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Judge approves rules that fight misclassification of independent contractors

By Michael Kuchta

9 July 2008

ST. PAUL - An administrative law judge has given Minnesota the green light to pursue its crackdown on the fraudulent misclassification of workers in the construction industry.
The judge, Bruce H. Johnson, said the Department of Labor and Industry can implement new rules to determine which workers are genuinely 1099 "independent contractors," and which are actually W-2 payroll employees.

Unions favor the new rules, saying they will help drive unscrupulous employers and workers out of the underground economy, which will level the playing field for workers and for legitimate contractors who obey the law.

The ALJ's decision "reconfirmed that tough, rigorous standards for independent contractors are necessary to combat the rampant fraud that's going on in the construction industry," said Kyle Makarios, political director for the North Central States Regional Council of Carpenters.

Unscrupulous contractors gain unfair edge

Misclassification is no small issue: About 1 in 7 Minnesota employers misclassifies workers, according to a 2007 investigation by the Office of the Legislative Auditor. In many sectors of construction, the rate of misclassification is even higher – about 1 in 3.

Misclassification deprives the state of tax revenue; deprives workers of unemployment insurance, workers compensation coverage and other legal protections; and lets unscrupulous employers dodge legal and payroll responsibilities, according to the Legislative Auditor. That cuts their costs by an estimated 26 percent, which gives them an unfair advantage over competitors.

Rules enforce 9 requirements in state law

The new rules enforce a new law that takes effect Jan. 1, 2009. Rep. Michael V. Nelson, a member of Carpenters Local 851, was chief author of that state law.

The rules require applicants who want to work as independent contractors to provide business forms, tax records, and other documentation that proves they meet the nine requirements in state law.

Among the nine requirements, independent contractors must be in business for themselves; must control how, when and where they do their job; and must incur their own expenses.

If individuals meet those requirements, the Department of Labor and Industry will provide them an "independent contractor exemption certificate." If they don't meet all nine requirements, they must be paid as employees.

Beginning Jan. 1, no construction contractor can hire an "independent contractor" unless the contractor verifies that the individual has received state certification.

Contractors and individuals who violate the law face fines of up to $5,000 and can be reported to tax, unemployment and workers comp authorities for further investigation.

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Certificates required beginning Jan. 1

In his ruling, the administrative law judge rejected arguments by the Builders Association of Minnesota and other opponents that the rules require too much documentation and force applicants to reveal too much financial information.

The legislation, Johnson wrote, requires the department to “do more than rubber stamp a sworn statement.” Without rigorous documentation that the applicant meets the nine requirements in state statute, Johnson said, “unsophisticated workers could just be pressured into signing a sworn statement, thus perpetuating the misclassification.”

Further, Johnson cited an argument by the Carpenters’ Makarios that, absent proper documentation, the rules “would simply exacerbate the problems under the current system in that exemption certificates would be used to legitimize the misclassification.”

Johnson‘s ruling, dated June 26, was made public July 2. It means the Department of Labor and Industry is free to begin taking applications for independent contractor certification, which it plans to do beginning Sept. 1. The application fee is $150; the state certification is good for 2 years. The department will list all certified independent contractors on its website.

Although misclassification of independent contractors occurs in many sectors of the economy, the new state law applies only to the construction industry. It does not affect home repairs for individual homeowners.

Michael Kuchta is communications coordinator for the North Central States Regional Council of Carpenters.

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