



Hiring Independent Contractors

A California Guide

Introduction

Hiring independent contractors in California comes with unique legal challenges due to the state's strict labor laws and classification criteria. This guide is designed to help navigate the complexities of engaging contractors, ensuring compliance with regulations like AB-5 and the ABC Test.

From determining proper worker classification to drafting airtight contracts and understanding your obligations, we cover *most** of what you need to know to minimize legal risks and successfully manage independent contractor relationships in California.

This guide is intended to be practical. The goal is to equip you with knowledge, strategies, and techniques to effectively use and execute contracts with independent contractors.

This guide **is not** intended to be “comprehensive,” “exhaustive,” “complete,” etc. etc. etc.. Believe it or not, hiring independent contractors can be VERY nuanced, and so too are the employment, labor, intellectual property, choice of law and and and ... all the laws that apply! So, we can't get into all the details, and we won't even try. BUT...we hope you take away something useful!

If you find something you don't agree with or have a “yeah, but”. . . we'd love to hear from you. Also, if something doesn't make sense or you'd like more information - CONTACT US!

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Disclaimer

As any good attorney should do, it is important to point out that the information presented in this guide is for *informational purposes only* and is *not specific legal advice*. Advice is only something that can be provided after a thorough review of your particular situation and by a licensed and experienced attorney.



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Part 1: An Overview of Independent Contractors

What Is an Independent Contractor?

In general, an independent contractor is someone who is in business for him or herself and has a specialized skill that ***is not part of your ordinary business***. California applies the “ABC Test” to determine whether a worker is an independent contractor.

In simple terms, a person is an employee if:

They provide services that your business ordinarily provides, do not operate their own “independent” business (i.e., they don’t have other clients), or they operate under the control of the hiring entity

The steps to determine whether a worker is an independent contractor or employee in California are as follows:

1. Apply the ABC Test

- a. If they pass the ABC Test, they are a contractor
- b. If they fail the ABC Test, then look for an exemption

2. Look for an Exemption

- a. If exemption applies, you’re done
- b. If exemption does not apply, look for an exception

3. Look for an Exception

- a. If an exception applies, apply the Borello test
- b. If an exception does not apply, they are an employee

4. Apply Borello

- a. If they pass the Borello test, they are a contractor
- b. If they fail the Borello test, they are an employee



In California, a worker is considered an employee unless and until the hiring entity can establish otherwise.



Background: *Dynamex*

Dynamex - “When a worker has not independently decided to engage in an independently established business but instead is simply designated an independent contractor by unilateral action of a hiring entity, there is a substantial risk that the hiring business is attempting to evade the demands of an applicable wage order through misclassification.”

The “ABC” Test in California

Following the *Dynamex* decision, the California legislature adopted AB5 which sets forth the “ABC Test” to determine if a person hired is an independent contractor or employee for the purposes of the Labor Code.

Under the ABC test, a worker is considered an employee and not an independent contractor, unless the hiring entity satisfies **all** of the following conditions:

- The worker 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; and
- The worker performs work that is **outside the usual course of the hiring entity’s business**; and
- The worker is customarily engaged in an **independently established trade**, occupation, or business of the same nature as that involved in the work performed.

Key Takeaways



- The work must be something that is not integral to the hiring entity’s business (i.e., the business would go on without those services)
- It does not matter what the contract says
- The worker must do similar work beyond the services performed for the hiring entity



Breaking Down the ABCs

To help remember and apply the ABC Test, let's say A=Autonomy, B=Business, and C=Customarily.

1. **Autonomy:** The contractor must have freedom to make decisions about how they perform their work. This means they have control over the methods, processes, and timing of their tasks, rather than following detailed instructions or being micromanaged by the company hiring them. They operate independently, setting their own schedule, choosing where and how to work, and using their own tools or resources.
2. **Business:** The worker must have their own independent business doing the type of work they are being hired for. They may have other clients, advertise their services, and operate like a business rather than relying on just one company for work.
3. **Customarily:** The work the person does must be different from what the company normally does. For example, if a company makes furniture, an independent contractor could be hired to clean the offices, but not to build furniture.

