Inside Sales Versus Outside Sales Has Several Pitfalls For The Uninitiated

Jonathan Fraser Light is the Managing Attorney at LightGabler, which serves almost 3,000 small and large public and private sector employers (for-profit and non-profit) in a variety of industries. He may be reached at jlight@lightgablerlaw.com.

"I have outside salespeople, they work from home." "My salespeople work primarily from the office, and I pay them a salary plus commission." "My salespeople are hourly, receive commissions, but no overtime on the commissions." "My salespeople get paid hourly and overtime, and receive commissions."

Each of these scenarios has potential or actual wage and hour pitfalls. It makes a huge difference whether someone is an inside salesperson or an outside salesperson. The most important factor for determining outside salesperson status – which is preferable, by far – is whether they spend more than 50% of their time away from a "fixed location" selling a service or product. If they primarily work from home, from their office, or are selling pots and pans for an outside company but at Costco, that's a fixed location and they are not outside salespeople. They need to be "on the road" so to speak, most of the time, to qualify for outside salesperson status.

Why does this matter? Because an outside salesperson need not be paid a particular base rate of pay, no overtime, not even minimum wage. They are not subject to meal and rest breaks premiums, just like any other exempt employee. Both state and federal law use the same criteria for determining outside salesperson status. Employers simply need to have a clearly written commission agreement in place, signed by both parties per California law (which or course can include reference to base pay).

If they are not outside salespersons (but selling), then they are "inside salespersons." Now it gets complicated. There is an "inside salesperson exemption" from overtime under both state and federal law, but only if very specific criteria are met. There are a few key factors affecting that status and federal and state law differ on the subject in one key respect discussed below.

Under state law, only certain business can take advantage of the inside sales exemption. If an employer is covered by occupational Wage Order No. 4 or industry Wage Order No. 7 ("Mercantile," meaning sales of products or services), they may take advantage of the inside sales exemption from overtime. If the company is primarily a manufacturer covered by Wage Order No. 1, for example, there is no inside sales exemption (don't ask me why). If the company is primarily a wholesaler and not a retailer, then federal law provides that the company may not take advantage of the inside sales exemption. So those rules narrow the field as to who is eligible.

Assuming the company and its salesperson qualify so far, the salesperson must also earn at least 1.5 times minimum wage in the pay period to qualify for the exemption. That's usually not an issue, as that would be only $24.75/hr in 2025. That dollar value will include both hourly pay and commission, a draw, or a salary; all sources of income for actual work performed in that pay period may be used (i.e., not sick, vacation or holiday pay).

The second criterion is usually the problem. Exempt inside salespeople must earn more than half their income from commission each pay period. Otherwise, overtime will apply for that pay period.

In my experience, most salespeople receive a fairly large base and so their commissions are a relatively small fraction of their overall compensation; certainly less than half each pay period or month. In those instances, they will receive overtime because commission doesn't exceed base pay.

One important misstep that is one of the cornerstones of class action litigation, is the failure to "gross up" any commissions or non-discretionary bonuses based on the amount of overtime worked in the relevant time frame. This gross-up also applies to meal and rest premiums, as well as sick time and usually PTO (but not vacation, so far). The bottom line is that when calculating overtime, all sources of income must be included among base pay, commissions and non-discretionary bonuses to determine the value of the overtime, mealat premiums, etc.

If a company proceeds this far in the analysis, here's where it really gets tricky. A case involving Time-Warner several years ago illustrates the problem. To be exempt from overtime, the employee's commissions must exceed base pay in **each** pay period. Here's where Time-Warner had a problem, and I see this frequently because commissions are generally calculated and paid monthly even though pay periods are typically bi-weekly or twice a month.

Assume that the monthly commissions are calculated after the month closes, and then the commissions show up on the first paycheck of the following month. Assume further that the payroll for March 16-31 is distributed on April 7, along with commissions for the entire month of March. There's plenty of commission in that first paycheck, so the commissions well-exceed the base rate for that pay period; no overtime is owed. So far, so good. The problem, however, comes with the next pay period. On April 22 the salesperson receives their paycheck covering April 1-15, but there's no commission, because March has cleared out and April isn't over. COMMISSIONS ARE ZERO, AND SO COMMISSIONS DO NOT EXCEED BASE PAY IN THAT PAY PERIOD. Just like Time-Warner, the company will owe overtime for the April 1-15 time frame. The company can't simply divide up the monthly-calculated commission and pay it in separate pay periods to get around the law. Rather, it should calculate and pay commissions semi-monthly or bi-weekly, but they can't just divide up the March commission and pay it in two April installments to solve the problem.

Lastly, note that all inside salespeople, regardless of whether they are exempt or not from overtime, must still observe all meal and rest break rules just like all other non-exempt employees. Also, if the salesperson is on straight commission or draw against commission, the employer may be required to separately calculate a value for rest breaks, as in piece-rate situations. That's the cherry on top of this confusing topic.