

# Life After AB5: A Toolkit

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***Please note: this information does not, and is not intended to, constitute legal advice; instead, all information is intended for general informational purposes only.***



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## Independent Contractors

### Negative outcomes of being an independent contractor

Independent contractors have no employee rights, benefits or statutory protections. Independent contractors do not get federal or state taxes withheld from their pay, either. Independent contractors must pay the IRS and California State estimated taxes quarterly, based on their earned income.<sup>1</sup> In addition, they are not guaranteed consistent paychecks or hours.

### Positive outcomes of being an independent contractor

Independent contractors usually have more control in their work lives. Independent contractors usually work without direct supervision from a client or hiring entity. They have greater amounts of control regarding their scheduling/hours they work, their projects, contracts, and intellectual property. Intellectual property includes an individual's copyrights, trademarks, and patents. Through this level of flexibility, independent contractors can determine their own rates, and are able to negotiate their own contracts as to their fees (whether or not the amount is above or below minimum wage), the methods by which a project is completed, their amount of creative control, and the timeline of project completion.

Independent contractors are also able to report certain required business expenses on their 1099 forms as unreimbursed business expenses. This includes vehicle expenses, mileage, and other travel expenses, home office expenses, supplies, health insurance premiums, continuing education, and more.<sup>2</sup> "The worker gets more "take home" pay as an independent contractor, since payroll taxes are not withheld"<sup>3</sup>

## Independent contractor law prior to *Dynamex*

### Common law test

The IRS/Common Law test to determine if someone is an employee or an independent contractor is largely based upon the contractor's "right to control" how they will perform the job, financial control, and the type of business relationship involved. The test asks the following behavioral question: Does the company control or have the right to control what the worker does and how the worker does his or her job? The test asks the financial question: Are the business aspects of the worker's job controlled by the

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<sup>1</sup> Publication 505 (2020), *Tax Withholding and Estimated Tax (2020)*, available at <https://www.irs.gov/publications/p505>

<sup>2</sup> Section 162(a) of the Internal Revenue Code (title 26 of the *U.S. Code*).

<sup>3</sup> Victoria Plettner-Saunders & Arlene Yang, *California Assembly Bill 5, Worker Misclassifications, and Their Effects On Nonprofit Arts And Culture Organizations*, 2, (2019) [White Paper], available at [https://d3n8a8pro7vhmx.cloudfront.net/arts4bayarea/pages/241/attachments/original/1573860786/ab5\\_white\\_paper\\_-\\_wolfbrown\\_.pdf?1573860786](https://d3n8a8pro7vhmx.cloudfront.net/arts4bayarea/pages/241/attachments/original/1573860786/ab5_white_paper_-_wolfbrown_.pdf?1573860786)



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payer? Aspects include how the worker is paid, whether expenses are reimbursed, who provides tools/supplies, and more. For the type of relationship, the test asks: Are there written contracts or employee-type benefits? Examples of relevant benefits are insurance, pension plans, vacation pay, and more. The test also asks: Will the relationship continue, and is the work performed a key aspect of the business of the payer?<sup>4</sup>

### Federal Department of Labor Wage & Hour Division test

The Federal Department of Labor Wage & Hour Division Test to determine whether or not someone is an independent contractor rather than an employee is based on the worker's "Economic independence". Economic dependence is determined through the Wage and Hour Division Test by looking at precedents from the Supreme Court. The test looks into six key factors, including:

1. The nature and degree of the potential employer's control.
2. The permanency of the workers relationship with the potential employer.
3. The amount of the worker's investment in facilities, equipment, or helpers.
4. The amount of skill, initiative, judgement, or foresight required for the worker's services.
5. The worker's opportunities for profit or loss.
6. The extent of integration of the worker's services into the potential employer's business.<sup>5</sup>

### *Borello* Test

California established its own factor-based test in a 1989 court case called *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations*. 48 Cal. 3d 342. This California test offers 11 flexible factors. "The factors focus on whether a company has control over the means and manner of performing contracted work, and additional secondary factors, such as who provides work tools and the individual's opportunity for profit or loss, to determine contractor status."<sup>6</sup> Since *Borello*, many artists and arts organizations have relied on their analysis of the *Borello* factors to provide and obtain artistic services under independent contractor agreements. The specific *Borello* test factors are as follows:<sup>7</sup>

1. Whether worker is engaged in an occupation or business distinct from hiring entity;
2. Whether the work is part of the company's regular business;
3. Who supplies the equipment, tools, and the place;
4. Worker's financial investment in equipment or materials;
5. Skill required in the particular occupation;
6. Whether the work is usually done without supervision;

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<sup>4</sup> IRS, *Independent Contractor (Self-Employed) or Employee?* <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee> (last updated Jan. 02, 2020).

<sup>5</sup> *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 730 (1947); *United States v. Silk*, 331 U.S. 704, 716 (1947) (Social Security Act case); [https://www.dol.gov/whd/opinion/FLSA/2019/2019\\_04\\_29\\_06\\_FLSA.pdf](https://www.dol.gov/whd/opinion/FLSA/2019/2019_04_29_06_FLSA.pdf).

<sup>6</sup> Aaron N. Colby and Janet Grumer, *New California AB 5 Law Expands Independent Contractor ABC test*, (Sept. 19, 2019), <https://www.dwt.com/blogs/employment-labor-and-benefits/2019/09/california-ab5-employment-law>

<sup>7</sup> SCOCAL, *S. G. Borello & Sons, Inc. v. Department of Industrial Relations*, 48 Cal.3d 341 available at: (<https://scocal.stanford.edu/opinion/s-g-borello-sons-inc-v-department-industrial-relations-30880>) (last visited Monday January 13, 2020).



