

What's New?

On September 18, 2019, Governor Newsom signed Assembly Bill (AB) 5, which addresses employment status and codifies the ABC test adopted by the California Supreme Court in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) 4 Cal.5th 903. AB 5 also expands the ABC test's use so that it is applicable to most provisions of the [Labor Code](http://leginfo.ca.gov/faces/codes.xhtml) (leginfo.legislature.ca.gov/faces/codes.xhtml) as well as the [California Unemployment Insurance Code \(CUIC\)](http://leginfo.ca.gov/faces/codes.xhtml) (leginfo.legislature.ca.gov/faces/codes.xhtml). AB 5 became effective January 1, 2020.

Employment

Generally, employment occurs when an employer hires an employee to perform services for wages. An *employer* can be any employing unit, such as a sole proprietor, joint venture, partnership, limited liability company, or corporation. An employer can also include associations, trusts, charitable foundations, nonprofit organizations, public entities, household employment, and other organizations. Section 621(b) of the CUIC sets forth the ABC test that is used, subject to certain exceptions, to determine whether an individual is an *employee* or independent contractor. If the ABC test applies, an individual is presumed to be an employee unless the hiring entity can prove the worker meets all three conditions of the test.

Who Is an Employer?

Section 675 of the CUIC provides that a business becomes a subject employer when it employs one or more employees and pays wages in excess of \$100 during any calendar quarter. Wages are compensation for personal services performed, including, but not limited to, cash payments, commissions, bonuses, and the reasonable cash value of nonmonetary payments for services, such as meals and lodging.

An employer must register with the Employment Development Department (EDD) within 15 days of becoming a subject employer. Employers are responsible for reporting wages paid to their employees and paying Unemployment Insurance (UI) and Employment Training Tax (ETT) on those wages, as well as withholding and remitting State Disability Insurance* (SDI) and Personal Income Tax (PIT) due on wages paid.

* Includes Paid Family Leave (PFL).

Who Is an Employee?

For purposes of the CUIC, an employee may be one of the following:

- A worker who is an employee based on the standard that applies under Labor Code section 2775 (e.g., the ABC test, the older *Borello* test, or another applicable test); or
- An individual who is identified specifically in the CUIC, such as corporate officers.

An employee may perform services on a permanent, temporary, or less than full-time basis. The law does not exclude services from employment that are commonly referred to as day labor, part-time help, casual labor, temporary help, probationary, or outside labor.

The ABC Test

Under the ABC test, an individual providing labor or services for remuneration is presumed to be an employee rather than an independent contractor unless the hiring entity demonstrates **all three** of the following conditions:

- A. The individual is free from control and direction, both under contract and in fact.
- B. The individual performs work that is outside the usual course of the hiring entity's business.
- C. The individual has their own independently established business of the same type as the work performed.

In analyzing Condition A of the ABC test, the California Supreme Court in *Dynamex* explained:

- 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.

The California Supreme Court in *Dynamex* provided the following examples of Condition A being applied:

- An employer failed to establish that work-at-home knitters and sewers who made the clothing were sufficiently free from the company's control where the employer provided the workers with the same patterns. The court reasoned that "[t]he degree of control and direction over the production (...) is no different when the sweater is knitted at home at midnight than if it were produced between nine and five in a factory." (*Fleece on Earth v. Dep't of Empl. & Training* (Vt. 2007) 181 Vt. 458, 923 A.2d 594.)
- A construction company proved that a worker who specialized in historic reconstruction was sufficiently free of the company's control where the worker set his own schedule, worked without supervision, purchased all materials using his own business credit card, and had declined an offer of employment proffered by the company (*Great N. Constr., Inc. v. Dept. of Labor* (Vt. 2016) 204 Vt. 1, 161 A.3d 1207).

In analyzing Condition B of the ABC test, the California Supreme Court in *Dynamex* explained:

- Contracted workers who provide services in a role comparable to that of existing employees will likely be viewed as working in the usual course of the hiring entity's business.

The California Supreme Court in *Dynamex* provided the following examples of Condition B being applied:

- Condition B **is** satisfied (i.e., services are **not** part of the hiring entity's usual course of business):
 - o When a retail store hires an outside plumber to repair a leak in a bathroom on its premises.
 - o When a retail store hires an outside electrician to install a new electrical line.
- Condition B **is not** satisfied (i.e., services **are** part of the hiring entity's usual course of business):
 - o 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.
 - o When a bakery hires cake decorators to work on a regular basis on its custom-designed cakes.

In analyzing Condition C of the ABC test, the California Supreme Court in *Dynamex* and subsequent appellate court decisions explained:

- The hiring entity must prove the independent business operation **is actually in existence** at the time the work is performed. The fact that the business operation could come into existence in the future is not sufficient.

- 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:

- o Incorporation, licensure, advertisements.
- o Routine offerings to provide the services of the independent business to the public or to a number of potential customers, and the like.
- Condition C **is not** necessarily satisfied:
 - o Where the hiring entity unilaterally assigns the worker the label "independent contractor."
 - o Where the hiring entity requires the worker, as a condition of hiring, to enter into a contract that designates the worker an independent contractor.
 - o If an individual's work relies on a single employer. For example, Condition 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 (*Garcia v. Border Transportation Group* (2018) 28 Cal. App.5th 558, 575).

