

Independent Contractor Status: Current Challenges, Best Practices & Wage Theft Exposure

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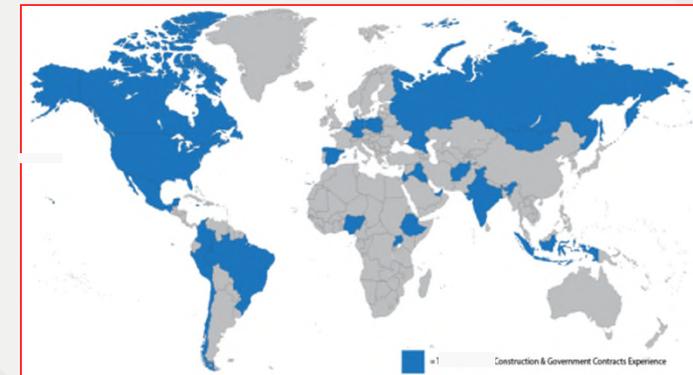
Introduction:

- Debra Friedman – Attorney-at-law
 - BA and JD from the University of Pennsylvania
 - Practicing employment law for 30 years
 - Counsel employers on the employee life cycle
 - Advise employers on wage and hour and government contract compliance
 - Train employees on a variety of employment law issues
 - Defend employers against discrimination, harassment and retaliation claims
 - Draft and enforce non-compete and non-solicitation agreements
 - Draft executive employment agreements
 - Handle employment due diligence in mergers and acquisitions

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Introduction:

- Larry Prosen – Attorney-at-law
 - BS in Architecture from University of Maryland; JD Catholic Univ.
 - Practiced Construction Litigation and Government Contracts for 23+ years
 - Litigated claims and disputes across the US and around the world – over 37 states and 6 continents
 - Disputes valued at up to \$500 million+
 - Hundreds of delay, impact, cumulative impact, LOP, Miller and Little Miller Act & private bond disputes; bid protests, claims, Internal Investigations; compliance reviews & SBA issues.
 - Represents many MCAA and ASA members on various claims – both Commercial & Public
 - Active in WBC for years – Chair, Program & Education Committee



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Overview of Presentation

- **Who is an independent contractor?**
 - Key tests and/or factors that agencies and courts may consider in determining independent contractor status
 - Best practices for evaluating potential independent contractor relationships
- **How is it that construction contractors can be jointly liable for subcontractors' failure to pay wages?**
 - Best practices for reducing risk exposure

WHY IS THIS IMPORTANT?

- Tax Liabilities
- Wage Liabilities – for you and others
- Worse Case – Tax & Wage Fraud Liabilities

The IRS and IC Status



- Why do we care?
 - Significant tax consequences, depending upon whether a worker is an employee or IC
 - Withholdings and employment tax requirements
 - Ability to exclude employer-provided benefits from gross income
 - Ability of an IC to deduct business expenses
 - Misclassification consequences
 - The employer could be liable for years worth of withholding taxes, interest and penalties and could face possible disqualification of employee benefit plans and/or cost of lost coverage to worker
 - The worker could face loss of business deductions and requirement to pay self-employment taxes
 - Civil penalties for intentional misclassification
 - Criminal penalties

IRS Three Categories of Evidence For Determining IC Status

- The IRS has identified three (3) categories of evidence that may be relevant in determining whether the requisite control exists under the common-law test and has grouped illustrative factors under these three categories:
 - behavioral control;
 - financial control; and
 - relationship of the parties

See IRS Form SS-8 (Determination of Worker Status of Federal Employment Taxes and Income Tax Withholding) for specific categories of evidence.

The IRS 20 Factor Test

1. Right to require compliance with instructions
2. Training
3. Integration of the worker's services into the business operations
4. Services rendered personally
5. Hiring, supervision, and paying assistants
6. Continuing relationship
7. Set hours of work
8. Full-time work for the business is required
9. Doing work on employer's premises
10. Order or sequence test

The IRS 20-Factor Test, Cont'd

11. Oral or written reports required
12. Payment by hour, week, or month v. payment by job or commission
13. Payment of business and/or traveling expenses
14. Furnishing tools and materials
15. Right to discharge
16. Right to terminate at any time without incurring liability indicates employee status
17. Significant investment in facilities used by the worker indicates IC status
18. Realization of profit or loss is generally an IC
19. Working for more than one firm at a time is indicative of IC status
20. Making service available to the public on a regular basis suggests IC status