Examples	
Probably an <i>Employee</i>	Probably an <i>Contractor</i>
<ul style="list-style-type: none"> • An electrician installs a new light for a customer of your electrical company • An administrative assistant provides a number of duties, one of which is posting regularly on your social media page 	<ul style="list-style-type: none"> • An electrician installs a new light fixture in your law firm office • A marketing agency create a social media campaign for your floor installation business



- What the contractor “wants” does not matter
- What the contract says, also does not matter
- Having a “paper business” (i.e., registered but not serving other clients) is generally not enough
- If you treat them like an employee, they probably are an employee



Employee vs Contractor Guidelines

A worker is more likely to be an **employee** if:

- Paid by the hour
- Work full time for the company
- Is closely supervised by the company
- Received training from the company
- Receives employee benefits
- The company provides the tools and equipment needed to work
- The services provided are an integral part of the company's business
- The position is permanent or open-ended
- The work replaced the work formerly completed by an employee
- Is restricted from working for other businesses
- Earns substantially all income from the work
- Contract contains broad intellectual property assignment

A worker is more likely to be a **contractor** if:

- Paid by the job
- Can set or negotiate their own rates
- Sets own working hours
- Provides the tools and equipment needed to do the job
- Works for more than one company at a time
- Pays own business and travel expenses
- Hires and pays own assistants
- Can earn a profit or suffer a loss as a result of the work for the company
- Operate a truly independent business and holds themselves out to other potential clients
- maintains a business location, which may include the individual's residence, that is separate from the hiring entity (but individual can choose to work at the hiring entity's location)
- If required, has a business license
- The individual is not restricted in working for more than one hiring entity



Part 2: Exceptions and Exemptions

California’s AB5 includes an ever-expanding list of “Exemptions” and “Exceptions” from application of the ABC Test. The main difference between exemptions and exceptions from California’s Assembly Bill 5 (AB5) is that **exemptions do not require workers to pass the ABC test, while exceptions do.**

Exemptions

Some workers are exempt from the ABC test and are not required to pass it to be considered independent contractors. These workers include licensed professionals such as doctors, dentists, lawyers, and accountants.

Exceptions

Other workers qualify for an exception to the ABC test, but still need to pass the less strict Borello test to be considered independent contractors. The Borello test considers how much control the employer has over the worker.

Examples	
Common Exemptions	Common Exceptions
Labor Code § 2783 Specific Occupations <ul style="list-style-type: none"> • Lawyer • Engineer • Accountant • Doctor • Direct sales salesperson 	<ul style="list-style-type: none"> • Labor Code § 2776 Business-to-business contracting relationships • Labor Code § 2778 Professional Services



There are specific requirements for each exemption and exception that have to be met. In some cases, if one criteria is not met, then the exception will not apply. Also, just because there’s an exception doesn’t mean that the worker is a contractor - you still have to pass the *Borello* test!



Exemptions from the ABC Test

Labor Code § 2783 Specific Occupations Exemption

Labor Code § 2783 outlines exemptions for specific occupations from AB-5, allowing certain professionals, such as doctors, lawyers, architects, and “direct salespersons”, to operate as independent contractors rather than employees. The exemption recognizes the nature of certain highly skilled, licensed professions, where individuals typically operate with greater autonomy and control.

The Direct Salesperson Exemption only applies if **all of the following conditions are met**:

- The individual is engaged in the trade or business of primarily inperson demonstration and sales presentation of consumer products, including services or other intangibles, in the home or sales to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis, for resale by the buyer of any other person in the home or otherwise than from a retail or wholesale establishment;
- Substantially all of the remuneration (whether or not paid in cash) for the services performed by that individual is directly related to sales or other output (including the performance of services) rather than to the number of hours worked by the individual; **and**
- The services performed by the individual are performed pursuant to a written contract between the individual and the person for whom the services are performed and the contract provides that the individual will not be treated as an employee with respect to those services for state tax purposes.

