

K&LNG Alert

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Employment Law Salary Deductions Under the FLSA: How Employers Can Stay Out of Trouble

Employers should take time to learn about two recent opinion letters from the U.S. Department of Labor that address deductions from the pay of salaried, exempt employees under the Fair Labor Standards Act ("FLSA"). The Department had implemented new regulations governing these "white collar" exemptions in August of 2004. The regulations updated and simplified existing overtime exemptions for executive, administrative, and professional employees whose salaries and duties met certain criteria. They also added an important new safe harbor provision relating to improper salary deductions. Since the regulations were promulgated, the new salary levels and duties tests have received much attention; however, there has been less focus on what qualifies as a salary and what consequences deductions can have on that salary.

These two opinion letters highlight issues that may arise with respect to deductions from salaried employees' pay. Employers should not overlook the significant consequences of improper salary deductions. Improper deductions could result in all salaried, exempt employees in a given job classification losing their exempt status and becoming entitled to additional overtime pay. This Alert describes what deductions are permitted, summarizes the two recent opinion letters, and explains how written policies can help shield employers from costly consequences.

SALARY DEDUCTIONS AND CONSEQUENCES OF IMPROPER DEDUCTIONS

To satisfy the salary component of the white collar exemptions, an executive, administrative, or professional employee must be paid on a salary basis

at a rate of not less than \$455 per week.¹ Paying an employee on a "salary basis" means the employer must pay the employee a predetermined amount not subject to deductions based on the quality or quantity of the employee's work. In other words, an employer must pay an exempt employee his or her full salary in any week in which the employee performs any work, regardless of the number of days or hours actually worked. However, an employer *may* reduce an exempt employee's salary in the following limited circumstances:

- In an employee's initial or final week of employment, an employer may reduce the salary amount to reflect the time actually worked.
- When an employee is absent from work for one or more full days because of personal reasons other than sickness or disability, an employer may reduce the employee's salary in full-day increments based on the number of full days the employee was absent. An employer may not reduce the employee's salary for partial days of work.
- When an employee is absent from work for one or more full days because of sickness or disability, an employer may reduce the employee's salary in full-day increments in accordance with a bona fide plan, policy, or practice that covers sickness or disability pay. An employer may similarly reduce an employee's salary when the employee receives salary replacement benefits under state disability or workers' compensation laws.
- An employer with a sick or disability plan, policy, or practice may also reduce an employee's salary

¹ Although this Alert addresses only *salary* requirements for the exemption, it is worth noting that administrative and professional employees satisfying the duties tests may also qualify for the exemption if they are paid on a *fee* basis, in accordance with 29 C.F.R. § 541.605. Computer employees satisfying the duties test may qualify for the exemption if they are paid an hourly rate of not less than \$27.63 per hour. See 29 C.F.R. § 541.400(b). Additionally, there is no salary or fee requirement for outside sales representatives, teachers, doctors, or lawyers. See 29 C.F.R. §§ 541.500(c); 541.303(d); 541.304(d).

for such full-day absences if the employee has not yet become eligible for, or has exhausted all leave under, the employer's plan, policy, or practice.

- When an employee takes unpaid leave under the Family and Medical Leave Act, an employer may reduce the employee's salary based on the amount of time the employee is absent.
- When an employee is absent because of jury duty, attendance as a witness, or temporary military leave, an employer may use the jury fees, witness fees, or military pay received by the employee to offset the salary owed. However, the employer is prohibited from further reducing the employee's salary for these absences.
- When an employee violates a safety rule of major significance, an employer may impose a salary deduction as a penalty against the employee. Such a deduction can be equal to a partial day's wages.
- When an employer suspends an employee without pay pursuant to a written disciplinary policy for workplace conduct, the employer may reduce the employee's salary based on the number of full days for which the employee was suspended.

