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MINNESOTA CRACKS DOWN ON EMPLOYEE MISCLASSIFICATION

By Joseph Richie

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As the gig economy continues to blur the line between employees and independent contractors, the Minnesota legislature has enacted sweeping changes to the law surrounding employee misclassification.

What exactly, is the problem? Many employers have long sought, where possible, to classify their workers as independent contractors to avoid the obligations and costs associated with employees. Employees are protected by minimum wage and overtime laws. Employers must provide employees with work environments that meet occupational safety and health requirements. Employees are entitled to workers' compensation and unemployment benefits, and employers must obtain workers' compensation insurance and pay into the unemployment insurance program. And employers must withhold income taxes from employees' paychecks and pay a portion of Social Security taxes on the wages.

But there is a flipside of course: in theory, independent contractors should be free to negotiate their own rates, to work as much or as little as they like, and to set their own schedules. And employers should lack the ability to dictate the where/when/how of the work performed by their independent contractors.

Obviously, a misclassification can be bad news for a worker, who might be wrongly denied minimum wages or overtime or, worse, find him or herself injured or otherwise unable to work and not be eligible for workers' compensation or unemployment benefits. But there are externalities too: businesses that misclassify workers may undercut those that play by the rules because of their low labor costs. And misclassification results in tax underpayment, leaving it to the rest of us to make up the difference.

Misclassification is nothing new, but the past decade has seen enormous growth in the "gig economy," as Ubers have wiped out taxi cabs, pizza delivery has been outsourced to DoorDash, and you can even hire a Taskrabbit to wait in line for you. Each of these apps—and dozens more—treat their workers as independent contractors, even though the apps often dictate wages and some even forbid their workers from accepting work outside the app.

Worker misclassification has been the subject of a recent task force of the Minnesota Attorney General and a study from the Office of the Legislative Auditor. Both groups recommended that the legislature clarify the law, strengthen enforcement mechanisms, and better enable state agencies to combat misclassification.

The legislature responded. So now there is a bright-line rule to separate employees and independent contractors, right? Not exactly. For all but the construction industry, the legislature continues to incorporate rules promulgated by the Department of Labor and Industry to define independent contractors. Those rules establish different tests exist for 31 professions as varied as babysitters, bulk oil plant operators, orchestra leaders, photographers' models, timber fellers, and jockeys. For unlisted professions, one's status is determined by weighing the employer's "control," as determined by 14 sub-factors, alongside 7 "non-control" factors.

For the construction industry, where misclassification is rampant, the legislature created a new statutory test for construction workers stating that an individual must "operate as a business entity" that meets 14 criteria to be considered an independent contractor.

Far clearer than the tests are the consequences for noncompliance. Effective July 1, 2024, all workers have a private right of action for misclassification, and employers are liable not only for compensatory damages (e.g., minimum wage, overtime, vacation and sick pay, health insurance, etc.) but also penalties of up to $10,000 for each misclassified employee. The legislature eliminated requirements that employers have "willfully" misclassified their employees, making it far easier to prevail on these claims. Given the new private right of action, the decreased burden, and the increased penalties, it is likely only a matter of time before plaintiffs' firms begin aggressively filing suits, similar to what we have seen in the recent past with collective actions under the Fair Labor Standards Act.

Further, the legislature created the "Intergovernmental Misclassification Enforcement and Education Partnership" to allow five state agencies tasked with investigating misclassification to better coordinate their work. Up to now, there has been tepid enforcement. By encouraging coordination, dropping requirements that employers have "willfully" misclassified employees, and creating a private cause of action, it is clear the legislature seeks more robust enforcement.

So what is an employer to do? Anyone who relies on independent contractors (or to be more precise, workers they classify as independent contractors) should thoroughly review the rules applicable to their industry, their internal policies, and also evaluate their adherence to those policies. It takes no CPA to know that $10,000/worker adds up quickly. Adjusting policies and procedures now—or even reclassifying independent contractors as employees—may be a comparatively small price to pay.

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