



ARIZONA

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Dinita L. James, Editor
Gonzalez Saggio & Harlan LLP

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EMPLOYEE MISCLASSIFICATION

Labor shortage stymies new home building

by Dinita L. James

At the peak of the housing boom in June 2006, Arizona had 244,300 construction jobs. As of August 2013, the state had about half that number of construction jobs (125,200), according to the Arizona Office of Employment and Population Statistics. Yet by all accounts, new home business is booming, with limited inventories of new and existing homes available on the market and bidding wars erupting. So where are the construction jobs?

Legal disconnect

One reason for the data disconnect may be a shortage of legal skilled construction laborers in the state. Just drive around any residential area with new home construction going on, and you will spot painted plywood signs stating, "Framers wanted" and "Painters needed."

The ramp-up in new home construction in Arizona in the wake of the Great Recession happens to coincide with the U.S. Department of Labor's (DOL) multiyear misclassification initiative. Thanks to the initiative, the DOL's Wage and Hour Division (WHD) is not waiting around for employees to complain about their classification. Instead, the WHD is beginning directed investigations and targeting particular industries.

In the federal fiscal year that ended on September 30, 2013, the Phoenix district office of the WHD focused its investigative efforts on electrical subcontractors. Eric Murray, the WHD's Phoenix district director, reported that the majority of companies investigated were found to have violated misclassification laws. The violations included cash pay, workers not on the books, improper classification of workers as 1099 independent contractors, and partnership schemes in which wages were reported on federal K-1 tax forms.

Contractors and subcontractors that use misclassification tactics can gain a significant unfair competitive

advantage over law-abiding companies. Because they do not pay payroll taxes or workers' compensation premiums, sketchy contractors can underbid ethical contractors. That's why the DOL is investigating worker misclassification with such vigor. The DOL's crackdown is likely one reason for the labor shortage in Arizona's home building industry.

While employee misclassification can result in violations of many laws, one big risk for owners of small businesses is the prospect that they could be held personally liable for misclassified workers' unpaid wages under the federal Fair Labor Standards Act (FLSA). In cases in which a company is not financially strong enough to cover double its unpaid wage obligations, courts have allowed employees to file claims against business owners, officers, directors, and executives who have substantial control and authority over the business.

Educating contractors

The Arizona Registrar of Contractors (ROC) regulates residential and commercial contractors. Unlike the DOL, the ROC responds only to complaints. The ROC reports that since 2012, it has filed only one case against a new home builder for illegal hiring practices. Instead, the agency is focusing on educating contractors. This summer, for the first time ever, the ROC posted a policy statement and checklist on its website to help contractors determine whether they are complying with all applicable laws.

Policy Statement #102, issued May 15, 2013, makes it clear that licensed contractors are required by Arizona law to comply with Social Security, workers' comp, unemployment insurance, and income and withholding tax laws. The ROC's policy statement cites five provisions of the Arizona Revised Statutes, and employee misclassification violations could result in a contractor's license being suspended or revoked. The ROC has also



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noted that aiding and abetting an unlicensed contractor is a Class 1 misdemeanor.

The ROC's checklist identifies 16 "independent contractor/employee evaluation factors" to assist home builders in determining whether a particular person is an employee or an independent contractor. According to the ROC, the key is to look at the entire relationship and determine who has the right to direct and control the work.

Ramp up right

Ethical home builders surely welcome the enforcement and education efforts that state and federal regulators are undertaking. As Arizona's construction industry begins to rebound, now is the time for home builders to

review their employee classification practices. If you are a home builder, you cannot afford to be ignorant of your subcontractors' employee classification practices, either.

Some of the analysis can be difficult, and employers may need to seek legal counsel on the proper classification of workers. It may be that your company's long-standing practices won't withstand close scrutiny. As the economy gets back on track, now is the right time to make sure your employee classification practices are also on track. The risks of misclassification are higher than ever.

Dinita L. James, the partner in charge of the Phoenix office of Gonzalez Saggio & Harlan LLP, is the editor of Arizona Employment Law Letter. You can reach her at dinita_james@gshllp.com or 602-840-3301. ♣