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

July 2, 2003

FLSA2003-4

Dear ***Name****,

This is in response to your letter asking whether certain payments the City of ***Name**** makes pursuant to a cafeteria benefits plan must be included in an employee's regular rate of pay for computing overtime under the Fair Labor Standards Act (FLSA). We regret the delay in responding to your request.

The City has established a cafeteria benefits plan under section 125 of the Internal Revenue Code. Pursuant to the plan, the City contributes $415.00 per month for the benefit of its full time police officers and a pro rata share for part time officers. The contribution may be used to purchase benefits, including medical insurance, dental insurance, vision insurance, and life insurance. You indicate that the City requires employees to participate in the dental, vision and life insurance programs. Such participation is mandatory even if an employee already has such coverage, such as through a spouse's insurance policy that covers the entire family. According to your letter, employees also must contribute $16.00 per month toward their retiree health insurance account. Based upon the Memorandum of Agreement between the City and the Police Officers' Association that you submitted with your letter, it appears that medical insurance also is mandatory unless an employee already has such coverage through another policy. If an employee submits proof of other medical insurance, the employee may receive the unused portion of the City's contribution in cash. Under a cafeteria benefits plan, once an employee makes an election for insurance coverage, the employee generally is bound for the plan year unless the employee experiences a change in status, such as a change in family status. You asked whether, in light of these facts, the City's cafeteria plan contribution has to be included in an employee's regular rate of pay for overtime purposes.

As you know, overtime premium payments under the FLSA are based upon time and one-half the “regular rate” of pay. Section 7(e) of the FLSA requires that all remuneration for employment paid to, or on behalf of, an employee must be included in calculating the regular rate, except those payments specifically excluded by sections 7(e)(1) through 7(e)(8). Section 7(e)(4) of the FLSA excludes from the regular rate “contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide plan for providing old-age, retirement, life, accident, or health insurance or similar benefits for employees.” 29 U.S.C. 207(e)(4).

The interpretative regulations implementing section 7(e)(4) provide that an employer’s contribution is excludable only if five criteria are met. The most relevant for your inquiry are that: “[t]he primary purpose of the plan must be to provide systematically for the payment of benefits” on account of retirement, disability, medical expenses, etc.; “[t]he employer’s contributions must be paid irrevocably to a trustee or third person pursuant to an insurance agreement, trust or other funded arrangement”; and “[t]he plan must not give an employee the right to assign his benefits under the plan nor the option to receive any part of the employer’s contributions in cash instead of benefits” although a plan may “still be regarded as bona fide even though it provides, as an incidental part thereof, for the payment to an employee in cash of all or a part of the amount standing to his credit… (iii) during the course of his employment under circumstances specified in the plan and not inconsistent with the general purposes of the plan to provide the benefits described in section 7(e)(4) of the Act.” 29 C.F.R. 778.215(a)(2), (4) and (5).

Section 7(e)(4) and the regulations require that an employer make contributions pursuant to a bona fide benefits plan in order for the contributions to be excludable from the regular rate. A bona fide plan may allow incidental cash payments to employees. Prior opinion letters addressing this issue established a 20% limitation or cap on the cash payments that could be made to employees in order for such payments to qualify as incidental. That cap historically has been applied on an employee-by-employee basis. Thus, if a plan allowed any employee to receive more than 20% of the amount standing to his or her credit in cash, the plan would fail to qualify as bona fide because such excessive cash payouts would dissipate the amount available for benefits. Nevertheless, the plan could authorize an employee to receive up to 100% of the amount standing to his or her credit in cash, if the money had to be used for purposes that were the

same or similar to the benefits listed in section 7(e)(4). See, *e.g.,* opinion letters of June 25, 1957; March 18, 1963; September 12, 1969; and December 21, 1971.

We continue to believe that this 20% cap is an appropriate method for assessing whether any cash payments are an incidental part of a bona fide benefits plan under 778.215(a)(5)(iii). However, because section 7(e) of the FLSA provides for the exclusion of employer contributions for benefits that are made pursuant to a bona fide plan, on further review we believe that the focus of the question should be whether the plan as a whole is a bona fide benefits plan. Therefore, we believe that the 20% test should be applied on a plan-wide basis. Moreover, such a plan-wide 20% test is more consistent with the regulatory language which allows "***all*** or a part of the amount" standing to an employee's credit to be paid in cash, so long as it occurs under circumstances which are consistent with such a plan's primary purpose of providing benefits. Because we have no information about the City's total contribution amount, or the amount employees receive in cash, we are unable to assess whether the cash payments are incidental.

The regulations implementing section 7(e)(4) allow a plan to provide cash instead of benefits to an employee, and nonetheless to qualify as a bona fide benefits plan, only if the cash is incidental and is provided under circumstances that are consistent with the overall primary purpose of the plan of providing benefits. 29 C.F.R. 778.215(a)(iii). The City's cafeteria plan appears to meet this requirement because the plan requires employees to demonstrate that they have other medical insurance before they are permitted to decline that coverage and receive cash; employees may not elect to receive the entire contribution in cash; employees are required to pay $16 per month for retiree health insurance; and employees are required to purchase mandatory individual dental, vision and minimum life insurance.

The City's plan is very different from the plan that the court assessed in Madison v. Resources for Human Development, Inc., 39 F. Supp. 2d 542 (E.D. Pa. 1999), vacated and remanded, 233 F.3d 175 (3d Cir. 2000) (remanded for the purpose of giving the proper degree of deference to the Department's interpretative regulations). The plan under review in that case did not require employees to show that they had coverage under another benefits package before they could opt to receive cash and employees could elect to receive the entire contribution in cash. The district court accordingly concluded that it did not satisfy the standard for exclusion.

In summary, a cafeteria plan may qualify as a bona fide benefits plan for purposes of section 7(e)(4) if: (1) no more than 20% of the employer's contribution is paid out in cash; and (2) the cash is paid under circumstances that are consistent with the plan's overall primary purpose of providing benefits. Although the City's cafeteria plan appears to meet the second criteria, we are unable to determine whether no more than 20% of the employer's contribution is paid out in cash. Accordingly, we cannot determine whether the City's cafeteria plan contribution must be included in an employee's regular rate of pay for overtime purposes. If you wish to provide us with this additional information, we would be happy to review it in light of the test we have set forth in this letter.

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. You have also represented that this opinion is not sought on behalf of a client or firm which is under investigation by or in litigation with the Wage and Hour Division or the Department of Labor.

We trust that the above information is responsive to your inquiry.

Sincerely,

Tammy D. McCutchen
Administrator

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