Checklist of Factors to Consider When Creating Sales Commission Agreements

Disputes over sales commission arrangements have led to confusion, hurt feelings, turnover and lawsuits. Here's a checklist to consider when creating sales commission agreements.

1. Make sure the agreement aligns with corporate strategy. For example, is the focus to create new accounts, maintain the profitability of sales, launch specific products, up-sell existing customers, etc.?
2. Sales commission agreements only apply to people who are making sales. Everything else will be considered a bonus or incentive agreement, which we won't be discussing here. Of course, you can add incentives and bonuses to the sales compensation mix.
3. When establishing sales commissions, consider the following factors
   - Quality of customer or client.
   - Cost of sale.
   - Profitability of sale/account.
   - Lifetime value of the customer or client.
   - Ongoing support of customers or clients.
4. Establish performance requirements/quotas for activities and/or outcomes. For example, you may require people to make a minimum number of calls, appointments, proposals, etc. You may also have quotas based on the number of new customers, total sales, referrals, etc.
5. Define geography/territorial limits.
6. Define the dollar limits for when approvals are required for sales.
7. Define when a sale is "earned." Is it at the time of invoicing, delivery, or payment?
8. Watch for the legalities surrounding offsets for returns, etc. not directly attributed to that salesperson.
9. Use typical examples when defining sales terms and commission formulas.
10. Be clear about any offsets against draws. How long will negative draws carry over? For example, it may carry over indefinitely until all caught up with commissions earned.
11. Since every workweek stands alone for purposes of minimum wage and overtime computation, any draw can be recovered only from commissions earned in that work week.
12. Define what happens to commissions earned, but not paid, at the time of termination. Usually, if the salesperson has completed everything they need to do to earn the sale, then they are entitled to a commission post-termination, unless there's ongoing service or support obligation.
13. Will they be treated as an employee or independent contractor? According to the IRS "control" remains the most important factor. Facts that provide evidence of the degree of control and independence fall into three categories:

- Behavioral: Does the company control or have the right to control what the salesperson does and how the salesperson does his or her job?
- Financial: Are the business aspects of the salesperson's job controlled by the payer? (These include things like how the salesperson is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
- Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

Get this wrong and you can expose yourself to extensive violations, taxes and penalties.

14. Understand the legal obligations surrounding inside sales and outside sales when it comes to overtime exemptions and minimum wage requirements. Many employers erroneously assume that employees qualify for the inside sales exemption merely by engaging in sales from the employer's office. Under federal law, the inside sales exemption applies only to employees who (a) earn more than 150% of the minimum wage, (b) derive at least 50% of their income from commissions, and (c) work in the "retail and service industry." Employers are engaged in the "retail and service industry" within the meaning of the Fair Labor Standards Act if they derive at least 75% of their annual sales revenue from goods or services, not for resale and are recognized as a retail or service establishment in their industry.

15. Under California law, the inside sales exemption is applicable only if (a) the employee earns more than 150% of the minimum wage, (b) more than 50% of the employee's compensation is derived from commissions, and (c) the employee works in the mercantile industry (covered by Wage Order 7) or in a professional, technical, clerical, mechanical or similar occupation (covered by Wage Order 4).

16. The outside sales exemption is specifically limited to those employees who customarily and regularly work more than half the working time away from the employer's place of business selling tangible or intangible items or obtaining orders or contracts for products, services, or use of facilities.

17. All commissions must be paid within a reasonable time depending on the transactions involved.

18. When a salesperson is terminated, and the employee has been prevented from completing the duties involved in an eventual sale; they may be able to recover all or a pro rata share of the commissions.

19. Any non-competition/non-solicitation language. Note: not allowed in CA.

Sales Commission Agreements can be complex arrangements. I encourage you to work with an attorney to develop a template that can be used at your company. For more info on the legal concerns re status go to:

www.dol.gov/whd/workers/misclassification/

www.irs.gov/pub/irs-pdf/p1779.pdf

www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee

www.dol.gov/whd/regs/compliance/whdfs20.htm

www.dol.gov/whd/overtime/fs17f_outsidesales.pdf

www.dir.ca.gov/dlse/FAQ_OvertimeExemptions.htm

Don Phin, Esq. is a veteran employment lawyer and also a highly rated presenter on the emotional intelligence required to be great at sales. To learn more go to www.donphin.com