



# DIRECT DEPOSIT, DEDUCTIONS, AND OTHER PAY ISSUES: WHAT IS REQUIRED? WHAT IS OFF LIMITS?

To pay employees in accordance with federal, state, and local laws, employers should understand rules governing the frequency and timing of pay, direct deposit, deductions, holiday pay, final pay, and recordkeeping. The following is an overview of what employers need to know about these pay-related issues.

## FREQUENCY AND TIMING OF PAY:

While federal law does not regulate how often you must pay employees, several states do regulate frequency of pay. Some states require that employers pay employees weekly or at least twice every month. Additionally, some states require employers to pay employees within a certain timeframe after the end of the pay period (e.g., within 7 days of the end of the pay period).

## DIRECT DEPOSIT:

Employers often give employees the option of receiving their pay by direct deposit. Some states, however, expressly prohibit employers from requiring employees to use direct deposit. In the absence of state restrictions, employers may require that employees receive their pay via direct deposit as long as the employee is free to choose the financial institution to which the funds will be deposited. It is a best practice to obtain and retain written authorization for direct deposit that includes designation of the employee's financial institution of choice.

## DEDUCTIONS:

The Fair Labor Standards Act (FLSA) and related state laws govern the circumstances under which employers are permitted to make pay deductions. These restrictions differ depending on whether the employee is classified as an exempt or non-exempt employee.

### *Non-Exempt Employees*

Generally under the FLSA, if the deduction is primarily for the benefit or convenience of the employer, the deduction must not reduce the employee's pay below the minimum wage or cut into overtime. Items for which deductions may not reduce a non-exempt employee's pay below the highest applicable minimum wage (federal, state, or local) or cut into his or her overtime pay include, but are not limited to:

- Cash shortages;
- Tools used in the employee's work;
- Employer-required uniforms;
- Damages to company property by the employee or any other individual;
- Financial losses due to clients/customers not paying bills; and
- Theft of company property by employees or any other individual.

If a non-exempt employee works overtime, deductions are limited to the amount that could be deducted if the employee had only worked a 40-hour week.

Under the FLSA, employers are generally required to obtain an employee's consent before they subject the employee to a permissible deduction. The agreement must be specific concerning the particular items for which deductions will be made (e.g., company uniforms, equipment, or employee theft), and the employee must know how the amount of the deductions will be determined. It is recommended that you obtain written acknowledgment of any conversations had regarding deductions from pay.

**Note:** Typically, when making deductions for losses or damages, the employer bears the burden of proof.

**IMPORTANT:** Your state law may further limit your ability to deduct from employees' wages. For more information on state requirements, visit the Wage Payment: Deductions from Employee Wages section of HR411's State & Federal Compliance Database.

### *Exempt Employees*

Under the FLSA, exempt employees receive a set salary for each week in which they perform any work. Deductions from an exempt employee's pay are permitted in a few limited circumstances, including:

- When an employee is absent for one or more full days for personal reasons other than sickness or disability;
- For one or more full day absence due to sickness or disability if the deduction is made according to a bona fide plan, policy or practice of providing compensation for salary lost due to illness;
- To offset jury or witness fees, or for temporary military duty pay;
- For penalties imposed in good faith for infractions of safety rules of major significance;
- For unpaid disciplinary suspensions of one or more full days imposed in good faith for workplace conduct infractions;
- In the employee's first or last week of employment if the employee does not work the full week; or
- For unpaid leave taken by the employee under the Family and Medical Leave Act.

## **HOLIDAY PAY:**

For some employers, paying employees for company observed holidays is another area of confusion. As with many pay-related issues, how you handle the situation will generally depend on whether the employee is exempt or non-exempt under the FLSA.

### *When the Company Closes on a Holiday*

Employers generally are not required to pay non-exempt employees when they do not work on a holiday, unless the employer has a policy or practice stating otherwise. However, the rule differs for exempt employees. If exempt employees work any part of the workweek, they must generally still receive their full salary if the company closes on a holiday, regardless of whether the employer offers paid holidays.

### *When Employees Work on a Holiday*

Under federal law, private sector employers are not generally required to provide premium pay for work performed on holidays (other than the overtime premium required for work in excess of 40 hours in a workweek); however, there are exceptions for certain employers in states such as Massachusetts and Rhode Island. Be sure to check your state law to ensure compliance.

### *Payday Falls on a Holiday*

If a scheduled payday falls on a holiday, some states require payment on the preceding business day. Absent such a requirement, employers generally have the option of paying employees on the day before or after the holiday. Before the start of the calendar year, employers should establish their paydays for the year taking into account their holiday schedule.

## **FINAL PAY:**

Under federal law, a departing employee's final paycheck must generally be provided by the next regular payday, but many states have implemented shorter timeframes for providing final pay. At the state level, final pay deadlines generally depend on whether the employee or the employer initiates the separation. For example, California requires that an involuntarily terminated employee's final pay be provided at the time of termination. If an employee resigns and gives less than 72 hours of notice, the employee's final pay must be provided within 72 hours of separation. If the employee gives at least 72 hours of notice that he or she is resigning, final pay is due on the employee's last day.

## Vacation Payout

Generally, federal law does not require employers to pay separated employees for accrued but unused paid time off. However, many states regulate vacation payouts. State laws generally address the issue in one of the following ways:

- Employers must pay employees for accrued, but unused vacation or paid time off at the time of termination;
- Employers must pay employees for accrued, but unused vacation or paid time off unless they have a policy that states such time won't be paid out at termination; or
- Employers must pay employees for accrued, but unused vacation or paid time off at termination only if the employer has promised to do so.

For more information on state requirements, visit the Vacation Pay section of HR411's State & Federal Compliance Database.

## RECORDKEEPING:

The FLSA requires that employers retain pay records for a period of at least 3 years, including:

- Total hours worked each day and workweek;
- Total daily or weekly straight-time earnings;
- Total overtime pay for the workweek;
- Deductions from, or additions to, wages;
- Total wages paid each pay period; and
- Date of payment and the pay period covered by the payment.

**Note:** Payroll records required for tax purposes should be retained for at least 4 years.

## WAGE STATEMENTS:

The FLSA does not require employers to provide wage statements to employees each time they are paid, but a growing number of states have enacted such a requirement. States may also dictate the earnings information that must be included on pay statements (e.g., gross and net earnings, pay periods, straight-time and overtime earnings, deductions, etc.).

**Note:** Wage statements are included as part of RUN Powered by ADP's payroll service. Employers should ensure that employees have access to a printed or electronic copy each time they are paid. Keep in mind, however, electronic delivery may be restricted by state law and in some cases requires advance authorization from the employee.

## CONCLUSION:

Employers should regularly review their pay practices to ensure that employees are paid in accordance with federal, state, and local wage payment laws. State laws often have more stringent pay requirements so employers are encouraged to monitor and review state and local laws, in addition to the FLSA.

This content provides practical information concerning the subject matter covered and is provided with the understanding that ADP is not rendering legal advice or other professional services. ADP does not give legal advice as part of its services. While every effort is made to provide current information, the law changes regularly and laws may vary depending on the state or municipality. This material is made available for informational purposes only and is not a substitute for legal advice or your professional judgment. You should review applicable law in your jurisdiction and consult experienced counsel for legal advice.