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7. Worker's opportunity for profit or loss;
8. How long the services are to be performed;
9. The degree of permanence of the working relationship;
10. The payment method, whether by time or by the job; and
11. Whether the parties believe they are creating an employer/employee relationship

### *Dynamex Operations v. Superior Court (2018)*

Previous California public policy established a presumption that a worker is an employee and not an independent contractor. A party who wanted to prove otherwise had the burden of proving independent contractor status to overcome the employee presumption. Most parties were able to rely upon the *Borello* factors to overcome the employee status presumption. The *Dynamex* case altered that dynamic.

[\*Dynamex v. Superior Court\*](#) was a California case decided in 2018. The case revisited *Borello*, and the Court concluded that the previous test to determine independent contractors was not working. *Dynamex* established a stricter test to prove that a worker is an independent contractor and overcome the presumption of employee status. The *Dynamex* Court's decision was intended to improve workers' lives and how they make their living. It was also intended to circumvent business' ability to undercut the market by turning everyone into independent contractors for the sole purpose of saving money.

### *Dynamex A B C test*

To prove that an independent contractor is not an employee, *Dynamex* adapted what is known as "the ABC test." In order to satisfy the ABC test and legally classify a worker as an independent contractor, a company or hiring entity must prove that the contractor is free from the company's control, performs work outside the company's primary business, and is regularly engaged in the trade the worker is hired for, independent of work for the company.<sup>8</sup> So, everyone is an employee, unless they:

- A. Are free from the control and direction of the hiring party.
- B. Perform work outside the usual course of the hiring party's business.
- C. Are "customarily engaged" in an independently established trade, occupation or business of the same nature as the work.

The most significant change in the law is that the work may not be within the hiring business' usual course of business. For example, a plumber who works for a plumbing company would ordinarily be classified as an employee, in contrast to a single plumber who provides services to a theatrical company as an independent contractor. In addition, the test is a significant shift away from *Borello*, in that, rather than a "totality of the circumstances" or balancing test that takes many factors into account, the *Dynamex* test requires all factors be met, without exception.

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<sup>8</sup> *Id.*



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## AB5: The law in general

On September 18, 2019, Governor Newsom signed California Assembly Bill 5 (AB5) into law. According to California’s Department of Industrial Relations, the reason for the change is that;

Employers oftentimes improperly classify their employees as independent contractors so that they, the employer, do not have to pay payroll taxes, the minimum wage or overtime, comply with other wage and hour law requirements such as providing meal periods and rest breaks, or reimburse their workers for business expenses incurred in performing their jobs. Additionally, employers do not have to cover independent contractors under workers' compensation insurance, and are not liable for payments under unemployment insurance, disability insurance, or social security.<sup>9</sup>

The enactment of AB5 roiled the arts industry in California. While certain professions were deemed exempt subject to evidence of their maintaining business practices that would be expected of an independent business as distinguished from an employee’s work, many others, such as musicians, music production engineers, performance artists and artist managers could not typically show that they had such a business or that their services were “outside the usual course of the hiring party’s business.” This put many arts organizations in the position of having to hire artists previously engaged as independent contractors as employees. It also put California artists at a disadvantage to out-of-state peers who might offer the same services without being subject to AB5’s strict definition of independent contractors.

Soon after enactment, the Legislature sponsors of AB5 promised a “Clean-Up Bill” that would expand on the exempt professionals lists and temper the independent business requirements for many more professionals including many in the arts. The expanded list of Exempt Professionals is provided below on page 8, *including exclusions to the new exemptions* which leave certain of these professionals subject to engagement as employees pursuant to AB5.

The best place to find the text of the original and clean-up statutes is through the State’s Legislative Information Website. The specific links are as follows:

[https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200AB5](https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB5).

[http://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200AB2257](http://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB2257)

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<sup>9</sup> State of California Department of Industrial Relations, “*Independent Contractor versus Employee.*” Labor Standards Enforcement. [https://www.dir.ca.gov/dlse/FAQ\\_IndependentContractor.htm](https://www.dir.ca.gov/dlse/FAQ_IndependentContractor.htm) (last visited Jan 08, 2020).



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It is also worth noting that “AB5 does not impact the more flexible tests that federal agencies, such as IRS or Department of Labor, use to determine whether a worker is an employee.”<sup>10</sup>

Wage and hour laws are traditionally enforced in California by the Department of Industrial Relations (DIR) through its Division of Labor Standards Enforcement (DLSE). Now that AB5 has expanded the *Dynamex* decision, there are additional state and local government agencies that can enforce employment laws. These agencies include the Attorney General, city attorneys, and more. California’s state government has also increased its enforcement budget so that state agencies are well-funded to enforce the new law.<sup>11</sup>

### Workers

What might you need to prepare for, or be concerned about if your employment classification may change?

#### Concerns workers may have

As a worker, your employer controls your schedule, salary, and the means by which your work is accomplished. You do not get to write business expenses off on your taxes, although there are some narrow exceptions. Your employer *likely* controls or owns the rights to works that you create during the course of your employment.

