

# CLEAR AS MUD: THE STATUS OF INDEPENDENT CONTRACTORS IN CALIFORNIA

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# INDEPENDENT CONTRACTORS

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- A 2019 study shows that 44 million workers, or 28.2% of the workforce are independent contractors
- Employers save approximately 30% by hiring independent contractors
  - Avoid paying payroll taxes, unemployment insurance, workers' compensation and disability
  - No benefits such as pensions, sick days, health insurance and vacation time
  - No minimum wage or overtime requirements
- Labor Commissioner estimates misclassification costs the state roughly \$7 billion in lost payroll taxes each year



A photograph of a yellow apple resting on a stack of two books, one red and one blue, on a light-colored surface. In the background, a green chalkboard is visible with a hand holding a piece of chalk.

# HISTORY

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- *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations* (1989) 48 Cal.3d 341
- *Dynamex Operations West, Inc. v. Superior Court* (2018) 4 Cal.5th 903
- AB5 became effective January 1, 2020
- AB 2257 went into effect on September 4, 2020
- Proposition 22 approved November 2020

- 1. Whether the hiring business has control (directly or indirectly) over the manner and means of accomplishing the result desired.
- 2. Whether the worker performing services holds themselves out as being engaged in an occupation or business distinct from that of the hiring business
- 3. Whether the work is a regular or integral part of the hiring business
- 4. Whether the employer or the worker supplies the instrumentalities, tools, and the place for the worker doing the work
- 5. Whether the worker has invested in the business, such as in the equipment or materials required by their task
- 6. Whether the service provided requires a special skill
- 7. The kind of occupation, and whether the work is usually done under the direction of an employer or by a specialist without supervision
- 8. The worker's opportunity for profit or loss depending on their managerial skill
- 9. The length of time for which the services are to be performed
- 10. The degree of permanence of the working relationship
- 11. The method of payment, whether by time or by the job
- 12. Whether the worker hires their own employees
- 13. Whether the hiring business has a right to fire at will or whether a termination gives rise to an action for breach of contract
- 14. Whether or not the worker and the hiring business believe they are creating an employer-employee relationship

## THE BORELLO MULTI- FACTOR TEST

# WAGE ORDERS OF THE INDUSTRIAL WELFARE COMMISSION ("IWC")

- To “employ” under the wage orders has 3 alternative definitions (Martinez v. Combs, 49 Cal.4th 35 (2010)):
  - (i) to exercise control over the wages, hours, or working conditions; or
  - (ii) **to suffer or permit to work**; or
  - (iii) to engage, thereby creating a common law employment relationship
- Home care providers are subject to Wage Order No. 15-2001



# ABC TEST

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- To meet the burden, the hiring entity must establish each of the 3 factors embodied in the ABC test:
- [A] that the worker 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*; **and**
- [B] that the worker performs work that is outside the usual course of the hiring entity's business; **and**
- [C] that the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.



# PART A: Is the Worker Free From the Control and Direction of the Hiring Entity?

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- The hiring entity must establish that the worker is free of such control to satisfy part A of the ABC test.
- A worker who is subject, either as a matter of contractual right or in actual practice, to the type and degree of control a business typically exercises over employees would be considered an employee.
- Depending on the nature of the work and overall arrangement between the parties, a business need not control the precise manner or details of the work in order to be found to have maintained the necessary control that an employer ordinarily possesses over its employees.



# PART B: Work That is Outside the Usual Course of the Hiring Entity's Business

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- Is the work “incidental” to the company’s work or an “integral part” of the business?
- A retail store hires a plumber or electrician to make repairs
- A clothing manufacturer hires work-at-home seamstresses to make dresses from cloth and patterns supplied by the company to be later sold by the company
- A bakery that hires cake decorators to work on a regular basis on its custom-designed cakes





# PART C: Customarily Engaged in an Independently Established Trade

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Such a worker typically takes steps to establish and promote an independent business

Business cards  
Business license  
Business phone

- Business location
- Advertising
- Other clients



Independent business operation must be in existence at the time the work is performed



Utilizing their own tools alone is insufficient



Not enough for company to prove it has not prohibited or prevented a worker from engaging in an outside business

# WHERE DOES DYNAMEX APPLY?

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- Applies to minimum wage, overtime, meal & rest breaks, etc.
- Does not apply to employee status for workers compensation, unemployment compensation, reimbursement of expenses, employee benefits



# RETROACTIVE APPLICATION

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- Vazquez v. Jan-Pro Franchising International, Inc.
- On January 14, 2021, the California Supreme Court unanimously ruled that Dynamex is retroactive
- The Supreme Court relied on “public policy and fairness concerns, such as protecting workers and benefitting businesses that comply with the wage order obligations.”

