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An Evaluation of the Contractor Registration Pilot Project and the Misclassification of Workers in the Construction Industry



MINNESOTA DEPARTMENT OF
LABOR & INDUSTRY

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An Evaluation of the Contractor Registration Pilot Project and the Misclassification of Workers in the Construction Industry

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Report to the 2013-2014 Biennium, Eighty-Eighth Legislature

December 31, 2013

This report, required under 2013 Minnesota Statutes Section 181.723, subdivision 4a, subpart (a), evaluates the Construction Contractor Registration Pilot Project currently in effect through June 30, 2014.

This report includes:

- A description of the Contractor Registration Pilot Project;
- Background information about the Advisory Task Force on the Misclassification of Workers, the Legislative Auditor's 2007 Evaluation Report, and Legislative initiatives on Misclassification of Employees as Independent Contractors;
- Background information about the Independent Contractor Exemption Certificate (ICEC) program;
- An evaluation of the contractor registration pilot project as a tool to address misclassification of workers as independent contractors;
- Recommendations to continue and improve the contractor registration program;
- Worker Misclassification Registration Enforcement Orders between January 1, 2013 and December 6, 2013 (Appendix A); and
- Internal Revenue Service Guidelines (Appendix B).

Executive Summary

The misclassification of employees as independent contractors has long been identified as a problem in the construction industry in Minnesota. Misclassification adversely impacts businesses, workers, and the economies of Minnesota and the U.S. Misclassification prevents workers from benefiting from protections that are provided to employees by law and creates a competitive disadvantage for contractors who comply with the laws relating to workers' compensation insurance, unemployment insurance, and tax withholding.

In 2009, Minnesota took an initial step in addressing the problem of misclassification by creating the Independent Contractor Exemption Certification (ICEC) program. However, because this program applied only to individual proprietors, most workers and subcontractors formed business entities in order to avoid having to obtain an ICEC and prove that they were in fact capable of acting as a true independent contractor.

In response to the experience of the ICEC program, and as a result of recommendations made by a task force convened by the Department of Labor and Industry (DLI) to bring contractors and regulators together to address the misclassification issue, the Construction Contractor Registration Pilot Project was enacted by the 2012 Legislature. The pilot project requires all building construction and improvement contractors who are not already licensed or registered with DLI to submit an online registration through the DLI's website.

The contractor registration pilot project opened for registration July 15, 2012. Between the rollout date and 12/1/2013, 12,198 contractors have registered with DLI.

This is more than five times the number of registrations achieved under the ICEC program and demonstrates the success of the program.

DLI, in conjunction with Department of Employment and Economic Development (DEED) and the Department of Revenue (DOR), reviewed the program's progress in November 2013. The review consisted of an analysis of a statistically valid sample of the registrations, an analysis of enforcement actions taken, and calculation of the economic impact of the industrial sector.

Benefits of the Pilot Project

The pilot project has proved beneficial in reducing the misclassification of workers in the construction industry. In the relatively short time since implementation for investigations, the three agencies have accomplished the following:

- DLI has complete ownership information on over 9,000 construction employers, information that previously required labor-intensive investigations in order to identify worker misclassifications.
- DLI, in 2013, has entered 80 registration enforcement orders of the construction contractor worker classification statutes and rules, resulting in 9 license revocations. DLI assessed \$721,500 in penalties and staying \$599,750 of those penalties, leading to a net collection of \$121,750 in civil penalties.
- DEED, since implementation of the pilot project, has identified 856 misclassified employees in the construction industry.

- DOR has received 53 referrals from DLI into possible tax violations as a result of the pilot project. Sixteen of these cases have been referred to auditors or are awaiting assignment. A further 21 cases either voluntarily complied or the violations were deemed too minor to pursue.

Challenges to Implementation

Challenges to full implementation of the contractor registration pilot project include the following:

- Incomplete ownership information or no ownership information was given in 24% of registrations.
- Self-reporting of the registration status of business entities with the Secretary of State's (SOS) office is problematic for registrants. Twenty – nine percent of applicants reported they were registered with SOS. Verification attempts using the SOS look-up tool showed they were not registered under the name they entered in the pilot project database. An additional three percent were registered with SOS but had stated they were not registered.
- Thirty-four percent of registrants in the pilot project reported they were self-insured for workers' compensation purposes. Because of the business size and the cost of self-insurance, this is very unlikely and shows confusion among registrants about the meaning of self-insurance for workers' compensation coverage.

Recommendations

The program's effectiveness can be further improved by implementing the following recommendations:

- Provide greater assistance to registrants. DLI should add staff to walk new applicants through the registration process, answer common questions, and providing a more stream-lined and user-friendly registration system.
- Modify the online registration form to minimize common registration mistakes made by registrants
- Develop a systematic program to verify the accuracy of the information provided by registrants.
- Increase investigations and enforcement efforts. DLI's experience has shown that additional investigators are needed to achieve more effective enforcement of the statutes governing worker classification. Two investigators are insufficient to provide the wide ranging and impactful enforcement effort that is required to make significant inroads into construction worker misclassification throughout the state. With approximately 15,000 construction employers in the state, additional investigators are necessary to produce a significant reduction of misclassification in the industry.

- Continue to evaluate whether additional resources will be needed long-term for DLI to perform necessary enforcement and administrative activities to meet program demands.
- Provide for greater information sharing among the three state agencies involved in enforcement of the statute.

Introduction

Misclassification of employees as independent contractors adversely impacts businesses, workers, and the economies of Minnesota and the U.S. Misclassification prevents workers from benefiting from protections that are provided to employees by law. For example, when a worker is an employee, the employer must withhold and remit state and federal income taxes from wages, withhold and pay Social Security and Medicare taxes, pay unemployment insurance taxes, provide workers' compensation insurance, adhere to minimum wage and overtime standards, comply with workplace safety and health requirements, and include the worker in employer provided benefit plans. However, a firm generally avoids these obligations when it misclassifies a worker as an independent contractor rather than an employee.¹

Misclassification may also help workers to avoid their own legal obligations. Some workers may prefer to be considered an independent contractor because their take-home pay might be higher or their earnings might be hidden from government programs, such as income tax collections and child support enforcement.

Misclassification of employees as independent contractors also has important tax and insurance ramifications for the state. Misclassifying employees as independent contractors unfairly raises system costs for unemployment insurance administered by the Department of Employment and

Economic Development (DEED), workers' compensation costs for compliant employers, causes underpayment of quarterly tax obligations, and subjects the employing entity to civil penalties.

The scope of the fiscal implications of the misclassification of employees as independent contractors can be gauged from an IRS study in 1984,

*"The IRS estimated that 15 percent of employers misclassified 3.4 million workers as independent contractors, resulting in an estimated federal tax loss of \$1.6 billion in Social Security, unemployment tax, and income tax (or \$2.72 billion in inflation adjusted 2006 dollars)"*²

The 2007 Minnesota Legislative Auditor's report, using DEED unemployment insurance data, found that,

*"An estimated 14 percent of employers subject to Minnesota unemployment insurance taxes—or 1 in 7—misclassified at least one worker in 2005."*³

Audits completed in late 2006 by the Minnesota Department of Revenue (DOR) Withholding Division supports the conclusion that worker misclassification is a problem in Minnesota. DOR conducted 37 audits targeting worker classification. Sixty-five percent of these investigations resulted in the re-classification of an "independent contractor" as an employee.⁴

¹ "Evaluation Report – Misclassification of Employees as Independent Contractors", James Nobles, Office of the Legislative Auditor, State of Minnesota, Nov. 2007.

² Ibid.

³ Ibid.

⁴ Ibid

Worker Classification

The criteria for determining the appropriate worker classification are contained in both federal and state statutes and rules. These criteria are generally based on the relationship between a specific worker and the hiring organization. Neither an organization nor a worker can insist upon designation as an independent contractor; rather, a worker's classification is determined by the circumstances under which he or she performs the work.

