Sonoma County Office of Education
Business Services

EXTERNAL PAYROLL AND FINANCE UPDATES
DBUG MEETING: JANUARY 22, 2019

REMINDERS

W2 and 1099 Common Errors:
Correct Classification of New Hires:
On April 30, 2018, the California Supreme Court established a stricter ABC test for employers to ensure employees are not misclassified as independent contractors. Please find attached, from CASBO’s 1099 workshop, a summary of the ABC test and its application. It is imperative LEAs correctly classify individuals.

It is recommended LEAs review all current independent contractor agreements now rather than at the end of the calendar year. The reasons being:

1. It is more difficult to correct pay history and collect both payroll taxes and applicable retirement from employees when not processed through payroll throughout the year.
2. Additionally, independent contractors likely will be caught off guard that they owe the LEA payroll taxes and applicable retirement.

OASDI and Section 218 Agreement:
LEAs are encouraged to familiarize themselves with and to review their existing Section 218 Agreement. It may be determine modifications need to be made to the existing Section 218 Agreement. For more information see DBUG Resources January 26, 2018, Business Update.

Please find attached a dated OASDI/Medicare qualification chart that still holds true. It is crucial Payroll Technicians set up employees payroll taxes in Escape correctly.
Examples of issues:

1. Certificated substitute who is a non-member of STRS should be set up for OASDI.
2. Certificated substitute who is a member of STRS should not be set up for OASDI.
3. Board Members elected after July 1, 1994 are required to be Medicare and OASDI covered.

Cash In-Lieu:
Cash in-lieu is a taxable fringe benefit regardless of whether the individual is a current employee or a retiree for which the cash in-lieu was part of a retirement incentive. Cash in-lieu compensation should run through payroll and all applicable payroll taxes apply.
California Supreme Court Changes the Standard for Determining Independent Contractor Status in California

The California Supreme Court issued a decision on April 30, 2018 in Dynamex Operations West Inc. v. Superior Court which significantly changed the standard for determining independent contractor versus employee status in California.

This new decision provides *strict and more limited rules* for determining worker classifications under California law than required through the Internal Revenue Service.

The California court ruling places the burden on the business *to prove* that a worker is an independent contractor rather than an employee, otherwise the worker will be presumed to be an employee.

Under the "ABC Test," the failure of a business to establish *any one* of three factors means that a worker will be determined to be an employee and not an independent contractor.

**A) The company must not be able to control or direct what the worker does, either by contract or in actual practice.** This is similar to the test used in the past. The control factor looks at whether the worker supplies his own tools and materials and how and when the work is done free of the control of the business hiring them.

**B) The worker must perform tasks outside of the hiring entity's usual course of business.** The Court gave the example of the application of this new test: A work at home seamstress hired by a clothing manufacturer to make dresses from cloth and patterns supplied by the company is an employee, as is a decorator contracted to regularly design cakes for a bakery. On the other hand, an outside plumber hired to fix a leak in its’ retail store on a one-time basis is an independent contractor. The plumber is not part of the store's usual course of business.

**C) The worker must be engaged in an independently established trade, occupation, or business.** The court will look at factors such as whether the business is incorporated or licensed, whether it’s advertised, and whether it offers services to the public or other potential customers.
California Penalties for Misclassification

California state law imposes tax penalties for misclassifying workers. These penalties include repayment of back payroll taxes, subject to interest and a 10% penalty on the unpaid taxes. Failure to withhold and pay California payroll taxes can also result in a fine up to $1,000 for a misdemeanor or sentence to jail for up to one year, or both.

IRS and State of California Audit Partnership

The IRS state partnering program, one of Governmental Liaison’s partnering components, facilitates and expands joint tax administration relationships between the IRS and state taxing authorities, such as departments of revenue and state workforce agencies.

IRS and state/local agencies share data with each other through a variety of ongoing initiatives. The information includes:

- Audit results
- Federal individual and business return information
- Employment tax information including worker classifications

California has a Memorandum of Understanding with the IRS that allows the IRS and California workforce agencies (EDD & FTB) to exchange audit reports and audit plans, and to participate in side-by-side examinations.

