

Department of Legislative Services
Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 838
Finance

(Senator Kramer, *et al.*)

Economic Matters

Workplace Fraud and Prevailing Wage - Violations - Referrals

This bill requires the Commissioner of Labor and Industry to refer certain complaints alleging violations of specified tax withholding and tax fraud provisions in the Tax-General Article to the Comptroller for an investigation by the Field Enforcement Bureau. The required referral only applies on a showing that (1) a knowing violation to properly classify an employee under the Workplace Fraud Act has occurred or (2) a knowing violation of the State Prevailing Wage Law has occurred.

Fiscal Summary

State Effect: General fund revenues and expenditures may increase beginning in FY 2024 due to tax compliance referrals, as discussed below.

Local Effect: The bill does not materially affect local government finances or operations.

Small Business Effect: Minimal.

Analysis

Current Law:

Workplace Fraud Act

Chapter 188 of 2009 (the Workplace Fraud Act) 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 Maryland Department of Labor (MDL) 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, MDL 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).

The Act distinguishes between an employer who improperly misclassifies an employee and an employer who knowingly misclassifies an employee, and civil penalties are more severe for an employer who is guilty of knowingly misclassifying an employee. The maximum penalty for a knowing violation is a \$5,000 fine for each employee who was not properly classified.

Prevailing Wage

Contractors and subcontractors working on eligible public works projects in Maryland must pay their employees the prevailing wage rate. “Public works” are structures or works, including a bridge, building, ditch, road, alley, waterwork, or sewage disposal plant, that are constructed for public use or benefit or paid for entirely or in part by public money.

The commissioner has the authority to enforce contractors’ compliance with the prevailing wage law, including assessing liquidated damages of \$250 per day per employee that is not paid the proper prevailing wage. See the **Appendix – Maryland’s Prevailing Wage Law** for additional information.

Penalties for Specified Tax Violations

Among other related penalties, a person who is required to withhold income tax and who willfully fails to withhold the tax as required under Title 10 of the Tax-General Article is guilty of a misdemeanor and subject to a maximum penalty of a \$10,000 fine and/or five years imprisonment.

Generally, a person who willfully or with the intent to evade payment of a tax under the Tax-General Article to prevent the collection of the tax fails to provide information as required or provides false or misleading information is guilty of a misdemeanor and subject to a maximum penalty of a \$5,000 fine and/or 18 months imprisonment.

State Fiscal Effect: The bill does not change the inspection process or the method by which wage and hour inspectors enforce the prevailing wage or worker classification laws and, therefore, does not materially affect MDL. MDL advises that it currently refers both knowing and unknowing violations to the Comptroller for investigation, so it does not anticipate any change in the number of referrals to the Comptroller under the bill for specified violations.

However, if additional violations are referred, then the Comptroller requires at least one additional compliance-related staff, at an annual general fund cost, per staff, of approximately \$85,000 to \$100,000 over the next five years. In that case, general fund revenues increase to the extent that additional tax audits result in additional assessments and collection of unpaid income taxes.

Additional Information

Prior Introductions: Similar legislation has not been introduced within the last three years.

Designated Cross File: HB 1261 (Delegate Valderrama) - Economic Matters.

Information Source(s): Comptroller's Office; Maryland Department of Labor; Secretary of State; Department of Budget and Management; Maryland Insurance Administration; Department of Legislative Services

Fiscal Note History:
km/mcr

First Reader - February 28, 2023

Third Reader - March 27, 2023

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Revised - Clarification - March 27, 2023

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Appendix – Maryland’s Prevailing Wage Law

Contractors and subcontractors working on eligible public works projects in Maryland, including mechanical service contractors that are part of public works projects, must pay their employees the prevailing wage rate. “Public works” are structures or works, including a bridge, building, ditch, road, alley, waterwork, or sewage disposal plant, that are constructed for public use or benefit or paid for entirely or in part by public money.

Eligible public works projects are:

- those carried out by the State;
- any public work for which at least 25% of the money used for construction is State money; and
- specified projects in tax increment financing districts if the local governing body approves of the application of prevailing wages.

Any public works contract valued at less than \$250,000 is not required to pay prevailing wages. The State prevailing wage rate also does not apply to (1) any part of a public works contract funded with federal funds for which the contractor must pay the prevailing wage rate determined by the federal government; (2) specified construction projects carried out by public service companies under order of the Public Service Commission; or (3) local House or Senate initiatives that receive State funds in the capital budget.

Prevailing wages are wages paid to at least 50% of workers in a given locality who perform the same or similar work on projects that resemble the proposed public works project. If fewer than 50% of workers in a job category earn the same wage, the prevailing wage is the rate paid to at least 40% of those workers. If fewer than 40% receive the same wage rate, the prevailing wage is calculated using a weighted average of local pay rates. The State Commissioner of Labor and Industry is responsible for determining prevailing wages for each public works project and job category based on annual surveys of contractors and subcontractors working on both public works and private construction projects.

The commissioner has the authority to enforce contractors’ compliance with the prevailing wage law, including issuing a stop work order if the commissioner makes an initial determination that a contractor or subcontractor may have violated the prevailing wage requirements. Contractors found to have violated the prevailing wage law must pay restitution to the employees and liquidated damages to the public body in the amount of \$20 a day for each laborer who is paid less than the prevailing wage or \$250 per laborer per day if the employer knew or reasonably should have known of the obligation to pay the prevailing wage. If an employer fails to comply with an order by the commissioner to pay

restitution, either the commissioner or an employee may sue the employer to recover the difference between the prevailing wage and paid wage. The court may order the employer to pay double or triple damages if it finds that the employer withheld wages or fringe benefits willfully and knowingly or with deliberate ignorance or reckless disregard for the law.

