

* SUPPLEMENT TO
INTERPRETATIVE BULLETIN
NO. 4

MAXIMUM HOURS
AND OVERTIME COMPENSATION

UNITED STATES DEPARTMENT OF LABOR
WAGE AND HOUR DIVISION
Office of the Administrator

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Some Special Problems

18. The Maintenance of a Constance Wage from
Pay Period to Pay Period Under the
Fair Labor Standards Act

Two principal ways have been proposed by employers by which they might continue to pay their employees a constant wage or salary from pay period to pay period even though overtime is worked in some week or weeks. The first has been termed the "time off" plan and the second the "prepayment" plan.

Before explaining the operation of the "time off" and "prepayment" plan certain basic requirements of the Act will be outlined which are material in determining the legality of any proposed plan. It must be remembered that the Fair Labor Standards Act takes a single workweek as its standard and permits no averaging of hours over two or more weeks. For the purposes of the Act each week stands alone. Time and a half overtime compensation must be paid the employee for all hours which he works in excess of 42 hours in a single workweek (40 hours after October 24, 1940). The pay period need not, however, coincide with the workweek. Thus, there is no objection if the pay period is bi-weekly, semi-monthly or monthly. But the amount of compensation due the employee at each pay period must be computed on the basis of a single workweek. It must also be remembered that overtime compensation due an employee must be paid in cash and normally at the time of the regular pay period, that is, when the employee customarily receives his straight time compensation. It may not be accumulated to be paid at any time subsequent thereto.

The "Time Off" Plan

To comply with the Act and to continue to pay a fixed wage or salary each pay period even though the employee works overtime in some week or weeks within the pay period, the employer lays off the employee a sufficient number of hours during some other week or weeks of the pay period to offset the amount of overtime worked so that the desired wage or salary for the pay period covers the total amount of compensation, including overtime compensation, due the employee under the Act for each workweek taken separately. The employer does not pay for overtime work in time off, nor does he average hours over a period longer than a week. Control of earnings by control of the number of hours an employee is permitted to work, not payment for overtime in "time off," is the essential principle of the "time off" plan.

Let us trace the operation of the "time off" plan in specific cases.

Case I: Hourly Rate Employees

Let us assume that the employee earns 50 cents an hour and is paid bi-weekly. The employer wishes him to earn \$42 for each pay period and therefore controls his hours in the following manner:

<u>1st pay period</u>		<u>2nd pay period</u>		<u>3rd pay period</u>	
<u>1st week</u>	<u>2nd week</u>	<u>3rd week</u>	<u>4th week</u>	<u>5th week</u>	<u>6th week</u>
46	36	39	44	39	46

For the first workweek the employee is entitled to \$24 ($\sqrt{42 \times 50\%$ / $\sqrt{4 \times 75\%$). So that the payment of \$42 at the pay period will satisfy the requirements of the Act the employer permits the employee to work only 36 hours during the second week of the pay period. The employee thus becomes entitled to only \$18 ($36 \times 50\%$) during the second week and the payment of \$42 ($\$24 + \18) at the pay period satisfies the requirements of the Act. It will be noted that in the second pay period fewer hours are worked during the first week and overtime is worked during the second week. The employer works the employee fewer hours during the first week because he anticipates that the employee will work overtime during the second week. The employee is thus entitled to only \$19.50 for the third week (39 hours x 50%) and to \$22.50 for the fourth week ($\sqrt{42 \times 50\%$ / $\sqrt{2 \times 75\%$) and the payment of \$42 ($\$19.50 + \22.50) at the pay period satisfies the requirement of the Act. Where overtime is expected to be worked during the later week or weeks of the pay period, however, the employer is confronted with the problem of anticipating the amount of overtime that will be worked in such week or weeks in order to keep the hours down during the early week or weeks so that the payment of the desired amount - \$42 in this case - at the pay period is sufficient to satisfy the requirements of the Act. Of course, if the employer miscalculates and the payment of \$42 is insufficient to meet the requirements of the Act at the pay period, he will be required to make up the difference in cash. This is illustrated in the third pay period when the employer expecting that the employee would work 44 hours during the sixth workweek, worked the employee only 39 hours during the fifth workweek. The estimate was incorrect and the employee worked 46 hours during the sixth workweek thus becoming entitled to \$43.50 for that pay period. The employee must be paid the \$43.50 at the pay period; the \$1.50 may not be credited to the employee and carried over beyond the pay period to be paid the employee at some subsequent time when he is given time off without pay.

