

# 2023 APMA ANNUAL FORUM

## MONTEREY PLAZA HOTEL

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*Presented by:*

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# **W-2s or 1099s? Exempt or Non-exempt? What you need to know about (Mis)classifying Employees**



# DISCLAIMER

While the presenter believes the information contained in this presentation is accurate, this presentation contains general information and guidance under CA law and cannot be relied upon for a specific factual situation or as legal advice. The law is constantly evolving and changing. For specific advice, please consult Patane Gumberg Avila or your legal counsel.



# Today's Agenda

## A. Independent Contractor or Employee?

- 1) Overview of Dynamex and "the ABC Test." How to Apply the ABC Test.
- 2) When does ABC Test Not Apply?
- 3) Dangers of Misclassification Claims.

## B. Exempt or Non-Exempt?

- 1) California law
- 2) Federal law

## C. Questions & Answers



# *What does Misclassification Mean?*

Two types of “Misclassification” cases.

1. Company utilizes the services of one (or more) workers has “misclassified” them as independent contractors. Typical claim is the worker(s) have been “misclassified” by the employer as independent contractors even though they are entitled to legal protections as employees.
2. “Misclassification” of Employers as “*exempt*,” referring to the white collar exemption for executive, administrative and professional employees. Such workers are exempt from the minimum wage, overtime, meal and rest period requirements.



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# *IC or Employee? Why Should I Care?*

*If an individual is determined to be an employee, all kinds of laws are triggered.*

1. Wage-hour;
2. OSHA;
3. Employment discrimination;
4. Workers' compensation;
5. Unemployment insurance / payroll tax laws.

*Independent contractors, however, fall outside most employment laws.*



# *ABC Test*

Presumption that a worker who performs services for a hiring entity is an employee for purposes of wage claims under the Industrial Welfare Commission (“IWC”) Wage Orders. (Dynamex case, later codified in California Labor Code.)

- 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 entity’s 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.



# *Some Occupations Excluded from ABC Test (AB 2775)*

1. Business-To-Business Relationships: An individual or business who contracts to provide services to another business.
2. Single Engagement B-to-B. One individual contracts with another to perform services at “a stand-alone non-recurring event in a single location, or a series of events in the same location no more than once a week.”
3. Referral Agencies. Businesses that provide clients with referrals for service providers to provide services.

“Graphic design, web design, photography, tutoring, consulting, youth sports coaching, caddying, wedding or event planning, minor home repair, moving, errands, furniture assembly, animal services, dog walking, dog grooming, picture hanging, pool cleaning, yard cleanup, and interpreting services”

4. Professional Services Exemption.; Lawyers, architects, accountants, appraisers, registered professional foresters, home inspectors, insurance agents (licensed), medical providers.
5. A few extras with legislative clout. Manufactured housing salespersons; international exchange visitor programs workers; competition judges (including amateur umpires and referees); newspaper distributors; and commercial fishers.



# ***Business Service Providers***

Business-To-Business Relationships: An individual or business who contracts to provide services to another business.

1. A business entity (preferably a partnership, LLC, LLP, or corporation, but could be sole proprietor) is a *“business service provider” (“BSP”)*
2. A *business service provider* contracts to provide services to another such business (known as a *“contracting business”*)
3. Contract must be in writing, specifying payment, including rate(s) of pay, services to be performed and due date of payment.
4. Determine if the work requires business service provider to have a business license. If it does, they have to have it.



# *Business Service Providers (Continued)*

5. BSP maintains a *business location* separate from the business or work location of the contracting business. (Ideally not their residence, but this is allowed under the statute).
6. BSP is customarily *engaged in an independently established business* of the same nature as work performed.
7. BSP can (and does) *contract with other businesses* to provide the same or similar services.
8. No clientele restrictions.
9. BSP *advertises and holds itself* to provide same or similar services.
10. BSP provides its own tools, vehicles, and equipment to perform the services, excluding proprietary materials
11. BSP can set its own hours and location of work.



# ***Business Service Providers (Continued)***

If criteria are met, the determination of employee or independent contractor status of the business services provider is governed by *Borello*.

According AB 5 author Lorena Gonzalez: *“by negative implication, that the business services provider is necessarily an employee if those criteria are not satisfied. Additionally, AB 5 is not intended to replace, alter, or change joint employer liability between two businesses.”*



# ***Borello Multi-Factorial Test***

1. The right to discharge at will, without cause;
2. Whether the one performing the services is engaged in a distinct occupation or business;
3. The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;
4. Level of skill required;
5. Who supplies the tools, and place of work for person doing the work;
6. Duration of time for which the services are to be performed;
7. Method of payment, whether by the job or by time;
8. Is the work part of the regular business of the principal; and
9. Intent of the parties. Do they believe they are creating the relationship of employer-employee?



# ***Rebuttable Presumption When License is Required for Workers' Compensation Coverage***

If a person performs services for which a contractor's license is required, and the person does *not* have such a license, there is an *irrebuttable presumption* that the individual is an employee.

If such a person *has* a license, there is a rebuttable presumption that the person is an employee, rather than an independent contractor, unless these three factors are satisfied:

1. The worker has the right to control and discretion as to the manner of performance of the contract for services in that the result of the work and not the means by which it is accomplished is the primary factor bargained for.
2. That the individual is customarily engaged in an independently established business.
3. That the individual's independent contractor status is bona fide and not a subterfuge to avoid employee status.



