



State of Utah
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Governor

SPENCER J. COX
Lieutenant Governor

Labor Commission
SHERRIE HAYASHI
Commissioner

JACSON R. MAUGHAN
*Deputy Commissioner and
General Counsel*

October 30, 2015

Governor Gary R. Herbert
Senator Curtis S. Bramble
Representative Val L. Peterson

To Governor Herbert, Senator Bramble, Representative Peterson, and the members of the Business and Labor Interim Committee.

This is the fifth annual report from the Worker Classification Enforcement Council ("Council"), submitted pursuant to U.C.A. § 34-47-202. In the year since the Council's October 2014 report, the Council has continued to meet on a quarterly basis. Agenda and Minutes for all Council meetings are available on Utah's Public Notice Website.

Over the last year the Council has continued its efforts to cooperatively investigate and address worker classification issues. Of note, the Labor Commission has received and investigated misclassification complaints through its hotline, referrals from the Department of Workforce Services, and referrals from the Commission's own wage claim unit. The Department of Commerce continues to focus its enforcement efforts on construction companies engaged in improper uses of the owner-worker model and is actively engaged in litigation over related issues. The Department of Workforce Services has piloted a successful program where auditors focus on an employer outreach program and conduct 1099 non-match status investigations. And, the Tax Commission has continued to provide referrals that have led to enforcement actions against those not complying with the law. Also, of note, in August 2015 the Council's work was highlighted in a *Utah Business* magazine article.

Regulatory and Law Enforcement Efforts, and the Status of Sharing Information by Member Agencies

The Labor Commission

The Commission has maintained a web page devoted to worker misclassification issues in the State of Utah since 2012. The web page defines employee misclassification, describes the negative impacts it can have across all facets of society, and educates the public on how to file a complaint of misclassification with the Commission. The Commission has also monitored a misclassification hotline since 2012. Though calls to the hotline have tapered off slightly, the Commission has received a number of

misclassification complaints through the hotline since its inception and continues to receive viable complaints through the hotline.

The Commission is responsible for ensuring each employee in the State of Utah is covered by workers' compensation coverage. When the Commission receives a misclassification complaint, either directly or as a referral through one of the Council's member agencies, the Commission's Industrial Accidents Division investigates the complaint to ensure the employer carries appropriate workers' compensation coverage for its employees. The Division also investigates hundreds of employers each year to ensure compliance with workers' compensation requirements. The Commission has assessed and collected thousands of dollars in penalties against noncompliant employers based on misclassification complaints and referrals, as well as these internal investigations.

The Commission received 128 specific complaints of misclassification during fiscal year 2015. These complaints were received primarily through the hotline, referrals from the Department of Workforce Services, and referrals from the Commission's wage claim unit. The Industrial Accidents Division found the employer to be noncompliant with workers' compensation requirements in 72 cases, assessing penalties in the total amount of \$2,383,717.

Of the 72 cases in which the Industrial Accidents Division found the employer to be noncompliant, 20% involved employers engaged in the professional services industry, which includes employers providing health services in either a home or an office setting. Sixteen percent (16%) of the cases involved employers engaged in the construction industry. Employers in the sales and transportation industries also demonstrated high percentages of noncompliance.

The Commission, like the Council's other member agencies, shares the misclassification complaints it receives, the results of subsequent investigations, and the results of its internal investigations with the other member agencies of the Council. This ability to share information between member agencies has been and continues to be critically important to the Commission's work and in addressing employee misclassification in Utah.

The Department of Commerce

The Department of Commerce continues its enforcement emphasis related to construction companies engaged in the owner-worker model and other methods of worker misclassification.

Other methods of worker misclassification include the following:

- (1) contractors inappropriately paying workers as independent contractors rather than employees; and

- (2) contractors accepting cash payments to avoid payroll taxes and to avoid reporting to governmental agencies either as employees or independent contractors.

One company the Department has taken action against for multiple violations related to misclassification has filed five different lawsuits attempting to challenge the investigations and agency actions taken against the company. These lawsuits address the following issues:

- (1) the constitutionality of requiring an owner-worker to be lawfully present in order to work in Utah;
- (2) citations issued to the company for having owner-workers who are not lawfully present and who provided fraudulent social security numbers,
- (3) the department's authority to issue investigative subpoenas requiring 153 owner-workers to produce original identity documents including social security cards, driver licenses, birth certificates, etc. These subpoenas were issued to owner-workers who have provided social security numbers that the Department has reason to believe may be false;
- (4) the constitutionality of Senate Bill 35 passed during the 2011 legislative session and Senate Bill 44 passed during the 2013 legislative session; and
- (5) a lawsuit which is an appeal of agency action taken against the company requiring the company to produce financial information of its owner-workers as required by the Construction Trades Licensing Act or alternatively if the company does not comply with the audit and reporting requirement, that its contractor license will be revoked.

The Attorney General's office continues to defend the Department of Commerce in each of these lawsuits and is close to concluding them.

The Department of Commerce continues to receive many referrals regarding contractors that are alleged to be hiring persons as independent contractors when the persons are acting as employees.

The complainants allege that companies are paying persons in cash in order to avoid payroll tax obligations and reporting requirements, as well as to thwart the investigation and actions that may result.

In August 2014, the division hired a full-time auditor to perform financial audits of contractor licensees and to investigate the payment practices and labor misclassification within the construction industry in the State of Utah. This is a newly created position aimed at addressing misclassification.