Case II: Salaried Employees

It will be noted that in the case of the hourly rate employees the payment of the desired, fixed amount - \$42 - at the pay period was sufficient to meet the requirements of the Act even though overtime was worked in one week of the pay period because there could be no doubt that in the shorter weeks when 36, 39 and 33 hours were worked the employee was entitled to only \$18.00, \$19.50 and \$16.50, respectively. Thus the employee received \$24.00, \$22.50 and \$25.50, the requisite amount of compensation, including overtime compensation, for the weeks in which he worked 46, 44, and 48 hours, respectively. It is important to bear this fact in mind in determining the applicability of the "time off" plan to salaried employees.

Let us take a concrete example of the application of the "time off" plan to a salaried employee who earns \$42.00, paid bi-weekly and works a regular workweek of 42 hours.

<u>1st Pay Period</u>		<u>2nd Pay Period</u>		<u>3rd Pay Period</u>	
<u>1st week</u>	<u>2nd week</u>	<u>3rd week</u>	<u>4th week</u>	<u>5th week</u>	<u>6th week</u>
42 hours	42 hours	46 hours	36 hours	42 hours	42 hours

The regular rate of pay of such employee is 50 cents an hour (\$21 / \$42 ÷ 27 ÷ 42 hours).

In the third workweek of the second pay period the employee works 46 hours and is entitled to \$24 (42 hours x 50¢ / 4 hours x 75¢). In the fourth workweek the employee works 36 hours, or six hours less than the regular number, and is entitled to only \$18 (36 hours x 50¢). At the end of the second pay period the employee is entitled to receive his fixed bi-weekly salary -- \$42 (\$24 / \$18).

The same result would follow if 36 hours were worked during the 3rd workweek and 46 hours during the fourth.

The payment of the fixed salary at the pay period in the above case is sufficient to meet the requirements of the Act only if it is assumed that the employer may properly deduct from the employee's bi-weekly salary when the employee works less than the regular number of hours in a particular week in the pay period and that, therefore, the employee is entitled to only \$18 during the fourth workweek. The salaried employee thus described is very much like an hourly rate employee. An employer who is required by contract or agreement with the employee to continue to pay the fixed salary even though the employee has worked less than the regular number of hours in some week or weeks in the pay period and therefore to credit the employee with \$21 for the fourth week even though only 36 hours were worked in that week, will not satisfy the requirements of the Act unless he pays the employee \$45 (\$24 for the third week and \$21 for the fourth week) at the end of the second pay period. It cannot be maintained in such case that the payment of the fixed salary - \$42 - at the pay period included the requisite amount of overtime compensation due the employee for the week during which he worked overtime. The employee is entitled to receive and would have received the fixed salary even if he had not worked overtime during the third week but had nevertheless worked less than 42 hours during the fourth week. Extra compensation must be paid an employee who works overtime. The contract or agreement to pay the fixed salary even when less than 42 hours is worked one week within the pay period may be expressed or implied. It may be implied from the fact that an employee is a salaried employee who, when no question of overtime is involved, customarily receives his full fixed salary even though less than the regular number of hours is worked in some week within the pay period. Likewise if the employee's salary is not normally decreased when he is off on a holiday, vacation, sick leave or other miscellaneous periods of leave during one week, such time off may not be used to balance overtime worked another week within the pay period. In other words the hours which the employer lays off the employee in one week of the pay period, to balance overtime worked in another week of the same pay period must be hours off for which the employee is not entitled to nor customarily receives compensation.

For this reason a "time off" plan cannot be applied to salaried employees working an irregular or fluctuating number of hours. It is the nature of such an employee's employment that he will continue to receive and he customarily does receive his fixed basic salary regardless of the number of hours he may work in a particular week or pay period. His salary is not docked when he happens to work fewer hours some week or pay

period. The regular rate of pay at which such employee is actually employed and upon which time and a half consequently must be paid, is the average hourly rate for the week and varies from week to week. The employee is entitled for his overtime work each week to a sum, in addition to the basic salary, equal to one-half the regular rate of pay multiplied by the number of hours which he works in excess of 42 in the week. See paragraph 12 of the Bulletin.