#### A note on “work made for hire”

Section 101 of the Copyright Act defines a “work made for hire” as either made by an employee, or “a work specifically ordered or commissioned for use... if the parties expressly agree in a written instrument.”<sup>12</sup>

If your contracts have stated that your services involve the production of creative works as “work made for hire,” then, since 1982, California law has provided for your treatment as an “employee” in California, at least for the purposes of Worker’s Compensation and Unemployment Insurance, pursuant to the California Labor and Unemployment Insurance Code provisions, as follows:

CA Labor Code

Section 3351.5. "Employee" includes:

(c) Any person while engaged by contract for the creation of a specifically ordered or commissioned work of authorship in which the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire... and the ordering or

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<sup>10</sup> Plettner-Saunders & Yang, *supra* note 1, at 3.

<sup>11</sup> Focus Media Law Group, *December 12, 2019 – Assembly Bill-5*, (2019), at 2.

<sup>12</sup> Section 101 of the Copyright Act (title 17 of the *U.S. Code*) <https://www.copyright.gov/circs/circ09.pdf>



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commissioning party obtains ownership of all the rights comprised in the copyright in the work.<sup>13</sup>

CA Unemployment Insurance Code  
Section 686

“Employer” also means any person contracting for the creation of a specially ordered or commissioned work of authorship when the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire, as defined in Section 101 of Title 17 of the United States Code, and the ordering or commissioning party obtains ownership of all of the rights comprised in the copyright in the work. The ordering or commissioning party shall be the employer of the author of the work for the purposes of this part.

Although it was rare for the contracting party to provide workers compensation and unemployment insurance benefits to independent contractors working on a work made for hire contract, these hiring entities are technically out of compliance with the law if they do not. In one respect, AB5 has merely further codified that legal requirement.

### Protect your intellectual property (IP) rights

If you are providing services as an employee that include your creation of original intellectual property to which you seek to retain personal rights, consider requesting an additional provision in the employment agreement called a “reservation of rights”. It is likely that your employer needs to have specific “exclusive” use rights in certain times, places or manners, but has no objection to your retaining other non-competitive use rights. Under these circumstances, spell out the specific rights that the employer needs, but add a provision to the employment agreement that identifies the retained employee rights. An example of this would be: “Employer expressly acknowledges Employee’s reservation of all rights other than those expressly provided to Employer herein.”

If you do not have an employment agreement, consider drafting your own Memorandum of Understanding or “MOU”. This can be in letter format. The MOU can identify the extent to which you may, as an employee providing creative services, retain certain interests in your intellectual property.

Another alternative is that you may be required to grant all rights to the contracting party or employer, but the parties agree that certain rights may be licensed back to you for ongoing or short-term use – such as for posting an image in your portfolio on your website.

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<sup>13</sup> Cal. Lab. Code §3351.5;  
[https://leginfo.legislature.ca.gov/faces/codes\\_displaySection.xhtml?lawCode=LAB&sectionNum=3351.5](https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?lawCode=LAB&sectionNum=3351.5)





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## Assignments

Another way to transfer intellectual property rights is by means of an “assignment”. An “assignment” is the sale agreement for intellectual property to someone else, the same way you would give a buyer legal title to physical property in exchange for a sum of money. An assignment usually applies to a pre-existing creative work rather than one where rights are transferred automatically by virtue of the legal relationship between a contracting party and a person providing creative services (e.g. an employment situation). Under an assignment agreement, as the “Assignor” you permanently transfer some or all intellectual property rights to the “Assignee” in exchange for a specified sum.”<sup>14</sup> Generally, you relinquish all control, involvement, and claim on the intellectual property rights transferred pursuant to an assignment.<sup>15</sup>

## About intellectual property licensing

“Under an intellectual property licensing agreement (also known as an intellectual property license, or an intellectual property license agreement), you retain ownership of your patent, copyright, or trademark, but you give another party permission to use some or all of your intellectual property rights for a specific amount of time for a fee or royalty. These intellectual property contracts typically specify termination dates and procedures.”<sup>16</sup>

There are three common licenses. These licenses are the exclusive license, sole license, and non-exclusive license. You can combine elements of these three types of intellectual property agreements, such as by giving an intellectual property license for exclusive rights in certain geographic areas.<sup>17</sup>

1. Exclusive License: You agree not to grant any other licenses of the invention and rights concerned, as well as to not use the technology yourself.
2. Sole License: You agree not to grant any other licenses of the invention and rights concerned, but you can use such rights yourself.
3. Non-Exclusive License: You agree to give the licensee certain rights, but you also reserve the right to grant licenses of the invention and rights concerned to third parties or to use them yourself.<sup>18</sup>

## What positive change will occur for employee workers

Under AB5, many individuals who provided services as independent contractors will now be considered employees. This new worker status comes with some benefits. If you are an employee, you will now:

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<sup>14</sup> Priori, *Intellectual Assignment Agreements & Licenses*, <https://www.priorilegal.com/intellectual-property/intellectual-property-assignment-agreements-and-licenses> (last visited Jan 13, 2020).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*



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- Get wage and hour laws protection, such as: at least minimum wage, overtime, meal and rest breaks, etc.<sup>19</sup> Note that in California, you gain overtime hours any time you work more than eight hours in one day.
- Get legally mandated benefits, including workers' compensation, state disability insurance, state unemployment, paid sick leave, and FMLA.<sup>20</sup> The Family and Medical Leave Act of 1993 (FMLA) is a federal law that provides job-protected, unpaid leave from work for certain family and serious medical reasons.<sup>21</sup>
- Have reimbursable business expenses: you should be able to request certain reimbursements from your employer under California law. Note, however, that the deduction for unreimbursed employee expenses was recently suspended for most employees in the Federal tax code.<sup>22</sup> A narrow exception for a “qualified performing artist,” requires the employee to have these characteristics:
  1. Performed services in the performing arts as an employee for at least two employers during the tax year,
  2. Received from at least two of those employers wages of \$200 or more per employer,
  3. Had allowable business expenses attributable to the performing arts of more than 10% of gross income from the performing arts, and
  4. Had adjusted gross income of \$16,000 or less before deducting expenses as a performing artist.
- Be on “payroll”
  - This means that your employer withholds your taxes and pays into Social Security and Medicare (matching your contribution).
  - The Federal Insurance Contributions Act (FICA) consists of both Social Security and Medicare taxes. Social Security and Medicare taxes are paid both by the employee and the employer. Each party pays half of the taxes. Together, both halves of the FICA taxes add up to 15.3%, which is broken down as follows:
    - Social Security (employee pays 6.2%)
    - Social Security (employer pays 6.2%)

