Legal-Related News

Affecting the construction industry

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You May Be Liable For Your Subcontractor's Workers Compensation Premiums

If your subcontractor does its books at the kitchen table rather than an IRS recognized place of business, the Washington Department of Labor and Industries (L&I) may be looking to you to pay your subcontractor's workers compensation ("WC") insurance premiums. In the recent Washington Court of Appeals decision, *Lee's Drywall Co., Inc. ("Lee's") v. L&I*, Lee's learned this lesson the hard way.

General contractors being liable for subcontractors' WC premiums is not a new concept. Before 1981, a contractor was directly and primarily liable for all subcontractors' premiums without exception. After that an exception was added to the statute, RCW 51.12.070, which allowed general contractors to escape liability under certain circumstances.

At the time applicable to the *Lee's* case (2003), a registered contractor was not responsible for a subcontractor's premiums if (1) the subcontractor was a registered contractor; (2) the subcontractor had "a principal place of business which would be eligible for a business deduction for internal revenue service tax purposes other than that furnished by the contractor for which the business has contracted to furnish services"; (3) "the subcontractor maintains a separate set of books or records that reflect all items of income and expenses of the business"; and (4) the subcontractor had been engaged to perform the work of a registered contractor. The statute was amended in 2004, to add a fifth requirement, that the subcontractor must have an industrial insurance account in good standing with L&I, or be a self-insurer.

Lee's subcontracted with Zagy's Drywall to perform drywall work. Lee's obtained proof that Zagy's was licensed, bonded, and insured. To its peril, Lee's did not determine whether Zagy's maintained either a principal place of business that would be eligible for a business deduction for IRS tax purposes or a set of books or records that reflected all items of income and expenses of the business.

Zagy's failed to pay its WC premiums for a portion of 2003 and was audited by L&I. Because Zagy's owner did his books and records on his kitchen table, the auditor concluded that the location did not qualify for an IRS business deduction. L&I assessed prime contractor liability under RCW 51.12.070 against Lee's to recover Zagy's unpaid premiums. Lee's resisted L&I's efforts to collect the premiums. Ultimately the Court determined that L&I had no obligation to collect the premiums from Zagy's before assessing them against Lee's.

Additionally the Court found Lee's had the burden of proving Zagy's met the statutory requirements to qualify for the statutory exception to the general contractor's liability. Lee's had maintained it only had to prove that Zagy's was truly an independent contractor with its own principal place of business. The Court unanimously disagreed.

In sum, according to the *Lee's* case, a contractor is directly and primarily liable for its subcontractors' WC premiums (for the project) unless it protects itself from liability by ensuring that its subcontractors meet all of the exception's requirements found in RCW 51.12.070(2). What efforts a general contractor must go through in order to verify its subcontractors meet the exception's requirements remain undefined (by the Courts).

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