Some employers who have worked their salaried employees an irregular or fluctuating number of hours have attempted to change the nature of their employment to an hourly rate basis and then use a "time off" plan. Whether the "time off" plan becomes applicable will depend upon whether, after the attempted change, the employees really are hourly rate employees or whether they continue to be salaried employees. Some criteria in making this determination may be suggested. Do the former salaried employees understand that they have become hourly rate employees and will be paid, as hourly rate employees normally are paid, only for the actual number of hours they work at the hourly rate? Are the employees actually paid at the hourly rate or is some salary arrangement superimposed upon the hourly rate? Furthermore, if the determination is made that the salaried employees have been converted into hourly rate employees, the Administrator in carrying out his duties of enforcement under the Act will sanction the procedure only if the hourly rate is representative of the rate at which the salaried employees may be said to have been employed while on a salary basis. An average hourly rate based upon the salaried employee's earnings and hours worked over a representative period of time (including both busy and slow seasons) will be considered to be representative of the rate at which the employees have been employed.

One further point needs to be brought out with respect to the application of the "time off" plan. The above examples of its operation take a bi-weekly pay period. The plan will also apply if the pay period is semi-monthly or monthly. But it will not apply to employees paid weekly because the overtime compensation due an employee may not be accumulated beyond the pay period but must be paid at the time of the regular pay period. Thus an employee who is paid his regular wages or salary weekly must also receive the overtime compensation due him weekly. The overtime compensation may not be accumulated to be paid him during subsequent weeks when he is given time off without pay. The "time off" plan is thus limited to employees who are paid bi-weekly, semi-monthly or monthly. A "prepayment" plan, however, is not so limited and, as will be indicated below, may be applied to employees paid weekly.

The Semi-Monthly Pay Period

When the employee is paid semi-monthly, questions have been asked concerning the method of handling the "split workweek" - the workweek which begins before and extends beyond the date of the pay period.

Since it is impossible in such case to ascertain at the pay period whether any overtime will be worked during the "split workweek," the employer may pay the requisite additional compensation for the number of overtime hours worked during such workweek at the next succeeding

period. At each pay period the employer will meet the requirements of the Act if he pays an amount in addition to the straight time wage or salary equal to one-half the regular rate of pay for the number of overtime hours worked in each of the completed workweeks in the period. In other words, overtime compensation earned in a particular workweek must be paid at the regular pay period in which such workweek ends. Payment for a workweek, however, may not be postponed beyond the pay period in which it ends.

The same principle governs the application of the "time off" plan to an employee who is paid semi-monthly. The employer may lay off the employee a sufficient number of hours during the other week or weeks which end in the pay period next succeeding the pay period which splits a workweek to offset the amount of overtime worked during the split workweek. In this way the payment of the desired wage or salary at the next succeeding pay period may cover the total amount of compensation, including overtime compensation, due the employee for each workweek, including the "split workweek," which ended in the period. The same principle applies where the pay period is monthly.

One further aspect of the operation of the plan needs to be clarified. The examples of the operation of the "time off" plan given herein revolve about 42 hours as the standard number of hours. The plan may, of course, revolve about a standard number of hours more or less than 42. It may be helpful to give specific examples of the operation of the "time off" plan in such cases.

Suppose the employee earns a salary of \$48, is paid bi-weekly and works a regular workweek of 46 hours. Let us assume that such employee prior to the Act earned \$46 bi-weekly and worked a regular workweek of 46 hours. His regular rate of pay is 50 cents an hour ($\$23 \div \$46 \div 27 + 46$ hours). On October 24, 1938, he continued to work a regular workweek of 46 hours and was paid \$47 therefor ($\sqrt{(44 \text{ hours} \times 50\text{¢})} \div (2 \text{ hours} \times 75\text{¢}) \div 2$). Since October 24, 1939, he continues to work a regular workweek of 46 hours and is paid \$48 therefor ($\sqrt{(42 \text{ hours} \times 50 \text{ cents})} \div (4 \text{ hours} \times 75 \text{ cents}) \div 2$).

