We have partnered with ThinkHR to provide their robust People Risk Management (PRM) solution as a complimentary service to help our clients save time and money while reducing risks associated with HR and compliance issues.

California Independent Contractors

Employers are generally required to withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. Alternatively, employers do not generally have to withhold or pay any taxes on payments to independent contractors. Moreover, according to the Internal Revenue Service (IRS), business owners or contractors who provide services to other businesses are generally considered self-employed.

In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

ABC Test

According to the California Supreme Court’s April 2018 decision in *Dynamex Operations West, Inc. v. Superior Court*, a business must apply the ABC test to prove that a worker is an independent contractor rather than an employee (employment status). In September 2019, per *California Assembly Bill 5*, the state legislature codified *Dynamex* by adding relevant provisions governing employment status to the state’s labor code, workers’ compensation code, and unemployment code. Of note, the law does not diminish the flexibility of employees to work part-time or intermittent schedules or to work for multiple employers.

Effective January 1, 2020

Effective January 1, 2020, according to *Cal. Labor Code § 2750.3* (to be updated by the state) for the California Labor Code, Unemployment Insurance Code, and California Industrial Welfare Commission (IWC) wage orders, a person providing labor or services for remuneration is considered
an employee, and not an independent contractor, unless the hiring entity demonstrates that all of the following conditions of the ABC test 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.

**Note:** Cal. Labor Code § 2750.3 does not permit an employer to reclassify an individual who was an employee on January 1, 2019, to an independent contractor due to the law’s enactment.

**Borello and Economics Reality Test**

According to Cal. Labor Code § 2750.3, the ABC test and *Dynamex* do not apply to the specific occupations, and whether a worker is an employee or independent contractor (employment status) is governed by the California Supreme Court’s 1998 decision in *S. G. Borello & Sons, Inc. v. Department of Industrial Relations* 48 Cal.3d 341 (*Borello*).

Under *Borello*, the applicable test to determine employment status is the multi-factor Economic Realities test where the most significant factor is whether the person to whom service is rendered (employer or principal) has control over, or has the right to control, the worker both as to the work done and the manner and means in which it is performed. Additional factors that may be considered, depending on the issue, are as follows:

- Whether the person performing services is engaged in an occupation or business distinct from that of the principal;
- Whether or not the work is a part of the regular business of the principal or alleged employer;
- Whether the principal or the worker supplies the instrumentalities, tools, and the place for the person doing the work;
- The alleged employee’s investment in the equipment or materials required by his or her task or his or her employment of helpers;
- Whether the service rendered requires a special skill;
- 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;
- The alleged employee’s opportunity for profit or loss depending on his or her managerial skill;
- The length of time for which the services are to be performed;
- The degree of permanence of the working relationship;
- The method of payment, whether by time or by the job; and
- 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.

**Express Exemptions**

According to Cal. Labor Code § 2750.3, the ABC test and *Dynamex* do not apply to the following occupations and, instead, employment status is governed by *Borello*:

- Commercial fishermen working on an American vessel.
- Direct sales salespersons.
- Licensed and practicing lawyers, architects, engineers, private investigators, or accountants.
Licensed insurance agents.
Licensed physicians and surgeons, dentists, podiatrists, psychologists, or veterinarians performing professional or medical services provided to or by a health care entity.
Motor clubs and individuals performing services via contract with the club.
Referral agencies and service providers. A referral agency is a business that connects clients with 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 providers. However, this does not apply to an individual worker, as opposed to a business entity, who performs services for a client through a referral agency that is governed by the ABC test.
Registered securities broker-dealers and investment advisers or their agents and representatives.
Work performed under a professional services contract, defined by Cal. Labor Code § 2750.3(c)(2)(B) with another business entity, and includes, but is not limited to, travel agents, graphic designers, grant writers, fine artists, photographers, and writers. This also applies to licensed manicurists (until January 1, 2022 when the exemption for manicurists expires), licensed barbers, and licensed cosmetologists under the terms and conditions in Cal. Labor Code § 2750.3(c)(2)(B)(xi).
Work performed under a subcontract in the construction industry, in this case the determination is governed by Cal. Labor Code § 2750.5 and by Borello.

