

Misclassification of Employees As Independent Contractors Recently Became More Costly

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On July 8, 2021, Governor Phil Murphy signed into law legislation that will enable regulators to pursue worker misclassification in New Jersey aggressively, increasing penalties and enforcement against businesses that misclassify employees as independent contractors. Part of that legislation, Assembly Bill No. 5892, which pertains to penalties and fines and becomes effective on January 1, 2022, is going to make misclassification a very expensive mistake.

Misclassification is when employers, purposefully or inadvertently, label workers as contractors instead of employees, often to pay them off the books, or to avoid paying the employer's share of employment taxes, insurance contributions, and other legal obligations.

Employers who routinely use independent contractors in any part of their business models, should closely watch new regulatory developments governing these relationships and adjust their employment practices if necessary.

In addition to increased penalties and fines, the new law creates additional liability for employers' "purposeful or knowing" misclassification of workers "for the purpose of evading payment of insurance premiums" as a violation of the New Jersey Insurance Fraud Prevention Act, subjecting them to harsh penalties and criminal investigation by the New Jersey Department of Banking and Insurance.

Under the new law, the state will create and fund the Office of Strategic Enforcement and Compliance ("OSEC") within the Department of Labor and Workforce Development, for oversight and coordination of the law with other state agencies. The OSEC is tasked to implement a more robust process of identifying employers who misclassify employees, issue stop-work orders at worksites, impose much stricter penalties and fines, and create a database to track employer payrolls.

Worker misclassification is more common than you may think. New Jersey uses the "ABC" test for determining whether independent contractors are properly classified. Codified in the state's Unemployment Compensation Law, the ABC test deems a worker an employee unless the employer can prove all three of the following:

- (A) The worker has been and will continue to be free from control or direction over performance of the service, both under a contract of service and in fact; and
- (B) The service is either outside the usual course of the business for which such service is performed, or the service is performed outside of all the places of business of the enterprise for which such service is performed; and
- (C) The worker is customarily engaged in an independently established trade, occupation, profession or business.

Although all three prongs of this test place a high burden of proof on the employer, the ramifications of the last prong of the test are frequently overlooked. Under this provision, if the worker does not perform substantially similar work for any other business, entity, or individual, the worker is automatically deemed an employee under state law. In other words, there is no such thing as a full-time independent contractor in New Jersey. Even if the independent contractor performs work for a business only part-time, or works sporadic, irregular hours, if they do not perform substantially similar work for anyone else, they are still deemed an employee for classification purposes.

Employer Actions:

It is imperative that employers not only review the work actually being performed for them by independent contractors, but also the extent of similar work the contractor performs elsewhere. Properly classifying workers is a technical, fact-specific task that requires a thorough analysis of the worker's terms and conditions of engagement, the nature of the service performed for the business, as well as the scope of the worker's engagement and performance under contracts with other businesses, entities, or individuals.

The Porzio employment team routinely provides guidance and defends cases involving challenges to independent contractor status.