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<sup>19</sup> Workplace Fairness, *Filing A Wage and Hour Claim*, <https://www.workplacefairness.org/wage-hour-claim-CA> (last visited Jan. 13, 2020).

<sup>20</sup> Legal Aid At Work, “SDI”: *Your Legal Rights*, [https://www.edd.ca.gov/disability/Employer\\_Workers\\_Compensation.htm](https://www.edd.ca.gov/disability/Employer_Workers_Compensation.htm); <https://legalaidatwork.org/factsheet/state-disability-insurance-sdi/>; <https://legalaidatwork.org/factsheet/lost-your-job-your-rights-and-benefits/>; [https://www.dir.ca.gov/dlse/paid\\_sick\\_leave.htm](https://www.dir.ca.gov/dlse/paid_sick_leave.htm); (last visited Jan. 13, 2020).

<sup>21</sup> United States Department of Labor, *Paid Sick Leave, FMLA, and Paid Family and Medical Leave*, (September 2016), <https://www.dol.gov/sites/dolgov/files/OASP/legacy/files/PaidLeaveFinalRuleComparison.pdf>

<sup>22</sup> Cal. Lab. Code §2802 [https://leginfo.ca.gov/faces/codes\\_displaySection.xhtml?lawCode=LAB&sectionNum=2802](https://leginfo.ca.gov/faces/codes_displaySection.xhtml?lawCode=LAB&sectionNum=2802); “The unreimbursed employee expense deductions have been suspended for tax years beginning after 2017, and before 2026, per section 67(g).” The rule suspension applies unless you are an Armed Forces reservist (member of a reserve component), a Fee-basis state or local government official, a Qualified performing artist, or a Disabled employee with impairment-related work expenses. <https://www.irs.gov/instructions/i2106>; *see also*: <https://www.irs.gov/pub/irs-pdf/p463.pdf>; <https://www.irs.gov/pub/irs-pdf/p535.pdf>



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- Medicare (employee pays 1.45%)
- Medicare (employer pays 1.45%)
- Get paid consistently: pay attention to the method and timing of the payment. Employers are usually required to pay 2 times a month, with some exceptions.
- Have the option of joining a union, which is a way for employees to negotiate for more favorable working conditions.
- Qualify for protections under the Fair Labor Standards Act, the Americans With Disabilities Act, and the Civil Rights Act

### For Workers: Choosing to remain an independent contractor

#### Exemptions under AB5: Professional Services

Subdivision (a) and the holding in *Dynamex* do not apply to a contract for “professional services,” and instead the determination of whether the individual is an employee or independent contractor shall be governed by *Borello* if the hiring entity demonstrates that all of the following factors are satisfied.<sup>23</sup>

Exempt Professional services related to the arts were originally deemed to include marketing specialists, graphic designers, grant writers, fine artists, freelance writers, and photographers (with limitations). Subject to the AB5 “Clean-up Bill” passed by the Legislature and Signed by the Governor in early September 2020, a number of other arts professionals were added to this list IF the *Borello* factors weigh in favor of independent contractor status AND the hired professional maintains a number of business practices that would be expected of an independent contractor as distinguished from an employee. These are listed as follows:

- Maintains a business location;
- Has a business license and any required professional licenses or permits;
- Has the ability to set or negotiate their own rates;
- Has the ability to set their own hours;
- Has work with other hiring entities, or holds themselves out to other customers; and
- Regularly exercises discretion and independent judgment.

In addition to these requirements, Section 2778 provides that such professionals provide services subject to a written contract that specifies the rate of pay and obligation to pay by a defined time, and on condition that the individual providing the services is not directly replacing an employee who performed the same work at the same volume for the hiring entity. Furthermore, the individual is not supposed to primarily perform the expected services at the hiring entity’s business location, and the individual cannot be restricted from working for more than one hiring entity.

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<sup>23</sup> California Legislative Information, *AB-5 Worker Status: Employees and Independent Contractors*, September 19, 2019), [https://leginfo.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200AB5](https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB5)



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2778 also removes the original AB5 restriction that still photographers or photojournalists “could not license content submissions to the putative employer more than 35 times per year.”<sup>24</sup> As long as such professionals meet all the above requirements and “pass” the *Borello* test, they may be deemed an independent contractor and avoid being engaged as an employee.

As mentioned, the list of professionals subject to AB5 and *Dynamex* employee status exemptions has been expanded to include music and music business professionals, “performance artists,” and editors and translators. However, there are also explicit exclusions to the exemptions that must be noted.