Note: If a court of law rules that the ABC test cannot be applied to a particular context, and is not otherwise based on an express exception, then a worker’s employment status is determined by Borello.

Additional Exemptions
The following additional exemptions apply to the determination of employment status:

- The employment relationship of real estate licensees is governed by Cal. Bus. & Prof. Code § 10032, not the ABC test or Dynamex. If § 10032 is not applicable, then the determination is governed as follows:
  o Cal. Unempl. Code § 650 for unemployment insurance purposes;
  o Cal. Labor Code § 3200 et seq. for workers’ compensation purposes; and
  o By Borello for all other purposes in the Labor Code. The statutorily imposed duties of a responsible broker, per Cal. Bus. & Prof. Code § 10015.1, are not factors for consideration under the Borello test.
- Licensed repossession agencies are governed by Cal. Bus. & Prof. Code § 7500.2, if the agency 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.
- Neither the ABC test or Dynamex apply to a bona fide business-to-business contracting relationship (business service provider) under the terms and conditions at Cal. Labor Code § 2750.3(e). However, this does not apply to an individual worker, as opposed to a business entity, who performs labor or services for a contracting business. The ABC test governs whether an individual working for a business service provider is its employee or independent contractor.
- An exception also applies to subcontractors providing construction trucking services for which a contractor’s license is not required, under the terms and conditions of Cal. Labor Code § 2750.3(f)(8).

Construction Trucking Services
For work performed after January 1, 2020 and before January 1, 2022, any business entity that provides construction trucking services to a licensed contractor utilizing more than one truck is the employer for all drivers of those trucks. **Construction trucking services** are hauling, and trucking services provided in the construction industry pursuant to a contract with a licensed contractor utilizing vehicles that require a commercial driver’s license to operate or have a gross vehicle weight rating of 26,001 or more pounds. The law does not prohibit an individual who owns their truck from working as an employee of a trucking company and utilizing that truck in the scope of that employment. An individual employee providing their own truck for use by an employer trucking company shall be reimbursed by the trucking company for the reasonable expense incurred for the use of the employee owned truck.

### Additional Terms

According to Cal. Labor Code § 2750.3(a)(2), any exceptions to the terms employee, employer, employ, or independent contractor, and any extensions of employer status or liability, that are expressly made by a provision of the Labor Code, Unemployment Insurance Code, or in an applicable IWC order including, but not limited to, the definition of employee’ in subdivision 2(E) of [IWC Order No. 2](https://www.iwc.california.gov/orders/2) (personal services industry) continues to be effective.

According to Cal. Labor Code § 2750.3(i):

1. The addition of the ABC test does not constitute a change in, but is declaratory of, existing law with regard to IWC wage orders and violations of the Labor Code relating to wage orders. In other words, Dynamex interpreted one of the three alternative definitions of employ, the “suffer or permit” definition, from the IWC wage orders but Cal. Labor Code § 2750.3 does not affect the application of alternative definitions of employ from the IWC wage orders, which were not addressed by Dynamex.
2. Insofar as the application the exemptions would relieve an employer from liability, they apply retroactively to existing claims and actions to the maximum extent permitted by law.
3. Except as provided above, in bullets 1 and 2, the provisions of Cal. Labor Code § 2750.3 apply to work performed on or after January 1, 2020.

### Enforcement

In addition to any other remedies available, an action for injunctive relief to prevent the continued misclassification of employees as independent contractors may be prosecuted against the putative employer in court.

### Workers Compensation and Independent Contractors

According to Cal. Labor Code § 3351, for workers’ compensation purposes an **employee** is every person in the service of an employer under any appointment or contract of hire or apprenticeship, express or implied, verbal or written, whether lawfully or unlawfully employed, and includes all the following:

- Aliens and minors.
- All elected and appointed paid public officers.
• All officers and members of boards of directors of quasi-public or private corporations while rendering actual service for the corporations for pay. However, an officer or member of a board of directors may elect to be excluded from coverage.

