

IT'S THE LAW

Risks and Potential Liabilities in Using and Misclassifying Independent Contractors — What Employers Need to Know

By Andrew R. Shalauta, Esq.,
Burnham Brown

During this economic downturn, businesses are increasingly turning to independent contractors to save on taxes and labor costs, and for the convenience of hiring specialized skilled labor for specific projects on a short-term basis. Unfortunately for employers, the risks and potential liabilities when using independent contractors are not well-known, and plaintiffs' attorneys are catching on. There is a rise in misclassification lawsuits and unemployment claims in California, so it is paramount for employers to ensure they are complying with the law.



Legal Tests & Tax Ramifications

Before hiring independent contractors, businesses should first be aware of the legal tests and IRS guidelines for maintaining independent contractor status. Just calling a worker an "independent contractor" does not make them so. Courts and government agencies will look at several factors to determine whether a worker is an independent contractor, including the employer's control over the work, whether the contractor can earn a profit or suffer a loss, and whether the contractor is working for more than one firm. Not all factors, or any one specific factor, need to be proven to establish a worker was an independent contractor. If a business fails this test, it can be very costly.

The tax costs of misclassifying an employee as an independent contractor are huge. Employers can be ordered to pay a percentage of the compensation paid, the employee's tax withholding for social security, medicare, and disability, plus interest. Employers can be ordered to pay back taxes for unpaid employer contributions for social security, medicare, and unemployment insurance. The IRS has additional penalties for failing to file tax returns. Criminal sanctions can include imprisonment up to one year and substantial

Continued on next page



NORTHERN CALIFORNIA DISTRICT COUNCIL OF LABORERS

4780 Chabot Drive Suite 200
Pleasanton, CA 94588
Office (925) 469-6800 Fax (925) 469-6900
Oscar De La Torre, Business Manager

The Northern California District Council of Laborers, its 15 affiliate local unions and 30,000 working families, are your partners in rebuilding California's infrastructure.

We are committed to recruiting, training and providing to the Construction Industry of Northern California its growing manpower needs for the twenty-first century: energetic, safety-conscious and trained in all recent construction technologies.

YOUR PARTNERS IN BUILDING CALIFORNIA'S FUTURE.

Labor & Member Services

COMMITTED TO INCREASING UNION CONTRACTOR COMPETITIVENESS

finances. The Workers' Compensation Appeals Board can also issue civil penalties, property liens, and stop orders.

Other Issues & Liabilities

The use of independent contractors can also lead to other unanticipated liabilities. An employer can be liable for harassment by an independent contractor in the workplace. An independent contractor can also sue the employer for harassment. An employer can also be sued for discriminatory conduct by a purported independent contractor under the theory that the independent contractor was acting as the employer's "agent." These scenarios create potential liability through contractors that the company is not even supposed to control.

An independent contractor can also sue the hiring company directly claiming he or she was an employee

and entitled to employment benefits. Under the same

pretenses, the independent contractor can also bring a workers' compensation claim or file for unemployment insurance benefits. An independent contractor can also sue the employer for personal injury on the premises because workers' compensation laws do not apply.

Special precautions also need to be taken in the construction industry to make sure all subcontractors are properly licensed. In California, contractors performing construction work must be licensed unless exempt. California law creates a presumption that an unlicensed contractor is an employee rather than an independent contractor. This opens the risk to suits against general contractors by unlicensed contractors and their employees under wage and discrimination laws. General contractors can be ordered to pay the unpaid wages of unlicensed subcontractors' employees. If a subcontractor is unlicensed, workers' compensation liability for the subcontractor's employees can also be imposed on the general contractor.

Disadvantages for using independent contractors also include losing control over how the work is performed and the right to terminate the worker at will. Independent contractors should not be required to follow training or instructions on how to perform the work. Independent contractors should not be supervised on work performance. Employers generally cannot control the hours of work or other aspects of their day-to-day employment.

Best Practices

To ensure compliance with the law, businesses should:

- ❖ Conduct audits to ensure that every independent contractor working for the company can meet the legal tests; requiring a worker to receive training, attend meetings, follow instructions, be accompanied by an experienced employee, or regularly report to the employer, are all facts that tend to show that the individual is an employee, not an independent contractor.
- ❖ Review independent contractor agreements to make sure they include all necessary provisions.
- ❖ Have an invoicing system for paying independent contractors.
- ❖ Make sure that independent contractors are maintaining proper insurance and paying their required taxes. ♦

Andrew Shalauta specializes in employment litigation and counseling for businesses at the Oakland-based law firm of Burnham Brown, www.burnhambrown.com, 510/444-6800.



Soil Stabilization and Pavement Rehabilitation

- Forefront in Quality, Cost, and Schedule Control
- Leader in Stabilization Products, including Quicklime Plus, High-Alkali Cement, and Custom Blends
- Alternate Design Methods and Techniques using Soil Stabilization



Phone: 925-862-2260
Toll Free: 800-308-8998
www.griffinsoil.com