For federal tax purposes, IRS guidance states, "all information that provides evidence of the degree of control and the degree of independence must be considered." The IRS categorizes facts that provide evidence relevant to worker classification into three categories: behavioral control, financial control, and the type of relationship between the worker and employer. (See Appendix for IRS guidelines).

Similar to the IRS, Minnesota's statutes and rules focus on the extent to which the hiring organization controls the method and manner in which the work is performed to determine the appropriate worker classification.

Because state statutes and rules, along with related judicial case law, establish DEED, DLI, and DOR's obligations regarding worker classification and the factors that each should consider when determining worker status, coordination of these laws is essential.

Misclassification of Workers in the Construction Industry

The 2007 Legislative Auditor report on *Misclassification of Employees as Independent Contractors* found that:

"The estimated percentage of employers in the construction industry that misclassified at least one worker in 2005 (15 percent) was in line with the estimated percentage of all employers that misclassified at least one worker (14 percent).

We looked more closely at the construction industry because of legislative interest and because some construction subindustries have qualities that DEED staff said characterize industries with more employee misclassification.

Although employers in the construction industry did not appear to misclassify workers in 2005 more often than employers overall, some subindustries within the construction industry stand out. As Table 2.3 shows, in auditing the 2004 or 2005 records of employers, DEED auditors found misclassified workers among 28 to 38 percent of employers in the roofing, drywall and insulation, residential remodeling, and commercial and industrial building construction industries. In contrast, one-tenth of audited employers in highway, street, and bridge construction and one-twentieth of audited employers in the site preparation industry misclassified workers. Although we cannot draw firm conclusions about differences in misclassification among subindustries, the results suggest that the impressions of DEED staff and others who mentioned specific industries as being problematic are

reasonable.”⁵

Independent Contractor Exemption Certificate

In an attempt to address employee misclassification in the construction industry, the 2007 Legislature enacted the Independent Contractor Exemption Certificate (ICEC) program, codified as Minn. Stat. § 181.723.⁶ The ICEC law applied to individuals performing building construction or improvement services as an independent contractor of the contractor for whom the services are performed.

Effective January 1, 2009, DLI began issuing ICECs to those individuals who submitted documentation demonstrating that they met the law’s definition of an independent contractor. The ICEC law used the criteria commonly referred to as the “nine-factor test.” These same criteria had been in the workers' compensation law since 1996 and the unemployment law since 1998, with minor modifications.

Under the ICEC law, an individual performing construction services for a construction contractor is presumed to be an employee of the contractor for purposes of workers' compensation, unemployment, OSHA and labor standards laws, unless the individual 1) holds an ICEC issued by DLI that shows the individual could meet the nine-factor independent contractor test; and 2) meets the nine-factor test at the time the

individual performs the construction services. The nine-factor test follows:

1) maintains a separate business with the individual's own office, equipment, materials, and other facilities;

(2)(i) holds or has applied for a federal employer identification number or (ii) has filed business or self-employment income tax returns with the federal Internal Revenue Service if the individual has performed services in the previous year;

(3) is operating under contract to perform the specific services for the person for specific amounts of money and under which the individual controls the means of performing the services;

(4) is incurring the main expenses related to the services that the individual is performing for the person under the contract;

(5) is responsible for the satisfactory completion of the services that the individual has contracted to perform for the person and is liable for a failure to complete the services;

(6) receives compensation from the person for the services performed under the contract on a commission or per-job or competitive bid basis and not on any other basis;

(7) may realize a profit or suffer a loss under the contract to perform services for the person;

(8) has continuing or recurring business liabilities or obligations; and

(9) the success or failure of the individual's business depends on the

⁵ Misclassification of Employees as Independent Contractors, James Noble, Office of the Legislative Auditor State of Minnesota, November 2007.

⁶ 2007 Minn. Laws, ch. 135, art. 3, sec 15

relationship of business receipts to expenditures.⁷

Another law affecting the construction industry also went into effect in 2009. A new DOR law required construction contractors to withhold 2% of the contractor's gross payments to its subcontractors who were individual proprietors.⁸ Because the withholding requirement (along with the ICEC program) only applied to individuals, it is believed that it prompted a huge increase in the number of business filings at the Office of the Secretary of State beginning in late 2008, see figure 1 below.

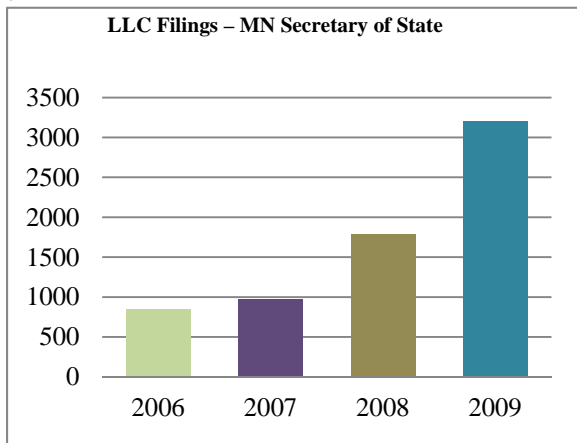


Figure 1

This move from an individual independent contractor to business entity resulted in just 2,354 ICECs being issued by DLI – about 10% of the number expected to be issued when the ICEC legislation was being considered. In 2008 and 2009, DLI received 1,960 applications and issued 1,625

⁷ Taken from the website of the Minnesota Office of the Revisor of Statutes, <https://www.revisor.mn.gov/statutes/?id=181.723&year=2008#stat.181.723.2>

⁸ Minn. Stat. §290.92, Subd.31 (Repealed 2012 Minn. Laws C, 295, art. 2,5.13)

exemption certificates. In 2010 the department received just 77 applications and issued 57 exemption certificates.

The Advisory Task Force on Misclassification of Workers

In 2009, the Minnesota Legislature created the Advisory Task Force on Employee Misclassification.⁹ The Task Force was composed of individuals representing commercial and residential general contractors, subcontractors, independent contractors and construction employees as well as representatives from DLI, DOR, DEED, and the Attorney General's Office.

The group met for over a year to discuss the difficult issue of employee misclassification in the construction industry. The Task Force recommended a proposed amendment of Minn. Stat. § 181.723. Other recommendations included increasing coordination among enforcement agencies and continued education of the construction industry.

The Task Force found that the ICEC program had not been effective in addressing the misclassification of workers in construction. There were several reasons for this:

- many independent contractors believed that the ICEC application process was too extensive and complicated because the applicant had to provide written documentation showing that the

⁹ Minn. Stat. § 181.723, Subd. 17 (2009)

individual could meet each of the nine-factors in the law.

- there were existing exemptions from coverage under the workers' compensation and unemployment compensation laws for certain businesses that had registered with the Secretary of State. However, some individuals who formed a business entity could not meet the nine-factor test and may not have complied with all the legal obligations that legitimate business entities complied with. This created a competitive disadvantage for legitimate business entities that did comply with the law.
- holding an ICEC did not provide a safe harbor for construction contractors who hired an individual subcontractor. An individual holding an ICEC must have also meet the nine-factor test in Minn. Stat. § 181.723 at the time the services were provided.
- misclassification of workers continued to occur. However, under current law, DLI's enforcement authority was limited to violations related to the ICEC.

The Task Force developed a legislative proposal, introduced in 2010, that included the following recommendations:

- Anyone not already licensed, registered, or bonded with DLI and is performing construction services in the state would register as a construction contractor using a simple on-line form. (Proposed section 181.723, subd. 4a.)

