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Attorney General's Office Issues Advisory on Massachusetts Independent Contractor Law

The Massachusetts Attorney General's Office ("AGO") recently released an Advisory clarifying its interpretation of the Massachusetts Independent Contractor Law, M.G.L. c. 149, § 148B, also referred to as the Misclassification Law (the "Law"). Advisory 2008/1, which supersedes the AGO's prior guidance on the subject, articulates the purposes of the Law and provides some valuable insight into the AGO's interpretation of the applicable three prong test, as well as the office's plans for enforcement.

The Law was intended to combat the widespread misclassification of individuals by Massachusetts businesses as independent contractors, as opposed to employees, thus depriving both the individuals of certain benefits and protections and the Commonwealth of significant tax revenue. Prior to enactment of the Law, courts traditionally had looked to a number of common-law factors in determining the existence of an employer/employee relationship including: the degree of control, the opportunity for profit and risk of loss, the employee's investment in the business facility, the permanency of the relationship, the skill required and the degree to which the employee's services were integral to the business. *See*, *e.g.*, *Commonwealth v. Savage*, 31 Mass. App. Ct. 714 (1991). Those factors continue to govern some employment matters, including tax withholding.

The Law now imposes a three-pronged test, all three parts of which must be met by the employer in order for an individual to be classified as anything but an employee. The burden of proof remains on the employer at all times under this test. The *first prong* requires that the individual be "free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact." This has long been a component of the test under G.L. c. 149, §148B. In interpreting this prong, the Advisory notes that, in general, "an independent contractor [unlike an employee] completes the job using his or her own approach with little direction and dictates the hours that he or she will work on the job."

The *second prong* of the test provides that the service the individual performs must be "outside the usual course of business of the employer." This requirement is relatively new (2004), and is far and away the most troubling and problematic for employers. Previously, an employer could alternatively demonstrate compliance merely by showing that the work performed was "outside of all places of the business of the enterprise," but this option was removed by the 2004 amendments to the Law. Along these lines, the AGO notes that it "recognizes the complexity that prong two presents and the concerns regarding legitimate independent contractors," but then does little to allay those concerns. The AGO intends to apply the second prong by specifically considering whether the services being performed by the purported independent contractor are "necessary to the business of the employing unit or merely incidental." The following two examples are provided by way of guidance. (1) If a "drywall company classifies an individual who is installing drywall as an independent contractor, this would be a violation of prong two because the individual installing the drywall is performing an essential part of the employer's business." (2) If, however, an "accounting firm hires an individual to move office furniture, prong two is not applicable

(although prongs one and three may be) because the moving of furniture is incidental and not necessary to the accounting firm's business."

Finally, the *third prong* of the test requires that the individual be "customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed." M.G.L. c. 149, s. 148B(a)(3). In other words, the contractor must customarily do what it is he or she is doing for the employer. This requirement, like prong one, is not new.

If an employer is not able to prove that a given individual meets the requirements of *all three prongs* above, the individual will be treated as an employee under Massachusetts law.[1] An employer's failure to withhold taxes, contribute to unemployment compensation, or provide worker's compensation is not considered relevant by the AGO for purposes of analyzing whether an employee has been appropriately classified. Similarly, an employer's good faith belief that an individual was properly classified as an independent contractor is treated as irrelevant.

Violations and Enforcement of the Law

As the Advisory makes clear, an employer violates the Law only when both of the following occur: *First*, the employer classifies or treats an individual as anything other than an employee, despite not meeting each of the criteria in the three-prong test above. *And second*, the employer violates any one of the enumerated employment laws below, in its treatment of the individual:

- Wage and hour laws
- Minimum wage laws
- Overtime laws
- Laws related to employee personnel and payroll records
- Payroll tax withholding laws[2]
- Worker's compensation laws

Under the Law, the AGO is authorized to impose both civil and criminal penalties for violations, and may seek enforcement against individuals as well as business entities. Individual violators may include corporate officers with management authority over affected workers. For purposes of investigation and potential enforcement, the AGO will consider the following factors as strong indicators of misclassification:

- Individuals providing services for an employer that are not reflected on the employer's business records;
- Individuals providing services who are paid "off the books," in cash, or provided no documentation reflecting payment;
- Insufficient or no workers' compensation coverage;
- Individuals providing services are not provided 1099s or W-2s by any entity;
- The contracting entity 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.

Avoiding these indicators should not be read as a "safe harbor," however; the AGO's announced intention seems to be to enforce the requirements of §148B even in the absence of these factors.

Significance

The 2004 amendments to §148B worked a major change in the definition of independent contractors for many state law purposes, and likely invalidate a vast number of relationships that Massachusetts businesses currently use, with varying degrees of legitimacy under the looser federal test. Enforcement over the last several years, however, has been relatively lax, or at least not well publicized. Whether the issuance of Advisory 2008/1 signals a new commitment by the Attorney General to enforcement of the amended statute remains to be seen, but should be taken as a strong suggestion that Massachusetts employers should review their independent contractor relationships to assess compliance with current requirements.

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[1] For purposes of income tax withholding, however, M.G.L. c. 62B provides a definition of employee that differs from the three-prong test in M.G.L. c. 149, s. 148B. Thus, treatment under the tax laws must be analyzed separately from the above.

[2] See footnote 1 above. The AGO's listing of tax withholding as affected by §148B thus seems to put it at odds with the Massachusetts Department of Revenue, which has issued guidance that it continues to apply its own statutory definition, which follows IRS guidelines, and does not consider the amended §148B relevant. *See* TIR 05-11 (September 13, 2005).

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