This agency partnership can increase your potential audit chances to be audited both on a federal and state level.
On April 30, 2018, the California Supreme Court issued a significant decision in the case of Dynamex Operations West, Inc. v. Superior Court. In Dynamex, the Court expressed concern that employers are misclassifying individuals as “independent contractors” in order to avoid paying employer taxes and/or avoid providing health care benefits. Given these concerns, the Supreme Court has now interpreted the term “employee” for use in certain California Industrial Welfare Commission (“IWC”) Wage Orders in a manner likely turning many “independent contractors” into “employees.”

Based on this change in the governing legal standards, Members are encouraged to review their independent contractor agreements, in keeping with the standards discussed below and the advice of their general counsels, to help ensure you are not misclassifying individuals as “independent contractors” when they should be considered your employees.

1. **Dynamex’s New Legal Test for an “Employee”**

For individuals covered by IWC Work Orders, the Court states that the term “employee” should now encompass all workers who “would ordinarily be viewed” as working in the employer’s business. Exception is made for individuals who have traditionally been viewed as “genuine independent contractors” and who customarily engage only in their own independent businesses. So, if an individual is performing tasks normally associated with a Member’s usual business operations (teaching, supervising, transporting, etc., in general or special education settings), subject to the additional provisions discussed in Section 2 below, the individual will be considered an “employee” unless the Member can prove all of these elements:

(A) that the individual is free from the control and direction of the Member in connection with the performance of his/her work, both under the contract terms and the actual nature of the performance of services;

(B) that the individual performs work that is outside the usual course of the Member’s business; and

(C) that the individual is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the Member.

It is important to note that this new rule does not apply to other areas like EDD or workers’ compensation, where existing and more limited definitions of "employee" still apply. As to civil wage and hour issues, the new rule might be best summarized this way: If the individual is performing a task or function normally performed by a Member’s employees, or is operating under the direct supervision and guidance of a Member’s employees, or does not regularly perform the same work or services through his/her separate business for other clients, the individual will likely be deemed your employee if an IWC Wage Order applies to him/her. As noted below, however, just because they might be considered an “employee” for certain purposes, that does not mean they are an “employee” for all purposes.

2. **The Applicability of Dynamex to Members/Public Agencies under the Governing Wage Orders**

Dynamex has received a great deal of media attention and concern, but its impact on public agencies is more limited than on private employers. While public agencies have long recognized their obligations under the federal Fair Labor Standards Act (“FLSA”), only limited attention has been given to the IWC Wage Orders because many of them expressly state that some or all of their provisions do not apply to state and local public agencies. In addition, to the extent the IWC Wage Orders do apply to Members, they have historically had limited actual relevance due to Education Code standards or collective bargaining agreements that provide the same or greater wage, hour, and workplace standards.

Given the holding in Dynamex, however, Members who have “independent contractors” performing services in the following areas, and for the following wage and hour topics, will now likely be governed by the Supreme Court’s new legal “employee” standard such that a review of their “independent contractor” status would seem appropriate:

- **Wage Order 4 - Professional, Technical, Clerical, Mechanical Occupations.** Most public employees (or independent contractors) fall within these provisions given their educational or professional roles. However, the only relevant provisions of Wage Order 4 are found in Sections 1 [Applicability], 2 [Definitions], 4 [Minimum Wage], 10 [Meals and Lodging], and 20 [Penalties], with the primary issues being overtime, exempt/nonexempt status, and “hours worked” for compensation purposes. Uniforms, equipment, meal and rest periods, reporting time pay, and seats are excluded from the applicability of Wage Order 4 to public agencies.
- **Wage Order 9 - Transportation Industry Professionals**, which includes individuals working for any "establishment" having a purpose of conveying persons or property from one place to another, as well as the warehousing, repair, storage, and maintenance of vehicles. This might include school bus/commercial van drivers and motor pool staff. In addition to the covered issues above under Wage Order 4, for commercial drivers, Wage Order 9 also includes Sections 11 [meal periods] and 12 [rest periods] standards.

- **Wage Order 15 - Household Occupations**, which include all services related to the care of persons or property within a private household, which might include in-home aides or assistants provided under an IEP if they are providing personal care or assistance. All Sections of this Wage Order apply.

- **Wage Order 17 - Miscellaneous**, which includes "any industry or occupation not covered by, and all employees not specifically exempted in, the Commission's wage orders in effect in 1997, or otherwise exempted by law...." All Sections of this Wage Order apply.

