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New Jersey Joins a String of States Cracking Down on Employee Misclassification

On May 3, New Jersey Governor Phil Murphy signed Executive Order No. 25, which established a Task Force on Employee Misclassification to address misclassification of employees as independent contractors. Governor Murphy indicated the measure was intended to crack down on "unscrupulous contractors who commit 1099 fraud to exploit workers and rob them of family and medical leave and safe workplace protections." According to the order, New Jersey loses more than $500 million in tax revenue every year due to the misclassification of employees. The task force is responsible for examining and evaluating existing misclassification enforcement; developing best practices to increase coordination of information and enforcement between different state departments and agencies; developing recommendations to foster compliance with the law, including employee education; and reviewing existing law and procedures related to misclassification.

Worker misclassification issues have been the subject of significant litigation in various states over recent years. New Jersey has jumped on the task force bandwagon, joining other states that have already established similar task forces to address employee misclassification, such as New York in 2016, and Connecticut and Massachusetts in 2008. Like New Jersey, these task forces were developed to investigate potential misclassification of employees and determine an appropriate methodology for the recovery of employee benefits, state taxes, unemployment contributions, and fines and penalties on behalf of improperly classified employees.

The ABCs of Independent Contractor Classification

Companies engaging independent contractors should take care to understand and apply the various tests under state and federal law used to determine whether an individual is an employee or an independent contractor.

Many states, such as Connecticut, New York, Massachusetts, and New Jersey, follow a version of the "ABC" test to determine whether an individual is properly classified as an independent contractor for purposes of specific claims. For example, under New Jersey unemployment compensation and wage law, an individual providing services as an independent contractor must: (a) be free from the company's control in performing the services; (b) perform work outside the usual course of the company's business or outside the company's place of business; and (c) be engaged in an independently established business. Connecticut, New York, and Massachusetts follow a similar ABC test, with some permutations. In March 2017, in *Southwest Appraisal Group, LLC v. Administrator, Unemployment Compensation Act*, the Connecticut Supreme Court clarified that under Connecticut's version of the ABC test, an individual may be classified as an independent contractor even if that individual works only with one company. Further, the court clarified that in determining whether an individual is "customarily engaged in an independently established trade, occupation, profession, or business" (under the C prong), several defined factors should be analyzed. These factors include whether the individual holds a state licensure or specialized skills; whether the services are performed under the individual's own name; the existence of business cards, printed invoices or advertising; and whether the service provider employs or subcontracts others.

Employers also should note that different tests may apply to different claims relating to misclassification. For instance, while New Jersey uses the ABC test on claims for wages and unemployment compensation as noted above, courts have held that the ABC test does not apply to other claims, such as those brought under the state workers' compensation law. Further, industry-specific and other laws and regulations may impact their classification analysis. For instance, New York City employers contracting with freelancers must comply with the Freelance Isn't Free Act, which became effective in May 2017.

In addition, New York employers in certain industries, such as the commercial goods transportation industry, may be subject to additional requirements.

What Should Employers Do?

Misclassifying workers can have significant costs. Among other things, an employer that has misclassified an employee as an independent contractor may be subject to payment of overtime and employee benefits, Social Security and Medicare taxes, payroll taxes, unpaid unemployment and disability insurance, unpaid workers' compensation coverage, and civil fines and penalties.

Employers should ensure that they review all workers who have been classified as independent contractors, and New Jersey employers in particular should expect increased enforcement on this issue. Although states use different tests to determine independent contractor status, overall the focus will be on the degree of control and supervision the company exercises over the worker. Accordingly, employers should carefully analyze the amount of control they have over an independent contractor's work, the nature of the work performed, how that work is performed, the location where the work is performed, the tools and equipment used to perform the work, and whether similar work is performed for other companies. Where these factors support an independent contractor classification, the company also should have a written agreement setting forth the independent contractor relationship. In light of the scrutiny that states are applying to this issue and the potential costs of misclassification, companies should proceed cautiously in this area and seek legal counsel as needed.

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