A reduction in salary that is inconsistent with these rules is considered an improper deduction. The practice of making improper deductions shows that an employer did not intend to pay employees on a "salary basis" and, therefore, disqualifies employees from the overtime exemption. An isolated or inadvertent improper deduction will not destroy the exemption if the employer reimburses the employee for the deduction. However, if the Department finds an actual practice of making improper deductions, all employees in the particular job classification subject to the deductions could lose their exempt status for the period during which deductions were made, even if some of those employees never had their own salaries reduced. Loss of the exemption would then subject the employer to liability for overtime compensation in addition to the salaries already paid. The employer could also face civil penalties for repeat or willful overtime violations.

RECENT OPINION LETTERS ADDRESSING SALARY DEDUCTIONS

FLSA Opinion No. 2006-7 addressed deductions from exempt employees' salaries for loss or damage to company equipment. Specifically, an employer sought to impose a fine, equal to repair or

replacement costs, on exempt employees who lost or damaged company-owned mobile phones and laptop computers. The opinion letter explained that this type of deduction violates the prohibition on reducing compensation based on the quality of an exempt employee's work. Moreover, these deductions do not fall within one of the categories of deductions expressly permitted by the regulations. The opinion emphasized the Department of Labor's position that any deduction not expressly permitted by the regulations violates the "salary basis" requirement for exemption, even if the employer has a signed authorization or agreement from the employee. By way of example, the opinion letter mentioned the following deductions that have been deemed to be improper: deductions for cash register shortages, deductions reflecting unacceptably high charges for unauthorized phone calls, and deductions for costs incurred when an employee erroneously executed an order to buy/sell 1,000 shares, instead of 100 shares, of stock for a client. The opinion letter also explained that it does not matter whether the employer takes the deduction directly from the employee's paycheck or requires the employee to make an out-of-pocket reimbursement. Either method prevents the employee from receiving a salary that is "free and clear" and paid on a "guaranteed" basis.

FLSA Opinion No. 2006-6 explained that employers may require salaried, exempt employees to work a specified number of hours per week and may require them to make up time lost for personal absences of less than one day. Employers may discipline exempt employees for failure to comply with policies or rules concerning work hours, so long as the disciplinary action does not run afoul of the regulations. For example, an employer should not dock an exempt employee's salary for not working required hours or for failing to make up lost time. The opinion letter made a point of noting that failure to work a requisite number of hours or to make up lost work time does not constitute violation of a "workplace conduct rule" for which an employer could suspend an employee for one or more days. "Workplace conduct" does not include workplace performance or attendance issues.

While these opinion letters did not announce a new position from the Department of Labor, they underscored the Department's strict adherence to salary requirements for exempt employees and its narrow view of permissible deductions.

THE IMPORTANCE OF A CLEARLY COMMUNICATED POLICY AND COMPLAINT PROCESS

The best way to prevent the potentially costly consequences of improper salary deductions is to have a written policy that articulates the prohibited deductions and provides a complaint process for notifying the employer of improper deductions. Such a policy can benefit an employer in two important ways. First, the Department of Labor's regulations set forth factors to be considered in determining whether an employer had an actual practice of making improper deductions, and one of the factors is the existence of a policy permitting or prohibiting the deduction at issue. Although it is not dispositive, a policy reflecting compliance can help tilt the scales against finding that there was an actual practice of improper deductions. Second, and more important, the regulations now provide a safe harbor provision for employers with a clearly communicated policy that prohibits improper deductions and includes a complaint mechanism. Employers with such a policy will not lose the exemption if they take the following steps after receiving an employee complaint: reimburse the employee(s) for the improper deductions, make a good faith commitment to comply in the future, and refrain from willfully

violating the policy by continuing to make the improper deductions. The regulations explain that the best evidence of a clearly communicated policy is a written policy distributed to employees.

The Department of Labor has created a sample policy to assist with compliance, and it is available on the Department's web site at:

http://www.dol.gov/esa/regs/compliance/whd/fairpay/fairpayprintpage2.asp?REF=modelPolicy_PF.htm.

Such a policy can be distributed by providing employees with a copy when they are hired, printing the policy in an employee handbook, or posting the policy on the company's Intranet site. In light of the ease with which employers can implement and distribute such a policy, there is no reason for employers not to take advantage of this safe harbor under the revised regulations.

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