A Timely Analysis of Legal Developments

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Colorado recently enacted the Misclassification of Employees as Independent Contractors Act, which provides for stiff penalties for employers who misclassify employees as independent contractors and provides a complaint process for workers who believe they are misclassified for unemployment insurance purposes.

Colorado Passes Stricter Penalties for Employers that Misclassify Independent Contractors

By Joshua B. Kirkpatrick and Katherine Dix

In June 2009, the Colorado legislature enacted the Misclassification of Employees as Independent Contractors Act. The new law creates a complaint process for workers who believe that they have been misclassified as independent contractors for purposes of unemployment insurance, and a process for the Colorado Department of Labor and Employment's Division of Employment and Training (the "Division") to issue Advisory Opinions to employers seeking advice on the proper classification of workers. Enacted as a means of punishing employers who are misclassifying employees as independent contractors and, therefore, not paying the proper amount of employment taxes, the Act has strict penalties for misclassification.

The Independent Contractor Landscape - A Refresher

Colorado law delineates the fine line between independent contractors and employees in different ways for different purposes. For example, whether a worker is an employee or an independent contractor may differ in the context of unemployment insurance, payroll taxes, and workers' compensation.

The Misclassification of Employees as Independent Contractors Act specifically relates to the Colorado Employment Security Act (CESA). The CESA provides that an individual shall be deemed an employee unless that "individual is free from control and direction in the performance of the service, both under his contract for the performance of service and in fact; and such individual is customarily engaged in an independent trade occupation profession, or business related to the service performed."[1] The CESA provides nine factors used in evaluating whether a worker is properly classified as an independent contractor:

1. whether the worker is required to work exclusively for the entity, except for a finite period of time;
2. whether the entity establishes quality standards for the worker or instructs him or her how to perform the work;
3. whether the entity pays a salary or hourly rate verses a contract rate;

4. whether the entity may terminate the work during the contract period, except for violations of the contract or failure to meet the specifications of the contract;
5. whether the entity provides more than minimal training;
6. whether the entity provides tools or benefits to the individual, other than materials and equipment;
7. whether the entity dictates time of performance, except for a completion schedule or a range of mutually agreed upon work hours;
8. whether the entity pays the worker directly instead of to the trade or business name of the individual; and
9. whether the entity combines its business operations with the individual's business.

These factors may be met with either factual evidence or a written document. Notably, a written contract can create a rebuttable presumption that an individual is an independent contractor, when that document contains a clear and conspicuous disclaimer that: (1) the independent contractor is not entitled to unemployment insurance benefits unless unemployment compensation coverage is provided by the independent contractor or some other entity, and (2) that the independent contractor is obligated to pay federal and state income tax on any monies earned.

Misclassification of Employees as Independent Contractors Act

The Misclassification of Employees as Independent Contractors Act adds teeth to the current requirements. Specifically, the Act creates a complaint process for workers who believe they have been misclassified, *i.e.*, erroneously classified as an independent contractor instead of an employee. Workers may now file a misclassification complaint with the Division. After receiving a complaint, the Division has 30 days to determine whether an investigation is warranted. Colorado employers are required to cooperate with the investigation and provide information as necessary.

If the Division finds a violation, the employer is liable for paying back taxes and interest. An employer who willfully disregards the law may also be fined $5,000 per misclassified employee for the first misclassification, and up to $25,000 per misclassified employee for a second or subsequent violation. In addition, upon a second or subsequent misclassification with willful disregard, the employer will be prohibited from contracting with, or receiving any funds from, the state for up to two years.

The Act also creates a process for employers seeking advice on the proper classification of workers. Colorado employers may now ask the Division for an Advisory Opinion on whether workers are properly classified as independent contractors instead of employees.

Recommendations

In light of Colorado's new Misclassification Of Employees As Independent Contractors Act, employers should consider:

- Obtaining counsel to review whether workers are properly classified as independent contractors.
- Reviewing independent contractor agreements to ensure that they track the statutory tests and memorialize the facts creating a legitimate independent contractor relationship.
- Seeking an advisory opinion for borderline classifications.
- Obtaining counsel to assist in an investigation into a misclassification complaint.

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[1] Colo. Rev. Stat. § 8-70-115(b).