February 14, 2001

FLSA2001-3

Dear ***Name****,

This is in response to your request for an opinion concerning the application of the Fair Labor Standards Act (FLSA) to prorating vacation, holiday, and sick pay to an hourly rate that non-exempt employees could receive each pay period instead of receiving the same benefits during the calendar year. Your client believes this option may assist in recruitment and retention of employees.

The proposed methods, questions and our responses follow:

> One method could be to use each employee's rate of pay to determine the amount of increase per hour. Take an employee whose hourly rate of pay is $10 per hour. The employee receives two weeks of vacation pay (8 hr. x $10 x 10 days) $800, 6 holidays each year (8 hr. x $10 x 6 days) $480, and 10 days sick pay (8 hr. x $10 x 10 days) $800, with a total annual benefit amount of $2080. Dividing this amount by 2080 hours (40hr. wkly x 52 wks) this is $1 per hour that the employee's pay would be increased.
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> Another method is to average the cost for each employee classification during the prior year to arrive at the median increase per hour for each employee classification. The amount of increases given would then vary around the median depending on the years of service. The more service, the larger the increase. This is consistent with the employer's current practice of awarding greater benefits based on years of service.
>
> Q.1. Inasmuch as these increases in pay per hour are payment for benefits that are excluded from the "regular rate of pay" for overtime compensation computation when paid for a day or part of a day, can the amount of these payments also be excluded when paid under the proposed methods?
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> A.1. No. Section 207(e) of the FLSA requires the inclusion in the regular rate of pay <u>all</u> remuneration for employment <u>except</u> certain specified types of payments. The conditions for exclusion of benefit plan contributions under §207(e)(4) are described in §778.215 of Regulations, 29 CFR Part 778, and they require that the payments be paid irrevocably to a third party. As indicated in §778.215(a)(5), the plan must not give an employee the option to receive any portion of the employer's contributions in cash instead of benefits. Similarly, under §207(e)(2) payments for periods when no work is performed, such as due to vacation or illness, may be excluded. However, that section is inapplicable because the payments here are made for the performance of work. Thus, the $1 per hour that the employee's pay is increased for all hours worked in the work week must be included in calculating his or her regular rate of pay.
>
> Q.2. Some employees may work 50 or more hours in a work week. They, accordingly, could receive their full "benefit amount" before the end of the year. Would the employer be required to keep a "running account" on each employee paid under this manner and cease paying the hourly "fringe benefit" when the employee has received the full amount?
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> A.2. With the understanding that the increase in pay per hour paid to employees in lieu of vacation, holiday, and sick leave would have to be included in calculating the regular rate of pay, the employer could keep a "benefit paid running account" on each employee and discontinue such payments at any time during the year. In order to avoid confusion, should your client decide to adopt such a program, your client may want to ensure that all employees fully understand the operations of this "pay in lieu of benefits" plan before it is offered to the employees.

This opinion is based exclusively on the facts and circumstances described in your request and is given on the basis of your representation, explicit or implied, that you have provided a full and fair description of all the facts and circumstances which would be pertinent to our consideration of the question presented. Existence of any other factual or historical background not contained in your request might require a different conclusion than the one expressed herein.

We trust that this information is responsive to your inquiry.

Sincerely,

Thomas M. Markey
Acting Administrator

*Note: * The actual name(s) was removed to preserve privacy.*