

Department of Legislative Services
 Maryland General Assembly
 2025 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 632 (Delegate Schindler, *et al.*)
 Economic Matters

Labor and Employment - Workplace Fraud - Application (Maryland Workplace Fraud Act of 2025)

This bill expands the Workplace Fraud Act to apply to all private sector employers, rather than only employers in the construction and landscaping services industries. Thus, the bill prohibits all private sector employers from failing to properly classify an individual as an employee and subjects them to the Workplace Fraud Act’s investigation procedures and penalties for noncompliance. The bill also makes technical and conforming changes related to the definitions of “construction services” and “landscaping services.”

Fiscal Summary

State Effect: Special fund expenditures increase by at least \$747,300 in FY 2026 for the Maryland Department of Labor (MD Labor), with ongoing costs. Special fund revenues correspondingly increase due to the Workers’ Compensation Commission’s (WCC) assessment on insurers in the State, which minimally increases State expenditures (all funds). Federal fund revenues and expenditures for MD Labor and general fund expenditures for the Comptroller each increase by \$295,700 beginning in FY 2026, with ongoing costs for audits. Potential significant general and federal fund revenue increase beginning in FY 2026 due to penalties and increased employer compliance with worker classification laws.

(in dollars)	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030
SF Revenue	\$747,300	\$876,500	\$913,100	\$951,500	\$989,200
FF Revenue	\$295,700	\$347,700	\$363,200	\$379,500	\$395,600
GF/NonBud Rev.	-	-	-	-	-
GF Expenditure	\$295,700	\$347,700	\$363,200	\$379,500	\$395,600
SF Expenditure	\$747,300	\$876,500	\$913,100	\$951,500	\$989,200
FF Expenditure	\$295,700	\$347,700	\$363,200	\$379,500	\$395,600
GF/SF Exp.	-	-	-	-	-
Net Effect	(\$295,700)	(\$347,700)	(\$363,200)	(\$379,500)	(\$395,600)

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

Local Effect: Potential significant increase in local income tax revenues. Minimal increase in expenditures due to the increased WCC assessment on all insurers in the State.

Small Business Effect: Meaningful.

Analysis

Current Law: 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 MD Labor 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, MD Labor 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 (UI) 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 Commissioner of Labor and Industry in MD Labor is responsible for enforcing the Act. 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 \$10,000 fine for each employee who was not properly classified. The Commissioner of Labor and Industry or the administrative law judge must consider specified factors when determining the penalty amount. Penalties can be doubled for employers who have previously violated the Act’s 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.

Joint Enforcement Task Force on Workplace Fraud

Executive Order 01.01.2024.04, dated January 9, 2024, establishes the Joint Enforcement Task Force on Workplace Fraud to coordinate the investigation and enforcement of workplace fraud. Among its charges is to facilitate data sharing among task force members, including maintaining an interagency online platform to share such information. The task force must report to the Governor by December 31 of each year as specified in the executive order; the report must, among other things, identify successful strategies for preventing workplace fraud that reduce the need for greater enforcement.

State Fiscal Effect: Expenditures increase for MD Labor's Division of Labor and Industry (DLI) to investigate worker misclassifications. Revenues correspondingly increase due to WCC assessment on insurers in the State. Thus, State expenditures (all funds) increase minimally due to a higher assessment charged by WCC to all insurers. DLI refers all misclassification cases to MD Labor's Division of Unemployment Insurance (DUI) and to the Comptroller's Office, so expenditures also increase for those agencies to conduct audits. To the extent that these referrals lead to increased tax compliance, revenues increase. Each of these related fiscal effects (DLI, WCC, UI tax compliance, and income tax compliance) is discussed below.

Maryland Department of Labor's Division of Labor and Industry

While the Workplace Fraud Act has been in place for landscaping and construction businesses since 2009, enforcement of the Act has been variable over the years. For instance, performance data maintained by MD Labor show almost no enforcement action related to worker misclassification for fiscal 2020 through 2023. MD Labor is working to strengthen enforcement of the existing program. As such, the fiscal 2026 budget as introduced includes \$1.25 million of WCC special funds for the program, which is more than double the \$600,257 appropriation that the program received in fiscal 2024. MD Labor reports that the existing program has 10.5 positions, which includes eight wage and hour investigators, one wage and hour supervisor, one administrative aid, and one half-time assistant Attorney General.

