

FIRST REPORT
of the
TASK FORCE ON
EMPLOYEE MISCLASSIFICATION
DECEMBER 1, 2008

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MISSION STATEMENT

The Task Force will study employee misclassification throughout the state of New Hampshire, focusing on what is meant by misclassification, the extent of misclassification, relative levels of misclassification in different industries and different regions of the state, and the impacts of misclassification on worker protections, revenue and funding. Further, the Task Force will report its findings and, if necessary, develop a comprehensive and statewide strategy to begin to address the issues identified, including its recommendations and if appropriate, proposed legislation.

Introduction

The 2008 session of the New Hampshire General Court passed Senate Bill 500, which along with strengthening penalties for employers purposefully avoiding workers' compensation insurance to their employees, also established a New Hampshire Task Force to Study Employee Misclassification.

Worker classification in the broader sense refers to the designation of a worker as an employee or independent contractor. Under New Hampshire law, every worker is considered to be an employee until proven otherwise. Working as an independent contractor is a legitimate and well-accepted business model here in NH, and using independent contractors is a legal means of doing business. However, in New Hampshire and nationally, there has been growing concern about the number of workers who are, in fact, employees but are being treated as independent contractors.

Correct classification of workers has important implications. Incorrect classification as either an employee or an independent contractor may affect many public and private issues, including but not limited to labor standards such as minimum wage and overtime requirements, unemployment insurance, federal and state payroll taxes, business profit taxes, compliance with workplace safety and health requirements and workers compensation insurance.

Neither employers nor workers can arbitrarily choose one status over another. Rather, various conditions and criteria for determining worker status are contained in federal and state laws and rules, and these factors are applied to the facts and circumstances of a specific relationship between a worker and an employer.

Employers that misclassify employees as independent contractors may not pay their fair share of business taxes, withhold income taxes or pay the employer's share of FICA and unemployment insurance. Other taxpayers are then required to pay relatively more in taxes to make up for those who avoid their obligations.

Many studies have been done or are ongoing around this issue, with one of the fundamental concerns being that employers that correctly classify their workforce as employees are likely to be at a competitive disadvantage to those employers that misclassify workers and thus avoid some of the costs of doing business we discuss above. Estimates of the cost savings to non-compliant employers, while they vary, can be significant. In a competitive industry, especially

one where competing organizations bid for contracts or jobs, this may mean lost business opportunities for those employers who ‘play by the rules’ and thus incur higher overhead costs.

While misclassified workers are still eligible to receive unemployment compensation and worker’s compensation for workplace injuries, the payment of such benefits may be delayed for an extended period of time while a determination is made as to whether they were misclassified. Typically, this determination process must be initiated by the worker, despite the fact that under New Hampshire law there is a rebuttable presumption that workers are employees. Such benefits are ultimately funded by other employers who have been properly paying their share of unemployment compensation and workers’ compensation. However, when a misclassified worker’s employer carries no workers’ compensation insurance, the cost for treatment for any workplace injury will ultimately be passed along to health insurers and state free care pools. This places an additional burden on taxpayers/consumers and employers who do provide health insurance. Finally, they may not be able to seek protections that employees are entitled to under the Fair Labor Standards Act or various employment discrimination laws.

The second meaning of misclassification is within the workers’ compensation arena. Workers are classified by the type of work they do, and the premiums are developed based on those classifications. Since different types of work result in different levels of risk of employee injuries or illnesses, the rates vary by classification. Thus, if employees are misclassified into the wrong employment types the premiums will not adequately reflect the risk of the work they do.

The Mission Statement (shown above) will focus and direct the activities of the Task Force, and allow us to look at employee misclassification from both these perspectives. After consideration, the Task Force determined that its first steps should be to solicit input and presentations from various governmental agencies, private industry, the insurance industry and other states working on the same or similar issues. To date, the Task Force has had several different presentations, each of which has contributed to the knowledge base of the members. We will continue in this fact-finding mode over the upcoming months as we develop an understanding, and then, if necessary, strategies for addressing, the misclassification issues.

Meeting of September 3, 2008

The Committee met for the first time on September 3, 2008. At that meeting Ms. Deborah Stone representing the New Hampshire Insurance Department was elected chairperson of the Task Force and Representative Randolph Holden was elected clerk.

The first order of business was developing the mission statement (see page 5).

As the issue of employee misclassification is not unique to New Hampshire it was decided the Task Force should explore what other states have done in this area or are in the process of doing. Several sources of information were identified and requests for the information were sent out.

It was also determined that representatives from the Department of Insurance, Department of Labor, and Department of Revenue Administration should make presentations on any information that would be helpful to the Task Force. In addition, it was suggested the Task Force should hear from workers' compensation insurance auditors in order to know what is really happening in the marketplace.

