

NIESAR & VESTAL LLP

Law Alert

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AB5 classifies the vast majority of California workers as employees

As of January 1, 2020, it will be very unlikely that any worker in California currently treated as an independent contractor will be allowed to continue to be so classified. Most will be classified by this new law as employees. Employers who ignore the law will be subject to severe penalties.

In its April 2018 decision in the *Dynamex* case, the California Supreme Court established a three-part test, commonly known as the “ABC” test, that hiring entities must meet to classify workers as independent contractors instead of employees.

On September 18, 2019, governor Newsom signed into law Assembly Bill 5 (“AB5”), which codifies the decision in the *Dynamex* case and clarifies its application. This law classifies the vast majority of California workers as employees.

The three-part worker-friendly test prohibits a hiring entity from classifying a worker as an independent contractor unless the hirer can establish all three of the following:

- (A) The hiring entity does not control or direct the worker in performing the work in fact or under the terms of a contract.
- (B) The work performed is outside the “usual course” of the hiring entity’s business.
- (C) The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

The new provisions expand the reach of the *Dynamex* ABC test. While the Supreme Court held in *Dynamex* that the ABC test applied to California’s wage orders, AB5 applies the test to workers not just for wage order purposes, but also under the California Labor Code and the Unemployment Insurance Code. This will certainly increase the costs for hiring entities because employees are entitled to benefits such as minimum wage, workers’ compensation, unemployment insurance, expense reimbursement, paid sick leave, and paid family leave. Payroll taxes apply to them as well. On January 1, 2020, the three-part test will apply for purposes of the Unemployment Insurance Code and all other provisions of the Labor Code. On July 1, 2020, the test will apply for purposes of workers’ compensation.

AB5 exempts certain occupations and business relationships from ABC’s application, and the less-stringent *Borello* test will continue to apply to those industries under certain conditions. Among the exceptions are licensed physicians, lawyers, engineers, accountants, and private investigators, certain marketing and human resources professionals, and licensed manicurists and barbers who can meet certain conditions, including setting their own rates. AB5 also excludes any “bona fide business-to-business contracting relationship,” that is, a relationship under which a sole

proprietor, partnership, or other form of business provides services to another business. A separate law alert will follow soon reviewing the *Borello* test factors.

All California businesses should carefully consider whether their independent contractors can still be considered as such when AB5 goes into effect on January 1.

The penalties and consequences of misclassification of employees as independent contractors are stringent. They include back wages and penalties for overtime, minimum wage, and meal and rest break violations. We also note that the Labor Code authorizes California's Labor and Workforce Development Agency to assess civil penalties of not less than \$5,000 and not more than \$15,000 for each violation of misclassification, plus any unpaid taxes.

This new law also leaves open the question of how multi-state employers should treat their workers: while the IRS insists on "consistent treatment", how should a multi-state hiring entity treat its workers consistently if the classification of its workers would be "employees" under the California laws and the classification would be that of "independent contractors" under the laws of some other states? There are several ways of treating these distinctions, which are beyond the scope of this law alert because they would require risk assessment and analysis of your particular business considerations. We would be happy to discuss this with you, in order to make sure that your business is compliant for not only employment law purposes, but also tax law purposes beginning January 1, 2020.

If you have questions concerning the qualification of your "independent contractors", the implications of AB5, or the choice of the best compliance option for your business, please feel free to contact Gerald Niesar (gniesar@nvlawllp.com), Oscar Escobar (oescobar@nvlawllp.com), or Carolina Aricu (caricu@nvlawllp.com).

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