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5 COSTLY EMPLOYEE CLASSIFICATION MISTAKES CALIFORNIA EMPLOYERS MAKE AND HOW TO AVOID THEM: YOUR 5-STEP ACTION PLAN

Insights
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5 Costly Employee Classification Mistakes California Employers Make and How to Avoid Them: Your 5-Step Action Plan

The federal government is working on business-friendly changes to rules covering independent contractor arrangements and overtime pay requirements, but California employers may not reap the benefits. Employers in the Golden State are subject to labor and employment rules that are stricter or more protective for employees than federal laws, and navigating compliance can be tricky. This Insight will walk you through everything you need to know about recent federal wage and hour changes, the unique rules that impact your California operations, and your five-step action plan to avoid costly mistakes.

Quick Federal Recap

There are two big rules brewing from the US Department of Labor (DOL) that employers across the country should be tracking:

- The DOL is advancing a rule to modernize its approach to determining whether a worker is an **independent contractor** or employee under federal wage laws. If finalized, [the proposal](#) from the Trump administration will make it easier for businesses to engage with independent contractors – including freelancers and gig workers – while providing clearer lines on what aspects of the

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Aaron Cargain

Partner

[415.490.9046](#)

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working relationship can trigger employee status. ([Read our full coverage on the proposal here.](#))

- And earlier this month, the agency officially removed a Biden-era **overtime rule** from its regulations. The rule, which had already been struck down in court, would have raised the earnings threshold to nearly \$60K for certain executive, administrative, and professional employees to be exempt from overtime pay requirements. The DOL's recent move affirms the \$35K salary threshold that had been implemented by the first Trump administration in 2019. ([Read our full coverage of the amendment here.](#))

The moves were welcome news for the business community – but may not offer relief for companies subject to California's rules. Read on for the top five employee classification mistakes California employers make and how you can avoid them.

1. Failing to Quantify Exempt Duties

Employees generally must be paid 1.5 times their regular rate for hours worked beyond 40 in a workweek, but the Fair Labor Standards Act (FLSA) has several exemptions from overtime pay requirements, including for executive, administrative, and professional (EAP) positions. Federal rules outline certain duties individuals must perform to qualify for those exemptions.

California also uses the EAP categories, but there are some key differences. For example, while federal and California law each require exempt work to be the employee's primary duties, federal law doesn't set a fixed amount of time for those duties. California, on the other hand, generally requires that the employee spend more than 50% of their time on exempt work to qualify for the EAP exemptions.

So, a position could be exempt from overtime under federal law but considered overtime eligible under California law, and also subject to California's meal-and-rest period requirements. California's Wage Orders and authority interpreting them emphasize that California's duties and salary tests, which are stringent than the federal tests, must be satisfied.

Employer Impact: Employers that fail to account for this "primary duty" nuance could unintentionally misclassify employees as exempt under California law and be on the

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hook for unpaid overtime wages, meal-and-rest period premiums, and related penalties.

2. Ignoring Adjustments to the State Minimum Wage

Here's another key difference under the EAP exemptions: under federal law, these white-collar exemptions generally require a salary of at least \$684 per week. California, however, ties the threshold to the state minimum wage and requires exempt employees to earn at least two times the state minimum wage for full-time work.

That means California's minimum exempt salary changes whenever the state minimum wage changes. For example, California's statewide minimum wage was raised to \$16.90 in 2026. Therefore, the exempt salary threshold for EAP exempt positions also increased to \$70,304, based on a 40-hour work week.

Employer Impact: California's statewide minimum wage regularly increases, typically in January. You'll need to monitor these changes even if you don't employ minimum wage workers to ensure compliance with the exempt salary threshold.

3. Misclassifying Employees as Outside Sales Professionals

California's **outside sales exemption** also has some important distinctions from federal law. As with the EAP exemptions, rather than simply focusing on the employee's primary duties, the outside sales exemption is quantitative and applies to an employee who "customarily and regularly works **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."

Employer Impact: Relying solely on job titles or general sales responsibilities is a liability risk, and employers may face misclassification claims for the failure to pay minimum wage, unpaid overtime, unpaid meal-and-rest period premiums, and related penalties.

4. Misunderstanding California's Unique Exemptions

The Golden State has additional exemptions to overtime pay that differ from the federal level. For example, California's wage-order guidance says inside sales professionals who work in **professional, technical, clerical, mechanical, and similar occupations**, as well as certain positions in the **mercantile industry** are exempt from overtime when their earnings exceed 1.5 times the minimum wage and **commissions** make up more than half of their pay.