During one week of the pay period the employee works 48 hours. To meet the requirements of the Act by the payment of the fixed salary, \$48, at the pay period, the employer must work the employee only 44 hours, or two hours less than the regular number, the other week of the pay period - ($\sqrt{(42 \text{ hours} \times 50 \text{ cents})} \div (6 \text{ hours} \times 75 \text{ cents}) \div 2 = \25.50 , the requisite payment for the overtime week) $\div \sqrt{(42 \text{ hours} \times 50 \text{ cents})} \div (2 \text{ hours} \times 75 \text{ cents}) = \22.50 , requisite payment for the other week = \$48, the bi-weekly salary).

Suppose the employee earns a salary of \$40, is paid bi-weekly and works a regular workweek of 40 hours. The regular rate of pay of such employee is 50 cents an hour ($\$20 \div \$40 \div 27 \div 40$ hours).

During one week of the pay period the employee works 44 hours. If the employer customarily pays time and a half for all hours in excess of 40 he must work the employee only 34 hours, or 6 hours less than the regular number, the other week of the pay period in order to meet the requirements of the Act by the payment of the fixed salary at the pay period.

$(\sqrt{(40 \text{ hours} \times 50 \text{ cents})} + (4 \text{ hours} \times 75 \text{ cents}) = \23 requisite payment for the overtime week $\sqrt{(34 \text{ hours} \times 50 \text{ cents}) = \17 , requisite payment for the other week $= \$40$, the bi-weekly salary). If payment at straight time is customary for the hours in excess of 40 the employer must work the employee only 35 hours, or 5 hours less than the regular number, the other week of the pay period in order to meet the requirements of the Act by the payment of the fixed salary at the pay period. $(\sqrt{(42 \text{ hours} \times 50 \text{ cents})} + (2 \text{ hours} \times 75 \text{ cents}) = \22.50 , requisite payment for the overtime week $\sqrt{(35 \text{ hours} \times 50 \text{ cents}) = \17.50 , requisite payment for the other week $= \$40$, the bi-weekly salary).

It will be noted that in the cases outlined above, the number of hours for which the employee is laid off in one week to balance overtime worked in another week of the pay period must be hours off the regular number of hours worked or the number of hours' payment for which will yield the desired fixed wage or salary and not off the standard number of hours fixed in the Act.

The Formula That May Be Followed

Where the regular number of hours worked is 42, the formula which employers have used to comply with the Act by paying the fixed salary at the pay period is to lay off the employee one and one-half hours in one week for each hour worked in excess of 42 in the other. However, this formula does not work out where the regular number of hours is more or less than 42 hours. Thus, in the case given above where the regular number of hours worked is 46, it is clear that the fixed salary already includes payment at time and a half for 4 overtime hours. These 4 hours may, therefore, be used to balance on a one-to-one basis 4 hours worked in excess of 46, which also must be paid for at time and a half. Thus in the example given, 2 hours in excess of 46 were worked in one week of the pay period; these are balanced by working the employee 2 hours less than 46 in the other week of the pay period. If the employee had worked 50 hours during one week, the fixed salary would be sufficient payment if 42 hours were worked the other week. But if 52 hours were worked one week, 4 of the hours in excess of the regular number could be offset by 4 hours off the regular number, 46, because they are all paid for at time and a half. The other 2 hours in excess of 46 however must also be paid for at time and a half and can be offset only by three additional straight time hours off 46 (one and one-half for one). Thus a total of 7 hours less than 46 or 39 hours must be worked in one week of the pay period when 52 hours are worked the other so that payment of the fixed salary at the pay period will satisfy the requirements of the Act. $(\sqrt{(42 \text{ hours} \times 50 \text{ cents})} + (10 \text{ hours} \times 75 \text{ cents}) = \28.50 , requisite payment for the overtime work $\sqrt{(39 \text{ hours} \times 50 \text{ cents}) = \19.50 , requisite payment for the other week $= \$48$, the bi-weekly salary).

