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Restructuring Compensation During Economic Challenges

Employers are facing a number of economic and financial challenges. Some employers have considered restructuring their compensation arrangements with employees as an alternative to avoid a reduction in force or layoffs. Restructuring of compensation packages raises a number of issues.

Some restructuring involves simply reducing current compensation. Other types of compensation restructuring involves changes in costs of benefits or benefit accruals. All of these changes must be analyzed both in the context of the applicable employee benefit and tax laws as well as the applicable labor and employment laws. Careful planning can permit a company to restructure a compensation package and avoid potential costly violations.

One popular restructuring option involves reducing current compensation with a promise to pay some or all of the reductions in the future when the employer's financial situation improves. The promised payment of compensation in the future for services currently being provided may constitute non-qualified deferred compensation that requires further consideration of the rules that apply to such arrangements under Section 409A of the Internal Revenue Code. Failure to consider these rules could result in (1) the employees being subject to a 20 percent penalty tax in addition to their income tax on such amounts and (2) the employer being responsible for withholding and reporting on such amounts. Careful planning is necessary to avoid these penalties while still accomplishing the employer's goals.

Restructuring compensation may also implicate employment agreements, collective bargaining agreements and other employment law issues. Where employees are covered by an employment agreement, a collective bargaining agreement, or even where employees are part of a collective bargaining unit that has not yet entered into a collective bargaining agreement, there are impediments to unilaterally reducing wages or benefits.

Outside of the employment agreement or collective bargaining contexts, there are other potential limitations to reducing compensation, such as existing federal and/or state minimum wage laws and the minimum salary levels for employees who qualify for a white-collar exemption. Additionally, there is the risk that reducing for some temporary period an exempt employee's salary and commensurately reducing the employee's hours of work requirement for that period could give rise to an argument that the employee is not really compensated on a "salary basis," but rather is a non-exempt hourly employee (i.e., eligible for overtime payments for hours over 40 worked in a work week). Finally, a reduction of hours by more than 50 percent for each month of a six-month period can potentially trigger the notification duty of the Worker Adjustment Retraining and Notification Act ("WARN"), if the requisite number of employees are affected.

Before making any temporary reductions in an employee's salary, benefits or hours, you should consult with employment counsel in order to avoid any unforeseen adverse consequences.

If you have any questions regarding the foregoing, please contact one of the attorneys listed below.

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