

Department of Legislative Services  
Maryland General Assembly  
2012 Session

FISCAL AND POLICY NOTE  
Revised

House Bill 1364  
Economic Matters

(Delegate Schulz, *et al.*)

Finance

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Labor and Employment - Workplace Fraud Act - Revisions

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This bill exempts specified employers from the presumption under the Workplace Fraud Act that an employer-employee relationship exists between the employer and an individual doing work for the employer if the employer presents specified documentation. It further establishes procedures and timetables for enforcement activities and resolution of disputes under the Act.

The bill takes effect July 1, 2012.

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Fiscal Summary

**State Effect:** None. The Department of Labor, Licensing, and Regulation (DLLR) can implement the bill's provisions with existing budgeted resources.

**Local Effect:** None.

**Small Business Effect:** Meaningful.

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Analysis

**Bill Summary:**

*Determination of Employer-Employee Relationships*

For the purpose of enforcing the Workplace Fraud Act, the presumption that an employer-employee relationship exists does not apply if an employer produces for inspections

- a written contract between the employer and a business entity that describes the nature of the work and the remuneration to be paid and includes an acknowledgement by the business entity of its responsibilities under the Act;
- a signed affidavit indicating that the business entity is an independent contractor who performs work for other employers;
- a certificate of status of the business entity that is issued by the State Department of Assessments and Taxation and indicates the entity is in good standing; and
- proof that the business entity holds all required occupational licenses for the work to be performed.

In addition, the employer must provide each individual classified as an independent contractor with the required notice of classification as an independent contractor and the implications of the classification.

#### *Workplace Fraud Enforcement Activities*

The commissioner may require each employer to identify and produce for copying or inspection all records relevant to the classification of each individual. An employer may comply with a requirement to produce records by producing copies of the records. An employer must comply with a request to copy or inspect records within 30 business days, or after an extension of time agreed to by both parties. Within 90 days of receiving all requested records, the commissioner must either issue a citation or close the investigation.

If the employer requests a hearing on the citation, the hearing must be held within 90 days of the request, unless the employer waives that right.

The commissioner must notify a public body that has a contract with the employer only if the commissioner issues a citation for a *knowing* violation of the act.

#### **Current Law:**

##### *Workplace Fraud Act*

Chapter 188 of 2009 (the Workplace Fraud Act) 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 statute, and subject to clarifying regulations issued by the Commissioner of Labor and Industry.

The “ABC test” incorporated in the Workplace Fraud 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 requirement to use the ABC test is not repealed by the bill. The ABC 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 Workplace Fraud 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.

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.

An employer issued a citation for misclassification may request a hearing within 15 days, which is referred to the Office of Administrative Hearings (OAH). If a hearing is not requested within 15 days, the citation becomes the final order. If a hearing is requested, the decision by OAH becomes the final order, which may be appealed for judicial review.

Upon issuing a citation for misclassification, the commissioner must notify any public body that contracts with the employer. Upon notification, the public body must withhold payment to the employer in sufficient amount to pay restitution to employees for wages due and to pay any taxes, benefits, or other contributions owed by the employer. Upon issuance of a favorable final order or court ruling, the public body must release the withheld funds to the employer.

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

**Background:** When a company hires an employee, it is responsible for paying half of that employee's Social Security and Medicare taxes, as well as premiums for workers' compensation and unemployment insurance (UI) coverage. Employers also typically withhold federal, state, and local income taxes. An employee is responsible for half of his or her Social Security and Medicare taxes, as well as any state and federal income tax in excess of the amounts withheld by the employer.

By contrast, an independent contractor pays all of his or her Social Security and Medicare taxes and has no income taxes withheld but is still responsible for paying them in full. Independent contractors are not covered by workers' compensation or UI, nor do they receive overtime compensation or benefits such as health insurance. They are treated by the law as temporary, freelance workers and are comparable to self-employed individuals.

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 UI. Other protections, such as employee safety requirements, minimum wage and overtime compensation, and anti-discrimination protections, are generally unavailable to these contractors.

DLLR advises that misclassification leaves many Maryland workers without access to workers' compensation or UI 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 it 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:** The Workplace Fraud Act authorizes the commissioner to conduct audits of employers in the landscaping and construction industries, either at his or her discretion or on the basis of complaints or referrals from other agencies. The level of enforcement activity is not expected to decrease as a result of the bill, but the outcomes of those enforcement activities may change. It is anticipated that fewer employer-employee relationships are established because of the added exemptions included in the bill. As a result, more firms likely are found to be in compliance and fewer are required to withhold State income taxes and pay workers' compensation.

Assuming that fewer firms are found to be misclassifying employees, DLLR issues fewer citations for misclassification; the additional 15 days to produce employment records likely reduces the number of civil penalties issued for failure to produce records. Since no civil penalties for misclassification have been collected to date, and only one penalty for failure to produce records has been collected, there is no meaningful reduction in general fund revenue from the foregone citations, but there is potential foregone revenue in the future.

**Small Business Effect:** To the extent that small businesses employ individuals who are reclassified as independent contractors under the bill's alternative definition criteria, they may have reduced payments for workers' compensation.

Individuals reclassified as independent contractors instead of employees lose the protections afforded to them by workers' compensation, UI, and occupational safety regulations because they are no longer considered employees.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** SB 1005 (Senator Pugh) - Finance.

**Information Source(s):** Judiciary (Administrative Office of the Courts); Department of Labor, Licensing, and Regulation; Office of Administrative Hearings; Department of Legislative Services

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