# *Unemployment Insurance Claim by Putative Contractor*

If an application for unemployment insurance is filed, the EDD will usually ask the putative employer to complete this questionnaire to make a determination under the Cal. Unemployment Insurance Code:

[https://edd.ca.gov/siteassets/files/pdf\\_pub\\_ctr/de187odi.pdf](https://edd.ca.gov/siteassets/files/pdf_pub_ctr/de187odi.pdf)



# *Willful Misclassifications*

It is unlawful for any person or employer to willfully misclassify an individual as an independent contractor. The law authorizes civil penalties against a person or employer who engages in an amount between \$5,000 and \$15,000 for each violation in addition to any other penalties or fines permitted by law.



# *Exempt or Non-Exempt?*

## *Why should I care?*

### *Bouchard v. Dick's Sporting Goods (2015) (Illinois)*

- Class action lawsuit filed in Illinois on behalf of former assistant manager.
- Plaintiff was hired as an hourly sales associate, and promoted to assistant manager.



# *Exempt or Non-Exempt?*

- ***Bouchard v. Dick's Sporting Goods (2015) (Illinois)***
- “Hardlines Manager”, who are classified as overtime exempt management. The pleadings allege plaintiff and other assistant manager jobs in the Dick's organization – did not include hiring, firing, supervising, disciplining, or delegating work to employees.
- They allege that assistant managers do not have the power to exercise any kind of “meaningful independent judgment and discretion.” –
  - \*I counted at least six other lawyers with New York firms trying to get pro hac vice admission in Illinois.



# *The Dangers of Misclassification*

- Exemptions are narrowly construed
- Unpaid overtime
- Reporting time pay
- Payment and penalties for meal periods and rest periods not taken (California)
- Significant penalties / liquidated damages
- Class action risk
- Attorneys' fees to the alleged misclassified employee / class members



# The Three Major Exemptions Under FLSA and CA

- Administrative
- Executive
- Professional
- Also, outside salespeople (not as major, but an important exemption)



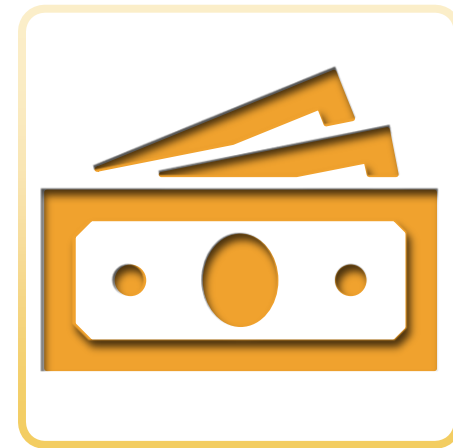
# The Three Tests

1. The “salary basis” test.
2. The “duties” test.
3. The “salary level” test.



# The Salary Basis Test

- Paid on a “salary basis”;
- Receives a “predetermined amount of compensation”;
- That is “not subject to reduction because of variations in the quality or quantity of work performed.”



# The Salary Basis Test

- Salary is not dependent on the days or hours worked.
- “No docking” rule, due to variations in quality or quantity of work, or for discipline, except for significant discipline of at least one or more days.
- The “Window of Correction” rule. Even if the deduction was improper, if it was isolated or inadvertent and reimbursement is made.



# The Salary Basis Test



- Must be compensated at least \$684 per week salary under federal regulations.
- In California, must be compensated at least 2x minimum wage full-time employment, meaning 40 hours per week of work, \$1,240 in 2023 ( $\$15.50 \times 2 \times 40$ ).
- \$64,480 yearly salary.

# Executive (Management) Exemption

- Customarily and regularly supervise two or more employees; AND
- Has the authority to hire or fire or whose suggestions and recommendations as to hiring or firing or promotions are given particular weight; AND
- Is “primarily engaged in” these duties.

# The Primary Duties Test for Management Exempt

- “Primary duty” must be the performance of exempt management work.
- “Primary duty” means the principal, main, major or most important duty the employee performs.



# The Primary Duties Test Factors

- Relative importance of the exempt duties;
- Amount of time spent performing exempt duties;
- Are they free from direct supervision?

# The Primary Duties Test for Management Exemption (California Distinction)

- Under CFRs, an exempt employee can spend less than 50% of his/her time doing non-exempt work *if other factors support exempt status*.
- California law measures the actual time spent performing exempt and non-exempt duties.
- In CA, “primarily” engaged in management duties will ONLY be found if the employee spends MORE than half their work time on exempt tasks.

# The Administrative Exemption

- Primary duty is performance of office/non manual work “directly related to the management or general business operations” of the employer; AND
- *Primary duty* includes the exercise of independent judgment and discretion with respect to matters of significance.
- Must still meet the salary level tests, but under CFRs can also be paid on a “fee basis”, which is a sum for a single job regardless of the time required for its completion.

# Work Directly Related to the Management or Business

Functional department heads such as tax, finance, accounting, audit, safety, insurance, labor relations, human relations, IT, regulatory compliance, etc.

# Job Titles NOT Determinative

**“Job title alone is insufficient to establish exempt status.”**

***“Titles come cheap.”***

# Discretion and Independent Judgment

- Generally means the comparison and evaluation of possible courses of conduct regarding “matters of significance”.
- Making a decision after evaluating the various possibilities.
- Burden is on the Employer to prove the exemption!

# Matters of Significance?

Factors include:

- Are these major assignments for the business?
- Does the work affect the business to a substantial degree?
- Authority to formulate, affect, interpret or implement management/operational policies.
- Investigates and resolves matters of significance on behalf of management.
- Burden is on the Employer to prove the exemption!

# “Learned Professional”

CFRs: Primary duty must involve the performance of work “*requiring advanced knowledge in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction.*”

# “Learned Professional”

- CA: Has to also have an advanced degree (more than a bachelor level).
- Under CFRs, not a determinative factor – will also look at job requirements.
- Implication: Under CFRs, a RN could be a learned professional, but not under CA law.



# THANK YOU!



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