The New World for Independent Contractors – After AB5

A Workshop by
UC Berkeley Law’s New Business Community Law Clinic
Workshop Agenda

• Hiring Workers – why it’s tough for New Businesses
• The Three Buckets – Employees, Independent Contractors, and Unpaid Workers
• The New World for Independent Contractors after AB5
  • Previously: The Borello Test
  • Now in 2020: The ABC Test
  • AB5 Exemptions
  • Enforcement – New Risks for Entrepreneurs
• Comparison – Hiring Employees vs. Independent Contractors
Hiring Workers – Why it’s tough for New Businesses

New businesses often start with:

• Little cash
• Lots of uncertainty
• Founders working without pay
• Informal relationships with workers

Why informal?

• Hard to commit to anything
• Lots of paperwork to formalize the relationship
• Law is difficult to understand:
  Q: What’s an employee?
  Q: What’s an independent contractor?
Hiring – The 3 Buckets

In contrast, California and the IRS define workers very carefully. Workers are divided into three distinct buckets:

- Employee
- Independent Contractor
- Unpaid Workers (Interns and Volunteers)

The default is to assume an employee relationship -- with the strictest requirements
Possible Risks

Maintaining informal relationships with workers can lead to:

- Government audit
- Misunderstandings with your workers
- CA Dept. of Employment Development/Dept. of Industrial Relations hearing
- Lawsuit by ex-worker claiming misclassification, seeking unpaid wages and employer taxes
Employees
Requirements for Hiring Employees

- Legal requirements come from a combination of Federal, State, and Local Laws:

  >> See 17-point Employer requirements checklist (Handout)

- **Note**: compliance with all requirements increases the cost of labor by about 30%

- California is an Employment-at-Will State – At any time, the Employer or Employee can leave the relationship for any lawful reason.

- **Recommended**: Use a Payroll Service to keep track of everything
Independent Contractors
What is an independent contractor?

Typically, someone who is:

- Hired on a part-time, as needed basis
- Paid based on hours worked or per project
- Expected to provide own supplies, workspace, travel expenses, etc.
- Receives no formal training from the employer
- Has an independent business that can serve others (e.g., a plumber)
Previous Standard: the Borello Test

- Adopted by the California Supreme Court in the 1989 case of Borello vs. Dept. of Industrial Relations, 48 Cal. 3d 341 (1989)
- Independent contractors must be **free from the hiring entity’s control**, both as to the work done and the manner and means in which it is performed
The Borello Test – Continued

In addition, the following factors are considered:

1. Whether the worker is engaged in an occupation or business that is distinct from that of the hiring entity (= given the most weight)
2. Whether the work is part of the hiring entity's regular business
3. Whether the hiring firm or the worker supplies the equipment, tools, and the place for the person doing the work
4. The worker’s financial investment in the equipment or materials required to perform the work
5. The skill required in the particular occupation
6. The kind of occupation—whether, in the locality, the work is usually done under the hiring firm's direction or by a specialist without supervision
7. The worker’s opportunity for profit or loss depending on their own managerial skill
8. How long the services are to be performed
9. The degree of permanence of the relationship
10. The payment method, whether by time or by the job
11. Whether the parties believe they are creating an employer/employee relationship.
New standard: the ABC Test

A. Independent contractors must be free from the hiring entity’s control, both as to the work done and the manner and means in which it is performed

B. Independent contractors cannot be used to provide regular or continuous services of the business

C. Independent contractors need to be in business for themselves, and be able to work for others
AB5 Exemptions

Workers in the following categories only need to meet the Borello test to be ICs:
• physicians, surgeons, dentists, podiatrists, psychologists, veterinarians
• insurance brokers
• lawyers
• architects and engineers
• private investigators
• accountants
• registered securities broker-dealers and investment advisers
• direct sales salespeople

**Note:** Workers in these categories must also have all required professional licenses.
AB5 Exemptions, Continued

The following Professional Service Workers are also Exempt:

- marketing professionals
- travel agents
- human resources administrators
- graphic designers
- grant writers
- fine artists
- enrolled agents
- payment processing agents
- Photographers/photojournalists who provide content to hiring entities (max. 35/year)
- freelance writers, editors, or newspaper cartoonists who provide content to hiring entities (max. 35/year).