Meeting of September 17, 2008

Cynthia Flynn of the New Hampshire Department of Labor explained the various steps the Department takes in making sure all employers are complying with the wage and hour and workers' compensation laws. When the Department receives a complaint, an inspector will go to the worksite and do an inspection. It is during these inspections that the Department of Labor determines if workers are employees or independent contractors and if the employer is carrying compensation insurance. Some employers try to bypass the compensation law by treating employees as independent contractors. In the State of New Hampshire, a person is presumed to be an employee unless the employer can prove they are independent contractors. SB 92, which was effective January 1, 2008, defines the twelve requirements that must be met in order to qualify as an independent contractor. Ms. Flynn testified that in her view it was premature to evaluate the effectiveness of the requirements under SB 92 in reducing the number of misclassified employees. However, as of the date of her testimony, while she was aware of cases pending before the Department, she was aware of only one case where there had been a determination of a repeated offense by an employer.

Christos Lianos from the New Hampshire Department of Employment Security spoke on how the Department differentiates between independent contractors and employees. There is a three-part test the Department uses for unemployment compensation claims which is called the ABC test and is used by 46 states. This test is different from the statutory test used by the Department of Labor. There are approximately 40,000 registered employers in New Hampshire; the Department audits 2% of these employers every year.

John Lighthall from the New Hampshire Department of Revenue spoke on the number of 1099s (non-employee compensation) issued in New Hampshire in 2006. It is not known how many of these 1099s may have been incorrectly issued to misclassified workers, but the Committee intends to further investigate this issue.

Meeting of October 1, 2008

The Committee heard from Daniel Montembeau, auditing manager at MEMIC Indemnity. In 2007, MEMIC Indemnity was the sixth largest workers' compensation insurer in New Hampshire. Mr. Montembeau stated 80% of MEMIC's insured contractors are using uninsured subcontractors, who may or may not be legitimately independent contractors. When doing an audit, MEMIC uses the 12 step test in SB 92 to help identify independent contractors. In addition, their auditors check payroll records (940's), certificates of insurance, 1099's, and contracts if possible. Mr. Montembeau pointed out that misclassified workers have been seen in the construction, taxicab, drywall installation, floor covering installation and building operation industries.

Thad Dougherty, New Hampshire senior auditor for Acadia Insurance also spoke to the Committee. In 2007 Acadia Insurance was the fifth largest workers' compensation insurer in New Hampshire. Mr. Dougherty stated he also goes through the same procedures MEMIC does in trying to identify independent contractors who are really employees. Mr. Dougherty explained some areas where he has been successful in separating independent contractors from employees, such as business cards with the employers 24 hour access number, painted signs on trucks and advertising. Mr. Dougherty also mentioned it is sometimes difficult to obtain all the necessary information to do the audit as he may be dealing with a bookkeeper, or an accountant off of the premises as opposed to the owner of the business. Bookkeepers and accountants generally don't know all the employees and who should be classified in which job. Mr. Dougherty stated that misclassified workers have been observed in the construction, property maintenance, newspaper delivery, trucking and shipping industries.

Meeting of October 15, 2008

Ellery Hathorn from the Department of Labor described four hearings recently held by the Department regarding alleged employee misclassification. In two of these cases; the workers were found to be properly classified as independent contractors; in the other two cases, the workers were found to be improperly classified as such. Mr. Hathorn chose these four cases for discussion purposes.

Chairperson Deborah Stone informed the committee the New Hampshire Department of Insurance does not hold hearings on employee misclassifications, but the Department works with the parties when possible to help them reach an agreement on the appropriate premium after an audit. Misclassification cases are heard at the Department of Labor if they have been triggered by a claim or potential claim. A recently enacted law directs misclassification cases stemming from the underwriting/premium side to the Department of Labor as well, however, second tier cases (i.e. subcontractor of a subcontractor working for a general contractor) are not within the scope of that law, and in those cases, disputes might be heard at the Department of Insurance. Some members of the Task Force have suggested that the Task force consider whether to make a recommendation that all cases be heard by one agency. Information on independent contractors from the following states was given to the committee for review: CT, ME, RI, MI, MT, CA, CO, DL, IL, NJ, NY, SC, TN, VT, WA, FL, IA, LA, MA, MN, MS and UT. The Task Force also

reviewed versions of independent contractor registration/certification processes in IN, MN, MT and RI.

