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## Pennsylvania Joins New Jersey in Penalizing Misclassification of Workers as Independent Contractors

*Legal Alert*

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November 17, 2010

Following the trend to penalize employers in the construction industry who misclassify employees as independent contractors, the Pennsylvania legislature has enacted the Construction Workplace Misclassification Act (CWMA), which becomes effective on February 10, 2011. Similar to the New Jersey Independent Contractor Misclassification Act, the Pennsylvania law establishes a rigid set of criteria that construction industry employers must follow in order to properly classify a worker as an independent contractor. Civil and criminal penalties may be imposed if a worker is misclassified. Although the Pennsylvania and New Jersey laws currently focus on construction employers, there are both federal and state initiatives aimed more broadly at any employers who misclassify workers.

### **Independent Contractor Analysis Under Pennsylvania Law**

Under the CWMA, a construction worker may not be treated as an independent contractor unless the following criteria are met:

- A. the individual has a written contract to perform services
- B. the individual is free from control or direction by the employer for the services the individual has been engaged to perform
- C. the individual is customarily engaged in an independently established trade, occupation, profession or business

To satisfy the third criteria above, "customarily engaged in an established trade, occupation, profession or business," the CWMA establishes the following six sub-factors to consider:

1. whether the individual who is engaged to perform services possesses the essential tools, equipment and other assets necessary to perform the services independent of the person for whom the services are performed
2. whether the individual will either realize a profit or suffer a loss
3. whether the individual has a proprietary interest in the business performing the service
4. whether the individual has a business location that is separate from the location of the person for whom the services are being performed

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5. whether the individual has previously performed the same services for another person or holds himself out to other persons as available and able to perform such services

6. whether the individual maintains liability insurance of at least \$50,000

### **Violations and Penalties**

The Pennsylvania Secretary of Labor may impose civil penalties for each misclassified worker of up to \$1,000 for the first offense and up to \$2,500 for each subsequent violation. Because each misclassified worker may constitute a separate violation, civil penalties may be substantial. In addition to the foregoing, the Secretary of Labor may issue a stop worker order—halting all work until the misclassification has been rectified. Criminal penalties for intentional and negligent violations also may be imposed. An intentional violation is a third-degree misdemeanor for which a one-year prison sentence may be imposed for a first offense. A negligent violation is a summary offense subject to a fine of up to \$1,000. There is a “safe harbor” provision included in the legislation that provides a defense for an employer who had a good faith belief that the worker qualified as an independent contractor at the time the service was performed. Significantly, however, civil and criminal liability will extend to any business or individual that contracts with the employer contractor, if they knew the classification by the employer was incorrect. The CWMA also contains a non-retaliation provision prohibiting an employer from taking adverse action or discriminating against a worker for making a good faith complaint about his or her classification as an independent contractor.

### **New Jersey Law**

In New Jersey, under the Construction Industry Independent Contractor Act (CIICA), it is a crime for an employer to knowingly (1) fail to provide workers’ compensation coverage; (2) misrepresent employees as independent contractors; or (3) provide false, incomplete or misleading information regarding the number of employees working for the employer. Punishment for an intentional violation of the CIICA may include a prison term of up to 18 months and fines of up to \$10,000. Criminal liability may be imposed not only against the business entity, but also against responsible individuals within the business. An employer who unknowingly violates any of these provisions is guilty of a disorderly person’s offense.

### **Federal Initiatives Affecting All Employers**

All employers, not just employers in the construction industry, should carefully consider whether their workers are properly classified as independent contractors because the U.S. Department of Labor (DOL), in conjunction with the Internal Revenue Service (IRS), has established an initiative to detect, investigate and prosecute employers misclassifying workers as independent contractors. On February 1, 2010, the DOL released its 2010 fiscal year budget in which 25 million dollars has been allocated for a “joint labor-treasury misclassification initiative.” Among other things, the initiative will add 100 personnel whose primary focus will be to investigate worker misclassification. The DOL’s focus to “detect and deter” such misclassification is reemphasized in its just-released Strategic Plan for fiscal years 2011 through 2016. Key goals are reviewed in the Strategic Plan, and listed among the top five is the DOL’s effort to rectify the misclassification of employees.

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Additionally, there are three pending federal legislative efforts aimed at eradicating worker misclassification. The Employee Misclassification Prevention Act (EMPA), the Fair Playing Field Act of 2010 (FPFA) and the Taxpayer Responsibility Accountability and Consistency Act of 2009 (TRACA) are focused on deterring the misclassification of employees. The EMPA would amend the Fair Labor Standards Act and require specific record keeping for employers and notice to workers who have been classified as independent contractors about how to challenge their classification. The FPFA would end the “safe harbor” that permits a business to treat workers as independent contractors if it has a reasonable basis to do so and has consistently treated such workers as independent contractors. The TRACA would allow workers who have been classified as independent contractors to petition the IRS to determine if they have been properly classified, in addition to providing penalties for misclassification.

### **What To Do Now**

Clearly, there is a strong effort by the federal government and various states to penalize employers who misclassify workers as independent contractors. Pennsylvania and New Jersey are among 18 states (including Delaware and New York) that have passed such legislation, and employers should take steps now to examine and evaluate their independent contractor relationships and independent contractor agreements.

### **Action Steps**

1. Evaluate current independent contractor relationships.
2. Review contractual agreements with independent contractors and ensure the relationship meets the criteria noted in the legislation.
3. Reclassify work relationships as necessary.
4. Require “partner” construction businesses to certify, in writing, that workers classified as independent contractors meet the requirements of the CWMA.
5. Educate managers and supervisors about the requirements necessary to maintain independent contractor status and in particular, make sure managers and supervisors do not interfere with the independent contractor’s freedom from control or direction of the services performed.

For more information about the information contained in this alert, please contact any member of the Labor and Employment Practice Group at Flaster Greenberg PC.