Landscaping and construction together make up 8.25% of the State's private sector workforce with 183,469 employees from 19,829 establishments. MD Labor estimates that applying all private sector employees to the Workplace Fraud Act adds approximately two million workers from 186,803 establishments under the purview of the Commissioner of Labor and Industry for workplace fraud enforcement. The Commissioner is required to investigate as necessary to determine compliance, including complaints and referrals, which cannot be absorbed within existing resources. MD Labor estimates needing 25 DLI employees if 1% of the 186,803 establishments are to be investigated. If only

0.5% of establishments are to be investigated, MD Labor reports needing 13 DLI employees.

The Department of Legislative Services concurs that MD Labor needs additional resources. However, it is unknown how many employees are misclassified as an independent contractor. Identifying misclassified workers is challenging because workers may not even realize that they are being misclassified. In 2024, the U.S. Department of Labor noted that independent contractors are most prevalent in the construction (19.3%) and professional and business services (25.1%) industries, accounting for 44% of independent contractors. Another study by the Economic Policy Institute cites construction workers and landscaping workers among the 11 most commonly misclassified workers. (The other commonly misclassified workers are truck drivers, janitors and cleaners, home health and personal care aides, retail sales workers, housekeeping cleaners, customer service representatives and call center workers, light truck delivery drivers, and manicurists and pedicurists.) It is likely that the current law, which applies only to workers in the construction and landscaping service industries, covers a significant portion of misclassified workers, but to cover all industries, MD Labor likely needs at least double its current enforcement staff.

Enforcement of workplace fraud is funded by WCC funds. Therefore, special fund expenditures increase by \$747,327 in fiscal 2026, which accounts for the bill's October 1, 2025 effective date. This estimate reflects the cost of hiring eight wage and hour investigators to perform field investigations, one wage and hour supervisor to oversee the investigators, one administrative aid to provide administrative support, and one assistant Attorney General to draft regulations, issue guidance, and review complex cases. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

DLI Positions	11.0
Salaries and Fringe Benefits	\$609,558
Operating Expenses	<u>137,769</u>
Total DLI FY 2026 State Expenditures	\$747,327

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses. This estimate reflects the minimum number of employees to have a viable program; thus, additional resources may be necessary if a higher degree of enforcement is desirable.

Workplace Fraud Penalties

General fund revenues increase modestly due to the bill's penalty provisions beginning in fiscal 2026. MD Labor advises that its enforcement efforts initially focus on compliance, issuing nonknowing citations with proposed penalties, which are usually waived if an employer comes into compliance. In calendar 2024, MD Labor imposed \$27,018 in fines

and collected \$24,657 in fines. Assuming similar fine imposition and collection rates, general fund revenues could increase by more than \$119,000 annually, although the actual impact is unknown as it relies on a number of variables. For instance, compliance may increase with greater enforcement, reducing penalty revenue in the out years.

Workers Compensation Commission

DLI expenditures for enforcing workplace fraud are derived from WCC, which funds its operations by assessing a tax on all workers’ compensation insurers in the State. WCC advises that it will increase its assessment on all insurers in the State to cover DLI expenses stemming from the bill. Thus, WCC special fund revenues increase. As the State is a workers’ compensation insurer, State expenditures (all funds) increase minimally as a result of the WCC assessment on all workers’ compensation insurers in the State.

Unemployment Insurance Tax Compliance Component

Maryland Department of Labor’s Division of Unemployment Insurance

Employers who misclassify workers as independent contractors avoid paying UI taxes. DUI receives referrals from DLI relating to the potential nonpayment of Maryland UI tax, so MD Labor anticipates DUI field audit assignments to increase significantly as part of joint enforcement efforts. Therefore, DUI expenditures increase by \$295,665 in fiscal 2026, which accounts for the bill’s October 1, 2025 effective date. This estimate reflects the cost of hiring four auditors in DUI to conduct field audits. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. This estimate assumes additional above-base federal funding will be provided if existing federal funding is insufficient for these expenses. Absent federal funding, general funds are required.

