



Analysis of Amended Bill

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Bill Number: AB 5

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Related Bills: See Legislative
History

Amended: March 26, 2019,
May 1, 2019, May 24, 2019, and
July 11, 2019

Subject: Worker Status for Employees/Independent Contractors

Summary

This bill would codify the decision of the California Supreme Court in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) 4 Cal.5th 903 (*Dynamex*) that presumes 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 for selected provisions of the Labor Code and Unemployment Insurance Code.

This analysis only discusses the provisions that impact the department’s programs and operations.

Recommendation – No position.

Summary of Amendments

The March 26, 2019, amendments modified provisions of the Labor Code as introduced December 3, 2018, that codified portions of the *Dynamex* decision and clarified the decision’s application in state law.

The May 1, 2019, amendments modified the language to include references to the definition of employee in the Unemployment Insurance Code and the Labor Code relating to wage orders of the Industrial Welfare Commission as well as other non-substantive changes.

The May 24, 2019, amendments exempt specified professions from the employment relationship test provided under *Dynamex* and provides that the employment relationship test for these professions shall be governed by the test adopted in *S.G. Borello & Sons, Inc. V. Department of Industrial Relations* (1989) 48 Cal.3d 341 (*Borello*) if certain requirements are met.

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The July 11, 2019, amendments exempted additional licensed professionals from the bill's provisions, expanded the bill's application to the definition of "employee" for purposes of the Unemployment Insurance Code, and made other clarifying changes.

This is the department's first analysis of the bill.

Reason for the Bill

The reason for this bill is to establish an employment relationship test which incorporates the employment relationship test provided for in *Dynamex*.

Effective/Operative Date

This bill would be effective January 1, 2020, and operative as of that date.

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.

1. **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.
2. **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

Under California tax law, there is no statutory definition of an "independent contractor", therefore, the determination of whether a worker is an employee or an independent contractor relies on federal income tax law, judicial tests and administrative guidelines. There is a rebuttable presumption under Labor Code section 3357 that a worker is an employee.

However, in order to rebut the presumption, a number of factors must be considered, none of which is controlling by itself.

The California Supreme Court in the case of *Borello, supra*, 48 Cal.3d 341 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, as stated above, 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.

This Bill

Under the Labor Code, Unemployment Insurance Code, and for the purpose of wage orders of the Industrial Welfare Commission, this bill would generally provide, except for specified statutory exemptions, that a person providing labor or services for remuneration shall 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.

These three factors are commonly referred to as the "ABC" Test and represents the employment relationship test provided for in the holding of *Dynamex*. This bill's provisions and the holding in *Dynamex* would not apply to specified occupations and instead, for these occupations only, the employment relationship test used will be the test adopted by the California Supreme Court in the case of *Borello, supra*, 48 Cal.3d 34. The professions subject to the *Borello* test include:

- A person or organization licensed by the Department of Insurance.
- A physician and surgeon licensed by the State of California pursuant to the Business and Professions Code, performing professional or medical services provided to or by a health care entity.
- A securities broker-dealer or investment adviser or their agents and representatives registered with the Securities and Exchange Commissions, the Financial Industry Regulatory Authority or licensed by the State of California.
- A direct sales salesperson.
- A real estate licensee licensed by the State of California.
- A worker providing hairstyling or barbering services, an electrologist, an esthetician, or worker providing natural hair braiding, who is free from direction and control both under the contract for the performance of the work and in fact. Free from direction and control includes but is not limited to, the worker meeting all of the following criteria:
 - Sets their own rates for services performed, provided the rate is equal to or greater than two times the minimum wages for hours worked and is paid directly by their clients.

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- Sets their own hours of work and has sole discretion to decide which clients from who they will provide services.
- Has their own book of business and schedules their own appointments.
- Uses their own funds to purchase requisite supplies used in connection with providing services.
- Maintains their own business license in connection with the services offered to clients.
- A repossession agency licensed pursuant to the Business and Professions Code.
- Individuals under contract to perform work. The relationship between a business entity and an individual performing work pursuant to contract with another business entity to provide services to the contracting business, if the contracting business entity demonstrates all of the following criteria are satisfied:
 - The service provider is free from the control and direction of the contracting business entity in connection with the performance of the work, both under the contract for the work and in fact.
 - The service provider is providing services to the contracting business rather than to customers of the contracting business.
 - The contract with the service provider is in writing.
 - If the work is performed in a jurisdiction that requires the service provider to have a business license or business tax registration, the service provider has the required business license or business tax registration.
 - The service provider maintains a business location that is separate from the business or work location of the contracting business.
 - The service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed.
 - The service provider actually contracts with other businesses to provide the same or similar services and maintains a clientele without restrictions from the hiring entity.
 - The service provider advertises and holds itself out to the public as available to provide the same or similar services.
 - The service provider has no other financial relationship with the contracting business.
 - The service provider can negotiate its own rates, provided that the rate is equal to or greater than two times the minimum wage for hours worked.
 - The service provider can set its own hours and location of work.
 - The service provider is not performing the type of work for which a license from the Contractor's State License Board is required pursuant to the Business and Professions Code.