The U.S. DOL FLSA Test



- Why do we care?
 - Worker classification impacts wage and hour issues, including minimum wage and overtime pay
 - Misclassified workers may be awarded back wages, overtime, and additional compensation for up to three years, along with the possibility of double the amount as liquidated damages
- The DOL has shifted in its focus for determining IC status in recent years
 - The law is in flux
 - January 2021: Trump administration put in place a business friendly rule
 - May 2021: Biden administration withdrew the rule
 - March 2022: Federal district court in Texas held withdrawal of the rule was invalid and the Trump IC rule is in force and effect as of March 8, 2021

Current DOL IC Rule

- **Two core factors:**
 - (1) the nature and degree of control over the work; and
 - (2) the worker’s opportunity for profit or loss.
- **Three additional, non-exhaustive factors to be considered *if* the core factors are not determinative or point in different directions:**
 - (1) the amount of specialized training or skill required for the work that the potential employer does not provide;
 - (2) the degree of permanence of the working relationship, focusing on the continuity and duration of the relationship and weighing toward independent contractor status if the relationship is definite in duration or sporadic; and
 - (3) whether the work performed is “part of an integrated unit of production.”



State Laws Are Taking the Lead . . .

- California:
- Effective January 1, 2020, employers are required to classify workers as employees **unless** they meet **all** the conditions of the ABC test:
 - A: The person 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.
 - **B: The person performs work that is outside the usual course of the hiring entity's business.**



- C: The person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

State Laws Are Taking the Lead . . .Cont'd

- The “ABC” test is gaining traction elsewhere . . .
 - Aside from California, at least 19 other states and the **District of Columbia** use some form of the ABC test for *some purposes* - including but not limited to: Connecticut, Colorado, Delaware, Illinois, Idaho, Indiana, **Maryland**, Massachusetts, New Jersey, Ohio, Pennsylvania, Washington



Stringent IC Tests for the Construction Industry

- (1) "Construction services" includes, without limitation, all building or work on buildings, structures, and improvements of all types such as bridges, dams, plants, highways, parkways, streets, tunnels, sewers, mains, power lines, pumping stations, heaving generators, railways, airports, terminals, docks, piers, wharves, buoys, jetties, breakwaters, levees, canals, dredging, shoring, rehabilitation and reactivation of plants, scaffolding, drilling, blasting, excavating, clearing and landscaping. The term "construction services" shall also include moving construction-related materials on the job site.



WHO is an employee & employer? – D.C.

- (2) “Employee” means every person, other than an exempt person or an independent contractor, providing construction services to another person.
- (3) “Employer” means any individual, partnership, firm, association, joint stock company, trust, limited liability company, corporation, the administrator or executor of the estate of a deceased individual or the receiver, trustee, or successor of any of the same, or any other legal entity permitted to do business within the District of Columbia employing a person to provide services, or any person or group of persons acting directly or indirectly in the interest of an employer.

Classification

§ 32-1331.03. Deemed employers.

For the purposes of this subchapter, the officers of a corporation and any agents having the management thereof who knowingly permit the corporation to violate this subchapter shall be deemed to be the employers of the employees of the corporation.

§ 32-1331.04. Workplace fraud prohibited.

- (a) An employer shall not improperly classify an individual who performs services for remuneration paid by an employer as an independent contractor.

Presumption of Relationship – D.C.

- (c) An employer-employee relationship shall be presumed to exist when work is performed by an individual for remuneration paid by an employer, unless to the satisfaction of the Mayor, the employer demonstrates that:
- (1) The individual is an exempt person; or
 - (2)
 - (A) The individual who performs the work is free from control and direction over the performance of services, subject only to the right of the person or entity for whom services are provided to specify the desired result;
 - (B) The individual is customarily engaged in an independently established trade, occupation, profession, or business; and
 - (C) The work is outside of the usual course of business of the employer for whom the work is performed.

