Rethinking independent contractor status

The decision could have broad consequences.

By Cameron L. Hess, CPA, Esq.
Guest Contributor

The recent California Supreme Court decision in ***Dynamex*** raises the question whether California businesses may soon be required to reevaluate whether workers classified as independent contractors should instead be treated as employees. Whether or not ***Dynamex*** will become a springboard for change, it serves as an important reminder to reexamine current worker classification.

In ***Dynamex***, the court ruled that all three of these conditions must be met in order to treat the worker as an independent contractor:

A) 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 (the ***Borello*** "Control Test");

B) The worker performs work that is ***outside*** the usual course of the hiring entity's business; and

C) The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

The Court stated that the "failure to prove any one of these three prerequisites will be sufficient in itself to establish that the worker is an included employee."

Dynamex

The ***Dynamex*** decision involved a private class of two delivery drivers who brought an action against a business for which they worked. They were seeking back pay due to violation of a California Department of Industrial Relations Labor Order involving transportation industry employees. The big catch was that the workers were being treated as independent contractors by the business.

This situation arose because Dynamex Operations West, Inc., a same-day shipping company, decided in 2004 to reclassify all drivers previously working as employees; it would instead treat them as independent contractors. The Supreme Court was absolutely clear that the sole purpose sought by Dynamex was to reduce its costs of having employees. Drivers had to still wear company uniforms, place Dynamex magnetic decals on employee-owned trucks, and make deliveries as scheduled to the locations and on the exact days scheduled. Drivers could be immediately fired for nonperformance.

Drivers were, however, given greater independence than they had been previously allowed. Drivers used their own trucks, could decide which days they worked, could accept work from others, and could reject work, if they immediately followed up to find another approved driver for Dynamex. They could not work for or with any competitor to Dynamex.

At issue was what standard should be used for worker classification.

Dynamex argued that the applicable standard was existing common law. If its business neither had the right or authority to "control" the worker, then all its workers could be treated as independent contractors under the Supreme Court ***Borello*** decision rendered nearly 30 years earlier.[1]

The plaintiff class, however, argued that the law on worker classification was uncertain, and a stricter standard should apply against Dynamex. They turned to recent decisions in Vermont and Maine adopting the "ABC Test";[2] neither state had many of these types of cases.

In releasing its findings in ***Dynamex Operations West, Inc.***,[3] the California Supreme Court believed the law was uncertain and followed the stricter standards adopted in Vermont and Maine. They held that hired workers must be treated as employees.

Based on this decision, the Court ruled that the wage order would apply to all former employees who had been reclassified. However, because the case had been limited to the litigants in the case, the order would not apply to subsequently hired workers who had other clients. In addition, the Court limited its decision to the wage order issues only; it did not address whether the new standard would apply to business expense reimbursements because this issue was not raised in the appeal before the court.[4]

Concerns over *Dynamex*

It is not surprising that in ***Dynamex*** a class of litigants took a position advocating for stricter independent contractor standards because it was in their best interests. However, the

Court could have still followed ***Borello*** as good law and still found that all plaintiff litigants were employees because, as drivers, they were subject to too much employer control. Even in those cases that were cited for Vermont and Maine, the courts focused heavily on the issue of control.

However, the concern with ***Dynamex*** is that this decision may influence other areas of employment law, particularly employment taxes because worker classification cases tend to be fluid and not bound to one segment of employment or labor law. It could go far beyond the transportation industry where the EDD has been very active for over a decade in examining workers who are drivers.

While present EDD regulations continue to be based on the issue of control,[5] the EDD may endeavor to either modify current regulations or follow current case law, wherein the expansion would be argued to not be in conflict with the regulations as a partial restatement of current law.

Accordingly, it is possible that the EDD may in the near future assert that ***Dynamex*** applies to all businesses for determining worker classification and not just the transportation industry. Requiring that a business prove that the worker does not engage in any activity that is "within the usual course" of a company's business would result in both confusion as to what is the usual course of a business and may cause workers to be reclassified as employees in completely unanticipated situations.

Example of expansive employee classification in tax practice: Betty Baker Bookkeeping performs accounting and tax preparation services. On January 1, 2018, John Smith, a licensed tax preparer, leaves Betty Baker's firm to open his own practice — Smith Bookkeeping. Smith, however, agrees to have his business subcontract with Better Baker Bookkeeping to help Betty out for the 2018 tax season. Smith, through his own office and using his own tax and accounting software, will prepare the returns and will sign all returns as the return preparer as required by federal tax law.