- Construction contractors would pay an \$80 bi-annual registration fee as compared to a \$150 fee every four years for an exemption certificate. (Proposed section 181.723, subd 5a (b).)
- Registration would be done online, without the need for extensive documentation of the nine-factor test. Public data will be easy for contractors and owners to look-up on-line once a year. (Subd. 6a.) This is in contrast to the ICEC law under which general contractors must print off and retain for five years an exemption certificate from the DLI web site each time they contract with an independent contractor.
- Construction contractors would provide their business name, the names and information about owners and officers of limited liability companies and corporations as well as proof of workers' compensation and unemployment insurance where required.¹⁰ This information is critical to the enforcement activities of DLI, DEED, and Revenue and is similar to the information currently required for licensed residential building contractors, electrical contractors, and bonded plumbers. (Proposed section 181.723, subd. 5a)
- The nine-factor test that helps identify an employee-employer relationship would be retained for individuals performing construction

¹⁰ See, Minn. Stat. §§ 176.182 and 270C.72 (2010).

work on a job site (Subd. 4). However, an independent contractor would no longer be required to obtain an exemption certificate before performing construction services. Disputes about whether an injured or unemployed individual satisfied the nine-factor test would be handled on a case-by-case basis or in litigation, the same as it was before 2009.

- Where a business entity providing construction services is registered with the Secretary of State, individual owners and officers would be required to:

- Maintain an active filing with Secretary of State as required by law;

- Operate under invoices and written contracts (as residential construction contractors are required to do under Minn. Stat. § 326B.809);

- Make payments to the business entity with whom they have contracted (not individual owners). (Subd. 7)

- Penalties were proposed for failure to register, hiring unregistered contractors, and coercing others to form a business entity. A discretionary maximum penalty of \$500 was proposed for the first failure to register. A notice of violation (without a monetary penalty) was proposed for the first time a contractor pays a subcontractor who is not registered. (Subd. 8)

- Rules related to independent contractor exemption certificates were proposed to be repealed.

This Task Force proposal was presented to the Legislature in 2011 where it received hearings but did not move to a vote of either body.

The 2012 Amendment – Contractor Registration Pilot Project

In 2012, DLI reviewed the work of the Task Force and developed a new proposal that included many of the Task Force recommendations.

Specifically, the proposal replaced the ICEC program with a two-year pilot project. The Legislature and Governor approved the amendments to Minn. Stat. 181.723, and the law went into effect on July 1, 2012.

The pilot requires contractors who provide building construction and improvement services to register with DLI, unless they are already licensed or registered with DLI or meet another exemption. This pilot project is intended to establish a simplified framework for determining whether individual building construction workers are employees or independent contractors.

The predominant goal of the amended law is to assist state agencies that are investigating employee misclassification in the building industry while leveling the playing field for businesses that properly classify their employees.

This pilot project went into effect on September 15, 2012 and as of December 1,

2013, 12,184 contractors had registered with DLI.

The law requires every construction contractor that performs building construction or improvement services on or after Sept. 15, 2012, to register with DLI, unless the contractor meets one of the exemptions described below.

Examples of construction contractors who must comply with the law are: individual independent contractors; businesses registered with the Secretary of State, such as limited liability companies, corporations and partnerships; and other types of business entities that perform building construction or improvement services.

Exempted from the requirements of the statute are:

- any person who, at the time the person is performing the construction services, holds a current license, certificate or registration under Minn. Stat. chapter 299M or 326B;
- fire protection system contractors and installers and potable water piping system contractors and installers licensed or certified under Minn. Stat. chapter 299M;
- an employee of the person performing the construction services, if the person was in compliance with laws related to employment of the individual at the time the construction services were performed;
- a person who is exempt from the residential building contractor license requirement because

their gross receipts do not exceed \$15,000 under Minn. Stat. § 326B.805, subd. 6, clause (5) and holds a valid certificate exemption issued by DLI.

- an architect or professional engineer engaging in professional practice as defined in Minn. Stat. § 326.02, subd. 2 and 3.
- a school district or technical college governed under Minn. Stat. chapter 136F.
- a person providing construction services on a volunteer basis, including but not limited to Habitat for Humanity and Builders Outreach Foundation, and their individual volunteers when engaged in activities on their behalf.
- a person who has given a bond to the state under Minn. Stat. § 326B.197 or 326B.46 for gas, heating, ventilation, cooling, air conditioning, fuel burning or refrigeration work (mechanical contractor bond); or plumbing, sewer or water service installation, or subsurface sewage treatment work.

The contractor registration pilot project requires applicants to provide DLI with the following information:

A complete application must include all of the following information about any individual who is registering as an individual or a sole proprietor, or who owns 25% or more of a business entity being registered:

- (1) the individual's full legal name and title at the applicant's business;
- (2) the individual's business address and telephone number;

(3) the percentage of the applicant's business owned by the individual; and

(4) the individual's Social Security number.

A complete application must also include the following information:

(1) the applicant's legal name; assumed name filed with the Secretary of State, if any; designated business address; physical address; telephone number; and email address;

(2) the applicant's Minnesota tax identification number, if one is required or has been issued;

(3) the applicant's federal employer identification number, if one is required or has been issued;

(4) evidence of the active status of the applicant's business filings with the secretary of state, if one is required or has been issued;

(5) whether the applicant has any employees at the time the application is filed;

(6) the names of all other persons with an ownership interest in the business entity who are not identified in paragraph (b), and the percentage of the interest owned by each person, except that the names of shareholders with less than ten percent ownership in a publicly traded corporation need not be provided;

(7) information documenting compliance with workers' compensation and unemployment insurance laws;

(8) a certification that the person signing the application has reviewed it; determined that the information provided is

true and accurate, and determined that the person signing is authorized to sign and file the application as an agent of the applicant. The name of the person signing, entered on an electronic application, shall constitute a valid signature of the agent on behalf of the applicant; and

(9) a signed authorization for the Department of Labor and Industry to verify the information provided on or with the application.

A registered person must notify the commissioner within 15 days after there is a change in any of the information on the application as approved. This notification must be provided electronically in the manner prescribed by the commissioner. However, if the business entity structure, legal form of the business entity, or business ownership has changed, the person must submit a new registration application and registration fee, if any, for the new business entity.¹¹

In addition to ensuring that subcontractors meet the nine factor test referenced above, contractors must also ensure their subcontractors' business filings are active with the Secretary of State and must have written contracts with their subcontractors in order to be able to treat them as independent contractors rather than employees.

The Online Registration Program

DLI, in conjunction with DEED and DOR, developed the online registration format for

¹¹ The Office of the Revisor of Statutes, 2012 Minnesota Statutes, §181.723, <https://www.revisor.mn.gov/statutes/?id=181.723>

the pilot project. Registration is free to applicants and can be completed online in about five minutes. The registration pages include links to the Secretary of State's office for verification of an active business filing, a link to DLI for registered contractors, and a link to DLI's lookup tool for current workers' compensation coverage.



The new registration requires contractors to supply online the following information;

- the business's legal name and any assumed name filed with the Minnesota Secretary of State;
- designated business address and physical address;
- telephone number;
- email address;
- Minnesota tax identification number, if one is required or has been issued;
- federal employer identification number, if one is required or has been issued;
- evidence of the active status of the applicant's business filings with the secretary of state, if one is required or has been issued;
- whether the applicant has any employees at the time the application is filed;

- the names of all other persons with an ownership interest in the business entity and the percentage of the interest owned by each person, except that the names of shareholders with less than 10 percent ownership in a publicly traded corporation need not be provided;
- information documenting compliance with workers' compensation;
- information documenting compliance with unemployment insurance laws;
- a certification that the person signing the application has reviewed it, determined the information provided is true and accurate, and determined the person signing is authorized to sign and file the application as an agent of the applicant; and
- a signed authorization for DLI to verify the information provided.

Additionally, any individual who is registering as a sole proprietor or owns 25% or more of a contracting business must also provide:

- the individual's full legal name and title at applicant's business;
- the individual's business address and telephone number;
- the percentage of the applicant's business owned by the individual; and
- the individual's Social Security number.