• With exception, any person employed by the owner or occupant of a residential dwelling whose duties are incidental to the ownership, maintenance, or use of the dwelling, including the care and supervision of children, or whose duties are personal and not in the course of the trade, business, profession, or occupation of the owner or occupant.

• All persons incarcerated in a state penal or correctional institution while engaged in assigned work or employment or engaged in work performed under contract.

• All working members of a partnership or limited liability company receiving wages irrespective of profits from the partnership or limited liability company. However, a general partner of a partnership or a managing member of a limited liability company may elect to be excluded from coverage.

• A person who holds the power to revoke a trust, with respect to shares of a private corporation held in trust or general partnership or limited liability company interests held in trust. To the extent that this person is deemed to be an employee, then they may also elect to be excluded from coverage if they otherwise meet the criteria for exclusion per Cal. Labor Code § 3352.

• A person committed to a state hospital facility under the State Department of State Hospitals while engaged in and assigned work in a vocation rehabilitation program, including a sheltered workshop.

• Beginning on July 1, 2020, any individual who is an employee under Cal. Labor Code § 2750.3; however, this does not apply retroactively.

Unemployment Insurance and Independent Contractors

According to Cal. Unempl. Code § 606.5, for unemployment insurance purposes whether an individual (or entity) is the employer of specific employees is determined by Cal. Unempl. Code § 621. Accordingly, an employee is:

• Any officer of a corporation.

• Any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee providing labor or services for remuneration, has the status of an employee rather than an independent contractor unless the hiring entity demonstrates that:
  o The individual 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;
  o The individual performs work that is outside the usual course of the hiring entity’s business; and
  o The individual is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

• Any individual, other than an individual who is an employee under subdivision (a) or (b), who performs services for remuneration for any employing unit if the contract of service contemplates that substantially all of those services are to be performed personally by that individual either (see note, below):
  o As an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services, for their principal.
As a traveling or city salesperson, other than as an agent-driver or commission-driver, engaged upon a full-time basis in the solicitation on behalf of, and the transmission to, his or her principal (except for sideline sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations.

As a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by that person that are required to be returned to that person or a person designated by a designee thereof.

- Any individual who is an employee pursuant to Cal. Unempl. Code § 601.5 or § 686.
- Any individual whose services are in subject employment pursuant to an election for coverage Cal. Unempl. Code § 701.
- Any member of a limited liability company that is treated as a corporation for federal income tax purposes.

**Note:** An individual is not an employee if they have a substantial investment in facilities used in connection with the performance of those services, other than in facilities for transportation, or if the services are in the nature of a single transaction not part of a continuing relationship with the employing unit for whom the services are performed.

## Willful Misclassification

According to Cal. Labor Code § 226.8, it is unlawful for any person or employer to engage in:

- Willful misclassification of an individual as an independent contractor. *Willful misclassification* is avoiding employee status for an individual by voluntarily and knowingly misclassifying that individual as an independent contractor.
- Charging an individual who has been willfully misclassified as an independent contractor a fee, or making any deductions from compensation, for any purpose, including for goods, materials, space rental, services, government licenses, repairs, equipment maintenance, or fines arising from the individual's employment where any of those acts would have violated the law if the individual had not been misclassified.

## Penalties and Enforcement

Engaging in willful misclassification incurs the following penalties enforced by the California Labor and Workforce Development Agency, court determination, or the California Labor Commissioner:

- Upon first violation, the person or employer will be subject to a civil penalty of between $5,000 and $15,000 for each violation, in addition to any other penalties or fines permitted by law.
- Upon recurrence or a pattern of violations, the person or employer will be subject to a civil penalty of between $10,000 and $25,000 for each violation, in addition to any other penalties or fines permitted by law.
- The Contractors’ State License Board will be notified of a violator that is a licensed contractor and the board will initiate an action against the licensee.

