

ASK ALAN | BY ALAN FRIEDMAN

# Worker Status Laws, Pt 1

Like many others, the music retail industry has long favored treating certain workers as independent contractors. Years ago, music store operators saw the wisdom of integrating music education and repair services into their revenue-earning activities, yielding value-added and profitable revenues to the bottom line. Some of that profitability came from treating teachers and/or repair technicians as independent contractors instead of as employees. This classification allowed retailers to pay workers a gross compensation and escape the payroll tax, reporting, and employment benefits trappings associated with classifying workers as employees.

But over the years, both federal and state tax authorities have gotten wise to the billions of lost revenue dollars from not collecting employer-matched Social Security and Medicare tax, unemployment tax, and income tax on profits aggressively lowered by business deductions or not reported at all.

## THE NEW BOSS, SAME AS THE OLD BOSS

According to recent studies, the U.S. is made up of approximately 12.5 million independent contractors, who are typically defined as individuals who work with an organization but are not counted as employees. This classification prevents them from enjoying various employment benefits that permanent employees get, as well as protective employment laws for minimum wages, overtime, vacation and other benefits.

While most businesses do their best to be fair with all workers, business owners are keenly aware of the cost-saving exploitations they derive when working with independent contractors. But as many businesses are starting to find out, those cost savings could pale in comparison to a surprise labor audit assessment of back taxes, unpaid employment prerequisites (like health insurance and 401(k) contributions), punitive interest and heinous penalties if the audit reveals worker misclassification.

Accordingly, it is critical for business owners to correctly determine whether individuals providing them services are contractors or employees. Any worker deemed an employee should have all Social Security, Medicare and federal, state and city income taxes withheld from their paycheck and remitted to corresponding tax authorities by their employer. Additionally, employers need to pay all applicable

federal and state unemployment tax, non-discriminating employment benefits, and operate in compliance with all federal and state labor laws, including the U.S. Fair Labor Standards Act that establishes minimum wage, overtime pay, recordkeeping and youth employment standards for all employees.

While many business owners have grown tired of hearing about these ever-increasing stringent labor laws and audits, a recent edict on worker classification from the California State Supreme Court should have all business owners, whether California-based or not, shaking in their boots — and wallets.

## CALI DREAMING (OF NEW REVENUE)

In a unanimous decision hailed as a landmark move that will significantly change the workplace, a California Supreme Court ruling now makes it much harder for employers to classify their workers as independent contractors.

The new ruling means independent contractors now have a safeguard against exploitation with their employment rights protected by the new law. While there's still speculation regarding the overall application of the ruling, there's a renewed sense of stability in terms of pay scale, breaks and benefits an individual can expect when working with any given business. But the increased payroll cost of abiding by this new ruling may impair an employer's ability to



**Not abiding by worker status laws can mean hefty penalties**

hire and/or retain its workforce, causing an unexpected decrease in employment.

**"ABC" MAY MEAN "IOU"**

With the implementation of an "ABC Test," the California ruling addressed and revised the criteria for classifying a worker as an independent contractor:

**A.** If the employer can prove, without any doubt, they do not exercise control over the worker's ability to perform a certain task.

**B.** If the worker is performing a task or job that is outside the functions of the business in question.

**C.** If the worker has an established trade or a business they customarily engage in.

For example, if a music store engages a plumber to fix the

store's toilet, the plumber will most likely meet all of the ABC Test criteria and be considered an independent contractor. But if a music store offers music lessons and engages dedicated music teachers, that music teacher will probably be deemed an employee by failing test item B above. Under these new guidelines, employers need to pay close attention to ensure any worker classified as a contractor meets all three ABC requirements. Otherwise, these workers are eligible to be reclassified as permanent employees in audit with all associated costs.

Interestingly, the new ruling gives rise to difficult decisions for businesses such as Uber and Lyft who usually classify their drivers as independent contractors.

It's worth noting misclassifying

workers is a punishable offense and gives rise to potential claims of tax fraud by taxing authorities.

**MORE STATES TO FOLLOW**

With California's ruling following on the heels of a similar ruling by the New Jersey Supreme Court, as well as tough rulings already in force in Massachusetts and Illinois, more states are sure to follow.

The California ruling will undoubtedly motivate other states to start re-evaluating their current tests and introducing better (or more stringent revenue-generating) ones. The decision brings some long-awaited clarity as hundreds of previously filed labor cases relating to employee misclassification can finally be addressed

and handled in a judicious manner. But the great unknown is the ultimate financial cost to employers for future labor law compliance, and worse, the cost for not having adhered to previous rules after being discovered in future audits.

Music retailers should self-audit and re-examine their employment practices to understand these labor laws that can injure or destroy a business for non-compliance. Next month's Part 2 will deal with the current federal rules on worker classification and what to do in the event of a state labor audit. Stay tuned. **MI**

Alan Friedman, CPA, provides accounting and financial services to music industry clients. He is a frequent speaker at NAMM U seminars and can be reached at 860-677-9191 or alan@fkco.com. Visit his website, fkco.com.



**RATO**<sup>®</sup>  
BALANCED-GEAR TUNING TECHNOLOGY

Predictable.  
Precise Tuning.  
Every String.



**graph tech**<sup>®</sup>  
GUITAR LABS  
The Nut & Saddle Experts

WWW.GRAPHTECH.COM/MIDDLE