In the music industry, the following may well qualify as independent contractors: recording artists, songwriters, lyricists, composers, managers of recording artists, record producers and directors, musicians, vocalists, music engineers and mixers engaged in the creation of sound recordings, and independent radio promoters. New Labor Code section 2780 also includes a ‘catch-all provision’ to include “other individuals engaged to render any creative, production, marketing, or independent music publicist services related primarily to the creation, marketing, promotion, or distribution of sound recordings or musical compositions.” [FN 2780(a)(1)]

The exclusions to the exemptions for musical business professionals are all those who are subject to union collective bargaining agreements that typically require their members to be contracted as employees. Furthermore, musicians and vocalists who are not royalty-based participants in the work created during any specific engagement, are entitled to receive minimum and overtime wages for hours worked during the engagement, as well as any CA Industrial Welfare Commission damages and penalties due to the failure to receive minimum or overtime wages for such services. [FN 2780(a)(4)(B)(1)]

To the great relief of bands and other live musical performers, 2780 also clarifies that performances at clubs and other venues do not trigger an employer-employee relationship, but again with exceptions to the exemption. Specifically, unless one of the following exceptions apply, single bookings (no more than one in the same venue per week excepting tours) are subject to *Borello* factors and the musical artist’s professional business status:

- 1) The musical group is performing as a symphony orchestra, the musical group is performing at a theme park or amusement park, or a musician is performing in a musical theater production;
- 2) The musical group is an event headliner for a performance taking place in a venue location with more than 1,500 attendees, or
- 3) The musical group is performing at a festival that sells more than 18,000 tickets per day. [FN 2780(b)(1) (A-C)]

Individual Performance Artists have also been recognized as professionals entitled to independent contractor status if they comport with the usual “proprietary rights” exercised by Performance Artists, including that their “character” is primarily of the individual’s invention, imagination, or talent, and that

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<sup>24</sup> *Id.*



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they are free from the control and direction of the hiring entity in connection with the performance of the work, both as a matter of contract and in fact. [FN 278(c)(1)] Individual Performance Artists are deemed to include but are not limited to, an individual performing comedy, improvisation, stage magic, illusion, mime, spoken word, storytelling, or puppetry. [FN 2780 (c)(1)(D)(2)]

In the publishing world, there are also newly identified exemptions with exceptions. Exemptions are provided for services performed by a freelance writer, translator, editor, copy editor, illustrator, or newspaper cartoonist, as well as content contributor, advisor, producer, narrator, or cartographer for a journal, book, periodical. However, that exemption requires that such professionals provide their services subject to a written contract that specifies the rate of pay, intellectual property rights, and obligation to pay by a defined time, AND, as long as the individual providing the services is not directly replacing an employee who performed the same work at the same volume for the hiring entity; the individual does not primarily perform the work at the hiring entity's business location, and the individual is not restricted from working for more than one hiring entity. [FN 2778(b)(2)(J) and (K)]

It should be noted particularly that the film industry was not granted any exemptions from the AB5 / *Dynamex* ABC test. The professional services subdivision expressly states that the exemptions otherwise provided do not include film and television crews working on live or previously recorded performances, including still photographers and cinematographers. [FN 2780(b)(2)(A).

Nor does the Clean Up bill provide exemptions for individual theatre artists or directors. While historically these positions have been subject to employee status and employee benefits pursuant to collective bargaining agreements between their unions (Actors Equity and Stage Directors and Choreographers Society) and the professional theatres in which they perform, those actors and directors who intend to perform in amateur productions and those performing arts organizations that have historically hired actors and dancers as individual contractors have not been provided any exemptions. Pending further amendments to the statutes, such organizations must expect to engage such performers as Employees and provide Employee benefits. The specific obligations of such Employers are detailed below on pages 12-13.

### Exemptions under AB5: Business-to-Business transactions

“Workers hired through another company may fall under the business-to-business exemption under AB5.”<sup>25</sup> This is one good way to remain exempt from AB5, however the exemption requires that the business service provider:

- Is free from the control and direction of the contracting business entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.
- Is providing services directly to the CB rather than its customers of the CB
- The contract with the business service provider is in writing.

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<sup>25</sup> Focus Media Law Group, *see supra* note 8, at 2.



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- If the work is performed in a jurisdiction that requires the business service provider to have a business license or business tax registration, the business service provider has the required business license or business tax registration.
- The business service provider maintains a business location that is separate from the business or work location of the contracting business.
- The business service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed.
- The business service provider actually contracts with other businesses to provide the same or similar services and maintains a clientele without restrictions from the hiring entity.
- The business service provider advertises and holds itself out to the public as available to provide the same or similar services.
- The business service provider provides its own tools, vehicles, and equipment to perform the services.
- The business service provider can negotiate its own rates.
- Consistent with the nature of the work, the business service provider can set its own hours and location of work.

### Loan Out companies

A “Loan Out company” is essentially an individual who is an employee, but who has a one-person corporation that “loans out” the services of the individual to other employers. This is usually used for tax purposes and the legal protections that come with being a corporation.<sup>26</sup> Most workers contracted through “Loan Out companies” will no longer qualify for independent contractor status, or fall under the business to business exemption, since loan out companies do not usually maintain a separate business location or have a business license.<sup>27</sup> This hiring structure will also be under closer scrutiny because it has been used by independent contractors to avoid being deemed a legal employee of the hiring company.

Unions are not exempt from AB5 either. People who work in California temporarily are not exempt from AB5. The work all workers perform in California has to abide by the AB5 employment laws.<sup>28</sup> “If your business regularly hires people in more than one state . . . please consult with your accountant regarding IRS rules concerning inconsistent employment classifications across states. You may decide to hire all people working in similar roles as employees (even the people not working in California) in order to best protect yourself from federal tax issues.”<sup>29</sup>

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<sup>26</sup> ABS Payroll, *What is a loan-out corporation?* <https://abspayroll.com/loan-out-companies/> (last visited January 22, 2020).

