior experience as a briefing attorney for the United States District Court and his extensive experience in employment and commercial lawsuits to secure favorable resolutions for his clients.

This guide is one in a series. For more information, or to receive the entire collection contact Michael Kelsheimer by email at mkelsheimer@grayreed.com or by phone at **469.320.6063**