California Employers Association™

FACT SHEET

Employee Bonuses

Bonus Considerations

There are a few considerations for employers who offer employee bonuses, including tax implications and wage and hour rules.

First, it is important to remember that bonuses are taxable. This means that cash bonuses, bonus checks, gift certificates and gift cards should be reported on the W-2 form for tax purposes. For non-monetary gifts, employers should consult their accountant or financial advisor about any possible tax ramifications.

Second, there are wage and hour implications depending on the bonus type. There are two types of bonuses: discretionary and non-discretionary. **Non-discretionary** bonuses impact a non-exempt employee's regular rate of pay. The *regular rate of pay* takes into account additional forms of compensation beyond the base rate, such as shift differentials, commissions, piece-work earnings, the value of meals/lodging, cash payments in lieu of health benefits, and non-discretionary bonuses. This means that if you provide non-discretionary bonuses, this will result in a regular rate of pay that is higher than an employee's base hourly rate.

The reason this is important is because the regular rate of pay is the figure used to calculate overtime, paid sick leave payments, reporting time pay, and meal/rest premium pay. Be sure your payroll system is factoring in the value of non-discretionary bonuses and other forms of compensation, otherwise you may be insufficiently paying your employees and risking wage and hour claims!

Because only non-discretionary bonuses impact the regular rate of pay, it is important to distinguish between what is considered discretionary or not.

Discretionary Bonuses

When an employer has the ability to decide if, when and what type of bonus will be awarded at the time it is issued, then the bonus is considered discretionary and does not impact the regular rate of pay. In other words, awarding the bonus is at the *sole discretion* of the employer.

To be discretionary, there should be no promise or expectation created ahead of time that the bonus will be awarded, nor any type of merit or goal system in place for the bonus to be received. The bonus should not be a part of any contract or agreement, or be dependent on the employee meeting specific goals or standards.

Some examples of *discretionary* bonuses include:

- Holiday or year-end bonuses where there was no employee goals established for eligibility and the bonus was not promised or announced ahead of time
- A one-time or spot bonus to an employee for a job well done
- Sign-on bonuses (as long as they are not tied to being or staying employed for a specific length of time)

Non-Discretionary Bonuses

When an employer creates an expectation of payment, if there is a predetermined timing or amount established, or a legal or contractual agreement has been made with employees, then the bonus is considered non-discretionary and *will impact* a non-exempt employee's regular rate of pay. This means that the employer has established factors to determine when, if, or why the bonus is awarded. In this situation, there is an expectation created that the bonus will be received if certain conditions are met.

Usually these conditions include employees achieving certain goals either individually or collectively. These goals can be based on production standards, attendance, performance targets or other metrics.

Some examples of non-discretionary bonuses include:

- Attendance bonuses for not missing work or being tardy
- Safety bonuses for length of time without an incident
- Individual or group production bonuses
- Quality or accuracy bonuses
- Hiring bonuses (when being employed for a predetermined time period is a condition of payout)
- Retention Bonuses

Employers should keep in mind that even if the supplemental pay is not referred to as a "bonus" this does not change the effect on an employee's regular rate of pay. For instance, calling an attendance bonus an "attendance premium" or calling a safety bonus a "safety incentive" does not change the fact that the award is based on meeting predetermined goals. It will likely still be viewed as a bonus by California's Labor Commissioner.

Bonuses and Compensation

Like any other element of employee compensation, bonuses can be a differentiator that give organizations a competitive advantage. However, California employers should consider whether non-discretionary bonus programs create more administrative headaches and liability risks than they are worth. Employers may consider an increase to the base hourly rate in lieu of non-discretionary bonus programs, to help simplify regular rate of pay calculations.