

## California can no longer ignore federal classification rules

By Hilary Weddell

Last month, the U.S. Department of Labor announced its highly anticipated federal overtime rule under the Fair Labor Standards Act (FLSA). The new rule updates the minimum salary requirement for employees to be considered exempt from the FLSA's overtime provisions.

Until recently, the federal rule governing classification of employees as exempt was generally irrelevant to California employers because California's salary-basis test exceeded federal standards. The new federal rule is now very important, as the new federal salary threshold is more than California's minimum. Employers must comply with the law that gives the most protection to employees, so employers must ensure exempt employees are paid at least the higher amount of the two.

### Salary-Basis Test Under California Law

California's test for whether an employee is properly classified as exempt is tied to the state's minimum wage. The California salary test, codified in California Labor Code Section 515, requires that an exempt employee earn at least two times the state minimum wage for full-time employment. Full-time employment is defined as 40 hours per week, and thus the minimum wage threshold cannot be prorated if an employee works only part-time.

On Jan. 1, the California minimum wage was increased to \$10 per hour. Thus, the current minimum salary for an exempt employee under California law is \$800 per week ( $\$10 \times 2 \times 40$ ), or \$41,600 per year.

### Minimum Salary Threshold Under Federal Law

Since 2004, the federal regulations have required a minimum salary of \$455 a week, or \$23,660 a year, for employees exempt from the FLSA's requirements. The new rule, which takes effect Dec. 1, raises the min-

imum salary threshold to \$913 per week, or \$47,476 per year. To ensure that the salary threshold will not become outdated again, the rule includes a provision automatically updating the amount every three years, beginning Jan. 1, 2020.

The new rule also increases the annual compensation requirement for the special exemption for "highly-compensated" employees who meet a minimum duties test from \$100,000 per year to \$134,004 per year. California law does not contain a special rule for "highly-compensated" workers.

There are other provisions of the new federal rule that employers should analyze, including a provision that allows employers to use non-discretionary bonuses and incentive payments to satisfy up to 10 percent

and is entitled to overtime for all hours worked in excess of 40 hours in a week or eight hours in a day. Although it is perfectly legal to pay nonexempt employees a set salary as opposed to an hourly rate, it is generally not recommended as it creates complications when calculating the regular rate of pay for overtime purposes, or when making deductions to the weekly salary to account for employee absences. Employers may also choose to reevaluate the workloads of employees previously classified as exempt and hire additional workers as needed to reduce the number of overtime hours worked by the newly reclassified employees.

This is an area that is not static, so employers should pay close attention to the salaries of exempt employees to be sure they stay in step with Cali-

Employee morale is often a concern when reclassifying employees as many workers feel the "exempt" status is prestigious and newly non-exempt employees may feel like they are being demoted when they are asked to start punching a time clock. However, employers should not just bury their heads in the sand. Misclassification of workers as exempt is one of the most litigated issues in the employment realm, and some of the largest awards of back pay by the courts stem from misclassification as the premiums and penalties may quickly add up.

### Opportunity for Audit

Remember, to qualify for the exemption, employees must not only be paid a certain amount, but must also meet certain tests regarding their job duties. This change in the law provides employers with an opportunity to review their exempt employees' job duties and ensure that they are properly classified as exempt. If an employee is classified as exempt but does not meet the duties test, the employer must convert the employee from exempt to nonexempt. Such a conversion may raise red flags, alerting the employee that he or she may have been previously misclassified and thus potentially have a claim for unpaid overtime or meal and rest-break premiums. The change in the federal salary test, however, provides employers with a window of opportunity to audit their classifications and make any necessary changes

Until recently, the federal rule governing classification of employees as exempt was generally irrelevant to California employers because California's salary-basis test exceeded federal standards.

of the new salary threshold. In order for bonuses to be credited toward the salary minimum, they must be paid at least quarterly. California law does not contain any similar provision.

### Compliance Options for California Employers

Employers who have employees classified as exempt but whose salary levels are below the new federal minimum level have a number of options for compliance with the new rule. Employers who would like to maintain an employee's exempt status must increase the employee's salary to an amount greater than that required by the new federal regulations (\$47,476 per year).

Alternatively, the employer may convert the employee to nonexempt. The employer may continue to pay the employee a set salary, or a new hourly rate may be established. Either way, the nonexempt employee must track and record all time worked,

California minimum-wage increases and increases to the federal threshold. Gov. Jerry Brown recently signed new legislation that will increase California's minimum wage starting Jan. 1, 2017, with annual increases until reaching \$15 an hour in 2022. When California's minimum wage hits \$12 an hour in 2020, the minimum yearly salary for exempt employees under California law will be \$49,920 per year, finally surpassing the new federal requirement. However, remember that 2020 is also the year the federal threshold will automatically increase. The amount of the federal increase is not known at this time as it will be updated to maintain it at the 40th percentile of weekly earnings of full-time salaried workers in the lowest wage Census Region (currently the South). Therefore, until at least 2020, but possibly thereafter, the federal minimum salary for exempt employees will be higher than that required by California law.

**Hilary Weddell** is an attorney with *McManis Faulkner*, where she focuses on employment law. She may be reached at (408) 279-8700 or [hweddell@mcmanislaw.com](mailto:hweddell@mcmanislaw.com).



HILARY WEDDELL  
McManis Faulkner