Stringent IC Tests for the Construction Industry, Cont'd

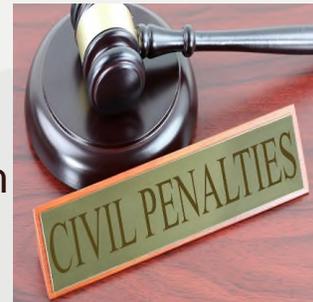
- D.C. has two limited exemptions for avoiding an employer – employee relationship:
 - (1) **The individual is an “exempt” person under the Code**, meaning:
 - (i) the individual (a) performs services in a personal capacity and employs no individuals other than a spouse, child, or immediate family member of the individual or (b) performs services free from direction and control over the means and manner of providing the services, subject only to the right of the person or entity for whom services are provided to specify the desired result;
 - (ii) the individual furnishes the tools and equipment necessary to provide the service; and
 - (iii) the individual operates a business that is considered inseparable from the individual for purposes of taxes, profits, and liabilities, in which the individual exercises complete control over the management and operations of the business

Stringent IC Tests for the Construction Industry, Cont'd

- (2) **The individual satisfies the ABC test:**
 - (i) The individual who performs the work is free from control and direction over the performance of services, subject only to the right of the person or entity for whom services are provided to specify the desired result;
 - (ii) The individual is customarily engaged in an independently established trade, occupation, profession, or business; and
 - (iii) The work is outside of the usual course of business of the employer for whom the work is performed.

Stringent IC Tests for the Construction Industry, Cont'd

- Remedies/Penalties in D.C.
- Officers of a corporation and any agents may be held liable as employers
- Individuals may file complaints with the Mayor of DC
 - Mayor may issue a stop work order
 - Civil penalties between \$1,000 - \$5,000 may be assessed for each violation
 - Each employee not properly classified is a separate violation
 - Employers who retaliate against an individual for reporting the violation shall be subject to a civil penalty between \$5,000 - \$10,000 for each violation
 - Employers also will be ordered to make restitution, pay any interest due, and otherwise comply with all applicable laws and regulations
 - More than two violations in a 2-year period subjects an employer to fines of \$20,000 for each employee or voluntary debarment for five (5) years and fines of \$5,000 - \$10,000 for each employee; debarred employers also may be ordered to make restitution, pay any interest due, and otherwise comply with all applicable laws and regulations



Stringent IC Tests for the Construction Industry, Cont'd

- Remedies/Penalties in D.C., Cont'd

- ***Individuals*** may bring a civil action within three (3) years after the alleged violation.
- Remedies include:
 - (1) Lost wages and benefits
 - (2) Liquidated damages (equal to the amount of lost wages and benefits)
 - (3) Compensatory damages
 - (4) Fine of up to \$500 for each violation; and
 - (5) Reasonable attorneys' fees and costs
- Additionally, courts may order:
 - (1) Reinstatement;
 - (2) Treble damages for lost wages or benefits; and/or
 - (3) Seniority rights

Stringent IC Tests for the Construction Industry, Cont'd

- **Maryland**

- “Construction services” includes the following services provided in connection with real property:
 - (1) building;
 - (2) reconstructing;
 - (3) improving;
 - (4) enlarging;
 - (5) painting;
 - (6) altering;
 - (7) maintaining; and
 - (8) repairing.



Stringent IC Tests for the Construction Industry, Cont'd

- Maryland has four (4) exemptions to an employer-employee relationship for construction industry businesses

(1) Satisfying a modified ABC test:

- (A) the individual who performs the work is free from control and direction over its performance both in fact and under the contract;
- (B) the individual customarily is engaged in an independent business or occupation of the same nature as that involved in the work; and
- (C) the work is: (i) outside of the usual course of business of the person for whom the work is performed; **or (ii) performed outside of any place of business of the person for whom the work is performed.**

(2) "Exempt person"

- Definition is very similar to DC

Stringent IC Tests for the Construction Industry, Cont'd

- (3) A business subcontracts some work to another business entity, which may have its own employees, **to do the same type of work in which the employer engages, at the same location where the employer is working. . . .**"
- (4) The subcontractor can provide the following:
- An affidavit that it is an independent contractor who is available to work for others;
 - Evidence that it is registered with the Department of Assessments and Taxation and is in "good standing";
 - Proof that it holds required occupational licenses for the work performed; and
 - A written contract with the contractor that describes the nature of the work, the remuneration to be paid and includes an acknowledgment by the business entity that the business entity is required to:
 - (1) withhold, report, and remit payroll taxes on behalf of all employees working for the business entity;
 - (2) pay unemployment insurance taxes for all employees working for the business entity; and
 - (3) maintain workers' compensation insurance.

Stringent IC Tests for the Construction Industry, Cont'd

Remedies/Penalties in Maryland

- Restitution to employees affected
- Compliance with the law
 - An employer who comes into timely compliance may not be assessed a civil penalty
- Civil penalties
 - An employer who fails to come into timely compliance shall be assessed a civil penalty of up to \$1,000 for each employee for whom the employer is not in compliance
- Employer may be ordered to pay any interest due

A graphic of a spotlight with a yellow beam of light shining down on the text.

