Can Indiana Employers Withhold or Claw Back Bonuses and Commissions?

January 13, 2020

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Extra pay may entice employees to sign on, produce income, or continue employment. Perhaps the employer offers signing bonuses to attract the best and brightest. Maybe the company persuades key employees to endure a reorganization or other difficult times by offering a "stay bonus" or hedges its recruiting expenses by offering a retention bonus. Many employers pay commissions as incentives for sales targets or performance bonuses to reward individual or company achievements. Employers may offer a myriad of bonus alternatives: performance-based bonuses, production bonuses, attendance bonuses, holiday bonuses, signing bonuses, relocation bonuses, or retention bonuses.

When employees miss the mark, the company naturally hopes to withhold or pull back the incentives. It stings when employees miss targets or quit before the retention period expires but it *really* hurts when they keep the incentive money too. Managing these incentive programs requires an understanding of the type of payments that can legally be withheld or pulled back, a recognition that payments can become so vested that they can no longer be called back, and a familiarity with lawful techniques to withhold or recoup funds when circumstances warrant.

Of course, the employer must not tread on wage and hour standards by reducing a nonexempt employee's wages below minimum wage and overtime requirements or paying an exempt employee less than the amount required to preserve that exempt status. But assuming wage and hour standards are met, the employer's right to withhold or claw back promised payments depends on whether the incentive payments are considered "earned wages" under state law.

Employers Can Never Withhold or Pull Back "Earned Wages."

In Indiana, "wages" must be paid within ten days after they are earned and cannot be waived or forfeited by the employee. An employer who withholds or attempts to claw back earned "wages" might find itself liable for the wages, plus double damages, and attorney fees under the Indiana Wage Payment Statute. Ind. Code § 22-2-5-2. Indiana courts define "wages" as pay that compensates the employee's labor or service. Ind.Code § 22-2-9-1(b). *Highhouse*, 807 N.E.2d at 740. In other words, wages compensate the employee for work, as contrasted with other payments that depend on contingencies such as customer payments, profitability or productivity of the company or one of its departments, employee attendance or tenure with the company, or commemoration of a holiday or company anniversary. *See, e.g. Brown v. Bucher and Christian Consulting, Inc.*, 87 N.E.3d 22 (2017). The definition of wages does not depend on whether the employer pays its employees with fixed payments or by a payment schedule according to time, task, piece, or commission.

Indiana courts tend to ask four questions to determine whether an employer's promised payments are wages subject to the Wage Payment Statute:

First: Is the payment "linked to a contingency" or factor outside the employee's control, such as company performance, department performance, or collection from the customer? If so, the payments cannot feasibly be determined or paid within ten days, do not lend themselves to the strictures of the Wage Payment Statute, and therefore will generally not be subject to the Wage Payment Statute.

Second: Does the pay relate directly to the employee's work? A bonus linked to the amount of work produced by the employee looks more like wages than a payment based on length of employment or financial success of the company.

Third: Are the wages paid on "a regular periodic basis for regular work done by the employee?" An annual bonus is less likely to be considered a wage than one distributed weekly or bi-weekly with each paycheck.

Fourth: Is the compensation the only form of pay to the employee or is it being paid in addition to wages? If the payment in question is the only type of compensation, it will more likely be deemed wages.

If a payment is a "wage" for which the employee has already performed the work, the employee's right to this compensation cannot be altered by contract or otherwise forfeited by the employee. The employee cannot agree to any deduction from these wages except through a written agreement for specified purposes such as health insurance premiums, union dues, charitable donations, repayment of employee loans, cost of employee uniforms and work tools (up to a specified maximum), judgment garnishments, payroll advances, and vacation advances. And that written agreement or wage assignment must be revocable at any time by the employee.

For employee debts that cannot be recovered through wage assignments, the Indiana employer must give the employee a full paycheck but can ask the employee to pay back loans, pay for goods or services purchased by the employee, or pay for damage to company property. An employer may terminate the employee or file a lawsuit for failure to repay these types of debts.

Vacation Pay May be "Wages" Under Indiana Law.

In some circumstances, unused vacation pay will be wages. Indiana law does not require employers to provide vacation benefits and employers who do offer paid vacation can lawfully establish a policy that employees receive no pay for accrued and unused vacation on termination of employment. *See Indiana Heart Associates, P.C. v. Bahamonde*, 714 N.E.2d 309 (Ind. App. 1999); *Die & Mold, Inc. v. Western*, 448 N.E.2d 44 (Ind. App. 1983). An employer's policy can also specify that employees who quit, are fired "for cause," or fail to give two weeks' notice will receive no payout for unused vacation. In this way, the vacation pay can itself be used to incentivize desired conduct.