In the case given above where the regular number of hours is 40 and the employer customarily paid time and a half for all hours worked in excess of 40, one hour in excess of 40 in one week may be offset only by one and one-half hours off 40 in another week. If the employer customarily pays straight time for the hours in excess of 40, then two hours in excess of 40 in one week may be offset by 2 straight time hours off 40 in another week, but every additional hour (i.e. in excess of 42) may be offset only by one and one-half additional hours off 40 in the other week.

The Prepayment Plan

Though overtime compensation due an employee must normally be paid at the time of the employee's regular pay period, there is no objection if the employer pays overtime compensation to become due to an employee in advance. This is the basic principle of the "prepayment" plan. Thus some employers in an attempt to keep the wage or salary constant from pay period to pay period, have resorted to paying their employees a sum in excess of what they earn or are entitled to in a particular week or weeks, which sum is considered to be a prepayment or advance payment of compensation for overtime to be subsequently worked. The operation of a prepayment plan may best be illustrated by specific examples.

A. Case I. Hourly Rate Employees

Let us take the example of an employee who is paid 50 cents an hour and works the following schedule:

Weeks	1	2	3	4	5	6	7	8
Hours Worked	35	36	44	40	42	38	46	36

The employer and the employee agree that in any week in which the employee works less than 40 hours, the employer will advance to the employee the difference between the amount equal to his regular rate of pay for 40 hours and the amount he would have received if he had been paid only for the number of hours he worked.

Thus in the first week the employee will be paid \$20.00 although he was entitled to only \$17.50. The employer will credit himself with \$2.50. For the second week the employee will be paid \$20.00 although he was entitled to only \$18.00 and the employer will credit himself with \$2.00. For the third week the employee will be paid \$20.00 although he was entitled to \$22.50 ($\sqrt{42 \text{ hours} \times 50 \text{ cents}} \neq \sqrt{2 \text{ hours} \times 75 \text{ cents}}$). In this way the employee will work off \$2.50 of the amount previously credited to the employer. The employee will now carry a credit of \$2.00. For the fourth week the employee will be paid \$20.00, to which he was entitled. For the fifth week the employee will be paid \$20.00 although he was entitled to \$21.00, and will work off \$1.00 more of the amount still credited to the employer. The employer will now carry a credit of \$1.00. For the sixth week the employer will be paid \$20.00 and \$1.00 more will be credited to the employer. The employer will now carry a credit of \$2.00. For the seventh week the employee will be paid \$22.00 although he was entitled to \$24.00 ($\sqrt{42 \times 50 \text{ cents}} \neq \sqrt{4 \times 75 \text{ cents}}$). The employee will thus have worked off the total credit accumulated by the employer and will be paid in cash the additional \$2.00 due him. For the eighth week the employee will be paid \$20.00 and the employer will credit himself with \$2.00.

It will be noted that only credits to the employer will be carried over beyond the pay period; credits to the employee, i.e., overtime compensation due the employee, will not be carried over beyond the pay period to be consumed by subsequent employer "advances," but will be paid in cash at the pay period. In this way the employer will never be indebted to the employee.

It cannot be emphasized too strongly that the validity of the plan depends upon the assumption that when the employee received \$20.00 in the weeks when he works less than 40 hours, he is being paid in excess of which he earns, or is entitled to and is therefore given a loan or advance which he may work out by subsequent overtime. Whether this is actually the fact is easily susceptible of determination in the case of hourly rate employees. But even in their case the question sometimes arises as to whether the "loan" or "advance" is really a loan or advance and not really a salary arrangement by which, for example, the employee in the above case is entitled to \$20.00 for work already performed without subsequent overtime work. The determination of this question may depend upon what the parties understand will happen when an employee severs his relationship with the employer. If the employer still has some accumulated credits at that time, will some attempt be made to get back the amount of the "loan" or "advance" from the employee since there is no further possibility that it will be worked out by subsequent overtime? The fact that no attempt will be made by the employer to collect the amount due him either by deducting such amount from the employee's last check or by some other way, is some indication that the "loan" or "advance" is simply a fictitious bookkeeping device.

Similarly the fact that at the end of the year or at the end of some shorter period credits accumulated by the employer are simply wiped off the slate and a new start is made, is some indication that there is no "loan" or "advance" in fact but simply a bookkeeping device. If there is no "prepayment" in fact and the plan is nothing but a bookkeeping device, the Act will have been violated. No one criteria may be sufficient to determine this question but all the criteria set forth herein will be given weight in deciding this question.

