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Client Alert

EMPLOYMENT LAW UPDATE

Virginia's New Worker (Independent Contractor) Misclassification Laws

Employers have regularly engaged individuals on an independent contractor basis to provide limited or specialized services on the company's behalf or to assist with overflow work the company receives from time to time. Beginning July 1, 2020, businesses will have to carefully weigh the benefits and risks of such engagements.

Continuing a trend that began under the Obama administration and has spread across a growing number of states, the Virginia General Assembly took aim at the use (and some would say misuse) by employers of workers who are classified as independent contractors. The newly enacted worker misclassification laws, effective July 1, 2020,[1] apply to all employers regardless of size and add significant protections and avenues for relief for workers misclassified as independent contractors in Virginia. The key provisions of the new law, discussed in more detail below are:

- Persons working for remuneration are presumed to be employees for purposes of payment of wages and benefits;
- An individual or the individual's representative may sue for misclassification as an independent contractor;
- Retaliation is prohibited against a person who reports or threatens to report they have been misclassified as an independent contractor; and
- Construction contractors and subcontractors are jointly and severally liable for misclassification of workers.

Who Is an Independent Contractor?

The new laws specifically create an "employee presumption," meaning that workers are presumed to be employees if they perform services in exchange for payment, unless the company can show the worker is an independent contractor under the IRS guidelines and regulations (26 CFR § 31.3121(d)-1).

Unfortunately, the IRS guidelines do not provide a bright-line test for companies to follow and require a fact-intensive analysis of the degree of control a company has over

[1] Although the laws are effective July 1, 2020, Virginia will not begin using the new employee presumption to pursue employers for back taxes for independent contractor misclassification until January 1, 2021.

all aspects of the individual's work. Accordingly, unless a company can show a worker has an independently established trade or business and performs work for other entities besides the company, that worker will likely be considered an employee.

The failure to properly classify an individual as an employee and pay taxes, benefits, and other required contributions may result in the following: (i) debarment from public contracts; (ii) a civil penalty up to $1,000 per misclassified worker for a first offense, up to $2,500 per misclassified worker for a second offense, and up to $5,000 per misclassified worker for a third or greater offense.

Potential Lawsuits and Damages

Not only will it be harder for a company to establish an individual is an independent contractor rather than an employee, but individuals or their representatives can sue a company for misclassification in Virginia state court. In such a lawsuit, as noted above, the court will presume the individual is an "employee" if a company paid the individual for services performed. In other words, the burden will be upon the employing entity to rebut that legal presumption by putting forth evidence to show that the worker is truly an independent contractor.

If the court determines the individual was misclassified as an independent contractor, the court may award the individual damages in the amount of any wages, salary, employment benefits (including expenses incurred by the employee that would otherwise have been covered by insurance) or other compensation lost, as well as reasonable attorneys' fees and costs.

No Retaliation

Under the new laws, employers are prohibited from discharging, disciplining, threatening, penalizing, discriminating against, or retaliating against any worker (even currently classified employees) who in good faith reports or threatens to report the employer for misclassification or failure to pay required benefits or contributions. The employee must have a reasonable belief that the information reported is accurate and reckless or malicious reports are not protected.

Employers are also prohibited from retaliating against workers (including employees) who are subpoenaed or requested to participate in an inquiry, investigation, or hearing against by an appropriate agency or in a court action.

An employee who is retaliated against for engaging in any of the above protected activities may file a complaint with the Virginia Department of Labor and Industry ("DOLI"), which may institute proceedings against the employer for remedies including reinstatement of the employee and lost wages. The DOLI may also impose a penalty

against the employer up to the amount of the employee's lost wages as a result of the misclassification.

Additional Liability for Construction Contractors and Subcontractors

Beginning July 1, 2020, contractors engaged in the construction industry are required to appropriately classify their workers. Contractors who fail to do so will be subject to sanctions by the Board of Contractors for misclassification. The Board of Contractors regulates tradesmen and licensed businesses engaged in construction, removal, repair or improvement of facilities or residential building energy analysis.

