

Consulting in California: *Understanding AB 5, and Keeping Your Independence*

12 November 2019



Featuring a panel of 6 speakers:

- Brian Berg
- Tom Coughlin
- Russ Harrison
- Chris Schaefer, JD
- Giacomo Vacca
- Walt Maclay

Our Panelists



Brian Berg

Berg Software Design
Consultant



Tom Coughlin

IEEE-USA President
Consultant



Russ Harrison

IEEE-USA
Dir.: Government
Relations



Chris Schaefer, JD

Employment
Law Attorney



Giacomo Vacca

Kinetic River
Consultant/
Business Owner



Walt Maclay

Voler Systems
Consultant/
Business Owner

Hysteria Leading Up to AB 5's Passage



What Led Up to AB 5

- ▶ On 18 September 2019, California Governor Gavin Newsom signed bill AB 5 into law.
 - ▶ AB 5 **redefines the relationship between employers and consultants**
- ▶ The law was drafted in response to a state Supreme Court case (*Dynamex Operations West, Inc. v. Superior Court of Los Angeles*) that made it ***harder for employers to classify individuals as contract workers, as opposed to regular employees.***
- ▶ AB 5 codifies that court case ("**Dynamex**") and strengthens contractor rules further.



California AB 5

Tom Coughlin

2019 IEEE-USA President

Russell Harrison

Director, Government Relations, IEEE-USA

IEEE-USA Involvement

- ▶ Alerted to problems with AB 5 in early September
 - IEEE member Brian Catanzaeo saw the problems
 - Media coverage distorted the bill
- ▶ We immediately:
 - Contacted IEEE leaders in California
 - Contacted the bill sponsor for clarification
 - Contacted other legislators
 - Send a formal letter to Gov. Newsom
- ▶ Plan moving forward
 - Advice to IEEE members on how to comply
 - Active advocacy to win changes?

Primary issues of concern

- ▶ How will “Business-to-Business” exemption work?
- ▶ How will state implement/enforce the law?
- ▶ How will new consultants enter the marketplace?
- ▶ How will companies respond?
 - Fewer consultants, more employees?
 - Greater burden placed on consultants to prove compliance?
 - Move consulting work out of state?

Chris Schaefer, JD

Chris has extensive experience in employment law

- ▶ licensed to practice before the US Supreme Court, all Ninth Circuit Federal District Courts, and all CA Courts has represented small businesses, and has developed a following in the special field of independent contractor law for over 40 years
- ▶ addressed the Assembly Committee that was creating AB 5 on behalf of some trucking companies in Feb. 2019
- ▶ was called to address a Senate Committee regarding independent contractor status
- ▶ has represented businesses against the CA Employment Development Department in over 300 independent contractor status cases
- ▶ negotiated with the EDD lead Tax Counsel regarding the CA regulation covering independent contractor status in Silicon Valley

Understanding Assembly Bill 5 (AB 5)

AB 5 modifies the test for **Independent Contractor (IC) status**:

- ▶ Cat. #1: Labor Commissioner
 - ▶ Wage & Hour Regulations – minimum wage, overtime, rest breaks, etc.
- ▶ Cat. #2: Workers Compensation
 - ▶ on job injuries, etc. insurance
- ▶ Cat. #3: Employment Development Department
 - ▶ unemployment, disability and training insurance, personal income tax withholding

AB 5: The Good News

Labor Commissioner (Cat. #1) and Workers Compensation (Cat. #2) have a new “recognized professions” exemption for Independent Contractor:

- ▶ an individual with an active California license and who practices one of the following five professions:
 - ▶ Lawyer, Architect, Private Investigator, Accountant, OR
 - ▶ **ENGINEER**
 - ▶ is not subject to the “ABC Test” or the Dynamex Case
- However, you must meet the Borello Case Test

AB 5: The Good News (cont.)

Employment Development Department (EDD) (Cat. #3):

- ▶ AB 5 includes a section indicating any “exceptions” to words like “employee”, etc., in **Unemployment Insurance Code (UIC)** shall remain in effect
- ▶ UIC includes an expanded list of professions that have a “rebuttable presumption” of Independent Contractor (IC) status so long as they have a degree from a four (4) year institution of higher learning, including **ENGINEER**
- ▶ However, **the CA code section that would have applied the Borello Case test was changed by AB 5 to the “ABC” Test**

The “ABC” Test for Independent Contractor (from Dynamex Case)

“ ..., a person providing labor or services for remuneration *shall be considered an employee rather than an IC unless* the hiring entity demonstrates that **all of the following conditions are satisfied**:

- ▶ A. The person is **free from the control and direction** of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.
- ▶ B. The person **performs work that is outside the usual course of the hiring entities business**.
- ▶ C. The person is **customarily engaged in an independently established trade, occupation, or business of the same nature** as that involved in the work performed.”