Meeting of October 29, 2008


George Rioux, District Director of the U. S. Department of Labor, made a presentation to the Committee on what his department is doing to identify employers who are not complying with federal labor laws. Mr. Rioux is in charge of northern New England and has 16 inspectors covering ME, NH, VT and MA. These inspectors visit businesses to make sure they are in compliance with federal labor laws. Most of the inspections are the result of complaints. Mr. Rioux explained that for the most part his inspectors have been focused on wage & hour complaints. He also said that the U. S. DOL has recognized that the issue of misclassifying employees as independent contractors is a rapidly growing problem and the U. S. DOL will be placing a special focus in that area beginning in 2009. Mr. Rioux roughly estimated that 60% of the complaints come from the construction industry with the manufacturing industry receiving the next highest number of complaints.

Conclusion

The Task Force represents a wide spectrum of businesses, organizations and workers.. The Task Force is still at the beginning of a long fact-finding process aimed at determining whether employee misclassification creates a serious problem in New Hampshire, and if so, to what degree. The Task Force will continue to invite input from different government agencies, businesses, legislators, etc. in order to further its understanding of the issues here in New Hampshire. Going forward, the Task Force will use the input to help it assess the effectiveness of New Hampshire's current laws, programs and policies to counter such misclassification and, if necessary, recommend further processes or legislation to address the aspects of misclassification in the future.

The Task Force will also assess the effectiveness of how the various executive branch departments share and make use of the results of each other's enforcement efforts. Finally, the Task Force will be inviting representatives from other states who are prominent in similar efforts of those jurisdictions in order to leverage the valuable work being done outside the state.

Respectfully submitted,


Deborah L. Stone
Chairperson

APPENDIX A

Statement from the Commissioner of the Department of Labor

“The NH Department of Labor has the mission to serve and protect the New Hampshire workforce. We can perform that task best when workers are properly classified as employees or independent contractors. Too often workers are taken advantage of by employers who seek to misclassify works, and deny them the protection of wage laws, safety controls, workers’ compensation and financial benefits such as tax payments and unemployment benefits.

Because of a recent state statutory change, which re-defined the word “employee” as used in our labor laws, we are now able to assure that employees are not unfairly treated by employers who seek to avoid providing proper legal benefits to workers, while still permitting person to enter into independent contractor relationships when they wish to do so. By making the presumption that work relationships are usually employment, the law assures that most workers gain the benefits of the laws designed to uphold the physical and financial well-being of those who must earn their living by providing labor for pay.

Our Department will continue to enforce these laws with thorough investigations and vigorous enforcement.”

Statement on Employee Misclassification
by the New Hampshire Department of Revenue Administration

The mission of the Department of Revenue Administration is to collect the proper amount of taxes due, incurring the least cost to the taxpayers, and in a manner that merits the highest degree of public confidence in our integrity, efficiency and fairness.

If employers misclassify their workers as independent contractors instead of employees, this would be one of many areas to consider in the performance of our audits. Treating a worker as an independent contractor may increase an employer's adjusted gross business profits but reduces their wage component for the Business Profits Tax apportionment formula. At the same time, the amount of Business Enterprise Tax an employer should pay would be decreased.

When conducting audits, the Department is often reviewing the pertinent issues months and sometimes years after the close of the tax year. The area of misclassification is problematic at that later date. The issue really needs to be addressed during the year in which the employment occurs. A more timely determination by other New Hampshire Departments such as the Departments of Labor and Employment Security would directly impact the employer's federal tax return. This return is the basis for the New Hampshire audits we perform. Therefore, early intervention and departmental cooperation are necessary to alleviate the issue of employee misclassification.

The Department of Revenue Administration has a long history of working very well with other New Hampshire agencies. On this issue and many others, we endeavor to further our cooperation and will continue to do so in order to collect the proper amount of taxes and live up to our motto of "Equity for All".

Margaret J. Fulton
Assistant Commissioner

Statement from the New Hampshire Insurance Department
Commissioner Roger Sevigny

The New Hampshire Insurance Department's main goal is to protect the consumers of the state of New Hampshire. The Department accomplishes this through many actions, paramount among them regulating the way insurance companies do business in the state and also monitoring and protecting the solvency of insurance companies so that they are able to pay claims.

The issue of employee misclassification affects the work of the Insurance Department and the Department of Labor in multiple ways having to do with Workers' Compensation insurance. Workers' Compensation law is actually a law through the Department of Labor and the basic issues of whether entities have workers' compensation insurance when required, whether workers are correctly classified as either independent contractors or employees, and whether an insurance company has to pay a claim for an injured worker when the correct classification is in dispute are all handled by them.