Spotlight on Virginia

- Effective January 1, 2021, workers are presumed to be employees unless the employer demonstrates that the worker is an independent contractor under the IRS guidelines (20 factor test)
- Employers are prohibited from requesting that a worker enter an agreement that results in misclassification
- The Virginia Department of Taxation may assess the following penalties against employers who misclassify their workers and fail to pay required taxes, benefits and other requirements:
 - Debarment from public contracts;
 - Civil penalty up to \$1,000 per misclassified individual for the first offense;
 - Civil penalty up to \$2,500 per misclassified individual for the second offense; and
 - Civil penalty up to \$5,000 per misclassified individual for a third or greater offense.

Other Tests Abound

- Safety and health laws (federal and state OSHA)
 - State unemployment compensation laws
 - Workers' compensation laws
 - Federal and state anti-discrimination laws
- Take-away: Determination of IC status, and the test that applies, depends upon the law at issue (and how an agency or court applies it to a specific set of facts)



Best Practices in Evaluating/Creating IC Relationships

- **Preliminary Considerations:**

- Consider the industry and how workers are generally classified in the industry
 - This is not determinative and is not a defense to IC status. It is most helpful in ruling out the option of IC status.
- Start any of the factor inquiries by asking whether the employer will control the manner and means of the work to be performed
- Evaluate other factors commonly looked at by agencies and courts in determining IC status, with the understanding that the test applied depends on who is challenging the designation

Best Practices in Evaluating/Creating IC relationships, Cont'd

- Do not have ICs perform the same work on the same terms as employees
- Do not provide an IC with an employee handbook or require the IC to comply with all employer workplace rules
 - Consider stand-alone policies such as anti-discrimination and harassment
- Be very cautious about changing the status of a current employee to that of an independent contractor
- Utilize a written agreement memorializing the IC relationship
 - Caveat: Labeling a worker an independent contractor is not determinative and the DOL considers it “immaterial”
- Require the IC to provide invoices for payment
- Require the IC to have own general liability, workers’ compensation insurance

Best Practices in Evaluating/Creating IC relationships, Cont'd

- Engage with ICs who have their own companies
- Do not give the IC a title (i.e., Vice President of Marketing)
- Do not give the IC business cards with the company logo
- If possible, avoid giving the IC a company email address
- Do not tell the IC that Employee “X” will be their supervisor
- If possible, do not give IC the same level of access to Company systems and data; focus on what the IC needs to know and how to provide the information without sharing other Company proprietary information
- Do NOT give the IC employee benefits such as healthcare, vacation days, etc.

Newsroom

AG Racine Sues Power Design, John Moriarty & Associates of Virginia, & Multiple Labor Brokers for Cheating Hundreds of Workers Out of Wages & Benefits

May 5, 2022

After Securing \$2.75 Million from Power Design to Resolve Previous Wage Theft Lawsuit, OAG Is Again Filing Suit Over Ongoing Misclassification of Construction Workers

WASHINGTON, D.C. – Attorney General Karl A. Racine today announced a new lawsuit against Power Design, Inc., an electrical contractor that has worked on dozens of development projects in the District, for illegally reducing labor costs by cheating hundreds of workers out of wages and benefits –and alleging that Power Design has failed to comply with the terms of [a previous \\$2.75 million wage theft settlement \(https://oag.dc.gov/release/ag-racine-announces-national-electrical-contractor\)](https://oag.dc.gov/release/ag-racine-announces-national-electrical-contractor).

The Office of the Attorney General (OAG) alleges that Power Design and multiple “labor brokers” illegally failed to classify at least 200 of construction workers as employees—improperly classifying them as independent contractors instead—to cut labor costs and increase profits. As part of this scheme, Power Design and its labor brokers failed to pay workers required overtime wages and denied them benefits. John Moriarty & Associates of Virginia (Moriarty), a general contractor that subcontracted with Power Design and benefitted from its unlawfully suppressed labor costs, is also named as a defendant. With this suit, OAG is seeking to stop Power Design’s illegal conduct, provide restitution for harmed workers, and impose civil penalties for violations of District law.



Joint & Several Liability

§ 32-1303. Payment of wages upon discharge or resignation of employee and upon suspension of work; employer's liability for failure to make such payment.