Any administrative or civil penalty or disciplinary action remains in effect against any successor corporation, owner, or business entity that:
• Has one or more of the same principals or officers as the person or employer subject to the penalty or action.
• Is engaged in the same or a similar business as the person or employer subject to the penalty or action.

Posting Upon Violation

In addition to any other remedy that has been ordered, the person or employer will be required to display prominently on its website, in an area that is accessible to all employees and the general public, or, if the person or employer does not have an website, to display prominently in an area that is accessible to all employees and the general public at each location where the violation occurred, a notice that sets forth:

• That the Labor and Workforce Development Agency or a court, as applicable, has found that the person or employer has committed a serious violation of the law by engaging in the willful misclassification of employees.
• That the person or employer has changed its business practices in order to avoid committing further violations of the law.
• That any employee who believes that they are being misclassified as an independent contractor may contact the Labor and Workforce Development Agency. The notice will include the mailing address, email address, and telephone number of the agency.
• That the notice is being posted pursuant to a state order.

Notice requirements may also be satisfied where in preparing the notice and an officer signs the notice and the notice is posted for one year commencing with the date of the final decision and order.

Liability for Knowingly Advising an Employer to Misclassify

According to Cal. Lab. § 2753, a person who, for money or other valuable consideration, knowingly advises an employer to treat an individual as an independent contractor to avoid employee status for that individual will be jointly and severally liable with the employer if the individual is found not to be an independent contractor.

However, this liability does not apply to:

• A person who provides advice to their employer.
• An attorney authorized to practice law in California or another United States jurisdiction who provides legal advice in the course of the practice of law.

Independent Contractor Reporting

Businesses and government entities (service-recipient) are required to report specified information to the California Employment Development Department (EDD) on independent contractors (service-provider).
Service-recipients must report independent contractor information if they hire an independent contractor and all the following statements all apply:

- A Form 1099-MISC must be filed for the services performed by the independent contractor.
- The independent contractor is paid $600 or more or enters into a contract for $600 or more.
- The independent contractor is an individual or sole proprietorship.

**When to Report**

Independent contractor information must be reported to the EDD within 20 days of either making payments totaling $600 or more or entering into a contract for $600 or more with an independent contractor in any calendar year, whichever is earlier. Businesses that transmit electronically must submit two monthly reports that are not less than 12 days and not more than 16 days apart. Report must only be submitted for new independent contractors.

**What to Report**

The following is required to be reported:

- **Service-recipient:**
  - Federal employer identification number (EIN).
  - California employer account number.
  - Social Security number.
  - Business name, address, and telephone number.
- **Service-provider (independent contractor):**
  - First name, middle initial, and last name.
  - Social Security number.
  - Address.
  - Start date of contract (if no contract, date payments equal $600 or more).
  - Amount of contract, including cents (if applicable).
  - Contract expiration date (if applicable).
  - Ongoing contract (check box if applicable).

**How to Report**

To submit a Report of Independent Contractor(s) (Form DE 542) online, employers must use e-Services for Business or submit a paper report of independent contractors by mail or fax. Form DE 542 may be obtained as follows:

- Download a fill-in DE 542 (PDF) from the EDD website.
- Order through the Online Forms and Publications page.
- Print data directly to the DE 542 by following the Print Specifications (PDF).
- Call the Taxpayer Assistance Center at 1-888-745-3886 to obtain a form.
- Create a form with all of the required information.
- Visit the nearest Employment Tax Office.

Mail or fax the paper DE 542 as follows:
Penalties

A service-recipient may be charged a penalty of $24 for each failure to report within the required time frames, unless the failure is due to good cause. If the failure to report is intentional or if the report is falsified, a penalty of $490 may be charged.

This article is a general overview and should not be construed as legal advice. In no event will we be liable for any damages whatsoever resulting from use of this material. We recommend that you seek legal advice when applying these guidelines.