<sup>27</sup> Focus Media Law Group, *supra* note 22.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*



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## Organizations and Hiring Entities

### Hiring entities: changes to make if you are converting independent contractors to employees

How does AB5 impact how you hire? Many big companies (such as Uber and Lyft) are not reclassifying their workers, and just intend to fight worker’s claims (and the state of California) in court.<sup>30</sup> However, for smaller companies who can’t afford extensive legal battles, the safest approach is to convert workers who were previously independent contractors (and who are not clearly subject to AB5 exemptions) into employees. Changing an individual’s status from independent contractor to employee can be beneficial to an organization and to the worker. Status as an employee prevents misclassification (and the prospect of significant employer penalties), and “protects art workers by giving them access to workers compensation insurance, disability insurance, unemployment insurance, sick leave, and reimbursements for expenses.”<sup>31</sup>

As an employer, you now need to pay workers at least minimum wage, along with complying with other wage and hour laws, and offering mandatory benefits. When hiring and employing workers, you need to comply with the Federal Fair Labor Standards Act, the Americans with Disabilities Act, and the Civil Rights Act, the CROWN Act, SB 1343 on Sexual Harassment training, California’s Fair Employment and Housing Act (FEHA), and the Fair Chance Act/Ban the Box.

- Minimum wage: If you usually pay on a “per project” basis, the pay needs to be enough to cover minimum wage for all hours required to do the work.
- Mandatory benefits include workers compensation, state disability insurance, state unemployment, paid sick leave, FMLA
- Fair Labor Standards Act: This act establishes minimum wage, overtime pay, recordkeeping, and child labor standards affecting fulltime and part time workers in the private sector and in federal, state, and local governments.<sup>32</sup>
- The Americans with Disabilities Act: “Title I of the Americans with Disabilities Act of 1990 prohibits private employers, State and local governments, employment agencies and labor unions from discriminating against qualified individuals with disabilities in job application procedures, hiring, firing, advancement, compensation, job training, and other terms, conditions, and privileges of employment. The ADA covers employers with 15 or more employees, including State and local governments. It also applies to employment agencies and to labor organizations.”<sup>33</sup>
- The Civil Rights Act: Prohibits Discrimination in employment based on race, color, religion, sex,

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<sup>30</sup> Margot Roosevelt and Ryan Faughnder, *California Has A New Law For Contract Workers. But Many Businesses Aren’t Ready For Change*, (Sep. 29, 2019), <https://www.latimes.com/business/story/2019-09-27/ab5-independent-contractors-how-businesses-are-responding>

<sup>31</sup> Pletner-Saunders & Yang, *supra* note 1, at 5.

<sup>32</sup> United States Department of Labor, *Handy Reference Guide To The Fair Labor Standards Act*, <https://www.dol.gov/whd/regs/compliance/wh1282.pdf> (last visited Jan. 13, 2020).

<sup>33</sup> United States Department of Justice, *Information and Technical Assistance on the Americans with Disabilities Act*, [https://www.ada.gov/ada\\_title\\_1.htm](https://www.ada.gov/ada_title_1.htm) (last visited Jan 13, 2020).





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or national origin.<sup>34</sup>

- Fair Employment and Housing Act (FEHA): “It is illegal for employers of five or more employees to discriminate against job applicants and employees because of a protected category, or retaliate against them because they have asserted their rights under the law.”<sup>35</sup>
- CROWN Act: Ensures protection against discrimination based on hairstyles by extending statutory protection to hair texture and protective styles in the FEHA and state Education Codes.<sup>36</sup>
- SB 1343: “By January 1, 2020, an employer having five or more employees shall provide at least two hours of classroom or other effective interactive training and education regarding sexual harassment to all supervisory employees and at least one hour of classroom or other effective interactive training and education regarding sexual harassment to all nonsupervisory employees in California within six months of their assumption of a position.”<sup>37</sup>
- California Fair Chance Act: “The Fair Chance Act, which went into effect on January 1, 2018, is a California law that generally prohibits employers with five or more employees from asking about your conviction history before making you a job offer. This type of law is also known as a “Ban the Box” law.”<sup>38</sup>

### Hiring entities: large scale changes you may need to make if you’re converting independent contractors to employees

Some workers may be paid less as employees than they were as independent contractors and some may be paid more. This depends on the time required for the project, previous IC rate negotiation, and more. Employers will also have payroll<sup>39</sup> requirements. For every new employee who was once an independent contractor, you may need to set aside about 12-15% of their current pay as the cost of employing them (including payroll increases and administrative costs).

You will need to withhold the appropriate amount of income taxes from the worker’s wages.

- Federal Unemployment, FUTA: employer pays 0.6%
- FICA Social Security Tax: employer pays 6.2%
- FICA Medicare Tax: employer pays 1.45%
- CA Employment Training Tax (ETT) rate for 2019 is 0.1 percent.<sup>40</sup>

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<sup>34</sup> US Equal Employment Opportunity Commission, *The VII of the Civil Rights Act of 1964*, <https://www.eeoc.gov/laws/statutes/titlevii.cfm> (last visited Jan 13, 2020).

<sup>35</sup> California Department of Fair Employment and Housing, *Employees and Job Applicants are Protected From Bias*, <https://www.dfeh.ca.gov/employment/> (last visited Jan 13, 2020).