Employer Impact: The calculations can be complicated. It's best to regularly audit your commission structures and pay data to ensure compliance, because misclassifying employees under these rules can result in costly litigation.

5. Using the Wrong Test to Determine Independent Contractor Status

Up until this point we've been talking about exemptions from minimum wage and overtime pay. But independent contractor misclassification is also a major compliance challenge in California.

When it comes to determining whether an independent contractor is in business for themselves or an employee of a certain entity, the federal government and California use dramatically different tests.

California has a much stricter approach compared to the federal DOL, which presumes a worker is an **employee** unless a hiring entity can meet three factors.

California's ABC test requires the employer to prove the worker is:

- free from control and direction;
- performs work outside the company's usual course of business; and
- customarily in an independently established trade or business.

But the analysis doesn't stop there. California's worker classification test has carveouts and exemptions for certain industries and positions, like real estate agents, physicians, accountants, and engineers, among other roles. Those

exemptions allow state agencies and courts to apply a more flexible common law test, so be sure to contact legal counsel to determine whether your industry may be subject to one of these exemptions.

By comparison, the federal DOL uses a broader “economic realities” analysis that looks at multiple factors in the whole working relationship. Under federal law, the DOL’s approach asks whether the worker is economically dependent on the business or operating their own business, using a multi-factor totality-of-the-circumstances test.

The Trump administration recently proposed a rule that is expected to generally make it easier for businesses to hire contractors and reduce misclassification risks. The test proposed by the DOL’s Wage and Hour Division considers five factors, placing greater weight on:

- the individual’s **control over the work**; and
- their opportunity for **profit or loss**.

If a worker’s status isn’t clear based on those two core factors, the proposal instructs businesses to look to:

- the **amount of skill** required for the work;
- the **degree of permanence** of the working relationship between the individual and the potential employer; and
- whether the work is part of an **integrated unit of production**.

Fisher Phillips will be monitoring updates closely as the DOL reviews comments and finalizes its updated independent contractor rule. However, even if the federal government issues a business-friendly rule, California companies will still have to comply with the stricter and more controversial state ABC test.

Employer Impact: The independent contractor determination can be critical for a business, as both California and federal law provide employees with minimum wage, overtime pay, among numerous other protections, while independent contractors don’t receive those benefits. Making the wrong call can lead to costly backpay, litigation, and other potential penalties.

Your 5-Step Action Plan

Businesses that are subject to more than one set of laws governing how they classify and pay their workers are generally required to follow the stricter standard. For employers operating in the Golden State, this means you will largely need to follow California's more onerous rules.

Recent and pending changes at the federal level will be felt more by California employers with workers **outside the state**, or for businesses that need to comply with both state and federal standards in a multistate workforce. For your California operations, consider taking these steps now to ensure compliance:

1. Stay Up to Date on State Rules: California employers should not apply federal rule changes when they are less protective than state law. Instead, you should follow California's unique rules, which are generally more stringent and nuanced than federal law.

2. Track Minimum Wage Changes: Because California's exempt salary thresholds are tied to the state minimum wage, you'll need to monitor and plan for increases, which regularly take effect at the beginning of the year.

3. Review Job Descriptions and Actual Job Duties: Regularly review employee job descriptions and update them as needed. Be sure to compare them to employees' actual job duties to ensure exemptions are applied correctly under California's stricter standards. You should also evaluate independent contractor relationships to confirm they satisfy California's ABC test.

4. Audit Your Pay Practices: Consider auditing your current pay practices and contractor arrangements under both state and federal law. Confirm that your current classifications under overtime exemptions and the ABC test for independent contractors can survive the stricter California analyses. For exempt commissioned employees, ensure commissions make up more than half their earnings. From a bigger picture perspective, you'll want to ensure all California wage-order requirements are satisfied.

5. Consult with Counsel: Your FP attorney can assist with reviewing your current pay and classification practices.

Conclusion

We will continue to track developments on both overtime and worker classification rules, so make sure that you are subscribed to [Fisher Phillips' Insight System](#) to get the most up-to-date information direct to your inbox. If you have compliance questions, consult with your Fisher Phillips attorney, the author of this Insight, or any member of our [Wage and Hour Practice Group](#) to assess and minimize potential risks.