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Employment Law

# The New Pitfalls Of Employment Misclassification For Virginia Employers

*by*
*Brendan C. Horgan*
*Karen S. Elliott*
*and*
*Shannon A. Kapadia*

*Eckert Seamans*
*Richmond, VA*

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# Commentary

## The New Pitfalls Of Employment Misclassification For Virginia Employers

**By**
**Brendan C. Horgan,**
**Karen S. Elliott**
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**Shannon A. Kapadia**

*[Editor's Note: Brendan C. Horgan, Karen S. Elliott and Shannon A. Kapadia are each Richmond-based attorneys with the law firm of Eckert Seamans and focus their practices on labor and employment and commercial litigation. Any commentary or opinions do not reflect the opinions of Eckert Seamans or LexisNexis® Mealey Publications™.* *Copyright © 2020 by Brendan C. Horgan, Karen S. Elliott and Shannon A. Kapadia. Responses are welcome.]*

### THE TIMES THEY ARE A CHANGIN'

In the past few years, the political winds in Virginia shifted in a manner not seen in the Commonwealth in over a generation. After the 2017 gubernatorial election and the 2018 mid-term elections, a Democrat presided as Governor of Virginia and Democrats controlled majorities in both the state House of Delegates and Senate for the first time in more than thirty years. In the most recent legislative session in 2019, this new democratic super-majority passed an aggressive package of employment reform bills that drastically changed the employment law landscape in Virginia.

One of the most notable changes — that Governor Northam referred to as his "flagship" employment law policy reform — is a series of laws targeting the misclassification of employees. A 2012 Joint Legislative Audit and Review Commission (JLARC) audit estimated the Commonwealth of Virginia lost roughly $28 million per year in tax revenue due to misclassification. Armed with the JLARC Audit, and pushing a broad series of reforms to benefit employees in the Commonwealth, Governor Northam signed these new misclassification bills into law. Virginia's new misclassification laws are some of the most aggressive anti-misclassification measures implemented in any state in the nation, including traditionally progressive and employee-focused states like California, New Jersey and New York. Virginia's new misclassification laws provide fertile ground for plaintiffs' attorneys to file lawsuits in state court. Employers should pause and pay close attention to their employment/independent contractor relationships and ensure each worker's categorization is still lawful in light of these new rules. Going forward, every Virginia employer must consider these new laws before entering into any relationship with a worker for pay.

### WHAT IS "MISCLASSIFICATION?"

"Misclassification" occurs when a business incorrectly categorizes a worker for payroll purposes. This most commonly means that an employer erroneously categorizes a worker as an *independent contractor* instead of an *employee*. The general difference between an independent contractor and an employee (recognizing that every state has its own specific test) depends on whether the entity paying for the worker's services has the right to direct and control the manner in which the work is completed. Generally speaking, independent contractors control *how* their own work is performed. Employees, again generally, must perform under the direction and supervision of the entity paying for their services.

Categorizing a worker as an independent contractor instead of an employee usually saves the employer money on benefits, minimizes the number of claims the worker may have against the employer, absolves the employer of certain duties that every employer owes to its employees, and minimizes certain employer payroll taxes. Additionally, some workers are better off categorized as independent contractors. For instance, if a worker is not concerned about benefits, he or she may be able to negotiate a higher rate of pay as an independent contractor. Or, a worker may prefer the flexibility of independent contractor status as opposed to operating under the employer's direct control and supervision.

## SUMMARY OF VIRGINIA'S NEW MISCLASSIFICATION STATUTES

Unless otherwise noted, effective July 1, 2020:

**a. Private Cause of Action[1].** The new laws create a new private cause of action for employees to file a claim in Virginia state courts against their employer for misclassification.

**b. Presumption of Employment[2].** All persons who work for compensation in Virginia are presumed to be employees. In a claim for misclassification, the burden is shifted to the employer to prove a worker is an independent contractor.