<sup>36</sup> [https://www.edd.ca.gov/Payroll\\_Taxes/Rates\\_and\\_Withholding.htm](https://www.edd.ca.gov/Payroll_Taxes/Rates_and_Withholding.htm) The Crown Act, <https://www.thecrownact.com/>; California Legislative Information, *SB-188 Discrimination: Hairstyles*, (July 4, 2019), [https://leginfo.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200SB188](https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201920200SB188)

<sup>37</sup> California Legislative Information, *SB-1343 Employers: Sexual Harassment Training: Requirements*, (Oct 1, 2018), [https://leginfo.ca.gov/faces/billTextClient.xhtml?bill\\_id=201720180SB1343](https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB1343)

<sup>38</sup> California Department of Fair Employment and Housing, *California Fair Chance Act*, <https://www.dfeh.ca.gov/resources/frequently-asked-questions/criminalhistoryinfoinemploymentfaqs/> (last visited Jan 13, 2020).

<sup>39</sup> Employment Development Department, *2019 Federal and State Payroll Taxes*, [https://www.edd.ca.gov/pdf\\_pub\\_ctr/de202.pdf](https://www.edd.ca.gov/pdf_pub_ctr/de202.pdf) (last visited Jan 13, 2020).

<sup>40</sup> Employment Development Department, *Rates, Withholding Schedules, and Meals and Lodging Values*, [https://www.edd.ca.gov/Payroll\\_Taxes/Rates\\_and\\_Withholding.htm](https://www.edd.ca.gov/Payroll_Taxes/Rates_and_Withholding.htm) (last visited Jan 13, 2020).





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- California SUTA is 1.5-8.2 percent on the first \$7,000 of an employee’s wages.<sup>41</sup>

You may thus need to adjust your hiring practices to account for increased costs, and some additional administrative hurdles.

### Hiring Entities: possible ways to continue non-employee relationships

#### Exemptions

For independent contractors, AB5 exemptions include: graphic designers, grant writers, fine artists, and more, but remember that *Borello* kicks in as soon as an independent contractor is exempt from AB5. Remember all the requirements for successfully meeting the business-to-business transaction exemption as well.

#### Hiring through a PEO

Hire through staffing agencies/professional employer organizations (PEOs). Professional employer organizations (PEOs) provide human resource services for their small business clients—paying wages and taxes and often assisting with compliance with myriad state and federal rules and regulations.

Once a client company contracts with a PEO, the PEO will then co-employ the client's worksite employees. In the arrangement among a PEO, a worksite employee and a client company, there exists a co-employment relationship, which involves a contractual allocation and sharing of employer responsibilities between the PEO and the client pursuant to a client service agreement (CSA). The PEO typically remits wages and withholdings of the worksite employees and reports, collects and deposits employment taxes with local, state and federal authorities.<sup>42</sup>

“PEOs “co-employ” your employees by becoming the “employer of record for tax purposes.” This means that the PEO is the company that will file the W2s for your employees. But, you would still retain control and oversight over your employees as before.”<sup>43</sup> “PEO services typically require a one-time startup fee and then an ongoing percentage of payroll, which can fluctuate from less than 5 percent to more than 15 percent, depending on the services and the average worker salary.”<sup>44</sup>

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<sup>41</sup> Caleb Newquist, *Here’s How Much It Actually Costs to Hire An Employee in California [Infographic]*, (May 30, 2018), <https://gusto.com/blog/hiring/cost-hire-employee-california>

<sup>42</sup> NAPEO, *PEO FAQs*, <https://www.napeo.org/what-is-a-peo/selecting-a-peo/faqs> (last visited Jan 13, 2020).

<sup>43</sup> Cameron Keng, *Danger of Using A Professional Employer Organization*, (September 12, 2016), <https://www.forbes.com/sites/cameronkeng/2016/09/12/danger-of-using-a-professional-employer-organization/#350645ea4a21>

<sup>44</sup> Julie Sloane, *Cure Your HR Ills*, (March 28, 2007), [https://money.cnn.com/magazines/fsb/fsb\\_archive/2007/03/01/8402022/](https://money.cnn.com/magazines/fsb/fsb_archive/2007/03/01/8402022/)



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### Hiring Entities: what happens if I don't do anything?

Wage and hour laws are generally enforced by the CA Labor Commissioner. The CA Labor Commissioner is part of the Division of Labor Standards Enforcement (DLSE) under the larger umbrella of the Department of Industrial Relations (DIR).<sup>45</sup> Employee classification may also be reviewed by the Employment Development Department (EDD), Federal Department of Labor, local government, or a hiring entity's worker's compensation carrier. The DIR and EDD will not generally unilaterally initiate a case against an employer. The DIR and EDD may audit a sector of the business community if they observe or anticipate violations, however.<sup>46</sup>

The most common way a legal case about employee/independent contractor classification arises is that the worker initiates a claim for unpaid wages, unemployment benefits, or worker's compensation. If a worker initiates such a claim, retaliation is an important issue. Workers are protected from any employer retaliation that occurs in response to the worker engaging in protection of their rights. This includes firing, demoting, suspending, or in any manner discriminating against a worker for engaging in a "protected activity" such as filing a claim.<sup>47</sup> Retaliation is a separate claim that the DIR or a court will look at, and can result in separate penalties.<sup>48</sup>

### Hiring Entities: penalties for violation

Penalties levied can include back wages, unpaid overtime, unpaid minimum wage, back benefits including sick leave, and more. The "look-back" period for a wage claim is generally three years and AB5 does mention that "specified Labor Code provisions of the bill apply retroactively to existing claims and actions to the maximum extent permitted by law."<sup>49</sup> An employer will face attorney's fees if the employee files in court, retains counsel, and wins. An additional penalty under CA Labor Code section 226.8 for willful or related misclassification is a minimum of \$5000, up to \$25,000.

