Final Report on Issues Relating to the New Definition of Employment As established in L.D. 1314

Presented to the Labor, Commerce, Research and Economic Development Committee by the Maine Department of Labor, Bureau of Unemployment Compensation and the Maine Workers' Compensation Board

MAINE DEPARTMENT OF LABOR
Bureau of Unemployment Compensation

MAINE WORKERS' COMPENSATION BOARD

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During the Second Regular Session of the 125th Legislature, P.L. 2011, Ch. 643, commonly referred to as L.D. 1314, was enacted. This law created a new independent contractor definition to be applied in both the unemployment and workers' compensation contexts. The new definition took effect on January 1, 2013. As part of the legislation, the Legislature requested that the Commissioner of Labor in conjunction with the Executive Director of the Workers' Compensation Board submit reports on the effect of the new definition. This document represents the Maine Department of Labor, Bureau of Unemployment Compensation and Workers' Compensation Board's final comprehensive report requested by the Legislature. The report was required to specifically include information in five areas, outlined below.

In addition, the Bureau of Unemployment Compensation and the Workers' Compensation Board have continued efforts to collaborate on the rollout of the new employment standard. In addition to joint educational and outreach efforts, which have previously been reported to this Committee, the Bureau and the Board have worked together to share information obtained during audits and have conducted joint audits of employing units where appropriate. The Bureau and the Board anticipate that this cooperation will continue, ensuring that employers receive consistent application of the new law.

Another important development to report is that the State of New Hampshire has expressed interest in how Maine's new employment standard is working in the unemployment and workers' compensation contexts. Staff from the Workers' Compensation Board and the Bureau of Unemployment Compensation have consulted with officials and staff members of the New Hampshire Department of Labor and the New Hampshire Bureau of Employment Security regarding the introduction and implementation of the new employment standard. These New Hampshire officials are exploring the introduction of legislation similar to Maine's new employment standard. If, in fact, New Hampshire were to adopt a standard that mirrored Maine's definition of employment, it would streamline enforcement of misclassification cases involving businesses that operate in both Maine and New Hampshire.

Set forth below are responses to the particular inquiries that the Bureau of Unemployment Compensation and the Workers' Compensation Board were directed to provide.

An analysis of the new criteria in comparison with previous criteria for both workers' compensation and unemployment insurance.

Unemployment Compensation

The attached table shows the audit experience from 2010 through 2014 conducted by the Bureau's field advisors and examiners to identify misclassification of workers, that is, instances in which an employing unit has improperly characterized a worker as an independent contractor or subcontractor when that worker is actually in an employment relationship with the employing unit. From 2010 through the second quarter of 2012, the Bureau's field advisors were conducting their audits using the test for employment that had been in the Employment Security Law since 1935, the so-called "ABC Test."[1] The percentage of misclassification for each quarter of 2010 through the first quarter of 2011 were quite high, ranging from 25 to 37 percent. These high numbers were largely attributable to the fact during this period the field advisors were engaged in a targeted audit of the construction industry, which has a historically higher level of misclassification of employers than would be found across a broader spectrum of industries.

In 2011, the field advisors resumed auditing employers on a random select basis. Thus, as shown in the table, even though the ABC Test was still being applied, the percentage of misclassification found decreased. For example, in the second quarter of 2011, of the 348 employers who were audited, 66 were found to have misclassified employees as independent contractors (294 workers), which was 19 percent of the audited employers. This number continued to decrease over the next three quarters to a low of 6.5 percent in the first quarter of 2012.

Beginning in the second quarter of 2012, the field advisors began applying an amended version of the ABC Test, which had been enacted by the Legislature to go into effect on June 10, 2011. This new test was a variation on the ABC Test in that it allowed an employing unit to overcome the presumption that a worker was in an employment relationship by meeting ***either*** part A and part B of the ABC Test, *or* meeting part A and part C of the ABC Test.[2] With this variation, employers being audited had a greater opportunity to show that a worker was not in an employment relationship. Thus the percentage of employers who were found to have misclassified workers was relatively low. In the fourth quarter of 2012 and the first quarter of 2013, the percentage of employers found to have misclassified workers was 4 percent.

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[1] The ABC Test, which was in effect from 1935 through January of 2013, read as follows:

Services performed by an individual for remuneration shall be deemed to be employment subject to this chapter unless and until it is shown to the satisfaction of the bureau that:

1. Such individual has been and will continue to be free from control or direction over the performance of such services, both under this contract of service and in fact; and
2. Such services is either outside the usual course of business for which such services is performed, or that such services is performed outside of all the places of business of the enterprise for which such services is performed; and
3. Such individual is customarily engaged in an independently established trade, occupation, profession or business.

[2] The Bureau conducts audits of employers for tax years after the tax periods in issue are closed. Therefore, even though the definition of employment changed as of June 10, 2011, the Bureau did not begin auditing the records for quarters that post-dated this change to the law until a year after the law went into effect.

