California AB 5 FAQs

California Assembly Bill 5
Worker Status: Employees and Independent Contractors

FREQUENTLY ASKED QUESTIONS ABOUT CALIFORNIA ASSEMBLY BILL 5

Q: What is assembly bill 5?

A: Assembly Bill 5 is a bill that California's legislature created to protect workers from being misclassified as independent contractors. This issue is in focus due to the boom of the gig economy, in which many business models rely on classifying workers as independent contractors. Those workers do not receive protections offered to W-2 employees, like minimum wage, workers' compensation, and other benefits. This bill affects employers who have workers performing work in California and makes significant changes as to how worker classification is determined. The bill clarifies that a worker is an employee and not an independent contractor unless a hiring entity satisfies a three-factor test, known as the "ABC Test".

Q: What is the "ABC test?"

A: The ABC test is a three-part test employers must apply if they want to classify a worker as an independent contractor. In order to be considered an independent contractor, the employer must show that the worker meets each of the three criteria listed below:

A. The worker is free from the control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact.
B. The worker performs work that 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 the work performed for the hiring entity.

Q: What is the risk of converting an independent contractor to an employee if I'm not sure whether the ABC test applies to them?

A: If a worker is incorrectly classified as an independent contractor when they should be treated as an employee, the hirer is at significant risk of failing to comply with their obligations as an employer, including withholding and remitting appropriate employment taxes, filing appropriate returns and reports, providing required benefits, and making offers of coverage. If an employee is misclassified as an independent

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contractor, the employer may be liable for overdue taxes, unpaid wages and overtime, and even civil lawsuits brought by the misclassified worker. Additionally, in the event of an audit or law suit, the employer bears the burden of proof to defend their choice in classifying the worker as an independent contractor. Particularly with the changes in AB 5, this burden may be difficult to meet. If an employer is unclear as to whether their worker should be reclassified pursuant to the ABC test, we recommend seeking outside counsel to assist in the analysis. Conversely, there is very little risk to classifying a worker as an employee when they could technically be considered an independent contractor.

Q: Will I need to register for a CA PIT/UI account if I don't already have one?
A: An employer would need to register with CA EDD here if they are not currently registered. Paylocity offers assistance with this registration if needed.

Q: When is this change effective?
A: This change becomes effective on 1/1/2020.

Q: Is this change retroactive?
A: The California state legislature clarified that this bill is declaratory of existing law, and should apply retroactively to existing claims to the extent permitted by law.

Q: Which employers are impacted?
A: Any employer with independent contractors working in California may be impacted by AB 5. We recommend reviewing the classifications of your California workers to determine whether they are classified appropriately in light of this change.

Q: How does an employer change an employee's status in the system?
A: New employee records must be assigned a tax form. In this case, we assume the worker has been assigned the 1099-M tax form but that after reviewing the ABC test, the employer has determined the worker should be a W-2 employee. Since the tax form cannot be changed on the employee record, the employer must create a new employee record, including a new employee ID, in HR and Payroll.

Q: Will my employee have to go through Onboarding?
A: If you determine that all three factors of the ABC test are not met, and your worker should be classified as an employee, then the independent contractor (1099-M) record must be terminated in HR and Payroll, and the worker must be re-hired as an employee (W-2). If you use Onboarding, you will need to create a new Onboarding event and process the worker as a new hire. If you do not use Onboarding, you should follow your usual new hire processes.

Q: Will my employee need to complete new hire paperwork, including I-9, W-4, and other documents?
A: Yes, your worker will probably need to complete new hire paperwork, including the I-9 and other documents, unless you have already furnished all appropriate notices and collected all necessary

documents from them. If you do not have a completed, unexpired I-9 for the worker or have not provided a California Wage Theft Prevention Notice to the worker, these will need to be completed if you must reclassify the worker as an employee. Additionally, if you are subject to E-Verify and have not processed the worker through E-Verify in the past, you may be required to submit an E-Verify case. Other new hire paper work such as a W-4 and California DE-4 must be completed, along with any other new hire documentation or benefits information.

Q: Will this change impact my status as an Applicable Large Employer under the Affordable Care Act?

A: Possibly. If an employer was not already considered an ALE, but is now converting enough independent contractors to employees that it crosses the FTE threshold to become an ALE, it is possible that the employer may become subject to the Employer Mandate of the ACA. Employers considering converting independent contractors to employees prior to 1/1/2020 should consult with a benefits broker or attorney immediately to determine if doing so will implicate their ALE status. Employers making changes effective 1/1/2020 should still consult with a benefits broker to determine the impact this change will have on the organization's overall employee benefit strategy, as ALE status for 2021 will be determined by the average employee counts in 2020.

Q: What will happen if I convert my independent contractor to an employee before 1/1/2020?

A: An employer may choose to convert their workers from independent contractors to employees prior to the 1/1 effective date. However, this may create unintended complications. For example, if an employer converts enough independent contractors to employees that they achieve ALE status, it may impact their obligations in terms of offers of coverage. Additionally, this change will impact the tax payment and reporting obligations of the employer as soon as the worker is reclassified.

Q: What is an independent contractor?

A: There are two measures for determining this. The IRS applies the "right to control" test, which considers the nature of the working relationship. They highlight three general aspects of the employment arrangement:

> (1) Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?
>
> (2) Financial: Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
>
> (3) Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)?
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> *Source: https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee*

The U.S. Department of Labor follows the standards set forth by the U.S. Supreme Court. The Supreme Court has indicated that there is no single rule or test for determining whether an individual is an independent contractor or an employee for purposes of the FLSA. The Court has held that the whole

situation must be considered to make this determination. Among the factors which the Court has considered significant are:

The extent to which the services rendered are an integral part of the principal's business.
The permanency of the relationship.
The amount of the alleged contractor's investment in facilities and equipment.
The nature and degree of control by the principal.
The alleged contractor's opportunities for profit and loss.
The amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor.
The degree of independent business organization and operation.

Source: https://www.dol.gov/whd/regs/compliance/whdfs13.htm