

ClearPath Case Study

Hot Young Fashion House Makes the Ultimate Employment Faux Pas



How a hot, young fashion house based in California went from appearing in all the latest magazines to appearing before the Employment Development Department and owing over \$100,000.

The buzz in the office was undeniable.

As a young fashion brand, seeing photos of stars such as Heidi Klum and Chrissy Teigen wearing your designs was almost too good to be true. The years of hard work, of wanting to see your work in fashion magazines, and the endless investment of building a business with the love of your life, were finally paying off. With all the media attention, the small team at the fashion house were already anticipating the orders that would start pouring in. And that meant growing the team to accommodate demand.

About the company

The GIA Collection designs, manufactures, and distributes quality leather accessories. Owned and operated by Gia, head designer, and Austin, her husband, The GIA Collection is as much a labor of love as it is a business. The



accessories designed by the brand are carried in thousands of stores across the world and have been worn by many of today's leading celebrities. With the focus on quality craftsmanship, and using only the finest of materials, GIA is committed to manufacturing products of value and taste. From inception in 2004, GIA has been a family company, built on love, trust, and reliability.

Hiring without a plan

With barely a thought to hiring procedures or what forms or contracts needed to be filled out, Austin quickly put out the word to friends and family that he would be adding at least a dozen more people to the team at The GIA Collection, as a result of the media exposure. The celebrity photos had already started the phones ringing and GIA needed a team of people in place, as soon as possible, to start fulfilling orders. With fluctuating demand, and the unpredictability of the fashion industry in general, GIA is a company that often adds or takes away part of its labor force at various times of the year. As part of a large family, Austin had always relied on immediate and extended members of that family to come to his aid, so he had a large support system.

“Orders were going out, business was good, and more and more people in the fashion industry were talking about GIA. My wife was busy designing, I was busy doing the paperwork on the orders coming in and dealing with suppliers, and our workers were doing what we had hired them to do. It turned out that there was one area of the business that was being neglected.”



What went wrong?

In the hiring frenzy, essential employment paperwork and documentation had been missed. None of the workers had contracts and none had been confirmed as contractors, even though many, if not all the people hired, were doing full-time work. Specifically, the problems for GIA began when one of the workers left the fashion brand and filed an unemployment claim early in 2016. Since unemployment insurance only applies to actual employees, a red flag was raised at the Employment Development Department (EDD).

When asked for prior employer information, the former fashion house worker was asked a variety of questions that led the EDD right to the front door of The GIA Collection. This one episode with the sole worker led the EDD to conduct a full audit of GIA and all former workers. Letters from the EDD were issued to set up interviews via telephone.

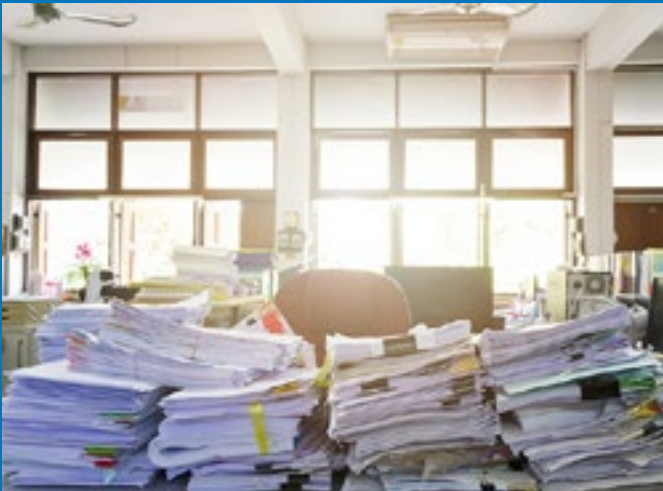
WHO IS THE EDD?

The Employment Development Department (EDD) is part of the Labor and Workforce Development Agency of the executive branch of the State of California. EDD offers a variety of services to millions of Californians under the Job Service, Unemployment Insurance, Disability Insurance, Workforce Investment, and Labor Market Information programs. As California's largest tax collection agency, EDD also handles the audit and collection of payroll taxes and maintains employment records for more than 17 million California workers.

Documentation requested by the EDD

The EDD requested the following information from The GIA Collection during the audit:

- Loans to Shareholders
- Payroll records
- W-2 forms filed
- Vendor list
- Accounts Payable payment records
- 1099 forms filed
- Contracts with Independent Contractors
- Invoices from Independent Contractors



“ Our family and friends were so frightened. The EDD was calling everyone and asking for documentation that no one had. I could barely sleep during this time, yet I had a business to run. How was I supposed to juggle all of these balls at once? ”

Austin and Gia were extremely shaken by the audit with the EDD. Their family and friends were being contacted and everyone wondered what kind of trouble they were in. No one fully understood what was happening, how it had happened, and what the future would hold after the audit. Because of the confusion, GIA was not able to produce a lot of the documentation requested by the EDD and, therefore, lost the case.

How much did the audit cost financially?

Personal Income Tax	\$50K*
Penalties & interest.....	\$20K
Legal Fees	\$10K
Employer Taxes	\$20K

Total Monetary cost \$100K

Emotional toll **Immeasurable**

* The employer is responsible for the worker's uncollected personal income taxes until it is proven that the worker paid their own taxes.

DID YOU KNOW?

The EDD publishes current year fraud convictions detected by the EDD and prosecuted on their website. Your company name, the amount you owed to the EDD, and other personal details are all made publicly available. Is this the kind of information you want a search engine to pull up when someone searches your business name?

What did the audit cost GIA – beyond dollars?

The EDD audit cost The GIA Collection almost two years, from the time of the first communication to today, and they continue to recover from the audit, the loss of trust with their family and friends, and the mental anguish. The reputation of the brand suffered while Austin and Gia both had their focus turned from fashion design to business.

Conclusion

Today, there is less buzz around The GIA Collection offices. Austin and Gia are still hard at work, designing and building their business, but are also focused on spreading awareness about the risk of non-compliance. The couple are not yet clear of the risks associated with non-compliance because, as in many other states, the EDD signed a Memorandum of Understanding with the IRS, meaning that the information collected during this time will be shared by the state agency with the federal agency, leaving the future open to an audit with the IRS as well.

“ It’s not that we didn’t care about our business and our workers. It’s that we didn’t have the knowledge or the time to devote to the issue of employment compliance. So, our warning to other businesses is to make time. And if you cannot make time in your own schedule, please hire a company like ClearPath. ”



In the long run, it pays to routinely re-evaluate how you classify your workers and determine if you are indeed reporting and paying the correct amounts of payroll taxes. Your business may be at risk if you misclassify a worker. Learn more about [how to protect your business](#) through the correct classification of workers.

RISK CALCULATOR

What's your potential cost for non-compliant 1099s?

The financial risks from Independent Contractors being reclassified include back-tax assessments, fines, and penalties. [CLICK HERE to use this calculator](#) to assess your potential exposure from worker misclassification.

Names have been changed to protect the identities of both the persons and businesses named in this case study.