**c. No Retaliation[3].** Employers are prohibited from retaliating against employees or independent contractors who report, or plan to report, misclassification or who participate in an investigation or court action regarding misclassification.

**d. Civil Penalties[4]. Starting January 1, 2021,** employers that misclassify employees and therefore fail to pay the proper employment taxes may be subject to up to a $5,000 fine for each violation.

**e. Bar on Award of State Contracts[5]. Starting January 1, 2021**, the new laws also give state agencies the power to deny the awarding of a state contract to companies that misclassify employees and therefore fail to pay the correct employment taxes.

**f. Back Taxes[6]. Starting January 1, 2021**, The Virginia Department of Taxation ("VDT") has the power to pursue employers for back employment taxes that were not paid due to misclassification. Similar to a state court action filed by an employee under the new misclassification law, the employer bears the burden of proving to the VDT that its workers meet the test to be classified as independent contractors.

**g. State Agency Sharing of Information[7]. Starting January 1, 2021,** the new laws will grant the VDT the power to request from, and share information with, several state agencies including the Virginia Employment Commission ("VEC") in a collective effort to identify employers liable for misclassification.

**h. Virginia Board of Contractors Sanctions[8].** An amendment to an existing law authorizes the Virginia Board of Contractors to impose sanctions against any contractor who intentionally misclassifies workers as independent contractors. The statute gives contractors an affirmative duty to properly classify its workers as either employees or independent contractors. The Board of Contractors regulates tradesmen and licensed businesses engaged in construction, removal, repair, or improvement of facilities or residential building energy analysis.

## VIRGINIA'S "OLD" TEST FOR INDEPENDENT CONTRACTOR STATUS — THE RIGHT TO CONTROL

Like many states, Virginia law established a balancing test to determine whether a worker was an employee or an independent contractor. The Supreme Court of Virginia articulated a four-factor test to use to determine whether a worker was an employee or independent contractor, analyzing whether the business paying for the services had the power to: (1) select and engage the worker; (2) pay wages; (3) dismiss the worker; and (4) control or direct the work[9]. Virginia courts attributed the most weight to the fourth factor and have referred to this test as the "right to control" test. Virginia courts traditionally engage in a detailed analysis balancing the facts of each case, including the contract between the entity and the worker as well as the circumstances of the actual work, and make a determination about employment status.

In determining whether a business has the "right to control" the work, a Virginia court will answer several factual questions such as: (1) who provides the tools;

(2) who dictates the schedule; (3) whether the business provides supervision; (4) whether the work is performed remotely or on the employer premises; (5) whether the work is the type that the business traditionally performs; (6) whether the business provides training to the worker; (7) whether the worker's work integrates into the business or is a standalone task; (8) whether the worker works full time; and any other appropriate facts that tend to support the relationship as that of independent contractor/payor as opposed to employee/employer. Traditionally, borderline cases have resulted in a determination of employment[10]. In other words, a tie is decided in favor of the employee.

By way of comparison, some states (e.g. California, New Jersey), follow a different test which finds the worker an employee unless the worker (A) 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) performs work that is outside the usual course of the hiring entity's business; and (C) is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed. This is often referred to as the "ABC Test." The ABC Test is widely recognized as more employee-friendly and makes it difficult for an employer to take a position that an employment status does not exist.

## VIRGINIA'S "NEW" TEST FOR INDEPENDENT CONTRACTOR STATUS — THE IRS GUIDELINES

Although the traditional common law test still technically exists in Virginia, (but for what purpose remains in question), causes of action brought under these new misclassification laws will apply a new standard. Instead of strictly applying the "right to control" test as established by Virginia common law, the new laws reference the Internal Revenue Service ("IRS") guidelines and regulations[11]. With the adoption of the federal IRS test, it appears that the Virginia legislature has and replaced a strict common law test by delegating the determination of the Virginia standard to the federal authorities. This raises a question of whether the new statute violates the Virginia Constitution. Until successfully challenged, it is the now the new standard.