Professional Service Workers must pass the Borello test—AND they must:

- maintain a business location separate from the hiring firm (okay to use own residence)
- have a business license, in addition to any required professional licenses
- be able to set or negotiate their own rates for the services performed
- be able to set their own hours
- (a) be customarily engaged in the same type of work under contract with another hiring entity, or (b) hold themselves out to other potential customers as available to perform the same type of work
- customarily and regularly exercise discretion and independent judgment performing their services.
AB5 Exemptions, Continued

Licensed barbers, manicurists, electrologists, cosmetologists, and estheticians also qualify as independent contractors under this exception if they meet the Borello test and also:

• set their own rates, process their own payments, and are paid directly by clients
• set their own hours of work and have sole discretion to decide the number of clients and which clients they provide services for
• have their own book of business and schedule their own appointments
• maintain their own business license for the services offered to clients, and
• issue a Form 1099 to the salon or business owner from which they rent their business space.

Note: the ABC test will apply to licensed manicurists starting in 2022.
AB5 Exemptions, Continued

Business service providers involved in a business-to-business contracting relationship are ICs if they pass the Borello test. The business service provider must also:

- be free from the hiring firm's control and direction while performing the work
- provide services directly to the contracting business rather than to customers of the contracting business
- have a written contract
- have all required business licenses
- maintain a business location separate from the hiring firm
- be customarily engaged in an independently established business of the same nature as that involved in the work performed

- contract with other businesses to provide the same or similar services
- maintain a clientele without restrictions from the hiring firm
- advertise and hold itself out to the public as available to provide the same or similar services
- provide its own tools, vehicles, and equipment to perform the services
- be able to negotiate its own rates
- be able to set its own hours and location of work (if consistent with the nature of the work)
- not perform the type of work for which a license from the Contractor’s State License Board is required.
AB5 Exemptions, Continued

Construction industry subcontractors are exempt from the ABC test. They must pass the Borello test and the subcontractor must:

• have a written subcontract
• be licensed by the Contractors State License Board and work within the scope of that license
• have all required business licenses and business tax registrations
• maintain a business location separate from the business or work location of the contractor
• have authority to hire and to fire other persons to provide or to assist in providing the services
• assume financial responsibility for errors or omissions in labor or services by having insurance, legally authorized indemnity obligations, performance bonds, or warranties for the services provided
• be customarily engaged in an independently established business of the same nature as that involved in the work performed.
• have the right to control how the work is performed
Enforcement – New Risks for Entrepreneurs

• The CA Employment Development Department, the Labor Commissioner’s Office and the Franchise Tax Board have authority over worker misclassification

• AB5 also gives the right to sue to:
  - the CA Attorney General
  - City attorneys, and local prosecutors
  - Individuals who have been misclassified, who can employ private attorneys to bring claims (with possibly attorney fees awarded)

• Claims are subject to a 4 year statute of limitations
Comparison: Hiring Employees vs. Independent Contractors

**Employee**

**Pros**
- Subject to Employer’s control
- Can work full-time for the business at set hours
- Can be trained for multiple roles
- Can supervise others

**Cons**
- Requires supervision
- Extra overhead costs for workspace, benefits
- More paperwork

**Independent Contractor**

**Pros**
- Specialized knowledge
- No health benefits or workman’s compensation
- Work on demand and only when needed
- May shield company from liability

**Cons**
- Lack of control
- Cannot provide CORE services of the business
- Can work for others
- Possible Misclassification penalty
QUESTIONS?

Contact the New Business Community Law Clinic: www.law.berkeley.edu/NBCLC

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Additional Helpful Resources:
• NOLO Press Books
• HR California – CA Chamber of Commerce