

Wisconsin To Focus on Eliminating Worker Misclassification and Its Underground Economy

Aug 24 2009

Practice Area: Construction Law and Litigation & Labor and Employment

A special State of Wisconsin Task Force is cracking down on Wisconsin employers who misclassify employees as independent contractors. "Worker misclassification" is the practice of employers wrongfully classifying workers as "independent contractors" when they are actually "employees" under the law. The Task Force believes that misclassification by an employer gives that employer an unlawful competitive advantage over those employers that "play by the rules." When workers are misclassified as independent contractors, the employer circumvents its wage payment and overtime obligations, as well as unemployment, worker's compensation and other withholding taxes and insurance obligations.

The savings from misclassification can provide an employer a significant — albeit, illegal — monetary windfall. But employers who misclassify workers risk penalties for back taxes, unemployment insurance payments owing for previously misclassified employees, wage and overtime litigation under the Fair Labor Standards Act and State laws, and other significant liability exposure. These penalties and liabilities could be very significant depending on the number of misclassified workers and the time span of the misclassification.

Worker misclassification is not a new or unique area of enforcement for the State. In a 2008 audit of only 2% of Wisconsin employers, the Task Force determined that 44% of workers were misclassified according to their standards. The Task Force reports that misclassification is particularly widespread in the construction industry. The Task Force found that in addition to denying workers the protection of workers' compensation and unemployment insurance, "the cost differential can be devastating to a law-abiding employer bidding for construction contracts and is generally destabilizing to the business climate."

The Task Force concluded that misclassification is a serious problem in Wisconsin and must be promptly addressed. In response, new legislation may be proposed and passed this fall. Possible legislation will make misclassification far more difficult. Much stronger enforcement tools and meaningful penalties are likely to be created which will ensure that workers are properly classified. It is also expected that the State's efforts to reduce misclassification will focus on the construction industry. To further reduce misclassification, the Task Force made a number of strong recommendations, including the following measures to be implemented:

- An “Office of Worker Misclassification” may be created.
- The Office would focus exclusively on worker misclassification and would include investigators and enforcement personnel who would personally visit job sites and ensure that all workers on site are properly credentialed as independent contractors or classified as employees.
- During a jobsite visit, all contractors and subcontractors will be required to provide proof of workers’ compensation insurance, an unemployment insurance account number, proof of registration for all independent contractors, payroll records for all employees (including appropriate payroll deductions), and the names, addresses and social security numbers for all workers on site.
- When a violation is found, including during a site visit, the Office will have the authority to issue stop-work orders for all work under the control of the noncomplying contractor.
- The special exemption to the “7-of-10 test” for truckers and loggers may be eliminated. The State is now questioning the policy of treating truckers and loggers separately and leaning toward eliminating the special treatment altogether.
- Stiffer penalties will be created as a sanction for those deemed to be willfully engaged in improper classification of workers.

Among other changes, it is expected that the current statutory “7-of-10 test,” used to determine whether a worker is an “employee” or an “independent contractor” for unemployment compensation purposes, will be amended. This may be helpful, because the 10-factor test can in some cases be difficult to interpret and apply.

Whether some or all of the recommendations will be adopted is difficult to accurately predict. But it seems more likely given the trend toward stricter enforcement, as evidenced by a provision in the last budget bill imposing a \$25,000 penalty per violation for any contractor who intentionally evades reporting employee wages and withholding taxes by misclassifying workers. Nor is Wisconsin’s push toward eliminating worker misclassification a novel endeavor. The problem exists in many other states, many of which have already created laws and enforcement procedures that Wisconsin can readily use as models for its own efforts.

Even if the proposed worker misclassification legislation is delayed this session, the evidence strongly suggests that Wisconsin intends to significantly increase its efforts to find and then eliminate worker misclassification and its underground economy. Businesses can expect that this will be sooner rather than later. Hence, employers—particularly those in the construction industry—should carefully revisit the status of any workers characterized as independent contractors.

Employers should carefully determine what measures, if any, should be taken now so they can withstand a State audit and to minimize the risk and fallout of any misclassification. Careful attention and development of sound strategy for addressing this matter should be on the forefront of any business who may be at risk of the disruptive results of an audit. In order to protect their interests, businesses who utilize independent contractors should retain documentation showing the person performing work for them is not an employee. This documentation may include business cards, invoices, insurance records provided to the business, agreements, bids, promotional materials, and notes.

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