General contractors, which includes contractors, laborers, mechanics and persons furnishing materials, are deemed to be the employer of a subcontractor's employees for purposes of the payment of wages. In addition, general contractors and subcontractors in the construction industry are deemed to be jointly and severally liable with respect to misclassification of workers if the following conditions are met:

- The general contractor new or should have known the subcontractor was not paying employees all wages due;
- The construction contract is related to a project other than a single-family residential project; and
- The value of the project or the total number of projects under a single construction contract is greater than $500,000.

Anticipated Questions

Q1. My small marketing firm engages an individual who has her own business to help the firm with accounting and bookkeeping. She works remotely on a part-time basis for us (she has other clients) but regularly performs those services for the firm. Can that individual remain an independent contractor or do I now have to make her an employee?

Likely, yes, the individual can remain an independent contractor if she has an independently established trade or business and works for more than one entity at the same time. Factors to consider in this scenario are whether the individual established a separate entity, such as an LLC or C Corporation; whether that entity filed tax returns; whether the individual maintains a website advertising the business; and whether the individual can demonstrate that she has performed services for more than just your firm in the last six to twelve months.

Q2. Is a business protected from a misclassification claim brought by an individual who signed an agreement stating that the individual is an independent contractor and not an employee?

While an independent contractor agreement could be a starting point for establishing an independent contractor relationship, the inquiry does not end with the agreement. Increasingly, agencies have shown a tendency to push aside those written agreements in favor of reviewing the economic reality of the relationship between the entity and the worker. The new Virginia laws even makes it independently unlawful to force a worker to sign an independent contractor agreement if that is not the true nature of the relationship. In other words, employers should not assume that an independent contractor agreement is some kind of "get out of jail free" card.

Q3. If the Virginia Employment Commission audits my company for worker misclassification, is there a chance I can also be subject to liability from other agency investigations, such as the Virginia Department of Labor and Industry?

Yes. The new Worker Misclassification law specifically authorizes the Tax Commissioner and other state entities such as the Virginia Employment Commission and Virginia Department of Labor and Industry to share information about misclassification situations. This modification to the law is somewhat significant as the Virginia Employment Commission, which has most aggressively pursued independent contractor issues in the Commonwealth, has not typically shared that information with other state agencies. Now, for example, an employer who was found to have misclassified workers by the Virginia Employment Commission could also be referred over to the Department of Labor and Industry for investigation.

Q4. Can businesses still enter into independent contractor agreements that state an individual is engaged is an independent contractor and not an employee after July 1, 2020?

There is not a complete ban on independent contractor engagements or agreements in Virginia (like there is for low wage worker non-compete agreements). However, as of July 1, businesses are prohibited from requiring or even *requesting* an individual to enter into an agreement or sign any document *if* that results in misclassification of the individual. Employers who are entering into an independent contractor agreement with the worker after July 1,2020 should take steps to ensure that they will be successful in establishing that the worker is indeed an independent contractor.

Q5. My company uses a number of workers who only come to our office and perform services on-site as needed on a part-time basis. The company directs the kind of work the workers do and has some oversight on how the workers complete assigned tasks. Can I still classify those workers as independent contractors?

The fact that a worker is only going to work on an on-call, part-time basis does not insulate them from the new laws and the required test for an independent contractor under the IRS guidelines. True independent contractors are viewed as those workers who can perform the work anywhere they want. A contractor who is typically required to perform work on-site at the offices of the company (or the company's customer) is more likely to be viewed as an employee. While it may seem expedient (for both the company and the worker) to characterize the person as an independent contractor and simply pay the worker a flat fee, there is little additional cost to enrolling the worker in the employer's payroll system, and doing the appropriate wage withholding and payment of FICA and Medicare. If the worker does not have control over the means and manner of their work for the company, it is likely the worker could qualify as an employee and the employer could be subject to significant liability for the misclassification.

Q6. I have an individual engaged as an independent contractor who works exclusively for my company on a full-time basis and wants to remain an independent contractor. Is it really worth forcing that individual to become an employee?

Although it may seem easier right now to continue to allow the individual to perform services as an independent contractor, the risk associated with erroneously classifying this individual is significant. A putative independent contractor who was later deemed to be an employee could have a claim for, among other things, unpaid overtime and the cost of benefits that were not extended to the worker (e.g., health coverage or 401(k) plan matching). Moreover, the potential damages could include "expenses incurred by the employee that would otherwise have been covered by insurance."

