Rising Inflation Will Lead to California Minimum Wage Hike in 2023: 5 Key Takeaways for Employers

Insights
7.01.22

California leads the nation in the call for higher minimum wages, emanating from the agricultural fields and reaching nearly every industry. Raising wages has been a major focus in the California Legislature – as well as in federal and state courts – and employers in the state will likely see a higher wage hike than expected next year. The minimum wage was supposed to reach $15 an hour for all employers in the Golden State by January 1, 2023, but Governor Gavin Newsom recently projected that the rate will rise to $15.50 due to record-high inflation. Combined with labor shortages and supply chain disruptions, the costs associated with a higher minimum wage will undeniably impact businesses in 2023. Increased wages mean higher employer-side payroll tax obligations and other related costs and will further strain businesses that are already reeling from the impact of the COVID-19 pandemic and the current economic environment. What are the five biggest takeaways for California employers given these critical developments?

1. **Small Businesses Face Substantial Increase**

   California's current minimum wage law, which was passed in 2016, aimed to raise the minimum wage in phases until it reached $15 an hour for all employers in 2023. The law specifies, however, that if inflation increases by more than 7% between fiscal years 2021 and 2022 (which ends on June 30), then the state's minimum wage shall increase by 3.5%. The California Department of Finance has projected that inflation will exceed 7.6% during this time, thereby triggering the increase in minimum wage effective January 1, 2023.

   If the inflation rate exceeds the 7% threshold as expected, the $15.50 minimum wage will apply to all California workers. Although this may be a welcome change for an estimated 3 million workers in California who are currently paid minimum wage, it will also directly impact the labor costs for businesses across the state regardless of employer size and will likely hurt small employers the most.

   Currently, the state's minimum wage law is divided into tiers depending on the size of the employer. Effective January 1, 2022, employers with 25 or fewer employees must pay $14.00 minimum wage, whereas employers with 26 or more employees must pay $15.00 minimum wage. However, the 2023 minimum wage increase will apply to all employers in the state, without a distinction between small and large employers as defined previously.

Therefore, small employers will have to increase minimum wages by $1.50 per hour starting in 2023, compared to employers with 26 or more employees, which will face only a $0.50 increase to their current minimum wage requirement. So, the relative impact of this increase will be most significant for small employers.

2. **Local Minimum Wage Ordinances Will Also Increase**

   The prevailing inflationary trends have also resulted in higher local minimum wages for residents in certain geographical areas. On July 1, multiple local minimum wage hikes went into effect across California. Many local jurisdictions throughout the state have their own minimum wage requirements that are higher than the state's minimum wage. Notably, these local minimum wage rates do not impact the minimum salary and pay requirements for most exempt employees. However, they generally apply to any non-exempt employee working within the geographic boundaries of the local jurisdiction, regardless of where a company's offices or headquarters are located. Employers should stay updated on local minimum wage ordinances in addition to the state minimum wage rates, in order to ensure compliance with all applicable minimum wage requirements.

3. **California Employers May See Additional Minimum Wage Hikes**

   Worker advocates across California are seeking to further increase the state's minimum wage to $18.00 per hour. Proponents of the Living Wage Act of 2022 have gathered more than a million signatures in an effort to put a measure on the ballot in November 2022 that would allow voters to decide whether or not to make the change. This measure would increase the state's minimum wage by $1.00 each year starting in 2023 and would follow the same tiered approach as the state's current minimum wage law. Under this measure, employers with 26 or more employees would be required to pay the $18.00 minimum wage by 2025, and employers with 25 or fewer employees would be required to pay the $18.00 minimum wage by 2026.

   We're still waiting to find out if the Living Wage Act has collected enough certified signatures to appear on the November ballot.

4. **Federal Minimum Wage is Unlikely to Rise Anytime Soon**

   California is not the only state facing pressure to increase the minimum wage. Twenty-one states rolled out wage hikes on January 1 this year, and 11 states are scheduled to increase their minimum wage rates in 2023 (Alaska, Arizona, Colorado, Hawaii, Maine, Minnesota, Montana, Ohio, South Dakota, Vermont, and Washington). Additionally, many local jurisdictions across the country are implementing their own wage rules.

   Notably, 20 states currently follow the federal minimum wage, which was last updated in 2009 and remains $7.25 an hour (approximately $15,000 a year for a full-time employee). Although President Biden has pushed for a $15 federal minimum wage, there does not appear to be Congressional consensus to increase the federal rate in the near future.