Exceptions: Circumstances Where the ABC Test Is Not Applicable

While the ABC test is the applicable test for most workers, for some jobs, industries, and contracting relationships, Labor Code sections 2776 and 2784 applies the *Borello* multifactor test, which is explained below, or other tests. For some occupations, the *Borello* test applies without further requirements (e.g., certain licensed professionals). However, for other occupations and industries, the *Borello* test applies instead of the ABC test only after the hiring entity satisfies other requirements first (e.g., certain professional services contractors; certain individuals working under construction subcontracts; certain service providers who are referred to customers through referral agencies). Additionally, for certain real estate licensees and repossession agencies, standards under the [California Business and Professions Code](https://leginfo.ca.gov/faces/codes.xhtml) (leginfo.legislature.ca.gov/faces/codes.xhtml) will continue to apply.

The exceptions from the ABC test may involve some rules and criteria that are not set forth here. Employers and workers should seek independent advice and counsel if they have questions about the applicability of any exception to their particular case. For additional information about and a full list of the ABC test exceptions, please visit the [Employment Status Portal](https://labor.ca.gov/employmentstatus) (labor.ca.gov/employmentstatus).

The *Borello* Test

The California Supreme Court established the *Borello* test in *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations* (1989) 48 Cal.3d 341. The test uses multiple factors to determine whether a worker is an employee, including whether the potential employer has all necessary control over the manner and means of accomplishing the result desired. Such control may be indirect and need not be actually exercised or detailed. The control factor is not dispositive. In other words, a worker cannot be deemed an independent contractor based on a lack of control alone. Instead, this factor 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).

Under the *Borello* test, like with the ABC test, a worker is presumed to be an employee. The hiring entity has the burden of proving that an independent contractor relationship exists. But unlike the ABC test, no single factor under the *Borello* test determines whether a worker is an employee or an independent contractor. Rather, courts

consider all potentially relevant factors, on a case-by-case basis, in light of the nature of the work and the arrangement between the parties.

Who Is an Employee/Employer by Specific Statute?

A worker not considered to be an employee under the ABC, *Borello*, or other applicable test may nevertheless be a statutory employee by law for purposes of UI, ETT, and SDI under circumstances that include, but are not limited to, the following:

- 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 his or her principal. See **Note** below.
- A traveling or city salesperson, other than 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. See **Note** below.
- A home worker performing services according to the specifications furnished by the person for whom the services are performed on materials or goods furnished by such person which are required to be returned to such person or a person designated by him or her. See **Note** below.

Note: For the statutory provisions listed to apply, the contract of hire must contemplate that substantially all the services are to be performed personally by the worker. In addition, an individual performing services in the three occupational categories listed would not be considered a statutory employee if the individual has a substantial investment in facilities used in connection with the performance of such services, other than 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 which the services are performed.

- An author engaged to create a work of authorship that was specially ordered or commissioned by another party. The parties must expressly agree in writing that the work shall be considered a work made for hire and that the ordering or commissioning party obtains ownership of all the rights comprised in the copyright in the work.
- Any member of a limited liability company that is treated as a corporation for federal income tax purposes.

- An unlicensed construction worker engaged to perform services for which a contractor's license is required (i.e., a contractor, licensed or unlicensed, who hires unlicensed construction workers or subcontractors is the employer of those workers or subcontractors).

Services Excluded by Statute from Employment

Services of certain employees are specifically excluded by law from being subject to UI, ETT, and SDI. Examples of such employees include, but are not limited to, the following:

- Family members, but restricted to:
 1. A child under 18 years of age in the employ of his or her biological or adoptive parent or parents;
 2. An adult in the employ of his or her biological or adopted child or children; or
 3. An individual in the employ of his or her spouse or registered domestic partner as defined in section 297 of the [Family Code](http://leginfo.legislature.ca.gov/faces/codes.xhtml) (leginfo.legislature.ca.gov/faces/codes.xhtml).

This exclusion can apply only to sole proprietorships and partnerships where the worker has one of the above referenced relationships with all partners. The wages paid to such workers are subject to PIT withholding and reportable as PIT wages.

- Students under the age of 22 enrolled full-time in an academic institution and performing services for credit in a qualified work experience program. Wages paid to such workers are subject to PIT withholding and reportable as PIT wages.
- Salesperson and broker services.

Additional Information

For further assistance, please contact the Taxpayer Assistance Center at 1-888-745-3886 or visit the nearest Employment Tax Office listed in the [California Employer's Guide \(DE 44\) \(PDF, 2.4 MB\)](http://edd.ca.gov/pdf_pub_ctr/de44.pdf) (edd.ca.gov/pdf_pub_ctr/de44.pdf) and on the [EDD](http://edd.ca.gov) (edd.ca.gov) website. Additional information is also available through the EDD's no-fee [payroll tax seminars](http://seminars.edd.ca.gov/payroll_tax_seminars) (seminars.edd.ca.gov/payroll_tax_seminars).

The EDD is an equal opportunity employer/program. Auxiliary aids and services are available upon request to individuals with disabilities. Requests for services, aids, and/or alternate formats need to be made by calling 1-888-745-3886 (voice) or TTY 1-800-547-9565.

This information sheet is provided as a public service and is intended to provide nontechnical assistance. Every attempt has been made to provide information that is consistent with the appropriate statutes, rules, and administrative and court decisions. Any information that is inconsistent with the law, regulations, and administrative and court decisions is not binding on either the Employment Development Department or the taxpayer. Any information provided is not intended to be legal, accounting, tax, investment, or other professional advice.