PERSPECTIVE

Los Angeles Daily Journal

WEDNESDAY, JUNE 20, 2018

Will Employee Classification Ruling Just Lead To Even More Lawsuits?

By Robert W. Wood

There are many liabilities lurking in independent contractor versus employee characterization. But in the end, who is an independent contractor and who is an employee? We know it matters, and that disputes occur. But do we know how and why?

Some people assume that just placing an "independent contractor" label on a worker's name badge resolves the question. But recharacterization is always possible, and by different agencies and parties. Even if you have a good handle on the issues that may weigh in favor of one classification or another for a particular worker, there is always more to learn.

And the stakes in California seem to be increasing. In *Dynamex Operations West, Inc. v. Superior Court*, 2018 DJDAR 3856 (April 30, 2018), the California Supreme Court applied a simple ABC test to decide whether delivery drivers were employees in a wage and hour case. Under the new test, a worker can be considered an independent contractor only when a company can show the worker controls his or her work, that the duties go beyond what the business normally does, and when the worker "is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity."

This contrasts with the much more detailed and lengthy tests most courts and agencies apply. The simple ABC test traditionally applies for unemployment claims. However, the new California case suggests this easy test — that clearly tilts in favor of employee classification — could spread like wildfire.

It is useful to think about government agencies. Perhaps most classically, the independent contractor versus employee distinction is raised by the IRS. After all, the IRS gets more money from wages, from which there is both income tax withholding and employment taxes. The latter do not fall exclusively on the worker and are shared by the employer. Independent contractors are paid the gross amount of their pay with no tax withholding. With contractors, the IRS never collects as much, and never as early.

If the "independent contractor" turns out to be an employee, then all of that pay was "wages," and the employer should have withheld. If an employer fails to withhold on wages, the penalties are severe. Often it is several years later when the worker's status is recharacterized, so the numbers can be significant.

The same concerns that can arise for federal income and employment taxes can also arise under California law. In general, it is harder to win a California employment and income tax case than it is to win a similar case against the IRS. Plus, there is usually less room to settle a California tax case. The IRS is more flexible than the California authorities.

In any event, you can usually expect to deal with both. These days, given exchange of information agreements between the IRS and California, one battleground usually turns into another.

The Employee Retirement and Income Security Act of 1974 has been amended many times and is among the more complex of federal laws. It governs pensions and employment benefits. Jointly administered by the IRS and the US Department of Labor, it regulates a vast system of enforcement and compliance. It excludes independent contractors from its coverage and nondiscrimination rules, so the IRS, DOL or both can scrutinize who you cover.

The workers' compensation system is designed to provide no-fault coverage to employees injured on the job. The key word is "employees," as workers' compensation covers employees, not independent contractors. That leads to inevitable coverage disputes.

An injured "independent contractor" who makes a workers' compensation claim may (or may not) realize only employees are covered. But even claims that start out innocently can end up being time consuming and expensive. A claim involving only a few dollars can become the first domino in an expensive and protracted controversy with several different agencies.

Unemployment insurance provides a base of support when workers lose their jobs. Axiomatically, unemployment insurance applies only to employees, not to independent contractors. Many putative independent contractors make claims for unemployment benefits.

As occurs with workers' compensation claims, they may (or may not) appreciate the distinction between the two classifications of workers. In either case, disputes often arise. A seemingly small claim may turn out to be the proverbial straw that broke the camel's back.

The Employment Development Department or California Department of Industrial Relations may come calling. Such agencies routinely receive complaints from workers which they are required to investigate. In the absence of worker complaints, the agencies may target certain industries, looking for misclassification in a particular industry or geographic area.

The vast system of laws governing organized labor covering strikes, walkouts, lockouts and more applies to employees, not to independent contractors. Thus, the independent contractor versus employee dichotomy is alive in the union context too. Finally, what about lawsuits from third parties?

If an independent contractor causes an auto accident, he can be sued. But if the driver is an employee on the job, the employee is an agent of his employer. Under the doctrine of *respondent superior*, that makes the employer liable too.

What happens if there is a written "independent contractor" agreement for the driver? Even if the driver was an "independent contractor," the injured party may sue the company claiming otherwise. The company may settle rather than risking a fight over worker status that may turn out badly.

Of course, as in *Dynamex*, suits can be brought by workers themselves, despite "independent contractor" agreements they signed. Some are class actions. A suit may be for wage and overtime protections, benefits, expense reimbursements, working conditions, stock options, etc.

Workers can claim that whatever their contracts and agreements *call* them, they are being *treated* as employees. Companies with clear written independent contractor agreements may be shocked that their contracts can be disregarded. However, the parties cannot make someone an "independent contractor" who is truly an employee.

Whether the *Dynamex* decision will trigger even more worker status disputes, and ones that tilt more in favor of employee characterization, remains to be seen. The last few years have already seen many such suits in many contexts. The rise of the gig economy is surely prompting even more claims. Lawyers on all sides of this classic issue are likely to be busy for years to come.

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