



Bill Analysis

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Bill Number: AB 1925

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Introduced: January 14, 2020

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Related Bills: See Legislative
History

SUBJECT

Worker Classification-Exemption for Small Businesses

SUMMARY

This bill would exempt small businesses from being subject to the presumption that a worker is an employee unless a hiring entity satisfies the factors of a 3-part test, commonly known as the "ABC" test in order to determine the status of a worker as an employee or independent contractor. Assembly Bill 5 (AB 5) codified that presumption and the "ABC" test, which was established in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) 4 Cal.5th 903 (Dynamex).

This is the department's first analysis of the bill and only addresses the provisions that impact the department's programs and operations.

RECOMMENDATION

No position

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for the bill is to exclude small businesses from the presumption that a worker is an employee unless the "ABC" test is met.

ANALYSIS

This bill would amend Labor Code section 2750.3 to exclude small businesses from the application of *Dynamex* and the presumption that a person providing labor or services for remuneration is an employee unless the hiring entity satisfies the "ABC" test, and instead, the determination of employee or independent contractor status for individuals hired by a small business would be governed by *Borello*.

The bill defines a small business as a business that meets all of the following:

- Is independently owned and operated.
- Is not dominant in its field of operation.
- Has fewer than 100 employees.
- Has average gross receipts of fifteen million dollars (\$15,000,000) or less over the previous three years.

Effective/Operative Date

Assuming this bill is enacted before September 30, 2020, this bill would become effective on January 1, 2021, and would apply for work performed on or after January 1, 2020. Under specified circumstances, the provisions would apply retroactively to existing claims and actions to the maximum extent permitted by law if it would relieve an employer from liability.

Federal/State Law

Federal Law

To determine whether a worker should be classified as an employee or independent contractor, federal law applies a two factor test, the Control and Relationship Test.

Control. Behavioral control is exerted if the business controls what work is accomplished and directs how it is done. Financial control is exerted if the business directs or controls financial and certain relevant aspects of a worker's job. Some of the factors to consider include:

- The extent of the worker's investment in the facilities or tools used in performing services and the extent to which the worker makes his or her services available to the relevant market.
- How the business pays the worker, and the extent to which the worker can realize a profit or incur a loss.

Relationship. It is also important in determining the worker's classification to understand how the employer and worker perceive their relationship. Items to consider include:

- The extent to which services performed by the worker are a key aspect of the regular business of the company and if the worker has unreimbursed business expenses.
- Written contracts describing the relationship the worker and company intended to create.
- Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation or sick pay and the permanency of the relationship.

State Law

AB 5 was signed by Governor Newsom on September 18, 2019. It created a presumption that a person providing labor or services for remuneration is presumed to be an employee rather than an independent contractor unless the hiring entity satisfies the "ABC" test adopted in *Dynamex*.

AB 5 added Section 2750.3 to the Labor Code, which provided under the Labor Code, Unemployment Insurance Code, and for the purpose of wage orders of the Industrial Welfare Commission, except for specified statutory exemptions, a person providing labor or services for remuneration will be considered an employee unless the hiring entity demonstrates that all of the following conditions are satisfied:

- A. The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.
- B. The person performs work that is outside the usual course of the hiring entity's business.
- C. The person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

Existing law exempts specified business relations and occupations from the application of the holding in *Dynamex* and the presumption that a worker is an employee unless the hiring entity demonstrated the "ABC" test, and instead provides that these exempt relationships and occupations are governed by the test adopted in *Borello*, specified provisions in the Business and Professions Code, the Unemployment Insurance Code, the Labor Code, or a combination of these.

Borello:

The California Supreme Court in the case of *S.G. Borello & Sons, Inc V. Department of Industrial Relations* ((1989) 48 Cal.3d 341 (Borello)) adopted the "economic realities" test. In applying this test, a significant factor to be considered is whether the person to whom service is rendered has the right to control the manner and means of the work performed.

Additional factors that may be considered under this test include:

1. Whether the person performing services is engaged in an occupation or business distinct from that of the principal;
2. Whether or not the work is a part of the regular business of the principal or alleged employer;
3. Whether the principal or the worker supplies the instrumentalities, tools, and the place for the person doing the work;

4. The alleged employee's investment in the equipment or materials required by his or her task or his or her employment of helpers;
5. Whether the service rendered requires a special skill;
6. The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;
7. The alleged employee's opportunity for profit or loss depending on his or her managerial skill;
8. The length of time for which the services are to be performed;
9. The degree of permanence of the working relationship;
10. The method of payment, whether by time or by the job; and
11. Whether or not the parties believe they are creating an employer-employee relationship may have some bearing on the question, but is not determinative since this is a question of law based on objective tests.

However, all of the factors must be considered in light of the facts and circumstances surrounding the worker's relationship with its employer and no one factor is given more weight than another.

Implementation Considerations

The department has identified the following concerns:

This bill uses terms that are undefined, i.e., a small business that is "independently owned and operated" and "Is not dominant in its field of operation." For clarity, it is recommended that the bill be amended.

It is unclear what the operative date of this amendment is intended to be. For clarity, it is recommended that the bill be amended to include a specific operative date.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

AB 5 (Gonzalez, 2019/2020, Chapter 296, Statutes of 2019) created a presumption that a person providing labor or services for remuneration will be considered an employee rather than an independent contractor unless the hiring entity demonstrates that the "ABC" test provided for in the holding of *Dynamex* and in Labor Code section 2750.3 is satisfied.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

This bill could impact the department's forms, education and processing cost. As the bill continues to move through the legislative process, costs will be identified.

ECONOMIC IMPACT

Revenue Estimate

This bill as introduced on January 14, 2020, does not generally change the way income or franchise tax is calculated under the Revenue and Taxation Code. However, it could change the amount of income and expenses reported to the FTB and would have an unknown impact on general fund revenue.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

This bill would allow specified small businesses to be excluded from the Dynamex decision under Labor Code section 2750.3 and instead would be governed by Borello. This bill could result in some workers who are currently treated as employees being reclassified as independent contractors under the proposed exclusion. This reclassification would shift responsibility for a number of business related expenses from businesses to the workers. An increase of qualified business expenses to the workers would likely decrease their tax liability, while the decrease in expenses to businesses would increase their tax liability. The net effect of these changes would depend on the marginal tax rates of the businesses and involved, and any adjustment that may take place in compensation levels or related business expenses. The net effect of all these changes on tax liability is not known.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

None noted.

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