HB 1590

Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

House Bill 1590 (Chair, Economic Matters Committee) (By Request – Departmental – Labor, Licensing, and Regulation)

Economic Matters

Employer Misclassification of Employees as Independent Contractors

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This departmental bill prohibits employers from failing to properly classify an individual as an employee, establishes investigation and notification procedures, and establishes penalties for noncompliance.

Fiscal Summary

State Effect: General fund revenues could increase by $2.4 million in FY 2009 only as a result of penalties assessed on noncompliant construction-related employers. Future year revenues reflect annualization and progressive compliance among employers. Potential additional revenues could accrue to the Special Administrative Expense Fund and the Uninsured Employers' Fund, with a potential marginal impact on tax revenues.

Department of Labor, Licensing, and Regulation general fund expenditures could increase by $595,700 in FY 2009 and Workers' Compensation Commission special fund expenditures could increase by $192,300 for investigative staff to administer and enforce the requirements of the bill. Future years reflect inflation and annualization.

(in dollars)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	$2,375,200	$4,750,400	$4,037,800	$3,432,100	$2,917,300
SF Revenue	-	-	-	-	-
GF Expenditure	595,700	765,800	802,900	841,900	883,100
SF Expenditure	192,300	245,000	256,900	269,400	282,700
Net Effect	$1,587,200	$3,739,600	$2,978,000	$2,320,800	$1,751,500

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Potential minimal increase in local income tax revenues.

Small Business Effect: DLLR has determined that this bill has minimal or no impact on small business (attached). Legislative Services disagrees with this assessment as discussed below.

Analysis

Bill Summary: The bill provides for additional damages and/or civil penalties for misclassification of employees as it relates to employment of minors, wage and hour law, wage payment and collection, prevailing wage, and living wage requirements. For purposes of enforcement, the bill creates a presumption of an employer-employee relationship unless the employer can demonstrate otherwise.

The Commissioner of Labor and Industry is authorized to investigate a complaint on his/her own initiative, on receipt of a written complaint, or on referral from another unit of State government. The commissioner may enter a place of business to observe work being performed, interview employees and contractors, and review records as part of this investigation. The commissioner may issue a subpoena for testimony and production of records. All required records must be kept by the employer for a period of three years. An employer that fails to produce records within five business days of the commissioner's request is subject to a fine of up to $500 per day. If denied access to a place of business, the commissioner may apply for an administrative search warrant.

The commissioner must issue a citation to an employer that fails to properly classify employees. The commissioner is required to send the employer notice of the violation and the amount of the penalty. If a hearing is not requested within 15 days of the notice, the violation and penalties are considered the final order of the commissioner. Hearings may be delegated to the Office of Administrative Hearings for a proposed decision, which is then affirmed or reversed by the commissioner.

After investigation, the commissioner may assess a civil penalty of $3,000 for each employee who is misclassified and order the employer to pay restitution to each affected employee. The civil penalty may be doubled if the commissioner determines that the employer willfully or repeatedly misclassified an employee. Penalties extend to successor corporations. A misclassified employee is also authorized to bring a civil action against the employer within three years of the violation; the court is authorized to award each individual up to three times any wages due, reasonable counsel fees, and other costs of the action.

The commissioner is required to notify the Office of Unemployment Insurance, the Workers' Compensation Commission, and the Comptroller on the issuance of a citation.

Other State agencies are required to share information concerning any misclassification of employees.

An employer may not take action against an employee for bringing an action against the company; likewise, employees are prohibited from making a complaint in bad faith. The commissioner is authorized to investigate upon a complaint that an employer took retaliatory action against an employee; the commissioner may file a complaint in circuit court to enjoin the violation, reinstate the employee, or take other appropriate action.

If an employer engaged in work with a public body fails to properly classify an employee, the public body is required to withhold from payment an amount sufficient to pay each employee the full amount of wages due; pay any benefits, taxes, or other required contributions; and satisfy a liability for any civil penalties owed. The commissioner must file with specified agencies a list of the employers who repeatedly misclassify employees. A listed employer is prohibited from entering into a contract with a public body for two years from the date of placement on the list.

A person or employer that attempts to evade classification requirements is subject to a civil penalty of up to $20,000. All civil penalties collected by the commissioner are payable to the general fund.

Unemployment Insurance

If the Secretary of Labor, Licensing, and Regulation determines that an employer has misclassified an employee as an independent contractor, any unpaid contribution or reimbursement payments accrue interest at a rate of 2% per month. If the Secretary determines that an employer knowingly misclassified employees, the employer is subject to a civil penalty of up to $3,000 per employee. An individual who advises an employer to misclassify employees is subject to a civil penalty of up to $5,000. These penalties and any interest accrue to the Special Administrative Expense Fund.

Workers' Compensation

The Workers' Compensation Commission has the power to conduct investigations, inspect a place of business, examine records, administer oaths, issue subpoenas, issue penalty assessment orders, levy and pursue actions, and seek injunctions to enforce classification requirements for employers.

