



PROPER PLANNING FOR VACATION PAY CAN MINIMIZE LEGAL HEADACHES

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Among the more frequent claims filed with the Wisconsin Labor Standards Bureau are assertions by departing employees that they are entitled to additional pay for unused vacation time. The law regarding vacation pay is often misunderstood by employers and employees alike. These misunderstandings can cause unnecessary animosity and poor morale as well as significant legal costs and unexpected financial liabilities. The solution lies in proper and thorough crafting of written vacation policies and clear communication of those policies at the time of hire and periodically during employment. This article summarizes the law on vacation policies and describes factors that should be addressed in creating a valid policy.

The Law: Neither state nor federal law requires an employer to provide any vacation time to its employees. A guide published by the Wisconsin Labor Standards Bureau states:

“Employers are not required by Wisconsin law to grant vacations to their workers, whether with pay or without. Such matters are determined entirely by written or unwritten agreements between the employer and the employee.”

One important feature of this rule is that employers have the flexibility to create the “contractual” terms of vacation benefits, which is a valuable legal tool. However, the rule also provides that a vacation benefit can be created by an “unwritten” agreement, or practice, which can create inadvertent financial and legal exposures if an employer is not careful.

The definition of “wages” under Chapter 109 of the Wisconsin Statutes includes “vacation pay”, meaning that employees covered by that statute can pursue, free of charge, claims for vacation pay as well as for unpaid wages. Among other things, Chapter 109, with few exceptions, requires that all wages, including “vacation pay”, be paid to departing employees on their next regular scheduled pay period following the end of their employment. Significant penalties exist for employers who fail to pay the proper amount of vacation pay on a timely basis. Free access to Chapter 109, and the availability of enhanced penalties, often encourage disgruntled ex-employees to pursue claims for vacation pay if the policy is not properly drafted or properly administered.

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Vacation Pay Policies and Practices: As indicated, Wisconsin law allows an employer freedom to create vacation pay policies, as long as the employee is informed of the policies and agrees, either in writing (most commonly by signing an offer letter or an Employee Handbook acknowledgment) or by conduct (by continuing employment after being advised of the policy). Thus, employers should create policies that meet their operational needs, while avoiding ambiguities and while providing a valuable benefit from the employee's viewpoint. The following is a checklist of factors that should be considered in creating a vacation pay policy:

- **Payment at the end of employment:** The most contested issue involving vacation pay is whether the employee is entitled to receive payment for unused vacation pay at the end of employment. Both employers and employees often mistakenly believe that this is required by law. It is not. However, if the employer wishes to avoid a legal claim on this issue, it should clearly identify whether unused vacation pay is paid at the end of employment and if so, under what conditions.
- **Conditions to receipt of Unused Vacation Pay:** Wisconsin allows employers to place reasonable restrictions on the payment of unused vacation pay, provided that those conditions are identified and agreed upon before the employee's departure (and before the employee's accrual of pay). For example, payment of unused vacation pay could be conditioned upon the employee's completion of an exit interview, upon a voluntary versus involuntary departure, upon execution of a release of claims, upon returning all company property, upon providing advance notice of a resignation, or upon similar restrictions. Such restrictions can be a valuable tool in facilitating a structured exit from employment and ensuring that the Company's rights are respected during that process.
- **Definition of "earned" or "accrued" vacation:** Another item that must be defined is how vacation pay is "earned" or "accrued" (and whether these two terms are synonymous and if not, what is the difference in meaning). Some policies require the employee to work the entire year before the vacation allotment is "earned" or "accrued", with the vacation to be used in the following year. Others indicate that vacation is "earned" or "accrued" at the beginning of the year, while others provide that vacation is "earned" or "accrued" as the year progresses. The definition of "earned" or "accrued" vacation time is a key factor in the amount of vacation pay that may be owed to an employee at the end of their employment, thus great care should be taken in ensuring that a clear explanation is contained in the policy.
- **Accrual during non-work hours:** Vacation policies should address whether vacation hours continue to accrue during non-work periods. For example, if an employee is

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granted a leave of absence, or is off work on a short term or long term disability policy, will they continue to accrue additional vacation during these periods?