# AB 5

- Codified Dynamex decision
- Expanded Dynamex so that it also applies under the California Labor Code and Unemployment Insurance Code
- Granted exceptions to the ABC test
  - During the legislative process, a variety of powerful business interest groups asked for special rules for their industries. Many succeeded in obtaining exemptions to AB5, mostly on the grounds that they set or negotiate their own rates, communicate directly with customers, and make at least twice the state's minimum wage.



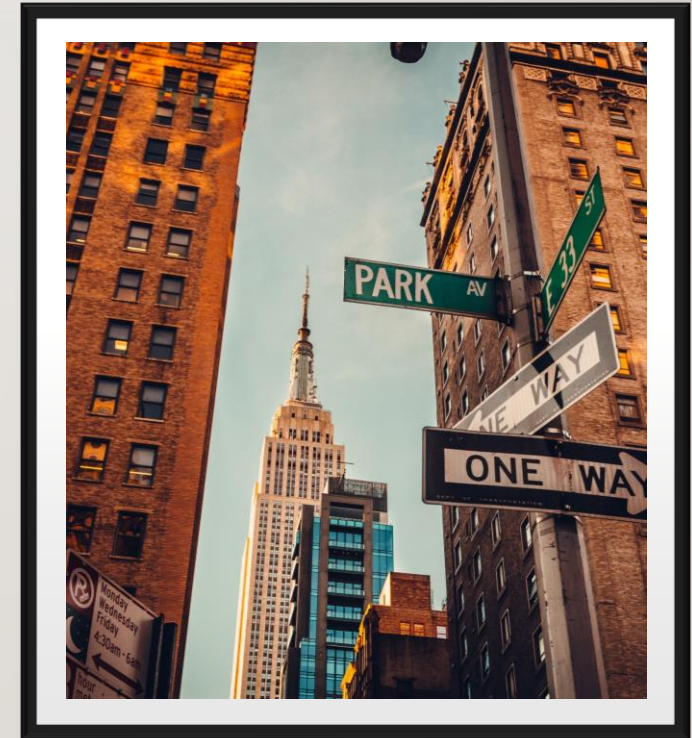
- The list of jobs given special treatment in the statute is both a testament to effective lobbying and a sign of the complexity of the 21st century workplace
- Doctors, psychologists, dentists, podiatrists, veterinarians
- Licensed insurance agents, stockbrokers, lawyers, accountants, architects, engineers, real estate agents
- Private investigators, direct sellers
- Hairstylists and barbers, aestheticians, electrologists, manicurists, cosmetologists
- Commercial fisherman,
- Marketing professionals, travel agents, graphic designers, grant writers, fine artists, enrolled agents, payment processing agents, repossession agents, and human resources administrators
- Photographers, photojournalists, freelance writers, editors or newspaper cartoonists who make 35 or fewer submissions a year
- Business-to-business activities
- Job title alone will not automatically exempt a worker from the classification requirements of AB5
- Many of the professions on this list have certain criteria that must be met in order for the individual to satisfy the exemption
- If a worker fails to satisfy the requirements of the AB5 test, then they are subject to the Borello multi-factor test

## EXEMPTIONS TO ABC TEST

# ENFORCEMENT

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- Various California agencies, including the Labor Commissioner, the Employment Development Department (“EDD”) and the Franchise Tax Board, have authority over worker misclassification; however, their efforts typically happen as the result of individual cases.
- AB5 empowers the attorney general, city attorneys in large cities, and local prosecutors to sue companies over violations of the Labor Code, the Unemployment Insurance Code, and/or the wage orders of the Industrial Welfare Commission



# AB 2257 – CLARIFICATION OF AB5?

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Further identifies narrow classes of workers who may more easily be classified as independent contractors.

Imposes new obligations on employers to justify their classification decisions

The result of well-funded lobbying efforts by various industries who felt that the ABC test cast too broad a net; or that they too deserved an exemption.

# BONA FIDE BUSINESS TO BUSINESS CONTRACTS

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The individual acting as a sole proprietor, or business entity formed as a partnership, limited liability company, limited liability partnership or corporation (“Business Service Provider”) contracts with another business, public agency, or quasi-public corporation (“Contracting Business”) and can demonstrate ALL of the following:

- 1) Free from control of the Contracting Business both under contract and in fact
- 2) Business Service Provider provides services directly to the Contracting Business rather than to the customers of the contracting business
- 3) The contract is in writing and specifies the payment amount, including applicable rate of pay and due date of payment
- 4) If the work is performed in a jurisdiction that requires a business license/tax registration, the business has one
- 5) Separate location (it can be the Business Service Provider’s home)
- 6) Customarily engaged in an independently established business of the same nature as that involved in the work performed
- 7) Can contract with other businesses to provide the same or similar services without restriction from the Contracting Business
- 8) Holds itself out to the public as available to provide the same or similar services
- 9) Provides own tools, vehicles and equipment to perform the services, not including any proprietary materials necessary to provide the work
- 10) Negotiate own rates
- 11) Set its own hours and location of work.



