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NJ Employers Beware: Federal and State Departments of Labor Team Up to Address Independent Contractor Misclassification

Employers often struggle when determining whether to classify their workers as independent contractors or employees. Misclassification—when a worker is treated as an independent contractor when that worker should, in fact, be an employee—subjects employers to a barrage of potential liability, including unpaid minimum wage and overtime payments, unpaid payroll tax contributions, liquidated damages, attorneys' fees and administrative penalties. In New Jersey, federal and state agencies will now work in tandem to discover employers' misclassifications and accompanying violations of wage and hour law.

As previously reported, New Jersey Governor Phil Murphy wasted little time ramping up the state's enforcement efforts to crack down on employee misclassification. Mindful of the inordinate amount of tax revenue lost, in May 2018, the Governor signed Executive Order No. 25 (EO-25), establishing a cross-agency Task Force to examine and evaluate current misclassification enforcement efforts; develop best practices to increase coordination and efficient enforcement; develop recommendations to assist employers, workers and the public in complying with the law; and review existing law and procedures related to misclassification.

More recently, on August 10, 2018, the U.S. Department of Labor Wage and Hour Division (USDOL) and New Jersey Department of Labor and Workforce Development (NJDOL) entered into a "Memorandum of Cooperation" designed to enhance and facilitate cooperation between the two agencies to "effectively and efficiently" target employers that wrongly misclassify their workers.

In its press release, the NJDOL noted that, by misclassifying their workers, employers do not pay their fair share of payroll taxes, at the expense of taxpayers. In fact, the NJDOL identified more than $80 million in unreported contributions since 2010. The NJDOL also stated that misclassified workers are deprived of protection under state and federal minimum wage and overtime laws, OSHA's safety regulations, and the National Labor Relations Act. In the latter case, such workers do not have the same rights to organize or bargain collectively with their employer. EO-25 also observed that misclassification creates unfair competition because it makes it more difficult for compliant employers to compete with those that do not follow statutory or regulatory requirements. The NJDOL identified workers in the "construction, transportation, information technology, and other [o]n-demand businesses" to be the most "vulnerable."

The Memorandum of Cooperation is a commitment to "conduct coordinated investigations," "coordinate their respective enforcement activities and assist each other with enforcement," "make referrals of potential violations of each other's statutes," and "exchange information in cases" that would mutually benefit the agencies. The NJDOL touts the Memorandum of Cooperation as an agreement that "adds teeth to labor enforcement efforts" and "sends a strong message to unscrupulous business owners that misclassification laws are being strictly enforced."

Under federal law, the U.S. Court of Appeals for the Third Circuit adopted a six-factor test to determine employment status under the Fair Labor Standards Act (FLSA). The test focuses on the degree of the employer's right to control the worker's performance, the worker's opportunity for profit or loss, the worker's investment in equipment, whether the services required a special skill, the degree of permanence to the working relationship and whether the services are integral to the employer's business. No single factor is dispositive, and courts must balance the factors and take a totality-of-the-circumstances approach. Under the FLSA, employers may be liable for damages for a period of three years.

New Jersey applies a hybrid of the "control" test and the "relative nature of the work test," which is essentially the same test applied under the FLSA, to coverage of entities under the workers' compensation statute. More rigorous tests, however,

apply to other laws. New Jersey applies the "ABC" test under the New Jersey Wage and Hour Law and the unemployment compensation statute. Under the ABC test, a worker is presumed to be an employee unless the employer can satisfy all three of the following criteria: (a) the worker is free from the employer's direction or control in fact and the employer has not reserved the right to control the worker's performance; (b) the worker is performing services outside the usual course of the employer's business or outside of the employer's place of business; and (c) the worker has a business, trade, occupation or profession that will continue even if the current relationship is terminated, i.e., the worker is not dependent on the employer for his or her livelihood. The New Jersey Wage and Hour Law has a two-year period of liability for employers.

The Memorandum of Cooperation sets up a framework for the USDOL to share information with the NJDOL that, under federal law, may not result in a finding of misclassification, but would result in violations of state law. The renewed vigor and coordination efforts between the USDOL and the NJDOL to combat misclassification mean that employers must be even more diligent in ensuring that any independent contractor relationship is a bona fide one to avoid potential liability. As mentioned above, employers may be liable for unpaid wages and overtime to employees, unpaid Social Security and Medicare taxes to the federal government, unpaid disability and unemployment taxes to the state government, unpaid workers' compensation coverage, and/or civil penalties. Employers should expect that the combined resources of the two agencies will result in greater scrutiny of the employer-employee relationship, and employers should consider conducting a self-audit and/or taking any corrective action before any government agency turns its attention to them.

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