The online registration form includes:

- an acknowledgement that registration does not authorize the applicant to perform work requiring a license, certification, or separate registration under Minn. Stat. chapter 326B;
- a requirement that the applicant must notify DLI within 15 days of any change in the information provided; and an authorization for DLI to verify the supplied information;
- a certification that the information provided is true, complete, and accurate; and
- information about how the data provided will be used by the agency (known as a “Tennessee Warning”).

In addition to the online form, DLI produced informational handouts on the law, answers to frequently asked questions, how the law affects ICEC holders, the nine-factor test, enforcement actions, and a checklist for the registration process. DLI also developed a simplified and searchable license lookup database for general contractors to determine the registration status of independent contractors.

Communication

In July 2012, DLI initiated an extensive campaign to educate and notify affected stakeholders on the pilot project. Beginning with inter-agency cooperation between DOR, DEED and DLI, the three agencies met to discuss the roll-out of the pilot project. Subsequent to these meetings, the pilot project’s contractor registration data base was developed, a standard image and name for the program was established, new email addresses for the program were established, the website for registration was

created, and a “Frequently Asked Questions” was added to the DLI website. A letter was drafted explaining the program and mailed to contractor associations, insurers, legislators, chambers of commerce, and state and local building officials.

In early July, DLI mailed materials outlining the requirements of the new program to a list of 15,000 construction employers provided by DEED. On July 12, 2012, the contractor registration website and lookup database were made available for registration and use. DLI issued its first press release on the program on July 19th, which received broad media coverage. An accompanying article was published in the Construction Codes and Licensing Division (CCLD) newsletter. Stakeholder meetings were conducted with the Association of Women Contractors (AWC), the Associated General Contractors (AGC), and the Minnesota Insurance Auditors Association to answer questions, explain the scope of the legislation, and gather feedback and respond to concerns.

Monitoring of the registrations was begun. By August 27, 2012, 1,134 contractors had registered, increasing to 3,561 by September 17th. On September 15, 2012 CCLD began mailing deficiency notices to registrants who had failed to provide all the information the statute required.

In September, a second mailing to contractor associations and other stakeholders was sent about the implications of hiring unregistered subcontractors, and postcards were provided to the U.S. Department of Labor for distribution by federal investigators. The AGC, MWCIA, and the unions representing the building trades distributed registration information via their respective newsletters

and by email to their members. DLI made a presentation to the Workers' Compensation Insurers Task Force in September 2012. Meetings were also held with the Minnesota departments of Finance and Commerce.

In October 2012, the Bloomberg Bureau of National Affairs published an article, "Minnesota Agency Reminds Contractors to Ensure Subcontractors Are Registered." Presentations were made to the AWC and the Construction Finance Management Association.

In November 2012, DLI launched a new worker misclassification website with links to DLI, U.S. Department of Labor and DEED to provide worker misclassification information to users. Simultaneously, the U.S. Department of Labor began a targeted enforcement program aimed at the roofing and siding industries which included contractor registration materials from DLI in their efforts.

Stakeholder meetings and outreach activities have continued throughout the pilot project period.

Pilot Project Analysis

Ownership Information

All the statistics in this section were derived from a random sample of the 10,217 registrants taken on August 13, 2013. The sample consists of a population of 370 applicants, yielding a 95 percent confidence level ± 5 percent.

Monitoring of the registrations began in mid-September 2012 and has continued throughout the duration of the pilot project. Review of the registrations submitted to DLI

through the online program revealed a number of issues revolving around the provision of ownership information. Specifically, some registrants were able to register successfully without providing all of the required ownership information. See Figure 2.

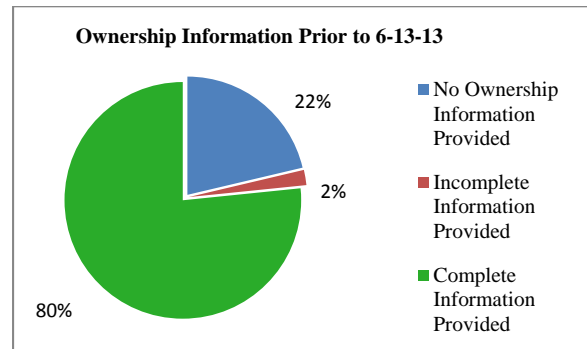


Figure 2

Changes were instituted to the online registration form in June 2013 to assist registrants in providing complete information to DLI. These modifications were successful in reducing the non-reporting of ownership information from 24% of registrants to less than 4%.

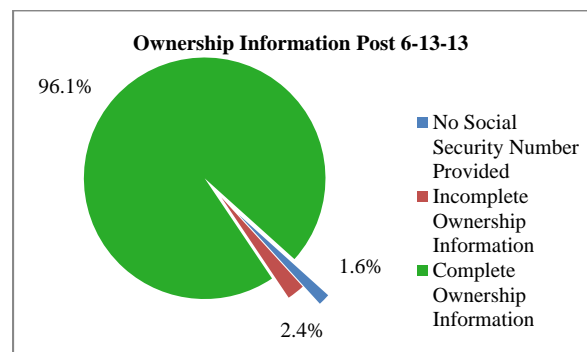


Figure 3

The changes to the registration process were largely successful in meeting the intent of the pilot project. After the online registration form changes were implemented, no

applicants failed to provide any ownership information and the majority of the incomplete registrations were simply providing inadequate ownership information. Challenges remain as discussed in detail in the following section.

Business Structure

The majority of registrants were of two business types: a limited liability company (LLC) or a corporation (INC). Other business structures employed by registrants were “doing business as” (DBA), individual proprietorships, partnerships, or other. LLCs and INCs comprised over 85% of registrants (see figure 4).

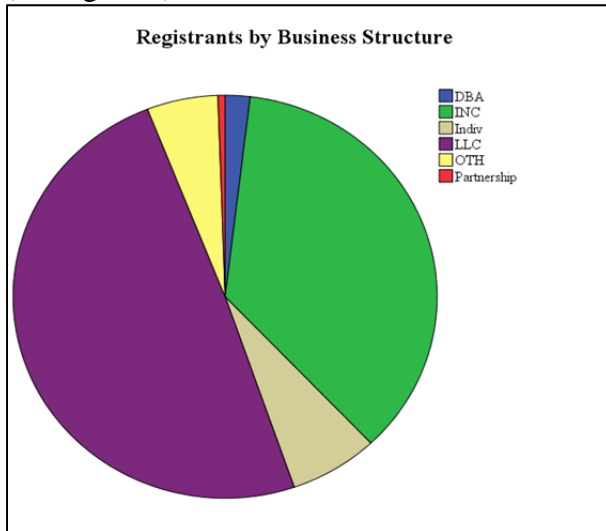


Figure 4

The prevalence of these types of business structures illustrates the importance of collecting complete ownership information as the statute requires (see p.3 section b).

Registration with Secretary of State

In response to the question, “Is this business registered with the Minnesota Secretary of State?”, 89 percent of registrants in the sample replied they were registered with the Secretary of State’s office.

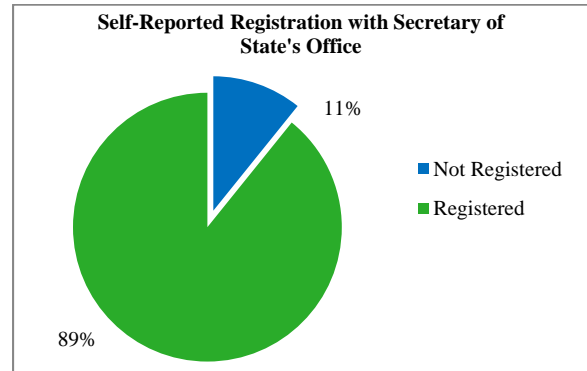


Figure 5

Using the Secretary of State’s business lookup tool to verify the information submitted by registrants in the sample yielded a much different result. There are a number of reasons that this can occur, such as registering under an alternative variant of the company name and the time lag for the entering of data into the Secretary of State’s system.

