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Expertise

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## [The Pitfalls of Paying Bonuses](#)

If you polled 100 random people on the street, it would be tough to find anyone who does not like work bonuses.

Employees like them for obvious reasons ? recognition and monetary reward for a job well done. Employers like them because they can lead to a boost in productivity, morale and foster loyalty. Companies also use bonuses as an incentive to attract and retain top talent, which has taken on added importance as the labor market grows tighter.

But like all things employment, there are legal risks to consider when offering bonuses.

The most common error employers make is assuming that bonuses do not need to be factored into overtime.

Under the federal Fair Labor Standards Act (FLSA), there are two types of bonus payments: discretionary and non-discretionary. Non-discretionary bonuses must be included in an employee?s regular rate of pay for the purpose of determining overtime, but discretionary bonuses do not.

A discretionary bonus is one that is not measured by, or dependent upon, hours worked, production, or efficiency (such as a ?holiday bonus? typically given at a year?s end to recognize employees).

By contrast, a non-discretionary bonus is one that is tied to certain benchmarks such as production targets or hours worked.

For example, a \$500 bonus paid quarterly to members of the accounting department ? including non-exempt employees ? when they meet certain benchmarks would be considered non-discretionary. Therefore, the \$500 must be factored into the non-exempt employees? overtime premium. This can be quite complicated. It may be easier for an employer to forego the non-discretionary bonus for non-exempt employees in favor of a generous year-end discretionary one that is not tied to any specific benchmarks.

This very issue is being litigated in a class action lawsuit against the medical testing giant Quest Diagnostics. In the case, a former employee alleges that the company shorts hundreds of hourly paid workers on their wages by not including automatic incentive payments in their overtime rate calculations.

A class action for wage and hour violations represents one of the greatest threats to a company?s existence. Defending against these types of claims is expensive and few, if any, insurance companies cover wage and hour claims. Such lawsuits may become more common as the unemployment rate steadily decreases, which has prompted some employers to become more aggressive with their compensation structures.

Because of the risks involved, employers should carefully examine their current bonus programs to ensure they comply with both federal and state wage and hour laws and consider taking the following steps with the help of an HR adviser:

- Ensure that the company has not agreed to pay a discretionary bonus in any offer letter or employee handbook
- Re-examine the structure of all bonus programs to determine whether they could be considered non-discretionary
- Identify the non-exempt employees who have been paid a non-discretionary bonus within the last three years
- Determine how much overtime the identified non-exempt employees tend to work each workweek, if any (if non-exempt employees who are eligible for a non-discretionary bonus rarely work overtime, then the risk of non-compliance may be diminished)
- Train the employees responsible for payroll how to properly factor-in non-discretionary bonus pay when calculating overtime pay
- Consider limiting non-discretionary bonuses to exempt employees who are generally not entitled to overtime
- Consider alternatives to non-discretionary bonuses, such as, a year-end bonus that is not tied to production or hourly benchmarks

By understanding these risks, employers can continue to offer competitive pay while remaining legally compliant.

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