(4) If an employer fails to pay an employee wages earned as required under paragraphs (1), (2), and (3) of this section, such employer shall pay, or be additionally liable to, the employee, as liquidated damages, 10 per centum of the unpaid wages for each working day during which such failure shall continue after the day upon which payment is hereunder required, or an amount equal to treble the unpaid wages, whichever is smaller.

(5) A subcontractor, including any intermediate subcontractor, and the general contractor shall be jointly and severally liable to the subcontractor's employees for the subcontractor's violations of [this chapter](#), [the Living Wage Act](#), and [the Sick and Safe Leave Act](#). Except as otherwise provided in a contract between the subcontractor and the general contractor, the subcontractor shall indemnify the general contractor for any wages, damages, interest, penalties, or attorneys' fees owed as a result of the subcontractor's violations of [this chapter](#), [the Living Wage Act](#), and [the Sick and Safe Leave Act](#), unless those violations were due to the lack of prompt payment in accordance with the terms of the contract between the general contractor and the subcontractor.

Maryland has Followed Suit

Effective: October 1, 2018

MD Code, Labor and Employment, § 3-507.2

§ 3-507.2. Recovery of unpaid wages

Action by employee

(a) Notwithstanding any remedy available under § 3-507 of this subtitle, if an employer fails to pay an employee in accordance with § 3-502 or § 3-505 of this subtitle, after 2 weeks have elapsed from the date on which the employer is required to have paid the wages, the employee may bring an action against the employer to recover the unpaid wages.

Award

(b) If, in an action under subsection (a) of this section, a court finds that an employer withheld the wage of an employee in violation of this subtitle and not as a result of a bona fide dispute, the court may award the employee an amount not exceeding 3 times the wage, and reasonable counsel fees and other costs.

General contractor liability

(c)(1) In this subsection, "construction services" has the meaning stated in § 3-901 of this title.

(2) In an action brought under subsection (a) of this section, a general contractor on a project for construction services is jointly and severally liable for a violation of this subtitle that is committed by a subcontractor, regardless of whether the subcontractor is in a direct contractual relationship with the general contractor.

(3) A subcontractor shall indemnify a general contractor for any wages, damages, interest, penalties, or attorney's fees owed as a result of the subcontractor's violation unless:

- (i) indemnification is provided for in a contract between the general contractor and the subcontractor; or
- (ii) a violation of the subtitle arose due to a lack of prompt payment in accordance with the terms of the contract between the general contractor and the subcontractor.

Virginia has Also Followed Suit

Code of Virginia
Title 11. Contracts
Chapter 1. General Provisions

§ 11-4.6. Liability of contractor for wages of subcontractor's employees

B. Any construction contract entered into on or after July 1, 2020, shall be deemed to include a provision under which the general contractor and the subcontractor at any tier are jointly and severally liable to pay any subcontractor's employees at any tier the greater of (i) all wages due to a subcontractor's employees at such rate and upon such terms as shall be provided in the employment agreement between the subcontractor and its employees or (ii) the amount of wages that the subcontractor is required to pay to its employees under the provisions of applicable law, including the provisions of the Virginia Minimum Wage Act (§ 40.1-28.8 et seq.) and the federal Fair Labor Standards Act (29 U.S.C. § 201 et seq.).

that the subcontractor is required to pay to its employees under the provisions of applicable law, including the provisions of the Virginia Minimum Wage Act (§ 40.1-28.8 et seq.) and the federal Fair Labor Standards Act (29 U.S.C. § 201 et seq.).

C. A general contractor shall be deemed to be the employer of a subcontractor's employees at any tier for purposes of § 40.1-29. If the wages due to the subcontractor's employees under the terms of the employment agreement between a subcontractor and its employees are not paid, the general contractor shall be subject to all penalties, criminal and civil, to which an employer that fails or refuses to pay wages is subject under § 40.1-29. Any liability of a general contractor pursuant to § 40.1-29 shall be joint and several with the subcontractor that failed or refused to pay the wages to its employees.

Tips to Reduce Exposure for a Subcontractor's Failure to Pay Wages

- Audit your pay practices to ensure compliance with federal and state wage and hour laws
- Carefully evaluate your subcontractors
 - Does the arrangement meet applicable independent contractor tests?
 - Does the subcontractor comply with federal and state wage and hour laws?
 - Does the subcontractor contract out work on the project? If so, take steps to ensure wage and hour compliance at all tiers; consider requiring pre-approval of all tiers of subcontractors hired
- Utilize indemnification provisions to address potential worker misclassification and wage payment claims
- Require subcontractors to provide certified payrolls

QUESTIONS?

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