

Department of Legislative Services
Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1246
Ways and Means

(Delegate Adams)

Income Tax Withholding - Employer Liability - Safe Harbor

This bill provides that an employer or payor that fails to withhold or pay income tax is not personally liable for that income tax if the employer or payor consistently treated the worker or similar workers as independent contractors and consistently treated the worker or similar workers as independent contractors in any required tax filings.

The bill takes effect July 1, 2016.

Fiscal Summary

State Effect: General fund revenues decrease beginning in FY 2017 as a result of not holding employers personally liable for failing to withhold or pay income tax on workers treated as independent contractors. Under one set of assumptions, general fund revenues may decrease by \$2.0 million annually. The Comptroller's Office can implement the bill with existing resources.

Local Effect: Local revenues decrease as a result of not holding employers personally liable for failing to withhold or pay income tax on independent contractors. No effect on local expenditures.

Small Business Effect: Potential meaningful. Small businesses that fail to withhold or pay income tax for independent contractors benefit by not being held personally liable for that income tax.

Analysis

Current Law: Generally, each employer must withhold from an individual's wages the amount indicated in the income tax withholding tables or schedules that the Comptroller prepares. Other payors are also required to withhold income tax. Each employer or payor must pay to the Comptroller the income tax withheld with the withholding return. If an employer or payor negligently fails to withhold or pay the required income tax, the employer or payor is personally liable for that income tax. If the employer or payor is a corporation, limited liability company, or limited liability partnership, any officer of that entity who exercises direct control over its fiscal management or any agent of that entity who is required to withhold and pay the income tax is personally liable for the income tax.

Generally, an employer must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. An employer does not generally have to withhold or pay any taxes on payments to independent contractors.

Background: The Workplace Fraud Act of 2009 (Chapter 188) established, 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.

The "ABC test" incorporated in the Workplace Fraud Act is used by the Department of Labor, Licensing, and Regulation (DLLR) to establish whether an employer-employee relationship exists for the purpose of determining whether an employee has been misclassified under the Act. While only used to detect workplace fraud in the specified industries, DLLR is required to use the ABC test in determining whether an individual is an employee in any industry for the purpose of determining whether the employer should pay unemployment insurance for the individual. The ABC test has three components, all of which must be met to establish that an individual is an independent contractor and not an employee:

- 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).

In calendar 2015, the Worker Classification and Protection Unit received 106 complaints related to misclassification of employees and opened 518 cases, including those initiated by the Commissioner of Labor and Industry. The unit issued 145 citations for misclassification and another 65 for nonresponse by employers.

State Revenues: The Comptroller’s Office conducts withholding tax audits and joint audits with the Joint Enforcement Task Force on Workplace Fraud to determine if businesses are compliant with reporting and remitting of withholding taxes and did not misclassify employees as independent contractors. **Exhibit 1** shows the audit assessments on employers for misclassifying workers from 2011 through 2015.

Exhibit 1
Withholding Tax Assessments
of Misclassified Workers
2011-2015

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Joint Audits	\$394,408	\$159,826	\$7,027	\$70,188	\$13,719
Withholding Tax Audits	730,895	251,347	521,153	843,836	1,559,908
Total	\$1,125,303	\$411,173	\$528,180	\$914,024	\$1,573,627

Source: Comptroller’s Office; Department of Labor, Licensing, and Regulation

By not holding an employer or payor personally liable for these assessments, the Comptroller Office’s ability to collect these assessments is limited. Since the assessments vary each year, it is unknown by how much general fund revenues would decrease as a result of not holding an employer or payor personally liable, but general fund revenues could decrease by \$2 million annually beginning in fiscal 2017.

Small Business Effect: Studies have reported that 20% of employers misclassify their workers. To the extent that an employer misclassifies its employees as independent contractors and negligently fails to withhold or pay income tax on these workers, the employer is not held personally liable for the income tax. Thus, small businesses benefit to the extent that the State is unable to collect amounts from withholding assessments for employees found to be incorrectly treated as independent contractors.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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