

Employee Misclassification

Sub. for HB 2135 revises the procedures used to determine if employees have been misclassified as independent contractors. The bill revises employment security law regarding the process used to determine the misclassification of employees, the communication of confidential taxpayer information between the Departments of Revenue and Labor, and penalties for repeated violations of employee misclassification.

The Secretary of Labor, or the Secretary's designee, has the responsibility to make all determinations regarding the classification of a worker as being an employee or an independent contractor. If the Department of Revenue has reason to believe that a business misclassified an individual, the Department of Revenue will request the Department of Labor to make a determination of the individual's status. The Department of Revenue is authorized to submit all relevant payroll and withholding tax information to the Department of Labor, which is required to abide by the same levels of confidentiality that is required statutorily of the Department of Revenue. If the Department of Labor needs additional information regarding the business in question, the Department of Revenue is required to provide it.

The Secretary of Labor determines an individual's status based upon the totality of circumstances, exercising strict impartiality in the determination process. A business will be deemed to have made a valid classification if the business has made a reasonable reliance based upon:

- A judicial decision;
- A ruling from the Internal Revenue Service (IRS), the Department of Revenue, or the Department of Labor;
- An audit performed by the IRS, the Department of Revenue, or the Department of Labor; or
- Work classifications that customarily are used by the industry in which the business operates.

The business needs to demonstrate that it has acted consistently in its employment practices and tax reporting. If the Secretary of Labor cannot ascertain a reasonable basis, then eight factors contained in the following questions are to be considered:

- Must the individual comply with specific instructions from the business regarding when, where, and how to perform the service;

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- Are the activities of the individual integrated into the ongoing operations of the business;
 - If needed to accomplish the desired end result, does the individual have the responsibility to hire, supervise, and pay assistants;
 - Must the individual work exclusively for the business in question;
 - Is payment by the business to the individual for services contingent on completion of established benchmarks or tasks;
 - Does the individual provide significant tools, materials, or other equipment used in the accomplishment of the desired end result;
 - Is the individual responsible for any expenses incurred in the performance of services; and
 - Can the individual suffer a loss in the course of performing services?

Once the Secretary of Labor has determined an employee's classification, the Department of Revenue accepts the determination. The Department of Revenue can request the Department of Labor to provide the information that was used to make the determination. If so, the Department of Revenue will maintain the same level of confidentiality that is required statutorily of the Department of Labor. If it has been determined that an employee was misclassified, then the two departments notify the business that additional Unemployment Insurance (UI) contributions and income withholding taxes are due.

Before a UI penalty or interest can be charged, the Secretary of Labor has the discretion to consider the appropriateness to the business. If a reasonable basis for the classification exists, the Secretary of Labor is prohibited from imposing penalties, interest, or the recovery of back taxes owed to the Employment Security Fund. The Secretary of Labor will educate businesses on the classification of employees. The Secretaries of Revenue and Labor are granted rule and regulation making authority to implement the Act.

The previous statutory UI definition for "employment" is revised by deleting the "two-prong" requirement. In order for an individual to be considered an independent contractor, that person's work must be: (1) free from the business's control and (2) performed outside the usual course of the business's operations. The new text states that an individual is considered an employee if the business retains the right to control the end result and the means by which the end result is accomplished.

Penalty provisions provide for a second and subsequent violations. For a second violation, a person who misclassifies an individual is subject to the civil penalty that previously was specified in statute and becomes subject to a class C nonperson misdemeanor. For subsequent violations, the person is subject to the civil penalty and class A nonperson misdemeanor.

The bill requires the Secretary of Labor to make an annual report to the Senate Committee on Commerce and the House Committee on Commerce and Economic Development. The report is to provide information regarding the number of employee misclassifications, investigations, and money collected in the preceding calendar year.