You should expect more efforts from worker advocacy groups to increase the minimum wage on a national scale. Among other developments, the IRS has recognized the impact of inflation on consumers and has recently increased the optional standard mileage rate for business travel to 62.5 cents per mile starting July 1. The IRS also announced inflation-adjusted increases for 2023 increases for health care savings accounts and high-deductible healthcare plans.

5. **Minimum Wage Increases Have Additional Pay Implications**

   A minimum wage hike in California affects other key wage thresholds, including the following:

   - Overtime and double-time rates. As employers continue to face labor shortages, many employees are working longer hours and more overtime to bridge the gap. Many employers are also offering recruitment and retention bonuses to attract and retain employees in light of the competitive job market. With the increase in minimum wage, employers should prepare for proportional increases to overtime and double-time rates of pay as well. In 2023, the minimum rate for overtime would be $23.25 per hour and $31.00 per hour for double-time (based on a $15.50 minimum wage). Additionally, nondiscretionary bonuses and other incentive compensation paid to employees must be factored into employees' regular rates of pay for overtime purposes, further increasing the costs for employee overtime and double-time hours. Therefore, you should review your practices to ensure you are calculating employees' regular rates of pay correctly.
   - Minimum salary requirement for "white-collar" exemptions. Employees who are exempt from overtime and meal and rest period requirements under the professional, administrative, or executive exemptions must be paid at least two times the state minimum wage to qualify for the exemption. The $15.50 minimum wage increase means that the minimum salary for white-collar overtime exemptions in California will increase to $64,480 annually or $1,240 weekly ($15.50 x 2 x 40 hours).
   - Minimum hourly earnings for exempt commission salespeople. Certain salespeople who primarily receive commissions will be exempt from overtime under the commissioned salesperson exemption (applicable only to Wage Orders 4 and 7) if they earn more than 1.5 times the state minimum wage. The minimum wage increase means that starting in 2023, these employees will need to earn more than $23.25 per hour, in addition to satisfying all other requirements, in order to qualify for the exemption.
   - Increase in tool-pay. Employees that are required to supply and maintain their own personal hand tools to perform their job must be paid California's "tool wage," which is equivalent to double the state minimum wage, or $31.00 per hour, starting in 2023.
   - Non-sales activity and rest-period pay. Employees that are paid commissions or on a piece-rate basis will also need to be paid at least the increased minimum wage rate for non-sales activity and rest period time. Employers may need to review employee compensation plans to determine whether the pay plans need to be updated or revised to be consistent with the increased minimum wage rate.

- Split-shift premiums. The minimum wage section of the Wage Orders provides that employees who work split shifts are entitled to an extra hour of pay at the minimum wage (although employees paid higher than the minimum wage may receive credits toward the one-hour premium).
- Meal and lodging credits. The Wage Orders provide for certain minimum-wage meal and lodging credits that will change when the minimum wage increases.

How Should Employers Prepare for Minimum Wage Increases?

With minimum-wage increases on the horizon, employers should forecast these changes in their fiscal planning and determine the potential impact on business operations in order to plan and prepare for these changes in the near future. Among other steps, many employers will likely increase consumer prices to cover higher labor expenses. The increase in minimum wage may also put pressure on employers to increase wage rates across the organization, not just for those who will benefit from the minimum wage increase. This may be especially true for employees who are already being paid in the $20 to $25 range, who may expect or demand a pay raise in light of the increase to minimum wage for less skilled or experienced workers.

You should consider auditing your pay practices and reviewing employee compensation plans to ensure compliance with current wage and hour requirements and prepare for any updates needed to your policies and practices well in advance of January 1, 2023, effective date (or July 1, 2022, in some localities) for minimum wage increases. With wages continuing to rise, the potential exposure and liability for noncompliant employment practices will rise as well. Employers that may be dealing with lawsuits or complaints related to their pay practices should seek creative solutions on how to resolve wage and hour claims.

Conclusion

Fisher Phillips is here to help employers navigate these tumultuous times. Because of the far-reaching implications of a minimum-wage increase, now is the time to act, as 2022 continues to be a challenging year for businesses and employers. Make sure you are subscribed to Fisher Phillips' Insight System to get the most up-to-date information. Please reach out to your Fisher Phillips attorney, the authors of this Insight, or any attorney in our California offices with any questions or to discuss any of the topics addressed above.

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