DUI Positions	4.0
Salaries and Fringe Benefits	\$266,190
Operating Expenses	<u>29,475</u>
Total DUI FY 2026 State Expenditures	\$295,665

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses. To the extent that referrals are higher than anticipated, additional auditors may be needed.

Unemployment Insurance Trust Fund

Unemployment Insurance Trust Fund (UITF) revenues from employer taxes may increase, potentially by millions of dollars, beginning in fiscal 2026 to the extent that enforcement increases compliance with UITF contributions.

Although UI claims may increase under the bill, any such increase is not expected to be significant. Under current law, a misclassified employee who files a claim may receive UI benefits provided that the division finds that the employer improperly classified the employee. In such cases, the employer is then responsible for unpaid UI taxes.

MD Labor expects a modest increase in fines collected by DUI due to broadened enforcement efforts. MD Labor reports the total amount of interest assessed, but not yet paid, for misclassified workers in 2024 was \$191,543. While the precise amount of additional revenue from fines is difficult to predict, MD Labor expects it to rise proportionally with the increase in enforcement actions.

Income Tax Component

Comptroller’s Office

The Compliance Division of the Comptroller’s Office receives referrals from MD Labor relating to the potential nonpayment or underpayment of Maryland withholding tax from businesses due to misclassification. Thus, the bill results in additional violations being referred to the Comptroller, requiring additional audit activity. Therefore, general fund expenditures increase by \$295,665 in fiscal 2026, which accounts for the bill’s October 1, 2025 effective date. This estimate reflects the cost of hiring four financial compliance auditors to investigate referrals from MD Labor. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Comptroller’s Office Positions	4.0
Salaries and Fringe Benefits	\$266,190
Operating Expenses	<u>29,475</u>
Total Comptroller FY 2026 State Expenditures	\$295,665

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses. To the extent that referrals are higher than anticipated, additional auditors may be needed.

Income Tax Revenues

Employers who misclassify workers as independent contractors avoid paying payroll taxes. To the extent that enforcement requires more employers to comply with income tax withholding requirements, the Comptroller may realize additional income tax revenue as a result of the bill. A recent study by the Century Foundation estimated that the State lost \$19.3 million in 2023 from construction workers being misclassified or paid off-the-books. Thus, general fund revenues may increase, potentially millions of dollars, beginning in fiscal 2026 to the extent that additional tax audits result in additional assessments and

collection of unpaid income taxes and to the extent that the bill increases overall compliance with existing laws.

Local Fiscal Effect: Local tax revenue may increase significantly with increased compliance with worker classification requirements. Local expenditures increase minimally due to the increased WCC assessment on all insurers in the State to cover MD Labor's enforcement costs.

Small Business Effect: Studies have estimated that 10% to 30% of employers misclassify their employees as independent contractors, and a study found that between 1% and 9% of workers are misclassified as independent contractors., Thus the bill likely affects a significant number of small businesses. However, small businesses in the construction services and landscaping services industries are already subject to the Workplace Fraud Act.

Small businesses that are found to misclassify their employees under the bill must pay UI, workers' compensation, and payroll taxes on behalf of misclassified employees. They are also subject to civil and administrative penalties relating to misclassifying employees. Expenditures by all small businesses increase minimally for higher WCC assessments.

Small businesses that currently comply with all worker classification requirements may become more competitive relative to those that do not currently comply and therefore have lower labor costs.

Additional Information

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

Designated Cross File: None.

Information Source(s): Comptroller's Office; Maryland Department of Labor; Subsequent Injury Fund; Uninsured Employers' Fund; Workers' Compensation Commission; U.S. Department of Labor; Economic Policy Institute; The Century Foundation; Department of Legislative Services

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