The IRS has published several different regulations and guidelines over the years that address the test for determining employment status. The Virginia statute cites to the current regulation at 26 C.F.R. § 31.3121(d)-1 which largely codifies the "right to control" test as well as other "guidelines and regulations.[12]" Additionally, the most recent IRS guidelines reference both a "20-factor" test and a "three-factor" test. The 20-factor test is the older IRS test, and the latest guidance suggests that the agency is increasingly relying on the three-factor test (which incorporates similar factors to the 20 factors), however the 20-factor test still exists and may be relied upon by the IRS.

**a. The 20-factor test.** The 20-factor test, when used, balances the following factors: level of instruction; amount of training; degree of business integration; extent of personal services; control of assistants; continuity of relationship; setting the schedule; demands for full-time work; need for on-site services; sequence of work; requirements for reports; method of payment; reimbursement of business or travel expenses; provision of tools and materials; investment in the work facilities; right to quit; realization of profit or loss; work for multiple companies; availability of workers service to other entities; control over discharge; and right of termination.

**b. The three-factor test.** The three-factor test is outlined in IRS Publication 15-A[13]. According to this newer test, if the employer (or the person for whom the services are performed) has the right to control or direct the result of the work, and not the means or methods of accomplishing such result, then the worker is an independent contractor. However, the final determination will depend on the facts of each case. These facts fall into three categories:

- behavioral control (control/supervision);
- financial control (pay, reimbursement, provision of tools); and
- the nature of the relationship between the parties (duration, existence of contract, benefits).

All these factors must be weighed to determine how a worker should be classified. No one factor is indicative and some factors may not be relevant to the facts at issue in a particular case. An employer should therefore analyze the facts and circumstances of worker relationships under each category as follows:

**i. Behavioral Control.** For the behavior control analysis, the employer should ask whether the company controls or has the right to control what the worker does and how the worker does his or her job[14]. This can be answered by considering the instructions that the business gives to the worker such as: when and where to do the work, which tools/equipment to use, what work must be performed by that particular worker, where to purchase supplies, etc. A worker may be classified as an employee even if no instructions are given because the business may still have a control over how the *results* should be achieved. The key consideration for this category is whether the business has retained the right to control the *details*. For instance, if the business provides the worker with tools and training on how to do the job and/or makes frequent inspections of the worker's work, these all lean in favor of an employer-employee relationship.

**ii. Financial Control.** The employer should ask whether the *business aspects* of the worker's job are controlled by the payor. These are things such as how the worker is paid, whether expenses are reimbursed, and who provides the tools/supplies to the worker. For instance, a worker who incurs unreimbursed expenses weighs in favor of being classified as an independent contractor. Further, while putting down a significant investment is not necessary for independent contractor status, such workers often invest more in their own tools or the facilities they use in performing services for someone else. Additionally, while it is common for some independent contractors to be paid by the hour, independent contractors are usually paid flat fees or are on a time and materials basis for the job performed. Independent contractors, rather than employees, are able to make a profit or loss and often advertise their services and/or hold themselves out as being able to perform similar services for others. Also, independent contractors are usually held contractually liable for the failure to complete their work.

**iii. Nature of the Relationship.** The employer should determine if there are written contracts (although see below regarding the Virginia statute regarding contracts) or employee type benefits, if the relationship will continue, and/or if the work performed by the worker is a key aspect of the business[15]. Per the IRS, if the business engages with the worker expecting to continue the relationship for an indefinite period instead of for a specific project, then this weighs in favor of classifying the relationship as an employer-employee relationship. Further, if a business hires a worker to perform services that are considered a "key" service, then it indicates that the business will have the right to control the worker's activities. Lastly, if the business provides the worker employee-type benefits such as workers compensation insurance and/or vacation pay, this also indicates the intent to form an employee-employer relationship.