If the commission determines that an employer misclassified an employee as an independent contractor or understated payroll, the commission must order the employer to secure compensation for the covered employee, assess a civil penalty of up to $5,000, notify specified agencies, and order the employer to pay the full amount of premiums due to the insurer plus interest. An employer who knowingly misclassifies an employee is subject to a civil penalty of up to $10,000, rather than $5,000.

The commission may assess interest on any unpaid civil penalty, assess a penalty of $5,000 for each misclassified employee, bring an action in circuit court, and notify the employer that the license to do business in the State may be suspended. The circuit court must award costs, including the reasonable costs of investigation and reasonable attorney's fees to the commission if it prevails in an action. Any civil penalties or interest assessed or recovered must be paid to the Uninsured Employers' Fund.

The commission must file with specified agencies a list of the employers that repeatedly misclassify employees. A listed employer is prohibited from entering into a contract with a public body for two years from the date of placement on the listing.

Other Provisions

Beginning in fiscal 2010, the Governor is required to include funds necessary for the effective administration and enforcement of classification requirements.

The Commissioner of Labor and Industry is required to report to the General Assembly on enforcement of classification requirements and recommend improvements to administration or enforcement activities.

Current Law: Maryland employment and procurement law establishes standards employers must follow in providing payment and adequate rates of compensation for employees. Additional insurance requirements provide wage protection for individuals who are injured or laid off in the course of their employment. Other federal and State laws additionally provide family and medical leave, collective bargaining protections, and occupational safety standards that apply exclusively to employees.

Prevailing Wage

The federal Davis-Bacon Act provides the foundation for state prevailing wage laws requiring workers performing a specific job to be paid an hourly wage consistent with the industry standard in a geographic area. The primary purpose of the laws is to stabilize wages by preventing employers from paying less than the rate commonly paid to workers performing comparable work in the region. The laws are also intended to prevent contractors from importing workers from lower-wage areas to undercut local bidders for government contracts.

Maryland Prevailing Wage Law extends to any public works contract in excess of $0.5 million with construction costs that are more than 50% State financed. Wage determinations issued for each construction project specify the wage and benefit rate for each classification of worker for the given type of construction. Each determination is made specific to the jurisdiction in which the project is located and is effective for a period of one year.

Wage Payment and Collection

Maryland Wage Payment and Collection Law regulates the payment of wages by State employers. The law requires employers to • pay workers the wage promised; • establish regular paydays; • pay wages when due; • pay employees in a specified manner; • pay employees at least once every two weeks, with exceptions; • furnish employees with a statement of gross earnings; • advise employees of their rate of pay and designated payday; and • pay an employee all wages due on termination of employment.

Insurance Requirements

All employers in Maryland are required to provide workers' compensation coverage for their employees. An employer, or their insurer, is required to compensate covered employees upon a determination that an accidental personal injury suffered by an employee was the result of his or her employment.

Employers are further required to meet federal and State unemployment insurance requirements for their employees. All private business employers and nonprofit organizations employing one or more persons are subject to Maryland Unemployment Insurance Law, with employer contributions generally based on taxable wages for covered employment.

Background: A May 2007 report by the U.S. Government Accountability Office found that in 2005 there were 10.3 million independent contractors working nationwide in industries that include construction, cleaning and janitorial services, food service, landscaping, and agriculture. Independent contractors in these industries often work on a contingent basis to provide extra coverage to an employer on a temporary or part-time basis. Independent contractors do not generally have access to employer-based health insurance coverage and pension programs and are not covered by workers' compensation and unemployment insurance. Other protections, such as employee safety requirements, minimum wage and overtime compensation, and anti-discrimination protections, are generally unavailable to these contractors.

An employer may intentionally misclassify an employee to avoid paying the wages and benefits generally due to its regular, full-time employees. This practice reduces the employer's costs by reducing the amount of compensation available to the employee and circumventing federal and state tax and withholding requirements. The Internal Revenue Service last estimated that 15% of employers had improperly classified one or more of their employees, resulting in a loss of $1.6 billion in Social Security, unemployment, and income tax revenues in 1984. GAO estimated that the loss in inflation-adjusted 2006 dollars is $2.7 billion. The IRS has developed a memorandum of understanding to prevent questionable employment tax practices and improve information-sharing among states and the federal government; as of November 2007, 29 states, not including Maryland, had signed the agreement.

There is no single, recognized standard for determining whether a worker should be properly considered as an employee or an independent contractor. Courts have generally used one of two tests to determine whether an employee is properly classified. An economic realities test attempts to determine whether the worker financially depends on the company or whether the worker is self-employed. A common law test attempts to determine the degree of control the contractor has over the end work product. Other considerations may include which party owns the tools or equipment used in performing the job, the worker's skill level, and the duration of the contract.

State Revenues: Under the bill's penalty provisions, DLLR's Division of Labor and Industry could generate almost $2.4 million in general fund revenues in fiscal 2009. Once fully operational, the misclassification unit could generate about $4.8 million in fiscal 2010, with incremental reductions each year based on anticipated improved compliance.