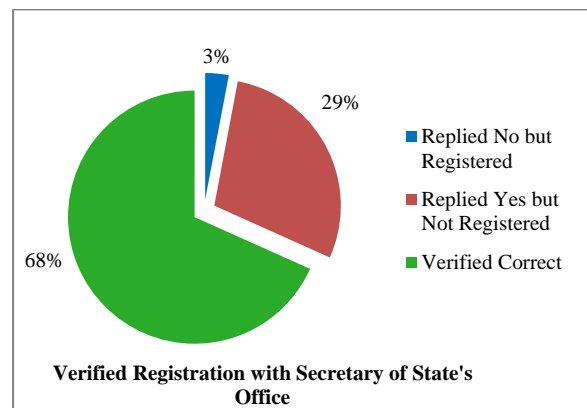


Figure 6

There appears to be either confusion by registrants as to the meaning of the question,

or they are unsure of how to properly register their business entity with the state. Additionally, six individual businesses in the sample listed LLC or Incorporated behind their business names without being registered with SOS.

Workers' Compensation

The majority of business registrants in the sample, 64 percent, reported that they had no employees.

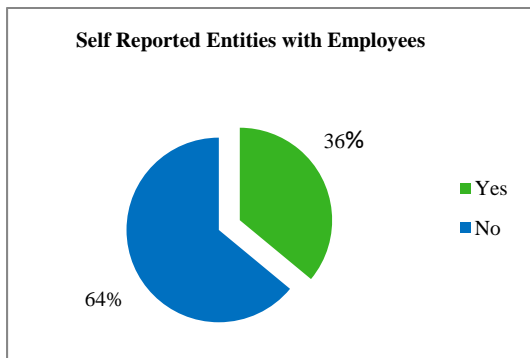


Figure 7

However, the majority of the registrants, 72 percent, self-reported that they had workers' compensation insurance coverage.

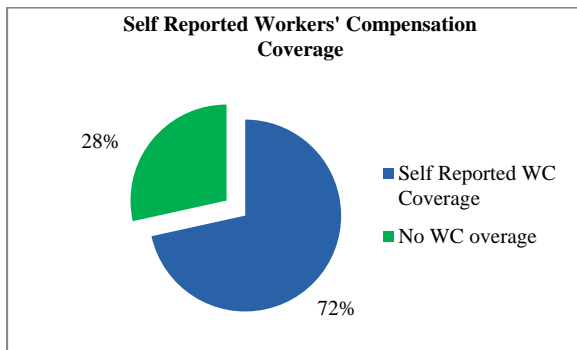


Figure 8

compensation insurance coverage.

Some subcontractors choose to purchase workers' compensation coverage for themselves even if they have no employees. Consequently, these numbers do not

necessarily represent misclassification but a general reflection of the registrant population.

Upon a separate examination of workers' compensation data, through the Minnesota Workers' Compensation Insurers Association (MWCIA), an independent verification of current workers' compensation insurance coverage was attained. The coverage data was matched with the DEED unemployment insurance accounts for the individual business entities, looking for employers who had reported employees to DEED but did not have workers' compensation insurance. One such employer in the sample was identified and reported for further investigation.

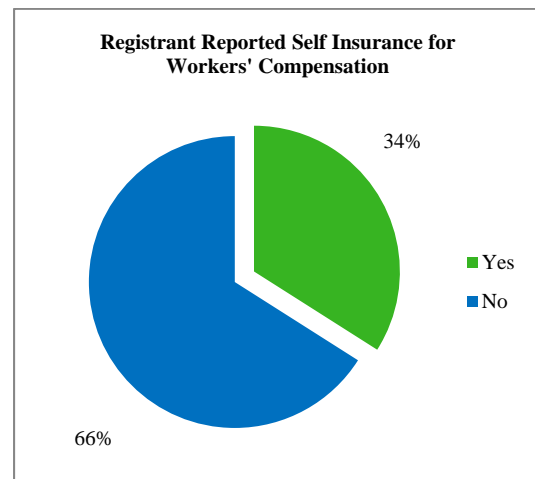


Figure 9

The number of businesses self-reporting that they were self-insured for their workers' compensation coverage is quite large and appears to indicate some level of confusion among registrants as to the meaning of self-insurance for workers' compensation purposes.

Information from discussions with the Minnesota Department of Commerce

indicates that the reported number of self-insured entities was extremely unlikely. The reasons cited were the bond requirements, approximately \$4.4 million for a company in the high risk category (the most likely classification for a construction company), the cost of setting up the insurance plan relative to purchasing workers' compensation coverage through the private marketplace, and anecdotally that they could only remember one construction company in the state that was self-insured. It is possible to be self-insured through groups such as The Builders Group. This possibility was examined. Of those businesses which were verified to have worker's compensation insurance (163), only 2 percent were insured through groups who offer self-insurance policies.

Further examination found that of the 264 registrants in the sample who reported they had workers' compensation insurance, 101 also reported they had no employees. An additional 24 registrants reported they had no workers' compensation coverage but had employees. When these 24 businesses were cross-checked with the DEED database only one was found to have had employees within the preceding quarter.

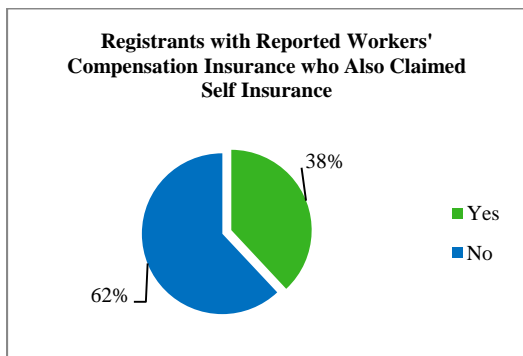


Figure 10

DLI proposes revising the registration procedure to clarify the confusion among registrants about self-insurance. DLI proposes requiring that registrants enter their workers' compensation policy number after an affirmative response. Alternatively, DLI plans to eliminate the check box for self-insurance in light of the rarity of self-insurance within the industry and the apparent widespread confusion over the meaning of the question.

Unemployment Insurance Information

Only 40 percent of the sample's registrants reported they had an unemployment insurance account with DEED.

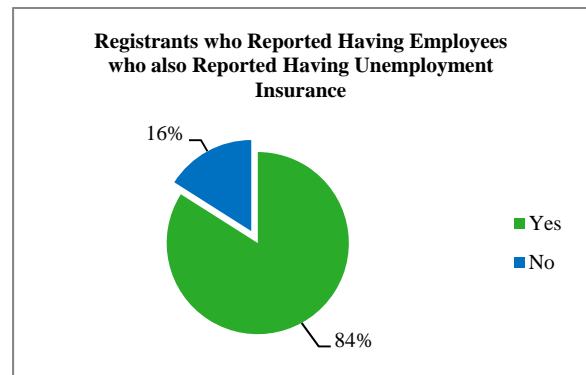


Figure 11

One hundred and thirty-four registrants, 36 percent, reported that they had employees. Of those entities reporting employees, 16 percent or 21 businesses self-reported that they did not have a required Minnesota unemployment account with DEED.

DLI proposes to continue to refer identified cases of contractors who self-report having employees to DEED for investigation. Identifying these cases requires looking up each individual registrant on the DEED database. These investigations will require

significant staff time as currently there are 12,184 active registrants as of December 1, 2013.

Contact Information

An examination of duplicate email addresses was conducted to get a sense of the need for verification of the mailing and email addresses provided. The examination of duplicate email accounts among registrants was conducted with the entire list of 10,644 registrants as of August 13, 2013. This search yielded 1,192 duplicate accounts or 11.2% of registrants. A search for duplicate street addresses among registrants yielded 546 duplicates, (5.1%). Duplicate addresses or email accounts could well be genuine in the case of roommates or relatives but the experience of DLI's enforcement staff indicates that some registrations are being submitted by contractors' accountants, general contractors, and other third parties.