## THE PRESUMPTION OF EMPLOYMENT

The most significant (and controversial) aspect of these new laws is the rebuttable presumption that all workers are employees unless proven otherwise. As will be discussed in the next section, workers are now able to sue their employer directly for alleged misclassification. Regardless of the outcome of the litigation, the employer will likely incur significant legal costs and be forced to produce documents at an early stage of the litigation. In other words, while many suits in Virginia state courts can be effectively defended via the filing responsive motions such as a *demurrer* (the Virginia state court equivalent of a motion to dismiss), the rebuttable presumption set forth in the new misclassification laws will force employers to disclose information that will likely complicate traditional motions practice.

Also troubling for Virginia employers, winning on summary judgment is notoriously difficult in Virginia Circuit Courts[16]. Most employer attorneys choose to remove state court actions to federal court when the allegations are based on violations of federal employment laws. Now, when sued under the new state statute, absent diversity jurisdiction or another "hook" to justify removal, employers may be forced to litigate misclassification cases in state court and navigate an increased risk facing a jury. This may result in a higher percentage of these types of cases settling early as opposed to being aggressively defended.

Finally, the new misclassification laws provide that the presumption of employment also applies for the purposes of taxation (Title 58), labor and employment (such as payment of wages) (Title 40.1), unemployment (Title 60.2) and worker's compensation (Title 65.2)[17].

## THE NEW PRIVATE CAUSE OF ACTION

The new laws create a new cause of action allowing Virginia workers to sue an employer for misclassifying

them as an independent contractor. If successful, these legal challenges will convert the worker from an independent contractor classification into an employee with full benefits.

### a. Burden of Proof in a Misclassification Action

Under the new laws, the worker bears the initial burden of production to prove that he or she is an "individual who performs services for a person for remuneration[18]." Upon that minimal showing, a court will recognize a rebuttable presumption that the worker is an employee. To rebut this presumption, the burden shifts to the employer to prove that the worker meets the IRS test for independent contractor status, discussed above.

The presumption that workers in Virginia are employees is an incredibly important departure from existing independent contractor law. Now, employees are able to sue their employers directly and the employer bears the majority of the burden of disproving the claim. Also, if the employee prevails, he or she will be entitled to attorneys' fees and costs. Therefore, the financial risk to the employee of bringing these types of claims is remarkably low, whereas the risk to the employer in defending these types of actions is significantly higher.

The new law also requires the employee prove the employer "had knowledge of the . . . misclassification." It is not entirely clear from the wording of the statute whether the employee must prove knowledge at the outset in order to trigger the presumption, or if knowledge can be proved at a later stage in the trial process. Nevertheless, employers must pay close attention to any communications from employees to employers that notify the employer about a potential misclassification. Any employer who receives any notification from an independent contractor regarding their classification status should be on alert to whether the notification supports the "knowledge" element in a misclassification suit. That type of notice is the type of evidence that an employee will use to prove the employer had knowledge of the misclassification.

### b. Available Damages

Damages available under the new misclassification laws include: lost wages, the value of missed benefits, expenses incurred by the employee that would have otherwise been covered by insurance, and the worker's attorneys' fees and costs[19]. This package of available damages is very significant and can very easily exceed six figures.

Additionally, the specter of an award in the amount of "expenses incurred by the employee that would have otherwise been covered by insurance" is of particular concern for Virginia employers. Presumably, if an uninsured worker is injured while working for an employer, and that worker would have had the benefit of employer health insurance had he or she been classified as an employee, then that worker may have a claim against the employer for unpaid medical expenses. Also, a worker who would have been covered by an employer's workers' compensation insurance policy may similarly be able to file a claim for damages in the amount of a potential workers' compensation claim. When deciding how to classify a worker, employers must now consider the degree of danger involved in the work. Businesses should confirm that any independent contractor is adequately insured prior to approving any work, but it is not entirely clear how courts would analyze a misclassified independent contractor whose injuries exceed their insurance coverage or who misrepresented the existence or amount of their coverage. Presumably, such a misrepresentation is a defense to employer liability for a workers injuries, but employers need to recognize that such a defense has not been asserted in an action brought under these new misclassification laws.

