California Employers Association ™

FACT SHEET

Commission Agreements

The Basics

Since January 1, 2013, employers who pay commission to employees performing work in California must have a written commission agreement with employees. (*See* Labor Code 2751.) In short, all California employers must ensure that all commission agreements:

- Include a method for calculating and paying the commissions;
- Are signed by the employee; and
- Are documented with an employee acknowledgement form (receipt of the agreement).

What is a commission?

A "commission" is a payment that varies in proportion to the value or number of units sold. Earned commissions are a form of wages. Once earned, wages cannot be forfeited. The definition of an "earned" commission also affects when a commission must be paid. Earned commissions must be paid with the next regular paycheck. Earned commissions are due with final paychecks just as vacation and paid time off are due to employees who leave the employer with their final pay. It is therefore imperative that the commission agreements explicitly define when the commissions are earned and payable.

What is NOT a commission?

A commission is not a fixed amount of money and must vary based on sales volume. The following types of payments are <u>not</u> considered commissions:

- Short-term productivity bonuses such as are paid to retail clerks.
- Temporary, variable incentive payments that increase, but do not decrease, payment under the written contract.
- Bonus and profit-sharing plans, unless there has been an offer by the employer to pay a fixed percentage of sales or profits as compensation for work to be performed.

Exempt Versus Non Exempt Employees

Overtime calculations for nonexempt employees must include commission payments because commissions are included in the calculation of the regular rate of pay for overtime. Employers need to ensure that nonexempt employees are receiving at least minimum wage for every hour worked (regardless of whether it's by commission, hourly wage, or draw).

- Remember: in order for inside salespeople to be exempt from overtime, they must earn at least 1.5 times the California minimum wage for each hour they work and at least 50% of their weekly income must come from commissions.
    - ➢ Inside salespeople are only exempt from overtime. They are still entitled to meal and rest breaks.
- Outside salespeople spend more than 50% of their time away from your place of business selling a product or service. These positions are exempt from overtime and meal and rest break requirements.

Tips for Commission Agreements

1. Keep it short and sweet. The longer and more confusing the agreement, the harder it will be to enforce.

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2. Determine whether you want an expiration date and, if so, review the agreement prior to its expiration. In the case of an agreement that expires but the employee continues to work under it, the agreement terms will remain in effect until a new agreement is put in place or employment is terminated.
    a. Plan ahead – if the compensation plan and commission arrangement is not working for you anymore, an expiration date will give you an opportunity to make necessary revisions.
    b. If you do not include an expiration date, ensure the at-will nature of employment, which includes revision of the agreement, is clearly stated.
3. In addition to providing the employee a signed copy of the agreement, which is required by law, maintain a copy of the commission agreement and acknowledgment of receipt in employee personnel files so they may be inspected or copied if requested at a later date. Document that a copy was provided to employees as well.
4. Consider attaching a job description.
5. Include the following information if applicable:
    a. Employee's name, title and the date the agreement was signed
    b. Name of a company representative and the date the agreement was signed by this person
    c. Base Salary
    d. Quotas and commission rate calculation: Clearly explain when a commission is earned and give examples, such as "commission is earned by an employee when the company has received payment for the product(s) sold".
    e. Timing of commission payout: When commissions are earned, thus when they are paid out – give examples. The agreement should provide enough detail that the employee can calculate the commission for each sale.
    f. Impact of returns (if applicable) – once a commission is earned, it is income and belongs to the employee so you can't take it back. Prepare agreements with this in mind.
    g. Recoverable Draw: how advances on commission will be handled
        i. Ensure inside salespeople are compensated for their ten minute rest breaks, especially if a draw is taken at a later date.
    h. Impact of termination on commissions – clearly defining when the commission is earned, therefore when the employee must be paid for it, will dictate when employee final pay for commissions must occur.