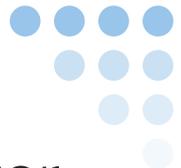


The **abc's** of Classifying an Independent Contractor



By Douglas Diaz

Editor's note: In many cases, our industry relies heavily on independent contractors. Recent changes with the Department of Labor (DOL) as well as with the IRS have made it more difficult to prove that a worker is an "independent contractor" rather than an "employee" who is entitled to benefits, overtime wages, and all the protections of the law. Starting in October of this year, local and federal DOLs will be enforcing these stricter requirements and possibly targeting your company for an audit. Although LD strongly encourages you to speak to your DOL, the article below gives some good information on how to prepare your company.

Government crackdowns on the misclassification of workers as independent contractors (ICs) have increased rapidly over the last several years. The United States Department of Labor (DOL) has embarked on what it calls a "misclassification initiative" designed to have more government investigators knocking on the doors of companies nationwide. The IRS has recently begun a similar enforcement program, and has even created a new tax form which provides workers with the opportunity to notify the IRS if they believe they have been misclassified as ICs.

Yet, while the IRS has always regulated this field, individual states have joined the increased enforcement party as well. Some have even created task forces to target employers who misclassify workers. The state attorney generals from New York, New Jersey, and Montana have also announced their intent to sue FedEx Ground Package Systems for its alleged misclassification of its drivers as ICs. It is clear that the transportation industry will continue to be a favorite target for increased enforcement.

The increase in state enforcement is especially significant because unlike the federal laws, which typically use the "right to control" test, approximately half of the states utilize a much more stringent test for companies to pass when determining if a worker is really an IC. This standard is usually referred to as the ABC test, based on how it is typically stated in three paragraphs of a state statute. While a company may generally escape an IC finding under federal law if it does not exercise much if any control over the worker, the states' ABC tests make you jump through additional hoops that companies often fail. Some of the states that use the ABC test or a version of it include New Jersey, California, Connecticut, Delaware, Maryland, Massachusetts, and Pennsylvania. New Jersey's test is typical of that employed by the other states in this area.

For a worker to be considered an IC under the ABC test, all of the following must be satisfied:

- A.** The worker has been and will continue to be free from control or direction over the performance of his services, both under his contract of service and in fact;
- B.** The service is either outside the usual course of the business for which such service is performed or the service is performed outside of all the places of business of the enterprise for which such service is performed; and
- C.** The worker is customarily engaged in an independently established trade, occupation, profession, or business.

The state courts have made clear that this test is to be liberally construed, so as to bring as many "employees" within its coverage as possible and to include relationships not ordinarily considered to constitute employment. This test is also stricter than most for IC status because most others allow a fact-finder to measure the totality of the circumstances of any given situation and to determine how much weight to give each factor. Under the ABC test, however, the relative strength of one factor will not mitigate the relative weakness under another factor. In other words, if you fail just one of the state factors, you will have an employee, not an IC.

The "C" prong is generally the one that gives companies the most trouble. Generally, the courts have held that the "independently established trade" must exist separate and apart from the relationship with a particular employer. What this means is that the government auditors who rely on the ABC test generally require a showing that the worker



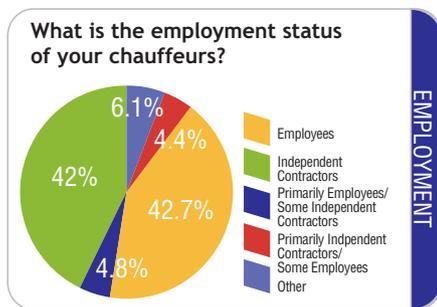
"Given the increased enforcement in this area, companies should do what they can now to better protect themselves."

at issue: (1) operates under a trade or corporate name; (2) has his own business cards, stationery, and business telephone; and (3) works for other companies beside the one being audited so that his income is not derived from just that company. Drivers classified as ICs more often than not fail this test because they are usually dependent on just one company for their income.

The real rub is if an IC is found to actually be an employee. Misclassifications and mistakes in status can result in considerable liabilities to employers. These can include back tax withholdings in the form of state unemployment and disability taxes, for not only the portion employers owe but also for the portion that should have been paid by the employees. In addition, employers may owe back wages, other benefits, and even overtime. With respect to wages and benefits, decisions under a state's ABC test can result in a nightmare situation where your company is now subject to increased liability regardless of how much you have already paid the worker as an IC.

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Indeed, some states, such as Massachusetts, have expanded the scope of damages available to employees misclassified as ICs. Consider the case last year in *Somers v. Converged Access*, where the Massachusetts Supreme Judicial Court held that even though a misclassified IC actually earned more than employees in comparable positions, he was still entitled to overtime, holiday, and vacation pay. The employer argued that in order to prevent a “windfall” to the worker, the damages should be measured by subtracting the higher compensation the worker received as an IC from the compensation the worker would have received had he been hired as an employee. This appeared to make sense considering that companies tend to pay ICs more than employees because they are general-



As our 2010-2011 statistics show, the industry is clearly divided on the status of its chauffeurs

ly not eligible for benefits. The court, however, rejected the argument and held that the worker can retain the higher compensation he received as an IC and recover overtime, holiday, and vacation pay.

In addition to the liabilities on the tax, wages, and benefits front, some states also now impose stiffer penalties for misclassification of workers. Connecticut, for example, recently passed a law increasing the civil penalty for misclassification from \$300 per violation to \$300 per day per violation. Other states have even focused on making misclassification a crime and limiting the ability of companies who misclassify their workers as ICs from conducting business. Some have also passed, or are in the process of seeking to pass, new laws which provide workers who believe they have been improperly misclassified with a private right of action. This will allow the workers to enforce their own rights in court and some of these state laws permit the worker to recover as much as triple damages. Such laws will make it more likely that these workers will be able to find lawyers willing to take their case.

As childlike as it sounds, failing the ABC test can result in some severe, adult-level consequences including a surprise audit. Given the increased enforcement in this area, companies should

do what they can now to better protect themselves. Internal reviews and self-audits should be on the top of the list. It is better that companies conduct these now and discover the potential problem areas themselves rather than leave matters in the hands of a state official who may have different priorities than you. **LD**



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