Additionally, as will be discussed in the following sections, losing a misclassification lawsuit also exposes an employer to state agency investigations, back taxes, and civil penalties.

## PROHIBITION ON RETALIATION

The new laws prohibits employers from retaliating against employees or independent contractors who: (1) report or plan to report that their employer misclassified them; or (2) are requested or subpoenaed to participate in an investigation or court action related to a misclassification claim[20]. "Retaliation" means discrimination, discharge, discipline, or denial of any privilege or benefit to which the worker would have otherwise been entitled.

This retaliation prohibition allows an employee to file a complaint against his/her employer with the

Commissioner of Labor and Industry if the complaint of retaliation is supported by "reasonable belief and good faith[21]." A complaint is not supported by "a reasonable belief and good faith" if: (1) the employee knew or should have known the information he/she provided was false; (2) the employee disclosed information maliciously; or (3) if the disclosed information is confidential as a matter of law. Upon receipt of a qualifying complaint and signed consent from the employee, the Commissioner is authorized to institute proceedings against the employer[22]. If the Commission finds that the employer took retaliatory action, the employer is subject to a civil penalty equal to the employee's lost wages[23].

## BACK TAXES AND CIVIL PENALTIES

Starting January 1, 2021, the Commonwealth will begin using the new presumption of employment when pursuing employers for back taxes for independent contractor misclassification. As a backdrop, independent contractors pay their own taxes and generally receive no employee benefits. Employers pay payroll taxes on behalf of employees into state coffers, so conversion from independent contractor to employee provides the state a means to recoup lost payroll taxes. The JLARC audit that revealed $28 million in lost employment tax revenue was one of the justifications for these new misclassification laws. With tax recoupment as a significant rationale for instituting these new laws, businesses would be wise to take steps to avoid a possible investigation. Every employer in the Commonwealth must understand and abide by these new laws to avoid financial penalties, sanctions, back tax collection, and even debarment from public contracts.

It is expected that beginning January 2021, the VDT will not hesitate using this new employee presumption to pursue employers for back taxes for independent contractor misclassification. Employers will be required to pay the designated taxes unless the employer demonstrates to the tax department's satisfaction that their 1099-designated workers qualify under the IRS guidelines as an independent contractor.

Also effective January 1, 2021, employers who misclassify employees and therefore fail to pay the proper employment taxes, benefits or other contributions will also be subject to a civil penalty of up to:

- $1,000 per misclassified individual for a first offense[24];
- $2,500 per individual for a second offense[25];
- $5,000 per misclassified individual for a third or subsequent offense[26]; and
- the Commonwealth may bar an employer from winning public contracts[27].

These statutes also make it unlawful to enter into, sign an agreement, or sign a document that results in the misclassification of a worker or inaccurately depicts the relationship between the employer and the worker[28]. Previously, some Virginia circuit courts have held that misclassification is sufficient under the Virginia common law to invalidate certain provisions of a contract of employment[29]. Now, the invalidation of employment contracts is codified by statute and is seemingly a much stronger defense for an employee against the enforcement of restrictive covenants (i.e. non-competition, confidentiality, and non-solicitation provisions) and/or actions by an employer against an employee for breach of an employment contract. This new statutory invalidation of contracts that misclassify a worker will be a powerful weapon in defending against the enforcement of restrictive covenants.

## SHARING OF INFORMATION AMONGST STATE AGENCIES

The new statutes will allow the Tax Commissioner to request from, and share information with, selected state agencies such as the VEC in a collective effort to identify employers liable for misclassification[30]. This new administrative power will aid the VDT in pursuing employers for back taxes.