3. **A Few Examples of Still Viable “Independent Contractor” Relationships**
   The Supreme Court opinion notes that the new “employee” standard should not be applied to traditional “genuine independent contractor” relationships. This should be a key point in a review of existing “independent contractor” agreements to determine if an issue of misclassification exists, with a few guiding examples provided.

   - Attorneys, accountants, auditors, etc., are historic “independent contractors,” even if some school districts/COEs have brought such functions “in house.” If a Member does not ordinarily or historically hire employees to fulfill such functions, having them performed by “independent contractors” should present no legal concern unless the individuals (i) are not performing such services for other clients, or (ii) they are regularly conducting their services at the Member’s facilities and/or with the use of its equipment/systems.

   - One-time/short-term professionals should be of limited concern if they are called upon to address emergency or short-term projects, particularly if the Member does not have employees generally capable and licensed to perform such tasks (i.e., plumbers, electricians, specialty cabling, etc.).

   Areas of concern can include:

   - Teaching aides, psychologists, occupational and physical therapy aides who provide training or support (particularly to special education students). If their tasks or functions are generally provided in support of students, or in meeting the Member’s obligations to students under special education/IEP standards, there can be a concern with classification since such individuals are probably also required to be certificated, or be providing services under the supervision of a certificated employee. Exception would be if the “independent contractor” has (i) unique or special skills targeted for a specific student or a specific training/educational module, and (ii) these services are not generally available through full-time or regular employees,

4. **Consequences of Misclassification**
   If an independent contractor has been misclassified and a complaint is filed either with the Department of Labor Standards Employment or a civil court, the Member may face compensatory exposures (certain unpaid wages or benefits depending upon the Wage Order category into which the individual falls), as well as certain fines, penalties and potential attorney’s fees. Thus, the claims can involve significant financial exposure such that contract reviews may result in both sound risk management and prudent cost avoidance.

5. **Conclusion**
   Members use “independent contractors” in many areas. While the Supreme Court opinion has raised concern as to proper classification of individuals performing certain tasks or who only provide services to a single Member, the impact of Dynamex is somewhat limited given its application only to wage orders and exemptions for public agencies with respect to several of the more onerous IWC Wage Order obligations. Nevertheless, staff training regarding proper supervision and oversight of independent contractors is an important way to avoid misclassification disputes. Members should also conduct reviews of their independent contractor agreements to ensure that they have been properly drafted and applied to a given individual. Members may consider a rotating review process throughout the year (as the agreements come up for review/renewal), to help ensure proper classifications of individuals without imposing an unworkable, immediate review process. If a question as to proper classification arises during a preliminary review, the contract/situation can then be further evaluated (internally or externally) to help ensure compliance with this new and important legal standard.
## OASDI/MEDICARE QUALIFICATIONS
**EFFECTIVE JULY 1, 1991**

<table>
<thead>
<tr>
<th>EMPLOYEE TYPE</th>
<th>MEDICARE</th>
<th>OASDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>STRS Member - full or part-time <a href="#">certificated position</a> hired before 4/1/1986</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>STRS Member - full or part-time <a href="#">certificated position</a> hired after 3/31/1986 or who has elected into Medicare</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>STRS/PERS Member - full time in another district. Hired to work concurrently for your district</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>PERS Member - <a href="#">Classified Position</a> under a Section 218 Agreement</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>PERS Member - hired before 4/1/1986 and <a href="#">Classified Position</a> not under a Section 218 Agreement (Some COEs)</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>PERS Member - hired after 3/31/1986 and <a href="#">Classified Position</a> not under a Section 218 agreement (Some COEs)</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>Employee - non participant member of a district retirement plan</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Employee a Member of a district Alternative Retirement Plan, hired after 3/31/1986</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>STRS Retiree - rehired in a <a href="#">Certificated position</a> after 3/31/1986</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>STRS Retiree - rehired into a <a href="#">Classified position</a> (EC 45134)</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>PERS Retiree - rehired into a <a href="#">Classified position</a> after 3/31/1986</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>PERS Retiree - rehired into a <a href="#">Certificated position</a></td>
<td>YES</td>
<td>YES</td>
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</tbody>
</table>

*Note: Highlights are additions and changes I made for clarification.*