



Bill Analysis

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Bill Number: AB 5

Subject: Worker Status for Employees/Independent Contractors

Summary

This bill would codify a portion of 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.

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 *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, 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

No provision of this bill shall permit an employer to reclassify an individual who was an employee on January 1, 2019, to an independent contractor due to enactment of 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*.

Any exceptions to the terms "employee," "employer," "employ," or independent contractor as defined in the Labor Code, Unemployment Insurance Code, or an applicable order of the Industrial Welfare Commission remain in effect.

For purposes of this bill, an individual is defined as an individual providing services through a sole proprietorship or other business entity. The individual must:

- Maintain a business location separate from the hiring entity. An individual is not prohibited from choosing to perform services at the location of the hiring entity.
- Have a business license in addition to any required professional licenses or permits for the individual to practice in their profession if work is performed more than six months after the effective date of this provision.
- Have the ability to set or negotiate their own rates for the services performed.
- Have the ability to set their own hours outside of project completion dates and reasonable business hours.
- Be customarily engaged in the same type of work performed under contract with another hiring agency or holds themselves out to other potential customers as available to perform the same type of work.
- Customarily and regularly exercise independent judgment in the performance of the services.

This bill's provisions provide that the ABC test outlined in *Dynamex* would not apply to specified occupations and instead *Borello* would apply. The professions subject to the *Borello* test include:

- A person or organization licensed by the Department of Insurance.
- A physician, surgeon, dentist, podiatrist, psychologist or veterinarian 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, except for employment settings currently or potentially governed by collective bargain agreements for these licensees.
- A practicing lawyer, architect, engineer, private investigator, or accountant who holds an active license from California.
- 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 commercial fisherman working on an American vessel, as defined, through December 31, 2022.
 - A commercial fisherman working on an American vessel is eligible for unemployment insurance benefits if they met the definition of "employment" under the Unemployment Insurance Code.
 - The Employment Development Department shall issue an annual report to the Legislature on or before March 1, 2021 and each March 1 thereafter.

- This subdivision shall become inoperative on January 1, 2023, unless extended by the Legislature.
- Professional services, performed under contract by an individual, in the following professions:
 - Marketing, under specified conditions.
 - Administrator of human resources, under specified conditions.
 - Travel agent services.
 - Graphic design.
 - Grant Writer.
 - Fine Artist.
 - Enrolled agent services.
 - Payment processing agent through an independent sales organization.
 - Services provided by a still photographer or photojournalist who does not license content submissions to the putative employer more than 35 times per year. A photographer or artist is not prevented from displaying their work product for sale.
 - Services provided by a freelance writer, editor, or newspaper cartoonist who does not provide content submissions to the putative employer more than 35 times per year.
 - Services provided by a licensed esthetician, licensed electrologist, licensed manicurist, licensed barber, or licensed cosmetologist if the individual sets their own rates, processes their own payments, is paid directly by the client, sets their own hours and has discretion to decide which clients to provide services to, has their own book of business and maintains their own business license. If the individual is performing services at the hiring entity location, then the individual issues a 1099 form to the salon or business owner from which they rent their space. The provision specific to licensed manicurist becomes inoperative on January 1, 2022.

This bill's provisions also provide that the ABC Test outlined in the holding in *Dynamex* would not apply to the following professions:

- A real estate licensee licensed by the state of California. If the section of the BPC that governs employee or independent contractor is not applicable then the determination is governed by the following:
 - Unemployment Insurance Code;
 - For purposes of workers compensation Section 3200 et seq; and
 - For all other purposes, in the Labor Code by *Borello*.
- A repossession agency.

Bona fide business to business contracting relationships

The determination of whether a business entity, formed as a sole proprietorship, partnership, limited liability company (LLC), limited liability partnership (LLP), or a corporation, is classified as an employee or independent contractor shall be governed by *Borello* if the business entity provides services to another such business and meets certain criteria, as specified.

The ABC Test and the holding in *Dynamex* would apply to an individual worker who performs labor or services for a contracting business.

Individuals performing construction work – contractor or subcontractor

For construction industry contractor and subcontractor relationships, the *Borello* test applies to determine if a subcontractor is an employee or an independent contractor if the worker if the contractor demonstrates that all of the following criteria are satisfied:

1. The subcontract is in writing.
2. The subcontractor is licensed by the Contractors State License Board and the work is within the scope of that license.
3. The subcontractor is domiciled 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.
4. The subcontractor maintains a business location that is separate from the business or work location of the contractor.
5. The subcontractor has the authority to hire and to fire other persons to provide or assist in providing services.
6. The subcontractor assumes financial responsibility for errors or omissions in labor or services as evidenced by insurance, legally authorized indemnity obligations, performance bonds, or warranties relating to labor or services being provided.
7. The subcontractor is customarily engaged in an independently established business of the same nature as that involved in the work performed.

A subcontractor does not need to establish that it is licensed with the Contractors State License Board if it provides construction trucking services for which a license is not required, provided all of the following criteria is satisfied:

- The subcontractor is a sole proprietorship, partnership, LLC, LLP, or corporation.
- The subcontractor is registered with the Department of Industrial Relationship as a public works contractor for work performed after January 1, 2020.
- The subcontractor uses its own employees to perform the construction trucking services.

- The subcontractor negotiates, contracts with and is directly compensated by the licensed contractor.

Any business entity that provides construction trucking services to a licensed contractor using more than one truck shall be deemed the employer of all drivers of those trucks for work performed after January 1, 2020.

The provisions specific to construction trucking services shall only apply to work performed before January 1, 2022.

Referral Agency

A referral agency is defined as a business that connects service providers with clients that provide graphic design, photography, tutoring, event planning, minor home repair, moving, home cleaning, errands, furniture assembly, animal services, dog walking, dog grooming, web design, picture hanging, pool cleaning, or yard cleanup.

Subject to specific conditions, the determination of whether the service provider is an employee of the referral agency is governed by the *Borello* test. However, the *Borello* test would not apply to an individual worker, as opposed to a business entity, who performs services for a client through a referral agency. Instead, the test in *Dynamex* would apply.

Motor Clubs

In the relationship between a motor club with a certificate of authority issued under the Insurance Code and an individual performing services pursuant to a contract between the motor club and a third party to provide motor club services using the employee and vehicles of the third party, *Borello* is used to determine whether the individual is an employee of the motor club.

The Attorney General or city attorney, in addition to other remedies available, may bring an action for injunctive relief against the putative employer to prevent the continued misclassification of employees as independent contractors.

Implementation Considerations

None.

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.

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

No departmental costs are associated with this bill.

Economic Impact**Revenue Estimate**

This bill as amended on September 6, 2019, does not 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 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.

Appointments

None.

Votes

| Location | Date | Yes Votes | No Votes |
|----------------|--------------------|-----------|----------|
| Concurrence | September 11, 2019 | 61 | 16 |
| Senate Floor | September 9, 2019 | 29 | 11 |
| Assembly Floor | May 29, 2019 | 59 | 15 |

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