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How California's New AB5 Law Affects Your Clients

Attempting to refine and contain current nebulous rules for independent contractors, California's new AB5 requires a new test be used to determine whether workers in California fall under employee or independent contractor status.

Nellie Akalp • Jan. 16, 2020



Attempting to refine and contain current nebulous rules for independent contractors, California's new AB5 requires a new test be used to determine whether

workers in California fall under employee or independent contractor status. The new law affects your clients, whether they are currently independent contractors or whether they hire independent contractors. Here's what to know and how to offer viable solutions.

Pre AB5

Much has been made in the news about California Assembly Bill 5 or AB5 and the repercussions for employers and independent contractors alike. The Bill, which aims to reclassify many independent contractors as employees, may reach beyond California's borders if other states follow suit or if your clients work with independent workers who cross into California to work for any amount of time.

AB5 went into effect January 1, 2020, however similar guidelines have long been in place as stated in the [IRS classification rules](#):

- **Behavioral Control.** Which party determines the when, where and how the work is performed? The more control a business has when it comes to on-the-job instructions, supplies purchased, tools used, etc., the more the worker is considered an employee. Independent contractors, on the other hand, receive no regular evaluations or ongoing training.
- **Financial Control.** Which party controls the financial and business purchases of the project—this includes investing in equipment and reimbursing expenses. Independent contractors use their own equipment (which can then be used for their other clients) and are paid a flat fee or predetermined hourly rate for contracted hours.
- **Relationship.** The IRS also scrutinizes how the relationship between the contractor and the business is outlined and followed. A written contract describing the temporary work or job, payment details and the end date of the project goes far in proving the relationship is not employer/employee.

Enter in AB5

[California's AB5](#) has gone beyond the IRS classification declares employers and independent contractors must apply a 3-point ABC test to determine whether an independent contractor should actually be reclassified as an employee.

A contractor is still considered independent if:

1. "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.” This is essentially the same definition the IRS uses for behavior, financial and relationship restrictions.

2. “The worker performs work that is outside the usual course of the hiring entity’s business.” The most controversial part of the test, this is where you’ll need to help clients really drill down on what exactly the contractor is expected to perform and how it is different from an employee’s responsibilities. For instance, extra help hired during a busy season would not appropriately be considered independent contractors; rather they would be designated as employees. A common scenario where a contractor is appropriate is hiring temporary tech help to set up a sales program or new website, as long as the business does not offer tech services itself.
3. “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.” Independent contractors rarely have just one client, while employees usually work for just one business. To avoid conflict, your independent contractor clients would be smart to make sure their companies are legally structured as a business (business licenses, state registration, Federal Tax ID) as proof of their independent status.

There are a variety of professions exempt from AB5 due to the points in the C portion of the test. For example professional service providers are exempt if they:

- Maintain a separate business location
- Have a business license and professional licenses
- Can negotiate their own rates for services
- Can set their own hours/schedule
- Have (or could have) multiple clients
- Maintain control of their time, tasks, and techniques

The following professions are also exempt:

- Attorneys
- Landscapers
- Accountants
- Insurance agents
- Doctors
- Dentists
- Veterinarians
- Architects
- Private investigators

- Engineers
- Investment advisors
- Direct salespersons
- Travel agents
- Some artists

Recently, [owner-operator truck drivers](#) were determined to be exempt by a Los Angeles County Superior Court judge, because a federal law prohibits states from passing legislation affecting motor carriers' prices, routes and services.

The new law is positioned to cause turmoil in the ride sharing sector and so far, [Uber](#) has made it clear it has no intention of changing its business model. According to a statement released by Uber after the Bill became law, the AB5 law does not apply to them because the “drivers’ work is outside the usual course of Uber’s business, which is serving as a technology platform for several different types of digital marketplaces.” You need to stay current to see if the government decides to crack down on ride sharing companies, in case it affects similar type clients.

Offering Clients Solutions

While enforcement of AB5 will most likely be slow, if your business clients are caught for misclassification, they may be facing not only fines, but possibly having to issue back pay and benefits. California already has a different worker misclassification law which has been in effect for eight years (California [Senate Bill 459](#)). Punishment for nonadherence comes with heavy penalties, giving “the state Labor and Workforce Development Agency the power to fine companies \$5,000 to \$25,000 per violation for willfully misclassifying workers and allows the state Labor Commissioner to assess additional civil and liquidated damages.”

For clients hiring independent contractors or clients working as independent contractors, creating separate business entities such as a corporation, LLC or partnership, establishes both parties as separate businesses and ensures there is not an employee/employer relationship. Businesses and workers should maintain separate business locations, have the required licenses/permits, register the business with the Secretary of State and file the correct documentation. As the new year begins and before tax season starts in full force, consider sending out an informative email newsletter letting your clients know about AB5 and what you can do to help them make sense of it.

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Nellie Akalp is a passionate entrepreneur, business expert and mother of four. She is the CEO of [CorpNet.com](https://corpnet.com), a trusted resource and service provider for business incorporation, LLC filings, and corporate compliance services in all 50 states. Nellie and her team recently launched a partner program for accountants, lawyers, and business professionals to help them streamline the business incorporation and compliance process for their clients.

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