## VIRGINIA BOARD OF CONTRACTORS SANCTIONS

An amendment to existing law now authorizes the Board of Contractors to impose sanctions against any contractor who intentionally misclassifies workers as independent contractors[31]. The statute gives contractors an affirmative duty to properly classify its workers as either employees or independent contractors. The Board of Contractors regulates tradesmen and licensed businesses engaged in construction, removal, repair, or improvement of facilities or residential building energy analysis. Thus, any Virginia business that is regulated

by the Board of Contractors must also consider the administrative risks of misclassification and possible effects on licensing and the possible consequences of a public censure.

## OTHER CONSIDERATIONS

### a. The Joint Employer Rule

Pursuant to the Fair Labor Standards Act ("FLSA") and as explained in the Department of Labor's Regulations, a business may be considered a "joint employer" of a worker in certain cases[32]. Being deemed a joint employer will obligate a business to pay owed wages that another employer failed to pay (i.e. the general contractor may be liable for unpaid wages that a subcontractor fails to pay if the general contractor is deemed a joint employer). Thus, even where a worker is properly classified as an independent contractor, a business may be liable as an employer if the other employer breaches a duty to its employee. For instance, if a subcontractor fails to pay its employees, the contractor may be liable for unpaid wages if it is determined to be a joint employer. The more functions that are shared between the employer and the other business, the more likely a court (or the DOL) is to determine that a joint employment relationship exists. Although this area of law is not directly impacted by the new misclassification laws in Virginia, every employer needs to also consider the *joint employer* factors as it engages workers for services. To determine whether this joint employer relationship exists, the United States Court of Appeals for the Fourth Circuit (which includes Virginia) set forth a list of six factors to consider:

- Whether, formally or as a matter of practice, the putative joint employers jointly determine, share, or allocate the power to direct, control, or supervise the worker, whether by direct or indirect means;
- Whether, formally or as a matter of practice, the putative joint employers jointly determine, share, or allocate the power to—directly or indirectly—hire or fire the worker or modify the terms or conditions of the worker's employment;
- The degree of permanency and duration of the relationship between the putative joint employers;
- Whether, through shared management or a direct or indirect ownership interest, one putative joint employer controls, is controlled by, or is under common control with, the other putative joint employer;
- Whether the work is performed on a premises owned or controlled by one or more of the putative joint employers, independently or in connection with one another; and
- Whether, formally or as a matter of practice, the putative joint employers jointly determine, share, or allocate responsibility over functions ordinarily carried out by an employer, such as handling payroll; providing workers' compensation insurance; paying payroll taxes; or providing the facilities, equipment, tools, or materials necessary to complete the work[33].

### b. Additional IRS and DOL Scrutiny

In addition to state scrutiny, the DOL and IRS may also make their own misclassification determinations for federal wage and tax purposes. The DOL has acknowledged having entered into memoranda of understanding with many states and the IRS to share such information.

## THE COST OF A MISCLASSIFICATION FINDING BY FEDERAL AUTHORITIES

If the IRS or DOL determine that an employer misclassified its employee, in addition to the new risks for violations of the new Virginia misclassification laws, the employer faces significant federal tax and other liability based on its tax responsibilities for employees:

**a. Federal Income Tax Withholding**. The employer may be responsible for payment of the worker's portion of federal income tax if the employee did not pay.

**b. Federal Insurance Contributions Act ("FICA") Withholdings: Social Security and Medicare Taxes.** The employer may be responsible for paying half of the Social Security contribution, or 6.2 percent of the worker's wages (up to the Social Security wage base) and one half (1.45 percent) of the Medicare tax for all employees (there is no limit on the amount of compensation subject to the Medicare tax). If employment status was determined, the employer is also always responsible for the employer's

share of payroll taxes, 6.2 percent up to the maximum, plus 1.45 for a 7.65 percent total (depending on total wages paid) for each employee.

**c. Federal Unemployment Tax ("FUTA").** The employer may be responsible for repaying applicable state unemployment insurance for the past (plus interest and penalties).