The Insurance Department gets involved in other aspects of the situation. Since workers' compensation is a type of insurance policy, the Department is responsible for regulating the forms, rates and rules the workers' compensation insurance companies use. Workers' compensation rates vary by work-type classifications; for example, the rate per \$100 of payroll for a clerical worker is a small fraction of the rate per \$100 of payroll for a carpenter. There are approximately 600 of these workers' compensation classification codes.

When workers are misclassified within these classification codes, the premiums collected do not appropriately reflect the risk borne by the insurance company. Also, if workers are incorrectly classified as independent contractors (when they should be classified as employees) there may be no premium collected for them at all if they choose to be excluded from workers' compensation. As a result, the total of all premiums collected within the system may not be adequate to pay the associated claims, resulting in higher rates, and thus premiums, for everyone in the system.

There has been an obvious need for the Insurance Department and the Department of Labor to work together to help ensure that the workers' compensation laws are applied appropriately and fairly, and that the workers' compensation market is working in such a way that there is availability and affordability of workers' compensation insurance. The two Departments have a long history of collaborative efforts and will continue to cooperate as we move forward. We also wish to facilitate better communication between all agencies of the state in order to continue to address the issues we face, with employee misclassification being a high priority.

Statement from New Hampshire Employment Security
Commissioner Richard Brothers

A central component of the mission of New Hampshire Employment Security (NHES) is the payment of unemployment compensation benefits to eligible claimants and the collection from employers of the tax which funds these payments.

The misclassification of workers as independent contractors improperly decreases the amount of taxes an employer pays, decreasing the amount of money in the Unemployment Trust Fund and thus the funds available for the payment of unemployment benefits. It also unfairly increases the tax burden on employers who are paying their fair share since an employer's tax rate is determined, in part, by the amount of money in the Trust Fund. Finally, if a worker is incorrectly led to believe that he or she is an independent contractor, the worker may mistakenly believe that he or she is not eligible for benefits and fail to apply.

If a misclassified worker does file for unemployment compensation, a "blocked claim" results, triggering an investigation by NHES' Contributions Section. If NHES determines that the individual is indeed an employee, benefits are paid, and the employer is required to pay taxes, including back taxes for the period during which the individual was an employee of the company plus interest. However, the investigation and determination of benefit eligibility delay the worker's receipt of benefits, potentially causing great hardship to the worker.

The only other means of identifying misclassifications traditionally available to NHES has been the random audit of employers.

More recently, NHES has gained access to information from the Internal Revenue Service which will enable the department to identify cases of misclassification in a more proactive manner. Also, since July 1, 2006, New Hampshire law has allowed NHES to impose upon an employer a penalty of up to \$25 for each misclassified worker for each calendar day such violation occurs.

NHES looks forward to greater communication and coordination among New Hampshire state agencies in identifying instances of worker misclassification and addressing this important issue.

APPENDIX B

Under New Hampshire law, every worker is considered to be an employee until proven otherwise (RSA 281-A:2.VI.b.1)

Any person, other than a direct seller or qualified real estate broker or agent or real estate appraiser, or person providing services as part of a residential placement for individuals with developmental, acquired, or emotional disabilities, who performs services for pay for an employer, is presumed to be an employee. This presumption may be rebutted by proof that an individual meets all of the following criteria:

(A) The person possesses or has applied for a federal employer identification number or social security number, or in the alternative, has agreed in writing to carry out the responsibilities imposed on employers under this chapter.

(B) The person has control and discretion over the means and manner of performance of the work, in that the result of the work, rather than the means or manner by which the work is performed, is the primary element bargained for by the employer.

(C) The person has control over the time when the work is performed, and the time of performance is not dictated by the employer. However, this shall not prohibit the employer from reaching an agreement with the person as to completion schedule, range of work hours, and maximum number of work hours to be provided by the person, and in the case of entertainment, the time such entertainment is to be presented.

(D) The person hires and pays the person's assistants, if any, and to the extent such assistants are employees, supervises the details of the assistants' work.

(E) The person holds himself or herself out to be in business for himself or herself.

(F) The person has continuing or recurring business liabilities or obligations.

(G) The success or failure of the person's business depends on the relationship of business receipts to expenditures.

(H) The person receives compensation for work or services performed and remuneration is not determined unilaterally by the hiring party.

(I) The person is responsible in the first instance for the main expenses related to the service or work performed. However, this shall not prohibit the employer or person offering work from providing the supplies or materials necessary to perform the work.

(J) The person is responsible for satisfactory completion of work and may be held contractually responsible for failure to complete the work.

(K) The person supplies the principal tools and instrumentalities used in the work, except that the employer may furnish tools or instrumentalities that are unique to the employer's special requirements or are located on the employer's premises.

(L) The person is not required to work exclusively for the employer.