Salesperson Examples	
Factors Favoring <i>Employee</i>	Factors Favoring <i>Contractor</i>
<ul style="list-style-type: none"> ● Received training ● Assigned quotas ● Required to follow leads ● Required to attend sales meetings ● Required to furnish reports ● Given expense allowances or a guaranteed salary ● Performs services continuous in nature ● Services are a direct and essential part of the business operation 	<ul style="list-style-type: none"> ● Pays their own expenses ● Establishes own hours of work ● Plans own itineraries for travel ● Not required to attend sales meetings ● Not required to make reports ● Received direction from the principal consisting only of establishing selling prices, terms and conditions of the sale, approval of credit, and furnishing samples, literature, or order blanks



Exceptions to the ABC Test

Labor Code § 2776 “Bona Fide Business-to-Business Contracting Relationship” Exception

The “Bona Fide Business-to-Business Contracting Relationship” exemption provides a legal framework under California law to determine when a business-to-business relationship qualifies for independent contractor status. This exemption helps distinguish true business partnerships from misclassified employment relationships. It allows two legitimate, independent businesses to contract with one another, provided certain conditions are met:

- Free from control and direction
- Provides services directly to the contracting business rather than to customers of the contracting business (does not apply if the business service provider’s employees are solely performing the services under the contract under the name of the business service provider and the business service provider regularly contracts with other businesses)
- The contract is in writing and specifies rate of pay, services provided, and due date for payment
- If required, the business service provider has a license
- Business service provider maintains a business, which may be a residence, separate from the contracting business
- The business service provider is independently engaged in business of the same nature
- The business service provider can contract with other businesses to provide the same or similar services and maintain 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
- Consistent with the nature of the work, the business service provider provides its own tools, vehicles, and equipment to perform the services, not including any proprietary materials that may be necessary to perform the services under the contract
- 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



Just because you are working with another business does not mean that the exception applies. You have to do some due diligence to make sure they are a “bona fide” business!



Labor Code § 2778: “Professional Services” Exception

Labor Code § 2778 establishes a "professional services" exemption under California's worker classification laws, allowing individuals in certain fields, like marketing, design, and consulting, to qualify as independent contractors if specific conditions are met. The purpose of this exemption is to acknowledge the flexible, project-based nature of these professions, where professionals often, and historically, have exercised significant control over how they deliver their services.

Criteria

- Maintains a business location, which may be their residence, separate from the hiring entity, but with certain exceptions the person may choose to perform services at the hiring entity's location
- Has a business license or tax registration if required in the location where the services are performed and a professional license if required by the profession
- Has the ability to set or negotiate their own rates
- Can generally set their own hours
- Is customarily engaged in the same type of work for another hiring entity or holds themselves out to potential customers for that type of work; and
- Customarily and regularly exercises discretion and independent judgment in the performance of the services.



Professional Services Include

- Marketing, provided that the work is original and creative and meets other criteria
- Administrator of human resources, provided that the work is predominantly intellectual and varied and meets other criteria
- Payment processing through an independent organization
- Freelance writer



Part 3: *Borello*

If an exception applies, then the next step is to apply the *Borello* test. Unlike the ABC test, the *Borello* test does not rely on any single factor to determine if a worker is an employee or independent contractor. Instead it is a “multi-factor” test that prioritizes “statutory purpose” and requires a holistic consideration of all of the available facts.

The *Borello* “Multi-Factor” Test

Under Borello, a court or agency would look at a number of factors to determine if a worker is an employee or contractor. Not any one factor is determinative, and all the factors will be considered “on the whole” to make a determination.

***Borello* Factors**

- Whether the worker performing services holds themselves out as being engaged in an occupation or business distinct from that of the employer;
- Whether the work is a regular or integral part of the employer’s business;
- Whether the employer or the worker supplies the instrumentalities, tools, and the place for the worker doing the work;
- Whether the worker has invested in the business, such as in the equipment or materials required by their task;
- Whether the service provided requires a special skill;
- The kind of occupation, and whether the work is usually done under the direction of the employer or by a specialist without supervision;
- The worker’s opportunity for profit or loss depending on their managerial skill;
- The length of time for which the services are to be performed;
- The degree of permanence of the working relationship;
- The method of payment, whether by time or by the job;
- Whether the worker hires their own employees;
- Whether the employer has a right to fire at will or whether a termination gives rise to an action for breach of contract; and
- Whether or not the worker and the potential employer believe they are creating an employer-employee relationship (this may be relevant, but the legal determination of employment status is not based on whether the parties believe they have an employer-employee relationship).



Part 4: Consequences of Misclassification

Under California Labor Code § 226.8, it is unlawful for any employer to willfully misclassify an individual as an independent contractor.

Willful Misclassification

Engaging in willful misclassification can subject an employer to a civil penalty by the Labor and Workforce Development Agency of anywhere from \$5,000 to \$25,000 for each violation.

