

Frequently Asked Questions: AB 5, the Gig Work Law

*This FAQ was compiled based on questions submitted by registrants for **Is The Gig Up?**, a webinar about AB 5 delivered by Alex King of Archetype Legal and Ariane Trelaun of Do Your Thing. The info contained in this FAQ is intended to expand upon the material presented in the webinar, and should not be considered legal or tax advice. No reader should act or refrain from acting on the basis of the information provided without first seeking the relevant advice from a professional in your jurisdiction. Please do consult with the accounting and legal professionals your business relies on as you proceed with your implementation. Archetype Legal PC and Do Your Thing disclaim all liability in respect to any actions taken or not taken based on the contents of this FAQ.*

Part-Time, Seasonal, Busy-Period Workers

What about when contractors work only a couple of hours per month for the business? Is there any way to delineate a contractor vs employee based on hours worked or wages earned, as opposed to the type of work performed?

That can help (key word is “can”), especially if they fall into the exceptions to the ABC test, as one of the Borrello tests is to what degree are they integrated into your business? If they're only providing very limited services, they look a lot less core to your business function. However, technically, the way the rules operate is that even if they're just working a single hour in a single day, and that's the extent of your relationship, they could still need to be classified as an employee.

May I add contractors/freelancers and have a blended staffing? For event or busy periods?

Yes, nearly all businesses have some form of a blended team. By way of example, Archetype Legal has full time employees, but we also hire outside agencies to help with things like bookkeeping, tax preparation and marketing. The key here is that we always hire “agencies” or active businesses, and not just individuals. As mentioned above, the obligation to classify someone as an employee applies even if you are simply hiring someone for one hour a year.

Are there different rules for Part-time vs Full-time Employees?

Speaking generally, the rules and your policies can be adjusted depending on the status of your employees. Again, you are encouraged to speak to a CPA, attorney and insurance professional to analyze your specific situation.

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Does hiring/tracking/paying through a 3rd party like Upwork have any impact on any of this?

If you are hiring through a third party staffing agency that will help cut off liability. The staffing agency will then work out the contractor/employee relationship with the service provider, and your relationship will be with the legal entity of the staffing agency giving you a very strong defense against misclassification. We encourage to ask this question directly of any third party, rather than assume it to be the case, however.

Implementation Questions

I've never had employees. If I need to move to having employees, how do I do this? Are there resources to help walk through the transition, paperwork, filing, etc?

Yes, there are definitely resources at your disposal. If you have someone doing your books now, they're a perfect person to ask for assistance, since they're most likely experienced in this kind of transition and its implications. A payroll company such as Gusto can also be very helpful because the onboarding there, for example, is really easy, just put in your employee's email address and Gusto handles all the paperwork for you except for the I-9 which has to be done by you. In addition, Gusto (and other payroll companies, too, to be fair) have integrated workers comp insurance solutions that can make this aspect of administering payroll much easier on you.

We also recommend an employment agreement with someone you're bringing on. There is a lot of value-add including, but not limited to, ensuring that trade secrets are protected, clarifying the at-will nature of the relationship, agreeing on certain forums if there was to be a dispute between you and your employee.

How can someone be an employee and hourly? Don't they have to be paid salary?

No, you are permitted to pay employees hourly. Take, for example, a Starbucks barista. They are employees of Starbucks, but they clock in and clock out and are paid an hourly rate (above minimum wage).

What are a few of the extra costs an employer can expect when classifying a worker as an employee vs a contractor?

When you're paying a worker as an employee rather than a contractor, your costs will increase to include the cost of the payroll service you decide to use (yes, you can administer payroll yourself, but we don't recommend it!), payroll taxes and workers compensation insurance. Note that in California, workers compensation insurance is required for all employees, even if you only have one, regardless of how many hours worked. For a really clear sense of what your cost will be once you treat a worker as an employee, check out Gusto's [Employee Tax Calculator](#).

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As a fellow small business owner, do you see any non-financial benefits to making workers employees? For example, "a sense of team"

A stronger team atmosphere and loyalty can follow from this change, as employees feel invested in the long-term success of the business. This leads to less turn over and harder work ethic. Making workers employees can also enhance retention, particularly if you choose to offer holiday and vacation pay, as well as health and other benefits.

Do I need to change from sole proprietor?

No, there is no requirement that you change from a sole proprietor to hire employees. However, there can be a lot of liability protection by doing so. By hiring employees through your entity (such as an LLC) if the employee is upset, he/she will be suing your LLC and not you personally, which means your personal assets are protected.

What if the "contractors" want to be 1099 vs. W2?

That won't be a defense if things go wrong. The fact that the contractor has communicated to you that this is still their preferred set up won't alleviate your obligation to follow the rules at the state level and at the federal level. That preference alone can't be used to insulate you from any type of liability.

