

HICKS NOTES

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February 2020

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CALIFORNIA EMPLOYERS FACE NEW INDEPENDENT CONTRACTOR LAW

Most of our clients are in California, so this month's newsletter is a quick overview of the new "Independent Contractor versus Employee" classification law that may affect retirement plans and their designs. Right now, it is uncertain exactly what test we will be using for ERISA retirement plan purposes, but having an understanding of the new law provides insight on what a federal agency might do under audit.

In September of 2019, Governor Newsom signed Assembly Bill (AB) 5 into law. The new law, AB 5, added a new section of the Labor Code 2750.3 on January 1, 2020 changing California's test for determining whether a worker is an employee or independent contractor for purposes of the labor code and hence potential retirement plan eligibility. This new law requires the use of the "**ABC test**" for determining independent contractor status as follows:

- A. The worker is free (contractually and in fact) from the control and direction of the hirer in connection with the work; AND
- B. The worker performs work that is not the hiring entity's usual business; AND
- C. The worker is customarily engaged in an independently established trade, occupation, or business of the same nature of the work performed for the hiring entity.

It is a codification and expansion of the ABC test which was first adopted in *Dynamex Operations West, Inc. v. the California Superior Court* (2018) 4 Cal.5th 903. Under the old law, there was the **Borello test** which looked at the relationship between the worker and employer. This test still applies to those exempt under the new law.

The State of California Labor Commissioner's Office has issued "Frequently asked Questions" about "Independent Contractor versus Employee" classification law. Click [here](#) to view the entire article, although I've quoted key excerpts below.

"The California Supreme Court established the Borello test in *S.G. Borello & Sons, Inc. v. Department. of Industrial Relations* (1989) 48 Cal.3d 341. The test relies upon multiple factors to make that determination, including whether the potential employer has all necessary control over the manner and means of accomplishing the result desired, although such control need not be direct, actually exercised or detailed. This factor, which is not dispositive, must be considered along with other factors, which include:

1. Whether the worker performing services holds themselves out as being engaged in an occupation or business distinct from that of the employer;
2. Whether the work is a regular or integral part of the employer's business;
3. Whether the employer or the worker supplies the instrumentalities, tools, and the place for the worker doing the work;
4. Whether the worker has invested in the business, such as in the equipment or materials required by their task;
5. Whether the service provided requires a special skill;
6. The kind of occupation, and whether the work is usually done under the direction of the employer or by a specialist without supervision;
7. The worker's opportunity for profit or loss depending on their 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;
11. Whether the worker hires their own employees;
12. Whether the employer has a right to fire at will or whether a termination gives rise to an action for breach of contract; and
13. Whether or not the worker and the potential employer believe they are creating an employer-employee relationship (this may be relevant, but the legal determination of employment status is not based on whether the parties believe they have an employer-employee relationship).

Borello is referred to as a "multifactor" test because it requires consideration of all potentially relevant facts – no single factor controls the determination. Courts have emphasized different factors in the multifactor test depending on the circumstances."

While the ABC test applies to most workers, the Borello test applies for some jobs and industries. Those occupations, where the Borello test applies instead of the ABC test, is a long list including but not limited to certain physicians, dentist, veterinarians, lawyers, engineers, insurance agents/ brokers, attorneys, architects, accountants, registered securities broker-dealers and direct salespersons.

Further quoting from the California article referenced above, all workers are presumed to be employees and the employer has the burden of proof to establish that they are independent contractors under these new rules.

“Below is a summary of the California Supreme Court’s explanation of how to apply the **ABC test**.

Part A: Is the worker free from the control and direction of the hiring entity in the performance of the work, both under the contract for the performance of the work and in fact?

- The hiring entity must establish that the worker is free of such control to satisfy part A of the ABC test. (Dynamex, 4 Cal.5th at 958.)
- 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. (Id.)
- 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. (Id.)

PART B: Does the worker perform work that is outside the usual course of the hiring entity's business?

- The hiring entity must establish that the worker performs work that is outside the usual course of its business in order to satisfy part B of the ABC test. (Dynamex, 4 Cal.5th at 959.)
- Contracted workers who provide services in a role comparable to that of an existing employee will likely be viewed as working in the usual course of the hiring entity's business. (Id.)
- Examples where services are not part of the hiring entity's usual course of business:
 - When a retail store hires an outside plumber to repair a leak in a bathroom on its premises.
 - When a retail store hires an outside electrician to install a new electrical line. (Id.)
- Examples where services are part of the hiring entity's usual course of business:
 - When a clothing manufacturing company hires work-at-home seamstresses to make dresses from cloth and patterns supplied by the company that will thereafter be sold by the company.
 - When a bakery hires cake decorators to work on a regular basis on its custom-designed cakes. (Id. at 959-960.)

PART C: Is the worker customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity?

- The hiring entity must prove that the worker is customarily and currently engaged in an independently established trade, occupation, or business. (Dynamex, 4 Cal.5th at 963.)
- The hiring entity cannot unilaterally determine a worker's status simply by assigning the worker the label “independent contractor” or by requiring the worker, as a condition of hiring, to enter into a contract that designates the worker an independent contractor. (Dynamex, 4 Cal.5th at 962.)
- Part C requires that the independent business operation actually be in existence at the time the work is performed. The fact that it could come into existence in the future is not sufficient. (See Garcia v. Border Transportation Group, LLC (2018) 28 Cal.App.5th 558, 574.)
- An individual who independently has made the decision to go into business generally takes the usual steps to establish and promote that independent business. Examples of this include:
 - Incorporation, licensure, advertisements;
 - Routine offerings to provide the services of the independent business to the public or to a number of potential customers, and the like. (Dynamex, 4 Cal.5th at 962.)
- If an individual's work relies on a single employer, Part C is not met. For example, Part C was not satisfied where a taxi driver was required to hold a municipal permit that may only be used while that driver is employed by a specific taxi company. (See Garcia, 28 Cal.App.5th at 575.) “

Most of the provision are effective January 1st, 2020 including changes for California taxes and regulations.

All retirement plans fall under ERISA and other governmental laws. Under current Federal Law, there is a two-part **Control and Relationship Test**.

- **Control:** Behavior Control is exerted if the business controls “What must be done” and “How the work must be done”. Are the duties being directed by the employer? Financial control looks to how the worker is compensated and whether or not a profit or loss can be incurred and the investment made by the worker.
- **Relationship** includes the extent which services are performed by the worker, along with their written contracts which may include other benefits are included in the agreements. Is it a typical employer/employee relationships? Form SSA-7160-F4, Employment Relationship Questionnaire is designed to aid in answering the question of employer and employee relationship.

For retirement plan sponsors, employee status is important for determining who is required to be covered by the plan. By definition, independent contractors are not employees and cannot be covered by the plan. Excluded independent contractors who are later determined to be employees would be due retroactive benefits under the plan and would be precluded from sponsoring their own retirement plans for the period they are determined to be employees.

Bottom Line: This is an area that will need examination for those who use independent contractors. I find it hard to say you are an employee for some things and not others. We will update you as guidance becomes available, but communication with clients who this may affect is important.