- **Annual carryover:** Another factor that should be addressed is how much unused vacation, if any, is allowed to be carried over from one year to the next. The failure to define limits to annual carryover, especially when combined with a lax vacation tracking system, can lead to unexpected financial liabilities to departing employees. Employers prohibiting carryover, particularly those with calendar vacation years, may experience high usage at the end of the year, which may impact operations, as well as negative morale from employees who are unable to use their vacation time. On the other hand, employers who allow carryover may find themselves facing significant long term financial liabilities. Some employers allow limited carryovers for short term period with prior permission, while others pay employees for unused vacation at the end of the year.
- **Calendar vs. anniversary vacation year:** Employers also need to decide whether to maintain a calendar vs. anniversary vacation year. Calendar years allow all employees to be on the same vacation schedule, which may be easier for yearly scheduling and planning as well as for continuous accrual tracking, particularly for automated timekeeping and payroll systems. Anniversary years may be easier to track initially, unless a specific formula is used for the initial year of hire. Employers who switch from anniversary to calendar years, or vice versa, need to take special steps to ensure that vacation is not lost or overpaid in the year of transfer.
- **First year vacation allowance:** Employers should define an employee's vacation "rights" during their first year of employment. For example, will they be allowed to use any vacation during their first year? Compelling an employee to serve a year without vacation may be perceived as a harsh rule by the new employee, and may result in fatigue and low productivity. If they are allowed to take vacation, what amount will they be able to use? This may depend upon the employer's definition of "accrual" and may include a prorate allotment based upon their month of hire in a calendar-based vacation year system.
- **"Borrowed" or "advanced use" vacation:** Employers should determine procedures for "borrowing" or advanced use of vacation before the vacation is "earned". For example, if the policy provides that vacation accrues throughout the year (or is not earned until the end of the year), will an employee be entitled to take vacation early in the year, before it is fully earned? If so, and the employee leaves during the year before the consumed vacation is fully earned, will the employee be required to pay it back? Will the employer seek to withhold this amount from the employee's last paycheck? These questions must be resolved during the creation of the policy.

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Moreover, if there is a requirement for payback of unearned vacation that is used, or if the amount of unearned vacation is deducted from the last paycheck, a signed, written consent must be obtained from the employee.

- **Scheduling:** The process for scheduling vacations should be defined, including, for example, the length of prior notice and how priorities for vacation will be handled within a department to ensure that adequate staffing exists. If a pure seniority system is adopted, will that mean that the most senior employees will always receive first picks for the most desirable vacation slots (holiday season, deer hunting, prime summer slots, etc) or will some rotation be used? Will “unscheduled” vacation be allowed, or only prior scheduled vacations? Vacation policies should always indicate that the employer has the right to cancel or modify vacation requests in its sole discretion to meet business needs.
- **Tracking:** An often overlooked feature of vacation policies is proper tracking systems. This issue is particularly important if the employer allows vacation carryover from year to year. Employees who complete their own time cards must be required to accurately track any vacation use. Tracking procedures are especially challenging for salaried or commissioned employees who may not be reporting their hours of work on a daily basis. Thus, the “honor” system is often adopted by default, which can occasionally lead to disputes over the amount of unused vacation by these categories of employees.
- **Commissioned employees:** A related issue relates to the administration of vacation policies to commissioned employees such as outside sales staff. Will these employees be provided “paid” vacation like other employees? If so, how will the “pay” for these employees be calculated? These questions should be defined in the vacation policy as well as in the commission policies.
- **Vacation intervals:** The vacation policy should define the minimum amount of vacation that employees will be allowed to take as scheduled or unscheduled vacation. For example, will employees be able to take ½ day vacations, will they be able to take 1 hour of vacation to, for example, attend a medical appointment, or will only full day vacations be allowed?
- **Vacation Pay:** If an employee normally works overtime or has incentives, commissions or other amounts added to their base pay, what amount will they receive for vacation pay? This should be answered in the policy. The policy should also indicate whether it is possible for the employee to “compound” their vacation pay with any other pay (for example, receipt of workers compensation or short term disability benefits).