"I'm an Independent Contractor Consultant. Now what do I do?"

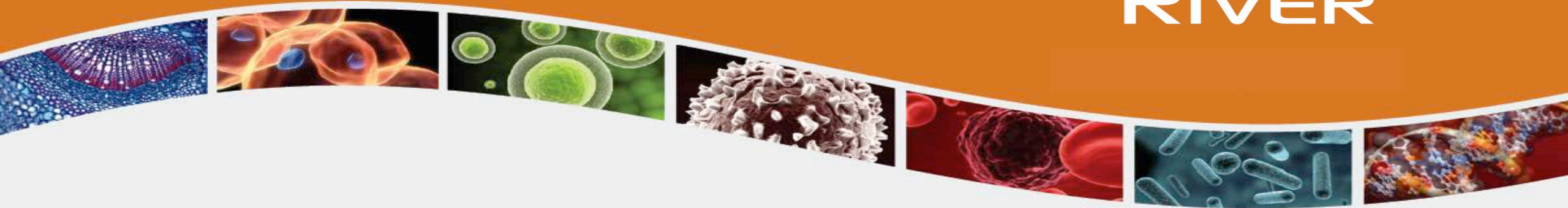
(ABC Test Details, 1 of 2)

- ▶ "A" - (1) Secure and have signed by you and your client a contract that has:
 - ▶ **no "control" terms**(!)
 - ▶ defines your services and client's business, **augmenting the DIFFERENCES**, and
 - ▶ supports your issues of **benefits and burdens of "self-employment."**
- ▶ "A" – (2) Be sure the perception of the actual and factual relationship between you and your client show that **the client has no control over your performance or related activities.**

"I'm an Independent Contractor Consultant. Now what do I do?"

(ABC Test Details, 2 of 2)

- ▶ "B" – Be sure that your written contract and facts of the services performed show that your services are **"outside the usual course"** of your client's business.
- ▶ "C" – Be firm in your belief, attitude, facts and terms of your written contract that you had sometime prior to the creation of your current client relationship **"independently chosen the burdens and benefits of self-employment."**



IEEE-CNSV Panel Discussion on CA AB-5 *(Some) Steps to Forming a Company*

November 12, 2019

Giacomo Vacca, Ph.D.

President, Kinetic River Corp.

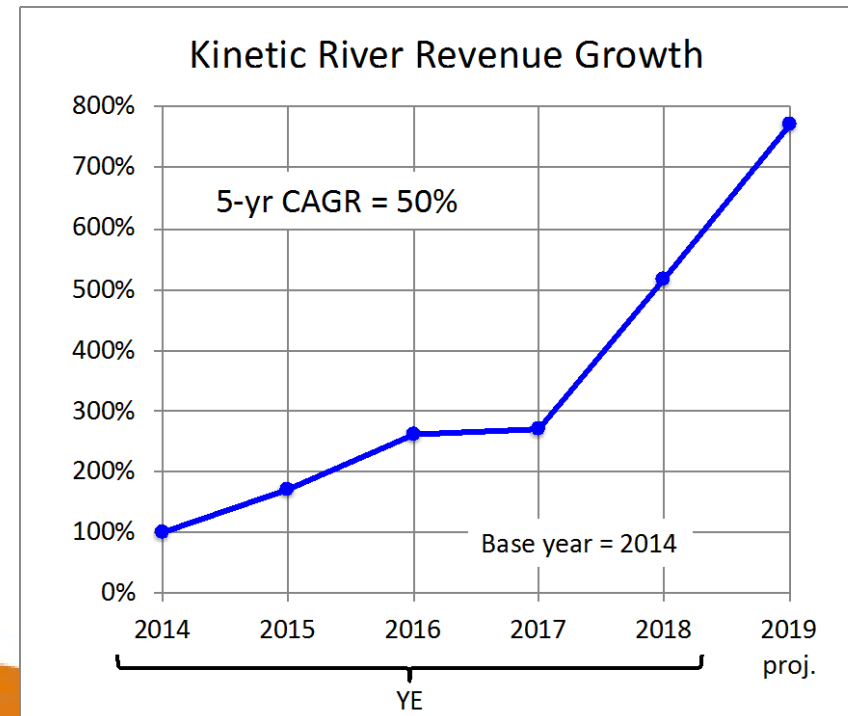
(Some) Steps to Forming a Company

- Responding to passage of AB-5
- Continue (or start) working as consultant & comply with AB-5
- One mitigation path: operate as a **company**, not sole proprietorship
- If not already Corp../LLC → this is a short guide to **form Corp.**
- Disclaimers:
 - I am not a lawyer
 - I am not a CPA
 - I get no referral bonuses from any of the entities mentioned
 - Kinetic River does business with several of the entities mentioned
- Following is **my** experience. I may be wrong and YMMV



Kinetic River Corp.