Similarly there were 370 registrants (3.5%) identified with duplicate Federal Employee Identification Numbers (FEIN). A line by line examination of the 370 duplicated FEINs showed that many appear to be corrections of names or addresses, mis-entries, or naming convention issues (example: T. A. Smith Construction as opposed to T A Smith Construction). Some of these duplications appear to be genuine updates as required by the statute while others are clearly multiple business names operating under the same FEIN. Those with multiple business names, 185 entities, were referred to CCLD to obtain clarifications from the registrant in those cases where the names on the multiple registrations were only slightly different or for investigation in

those cases where the names were completely different.

DLI proposes to strengthen our efforts to maintain an error free database. Businesses operating under multiple names using the same FEINs should be investigated by DLI's CCLD. Similarly, multiple businesses operating at the same address or employing the same email addresses should be given increased scrutiny for misclassification or error.

Investigations of Misclassification and Enforcement Actions at DLI

DLI, DOR, and DEED have all taken enforcement actions based on information gained from the registration program.¹²

Since enactment of the 2008 Independent Contractor Exemption Certificate (ICEC) legislation, DLI's CCLD has had two full-time investigators assigned to misclassification of workers in the construction industry. The 2012 pilot project provided additional tools to aid in these investigations.

In the 12 month period since the pilot project became effective on September 15, 2012, CCLD has opened 205 formal "registration" investigations, 140 of which remained active in September 2013. Most of these investigations focused on either a specific construction project or a particular general contractor. Investigations are often initiated based on tips received from the public (usually other contractors), staff of

¹² DLI's enforcement authority as described in this section is in Minn. Stat. § 326B.082.

other state agencies or other business units within DLI (Labor Standards, Special Compensation Fund [SCF], or CCLD's Enforcement Services Unit), or random site visits by CCLD investigators.

The first step in most investigations is the service of a subpoena on the prime contractor, seeking information regarding the contractor's employees and subcontractors, including contracts, invoices, and evidence of payments made to the subcontractors since September 15, 2012. Once this information has been provided, the investigator analyzes the data and researches each subcontractor to verify whether they are licensed or registered with CCLD, whether they have an unemployment insurance account and have reported wages for their employees to DEED, and whether their business filing with the Secretary of State is active. Subpoenas are then sent to each of these subcontractors, seeking the same information regarding their subcontractors. This process is followed until the investigator has identified each layer of subcontractors down to the individual workers on jobsites.

If investigators identify workers or owners of companies that have been improperly treated as independent contractors (under Minn. Stat. § 181.723), they present their findings to the hiring contractor and propose a sanction for the misclassification violations. This proposal is in the form of a consent order, which identifies the violations and contains a civil penalty which is often stayed upon contractor compliance. The intent of the stayed penalty is to incentivize future compliance by clarifying the penalties for future misclassification. Upon acceptance of the consent order, the

contractor signs the order and returns it with any civil penalties that are not stayed.

In the one year since the pilot project began, DLI has entered into 47 consent orders. The total amount of the civil penalties described in the consent orders is \$504,000, of which \$420,000 was stayed.

In cases where DLI and the contractor cannot agree on appropriate sanctions for violations that have been identified, or if the contractor fails to cooperate with the investigation, DLI issues an administrative order against the contractor. This order contains a detailed recitation of the facts of the case, a description of the violations that were found, and imposes a civil penalty. The subject of the order is provided a 30 day period to request a hearing at the Office of Administrative Hearings to contest the DLI's action. If a hearing is requested, the case is set for a contested case proceeding pursuant to Minnesota Statutes Chapter 14. If no hearing request is made within 30 days, the order becomes final and the penalty becomes a judgment against the contractor in Ramsey County District Court and collection proceedings are commenced.

In the first 12 months of the pilot project, the Department issued 11 administrative orders with civil penalties totaling \$47,500. Of these, three orders were issued to independent contractors who performed services without being registered. Minn. Stat. § 181.723, subdivision 8a, requires that the penalty for performing services without being registered is \$2,000, but the penalty must be forgiven if the contractor registers within 30 days of the administrative order. The Department's investigators have found many contractors performing building

services without being registered, but in the vast majority of these cases, the contractor registered without the need for an administrative order.

In cases where the contractors are registered in the pilot project, the Department may also seek the revocation of the contractor’s registration. This is accomplished through the issuance of a licensing order which, like an administrative order, contains findings of fact, conclusions of law, and an order for the payment of a civil penalty. It also revokes the contractor’s registration and orders them to cease and desist from offering building construction services in Minnesota. The subject of the licensing order also has 30 days in which to request a hearing to contest the department’s action. When a licensing order becomes final, CCLD notifies any contractors who had done business with the revoked contractor to advise them that the contractor is no longer registered and may not be treated as an independent contractor.

In the first year of the pilot project, the Department issued 10 licensing orders that revoked a contractor’s registration. These orders also assessed a total of \$15,000 in civil penalties. In the majority of these cases, the registration was revoked because the contractor provided false information or failed to respond to a subpoena.

Upon the completion of an investigation, CCLD investigators refer their findings to DEED, DOR, or the Special Compensation Fund (SCF) in DLI for further investigation into possible violations of unemployment insurance regulations, tax withholding, income tax, or workers’ compensation insurance laws. In the first year of the pilot project, CCLD identified a total of 294

misclassified workers and made 53 case referrals to DEED and DOR, and another 10 to the SCF.

DEED has determined gross wages reported in the construction sector to be \$5.2 billion in 2012 and growing as the economic recovery strengthens, see Figure 12. Unemployment tax revenue due on gross wages in the construction sector were \$297M in 2009, \$236M in 2010, \$280M in 2011, and \$299M in 2012.



Figure 12

In the four year period following the recession, DEED has seen a decrease in the number of employers in the construction industry even though the overall number of employees has almost recovered to pre-recession levels, see Figure 13.

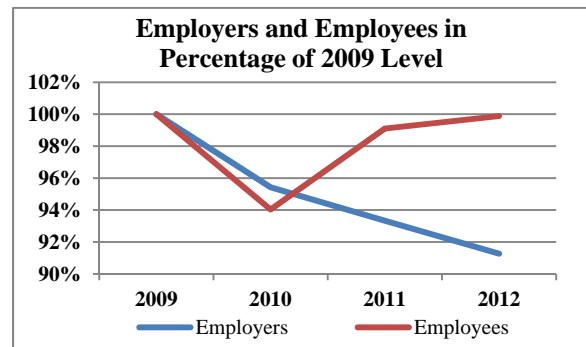


Figure 13

In 2011, DEED completed 478 audits of employers identifying 619 misclassified workers. In 2012, 159 audits were conducted identifying 256 misclassified workers.

DEED is currently in the process of analyzing data supplied by DLI as well as data taken from the contractor registration program and is preparing to send its first batch of audits to their auditors. In a number of audits already conducted, DEED has used the contractor registration program to help identify the misclassification of workers.

DOR also receives referrals from DLI for investigation into possible tax violations. In the first year of the pilot project, DLI has made 53 referrals to DOR. DOR has assigned five cases for audit examination and an additional eleven cases are waiting to be assigned to auditors for examination. Twenty-one referrals were determined to have either already corrected the issue identified, been too new of an entity to audit, or the compensation amounts would have been very small. DOR, to date, has examined the referrals from DLI for withholding tax but there are a number of accounts that DOR will be referring to other taxing departments within DOR for possible actions.

Recommendations to the Legislature

Continue the registration program

DLI recommends continuation of the pilot project as the misclassification of building construction workers continues in Minnesota. An important tool in identifying the misclassification of workers is information from business entities claiming to be independent contractors. Accurate business ownership information is critical to program effectiveness. However, many contractors were able to register in the pilot project without providing complete ownership information. Other information provided by registrants, as the pilot survey sample results show, is also sometimes incomplete or the request for information requested is misunderstood and consequently data has been mis-entered by registrants.

