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IRS - the difference between
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Construction Workplace
Misclassification Act

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NEW PENNSYLVANIA LAW EXPOSES CONTRACTORS TO CRIMINAL LIABILITY FOR MISCLASSIFYING INDEPENDENT CONTRACTORS

The Pennsylvania legislature has just enacted a new law which significantly impacts the Pennsylvania construction industry. The "Construction Workplace Misclassification Act" targets contractors who misclassify their employees as "independent contractors." Such misclassification can occur if a contractor incorrectly treats an employee as an independent contractor for the purpose of avoiding expenses such as payroll taxes, worker's compensation insurance costs, and unemployment compensation expenses, which would be payable for actual employees. The Act provides for civil penalties, potential stop work orders, and criminal liability for such actions.

The Act applies to employers in the "construction industry," which is defined as a business involved in the erection, reconstruction, demolition, alteration, modification, building, assembling, site preparation and repair of real property on public or private projects.

It contains a relatively narrow definition of an "independent contractor." Under the Act, a person is an "independent contractor" only if: 1) the individual has a written contract to perform services; 2) the individual is free from control or direction of his performance, under the contract and "in fact"; and 3) the individual is "customarily engaged in an independent trade, occupation, profession or business" with respect to the construction services he provides.

The Act states that an individual is "customarily engaged in an independent trade, occupation or business" only if: 1) the individual possesses the essential tools and equipment to perform the services independent from the person he contracts with; 2) the contractual arrangement in place calls for the individual to earn a profit or suffer a loss as a result of the performance of the service; 3) the services are performed through a business in which the individual has a proprietary interest; 4) the individual maintains a business location separate from the location of the person for whom he is working; 5) the individual previously performed the same or similar services for another person as an independent contractor or holds himself out to the public as available to perform such independent contractor services; and 6) the person maintains liability insurance in an amount not less than \$50,000. Each of these stringent requirements must be met before an individual may be classified as an "independent contractor."

The misclassification of each individual constitutes a separate violation of the Act. The Secretary of Labor and Industry can issue an administrative Order to Show Cause against any person or company it believes has violated the Act. If it is determined that a violation has occurred, a fine of not more than \$1000 may be imposed for the first offense, and not more than \$2500 for each subsequent offense. The Secretary can also petition a court to issue a "stop work order" preventing the further employment of the misclassified individual. Violations of a stop work order are punishable with a penalty of \$1000 per day per violation.

An "intentional" violation of the Act carries with it potential criminal liability. If the Secretary concludes that there is probable cause to believe that an employer has committed a criminal violation of the Act, it can refer the violation to the Attorney General or a county District Attorney for prosecution. The Act provides that evidence of a prior conviction under the Act shall be considered evidence of intent for a subsequent prosecution. A first offense under the Act is a misdemeanor of the third degree; second or subsequent offenses are misdemeanors of the second degree. If the failure to properly classify is merely negligent, it is a summary offense punishable by a fine of not more than \$1000.00.

The Act also contains an anti-retaliation provision which bars an action against an individual who alleges non-compliance with the Act. It creates a rebuttable presumption of retaliation if an employer takes "adverse action" against an employee within 90 days of the exercise of an employee's rights under the Act. Such retaliation would presumably expose an employer to "whistle blower" liability.

This legislation imposes formidable new risks, apart from federal tax liability, for contractors who misclassify their employees as independent contractors. Construction employers are advised to review their hiring practices to ensure that they conform to the requirements of this new law.