Any person who misclassifies an employee as an independent contractor for the purpose of willfully attempting to evade or defeat any tax under the Internal Revenue Code may be found guilty of a felony, fined up to \$100,000 and sentenced up to five years in prison. The IRS may even impose penalties for misclassification that are unintentional. 26 U.S.C. § 3102(f) § 3509.

“Willful” Misclassification

“avoiding employee status for an individual by *voluntarily* and *knowingly* misclassifying that individual as an independent contractor.”
Labor Code § 226.8(j).

Pattern or Practice of Misclassification

If the Labor and Workforce Development Agency, or any court, finds that an employer has engaged in a “pattern or practice” of misclassification violations, the employer may be subject to civil penalties ranging from \$10,000 to \$15,000 per violation.



What difference does it make if a worker is an employee rather than an independent contractor?

California’s wage and hours laws (e.g., minimum wage, overtime, meal periods and rest breaks, etc.), workplace safety laws, and retaliation laws protect employees, but not independent contractors. Additionally, employees can go to state agencies such as the Labor Commissioner’s Office to seek enforcement of these laws, whereas independent contractors must resolve their disputes or enforce their rights under their contracts through other means.



Remedies for Workers

Workers who have been misclassified as independent contractors and who should have been classified as employees are entitled to recover all the benefits to which they would have been entitled had they been properly classified. See Labor Code § 2802(a). These benefits may include payment for back pay, plus interest, on account of:

- Insufficient minimum wage
- Overtime
- Missed meal break; and/or
- Rest periods



In some cases, employees may also recover attorney fees and court costs. (Labor Code § 2699(g))

Unemployment Benefits

An employee misclassified as an independent contractor who gets laid off may still file a claim for unemployment insurance with the Employment Development Department. If the EDD determines the employee has been misclassified, he or she may still receive unemployment benefits and the employer could be fined.

Workers' Compensation

Misclassified workers who are hurt on the job may still file a claim for workers' compensation with the Department of Industrial Relations Division of Workers' Compensation. Uninsured employers may be punished with fines up to \$10,000 and/or imprisonment up to one year.

Discrimination/Retaliation

Workers who face discrimination or retaliation in any manner whatsoever - for example, if the employer fires a worker because they complain about being classified as an independent contractor or not being paid overtime, or because the worker filed a claim or told the employer that they intend to file a claim with the Labor Commissioner - can file a discrimination/retaliation complaint with the Labor Commissioner's Office. However, it is important to note that the Labor Commissioner does not have jurisdiction over workers who are in fact independent contractors. The worker can also file a lawsuit in court against the employer instead of filing a complaint first with the Labor Commissioner's Office.



Part 5: Intellectual Property Considerations

Under the Copyright Act, intellectual property created by an **employee** belong to the employer if they are made within the scope of employment under the “work made for hire” doctrine. Intellectual property created by an independent contractor will not automatically be owned by the employer - even if the idea, invention, or expression is made within the scope of the contractor’s engagement or on the worksite of the employer. In some cases, independent contractors may gain rights to intellectual property or rights of a co-author.

Contractors Under the “Work Made For Hire” Doctrine

For independent contractors, the Work Made For Hire doctrine only applies in limited circumstances where two conditions are met:

- There is a written agreement between the parties**, signed before the work is created, that explicitly states the work is to be considered "made made for hire;" ***and***
- The work falls into one of nine specific categories** outlined by the Copyright Act, such as commissioned work for a contribution to a collective work, a part of a motion picture, a translation, or instructional texts, among others. The nine categories are:
 - Contribution to a collective work (*articles in a magazine or anthology*)
 - Part of a motion picture or other audiovisual work (*film scenes and TV episodes*)
 - Translations
 - Supplementary work (*forewords, illustrations, and charts that complement a work*)
 - Compilation (*databases or assembled collections of data*)
 - Instructional text (*manuals, textbooks designed to teach*)
 - Tests (*academic or professional assessments*)
 - Answer material for a test (*solutions or guides for tests*)
 - An atlas



Software does not neatly fall into one of the nine specific categories under the "work made for hire" doctrine in the Copyright Act.



A Work Made for Hire Clause in an independent contractor agreement may cause a California-based independent contractor to be a “statutory employee” under workers’ compensation, unemployment insurance, and disability insurance laws.



