

# THE DAILY RECORDER

December 5, 2006

## Holiday Bonuses and Employment Laws

by Jennifer Brown Shaw

As the end of the year approaches, many employees are anticipating bonuses. Some may be based on the employer's financial performance. Others may be based on the workers' job performance. Some are purely recognition of the end of the year or the holidays.

Because a bonus by definition is not required to be paid and is something "extra," unwary employers may conclude they are free to pay or not pay bonuses on terms they see fit. However, bonuses are governed by state and federal wage and hour laws. Particularly in California, employers should become familiar with the various legal issues that arise in the context of bonus payments.

### Timing of Payments

Whether discretionary or based on a set formula, bonuses are a form of "wages" under the California Labor Code. As such, employers must ensure bonuses are paid timely under Labor Code section 204. The general rule is that a bonus must be paid on the payday that applies to the pay period in which the bonus is earned and can be calculated. So, if a bonus is earned and can be calculated as of December 10, for example, it would have to be paid by the next pay day (anywhere between December 16 and 26).

### Most Bonuses Must Be Included in Overtime Calculations

Overtime is calculated based on a "regular rate" of pay. The term "regular rate" is not always equivalent to the "base" rate (such as an hourly wage or salary). Rather, the "regular" rate includes base pay *plus* commissions and most bonuses. Both state and federal

wage and hour laws require including commissions and bonuses in the calculation of overtime, because otherwise employers might be tempted to avoid paying overtime by offering lower hourly rates and higher bonuses.

The only bonuses that are not included in the "regular rate" are purely discretionary bonuses. Under federal regulations, "the employer must retain discretion both as to the fact of payment and as to the amount until a time quite close to the end of the period for which the bonus is paid. The sum, if any, to be paid as a bonus is determined by the employer without prior promise or agreement." The value of a holiday gift, such as a turkey, similarly does not have to be included in overtime. Whether or not a bonus qualifies as "discretionary" is tricky and should be reviewed with counsel.

On the other hand, bonuses based on attendance, productivity, a formula, etc. must be included in the "regular rate." If a bonus is paid quarterly or less frequently, the law requires the employer to pay the marginal overtime premium retroactively. To calculate the unpaid overtime, the bonus must be allocated to the pay periods in which it earned. For example, assume an employee works 2000 hours one year, including 100 overtime hours. The employer gives the employee a \$1000 attendance bonus for his attendance during the year. Because the employee previously did not receive overtime pay based on the additional \$1000 in earnings, some marginal overtime on the extra value is due.

The marginal overtime due is calculated as follows: \$1000 bonus/2000 hours to generate bonus = \$0.50 per hour. Then,  $\frac{1}{2}$  (representing the unpaid overtime premium) \* \$0.50 \* 100 overtime hours worked = \$25.00 in additional overtime compensation due. (If the overtime hours were "double time" overtime hours instead of "time and one-half," then one would substitute "1" for the "1/2" in the formula.)

### "Earning" a Bonus

As noted above, the bonus need not be paid until it is "earned" and can be "calculated" or "ascertained." The employer has a broad degree of control over when a bonus is "earned." The bonus plan may say a bonus is earned based on company profits, the employee achieving a certain level of productivity, or good attendance. Once the employee meets the earning criteria, whatever they are, the bonus is earned and must be paid. In the case of a purely discretionary bonus, the bonus is due on the payday applicable to the pay period when it is awarded, as explained above.

The employer may set the "earning" date on the occurrence of some external event. For example, the bonus plan may provide that the bonus is not "earned" until the company's financial statements are approved by the auditors. Once the auditors approve the financial payments, the bonus is earned and payment is due.

### Lawful and Unlawful Bonus Criteria

Some employers condition bonuses on an employee's remaining employed until a certain date or for a certain period of time.

For example, some bonuses require the employee to remain employed until the “payment” date following months after a bonus was calculated.

Clear forfeitures with respect to bonuses generally will be upheld. For example, a requirement that employees remain employed until a certain date to earn a bonus will generally be enforced. There are a couple of caveats applicable. First, the California Division of Labor Standards will scrutinize the bonus plan to ensure the time between earning and payment is reasonable.

Second, the DLSE becomes especially concerned when a bonus plan requires employment until a certain date, but the employer fires the employee before the worker can satisfy the condition. The DLSE, relying on an old judicial opinion, will investigate whether the employer had a “sufficient reason” to terminate the employee’s employment. On the other hand, forfeitures when an employee voluntarily quits are generally enforced.

Employers’ selection of criteria upon which bonus calculations are based also may run afoul of the law. For example, the courts have held that bonuses that take into account workers’ compensation costs are illegal as against public policy. Similarly, bonuses that are based on net profits also include expenses that cannot be taken into account. Bonuses that permit deductions due to losses such as theft or other damage due to ordinary negligence also will be struck down. The prevailing interpretation

of California law appears to be that it is better to pay no bonus than to pay a bonus that includes allegedly illegal formulas. The California Supreme Court is considering a case, *Prachasaisoradej v. Ralph’s Grocery*, that may shed light on this confusing area of the law.

### Conclusion

Despite the many wage and hour laws governing bonuses, employers should not lose the holiday spirit. Spontaneous bonuses not based on a formula, pre-announced policy are essentially gifts that can increase employee morale and loyalty. Productivity and other formula-based incentives can improve profitability. Also, bonuses help employers maintain competitiveness in a changing salary market.

That said, careful attention to the wage and hour laws governing bonuses will help employers avoid the maxim, “No good deed goes unpunished.”

---

*Reprinted by permission of The Daily Recorder.*



[jshaw@shawvalenza.com](mailto:jshaw@shawvalenza.com)

Jennifer Brown Shaw is a partner at Shaw Valenza LLP. Her practice includes providing regular advice and counsel to private and public sector employers. She also develops and presents seminars on legal issues in the workplace for management and non-supervisory employees.



300 Montgomery Street, Suite 788  
San Francisco, California 94104  
Tel: (415) 983-5960  
Fax: (415) 983-5963

520 Capitol Mall, Suite 630  
Sacramento, California 95814  
Tel: (916) 326-5150  
Fax: (916) 497-0708

[www.shawvalenza.com](http://www.shawvalenza.com)