Thus far this auditor's efforts have resulted in the following:

- 175 opened cases;
- 96 closed cases;
- 32 cases closed with administrative sanctions including fines, probation, and/or revocation of licensure;
- \$18,000 in fines paid as a result of signed stipulations and orders; and
- 21 cases with outstanding stipulation offers.

The Department of Commerce continues to benefit from information that has been exchanged through the Worker Classification Coordination Enforcement Council. This exchange of information with other agencies has assisted the Department of Commerce to take action against contractor licensees that are not complying with financial responsibility requirements. The Department of Commerce's actions against these contractors have assisted the Department of Workforce Services in its collection efforts for the Unemployment Insurance Fund.

The Department of Workforce Services

The Department of Workforce Services Unemployment Insurance Division (DWS/UI) completes both "random" and "targeted" audits on Utah employers. In the last five and one-half year period ending June 30, 2015, DWS/UI completed 6,131 "random" audits, covering \$1.6 billion in total reported wages. The random audits identified \$47 million in total unreported wages paid to 6,994 workers who were misclassified as independent contractors, averaging \$7,666 in unreported earnings and 1.1 misclassified workers per random audit completed.

During fiscal year 2015 alone, a total of 843 random audits were completed. Findings for the year include a total of \$6.0 million in unreported wages and 737 misclassified workers. During the five and one-half year period ending June 30, 2015, DWS/UI completed 1,949 "targeted" audits of Utah employers, covering \$2.6 billion in total reported wages. These audits primarily use IRS Form 1099 information to identify potential unreported workers. The targeted audits identified over \$125 million in total unreported wages paid to 21,581 workers who were misclassified as independent contractors, averaging \$64,135 in unreported earnings and 11.1 misclassified workers per targeted audit completed. During fiscal year 2015 alone, a total of 409 targeted audits were completed. Findings for the year include a total of \$28.1 million in unreported wages and 4,114 misclassified workers.

The random and targeted audit results demonstrate that while the vast majority of registered Utah employers are reporting workers properly, a significant number of Utah employers are misclassifying their workers. In recent years, DWS/UI has focused more of its audit resources on targeted audits to increase employer compliance.

The U.S. Department of Labor (DOL) has issued repeated guidance to all state UI agencies that worker misclassification detection and enforcement is a priority. States were advised of a new core performance outcome measure in the UI performance management system in 2011, which measures how effectively states use their audit resources to detect employers that misclassify their employees. The DOL measure is comprised of four factors: 1) Percent of employers audited annually, 2) Percent of total wage change from audit, 3) Percent of total wages audited, and 4) Average number of misclassifications detected per audit. DWS/UI achieved an effective audit score of 11.6 for the year ending June 30, 2015, surpassing the minimal acceptable score of 7.

Based on the effective audit measure score and other determining factors, Utah was awarded a \$327,974 “high performance bonus” grant by the U.S. Department of Labor in 2014. The bonus was provided for achieving superior performance in the area of worker misclassification detection and enforcement by the UI Contributions Field Audit team. Only four states qualified for this bonus; Utah achieved the second highest score nationally. This money was invested in programming that increases the capability of DWS/UI to collect benefit overpayments and audit larger employers.

Since October 2014, DWS/UI has piloted three new senior auditor positions which focus primarily on implementing an employer outreach program and conducting 1099 non-match status investigations. These investigations involve employers with a large number of 1099’s issued that are not yet known to the UI system. While these types of investigations often take twice as much time to complete, with an average of 19.8 hours compared to 9.6 hours for a targeted audit, they often result in a significantly higher amount of misclassified workers per audit. DWS/UI plans to continue this through fiscal year 2016 as an additional tool in combating worker misclassification.

The Department of Commerce and Labor Commission employees continue to work with DWS/UI employees in addressing this issue. Commerce employees coordinate investigations with DWS/UI when contractors are violating unemployment insurance laws. As a direct result of coordinated enforcement, DWS/UI collected \$709,692 in past-due contributions from 62 Utah employers in calendar year 2014. DWS/UI employees also referred more than 100 of unemployment insurance audits to Commerce, the Labor Commission, and the Utah Tax Commission, identifying about 3,400 workers who were determined to be employees, not independent contractors. The Utah Tax Commission identified and referred numerous instances where employers issued Internal Revenue Service W-2 forms to employees that were not properly reported to DWS/UI.

The collaboration facilitated through this Worker Classification Enforcement Council continues to support DWS/UI goal of detecting worker misclassification and enforcing the unemployment insurance laws.

The Tax Commission

The Tax Commission has benefited greatly from the information and referrals obtained as a result of its participation on the Worker Classification Enforcement Counsel. The Commission has taken the information to ensure that employers have properly classified their employees as well as used this information to establish the employers' requirement to file their employee withholding taxes and W-2 information with the Tax Commission. The Commission has also been able to share information with the Department of Workforce Services regarding employers who are required to file their unemployment returns. This information has also been shared with the Internal Revenue Service to ensure that the employers are meeting their requirement for filing the federal returns. The information being shared is only employer information. The Tax Commission is prohibited from sharing individual taxpayer information with other agencies or with the Council.

Recommended Legislative Changes

The Council appreciates the attention the Legislature has given to worker classification issues. The Council has no specific recommendations for the 2016 legislative session.

We look forward to continuing to report annual progress, and are glad to provide any other requested information or answer any questions.

Sincerely,



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ENFORCEMENT COUNCIL
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LABOR COMMISSION



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cc: Senator Karen Mayne