Assistance

As the analysis of the pilot project shows, registrants are often confused by several information requests, i.e. workers' compensation insurance, registration with the Secretary of State's office, and ownership. Currently, there is no comprehensive mechanism for registrants to be able to seek help with the application process. DLI recommends that it add staff to walk new applicants through the registration process and answer common questions, thus creating a more stream-lined and user-friendly registration system.

Modify online registration form

Some changes to the registration form are necessary based upon the results of the analysis. DLI recommends that it add required fields for the collection of workers' compensation insurance policy numbers. The question "Is this business self-insured for workers' compensation insurance?" should then be eliminated. A check box, indicating an update of information, should be added to the form for those applicants entering more timely information or editing errors. The check box would simplify data purging for staff and provide cost savings. Where ownership by multiple individuals has been indicated, the form should be designed to not allow for ownership to total less than 100 percent.

Verification

As noted in the Enforcement section, most investigations into misclassification of workers are initiated through tips from the public. No verification of the information provided to the DLI in the registration process is made outside the aforementioned investigations. DLI recommends that simple verification efforts be instituted. First, DLI would verify email and postal addresses by email and the U.S. Postal Service by requesting a response. Second, DLI would use the SOS business lookup screen to verify registration and flagging those entities not registered. Third, DLI would access the DEED employer database to search for employment activity and fourth, DLI would use its Workers' Compensation Insurance Verification tool for those registrants claiming employees. Instituting these steps

would improve data validity, limit registrant errors, and uncover problematic cases.

information regarding ongoing investigations more readily with DLI.

Increased Investigations and Enforcement

DLI's experience has shown that additional investigators are needed to achieve more effective enforcement of the statutes governing worker classification. Two investigators are insufficient to provide the wide ranging and impactful enforcement effort that is required to make significant inroads into construction worker misclassification throughout the state. With approximately 15,000 construction employers in the state, additional investigators are necessary to have a meaningful impact on misclassification in the industry. See Appendix 1 for a listing of recent enforcement actions taken at DLI.

DLI is currently supporting its pilot project activities through the Construction Codes and Licensing Fund which is financed through construction license and permit fees. DLI will continue to evaluate if additional resources are needed for enforcement and administrative activities in the long term.

Format of Law

DLI recommends that the legislature move the contractor registration program to Minnesota Statute 326B. This is where the DLI authority for regulation and administration of construction codes and licensing is located.

The enabling legislation should also include clarification of the data privacy laws to allow DEED and DOR to be able to share

Appendix A

WORKER MISCLASSIFICATION REGISTRATION ENFORCEMENT ORDERS January 1, 2013 – December 6, 2013

All stayed penalties are stayed on condition of no future violations of the construction contractor worker classification laws and rules

Abdias Construction, LLC and Abdias Venegas

Minneapolis, MN 55408

*Consent Order: \$5,000 civil penalty with \$4,800 stayed – 5/21/2013

*REG1212-00010/WWH

Able Restoration Group, Inc.

Lakeville, MN

*Consent Order: \$5,000 civil penalty with \$4,800 stayed – 6/12/2013

*REG1304-00003/MG

Alfredo Perez Roofing, LLC and Alfredo Perez

St. Paul, MN

*Consent Order: \$5,000 stayed civil penalty – 12/05/2013

*REG1309-00041/MG

Andrew T Fox Construction and Andrew T. Fox – Lic#BC648977

Zimmerman, MN

*Consent Order: \$10,000 civil penalty with \$9,600 stayed – 9/10/2013

*REG1302-00001/WWH

Antonio Drywall, LLC and Marco Antonio Rivera

Brooklyn Park, MN

*Licensing Order: Registration revoked; \$5,000 civil penalty – 2/27/2013

*REG1301-00004/MG

Bahena-Bahena, LLasmin

Brooklyn Center, MN

*Administrative Order: \$5,000 civil penalty – 10/15/2013

*REG1305-00050/MG

Bayport Roofing and Siding LLC. And Jayme C. Meyer – Lic#BC642686

Minneapolis, MN

*Consent Order: \$10,000 civil penalty with \$9,300 stayed – 9/16/13

*REG1306-00003/WWH

BNM Construction, Inc. and Nageswara Rao Devarapalli

Blaine, MN

*Consent Order: \$10,000 civil penalty stayed – 2/13/2013

*REG1212-00005/WWH

Bradley Anderson d/b/a Brad Anderson Drywall

Detroit Lakes, MN

*Consent Order: \$10,000 civil penalty with \$9,500 stayed – 12/3/13

*REG1305-00039/WWH

Brad Thompson Floorcovering, LLC and Brad Thompson

Rochester, MN

*Consent Order: \$10,000 civil penalty with \$9,700 stayed – 11/21/2013

*REG1305-00073/MG

Bramex Construction, LLC and Jose Louis Mondragon Rodriguez

Burnsville, MN

*Consent Order: \$5,000 civil penalty with \$4,700 stayed – 5/14/2013

*REG1302-00003/MG

Braves Drywall, Inc. and Edgar Soriano

Brooklyn Park, MN

*Consent Order: \$10,000 civil penalty – 3/13/2013

*REG1210-00001/MG

Charles Merritt Homes, Inc. and Jay Merritt

Farmington, MN

*Consent Order: \$10,000 civil penalty with \$9,700 stayed – 5/3/2013

REG1301-00015/WWH

Chore Drywall, LLC and Jorge A. Sifuentes Ramirez

Brooklyn Park, MN

*Consent Order: \$5,000 civil penalty with \$4,800 stayed – 4/23/2013

*REG1301-00002/MG

Concrete Solutions, LLC and Jason A. Hanauska

Rogers, MN

*Administrative Order: \$2,000 civil penalty, forgivable if registration achieved
within 30 days – 9/18/2013

*REG1305-00032/WJW

Corpman Contracting, LLC and Nathan Corpman

Burnsville, MN

*Consent Order: \$12,000 civil penalty with \$11,000 stayed – 4/23/2013

*REG1212-00012/WWH

Creative Custom Remodeling, LLC and Michael D. Shore

Foreston, MN

*Consent Order: \$15,000 civil penalty with \$14,750 stayed – 6/27/2013

*REG1305-00014/WWH

Custom Cut Carpentry LLC and Shawn B. Olson

Andover, MN

*Consent Order: Administrative Order vacated; \$14,000 civil penalty with \$13,000 stayed upon conditions– 12/3/13

*REG1212-00003/WWH

Dave Buck Construction, Inc. dba Hastings Siding & Remodeling and David Buck

Hastings, MN

*Consent Order: \$10,000 civil penalty with \$9,500 stayed – 4/29/2013

*REG1302-00004/MG

DLS Framing, LLC and David Lyle Schommer

Jordan, MN

*Administrative Order: \$5,000 civil penalty – 9/18/2013

*REG1305-00010/WJW

Done Right Painting, Inc. and Christopher Eyrich

Maple Grove, MN

*Administrative Order: \$12,000 civil penalty with \$2,000 forgivable – 9/18/13

*REG1305-00009/WJW

Duke Steenberg Construction LLC and Douglas Steenberg

South Saint Paul, MN

*Consent Order: \$10,000 civil penalty with \$9,700 stayed – 10/7/2013

*REG1305-00004/WWH

Elmer Pedraza, LLC and Elmer Pedraza

Minneapolis, MN

*Licensing Order: Revocation of registration – 6/20/2013

*REG1306-00001/WJW

Federico Drywall, LLC and Federico Espinoza Cruz

Burnsville, MN

*Licensing Order: Revocation of registration – 6/05/2013

*REG1301-00003/MG

Fix U Roofing, LLC, Ru2 Construction, LLC, and Sabas Hemir Hernandez Pineda

Roseville, MN

*Consent Order: \$15,000 civil penalty with \$14,000 stayed – 12/04/2013

*REG1309-00037/MG

Floor Me Hardwood Floors, LLC and Dominique R. Turner

Cannon Falls, MN

*Consent Order: \$10,000 civil penalty with \$9,500 stayed – 10/04/2013

*REG1305-00027/WWH

FM Contracting, Inc. and Mark B. Bement

West Fargo, ND

*Consent Order: \$4,000 civil penalty with \$3,800 stayed – 6/18/2013

*REG1305-00013/WWH

GBI Homes, Inc. and Gary T. Goodwin

Chaska, MN

*Consent Order: \$11,000 civil penalty with \$10,400 stayed – 5/21/2013

*REG1301-00016/WWH

Gonzalez Roofing, LLC and Juan Gonzalez

St. Paul, MN

*Licensing Order: Revocation of registration, \$1,000 civil penalty – 4/29/2013

*REG1301-00012/MG

Gopher State Contractors, Inc.

