SB 600

Department of Legislative Services

Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

Senate Bill 600 (Senator Young, *et al.*)
Finance

Business Regulation - Independent Contractor Registry - Presumptions Under Workplace Fraud Act

This bill requires the Department of Labor, Licensing, and Regulation (DLLR) to develop and maintain a registry of independent contractors in the construction and landscaping industries. Individuals on the registry are exempt from the presumption under the Workplace Fraud Act of 2009 that they are employees of the persons for whom they perform work. If an employer seeks and obtains evidence that an individual is on the registry, that fact must be considered strongly by DLLR in determining whether the employer knowingly misclassified an employee as an independent contractor. DLLR is required to develop regulations to implement the bill's requirements.

Fiscal Summary

State Effect: Special fund expenditures by DLLR increase on a one-time basis by $270,000 in FY 2013 to develop the required registry and associated regulations. Ongoing maintenance of the registry can be carried out with existing budgeted resources, which are assumed to be reallocated from conducting employer audits to verifying the eligibility of prospective independent contractors for inclusion in the registry. No effect on revenues.

Local Effect: None.

Small Business Effect: Meaningful for small businesses in the construction and landscaping industries.

Analysis

Current Law: Chapter 188 of 2009 establishes, for the purpose of enforcement only, a presumption that work performed by an individual paid by an employer creates an employer-employee relationship, subject to specified exemptions. It prohibits construction companies and landscaping businesses from failing to properly classify an individual as an employee, and establishes investigation procedures and penalties for noncompliance.

An employer in an affected industry misclassifies an employee when an employer-employee relationship exists, but the employer has not classified the individual as an employee. An employer-employee relationship exists in an affected industry unless an employer can demonstrate that a worker is an exempt person, or independent contractor, as defined in the statute and subject to clarifying regulations issued by the Commissioner of Labor and Industry.

The "ABC test" incorporated in the Act is used by DLLR to establish whether an employer-employee relationship exists for the purpose of determining whether an employee has been misclassified under the Act. The test has three components, all of which must be met to establish that an individual is an independent contractor:

A. the individual is free from control and direction over his or her performance both in fact and under the contract (Alone);
B. the individual customarily is engaged in an independent business or occupation (Business); and
C. the work performed is outside the usual course of business, or outside the place of business, of the person for whom work is performed (Control).

The Act distinguishes between an employer who *improperly* misclassifies an employee and an employer who *knowingly* misclassifies an employee, and penalties are more severe for an employer who is guilty of knowingly misclassifying an employee.

An employer found to have *improperly* misclassified an employee must, within 45 days, pay restitution to any employee not properly classified and come into compliance with all applicable labor laws. An employer is subject to a civil penalty of up to $1,000 for each employee not in compliance, but the Commissioner of Labor and Industry cannot penalize employers who conform to applicable labor laws within 45 days. Penalties extend to successor corporations.

An employer is guilty of *knowingly* misclassifying an employee if the employer misclassifies the individual with actual knowledge, deliberate ignorance, or reckless disregard for the truth. For a knowing violation, an employer is subject to a civil penalty

of up to $5,000 per misclassified employee, regardless of whether the employer enters into compliance within 45 days. Penalties extend to successor corporations if they have one or more of the same principals or officers as the employer against whom the penalty was assessed, unless those individuals did not, or with the exercise of reasonable diligence, could not know of the violation for which the penalty was imposed. Penalties can be doubled for employers who have previously violated these provisions. An employer who has been found to have knowingly misclassified employees on three or more occasions may be assessed an administrative penalty of up to $20,000 for each misclassified employee.

The Commissioner of Labor and Industry must investigate the two specified industries as necessary to determine compliance. Investigation of a misclassification complaint may be on the commissioner's 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 or work site 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 15 business days after the commissioner's request is subject to a fine of up to $500 per day. If an individual fails to comply with a subpoena, the commissioner may file a complaint in circuit court requesting an order directing compliance.

Under circumstances delineated in statute, criminal penalties may also apply to employers who misclassify employees.

Background: DLLR advises that misclassification leaves many Maryland workers without access to workers' compensation or unemployment insurance benefits in the event that they are injured or laid off. DLLR also estimates that misclassification results in almost $22 million in underpayment to the Unemployment Insurance Trust Fund, and potentially underpayment of State income taxes.

As of December 2011, DLLR's Task Force on Workplace Fraud had conducted 660 investigations under the Workplace Fraud Act, and issued 12 citations, which translates into a 98% compliance rate. The task force collected $33,000 in civil fines from employers for failing to provide employment records in a timely fashion, but has not assessed fines for misclassification because the cited employers have either come into compliance or have their cases still pending. In addition, audits conducted by the Division of Unemployment Insurance have resulted in more than $600,000 paid into the trust fund. DLLR advises that these funds represent employer compliance going forward; to date, DLLR has not attempted to collect retroactive payments for misclassified employees.

State Fiscal Effect: Funding for the Workplace Fraud unit within DLLR is provided by the Workers' Compensation Commission. The unit consists of 10 full-time staff, including an assistant Attorney General, four fraud investigators, and two auditors. Much of their effort has been devoted to conducting audits of employer records in the construction and landscaping industries to determine if individuals who work for the employers are being correctly classified. Under the bill, Legislative Services assumes that the time consumed by such audits would diminish greatly because they would consist largely of matching employer records with independent contractor names on the registry. However, it is assumed that resources previously devoted to auditing employer records would be shifted to confirming and verifying information provided by individuals seeking to be registered as independent contractors to ensure that they met the criteria established in statute and regulation.

Legislative Services estimates the cost of contracting with an information technology consultant to develop the registry is approximately $250,000. Ongoing maintenance of the registry, as well as verification of information provided by actual and prospective registrants, could be conducted with existing resources of the Workplace Fraud Unit. In addition, DLLR would need to retain an employment attorney on a one-time basis to consult on the development of regulations regarding eligibility for the registry. The one-time cost for the consulting attorney is estimated to be $20,000. Because no provision is made for the collection of registration fees for independent contractors, it is assumed that these funds are special funds from the Workers' Compensation Commission, which funds the Workplace Fraud Unit.

Small Business Effect: Although small businesses in the construction and landscaping businesses would still be required to correctly classify their employees and independent contractors, most of the burden for demonstrating compliance with the Workplace Fraud Act would shift from the employers to the independent contractors. Independent contractors would have to demonstrate that they meet the criteria for inclusion in the registry, and then employers simply have to show that they hire only independent contractors on the registry.

Additional Information

Prior Introductions: None.

Cross File: HB 734 (Delegate Schulz, *et al.*) - Economic Matters.

Information Source(s): Department of Labor, Licensing, and Regulation; Department of Legislative Services

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