Employers may also face penalties from the state and federal government. Hiring entities can face penalties for: improper wage statements, misclassifying employees, waiting time penalties for failure to pay all wages at the time the employment ended, and unpaid tax with interest and penalties as well. All this can lead to workers suing or filing claims with the Labor Commissioner leading to state agency audits and more.<sup>50</sup>

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<sup>45</sup> Department of Industrial Relations, *How to File a Wage Claim*, <https://www.dir.ca.gov/dlse/HowToFileWageClaim.htm> (last visited Jan 13, 2020).

<sup>46</sup> Employment Development Department, *Employment Tax Audit Process*, [https://www.edd.ca.gov/pdf\\_pub\\_ctr/de231ta.pdf](https://www.edd.ca.gov/pdf_pub_ctr/de231ta.pdf) (last visited Jan 13, 2020).

<sup>47</sup> Department of Industrial Relations, *Retaliation*, [https://www.dir.ca.gov/dlse/FAQ\\_Retaliation.htm](https://www.dir.ca.gov/dlse/FAQ_Retaliation.htm) (last visited Feb 5, 2020).

<sup>48</sup> Department of Industrial Relations, *Retaliation Complaint Investigation Unit*, <https://www.dir.ca.gov/dlse/dlseRetaliation.html> (last visited Jan 13, 2020).

<sup>49</sup> California Legislative Information, *Legislative Counsel's Digest: Assembly Bill No. 5* [https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200AB5](https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB5) (last visited 1/22/20).

<sup>50</sup> Plettner-Saunders & Yang, *see supra* note 1, at 2-3.



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## Strategies For Moving Forward

### Employers

There are strategies an employer might use when moving forward. Employers should carefully consider whether or not they can hire someone as an independent contractor for a given service. Service providers will only qualify as independent contractors under AB5 if they have agency in their own contracting and control their own work (see *Borello* for more), as well as fall into one of the exemptions. A person should be put on the payroll as an employee if they are not exempt from AB5. To be safe, the best idea is to convert all independent contractors into employees.<sup>51</sup>

Consider getting an outside HR consultant. If you can't pay for a consultant, reach out to your board or executive team. Consider joining a PEO or using a Hiring Agency.

### Where do I get the money for all of this?

If you are a non-profit, one idea is to ask your grant-funders for more funding to help employ people in accordance with the law. If you're a for-profit entity, you might need to charge slightly more for your company's services or products to cover the 12%-15% increase in pay to your new employees. An example of charging more would be: raising ticket prices from \$50 to \$56, or raise class/workshop cost from \$20 to \$24.

### Get everything in writing, and make relationships clear.

Along with using HR consultants and Hiring Agencies, make sure that independent contractors:

- “Have a written agreement with an assigned specific scope of work for a specific, limited, duration;
- Require the worker to use the worker's own tools and/or work off the organization's premises;
- Pay the worker by a flat fee, rather than by the hour;
- Ensure minimal supervision and control over the worker;
- Do not reimburse expenses;
- Do not have employees and contractors performing the same work;
- Do not require set hours; and
- Require the independent contractor to have a business license, in addition to any required professional licenses or required permits.”<sup>52</sup>

### Individuals/Contractors

If you want to be a “business” to qualify for the business to business exemption, you need to begin getting

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<sup>51</sup> *Id.* at 5.

<sup>52</sup> *Id.* at 6.



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together an actual business that qualifies for the exemption. If you qualify for a professional services exemption, confirm that the work performed and your professional status fit all criteria.

### Workers in general

Workers should advocate for themselves. Make sure you are in control of your independent contracts and that you are exempt from AB5 if someone asks you to independently contract. If you do not fall into an AB5 exemption, ask to be employed, and confirm that the hiring entity complies with all the laws. If you feel as if you are misclassified, consider speaking to your hiring entity to try to work out a fair resolution before filing a claim. Remember that retaliation is unlawful.

### Helpful Resources:

- CLA's Workshop on AB5: <https://youtu.be/eOkBp-ULsQI>
- CLA's Workshop on Business Formation: <https://youtu.be/UV45lwFg5Qg>
- Arts Arbitration and Mediation Services (AAMS), a program of California Lawyers for the Arts, is a resource that offers negotiations counselling as well as alternative dispute resolution services to resolve workplace disputes.
  - SF Bay Area: 510-990-6030 (all arbitrations handled by SF office)
  - Los Angeles: 310-207-0001
  - Sacramento: 916-442-6210
  - Website: <https://www.calawyersforthearts.org/arts-arbitration-mediation-services.html>
- California Lawyers for the Art's State Bar Certified Legal Referral & Information Service [LRIS] has been serving the creative arts community since 1974. Let us find you a well-screened, highly-qualified attorney who will work with you to solve your legal issue in a professional manner.
  - TOLL-FREE 888-775-8995
  - Website: <https://www.calawyersforthearts.org/lawyer-referral-information-service.html>
- Online resources with information about AB5:
  - [https://www.betterbayarea.org/state\\_lawab5](https://www.betterbayarea.org/state_lawab5)
  - <https://www.californiansforthearts.org/ab5-news>
  - <https://www.talentwave.com/understanding-ab5-carve-outs/>



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- Here is the State of California's text of the law:  
[https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200AB5](https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB5)
- CLA also worked with Teaching Artists Guild on a webinar that contained [these additional resources](#).
- You can also try reviewing the [State's HR Website](#).
- Or consider [hiring a PEO](#).