DLLR advises that there are 2,466 construction sites active in the State. The IRS has estimated that 15% of employers have misclassified one or more employees. Applying this percentage to the State's construction sites, violations would be expected at approximately 370 sites statewide, with DLLR estimating an average of six violations per site based on the number of trades operating on a typical construction project. The focus on the construction industry reflects the experience of DLLR in enforcing existing prevailing wage provisions in this sector. Studies of misclassification have shown a predominance of these practices among construction industry employers. Although construction sites would be the primary focus of investigation, the unit would be authorized to investigate employers in other sectors that may be engaged in misclassification. Expanding the focus of the unit could increase revenues, but would likely require significant additional staff to implement.

In the first full year of enforcement activity, the bill could generate as much as $4.8 million in general fund revenues, primarily from construction industry employers. First-year start-up delays in fiscal 2009 would likely reduce that amount by at least half, producing an estimated $2.4 million in fiscal 2009. With progressive rates of compliance, penalty revenues could decrease by a conservative estimate of 15% per year; DLLR advises that annual revenue reductions could be as much as 20% per year once fully implemented. These revenues accrue to the general fund.

In addition to these general fund revenues, the Special Administrative Expense Fund and the Uninsured Employers' Fund could experience additional revenues as a result of the bill. Any civil penalties or interest received by the Office of Unemployment Insurance would be deposited into the Special Administrative Expense Fund. The amount of additional interest is estimated at $21,600 per year under the bill. Any civil penalties or interest recovered by the Workers' Compensation Commission as a result of its enforcement activity is paid to the Uninsured Employers' Fund. The total amount of special fund penalty revenues generated under these provisions cannot be reliably estimated at this time.

In addition to the penalty revenue, the Comptroller could realize additional income tax revenue as a result of the bill; however, the new requirements would likely affect the timing of tax payments more than the amount. The Comptroller's Office advises that much of the revenue from withholding would have otherwise been collected through estimated and final tax payments from workers classified as independent contractors. If additional workers are classified as employees, more tax payments would be generated through employer withholding rather than estimated taxes. Increases in total tax revenue are expected to be marginal.

State Expenditures: The Division of Labor and Industry estimates that it would require 13 staff to comply with the requirements of the bill, with 6 investigators assigned to the field and 7 staff assigned to the office to handle administrative workload. Investigators would focus on the estimated 2,466 construction sites as well as employment sites in other industries in which misclassification is suspected. Administrative staff would assist in meeting the other requirements of the bill, including inspection tracking and scheduling, database development, hearing and court appearances, and production of documents.

Given these staffing levels, general fund expenditures by the Division of Labor and Industry could increase by an estimated $595,719 in fiscal 2009, which accounts for the bill's October 1, 2008 effective date for active enforcement activities. This estimate reflects the cost of hiring six fraud investigators, three data entry specialists, three administrative and program personnel, and one assistant Attorney General.

In addition to these personnel and expenditures, the Workers' Compensation Commission could experience additional expenses to fulfill investigative and administrative requirements. The bill authorizes the commission to conduct investigations, examine records, issue penalty orders, and perform other enforcement and regulatory duties. Although the Division of Labor and Industry would likely take the lead on these actions, the Workers' Compensation Commission would require a minimum level of staff to meet statutory requirements. Special fund expenditures could increase by an estimated $192,250 in fiscal 2009. This estimate reflects the cost of hiring two fraud investigators and two administrative and program personnel.

In total, fiscal 2009 general and special fund expenditures could total $787,969 in fiscal 2009. This estimate includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses as shown below.

Positions	17
Salaries and Fringe Benefits	$677,587
Mileage and Other Travel Expenses	24,655
Computers and Office Equipment	37,800
Other Operating Expenses	47,927
Total FY 2009 State Expenditures	**$787,969**

Future year expenditures reflect • full salaries with 4.4% annual increases and 3% employee turnover; and • 2% annual increases in ongoing operating expenses.

Other State agencies could also be impacted by this bill. The commissioner is required to file certain reports with the Secretary of State, Department of Budget and Management, and Department of General Services, which would be required to track this information with State contracting and procurement decisions. The Office of Administrative Hearings could also experience increases in workload to adjudicate contested administrative penalties.

Local Fiscal Effect: Local tax revenue could also increase marginally with increased compliance with classification requirements.

Small Business Effect: Expenditures could increase for small business to comply with recordkeeping requirements. In addition, the bill could increase the relative competitiveness of employers that currently comply with classification requirements, while increasing expenditures among those small businesses that do not properly classify employees. Small businesses that violate classification requirements would be barred from contracts with public bodies for two years.

Additional Information

Prior Introductions: A similar bill was introduced as HB 12 during the 2007 special session but was not referred to committee.

Cross File: None.

Information Source(s): Secretary of State; Workers' Compensation Commission; Injured Workers' Insurance Fund; Governor's Office; Department of Labor, Licensing, and Regulation; Department of Budget and Management; Department of Legislative Services

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