

Employment Law Update: Recent Case Law Supports Categorization of Workers as Employees

10/19/22

The New Jersey Department of Labor (“NJDOL”) uses the ABC test to determine whether a worker is an employee eligible to receive unemployment compensation benefits and for purposes of other wage and hour issues. The recent New Jersey Supreme Court case of *East Bay Drywall, LLC v. Department of Labor and Workforce Development* (“*East Bay Drywall*”) upheld the NJDOL’s decision that East Bay Drywall’s workers, categorized by East Bay Drywall as independent contractors, were actually employees of the company.

Why does it matter whether a worker is an employee or an independent contractor?

An independent contractor is responsible for payment of any taxes owed after he/she is paid by the business engaging the independent contractor for work. On the other hand, if a worker is categorized as an employee, the worker is paid by his/her employer, who is responsible for taking taxes out of the worker’s paycheck, including payroll taxes. Some workers and businesses prefer categorization as independent contractors because payroll taxes are not taken out of paychecks, and neither the worker nor the business is required to pay payroll taxes.

Another distinction between independent contractors and employees is that independent contractors are not eligible for unemployment insurance benefits, while employees are eligible for unemployment insurance benefits. Although independent contractors are not entitled to unemployment insurance benefits, they often apply for unemployment insurance benefits through the NJDOL when they are out of work. When this happens, an NJDOL audit is often triggered to determine whether the worker was properly categorized as an independent contractor and not entitled to unemployment benefits, or whether the worker is entitled to unemployment benefits because the worker should have been categorized as an employee. This is what happened in *East Bay Drywall*.

East Bay Drywall Mischaracterized Employees as Independent Contractors

The New Jersey Supreme Court in *East Bay Drywall* used the ABC test to analyze whether the workers hanging drywall for East Bay Drywall were independent contractors or employees. The ABC test presumes that a worker is an employee, unless all three prongs of the below test are satisfied by a worker:

- A. The worker has been and will be free from control or direction over the performance of work by the business enterprise;
- B. The worker does not perform the work in the place of business in which the work is usually performed by the business enterprise; and
- C. The individual is customarily engaged in an independently established trade, occupation, profession, or business.

The New Jersey Supreme Court stated that it was clear that many of East Bay Drywall’s workers did not meet prongs A. and B. Thus, the Court’s greatest concern in analyzing the facts centered on prong C. above. The

Court examined whether the workers' businesses, through which they were paid while incorporated and insured, were truly independent and established corporate entities that would qualify the workers as independent contractors. The Court emphasized that to have an independently established business, the business must be "stable and lasting" and not terminate once one business engagement ends. According to the Court, total dependence on one business entity for the entirety of a worker's income is the hallmark of an employee. Many of the independent contractors in *East Bay Drywall* consisted of only one worker and depended solely on East Bay Drywall for income. The Court held that these businesses assumed the appearance of an independent entity in name only. Therefore, the New Jersey Supreme Court upheld the NJDOL's decision to categorize the East Bay Drywall workers as employees.

The New Jersey Supreme Court also affirmed that East Bay Drywall owed thousands of dollars in unpaid unemployment and temporary disability contributions as a result of its mischaracterization of workers.

TAKEAWAY: Employers must ensure that they properly analyze their relationship with their workers in determining whether a worker is characterized as an independent contractor or an employee. If you need assistance determining whether a worker is an independent contractor or an employee or have questions on any other federal or New Jersey employment law, contact [Stephanie Gironda](#) or any member of the Wilentz [Employment Law](#) Team.

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