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Inherent risks in hiring and misclassifying independent contractors – by Andrew R. Shalauta

EMPLOYERS SHOULD be aware of the business advantages and risks in using independent contractors. Independent contractors are used in many industries to offset rising business expenses and reduce labor costs. An employer does not have to pay the usual contributions for unemployment tax, medicare, and social security for independent contractors. Employers generally do not provide medical or life insurance, vacation leave, sick time, retirement plans, or workers compensation for independent contractors, leading to additional reductions in business expenses and payroll administration costs.

However, a significant risk in hiring independent contractors is that a court or government agency can determine that an employee has been misclassified as an independent contractor. Disadvantages also include losing control over how the work is performed and the right to terminate at will. If a court or government agency determines a worker was misclassified as an independent contractor, an employer is subject to substantial federal and state tax penalties, taxes, interest, and criminal sanctions. As California courts are increasingly finding workers have been misclassified by employers, employers need to take steps to make those classifications defensible if challenged in a lawsuit or by the government.

Specific federal and state penalties



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for misclassifying workers include a percentage of the compensation paid, the employee's withholding for social security, the employee's withholding for disability, plus interest. Additionally, an employer can be ordered to pay penalties for missed employer contributions for social security, medicare, and unemployment insurance.

The Internal Revenue Service (IRS) can add penalties for failure to file returns and disregarding other IRS rules. Criminal sanctions can include imprisonment and fines of up to \$25,000. The state taxing authority, the EDD (California Employment Development Department), can separately assess penalties for missed contributions of unemployment insurance, plus interest.

The Workers Compensation Appeals Board (WCAB) can also issue civil penalties and a stop order prohibiting the employer from using employee labor until the employer secures workers compensation coverage. Knowing the penalties are significant, it is important for employers to be aware of the factors used to determine classification.

California courts and government agencies look to several factors to determine whether an individual is an independent contractor or regular employee. The most important factor is probably the right of the employer to direct the way the individual performs his or her work. Other factors include

the method of paying whether by time, job, or commission; whether the occupation is usually done by a specialist without supervision; whether the employer provides supplies; the length of time of service; whether the work is part of the employer's regular business or the individual's separate business; whether the individual is working for multiple principals, and, the parties' intent. Not all or even of a majority of this criteria need to be met to show an individual was an independent contractor. The courts, the IRS, and the EDD will look at the particular circumstances of the work and the relationship between the employer and individual worker.

If employers are going to hire independent contractors, they should be cognizant of these factors that determine classification. Employers should treat the relationship as contractual and not terminable at will when employing independent contractors. The business should use an independent contractor agreement that pays by the job for specific services. The individual should bill the business for the services rendered. The individual should be required to have his or her own worker's compensation coverage and liability insurance. The individual should control how the work is performed, provide his or her own

tools, training, transportation, instructions, etc.

On the other hand, 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 individual is an employee, and not an independent contractor.

How does an employer get caught for misclassifying an individual? A worker can bring a lawsuit claiming he or she was misclassified as an

independent contractor. The classification issue is also often raised when an individual files for unemployment benefits with the EDD or IRS, or files a claim for worker's compensation benefits. The IRS can also conduct a random audit of a business.

Before making a decision to hire an independent contractor, an employer should consult with an experienced employment law attorney to avoid risks in misclassifying employees.

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Acevedo appointed to Parks Board

WILLIAM C. ACEVEDO, a partner at Wendel, Rosen, Black & Dean LLP, was recently appointed to the Board of Directors of the East Bay Regional Parks Foundation (www.regionalparksfoundation.org), whose mission is to support the East Bay Regional Park District through fundraising that provides broader public access, resource protection and preservation, educational and recreational programs, and acquisition of parklands. Over the past 37 years, the Regional Parks Foundation has received donations, land and in kind services valued at more than \$35 million. Acevedo is beginning the first year of his two-year appointment.

"The Regional Parks Foundation is one of the most important resources for the Park District, which fosters the development, protection, and preservation of many of the Bay Area's last remaining open spaces," said Acevedo. "Parks of this kind offer needed educational, recreational and ecological elements, and now, more than ever, it is important to keep our parks healthy, protected and accessible for residents, visitors and especially youth. I have enjoyed the various regional parks and advocated for the Park District for a long time. My new role on the board will increase my capacity to help the Park District flourish."

The Regional Parks Foundation's funding supports critical extra-curricular activities and initiatives, such as youth programs like Camp Arroyo for disabled children and "camperships," which are camp scholarships for at-risk youth in



William C. Acevedo

low-income families; environmental and habitat restoration projects; renewable energy resources for the parks' buildings; and operation of Parks Express, a low-cost transportation service for organized and under-represented groups. In addition, the Regional Parks Foundation is currently dedicating funding and resources in support of passing a new bond measure to extend Measure AA to allow for renewed funding for Regional

Park land acquisition, new park and trail development, habitat restoration, rehabilitation of aging park facilities, as well as funding for city parks and recreation departments and special park districts.

At Wendel Rosen, Acevedo is a litigator and leader of the firm's Green Business Practice Group. He works with clients in a variety of areas, including contractual disputes, environmental contamination claims, toxic tort, personal injury and property damage matters. His diverse client-base includes corporate entities, property development and management entities, small and mid-sized companies, and public agencies. In addition to his Foundation involvement, Acevedo's legal and community activities include serving as Chair of the Richmond Economic Development Commission; member of the Richmond General Plan Advisory Committee; counsel to the board of the Rosie the Riveter Trust; and member of the Alameda County Bar Association. He received his J.D. from Boston College Law School (1997) and his B.A. in English and political science from Rutgers University (1994).