Under California Unemployment Insurance Code Section 656, because Smith is considered to have specialized skills as a licensed professional, he is generally presumed to be an independent contractor.[6] However, the EDD may try to assert that in light of ***Dynamex***, Smith is Betty's employee. Following ***Dynamex***, while Smith meets parts "A" and "C" of the ABC Test, and has his own office, sets his own schedule, and uses his own equipment, the EDD might argue that he is an employee because Baker cannot meet part B of the ABC Test.

Because Smith provides the "usual business services" undertaken by Betty Baker Bookkeeping, the EDD may consider Smith to be an employee of Betty Baker Bookkeeping for payroll time keeping, records, overtime, and labor law issues. There may be a question as to whether Section 656 continues to offer protection. In addition, under Department of Industrial Relations (DIR) labor orders, arguably Betty might be found to be liable to ensure Smith takes daily meal and rest breaks at Smith's competing office and that other labor law orders were met.

This might also further open Pandora's Box for other issues, including:

- Penalties for failure to withhold and pay income and payroll taxes;
- Penalties for failure to issue proper pay stubs and a W-2;
- Liability for workers' compensation payments; and
- Other employment-related fines and penalties.

Because the EDD and DIR are just two of the seven departments within California's Welfare and Workforce Development Agency, there is a risk that other departments may argue that Betty's liability should be extended to these areas.

Implications of *Dynamex*

The EDD has not yet asserted that ***Dynamex*** will apply to anyone for employment tax purposes. Hopefully that will never occur. On the other hand, it makes sense for businesses to carefully review the classification of all workers currently hired as independent contractors. Under ***Dynamex*** there is a risk that the status of their worker classification will change for California employment tax purposes as well.

Other recent developments

In what might be a short-lived victory for the gig economy industry (think Uber and Lyft), a U.S. district court in California found that a delivery driver for Grubhub, Inc., an internet food ordering service, was an independent contractor and not an employee.[7] However, the case was decided before the ***Dynamex*** decision was issued, so the court relied on the ***Borello*** control factors to reach its decision.

The court found that the driver, an aspiring actor, had the freedom to choose his own hours, what deliveries he was going to accept, what route he was going to take, and how long he was going to take to make the delivery. He also could work for other companies at the same time and did not have to wear a uniform or use Grubhub's equipment.

Had the court used the ABC standard adopted in the ***Dynamex*** decision, the court might very well have decided differently. In discussing the various primary and secondary factors, it appears the court would have found that the "B" and "C" portion of the ABC Test would not have been met, which would mean the driver would have been classified as an employee.

The court noted the driver did not run a delivery business and therefore was not engaged in a distinct occupation or business. The court also noted that the food delivery service was becoming a growing part of Grubhub's regular business, especially in the Los Angeles area where the driver was working.

In April, Uber scored a victory in the U.S. district court in Pennsylvania, where the court found that three UberBLACK drivers who were suing over alleged minimum wage and overtime violations were independent contractors and not employees.[8]

Unlike the ***Borello*** standard used in California, Pennsylvania law puts the burden on the worker to show he or she is misclassified. Using a six-factor test, the court determined that the workers were independent contractors because they had their own limousine service businesses and simply used UberBLACK as a means of getting more business.

They chose their own hours, could hire subcontractors, were not required to wear uniforms or display UBER logos, could work for competing companies, had the opportunity to manage how much profit or loss they made, and invested substantial funds in their own cars and equipment. The court did note that the limousine services provided by the drivers was an integral part of Uber's business, but noted that the other factors weighed in favor of finding that the workers were independent contractors. Had an ABC analysis been utilized by the court, it is likely the court could have reached a different decision.

It should also be noted that Uber and other gig worker employers have been fairly successful in keeping class action lawsuits regarding worker classification out of the courts through arbitration agreements. On May 21, 2018, the U.S. Supreme Court upheld this approach in ***Epic Systems Corp. v. Lewis***, Case No. 16-285.

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[1] *S.G. Borello & Sons, Inc. v. Dept of Ind. Rel.* (1989) 48 Cal. 3rd 342

[2] *Fleece on Earth* (2007 VT); *McPherson Timberland* (1998 ME)

[3] *Dynamex Operations West, Inc.* (April 30, 2018) Los Angeles County Superior Court, Case No. S222732

[4] *Id.*

[5] 22 Cal. Code Regs. §4304

[6] *In the Matter of: Associated Indian Services* (CUIAB Appeals No. F-T-13496, PT-450)

[7] *Lawson v. Grubhub, Inc.* (Feburary 8, 2018) U.S. Dist. Ct., N.D. Calif., Case No. 15-cv-05128-JSC

[8] *Razak v. Uber Technologies* (April 11, 2018) U.S. Dist. Ct., Eastern Dist. of Penn., Case No. 16-573