

Misclassification risks

How to avoid incorrectly classifying employees as independent contractors **Interviewed by Adam Burroughs**

While there are benefits to classifying a worker as an independent contractor, such as not having to pay overtime or worker's compensation, you can face severe penalties for misclassification including back pay and litigation.

"You want to make sure you are correct on the facts of the law when you establish an independent contractor relationship," says David McLaughlin, a partner with Ropers Majeski Kohn & Bentley.

There are several legal factors that determine how a worker should be classified.

"Employers and principals should be careful to examine the facts of each relationship and then apply the law to those facts," McLaughlin says. "In other words, it might be time for a gut check on these factors."

Smart Business spoke with McLaughlin about the consequences of misclassifying workers and how to play it safe to avoid the potential financial Armageddon of misclassification.

Why is it important for employers to correctly classify workers?

Both California and federal agencies are cracking down on independent contractor misclassifications. There's a new California law imposing a penalty of up to \$25,000 for each violation where a worker is willfully misclassified. The Department of Labor and the IRS are going to start sharing information as part of a misclassification initiative to try to catch more violations. If you have a worker who is not characterized as an employee then the employer or principal does not have to pay payroll taxes, overtime, meal and rest periods, unemployment insurance, disability or social security. So there is a benefit to an employer having an independent contractor, but if you fall into a misclassification situation then you may face a wage claim and penalties.

How does an employer know if a worker is an employee or independent contractor?

The definition of an independent contractor in the Labor Code is any person who renders service for a specified recompense for a specified result, under the control of his principal as to the result of his work only and not as to the means by which such result is accomplished. There are slightly different tests depending on which agency



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is pursuing the misclassification. When the case is in Superior Court of California, the main consideration is control plus 11 other factors. The key is the right to control the worker both in regard to the work done and the manner and means by which it is performed.

Other factors are: Whether the person performing the services is engaged in an occupation of business distinct from that of the principal; whether or not the work is part of the regular business of the principal or alleged employer; whether the principal or worker supplies the instrumentalities, tools and the place for the person doing the work; the alleged employee's investment in the equipment or materials required by his or her task or his or her employment of helpers; whether the service rendered requires a special skill; 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; the alleged employee's opportunity for profit or loss depending on his or her managerial skill; the length of time for which the services are to be performed; the degree of permanence of the working relationship; and the method of payment, whether by the time or by the job. Whether the parties believe that they're creating an employer-employee relationship may have some bearing on the

question, but it is not determinative.

The analysis is not black or white. Each of these factors should be considered but they need not be unanimously established. The existence and degree of each factor is a question of fact. The legal conclusion to be drawn from those facts, however, is a question of law, which a judge can decide.

What is the impact of an employer getting a worker to sign an independent contractor agreement?

The contract or contractor's agreement is not determinative of whether that person is in fact an independent contractor. It's one of the factors considered and it's probably one of the easiest things you can do to satisfy part of the test. A contractor's agreement will have little value if the employer or principal controls the manner and means to get the work done.

What are the risks of misclassifying employees as contractors?

The misclassification of a worker can expose employers to a wage and hour claim and attorney fees to defend that claim. Employers have exposure to waiting time penalties related to wage claims. Business owners also have exposure to other workers who are similarly situated, leading to a potential class action lawsuit.

In addition, there is exposure to stiffer monetary penalties for willful misclassification. These penalties may include a requirement that the employer publicize on its website a court or agency finding that the employer committed a serious violation of the law and which invites other misclassified employees to contact the appropriate labor agency.

California and federal interest in identifying independent contractor misclassification creates danger for principals using independent contractors. Now, more than ever, it is critical for employers and principals to carefully evaluate independent contractors to confirm they are properly classified. Reclassifying workers to employees has many dangers. California businesses that are considering this should seek legal counsel to help with understanding and navigating the potential risks and ramifications. <<

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