Typically, contractors will resist becoming a W2 employee because of the impact of mandatory withholdings on their net pay. Conversely becoming an employee will mean that they are paying their federal and state taxes via those withholdings throughout the year, removing from them the responsibility for setting aside an adequate percentage of their earnings as a contractor to cover their tax liability and minimizing unpleasant tax-time surprises. That impact on their net pay is real. It's not unusual for employers, when making this conversion from contractor to employee, to agree to an increase in the now-employee's rate, to offset the impact on the worker's cash flow of having those required amounts withheld.

Another contractor objection can be a perceived loss of independence or flexibility. Employees can still be hourly on flexible schedules; they can still operate with minimal supervision.

Do you have to offer Health Care?

No. It is not a hard and fast rule that all employers must offer health insurance in CA.

Under the Affordable Care Act (ACA), businesses with 50 or more full-time equivalent (FTE) employees that do not offer health coverage, or that offer health coverage that does not meet certain minimum standards, may be subject to a financial penalty, referred to as the Employer Shared Responsibility payment.

Additionally, the location of your business (such as San Francisco) can adjust these rules and you are encouraged to connect with an attorney and insurance broker to better understand your obligations.

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What if the "contractors" are outside California? Does that matter?

As a quick disclaimer, Archetype is not licensed to practice in all 50 states, and we are primarily focused on CA.

With that as a backdrop, there are some important factors though here to consider, If you're hiring a contractor from another state your standard contract very well may say, "This relationship is governed by California law," and then you can't have it both ways. You can't say, "Well, if the dispute arises, I want to make it really easy for me and handle this in San Francisco, California where I'm based, but at the same time want to rely on Texas law because that might be a little bit more employer-friendly."

Alternatively, if for example you speak to an attorney and Texas law is more employer friendly so you sign a consulting agreement governed by Texas law (again, just an example) if some type of large dispute happened, now all of a sudden you are flying to say Dallas, Texas to fight this issue with this service provider. That has its own drawbacks as well.

If they are employees, am I required to provide laptops? phones? etc?

There is not a black and white rule that requires employers to provide specific equipment, but most employees will expect some level of accommodation. For example, if I am hiring an associate, he/she would expect that I would provide him/her with a computer, software, printer, etc. The failure to provide such equipment would decrease how attractive the position is.

Enforcement/Penalties

How do we get caught? Who's ever going to know if I do this or don't do this? How will they know if you don't treat people correctly?

There are two ways we've seen it come up with relative frequency. The IRS, the state of California, and the EDD does not have the resources or the time to be kicking in your front door and looking at your operations and seeing what you're doing. Thus, usually you have to kind of tip them off. The two ways we see it happen are the worker is let go by you and you say, "Hey, listen, you were great. We appreciate the 20 hours a week you've been giving us for the last six months, but we no longer need your services."

From there, the party who was let go starts figuring out how he/she can help support his/her family. He/she goes to the EDD and the powers that be to try and collect unemployment and the EDD looks at the relationship and says, "Interesting because everything we're seeing here shows that you are a contractor, but you obviously thought you were an employee. Let's now find out what was going on here with that company." That's situation one.

The other situation is when you're reporting to the IRS that you're a business that has basically \$500,000 in receipts, but you have \$350,000 in 1099 contractor expenses. That's also looks a

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little bit odd because most people would need much higher W2 expenses as far as workers go, which may cause them to audit and look into what you're doing.

The other big one is the idea of a lawsuit. If someone can sue and say, "I was wrongly classified," that lawsuit alone or the threat of a lawsuit can have such a dramatic impact on your business from a legal fees and a defense standpoint, and if the worker can show he/she should have received meals and rest breaks, overtime, health insurance, the penalties can loom large.

What do the monetary penalties look like?

I think the penalties can be as high as 40% on top of what should have been paid properly to cover all of the Workers' Comp insurance and everything else that came out. You can quickly see how if you've been paying this contractor \$40,000 over the last eight months and now the IRS gets involved and says, "You owe another 18 grand here on top of this and penalties."

You also have to factor in that if the IRS is making this claim, you're probably also paying a CPA, a lawyer, other people to help you in the defense.

Specifically for Estheticians

I am a licensed esthetician interested in expanding my business by adding a second esthetician to provide services on the days I'm not there. They will book clients through my scheduling software, I will provide all of the supplies required, and they will be operating in my space on my client list. Would they have to be an employee or can I treat them as a contractor?

AB5 carves out an exception of esthetician, which means the relationship is governed by the Borello Test, and provided these factors are present

The esthetician must:

- (I) Sets their own rates, processes their own payments, and is paid directly by clients.
- (II) Sets their own hours of work and has sole discretion to decide the number of clients and which clients for whom they will provide services.
- (III) Has their own book of business and schedule their own appointments.
- (IV) Maintains their own business license for the services offered to clients.
- (V) If the individual is performing services at the location of the hiring entity, then the individual issues a Form 1099 to the salon or business owner from which they rent their business space.

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Please be in touch if we can be of any assistance to you - thank you!

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