In 2012 the Legislature modified the definition of employment again, applying an entirely new approach to both unemployment and workers' compensation. The new standard went into effect in January 2013, but again because of the natural lag time that is inherent in tax audits, it was not until April of 2014 that the Bureau was auditing employers for 2013 tax quarters using the new standard.

Also in 2012, the United States Department of Labor amended the requirements for how the Bureau was to conduct audits. Prior to 2012, the Bureau was required to conduct audits of at least 2 percent of all employers who were paying unemployment contributions. In 2012, the USDOL shifted the audit emphasis to focus on misclassification. The USDOL performance standards compelled the states, including Maine, to seek new information tools and use audit selection methods to help identify where misclassification may be occurring. The audit selection practices included targeting businesses that issued a large number of 1099s, or had shown a shift toward the use of 1099s, which indicated high use of independent contractors. In accordance with these new federal performance measures, the Bureau redirected its audits to identify misclassification.

Audits conducted following the change to the new employment standard and a change in the federal requirements resulted in an increase in the finding of misclassification. In the third quarter of 2014, for example, of the 296 employers audited, the field found that 81 employers, or 27 percent, had misclassified workers as independent contractors (235 workers). This was up from 6.8 percent in the second quarter of 2014. The fourth quarter of 2014 showed that 21 percent of employers had misclassified workers.

The Bureau believes that the increase in the finding of misclassification is the result of both the change in the standard as well as the federal government's directive to increase the percentage of misclassification findings. The new employment standard asks very clear and specific questions as part of the definition itself. This requires the employing unit to give a much more accurate picture of exactly what is happening in the workplace, which has resulted in finding misclassification that previously was missed. The specificity of the language also requires the field advisors to apply consistent criteria, leading to more consistent audit findings.

In addition, there is one mandatory component of the new employment standard that was not contained in the original ABC Test: "The individual has the opportunity for profit and loss as a result of the services being performed for the other individual or entity." 26 M.R.S. § 1043(11)(E)(1)(c). In asking this question, the Bureau is finding that some workers who are being classified as independent contractors are not, in fact, risking financial loss when taking a particular assignment from an employing unit. These workers are paid by the employing unit regardless of whether the employing unit suffers a loss. These workers may not have any investment in their business and do not have the hallmarks of a truly self-employed individual. Applying this mandatory provision of the new standard, many employing units are unable to overcome the presumption that such workers are in an employment relationship. The Bureau believes that this particular criterion may be leading to increased findings of misclassification.

Please see chart on page 5.

Workers' Compensation

The Workers' Compensation Board finds the new standard is easier to understand for employers, employees and independent contractors to determine whether or not an employer-employee relationship exists. In 2013, the new language created a rebuttable presumption that an individual performing services for remuneration is an employee. This was new and it shifted the burden of proof to the hiring entity to prove it is more probable than not that the individual is an independent contractor rather than an employee. This relieved the Workers' Compensation Board of issues created by employers and potential employees who refused to cooperate with investigations into their employment status.

Additionally, the new test is more straightforward, which adds to ease of use. In the previous test, the Workers' Compensation Board looked at certain factors and weighed the totality of the circumstances in determining whether a worker was an employee or independent contractor. This test made it harder to determine whether the workers were employees or independent contractors. The new test lists certain criteria that *must* be met in order to be considered an independent contractor. For example, in the new test, a worker must be allowed to hire and employ assistants. If not, they are not considered to be an independent contractor. In the previous test, this was just one factor that was looked at and was not given any more weight than other factors. This change has introduced more certainty into determining whether a worker is an employee or independent contractor.

Unemployment Audits

	# of misclass employees	# of Employers with misclass		Audit Year	Test Used
2010		Misclass Audits/Total Audits			
1st qtr	331	76/297	25.60%	2008	"ABC Test"
2nd qtr	301	72/190	37.90%	2009	"ABC Test"
3rd qtr	462	85/238	35.70%	2009	"ABC Test"
4th qtr	259	51/189	27.00%	2009	"ABC Test"
	1353				
2011					
1st qtr	278	71/209	34.00%	2009	"ABC Test"
2nd qtr	294	66/348	19.00%	2010	"ABC Test"
3rd qtr	79	26/254	10.20%	2010	"ABC Test"
4th qtr	150	27/211	12.80%	2010	"ABC Test"
	801				
2012					
1st qtr	64	12/185	6.50%	2010	"ABC Test"
2nd qtr	55	16/219	7.30%	2011	"A+B or A+C and ABC Tests"
3rd qtr	238	33/298	11.10%	2011	"A+B or A+C and ABC Tests"
4th qtr	132	14/198	7.10%	2011	"A+B or A+C and ABC Tests"
	489				
2013					
1st qtr	77	9/209	4.30%	2011	"A+B or A+C and ABC Tests"
2nd qtr	61	9/153	5.90%	2012	"A+B or A+C"
3rd qtr	9	9/114	7.90%	2012	"A+B or A+C"
4th qtr	37	3/75	4.00%	2012	"A+B or A+C"
	184				
2014					
1st qtr	13	4/103	3.90%	2012	"A+B or A+C"
2nd qtr	19	9/132	6.80%	2013	New Employment Standard
3rd qtr	235	81/296	27.40%	2013	New Employment Standard
4th qtr	118	45/211	21.30%	2013	New Employment Standard
	385				

