

## Employee classification basics

It is the generation of flexibility. Employees often want the ability to work when they want and where they want, and they dread the idea of punching a time clock. However, in spite of those desires, every employer must be mindful of the laws surrounding how to correctly classify its employees.

This article provides an overview of some of the basic considerations an employer should consider when determining whether to classify employees as non-exempt (and pay them by the hour) or classify employees as exempt.<sup>1</sup>

### What is an "exempt" employee?

- No employee who earns less than two times California's minimum wage for full-time employment may be classified as an exempt employee. In 2017, employees who work for an employer with 25 or fewer employees, that equates to \$3,466.67 per month; for employers with more than 25 people, that equates to \$3,640 per month. The minimums will go up in January 2018. In 2018, minimum monthly salary for employers with 25 or less employees will be \$3,640 per month. For employers with more than 25 employees, the monthly minimum is \$3,813.33.
- Employees must spend more than half of their time performing exempt tasks.

### What are examples of exempt employees?

Some of the most common exemptions and the requirements for each exemption are listed below; there are also exemptions for inside and outside sales persons. In addition to the requirements above, to be properly classified under any of the exemptions, the employee must meet all requirements of the applicable exemption:

#### Executive/managerial exemption

- The employee's duties and responsibilities involve the management of the enterprise in which he or she is employed or of a customarily recognized department or subdivision of the enterprise.
- The employee customarily and regularly directs the work of two or more other employees.
- The employee has the authority to hire or fire other employees, or the employee's suggestions and recommendations on hiring, firing, advancement and promotion, or any other change of status of other employees is given particular weight.
- The employee customarily and regularly exercises discretion and independent judgment in performing his or her duties.

#### Administrative exemption

- The employee spends more than one-half of his or her work time performing office or non-manual work directly related to management policies or general business operations for the employer or the employer's customers.
- The employee "customarily and regularly" exercises discretion and independent judgment in carrying out job duties as

- to matters significant to the employer's business.
- The employee performs his or her job only under general supervision and works along specialized or technical lines requiring special training, experience or knowledge.

## Computer professional exemption

- The employee is primarily engaged in work that is intellectual or creative and requires the exercise of discretion and independent judgment.
- The employee is primarily engaged in duties that consist of one or more of the following:
  - The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications.
  - The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to, user or system design specifications.
  - The documentation, testing, creation or modification of computer programs is related to the design of software or hardware for computer operating systems.
  - The theoretical and practical application of highly specialized information to computer systems analysis, programming and software engineering.
- The employee's hourly rate of pay, or annual salary if paid on salaried basis, meets a minimum threshold amount set by California's Division of Labor Statistics and Research (DLSR).
  - In 2017: minimum annual salary is \$88,231.36; monthly minimum is \$7,352.63; hourly minimum is \$42.35.
  - Effective January 1, 2018: minimum annual salary is \$90,790.09; monthly minimum is \$7,565.85; hourly minimum is \$43.58.

## What happens if a company misclassifies its employee?

Failure to correctly classify and pay employees is a mistake that can trigger many types of liability and penalties, including a possible misdemeanor for failure to pay minimum wage. If the failure to properly classify employees results in significant monetary liability and penalties, that liability can also create concern for prospective investors and acquirers in an acquisition. As a result, a company's proper classification of its employees is often a matter of diligence in a financing or acquisition.

Having the right team in place can be the key to a company's success. However, a company must be aware of how it is classifying its employees and ensure that all classifications are based on employees' actual duties and responsibilities. These classifications need to be made accurately, without regard to what the job description may say, whether or not competitors classify employees similarly or what the employee's desires may be. Otherwise, a company may find itself facing an unexpected and potentially significant liability.

<sup>1</sup> This article focuses on the classification requirements under California law. The laws of other states may differ and employers are encouraged to consult with local counsel licensed to practice law in the relevant state.



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