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- **Length of a vacation “day”:** Vacation policies should also define vacation in terms of “hours” or, if vacation is awarded by “days”, then the term “day” should be defined. For example, some employees may commonly work 8 hour days, while some employees may average more than 8 hour days or be assigned to 10 hour or 12 hours shifts. The policy should define how it will work for each category of employee.
- **Part time employees:** Vacation policies should indicate whether part time employees are eligible for vacation and if so, in what amount. Failure to provide pro-rated vacation to part time employees may create morale issues or an impediment to hiring quality part time staff.
- **Compelled Vacation use:** Vacation policies should define whether there are situations in which the employer may compel vacation use. For example, during periods of federal FMLA use, employers have the right to force employees to use vacation in most circumstances. Likewise, some employers may wish to reserve the right to assign vacation to employees with attendance problems as part of a deterrent.
- **Annual allowance:** Vacation policies should also define the annual allowance of vacation and whether this allowance can be modified by the employer in instances, for example, of transfers to other divisions or departments or as part of a corrective action process.
- **Employees in other states:** Wisconsin employers who have employees in other states need to review the wage hour laws in those other states to ensure that their vacation policies comply with those laws. There are a number of states which have vacation pay laws that conflict with the Wisconsin rules, so care must be taken to account for those differences for out of state employees.
- **Deviations from policy:** Because Wisconsin allows vacation policies to be written or unwritten, employers should be careful not to deviate from their written policies or they may expose themselves to an argument that they have created a new, unwritten policy applicable to all employees. If a deviation is created, the company should describe the deviation in a written memo and confirm that the deviation is a one-time event only and is not intended to change the written policy.
- **New Hire Deviations.** Occasionally, in order to attract new hires, an employer will agree to allow the new employee to receive more vacation than the standard vacation policy provides. In these circumstances, the offer letter should specifically address first year usage. For example, what will occur if the employee leaves the company during

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that first year, will they be paid for the full allotment of vacation agreed upon in the offer letter?

- **Employee Acknowledgments:** Employers must be able to demonstrate that the employee understood and agreed to the vacation policy and any modification to the policy. This can be best accomplished by a written acknowledgment signed by the employee. This should be obtained when the employee is hired, and when any revision to the policy occurs.
- **Holidays or illnesses during vacation:** Vacation policies should address whether vacation time will be assessed when a paid holiday or an illness occurs during the vacation, and/or whether double pay (vacation/sick pay and holiday pay) is available during such occasions.
- **Paid Time Off policies:** Some employers have begun to combine vacation pay, paid sick leave, paid holidays or other paid leave into one “Paid Time Off” (“PTO”) policy. There are both advantages and disadvantages to this system. Such a system may be easier to administer than separate policies, and may avoid the need for medical excuses to obtain paid sick leave. However, employees may use up their PTO as vacation days and have no available time to cover unforeseen sicknesses, creating problems for employers and possibly more time off than existed under the original policies. PTO also is easier for an employee to “substitute” during federal FMLA leave, which may encourage more FMLA use in some circumstances.
- **Tracking vacation for overtime purposes:** Either within the vacation policy or in its overtime policy an employer should determine whether vacation days will be counted toward the 40 hour workweek threshold for overtime purposes. Neither state nor federal law require vacation hours to be included as “hours worked” for overtime calculations, but employees may fail to understand this rule, and the policy may not be applied consistently if not expressed in writing.

In summary, there are many issues relating to vacation pay that can become grounds for a legal dispute if not addressed in the policy. Vacation pay disputes are a frequent occurrence and can be costly for an employer to defend, and costly to pay if the employee succeeds in their claim. Fortunately, Wisconsin law allows great latitude for employers to create favorable provisions in their vacation policies. Human Resource professionals should take advantage of these rights and create well-defined, thorough policies and provide them to employees in exchange for written acknowledgements. Because of the risks relating to vacation pay, employers are encouraged to have their policies and any revisions reviewed by legal counsel prior to distribution.