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- Individuals providing professional services and that meet any of the following:
 - Must have an active license from the state of California in law, dentistry, architecture, engineering, podiatry, veterinarian, private investigations or accounting.
 - Possess an advanced degree in the field of marketing or administration of human resources from an accredited university, college or professional school.
 - Work performed by a freelance writer who does not provide content to any one publication over twenty five times per year.

For contracts for professional services, overall, the *Borello* test applies if the hiring entity demonstrates, additional factors have been satisfied including the individual has a separate business location, a business license and the individual has the ability to engage in other contracts for services amongst other factors.

Professional services does not include professionals engaged in the health care and medical fields.

Individuals performing construction work – contractor or subcontractor

For construction industry contractor and subcontractor relationships, the *Borello* test applies if the contractor demonstrates that all of the following criteria are satisfied:

- The individual is free from the control and direction of the contractor in connection with the performance of the work, both under the contract for the performance of the work and in fact.
- The subcontract is in writing.
- The subcontractor is licensed by the Contractors State License Board and the work is within the scope of that license.
- If the work is performed in a jurisdiction that requires the subcontractor to have a business license or business tax registration, the subcontractor has the required business license or business tax registration.
- The subcontractor maintains a business location that is separate from the business or work location of the contractor.
- The subcontractor has the authority to hire and to fire other persons to provide or assist in providing services.
- The subcontractor assumes financial responsibility for errors or omissions in labor or services as evidenced by insurance, performance bonds, or warranties relating to labor or services being provided.
- The subcontractor is customarily engaged in an independently established business of the same nature as that involved in the work performed.

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This bill, under the Unemployment Insurance Code, would provide that the definition of an “employee” would also mean any individual who is an employee pursuant to the above discussed Labor Code provisions that would be enacted by this bill.¹

Implementation Considerations

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill does not specify its intention regarding whether the classification of an individual as an employee would also apply for income and corporate franchise tax purposes under the Revenue and Taxation Code (R&TC). For clarity and ease of administration, it is recommended that the bill be amended.

The bill uses a term that is undefined, i.e., “Service Provider.” The absence of a definition to clarify this term could lead to disputes with taxpayer and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

Legislative History

AB 71 (Melendez & Kiley, 2019/2020) would require a determination of whether a person is an employee or an independent contractor to be based on a specific multifactor test, including whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired, and other identified factors. This bill is currently pending before the Assembly Labor and Employment Committee.

SB 238 (Grove, 2019/2020) would require, for purposes of claims for wages and benefits arising under wage orders, an analysis of whether the worker is economically dependent upon the hiring entity to determine whether the worker is an employee based upon economic reality of the relationship with the hiring entity. The bill would require this analysis to be based solely upon enumerated factors that are similar to those used as part of the Economic Realities Test in the federal Fair Labor Standards Act of 1938. This bill is currently pending before the Senate Public Employment Committee.

¹ Labor Code section 2750.3.

Other States' Information

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida law generally applies 10 common law factors in determining whether a worker should be classified as an employee or an independent contractor. The extent of control the business may exercise over the details of the work is considered the most significant factor.

Illinois law, under the Unemployment Insurance Act, generally deems service performed by an individual for another to be employment, unless the hiring unit satisfies a three-factor test, substantially similar to the tests that would be established by this bill.

Massachusetts law, known as the Massachusetts Independent Contractor Law, generally deems an individual performing any service, except as otherwise specified, an employee, unless a three-factor test is satisfied, substantially similar to the tests that would be established by this bill.

Michigan law, for services performed on or after January 1, 2013, generally applies the IRS 20-factor test outlined in Revenue Ruling 87-41 in determining whether an individual performing services should be classified as an employee or an independent contractor. The factors are generally organized into three categories: behavior control factors, financial control factors, and relationship factors.

Minnesota law generally applies a five-factor tests for occupations other than building trades in determining whether an individual performing services is an employee or independent contractor. The degree of control is generally the most significant factor.

New York law generally applies a multi-factor test in determining whether an individual performing services is an employee or an independent contractor. The level of supervision, direction and control is generally the most important in making the determination.

Fiscal Impact

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This bill as amended on July 11, 2019, does not change the way income or franchise tax is calculated under the R&TC. However, it could change the amount of income and expenses reported to the Franchise Tax Board (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 likely result in some workers who are currently treated as independent contractors being reclassified as employees. This reclassification will shift responsibility for a number of business related expenses from workers to the businesses. A reduction of qualified business expenses will likely increase the tax liability of workers, while the increase in expenses will decrease the tax liability of many businesses. The net effect of these changes will depend on the marginal tax rates of the businesses and workers 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. In addition, reclassified workers will now receive W-2s reporting their wages to FTB. This should increase the level of compliance for these workers, thereby increasing tax revenues.

Policy Concerns

This bill could create federal-state reporting differences due to varying factors used to interpret who is an employee or independent contractor under federal and California laws. This could create some confusion for taxpayers.

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