New Jersey Poised to Crackdown on Employee Misclassification

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New Jersey employers should expect to see a significant expansion of State investigations into misclassification of employees as independent contractors. These investigations have always presented risks and costs to employers, but recent portentous announcements by Governor Phil Murphy's administration indicate that the cost of misclassification is likely to increase exponentially.

By way of background, employee misclassification occurs when an employer classifies its workers as "independent contractors" rather than "employees." Independent contractors are not entitled to the same rights as employees, such as wage and hour protections, paid sick leave, and unemployment benefits. Independent contractors are also treated differently than employees for tax purposes. Misclassification can take several forms, from employers simply paying workers off the books to requiring employees to form their own LLC or franchise as a condition of obtaining a job.

New Jersey applies the **"ABC** test**"** when analyzing potential employee misclassification. To demonstrate the worker is an independent contractor, an employer must show that in the performance of a service to the employer:

A. The individual has been and will continue to be free from control or direction;

B. The service is either outside the employer's usual course of business of the employer or that such service is performed outside of all the employer's places of business; and

C. The individual is customarily engaged in an independently established trade, occupation, profession or business.

[N.J.S.A. 43:21-19(i)(6)(A)-(C).]

Importantly, this test is conjunctive – if all elements are not met, DOL will deem the worker an employee. In that case, DOL may assess fines and penalties for unpaid unemployment insurance and other employment taxes going back six years. Further, these investigations tend to span out, as DOL investigates all of the employers from whom an alleged independent contractor received income.

In May 2018, early into his tenure, Governor Murphy signed an executive order establishing a Task Force on Employee Misclassification ("Task Force"). The goal was to identify and reduce instances of employee misclassification, especially in some low-wage industries where that practice has been found to be particularly problematic, such as janitorial services, home care, construction, trucking, and delivery services.

On July 2, 2019, the Task Force released a report ("Report") detailing recommendations for immediate action at the administrative level and proposed legislative reforms. As a starting point, the Task Force cited a 2018 audit performed by the State DOL in 2018 of just 1% of employer accounts. This audit revealed that 12,315 New Jersey workers had been misclassified by their employers, with an estimated cost to the State of $14 million in unpaid/uncollected employment taxes resulting from $462 million in underreported wages. Such underreporting has the result of requiring compliant employers to pay a greater share of contributions to the Unemployment Trust Fund to accommodate for the shortfall. The Task Force also pointed to the impact on child support collections that are generally accomplished through wage garnishment.

The Report outlines steps already taken to combat misclassification, including the State's signing a Memorandum of Understanding with the U.S. DOL, which will result in increased coordination and information sharing. Likewise, the Task Force – comprised of representatives from the State DOL, Treasury, Law and Public Safety and other Departments that perform licensing functions – has taken steps to cross-train its member-agencies' personnel on misclassification law. The intent is to increase enforcement actions by having investigators who may be looking into, for example, cosmetology certifications, to also look into potential misclassification issues. Because of the breadth of regulation and licensing of professionals in New Jersey, this tactic alone could sweep in many more employers than relying on DOL's audits and investigations of specific misclassification complaints alone.

The Report also notes that the State DOL sent a letter to 20,000 accountants earlier this year. The letter seeks to educate practitioners on the ABC test and remind "in the strongest possible terms" that an employer's statement that a worker was a "1099 employee" or performing "1099 work" has no bearing of whether the test is actually satisfied.

Finally, the Report also recommends legislative action. Proposals include increasing maximum fines from $1,000 to $5,000 for first violations and $10,000 for subsequent violations; assessing the cost of DOL investigations on employers found to have misclassified employees; making business owners individually liable; and publicly shaming companies found to have misclassified employees.

One of the most significant legislative recommendations is the sharing of tax information with DOL. Currently, when DOL requests information from the audit subject, this includes Schedule Cs and other tax information that would show the percentage of income an entity received from one source. The fewer sources, the harder it is to claim the entity is an independent business and not just an employee of the income source. Obtaining access to the tax information directly from the State's taxing agency would make the DOL's work significantly easier.

One recommended legislative action has already been signed into law by the Governor on July 9. This law gives the DOL Commissioner the ability to issue stop-work orders on public contracts as

necessary after only an initial determination that misclassification violations have been discovered. This expanded power could prove costly to employers, though it remains to be seen how often or in what circumstances the Commissioner may choose to exercise it.

In sum, the release of this report signals that the Murphy administration is gearing up to take action on misclassification. In anticipation of such efforts, employers should begin to re-evaluate the status of any workers that they currently identify as independent-contractors, and take care when considering entering into new independent contractor agreements. To that end, employers should contact experienced labor counsel to review and revise independent contractor agreements, and attempt to avoid or minimize the risk of costly mistakes associated with misclassification. If you have any questions or concerns, please contact Kenneth A. Rosenberg at 973.994.7510, krosenberg@foxrothschild.com, Justin Schwam at 973.548.3313, jschwam@foxrothschild.com, Nicole Espin, at 973.548.3334, NEspin@foxrothschild.com or any member of Fox Rothschild's Labor & Employment Department.