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Mary Pat Gallagher,
Esq.

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(973) 256-9000

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The "Qualifying Overtime Premium": A Complicated But Potentially Very Helpful Way to Structure Overtime

By Mary Pat Gallagher, Esq.

It is well known that when a non-exempt employee works more than 40 hours in a workweek, he must be paid time and one-half of his regular rate of pay. The regular rate of pay is determined by dividing the total hours of work during the normal, non-overtime week into the employee's total pay for the week, exclusive of any overtime payment. However, there are situations in which an employer may actually save money by specifying the overtime premium payments an employee will receive. However, as will be discussed, these situations are rather specific.

Under the Federal Labor Standards Act ("FLSA"), a "qualifying overtime premium" is defined as certain premium payments made by employers for "work in excess of or outside of specified daily or weekly standard work periods or on certain special days." The advantage of these premium payments is that they do not need to be included in the employee's regular rate of pay for the purpose of computing overtime compensation due. Moreover, the extra compensation provided by these premium payments may be credited toward the overtime payments otherwise required by the FLSA.

To qualify as an excludable overtime premium, there must be an employment contract (oral or written) under which the rates of pay and the daily and weekly work periods are clearly defined and established in good faith. Also, the premium payment must meet one of the following criteria:

- The premium is paid for hours worked by the employee in any day of the workweek in excess of eight hours per day, in excess of the maximum workweek applicable to the employee, or in excess of the employee's normal or regular working hours. For example, where an employee has normal working hours of seven hours per day (35 hours per week) and is paid a premium rate for work in excess of those hours, the extra compensation provided by those premium rates and paid for the excessive hours is a true overtime premium to be excluded from the regular rate and it may be credited toward overtime compensation due.
- An employee is paid a premium rate for working "special days," such as Saturdays, Sundays, holidays, or either regular days of rest or on the sixth or seventh day of the workweek. To qualify as a true overtime premium under this criterion, the rate of pay must be at least one-and-a-half times the "rate established in good faith for like work performed in non-overtime hours on other days." If the premium rate is less than time and one-half, the extra compensation provided by such rate must be included in determining the employee's regular rate of pay and cannot be credited toward statutory overtime due, unless it qualifies as an overtime premium under the first criteria, i.e., payments of premium rates in excess of regularly established work hours or work week.
- An employee is paid a premium rate pursuant to an applicable employment contract (oral or written) or collective bargaining agreement, for work outside of the hours established in good faith by the contract or agreement as the basic, normal, or regular workday (not to exceed eight hours) or workweek (not to exceed 40 hours), where such premium rate is not less than one and one-half times the rate established in good faith for like work performed in non-overtime hours on other days.

Non-Excludable Premiums

Not all premiums are created equal. The FLSA makes it clear that extra compensation provided by premium rates other than those described above cannot be treated as overtime premiums. Whenever such other premiums are paid, they must be included in the employee's regular rate before statutory overtime compensation is computed, and no part of the premiums may be credited toward statutory overtime pay.

For example, if the basic workday, established in good faith, is the hours from 8 a.m. to 5 p.m., a premium of time and one-half paid for hours between 5 p.m. and 8 a.m. qualifies as an overtime premium. However, where the contract does not provide for the payment of a premium, except for work between midnight and 6 a.m., the premium would not qualify under this section because it is not a premium paid for work outside the established workday, but rather, it is a "shift differential" paid to encourage an employee to work less desirable hours. Similarly, where payments of premium rates for work are made after 5 p.m. only if the employee has not

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had a meal period or rest period, they are not regarded as overtime premiums. Rather, they are premiums paid because of undesirable working conditions. Another example is where a premium is paid to an employee only when he received less than 24 hours' notice that he is required to report for work on his regular day of rest. If this premium is imposed as a penalty upon the employer for failure to give adequate notice to compensate the employee for the inconvenience of reporting to work on his regular day of rest, the extra compensation must be included in the employee's regular rate of pay. And there are even more pitfalls.

Calculation of Overtime With and Without an Agreement

The following illustrates how total payment is calculated assuming that the employee regularly works 40 hours per week at the rate of \$10.00 per hour and is paid double time (\$20.00 per hour) for eight hours of work on Sunday. For purposes of the illustration, the employee has an employment agreement clearly delineating that weekend premium pay is paid in addition to any overtime payment due and is not included in determining the regular hourly rate of pay for the purpose of calculating overtime payments.

In such a case, the total remuneration without the overtime premium equals \$480.00 (\$400.00 for the 40-hour work week and \$80.00 for Sunday's work). The regular rate of pay equals the total remuneration \$480.00 divided by the total hours worked (48) or \$10.00. The overtime pay is equal to \$40.00 (the regular rate of pay of \$10.00 multiplied by the eight hours of overtime multiplied by .5). The overtime premium equals \$80.00 (\$10.00 per hour multiplied by eight hours). The overtime premium is subtracted from the calculated overtime pay to determine the actual amount of overtime pay due, but the result cannot be less than zero. ($\$40.00 - \$80.00 = \$0.00$). Based on the foregoing, the employee's gross wages equal the sum of the employee's total remuneration, overtime premium and overtime pay for total gross wages of \$560.00 ($\$480.00 + \$80.00 + \$0.00 = \560.00).

By contrast, if the double time for weekend work had not been clearly delineated as premium pay in the employment agreement, the total remuneration would equal \$560.00 (\$400.00 for the 40 hour workweek and \$160.00 for Sunday's work) and the regular rate of pay for purposes of calculating overtime would equal \$11.67 ($\$560.00/48$ hours). In this case, the employee's gross wages would equal the total remuneration of \$560.00 plus overtime of \$93.36 ($\11.67 multiplied by eight hours) for total gross wages of \$653.36.

Conclusion

As the foregoing demonstrates, when properly understood and managed, an employer can benefit from an agreement that clearly defines overtime premiums. Absent such a clear agreement, the employer risks a determination that the overtime premium was improperly excluded from the calculation of the employee's regular rate of pay.

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