Case II. Salaried Employees

Let us take the example of a salaried employee who earns \$21.00 a week for a regular workweek of 42 hours and whose regular rate of pay is therefore 50 cents an hour. ($\$21 \div 42$ hours).

Weeks	1	2	3	4	5	6	7	8
Hours	36	42	42	42	42	42	42	48

For the first week the employee will receive \$21.00 although he earned and is entitled to only \$18.00 (36 hours x 50 cents). The employer will credit himself with \$3.00 as a prepayment of compensation for overtime to be subsequently worked. The employee will receive \$21.00 during each of the next six weeks. For the eighth week the employee is entitled to \$25.50 ($\sqrt{42 \text{ hours} \times 50 \text{ cents}} + \sqrt{6 \text{ hours} \times 75 \text{ cents}}$). He will thus have worked off the entire credit of \$3.00 accumulated by the employer and will received \$22.50 in cash.

The validity of the plan as outlined depends upon the assumption that the employee is overpaid when he received \$21.00 for the first week of 36 hours and that therefore the employer has loaned or advanced him \$3.00. In addition to the criteria set forth under case I to determine

whether the "loan" or "advance" is real or only a bookkeeping device an additional consideration comes into play with respect to the salaried employee who works a regular number of hours. If the employer, who contemplates adopting a "prepayment" plan is presently required by contract or agreement with the employee, express or implied, to pay him the fixed wage or salary even when the employee works less than the regular number of hours in some week or weeks, it cannot be said that the employee is paid in excess of what he earns or is entitled to when he receives the fixed wage or salary in such weeks. He has received no "loan" or "advance" and no amount therefore may be credited to the employer as a prepayment of compensation for overtime to be subsequently worked.

For the same reason a prepayment plan cannot be applied to a salaried employee who works a fluctuating number of hours. Since the nature of such an employee's employment is that he will receive the fixed basic salary regardless of the number of hours worked it cannot be said that such an employee is paid in excess of what he earns or is entitled to in any week in which he receives the fixed salary even though such weeks may have been short weeks.

We have considered above the question of the conversion of a salaried employee working a fluctuating number of hours into an hourly rate employee.

The amounts paid to an employee while absent from work on a vacation, holiday, sick leave or other miscellaneous periods of leave, may not be considered by the employer as prepaid overtime compensation just as the time off during such periods may not be used to balance overtime worked within the pay period. Payment during holidays, vacations, etc., is not payment for overtime and may not be considered by the employer as compensation for the employee's overtime work under the Act.

In two respects a prepayment plan, if it may be properly applied to salaried employees, is not subject to the same restrictions as a "time off" plan. It is not confined, in its operation, to the pay period. Credits to the employer, i. e., amounts paid by him in excess of the amounts earned by the employee or to which the employee is entitled, may be carried over beyond the pay period until they are consumed by the overtime work of the employee. Secondly, a prepayment plan may be applied to employees who are paid weekly.

It need not be restricted in its application, as is the "time off" plan, to employees paid on a bi-weekly, semi-monthly, or monthly basis. Under a prepayment plan the employee is being paid the overtime compensation due him, either in advance or, at the latest, at the time of the regular pay period.

Where applicable, a "time off" and "prepayment" plan may be applied in conjunction with each other.

U. S. DEPARTMENT OF LABOR
WAGE AND HOUR DIVISION
Washington

ERRATUM SHEET

Please make the following corrections in:

"Supplement to Interpretative Bulletin No. 4 -
Maximum Hours and Overtime Compensation" (R-887;
released July 14, 1940)

Page 2, "Case II - Salaried Employees"

Correct to read:

- Line 5 - "shorter weeks when 36, 39 and 39 hours
were worked the employee was entitled"
- Line 6 - "to only \$18.00, \$19.50 and \$19.50,
respectively. Thus the employee received"
- Line 7 - "\$24.00, \$22.50 and \$24.00, the requisite
amount of compensation, including"
- Line 8 - "overtime compensation, for the weeks in
which he worked, 46, 44 and 46 hours."