**d. State Unemployment Tax.** The employer may be responsible for paying applicable state unemployment insurance for the past (plus interest and penalties).

**e. Workers' Compensation Tax.** The employer may be responsible for paying applicable workers' compensation tax for the past (plus interest and penalties). This is a state tax.

**f. Health and Welfare Benefits.** The employer may have to provide all the same benefits as regular employees receive. There are fines and penalties for Affordable Care Act ("ACA") violations[34].

**g. Pension Plans.** If the employer is unable to exclude reclassified workers from participation, the employer may be responsible to pay for retroactive coverage, vesting and contributions in one or more plans.

**h. Unreimbursed Business Expenses.** Reclassified employees may be eligible for past expense reimbursements.

**i. IRS Penalties.** In addition to paying the employer's share of payroll taxes, the employer may have to pay a penalty of 20 percent of the FICA that should have been withheld and 1.5 percent of wages (but the 1.5 percent is only if the independent contractor failed to pay, and you have no way of knowing if they paid).

The employer is entitled to a credit for any federal income tax paid by the employee. If the IRS decides that the employer has been deliberately misclassifying the workers, it can hold the employer responsible for all employment taxes that should have been paid, including income tax and the employee's share of FICA and FUTA. In the worst case scenario, the IRS can go after the business owners/officers personally and hold them responsible for a 100 percent penalty on each responsible person. If the business cannot pay, then the owners can be responsible personally.

**j. Loss of FLSA Exemption.** An employee can bring an administrative claim to the DOL Wage and Hour division or file a private lawsuit under the FLSA. If the DOL determines that a (previously exempt) employee is misclassified, then the exemption may be lost, and overtime or other unpaid wages plus possible liquidated damages may be due.

## WHERE DO EMPLOYERS GO FROM HERE?

These new laws have significantly increased the cost of misclassifying a worker in Virginia. The cost/benefit analysis that every employer must undertake prior to entering into an independent contractor relationship with a Virginia worker is now completely different. Employers must consider the new risks of possible administrative investigations and employee lawsuits. Where the application of the factors set forth in the IRS guidelines do not clearly support an independent contractor relationship, employers may want to err on the side of categorizing workers as employees. Prior to the enactment of these new laws, taking a chance by categorizing a "borderline" worker as an independent contractor was not a particularly risky proposition. Now, employers who get the analysis wrong face significant new financial consequences in Virginia courts and before Virginia state agencies.

### a. Review existing contracts with workers and employer policies.

Every business needs to review its standard contracts and policies to ensure it is best positioned to defend against misclassification investigations or lawsuits. If a worker is an independent contractor, the contract for services should make clear that the nature of the relationship meets the IRS guidelines for an independent contractor relationship (by addressing each factor). Similarly, in drafting contracts, businesses should also assess the factors that a court or the DOL would analyze to determine if a joint employer relationship exists. If facts about the manner in which work is completed are in question, the contract may serve as evidence of the intent of the parties regarding the nature of any relationship. A contract is not a blanket defense against what is actually happening day to day. If the contract defines the nature of the relationship in a way that supports the worker is an independent contractor, the worker needs to perform his or her services in

accordance with the provisions of that contract. Also, businesses need to keep in mind the new misclassification laws will invalidate any contract that misclassifies a worker. Virginia businesses need to put time and thought into the drafting of all independent contractor and employment agreements and ensure the work is performed in accordance with each contract.

**b. Create a process for analyzing the IRS factors for every independent contractor relationship with a worker.**

Prior to categorizing any worker, every company in Virginia (or legal counsel) should analyze the IRS guidelines and assess whether every relationship with an independent contractor complies with the IRS guidelines. This process should be built into the hiring/contracting process.