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## REFERRAL AGENCIES

A referral agency is a business that provides clients with referrals for service providers to provide services under a contract with the exception of certain services, such as in-home care.

The referral agency exemption was expanded to include consulting, caddying, wedding or event planning, youth sports coaching, and interpreting services

# PROFESSIONAL SERVICES

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- Exemptions now exist for workers who provide underwriting inspections and other services for the insurance industry, manufactured housing salespersons, workers engaged by an international exchange visitor program, consulting services, animal services, and competition judges with specialized skills, as specified.
- Also, the new exemptions cover licensed landscape architects, specialized performers teaching master classes (of one week), registered professional foresters, real estate appraisers and home inspectors, and feedback aggregators.
- Specifically excludes in-home care services



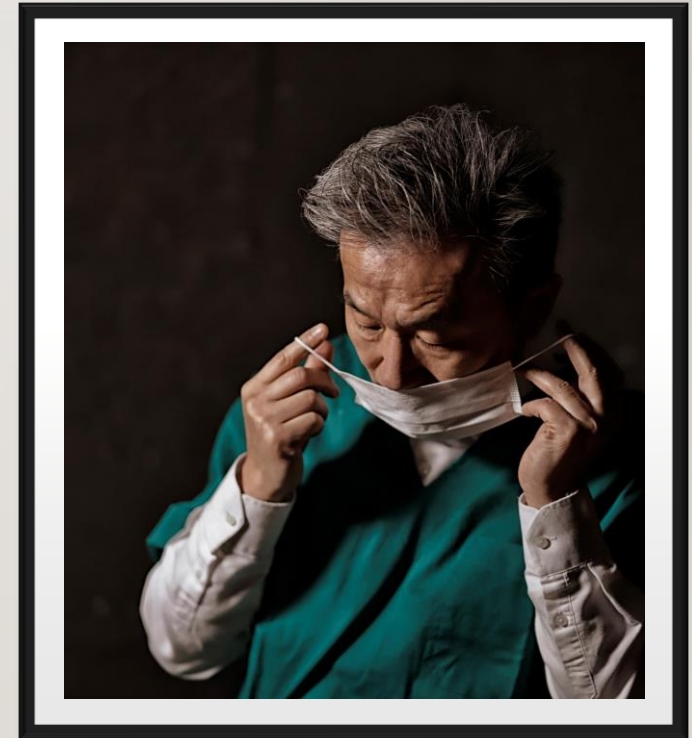
## ADDITIONAL CONSIDERATIONS AND CONSEQUENCES

- Existing law authorized legal action against employers who misclassify employees to be prosecuted by the Attorney General or a City Attorney.
- AB 2257 additionally authorizes a District Attorney to prosecute such an action.
- This bill makes changes to tax law regarding the determination of the status of a worker as either an employee or an independent contractor.

# INDEPENDENT CAREGIVER

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- Commonly used to describe a home care professional who does not work for an agency.
- According to the IRS, if a privately hired / independent caregiver is paid more than \$2,100 per year (in 2019), they are considered a household employee, not an independent contractor.
- The family hiring the independent caregiver takes on all the responsibilities of being an employer, which includes payroll and taxes.





# PROPOSITION 22

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- Passed with 59% of the vote
- Granted app-based transportation and delivery companies an exemption to AB5
- Exempted drivers from state mandated employee benefits while providing additional protections:
  - 120% of the local minimum wage for each hour driven with a passenger or en route
  - 30¢ per mile for expenses for each mile driven with passenger or en route
  - Health insurance stipend for drivers who average 15+ hours per week driving
  - Requires the companies to pay medical costs and some lost income for drivers hurt while driving or waiting
  - Prohibits workplace discrimination and requires that companies: develop sexual harassment policies, conduct criminal background checks, and mandate safety training for drivers





## CALIFORNIA V. FEDERAL LAW

- Workers may be considered employees and have protection under California law, even if they are determined not to be employees under Federal law
- The tests used to determine employee status under California law differ from the tests used under federal law, such as the federal Fair Labor Standards Act (“FLSA”)

# PENALTIES FOR MISCLASSIFICATION

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Penalties may be assessed for wage violations associated with a worker being misclassified as an independent contractor (e.g. missed meal and rest breaks, unpaid overtime, etc.)

Labor Code §226.8 prohibits the willful misclassification (voluntarily and knowingly) of individuals as independent contractors

Civil Penalties of between \$5,000 and \$25,000 per violation

May be subject to discipline by the Contractors State License Board

Notice must be prominently displayed on business' website

# WHAT SHOULD EMPLOYERS DO?

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CAREFULLY AUDIT ALL  
INDEPENDENT CONTRACTOR  
ARRANGEMENTS



MAKE SURE THERE IS A WRITTEN  
AGREEMENT MEMORIALIZING  
THE RELATIONSHIP



WHEN IN DOUBT, CONVERT  
WORKERS TO EMPLOYEE STATUS



# THANK YOU FOR WATCHING!

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