Thus, for example, imagine that Dewey, a full-time worker being treated as an independent contractor by Acme Corporation, contracts COVID-19. He is hospitalized and is on a ventilator for 10 days before he is able to sufficiently recover and eventually return home. Because Dewey did not have any health insurance, he has a $120,000 medical bill waiting for him. If Dewey were to contend successfully that he should have been treated as an employee and covered under the employer's health care plan, the employer could be held responsible for payment of those expenses.

Q7. Our company engaged an individual who works as a proofreader at her home in Kentucky. We send her books to proofread and pay her an hourly rate to proofread and edit the books. We only send her books to proofread as they become available so she does not have a set schedule or set amount of work. Can I continue to treat the individual as an independent contractor?

It depends. If the proofreader serves as a proofreader for other businesses and maintains an independent proofreading business, then there is a solid argument that she is an independent contractor. However, another relevant factor is whether your company is in the publishing business because if so, proofreading is likely to be considered part of the company's process and the individual may be viewed as an employee.

An issue also arises as to the enforceability of the Virginia law with respect to workers who are not located in the Commonwealth. Virginia-based employers should not assume, however, that simply because the worker is outside of the Virginia state lines, that they would not be subject to the penalties under these laws.

Q8. Our company use a temporary staffing company to provide us with workers during our busy seasons. We pay the staffing company and the staffing company takes care of benefits and pays the workers their wages, withholds taxes, etc. Could those workers be viewed as our employees?

It is certainly possible that the worker, if they are subject to your direction and supervision, and not the direction and supervision of the staffing company, would be viewed as an employee for certain purposes. For example, such a worker could well be viewed as an employee for purposes of the federal discrimination laws. However, under the new Virginia laws, this should not, as a practical matter, pose a problem for the employer if the employer has evidence that the staffing company is indeed complying with all of the requirements for employment. In other words, even if the worker could claim that they should have been treated as an employee of your company, it is likely the employee would not be able to demonstrate any damages.

Action Items for Employers

In light of the new laws, employers should immediately take the following steps:

1. Every employing entity should conduct a complete audit of any worker who is being paid on a 1099 basis. This would include those workers who had set up their individual LLCs or corporate entities.

2. In conducting the audit, the employing entity should consider the following questions

   - *How long has the worker been providing services to the company?* A fulltime relationship that has lasted more than six months looks more like an employer-employee relationship than a true independent contractor relationship.

   - *Is the work being performed on a full-time basis?* Depending on the length of the relationship, a full-time worker will generally be considered to be an employee, and, under the new law, the burden will be upon the employing entity to rebut the legal presumption included in the bill. A true independent contractor is someone who is providing services to more than one person or entity.

   - *Does the worker have an independently established trade or business?* For example, has the worker established a separate entity, such as an LLC or C Corp? Has that entity filed tax returns? Does the worker maintain a website advertising his/her business? Does the worker have his or her own business cards and other promotional materials? Can the worker demonstrate that he/she has performed services for more than one entity in the last 6 to 12 months?

   - *Is there a written contract/agreement between the company and the worker specify an independent contractor status?* It should be noted that while a written contract or agreement is a starting place for establishing an independent contractor relationship, it does not end the inquiry, and increasingly agencies have shown a tendency to push aside those written agreements in favor of reviewing the economic reality of the relationship between the entity and the worker. Indeed, the new Virginia law (Section 58.1-1903) makes it independently unlawful to force a worker to sign an independent contractor agreement if that is not the true nature of the relationship. In other words, employers should *not* assume that an independent contractor agreement is some kind of "get out of jail free" card.

   - *Is the worker performing work on company premises (or the premises of the company's customer)?* True independent contractors are viewed as those workers who can perform the work anywhere they want. The employing entity controls the result of the work to be performed, but not the "means and manner" by which it is performed. A contractor who is typically required to perform work on-site at the offices of the company (or the company's customer) is more likely to be viewed an employee.

In summary, despite the reality that many workers prefer to remain independent contractors to take advantage of business deductions and the freedom that serving as an independent contractor affords, perceived abuses (whether true or not) by the employer community have led legislators to clamp down severely in the Commonwealth. Wise businesses will take critical steps to eliminate potential liability by reducing the number of independent contractors.

More Questions?
We are here to help.

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