- incorporated 2/2010
- went full-time 7/2011
- purpose: develop tech/IP, sell/license it
- main focus: life science HW
- revenue:
 - gov't grants
 - expert witnessing
 - custom products
 - engineering consulting
- fully self-funded (no VCs, no debt)
- profitable since yr 2
- 5 FTEs, 7 PTEs/advisors, contractors
- GV 100% owner
 - several optionees
- S corporation; Mountain View
- CA resale #
- www.KineticRiver.com
- 2 trademarks



(Some) Steps to Forming a Company

- ✓ Choose a business **purpose** \$0; time
- ✓ Choose a business **model** \$0; time
- ✓ Lay out a VERY rough business **plan** \$0; time
- ✓ Identify sources of (initial) business **funding** \$0; time; equity
- ✓ Optional: choose business **partner(s)** \$0; time; equity

✓ = assumed already done by those in the audience

• = to do

X = assumed not relevant to this audience

\$xx, time, equity = expected cost of task



(Some) Steps to Forming a Company

- Choose a business **structure** \$0 – \$1,000's
 - e.g.: sole proprietorship, LLC, **Corp.**
 - consult CPA/law firm for up-to-date consequences
- Choose an (initial) business **address** \$0 – \$1000's/mo.
- ✓ Choose a business **name** \$0 – \$1,000's
- Choose a business **domain name** \$10 – 100
- Get a **website** \$0 – \$10,000's
- ✗ Decide whether to register **trademark(s)** \$0 – \$1,000's



(Some) Steps to Forming a Company

- Get proper forms and file them **\$100's – \$1,000's**
 - request **Federal EIN** from IRS
 - get corporation documents kit
 - optional: get help from law firm familiar with business formation
- Corp: Decide whether to be a C-Corp. or S-Corp. **\$0; time**
 - S-Corp: income passthrough to shareholders
 - if S-Corp.: **file S-Corp. election** with IRS
 - optional: get help from accounting firm familiar with these issues
- ✗ Decide if you will have tax-exempt product sales **\$0; time**



(Some) Steps to Forming a Company

- Corp.: submit **incorporation papers** to CA Secretary of State \$10's
- Submit **Fictitious Business Name** application \$10's
- Get **business licenses**/permits \$10's
- ✓ Get company **bank account** \$10's
- ✗ Determine your business classification codes \$0; time
- ✗ Optional: get DUNS number \$0; time



(Some) Steps to Forming a Company

- Find and keep good **service providers** \$0; time
 - bookkeeping (e.g.: Stamm Bookkeeping)
 - accounting (e.g.: Alpha B Group)
 - legal (e.g.: Jonathan Sweet, Grellas & Associates, Procopio)
 - patent prosecution (e.g.: Aurora Consulting)
 - website developer (e.g.: Dejalane)
 - early business strategy (e.g.: SKMurphy)
 - IT support (e.g.: IT Total Care)
 - press releases (e.g.: eReleases)
 - office admin
 - marketing

Prepared by the Law Office of Chris A. Schaefer
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**** UNDERSTANDING ASSEMBLY BILL NO. 5 ****

AB 5 modifies the test for independent contractor (“IC”) status for:

- A. Labor Commissioner (Wage & Hour Regulations – minimum wage, overtime, rest breaks, etc.); 01/01/2020; See AB 5, Sec. 2, Labor Code 2750.3 (a) (1) [New Code, adds ABC test].
- B. Workers Compensation (on job injuries, etc. insurance); 07/01/2020; See AB 5, Sec. 3. Modifies existing Labor Code 3351 [New section (i) [adopts Labor Code 2750.3 adding ABC test and creates Labor and Workers Comp synchronicity].
- C. Employment Development Department (unemployment, disability and training insurance, personal income tax withholding [i.e., IC status]); 01/01/2020; See AB 5, Sec. 5.; Amends Unemployment Insurance Code 621 (b) deleting common law (“Borello”) test and adds ABC test.

First: the “Good News”

Labor Commissioner and Workers Compensation have a new “recognized professions” exemption: an individual with an active California license and who practices one of the following – lawyer, architect, ENGINEER, private investigator, or accountant” is not subject to the ABC test or the Dynamex Case.

However, to be an IC they must meet the Borello Case test. [Test summary: CA Code of Regulations, Title 22, section 4304-1; search 22 CCR 4304-1.]

