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The Crackdown On Independent Contractor Misclassification

One of the most common and costly mistakes an employer can make is to misclassify an employee as an independent contractor. Whether intentional or not, it exposes employers to substantial fines, penalties and even criminal prosecution.

Misclassification creates severe challenges for workers, employers and insurers, as well as for policy enforcement. Misclassified workers lose access to unemployment compensation benefits, appropriate

levels of workers' compensation insurance and employer-based benefits, and the protections of wage and hour and other labor

laws. For employers, misclassification creates an uneven playing field. Employers that classify workers appropriately have higher costs and can be underbid by employers that engage in misclassification.

A 2006 study by the U.S. Government Accountability Office (GAO) noted that employers can skim 30 percent off their payroll costs by simply misclassifying their employees as independent contractors. The GAO estimates the loss of revenue from misclassification at more than \$4.7 billion. Employee misclassification also can be devastating to employers that make considerable use of improperly classified independent contractors. Such employers face liability for unpaid federal, state and local income tax withholdings and liability for Social Security and Medicare contributions—



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all of which are not addressed when an individual is given a “straight check” and Form 1099. Other potential areas of liability include unemployment compensation, workers’ compensation insurance premiums, overtime, state-mandated benefits programs and other work-related benefits, along with eligibility for protection or benefit under federal and state statutes.

According to the GAO, in 2005, the percentage of independent contractors in construction (22 percent) was greater than in other industries. The construction industry is generally more susceptible to worker classification abuses because of the significant competitive advantages gained by employers that misclassify their workers.

PREVAILING WAGE OBLIGATIONS

Some employers use misclassification as a way to avoid paying prevailing wage rates on publicly funded construction projects, but the potential liability far outweighs the perceived benefits.

For example, although the statutes vary, many states have special provisions imposing significant penalties for employers that misclassify employees to avoid prevailing wage rate obligations. New Jersey’s Construction Industry Independent Contractor Act, for instance, levies criminal and civil penalties against employers that violate the state’s prevailing wage law by misclassifying workers as independent contractors (and thereby avoiding prevailing wage requirements).

Under the statute, worker misclassification can result in immediate suspension of a contractor’s registration, a stop-work order for second and subsequent violations, and debarment from contracting for public works.

The consequences of prevailing wage rate violations are illustrated in an October 2008 settlement between the attorney general of Massachusetts and a construction company that intentionally failed to pay seven of its employees the

proper prevailing wage. The company misclassified the employees as independent contractors, failed to submit true and accurate certified payroll records, and failed to maintain true and accurate general payroll records.

The company agreed to pay \$19,215 in restitution to the affected employees and \$4,000 in fines for failing to pay the prevailing wage. The company also had to pay \$5,000 in fines for misclassification and another \$3,000 in fines for failing to maintain general and payroll records and submit true and accurate certified payroll records to the awarding authority at one public works jobsite.

In addition to restitution and penalties, the company agreed to a debarment that prevented it from bidding on any public construction projects for one year.

CRIMINAL PENALTIES

Several states have addressed employee misclassification by enacting laws targeting construction industry employers. These laws impose substantial financial and criminal penalties on employers guilty of employee misclassification. For example, the New Jersey act presumes that all persons working for construction contractors are employees, and it places the burden on the contractor to prove otherwise.

A contractor found to have misclassified employees is subject to monetary fines of up to \$1,000 and/or up to 90 days of jail time for each offense. Importantly, each week in which the employee is misclassified (even for one day during that week) is treated as a separate offense, meaning that penalties for a single misclassified worker can easily amount to tens of thousands of dollars.

Also, if the contractor is found to have

“knowingly” misclassified an employee as an independent contractor, it is subject to more severe penalties, including fines of up to \$150,000 and up to 10 years of imprisonment. Similar laws have been passed in Delaware, Massachusetts and Illinois.

In addition, construction industry employers that are found guilty of misclassifying employees cannot leave their infringements in the past. They typically are obligated to disclose prior violations when completing contractor registration forms in connection with the submission of a bid for a public works project. The failure to disclose prior violations (or failing to accurately represent such infractions) could result in civil liability, as well as the denial, suspension or revocation of an employer’s contractor registration.

Misrepresentation or intentional omissions of classification abuses could render an otherwise successful bid non-responsive, and even result in the disqualification of the bid or the revocation of a successful bid award. Ultimately, the disqualification or revocation could result in a claim being made against a contractor’s bid bond.

In light of the increased scrutiny on independent contractor relationships, construction industry employers must focus on ensuring they have properly classified their independent contractors. Efforts should include internal audits and effective remedial measures. Due to the complexity of the issue and the differing standards involved under federal and state laws, employers should actively involve their labor counsel in the auditing process to help reconcile the applicable laws, evaluate the factors, and address legal and employee relations issues involved in the remedial process.

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