ICRMA

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Workers' Compensation Requirements for Sole Proprietors

Training Question: Applicability for Husband-and-Wife Business Owners

During a recent Contractual Risk Transfer course, a participant raised an important question regarding workers' compensation requirements. Specifically, the inquiry was whether workers' compensation coverage is necessary for a husband and wife who jointly own their business and are providing services to a local agency.

Initial Consideration

At first glance, the instinctive response might be that workers' compensation is not required in this scenario since the business is operated as a sole proprietorship by the married couple.

Criteria for Determination

However, it is essential to apply a specific set of criteria to properly analyze the situation and make a final determination regarding the necessity of workers' compensation coverage for the business owners.

In California, whether your husband-and-wife owned company must carry workers' compensation insurance depends on how the business is organized and whether either of you are legally considered "employees." Here is a clear breakdown of the law:

General Rule

Under California Labor Code Section 3700, any employer with one or more employees must have workers' compensation insurance. This requirement applies regardless of the size of the company or how closely related the workers are (even family members).

Husband & Wife Only Working for Their Company

1. If the business has no employees other than you and your spouse and neither of you are legally treated as employees:
In many cases, workers' compensation insurance is not strictly required if no one is an employee. For example:
   - Sole proprietorships: the owner does not have to carry workers' comp for themselves.
   - General partnerships: partners generally are not considered employees of the partnership for workers' comp and therefore may not need a policy if both owners are partners and no other employees exist. Several legal sources indicate that sole owners/partners can choose not to carry coverage for themselves.

2. If your company is a corporation (e.g., an S-corp or C-corp) or an LLC where members are treated as employees:
   - California considers corporate officers and LLC members "employees" unless they elect to exclude themselves.
   - However, there is a narrow statutory exemption — under Labor Code Section 3352, certain owners (such as corporate officers or LLC members) who own enough of the business and meet specific requirements can elect in writing to be excluded from workers' compensation coverage.
   - If neither of you will be treated as employees (or you timely sign the proper exclusion/waiver), you may not have to carry a policy.

Key Points That Matter

- Who counts as an "employee"? California law treats family members (including spouses) as employees if they perform work and are treated as employees under your business structure — e.g., if they receive W-2 wages.
- Structure matters:
  - Partnership with two partners who do all the work: generally, no insurance obligation for partners themselves.
  - Corporation or LLC where members/officers work and get paid: you often must carry workers' comp unless you file an exclusion/waiver with your insurer.
- Hiring even one other employee (non-owner): insurance becomes mandatory.

Risks of Not Carrying Insurance

If you are legally an employer and do not carry workers' compensation:

- The state can issue fines and stop-work orders.
- You could face civil penalties and criminal charges.
- You may be personally liable for medical costs if someone is injured.

If you truly have no employees other than the two of you and you structure the business so that neither of you is legally an employee (e.g., a partnership or you file the proper exclusion in a corporation/LLC), workers' compensation insurance is generally not required for you. Suppose you are treated as employees (e.g., both spouses on payroll) and have no valid exclusion/waiver; then California law would require you to carry workers' compensation coverage.

Because this topic depends heavily on the business entity type and how the owners are classified.

Potential consequences for the local agency could be:

Loss of Contractual Risk Protection

Most local agency vendor agreements require vendors to carry workers' compensation insurance as an insurance condition of the contract. If the vendor does not have the coverage:

- The local agency may lose coverage protections that would otherwise shield it from claims arising out of the vendor's work.
- The local agency could be forced to defend or indemnify against claims that would have been covered by the vendor's policy, especially if insurance were contractually required but not obtained.
- Contract terms that require vendors to maintain coverage are part of the local agency's risk-management strategy; failure to enforce them undermines those protections.

Potential Liability Through "Joint Employer" / Labor Laws

While general workers' compensation law places obligations on the direct employer, other California labor laws can extend liability to entities that use labor supplied by vendors in certain circumstances:

- Client employer or joint liability rules (e.g., under Labor Code §2810.3) can make a business jointly liable with a labor contractor for wage-and-hour violations and failure to provide workers' compensation if labor is supplied to the client and the client exercises

significant control over the work. Although some exceptions apply, this illustrates that liability exposure is not always confined to the direct employer.

This is more common in wage/hour claims but underscores how California law can extend liability when an organization contracts with a vendor and then effectively controls aspects of the work.

Claims Against the Local Agency Under California Government Code

Public entities are generally protected by governmental immunities (e.g., California's Tort Claims Act). However, immunity is not absolute. There are exceptions where a governmental entity can be held liable for personal injuries arising from:

- Negligent acts of independent contractors (if certain conditions are met), or
- Failure to perform a statutory duty, including compliance with legal requirements in engaging contractors.

This means that if the local agency knew (or should have known) a vendor lacked required workers' compensation coverage and that lack contributed to an injury or loss, there could be grounds for a claim against the local agency — at least to the extent immunity exceptions apply. The specifics depend heavily on facts and legal interpretation in individual cases.

Best Practices

To minimize exposure, local agencies typically:

- Require proof of workers' compensation insurance (or a valid exemption) before awarding a contract.
- Include contractual indemnity and insurance requirements that shift risk back to the vendor.
- Verify coverage periodically and enforce contract terms strictly.

Failing to obtain and verify this coverage for a vendor does not automatically make the local agency the "employer," but it can erode contractual defenses, expose the local agency to statutory claim exceptions, and potentially lead to joint or derivative liability under related labor laws.

Contacting ICRMA for Support

If, at any point during the contract review process, you are unsure about the terms or have questions regarding risk management, it is important to reach out for assistance. In situations where there is uncertainty, contact ICRMA for guidance and support. ICRMA can provide valuable insight and help ensure that the contract terms align with the city's risk management policies. Seeking assistance before signing any agreement can prevent costly mistakes and ensure that risks are effectively managed. Director of Loss Control Bob May. Biem47@outlook.com