**c. Create a process that ensures any notice from an employee of an alleged misclassification is immediately provided to Human Resources and legal departments.**

As discussed, an employee who sues his or her employer for an alleged misclassification must prove the employer has "knowledge" of the misclassification. Therefore, employers must be very cognizant of any communication or notice from a worker or their attorney that discusses that worker's status. Businesses must ensure these communications, written, oral or otherwise, get to Human Resources or the legal department without delay.

**d. Businesses should work with counsel to discuss other methods to mitigate exposure.**

Depending on a Virginia business's unique circumstances, counsel may be able to put into place other measures of protection—such as mandatory arbitration provisions, written acknowledgments for workers to acknowledge employment status is correctly categorized, or other contract provisions that will comply with the law and best protect the business.

## Endnotes

1. Va. Code § 40.1-28.7:7A.
2. Va. Code § 40.1-28.7:7B.
3. Va. Code § 40.1-33.1.
4. Va. Code § 58.1-1901.
5. Va. Code § 58.1-1902.
6. Va. Code § 58.1-1900 *et seq.*
7. Va. Code § 58.1-3.4.
8. Va. Code § 54.1-1102.
9. *Atkinson v. Sachno*, 261 Va. 278, 285 541 S.E.2d 902, 905(2001).
10. *See e.g. Va. Emp't Comm'n v. A.I.M. Corp.,* 225 Va. 338, 346 302 S.E.2d 534, 539 (1983).
11. IRS "guidelines" means the most recent version of the guidelines published by the [IRS] for evaluating independent contractor status, including its interpretation of common law doctrine on independent contractors, and any regulations that the IRS may promulgate regarding determining whether an employee is an independent contractor, including 26 C.F.R. § 31.3121(d)-1. Va. Code § 40.1-28.7:7C.
12. *Id.*
13. *Employer's Supplemental Tax Guide*, I.R.S. Pub. No. 15-A, Cat. No. 21453T (Dec. 23, 2019), https://www.irs.gov/pub/irs-pdf/p15a.pdf.
14. *Id.*
15. *Id.*
16. In Virginia, Circuit Courts have jurisdiction over claims greater than $25,000, and share jurisdiction with General District Courts for claims between $100 and $25,000. Va. Code §17.1-513. It seems likely the majority of misclassification litigation will occur in Circuit Courts.
17. Va. Code §§ 58.1-1900 *et seq.*
18. Va. Code § 40.1-28.7:7B.
19. Va. Code § 40.1-28.7:7A.
20. Va. Code §§ 40.1-33.1A & 40.1-33.1B.
21. Va. Code § 40.1-33.1C.
22. *Id.*
23. Va. Code § 40.1-33.1D.

24. Va. Code § 58.1901.

25. *Id.*

26. *Id.*

27. Va. Code § 58.1-1902.

28. Va. Code § 58.1-1903.

29. *See e.g. Reading & Language Learning Ctr. v. Sturgill*, 94 Va. Cir. 94 (2016).

30. Va. Code § 58.1-3.4.

31. Va. Code § 54.1-1102.

32. 85 C.F.R. 2820.

33. *Salinas v. Commercial Interiors, Inc.*, 848 F.3d 125, 141–42 (4th Cir. 2017).

34. There are two types of penalties that a company could owe if it does not provide the appropriate level of health insurance coverage to full-time employees:

- Failure to offer coverage penalty: This penalty is $167/month for every full-time employee (minus 30), if one or more full-time employees receives a subsidy for coverage.
- Failure to offer affordable coverage penalty: This penalty is $250/month for each employee that was not offered affordable coverage, obtained coverage in a marketplace exchange, and received a subsidy for that coverage. ■

**MEALEY'S LITIGATION REPORT: EMPLOYMENT LAW**
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1600 John F. Kennedy Blvd., Suite 1655, Philadelphia, PA 19103, USA
Telephone: (215) 988-7731 1-800-MEALEYS (1-800-632-5397)
Email: mealeyinfo@lexisnexis.com
Web site: http://www.lexisnexis.com/mealeys
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