Employment Development Department: AB 5 includes a section indicating any “exceptions” to words like “employee”, etc. in Unemployment Insurance Code shall remain in effect. So, UI Code 656 includes an expanded list of professions that have a “rebuttable presumption” of IC status so long as they have a degree from a four (4) year institution of higher learning, including ENGINEER.

However, the CA code section that would have applied the Borello Case test was changed by AB 5 to the ABC test.

The “ABC” Test for Independent Contractor

“ ..., a person providing labor or services for remuneration shall be considered an employee rather than an IC unless the hiring entity demonstrates that all of the following conditions are satisfied:

- A. The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.
- B. The person performs work that is outside the usual course of the hiring entities business.
- C. The person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.”

NOTE: The above test was created by CA Supreme Court in the “Dynamex Case”, cited 4 Cal. 5th 903 and decided April 30, 2018. In that 85-page decision, the meaning of each part of “ABC” was discussed in pages 68 through 76. Currently, we have no better defining language for the terms of the ABC test besides those Dynamex 9 pages. We will quote some of that defining language below.

A. “The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.”

- Quoting Borello, “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, but does not possess over a genuine independent contractor.” (p. 69)
- “(hiring entity failed to establish that truck driver was free from its control within the meaning of part A..., where hiring entity required truck driver to keep truck clean, obtain company’s permission before transporting passengers, to go to company’s dispatch center to obtain assignments ..., could terminate driver’s services for tardiness, failure to contract dispatch unit, or any violation of company’s written policy). (p. 69)
- “(construction company established that worker who specialized in historic reconstruction was sufficiently free of the company’s control to satisfy ... A ..., where worker set his own schedule, worked without supervision, purchased all materials he used on his own business credit card, and had declined an offer of employment proffered by the company because he wanted control over his own activities.)” (p.69)

B. “Does the worker perform work that is outside the usual course of the hiring entity’s business?”

- “... independent of the question of control, ... one principal objective ... is to bring within the ‘employee’ category *all* individuals who can reasonably be viewed as working “*in the [hiring entity’s] business ...*, that is, all individuals who are reasonably viewed as providing services to the business in a role comparable to that of an employee, rather than a role comparable to that of a traditional independent contractor.” (pp.69-70)
- “Thus, ... when a retail store hires an outside plumber to repair a leak ... on its premises or hires an outside electrician to install a new electrical line, the services ... are not part of the store’s usual course of business....” (p. 70)
- “(W)hen a bakery hires cake decorators to work on a regular basis on its custom-designed cakes ..., workers are part of the hiring entity’s usual business operation....” (p. 70)
- What is “outside the usual course of ... business”? The Connecticut Supreme Court answered this question. “... ‘usual’ does not mean ‘if you do it, it is within your usual course of business. We agree, that ‘usual,’ in accordance with its common usage, simply means that an activity is performed by an enterprise on a regular or continuous basis. “... if the activity is not performed on a regular or continuous basis, then the employer has satisfied prong B because the activity is ‘outside the usual course of the business of the enterprise.” (p.73, quote from *Matattuck Museum... v. Administrator*, 238 Conn. 273 at 279-280.)

C. Is the worker customarily engaged in an independently established trade, occupation or business of the same nature as the worker performed for the hiring entity?

- “As a matter of common usage, the term “independent contractor,” when applied to an individual worker, ordinarily has been understood to refer to an individual who *independently* has made the decision to go into business for him or herself. (... describing independent contractor as a worker who ‘has independently chosen the burdens and benefits of self-employment’].)” (p. 74)
- Re independent contractor: “Such an individual generally takes the usual steps to establish and promote his or her independent business – for example, through incorporation, licensure, advertisements, routine offerings to provide the services of the independent business to the public or to a number of potential customers, and the like.” (p. 74)
- “[explaining ... part C..., ‘the adverb ‘independently’ clearly modifies the word ‘established’, and must carry the meaning that the trade, occupation, profession or business was established, independently of the employer” (footnote 30, p. 75)

“I’m an Independent Contractor Consultant.
Now what do I do?”

“A”- (1) Secure and have signed by you and your client a contract that has no “control” terms(!), defines your services and client’s business augmenting the DIFFERENCES, and supports your issues of benefit and burdens of “self-employment.”

“A” – (2) Be sure the perception of the actual and factual relationship between you and your client show that the client has no control over your performance or related activities.

“B” – Be sure that your written contract and facts of the services performed show that your services are “outside the usual course” of your client’s business.

“C” – Be firm in your belief, attitude, facts and terms of your written contract that you had sometime prior to the creation of your current client relationship “independently chosen the burdens and benefits of self-employment.”

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- Call to discuss your contract and other IC issues.