

Legal News



Bonus payments in employment

Helga Mesaros, Attorney-at-law, Legal Services, helga.mesaros@ch.ey.com

Dear clients and business friends

Bonus payments to top managers and other members of management are a controversial issue that, in the meantime, has become not only a topic of public but also of political discussion. With the "Rip-Off Initiative" or the "Bonus Tax", there are concrete regulatory plans in this regard on the agenda of the Federal parliament. In addition, efforts are also being made at international level to prevent excessive bonuses by means of legislation. It remains to be seen what result will come out of these endeavours.

How are bonus promises and bonus payments to be classified from a legal point of view? Are they voluntary or are they contractually payable claims? Can a bonus be reduced or even cancelled altogether? If necessary, how can the voluntary character of a bonus payment be secured from the point of view of the employer? These and other questions are discussed in this edition of Legal News.

Daniel Bachmann
Attorney-at-law, Partner, Legal Services
daniel.bachmann@ch.ey.com

1. Expression

The expression "bonus" in connection with remuneration in employment is *not legally defined*. The term comes from the Anglo-Saxon world and is used in general language for every kind of remuneration in employment that does not represent a fixed salary and is paid out as a reward for work performed as well as an incentive for future work. The kind of remuneration it represents in each individual case is identified by interpretation of the relevant agreement in the employment contract. A careful formulation of the bonus agreement is therefore advisable.

2. Forms of appearance

A bonus can be structured so that it is discretionary or non-discretionary. In the case of *discretionary* bonuses, the level cannot be objectively calculated. It lies within the sole discretion of the employer to decide on paying it out and the amount involved. On the other hand, *non-discretionary bonuses* can be objectively calculated; if certain criteria defined in the bonus agreement are fulfilled, the bonus has to be paid.

Bonuses can be comprised of *cash payments, payments in kind* or both. In practice, common payments in kind are (employee) shares and/or options.

Depending on the specific manner in which they are structured, cash and/or payments in kind can represent salary in the sense of a variable salary for performance, a share of a company's profits, piecework pay, a commission or a

gratuity in the sense of article 322d CO. Particularly the demarcation between a variable performance salary and a gratuity gives rise to discussion in practice.

There are numerous *mixed forms* which include various types of cash payment as well as other combinations between cash and payments in kind, none of which make the legal qualification of the bonus a simple matter.

Furthermore, the bonus can be linked to certain *conditions*. Here again, those conditions can be discretionary or non-discretionary.

3. A salary claim or a voluntary payment?

Article 319 para. 1 CO defines that compensation paid out for work performed is salary. On the other hand, a gratuity is an exceptional payment on special occasions and is only contractually payable if it has been agreed accordingly (article 322d CO). The *legal character of the bonus - salary or gratuity -* is therefore decisive.

In practice, discretionary bonus payments are often equated with a gratuity in the sense of article 322d CO. With this form, the employer has a very far-reaching degree of discretion and can make not only the payment but also the level of bonuses dependent upon conditions which are not covered by employment law. There is usually no imperative equal treatment between the employees. Furthermore, gratuities are payments made accessory to the salary, i.e. *in addition to the salary*.

The Federal Court has determined that bonus payments which are *regularly* at the same level or higher than the basic annual salary are no longer to be considered accessory but as salary (BGE 131 III 621). In the case of lower salaries, smaller percentile bonus payments are sufficient to give effect to the salary character of regular payment.

If merely the level of the bonus (gratuity), but not payment of it, is discretionary, the employer can only define the level.

A gratuity agreement can make payment dependent upon *conditions* such as the employment still being intact without notice of termination having been tendered, etc. Unless otherwise agreed, there is no pro rata claim if the employment arrangements come to an end. On the other hand, a bonus which has the character of salary is payable pro rata when the employment ends.

Many employers make the bonus agreement subject to discretionary payment. The existence, or non-existence, of that kind of reservation can give rise to uncertainties.

If the bonus is not expressly declared to be of discretionary nature, the Federal Court and prevailing doctrine assume that a bonus in the sense of a gratuity that has been paid out three years in succession without reserve must be deemed to be agreed under the principle of good faith, even if it was originally paid out as a voluntary and discretionary payment (BGE 129 III 278). If, in those three years, varying amounts were paid, the bonus is deemed to be payable under the same principle, but the level must be determined by the court (BGE 131 III 615 ff).

If, on the other hand, *agreement is reached that a bonus is subject to discretionary payment*, it is advisable to record this not only in the employment contract but also on every bonus statement or to make the employee aware of it by means of a separate letter.

Despite subjecting a bonus to discretionary payment, the Federal Court has decided that a bonus that has been paid out for years, even though the preconditions for it were not fulfilled (e.g. poor performance of the employee or poor course of business) must be deemed to be a component of the salary because the reservation of discretionary payment has become meaningless. Even discretionary payments that have been made for decades can therefore, according to the Federal Court, become components of salary (BGE 129 III 281). The doctrines on this jurisprudence are wide apart.

If one follows this jurisprudence decreed by the highest judges, one must assume that a three-year, uninterrupted payment of (high) bonuses must be regarded as a regular payment and therefore the employer can only reduce or cancel a bonus of that kind by means of a dismissal with the option of altered conditions of employment.

If a bonus is to be treated as a component of salary, it has to be definable and measurable. The conditions and the measurement of those bonus payments must be contractually recorded.

Insuring the bonus in the 2nd pillar or under the accident or sickness compensation coverage also leads to the assumption that the bonuses are to be classified as (variable) salary and not as gratuities.

4. Conclusion

The term "bonus" which has drawn so much attention in the recent past is so diverse that it is hardly comprehensible and has to be qualified against the background of each specific case. Even if a bonus is subjected to discretionary payment, the employer can risk having to pay it out. The topic will certainly continue to be of effect in the media but will keep the courts busy as well.

Ernst & Young

Assurance | Tax | Legal | Transactions | Advisory

Ernst & Young is a leading provider of audit, tax, transaction and advisory services. Our 144,000 employees around the world provide quality services by combining our common values with consistent commitment. In Switzerland, Ernst & Young is a leading audit and advisory company offering services in the area of tax and legal issues, as well as in transactions and accounting. Our 1,940 employees in Switzerland generated revenue of CHF 546 million in the 2008/2009 business year. We stand out as a company because we help our employees, clients and stakeholders to realize their full potential. Further information can be found on our website at www.ey.com/ch.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, UK, does not provide services for clients.

Imprint

Legal News

Electronic publication in German, French and English.

Designed and produced by

Ernst & Young Ltd
Marketing and External Communications
P.O. Box
8022 Zurich

Subscriptions / address changes

www.ey.com/ch/newsletter

www.ey.com/ch/legal

© 2010 Ernst & Young AG
All Rights Reserved.

The Legal News provides an overview of new legal developments. The content does not represent any legal advice.

Contacts Legal

Basel: Dominik Matter
dominik.matter@ch.ey.com

Berne: Daniel Bachmann
daniel.bachmann@ch.ey.com

Geneva: Olivier Dunant
olivier.dunant@ch.ey.com

Zurich: René Schwarzenbach
rene.schwarzenbach@ch.ey.com