

Bonuses: gratuity or salary component?

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ABSTRACT

It is quite common for employee compensation to comprise a basic salary plus a variable component (usually referred to as a “bonus”). As the Swiss legal system does not know the term ‘bonus’ as such, deciding how variable compensation should be categorised legally and whether it qualifies as a gratuity or as part of an employee’s salary, is problematic. Making the distinction involves taking a closer look at both the underlying contractual basis and the company’s practice. What at first seems to be a fairly trivial question of definition turns out to have significant legal implications.

1. LEGAL CATEGORISATION

Whether a bonus is to be considered a gratuity, performance pay, profit-sharing or a hybrid depends primarily on how the contract is drafted. But it also depends on the company’s practice when it comes to paying the bonus, and how it relates to the employee’s salary (its accessory nature).

a) Contractual formulation

The key here is whether the bonus can be viewed as a voluntary gratuity, or whether it’s been formulated in such a way that the amount has been determined, or is at least determinable, and is thus no longer at the employer’s discretion. In the first scenario, a bonus can be considered a gratuity. If the amount of the bonus has been determined or is determinable, it’s generally assumed to be a component of salary. For example, a bonus linked solely to operating profit or other specific financials would be determinable. But if a bonus is linked to personal performance targets that have not been measurably formulated respectively the achievement of these targets involves a subjective appraisal, or if its payment (despite the bonus being determinable) is at the employer’s discretion, the bonus should be treated as a gratuity. This also applies if the bonus is paid out by the employer as a completely voluntary special payment.

This means it is not always easy to differentiate between a gratuity and salary component in the individual case. For this reason, the Swiss Federal Supreme Court takes in ambiguous cases also account of factors such as the regularity of the payment and the size of the bonus as a proportion of the basic salary. If on this basis the bonus can still be considered as an additional benefit on top of salary rather than primary compensation, the payment is deemed to be a gratuity (the so-called “accessory nature”).

b) Accessory nature

In cases of low income, even a relatively small bonus is deemed to be a salary component; this is certainly the case when the bonus can be viewed as the actual remuneration. If the salary is higher (around CHF 100,000 or more p.a.), the bonus paid out can be correspondingly higher before it has to be categorised as a salary component. A certain regularity of payment, on the other hand, suggests that the bonus should be viewed as a salary component.

According to the case law of the Swiss Federal Supreme Court, non-determinable bonuses paid to employees with a very high income will always qualify as a gratuity. At this level of income, case law has essentially abandoned the principle of “accessory nature”, and the imperative of safeguarding the employee’s interests is no longer seen as justifying any restriction in the employer’s private autonomy. In a recent case, the Swiss Federal Supreme Court defined very high income as annual compensation greater than or equal to five times the median annual salary.

To summarise: A bonus should always be categorised as a salary component if the employer has given up its discretion (in particular by determining the bonus or making it determinable), or, unless in case of very high salaries, if the size of the bonus as a proportion of the salary means it no longer qualifies as a special payment on top of the salary. If the circumstances prevent clear categorisation, the courts will often decide in favour of a salary component to the detriment of the employer.

2. LEGAL IMPLICATIONS OF QUALIFICATION

Whether or not a bonus qualifies as a salary component or a gratuity will have a bearing on whether the employee is entitled to the payment. If it is deemed to be a gratuity, the employee essentially has no legal entitlement to payment of the bonus. If it qualifies as a salary component, the employer will be legally obligated to pay the bonus, even if employment has been terminated. This means that as long as the criteria for payment of the bonus are met, it must be paid on a pro-rata basis.

3. PAYMENT OF GRATUITY DESPITE DISCLAIMER

Employers paying gratuities often make specific mention of the discretionary nature of the payment. However, a clause of this sort does not exclude the employee’s entitlement in all cases. For example, the Swiss Federal Supreme Court ruled that an employer who for many years had made a payment at its discretion, even though it would have had grounds during this time for not doing so (e.g. poor business performance), was nevertheless required, on the basis of the principle of good faith, to continue making the payment as part of its employee’s salary entitlement.

4. RECOMMENDATION

For the sake of clarity and to avoid misunderstandings between the employer and its employees, the bonus clause in the employment contract should reflect the mutual agreement of the parties, and this clause, as well as any provisions governing bonuses in other regulations, should be formulated in clearly understandable terms. As explained above, however, it should also be borne in mind that describing a payment as discretionary does not automatically make it a gratuity if the actual the employer’s practice or the principles of bonus determination suggest otherwise.

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