The Governor must include at least \$385,000 in the budget each year for the Prevailing Wage Unit within the Maryland Department of Labor (MDL).

The University System of Maryland (USM), Morgan State University (MSU), St. Mary's College of Maryland, and the Maryland Stadium Authority (MSA) are all exempt from the prevailing wage law. However, USM, MSU, and MSA all voluntarily comply with prevailing wage requirements for contracts that exceed the \$250,000 threshold.

History of the Prevailing Wage

The federal Davis-Bacon Act, originally enacted in 1931, requires contractors working on federal public works contracts valued at more than \$2,000 to pay their employees the prevailing local wage for their labor class, as determined by the U.S. Secretary of Labor. The general intent of the law, and similar state and local laws, is to stabilize local wage rates by preventing unfair bidding practices and wage competition. Thirty-two states and the District of Columbia currently have prevailing wage laws; since 1979, nine states have repealed their prevailing wage laws.

Maryland adopted a prevailing wage law in 1945 (Chapter 999), but it only applied to road projects in Allegany, Garrett, and Washington counties. In 1969, the statute was amended to include State public works contracts of \$500,000 or more. There have been periodic changes to the law and the definition of "prevailing wage." In 1983, the law was broadened to include public works projects in which the State funds 50% or more of the total project costs and 75% or more in the case of public schools. Chapter 208 of 2000 reduced the prevailing wage threshold for public schools from 75% to 50% of construction costs, thereby bringing school construction projects in line with prevailing wage requirements for other public works projects. Chapters 281 and 282 of 2014 further lowered the State funding threshold for school construction projects to 25% of total construction costs, thereby requiring the vast majority of public school construction projects in the State to pay the prevailing wage, subject to the \$500,000 contract value threshold. Chapters 57 and 58 of 2021 lowered the State funding threshold for all public works projects (including school construction) to 25% of total construction costs and lowered the contract value threshold for payment of prevailing wages to \$250,000; however, legislative bond initiatives that receive State funds in the capital budget are exempt from the requirement to pay prevailing wages.

The number of prevailing wage projects rose dramatically following the Great Recession and has remained high each year since. MDL advises that, during fiscal 2022, its prevailing wage unit monitored 921 projects, down slightly from 941 projects in fiscal 2021, but significantly higher than 496 in fiscal 2014. To accommodate the increase in projects, the number of prevailing wage investigators increased in fiscal 2016 from three to six; as of January 2023, there are five investigators in the unit.

Six Maryland jurisdictions – Allegany, Baltimore, Charles, Montgomery, and Prince George’s counties and Baltimore City – have local prevailing wage laws requiring public works projects in the jurisdiction to pay prevailing wages.

Research on the Effects of Prevailing Wage on Contract Costs

The Department of Legislative Services (DLS) has reviewed research on the effect of prevailing wage laws on the cost of public works contracts and has found inconsistent and/or unreliable results. The primary challenge confronted by all prevailing wage researchers is identifying an appropriate “control group” consisting of projects of similar type, timing, and location that do not pay the prevailing wage. In most jurisdictions that require a prevailing wage, all projects of a specified type and size are subject to it, so there is no natural control group. Some researchers have compared project costs in states or localities before and after they adopted prevailing wage requirements, but their findings are clouded by the difference in time, during which construction costs changed and other factors were not consistent. Another deficiency in the research is that it almost always relies on project bid prices (*i.e.*, the anticipated cost prior to the beginning of construction) rather than actual final costs. As most construction projects experience change orders or cost overruns affecting their cost, reliance on bid prices negatively affects the validity of the findings. Therefore, research findings related to the effect of the prevailing wage on project costs are inconsistent and often inconclusive. A similar review of research conducted by MDL (at the time, the Department of Labor, Licensing, and Regulation) for the Task Force to Study the Applicability of the Maryland Prevailing Wage Law also concluded that “data limitations create difficulty for researchers on both sides of the issue.”

Local school systems occasionally solicit side-by-side bids with and without prevailing wages to help them decide whether they want to accept the full State match (and, thus, be subject to the prevailing wage) or a lesser State match without being subject to the prevailing wage. Data provided to the Public School Construction Program by Anne Arundel, Carroll, Frederick, Howard, and Washington counties, from 2012 through 2015, shows that the cost differential between bids with and without prevailing wages for 266 individual bids submitted for 26 different school construction and renovation projects averaged 11.7%, with a range from 0% to 49%. As with other research data, these represent bid prices, not actual construction costs. An independent analysis of the Maryland side-by-side bid data concluded that factors other than prevailing wages, including bid

timing and the level of competition for the bids, accounted for most of the differences between the prevailing wage and nonprevailing wage bids.

One area of the research in which there is a general consensus, and which is supported by the U.S. Bureau of Labor Statistics, is that labor costs represent between 20% and 30% of construction costs (with materials and site costs making up most of the rest). Therefore, a 10% gap between prevailing wages and market wages could theoretically increase total contract costs by about 2.5%, and a 20% gap in wages could increase total contract costs by about 6%. Given the empirical evidence that prevailing wages tend to be higher than nonprevailing wages and that labor costs are a significant portion of overall project costs, DLS believes that it is reasonable to expect that the prevailing wage requirement adds between 2% and 5% to the cost of a public works project. Given the inconsistency and inconclusiveness of the empirical research, however, actual effects may vary by project, with some projects exhibiting higher cost differences and others experiencing negligible differences.