U.S. Department of Labor
Employment Standards Administration
Wage and Hour Division
Washington, D.C. 20210

August 26, 2005 **FLSA2005-22**

Dear ***Name****,*

This is in response to your request for an opinion concerning the applicability of the Fair Labor Standards Act (FLSA), 29 U.S.C. § 207(a), to your client's incentive bonus plan. Specifically, you inquired whether the calculation method used properly excludes the previous year's bonus in calculating an employee's current year bonus.

In your letter, you state that the employer pays an incentive bonus to non-exempt employees in February of each year. The amount of the bonus is dependent upon the company's performance during the previous calendar year and employees are informed of the potential to earn the incentive bonus based on overall company performance. In a conversation with a member of the Wage and Hour Division staff on December 16, 2004, you stated that, for this discussion, the incentive bonus plan should be considered as nondiscretionary, and therefore, as a bonus that must be included in the regular rate for purposes of overtime computation.

In accordance with the provisions of 29 C.F.R. 778.210 (copy enclosed), your client computes the bonus as a percentage of each employee's straight time and overtime wages earned during the previous calendar year. In your letter, you include the following example:

> In February 2001, the company decides to pay a 3% bonus based on company and employee performance during calendar year 2000. Assume employee A earned $40,000 in straight time and $1,000 in overtime wages during calendar year 2000. The incentive bonus is computed by applying the 3% bonus factor to both the $40,000 in straight time (ST), and $1,000 in overtime (OT) earnings as shown below:
>
> Calendar Year 2000
> $40,000 (ST) X 3% = $1,200
> $ 1,000 (OT) X 3% = $ 30
> $1,200 + $30 = $1,230 total incentive bonus paid in February 2001

You then ask us to assume employee A earns the same $40,000 in straight time and $1,000 in overtime wages for calendar year 2001, and the employer also decides to pay the same 3% bonus payment in February 2002 based on wages earned during calendar year 2001. In calculating the incentive bonus based on total wages earned in calendar year 2001 (to be paid in February 2002), you ask if the employer is required to include the incentive bonus amount of $1,230 paid in February 2001 when applying the 3% bonus factor. In other words, since your client has chosen to calculate the bonus using the "percentage of total earnings" method in 29 C.F.R. 778.210, you seem to be asking whether the February 2001 bonus payment must be included in the employee's "total earnings" for 2001.

It is our opinion that the company does not have to include the bonus paid for a preceding calendar year when computing the bonus amount due for the current year, even if the bonus paid for the preceding year was actually paid in the current year. The method in 29 C.F.R. 778.210 provides that each year's bonus must be calculated as a percentage of total earnings for that year. See Opinion Letter dated January 23, 1997 and Field Operations Handbook ¶32c04(a) (copies enclosed). For example, the bonus for year 2000 is calculated based on year 2000 earnings, even though it is paid in 2001. Thus, the year 2001 bonus may be said to have been "earned" in year 2000. Since the bonus for year 2001 is to be based on year 2001 earnings (even though it will not be paid until February 2002), it need not include, in the calculation of those earnings, amounts earned as bonus for year 2000. In your client's case, proper recordkeeping should make it clear whenever an incentive bonus payment made in any particular year is given based on total compensation earned in the preceding calendar year and meets the requirements of 29 C.F.R. 778.210. Such bonus payments need not be recognized as compensation for the year in which they are actually paid.

This opinion is based exclusively on the facts and circumstances described in your request and is given on the basis of your representation, express or implied, that you have provided a full and fair description of all the facts and circumstances that 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. You have represented that this opinion is not sought by a party to a pending private litigation concerning the issue addressed herein. You have also represented that this opinion is not sought in connection with an investigation or litigation between a client or firm and the Wage and Hour Division or the Department of Labor. This opinion letter is issued as an official ruling of the Wage and Hour Division for purposes of the Portal-to-Portal Act, 29 U.S.C. 259. See 29 C.F.R. 790.17(d), 790.19; Hultgren v. County of Lancaster, Nebraska, 913 F.2d 498, 507 (8th Cir. 1990).

We trust that the above is responsive to your inquiry.

Sincerely,

Alfred B. Robinson, Jr.
Deputy Administrator

Enclosures: 29 C.F.R. § 778.210
Opinion Letter dated January 23, 1997
Field Operations Handbook ¶32c04(a)

**Note: The actual name(s) was removed to preserve privacy in accordance with 5 U.S.C. 552 (b)(7).*