Until June 10, 2011, the ABC Test was in place to determine the existence of an employment relationship. From June 10, 2011 until December 31, 2012, the ABC Test was modified to be the A+B or A+C Test. Under this variation, the employing unti had to meet prong A so as to show that it had no control over the worker(s) in question, but then the employing unit had to meet either Prong B or Prong C.

As of December 31, 2012 the New Employment Standard went into effect. The New standard replaces the “ABC Test”, as well as the “A+B or A+C Test”.

The identification of any issues with the interpretation or the understanding of the new criteria language by agency staff, businesses and workers.

Bureau of Unemployment Compensation

The field advisors do not report difficulty with applying and interpreting the new standard. The Bureau finds the new standard easier to apply because of the clarity of the language and the greater opportunity to elicit specific information from employers. While the new employment standard contains many of the same components of the ABC Test, because those components are specifically included in the language of the law itself, the Bureau believes that employing units are finding it easier to understand how they have "failed" to meet the test. The number of appeals to the Maine Unemployment Insurance Commission of determinations of liability for unemployment contributions has decreased since the new standard has been in effect.

Workers' Compensation Board

The Workers' Compensation Board has not found any significant issues with the interpretation or the understanding of the new language by agency staff, businesses and workers. It has been easier to communicate with employers, employees and independent contractors regarding the test because it is the same one applicable in the unemployment context. Previously, this issue caused great confusion because the tests for each agency were different. This source of frustration and confusion has since been relieved. The staff finds the test to be clear and easier to explain to the public. Employers have commented the new test can be helpful for planning purposes when structuring their businesses.

The identification of any issues in the application of the criteria across different industries and occupations.

Bureau of Unemployment Compensation

Audits conducted between 2010 and 2014 revealed that 76.5% of the audits with misclassified workers were in the construction industry; 7.4% of the audits with misclassified workers were in the landscaping Industry; the remaining 16.1% of misclassified workers were found across several industries, such as hotels, restaurants, dentists, used car dealers, janitorial services. Application of the new employment standard is still in the early stages of implementation so it is unknown whether there will be a shift in the sectors of employment in which misclassification is found.

Workers' Compensation Board

The Workers' Compensation Board found no specific issues in the application of the criteria across different industries and occupations. The new test does not have a unique test for construction subcontractors as was the case in the former law. It makes it easier on the staff and employers to have a single test. Additionally, it does not give the impression to the construction industry they are being singled out with a different standard on who is an independent contractor.

One potential issue has arisen regarding employers who collect remuneration in an atypical fashion and whether or not the employment presumption applies to them. It is too soon to tell if this will be a specific or significant issue for certain industries.

Data, to the extent possible, on the potential effect of identified misclassification on the affected workers with regard to loss of fringe benefits or other workplace benefits.

Unemployment Compensation

As set forth above, the number of workers who have been identified as being misclassified has increased due to the change in federal audit requirements as well as the change in the definition of employment. Presumably these workers, once properly classified as being in an employment relationship, will be eligible for benefits that are available to employees, such as fringe benefits and other workplace benefits.

Workers' Compensation

The Workers' Compensation Board does not collect specific data on the loss of fringe benefits or other workplace benefits for misclassified employees. Presumably once workers are identified as misclassified they will then be entitled to all of the fringe and workplace benefits that other employees receive.

Data on the effects of the use of the new misclassification penalty.

Unemployment Compensation

The Legislature added a section to the Employment Security Law that provides that an employer who "intentionally or knowingly misclassifies an employee as an independent contractor" commits a civil violation and is subject to penalties up to $10,000 per violation. 26 M.R.S. § 591-A. To date the Bureau has not had an audit finding that resulted in a finding of intentional or knowing misclassification that would warrant enforcement of this provision. In future, as the new standard becomes more established and employers are audited under the new definition, the Bureau believes this penalty provision will be enforced. In a case, for example, where an employer was audited using the new standard and then is subsequently audited and found to have misclassified workers again, the Bureau will have the basis for a finding of an intentional and knowing misclassification.

Workers' Compensation

The Legislature did not enact a new misclassification penalty in the Workers' Compensation Act. The Board had sufficient penalties in 39-A M.R.S. § 324(3) and § 360(2) to penalize employers who misclassify employees.

MAINE DEPARTMENT OF LABOR