

Maryland and IRS Target Misclassification of Workers as Independent Contractors

Businesses and other organizations and persons that hire people to work for them (referred to in all cases as “businesses” in this *Alert*) must be very cautious when classifying workers as independent contractors rather than employees. This is particularly true for Maryland businesses in light of a new Maryland law and an Executive Order issued by Governor O’Malley addressing the misclassification of independent contractors. The Internal Revenue Service (“IRS”) has also announced an employment tax audit initiative focusing on the misclassification of independent contractors, which should be of concern to all employers.

Maryland Workplace Fraud Act of 2009

This law goes into effect on October 1, 2009, and applies to Maryland businesses who classify individuals working for them as independent contractors. While it is beyond the scope of this *Alert* to explain this law in detail, below are some key aspects of this Act as they apply to various businesses.

Construction and Landscaping Businesses

With respect to businesses in the construction and landscaping industries, the Act:

- Contains a very stringent definition of “independent contractor” and the presumption of an employer-employee relationship rather than that of an independent contractor.
- Requires employers to pay restitution to misclassified persons and possible civil penalties up to \$20,000 per misclassified employee.
- Provides the Commissioner of Labor and Industry with broad powers of investigation, including subpoena power and the right to enter worksites, interview employees, and copy documents.
- Permits fines up to \$500 per day for failure to produced requested materials within 15 days.
- Requires employers to provide independent contractors with written statements of their classifications, the implications of such classification, and other information.
- Requires employers to keep for at least 3 years records detailing: the occupation and classification of each employee and independent contractor; the rates or methods of pay; the amounts paid each pay period; the hours worked each day and each period; and “evidence” that each person classified as an independent contractor is an “exempt person” or is an independent contractor.
- Permits persons not properly classified as employees to sue for damages.
- Prohibits discrimination or retaliation against a person for filing a complaint or testifying in an action under the Act.

- Prohibits creation of new entities for the purpose of evading the Act.

All Businesses

With respect to all businesses, the Act also amended the Maryland Unemployment Insurance Law and the Maryland Workers' Compensation Act to presume that workers are employees, and to add significant penalties that can be imposed against businesses for knowing failure to properly classify individuals as employees and thereby failing to make unemployment insurance tax contributions or providing workers' compensation coverage for such persons.

Maryland businesses should also be aware that even if a person is properly classified as an independent contractor for income tax purposes, the person may still be considered and need to be classified as an employee for unemployment insurance tax purposes (requiring payment of unemployment insurance taxes on the compensation paid to the independent contractor) and/or for workers' compensation purposes (requiring the person to be covered by the business' workers' compensation insurance).

Maryland Executive Order

Following passage of the Workplace Fraud Act, Governor O'Malley signed an Executive Order establishing a Joint Enforcement Task Force on Workplace Fraud. This task force is comprised of officials from several state agencies who are to coordinate the investigation of workplace fraud and enforcement against those who engage in it. "Workplace fraud" means an employer's failure to classify an individual as an employee in violation of law. Thus, the mandate of the Task Force affects *all* employers, not just those subject to the Workplace Fraud Act. In addition, the Task Force is charged with proposing administrative, legislative or regulatory changes to combat workplace fraud. Thus, Maryland employers can anticipate the possibility of further legislation regarding "workplace fraud."

IRS Initiative

The IRS has announced that, beginning this fall, it will begin a program of detailed employment tax audits focusing on four areas, one of which is worker classification (employee vs. independent contractor). This program is expected to last for at least three years.

Federal Legislation

It should also be noted that legislation has been introduced in Congress designed to prevent misclassification of employees as independent contractors or other non-employees.

As a result, businesses should carefully review their independent contractor relationships to determine whether their independent contractors are properly classified as such and whether these relationships comply with state and federal laws.

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