But, if the employer has no established policy or contract giving it the right to withhold unused vacation pay upon termination of employment, that vacation pay is deemed to be deferred compensation in lieu of wages. And it must be paid to the employee on the employee's next regular payday after a termination of employment, regardless whether the employee quits voluntarily or is fired. Ind. Code §§ 22-2-5-1 and 22-2-9-1. If the employer had no policy or contract in place when the vacation pay was earned, it cannot withhold the vacation pay when the employee is terminated. Refusing to pay those wages could render an employer liable for the vacation pay, double damages, and attorney fees under the Indiana Wage Payment Statute. Ind. Code § 22-2-5-2.

Employers Can Control Non-Wage Payments Contractually Through Employment Contracts or Written Policies.

For payments that are not earned wages, the prudent employer can impose conditions to reserve the right to withhold or clawback incentive payments from employees who do not keep their end of the bargain. A policy stating that the bonus or commission is earned and paid *after* the employee achieves the goal is safest for the employer and easiest to administer. For example, an employer that pays a retention bonus *after* the retention period does not risk the employee accepting the retention bonus at the beginning of the retention period, leaving before the end of that period, and failing to repay the bonus. Delaying the payment avoids the unpleasant and uncertain task of clawing back the compensation, possibly from an employee without the financial resources to repay it. It also avoids an argument by the employee that money already paid should be deemed earned when it was paid.

But in some cases, a policy that delays payment does not effectively incentivize. A signing bonus, for example, sets the company apart from others to attract highly competitive employees, best and brightest students, or specialized talent. Delaying the payment dilutes its power to attract employees who may need the cash to buffer the risk of a job change or transition from school into the work-world.

Employers may choose to accept the risk of paying the bonus or commission upfront to meet competitive demands in the marketplace or to demonstrate their commitment and goodwill to employees. Those employers might consider one of the following options to reduce their financial risk:

- The employer may make payments subject to a vesting schedule, by which payments vest and are paid incrementally as significant benchmarks occur, such as the closing of the sale, the first anniversary, and the second anniversary. An employer might pay half of the signing bonus at the time of employment and the other half after a year's employment, for example.
- The employer may require that the employee sign a promissory note for the upfront bonus with the stipulation that the bonus be repaid if the employee fails to meet the required conditions. Or the promissory note could be forgiven over time so long as the employee continues employment. These payment structures may have tax consequences for both the employer and the employee but would streamline collection from the wayward employee.

Employers Must Publish a Carefully Drafted Bonus or Commission Policy.

Any bonus or commission policy should be published to employees, either through a written handbook, an employment contract, or a stand-alone bonus or commission agreement. To manage employee expectations and minimize the risk of future disputes, the written policy should:

- Use clear, plain, and precise language so that employees (and possibly judges) can readily understand and apply it.
- Identify when the payment is earned. Specify all conditions, such as fulfilment of performance goals, continued employment, or customer payments, that must be satisfied for the payment to be earned. State directly that an employee who terminates before all conditions are met does not earn the commissions.
- State whether the bonus is discretionary with the employer and, if so, identify any guidelines for the exercise of that discretion. If it is fully discretionary, it should state expressly that the employer has "sole discretion" to determine whether a bonus will be paid, when it will be paid, and in what amount, if at all.
- For non-discretionary bonuses and commissions, provide formulas and examples for calculating the bonus under a variety of scenarios. For commissions that are calculated from "net" income, detail the full the list of expenses that are backed out before commissions are determined.
- Advise whether the bonus or commission is forfeited upon termination of employment. If the payment is to be forfeited, state directly the amount that must be repaid if employment ends before that term expires, the timing for repayment, interest on unpaid funds, and recovery of legal expenses of collection.
- Give the payment date for amounts that become payable during employment (if any) and, if applicable, following termination. NOTE: Deferred payments must comply with Section 409A of the Internal Revenue Code (designed to address financial and tax abuses from certain deferrals of employee compensation) or they may be subject to a 20% excise tax.

EMPLOYER TAKEAWAY: Be aware of the difference between wages and non-wage compensation — withholding wages can have painful consequences. Pay wages within ten days after they're earned or with the next regular paycheck after termination of employment.

For non-wage compensation, understand the company's objective for the incentives and, if it doesn't defeat that objective, create a policy that pays *after* the goal is achieved. If the enticement depends on upfront payment, consider a payment structure that preserves the allure for the employee but reduces the risk to the employer. In all cases, draft and publish a clear, simple, and comprehensive policy, provide examples to show employees how it works, and reserve proper discretion to the employer as intended.