Assignment of Intellectual Property Rights

So, if the Work Made For Hire doctrine cannot apply, or if you do not want it to apply to your contractors, what do you do?

Glad you asked. You can use an intellectual property **assignment** and/or **license** provision in your independent contractor agreement that transfers (*assigns*) or licenses (*shares*) intellectual property rights between your company and the contractor.

Intellectual property assignments and licenses are beyond the scope of this guide, but a couple of guidelines should be considered when using them in independent contractor agreements:

- Avoid overly broad Assignment provisions** that could point to employee status

Don't say this...

“Contractor hereby assigns to Company all rights, title, and interest in and to the work product they create during the term of this Agreement.”

Say something like this...

“Contractor hereby assigns to Company all rights, title, and interest in and to the Deliverables specified in the SOW attached to this Agreement.”

- Allow the contractor to retain some rights** in the assigned work product

Don't say this...

“Contractor agrees not to use or disclose any of the work product created during the term of this Agreement, including in Contractor’s portfolio of past works, its website, or social media accounts.”

Say something like this...

“Contractor is permitted to display a portion of the Deliverables created for Company on Contractor’s portfolio, including on Contractor’s website, social media accounts, and other mediums.”



Part 6: Best Practices for Working With Independent Contractors

If you've made it this far, you may be scared to work with "contractors" in California. That's fair (to say the least), but if you do find yourself or your company working with contractors, here's a quick list of **do's** and **don'ts**.

Do This...

- Do contract with a business, not with an individual
- Do require the contractor to provide an invoice (do not make regularly-scheduled payments without an invoice)
- Include the ability of the worker to earn a profit or incur a financial loss (time does not count)
- Do include an intellectual property assignment clause, but grant back a limited license
- Do check to ensure they are holding themselves out to the public (website, social media)
- Do make payments contingent on successful project completion

Don't Do This...

- Don't make anything mandatory (reports, meetings, quotas, etc.)
- Don't call any payment a "salary"
- Don't pay for their expenses
- Don't provide an employment "offer letter"
- Don't have them sign an "Employee Handbook"
- Don't use a Work-Made-For-Hire clause
- Don't let an employee go and replace with an independent contractor
- Don't include the ability to discharge at any time at will and without cause (discharge should be at end of a term or a breach of the contract)
- Don't unilaterally assign the label "independent contractor"
- Don't max out their schedule such that they cannot work for anyone else (no more than 80% of time, or 30 hours per week)



These are "Best Practices," not rules. Following these best practices alone will not ensure that a contractor is not misclassified. Conversely, not every item above needs to be followed to a "T." Every situation requires a separate analysis.



Part 7: Conclusion

In conclusion, hiring independent contractors in California requires careful attention to legal requirements and best practices to ensure compliance with the state's strict employment and labor laws. By understanding proper worker classification, drafting clear and comprehensive contracts, and addressing key considerations like intellectual property ownership and payment terms, businesses can avoid costly penalties and maintain productive relationships with contractors.

Remember - employment-related laws are complex, change frequently, and need to be applied on a case-by-case basis. Staying informed about evolving regulations and proactively managing contractor agreements will help safeguard your business and ensure successful, compliant contractor engagements, but there's no substitute for professional legal guidance.

WARNING

California is heavily enforcing employee misclassification laws, and it doesn't necessarily take a violation or a disgruntled former "contractor" to raise the issue. The California Employment Development Department (EDD) can perform audits at will, and misclassification isn't something you can just "fix." **It's imperative that you're doing things the right way from the beginning!**



Worksheet: Employee vs Contractor

Do you instruct or supervise the person while working?

Can the worker quit or be discharged at any time?

Is the work being performed part of your regular business?

Does the worker have a separately-established business?

Do they have a website?

Do they have other clients?

Do they have a business license?

Are they free to set their own pricing and terms?

Do they have substantial training or experience in the work?

Do you have employees doing the same type of work?

Do you furnish tools or equipment to perform the work?

Do you provide any training to the worker?

How are they paid? (hourly, fixed amount, flat fee, etc.)

Were they previously an employee of your company?

Are they required to attend regularly-scheduled meetings?

Do you measure their work based on time or performance?

Do they believe that they are an employee?

Have you ever referred to them as an employee?

Do they perform work directly for you or your customers?

Are they in a professional trade (doctor, lawyer, accountant) etc.?



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