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## **EMPLOYER BEWARE:**

### **Employee or Independent Contractor Making the wrong decision has gotten more costly**

**By  
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For many employers, the choice to hire an employee or an independent contractor had become one of convenience. It's cheaper and easier to hire independent contractors. They don't get medical or other employee benefits; they don't get overtime and aren't subject to minimum wage restrictions; the employer doesn't withhold taxes, provide worker's compensation or contribute to unemployment compensation and they help moderate the impact of peaks in workflow. Perhaps most significantly, they can be fired with few repercussions if things don't work out or the business takes a downturn. For many employers, their use of independent contractors provides their edge in a competitive market. However, beginning July 13, 2008, the Massachusetts legislature will send a clear message to local employers that they are required to pay their employees what they are entitled to when they are entitled to it, or run the risk of harsh penalties.

There have long been IRS and Department of Labor regulations that set forth the requirements for determining the appropriate categorization for an employee and an independent contractor. There have also been monetary penalties that could be assessed to an employer that incorrectly categorized its contractors.

For Massachusetts employers and companies with Massachusetts-based employees, that landscape has just gotten much more difficult to navigate.

On April 14, 2008, MA Senate Bill No. 1059 (S. 1059) became law. This new law makes violations of Massachusetts's wage and hour laws, including inadvertent violations, subject to **mandatory treble damage** awards with no available defense. This law becomes effective on July 13, 2008.

Historically, treble damages were considered discretionary, punitive in nature and were awarded to punish an employer's willful misconduct. As a result of this new legislation, employers will be required to pay "triple damages, as liquidated damages, for any loss of wages and other benefits; and the costs of the litigation and reasonable attorneys' fees" will be awarded to any plaintiff who successfully litigates a claim under the Massachusetts wage and hour laws. As passed, inadvertent violations and good faith efforts will not avoid the imposition of triple damages.

To further complicate this issue, the MA Office of the Attorney General has issued a new Advisory (No. 2008/1) interpreting the Massachusetts Independent Contractor Law, M.G.L. c. 149 §148B, which sets forth a three prong test for determining independent contractor status. *All three of the following elements* must be satisfied to establish independent contractor status:

- 1) Freedom from Control. The burden is on the employer to demonstrate that the services performed are largely free from its actual control or direction. For example, the general nature of the job provides that an independent contractor completes the job using his/her own approach with little direction and dictates the hours that he/she will work on the job.
- 2) Service Outside the Usual Course of the Employer's Business. The services performed must be "outside the usual course of business of the employer." If the *service the individual is performing is necessary to the business of the employing entity rather than* merely incidental, the individual must be classified as an employee. By example, newspaper carriers working for a newspaper or machinists working for a manufacturer perform services necessary to the business. But, an individual performing landscaping for either employer is performing services outside the usual course of business. The newspaper carrier and machinist, respectively, must be employees; the landscaper could be an independent contractor.
- 3) Independent Trade, Occupation, Profession or Business. The individual must be *customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service performed* and capable of performing the service for others, i.e. the nature of the business must not compel the worker to depend on a single employer for the continuation of services. In this connection, the worker's dependency on one employer or his/her ability to perform services of a similar nature for multiple employers can be an important consideration.

Some employers have sought to protect themselves from the misclassification issue by requiring contractors to set up LLC or Subchapter S Corporations. The Attorney General is on the alert for such efforts to sidestep the implication of its Advisory opinion and will enforce the law against employers that "allow, request or contract with corporate entities such as LLC's or S-Corporations that exist for the purpose of avoiding the Law.

An employer's failure to withhold taxes, contribute to unemployment compensation or provide worker's compensation, or the individual's status as a sole proprietor or partnership are not relevant indicators that the individual is properly an independent contractor. Rather, the employer's compliance with all three prongs set forth above is the relevant standard.

A final complication...to encourage the reporting of violations, in May, Gov. Deval Patrick announced a toll free hotline and website for reporting suspected workplace fraud and a Joint Task Force—the Underground Economy Task Force—which is comprised of more than twelve agencies,

charged with the mandate to investigate reported issues and to retrieve the millions of dollars in revenue which are lost to the Commonwealth of Massachusetts every year through these and other wage and hour violations.

A fair reading of the Advisory Opinion and the provisions for mandatory treble damages for errors-even unintentional ones--confirms that violations can be costly. The statute authorizes the AG to impose substantial civil and criminal penalties, as well as liability for both business entities and individuals, including corporate officers, and those with management authority over affected workers.

#### What's an Employer to do

Employers should promptly undertake a review of their use and classification of independent contractors. The following situations may be initial indicators of a misclassification that warrant further investigation:

- Individuals providing services for an employer who are paid "off the books", "under the table," in cash or in ways that are not documented by 1099 or W-2s;
- Insufficient or no workers' compensation coverage exists;
- The employer provides equipment, tools and supplies to individuals or requires the purchase of such materials directly from the contracting entity;
- Alleged independent contractors do not pay income taxes or employer contributions to the Division of Unemployment Assistance;
- An employer has employees and independent contractors performing the same job duties;
- An employer who has independent contractors performing essential parts of the employer's business; and/or
- An employer who does not hire independent contractors through third party organizations e.g. an agency

The new law clearly points to a number of immediate actions for all Bay State employers as well as out-of-state employers with sites and employees in Massachusetts. All affected employers should review current wage and hour policies and practices for strict compliance with state law. At a minimum, this audit should include a review of exempt/nonexempt classifications to be sure all employees are correctly classified as well as employer procedures relating to timely payment of wages, overtime, vacation pay, holiday pay, on call pay, pay upon separation from employment, and pooling and distribution of gratuities. Employers located in other states should also be on the alert for the passage of similar statutes in their states.

Given the potential for increased awards and provisions for attorneys' fees, it is likely that this new law will increase the number of wage and hour lawsuits brought against Massachusetts employers. The mere prospect of such claims will be very costly to employers in defending against wage and hour cases.

The laws relating to independent contractors grow increasingly more complex. For more information concerning the implications of the new law relating to mandatory treble damages or the Advisory Opinion regarding independent contractors on your business, their potential consequences, and assistance in evaluating your current policies and practices, employers are encouraged to seek the advice of counsel with expertise in this area.