Rice, MN

*Consent Order: \$5,000 civil penalty with \$4,500 stayed – 11/21/2013

*REG1305-00025/WWH

Hiller Stores, Inc. and David Bahr

Rochester, MN

*Consent Order: \$40,000 civil penalty with \$30,000 stayed – 6/03/2013

*REG1301-00026/WWH

HM Drywall, LLC and Hermenegilgo Moreno Salinas

Brooklyn Center, MN

*Licensing Order: Revocation of registration and \$2,000 civil penalty – 6/20/2013

*REG1301-00019/WJW

JER Roofing, LLC and Abraham Barragan Ambriz

St. Louis Park, MN

*Consent Order: \$10,000 civil penalty with \$9,300 stayed – 6/03/2013

*REG1301-00005/MG

Jim Sylvester Merrill

Minneapolis, MN

*Consent Order: \$15,000 civil penalty with \$14,500 stayed – 9/10/2013

*REG1212-00023/WWH

John Rengel Services, LLC and John Rengel

Buffalo, MN

*Consent Order: \$4,000 civil penalty with \$3,900 stayed – 3/18/2013

*REG1212-00011/WWH

John's Glass Service and John Truebenbach

Mapleton, MN

*Consent Order: \$1,000 civil penalty with \$900 stayed – 7/19/2013

REG1305-00028/WWH

JYE Construction, LLC and Juan Gonzalez

Shakopee, MN

*Administrative Order: \$2,000 civil penalty, forgivable if registration achieved within 30 days – 8/15/2013

KCS, Inc. and Travis Kabes

New Prague, MN

*Consent Order: \$10,000 civil penalty with \$9,250 stayed – 9/16/2013

*REG1305-00030/WWH

Knight Remodeling LLC and William F. Knight

Coon Rapids, MN

*Administrative Order: \$5,000 civil penalty – 6/14/2013

*REG1301-00010/WJW

Lakewood Siding & Additions, Inc. and Peter J. Dicke

Hudson, WI

*Consent Order: \$5,000 civil penalty with \$4,800 stayed – 6/27/2013

*REG1304-00004/MG

Legacy Exteriors, LLC and Daniel C. Sedlacek

Buffalo, MN

*Consent Order: \$10,000 civil penalty with \$9,400 stayed – 6/03/2013

*REG1304-00002/MG

Locos Drywall, LLC and Fausto Guerrero Sustaita and Juan Pablo Govea Sanchez

Shakopee, MN

*Licensing Order: Revocation of registration – 4/29/2013

*REG1301-00007/MG

L&W Drywall, LLC and Dan F. Lunder

Hawley, MN

*Consent Order: \$10,000 civil penalty with \$9,600 stayed – 9/16/2013

*REG1305-00040/WWH

MABB, LLC and Miguel A. Bautista-Bautista – IR668272

St. Paul, MN

*Consent Order: \$10,000 civil penalty with \$9,500 stayed – 10/23/13

*REG1305-00051/MG

Marciano Carreto Construction, LLC and Mariano Carreto

Richfield, MN

*Consent Order: \$10,000 civil penalty with \$9,300 stayed – 6/27/2013

*REG1301-00011/MG

McPhillips Bros. Roofing Company and Kenneth Berwald

St. Paul, MN

*Consent Order: \$10,000 stayed civil penalty – 12/02/2013

*REG1310-00010/MG

Medina Roofing, Inc. and Erasto Medina

Newport, MN

*Consent Order: \$5,000 civil penalty with \$4,800 stayed – 3/18/2013

*REG1212-00015/WWH

Merrill, Jim Sylvester, dba Jim Merrill Construction

Minneapolis, MN

*Consent Order: \$15,000 civil penalty with \$14,500 stayed – 8/21/2013

*REG1212-00023/WWH

Merritt Restoration, LLC and Danielle C. Merritt

Rockford, MN

*Consent Order: \$5,000 civil penalty with \$4,800 stayed – 4/19/2013

*REG1212-00024/WWH

Mertens Carpentry, LLC and Jason P. Mertens

St. Cloud, MN

*Consent Order: \$15,000 civil penalty with \$14,250 stayed 5/21/2013

*REG1212-00017/WWH

Metro Carpentry, LLC and Joel Hivala

St. Bonifacius, MN

*Consent Order: \$12,000 civil penalty with \$11,500 stayed – 10/29/2013

*REG1305-00031/WWH

Metro Classic Homes, Inc. and Michael J. Lindor

Eden Prairie, MN

*Consent Order: \$4,000 civil penalty stayed – 4/18/2013

*REG1301-00013/WWH

Moore Drywall, LLC and Gary Moore

Claremont, MN

*Consent Order: \$14,000 civil penalty with \$13,500 stayed - 8/21/2013

*REG1305-00003/WWH

Moreno Services, LLC and Gil Moreno

Minneapolis, MN

*Licensing Order: Revocation of registration – 6/20/2013

*REG1212-00002/WJW

Nasby Construction, Inc. and Douglas A. Nasby

Lakeville, MN

*Administrative Order: \$5,000 civil penalty – 9/18/2013

*REG1305-00002/WJW

North Country Installers, Inc. and Thomas R. Clarke and Douglas A. Lang

Brooklyn Park, MN

*Consent Order: \$10,000 civil penalty with \$9,500 stayed – 12/05/2013

*REG1307-00006/MG

Northern Building Contracting, LLP and John M. Hensrud and Chad Terpstra

Owatonna, MN

*Consent Order: \$10,000 civil penalty with \$9,600 stayed – 4/23/2013

*REG1212-00019/WWH

Northern Hideaway Homes, Inc. and Arnold J. Lawson

Cambridge, MN

*Consent Order: \$10,000 civil penalty with \$9,400 stayed – 5/22/2013

*REG1301-00023/MG

Orozco, Ufrano Cortes

West St. Paul, MN

*Administrative Order: \$5,000 civil penalty – 6/06/2013

*REG1212-00001/WJW

Painting Expectations, LLC and Robert Warthen

South St. Paul, MN

*Licensing Order: Revocation of registration and \$2,000 civil penalty – 5/20/2013

*REG1212-00002/WJW

Photo Finish Painting, LLC and Robert J. Jones

Oak Grove, MN

*Consent Order: \$10,000 civil penalty with \$9,700 stayed – 12/05/2013

*REG1310-00008/MG

Ploog, Patrick R.

Lakeville, MN

*Consent Order: \$5,000 civil penalty stayed – 9/10/13

*REG1305-00034/WWH

Ramirez Pro Painting, LLC and Omar Ramirez

Maplewood, MN

*Consent Order: \$40,000 civil penalty with \$30,000 stayed – 8/21/2013

*REG1305-00017/MG

Renderos Roofing and Siding, Inc. and Ricardo A. Renderos

Monticello, MN

*Administrative Order: \$5,000 civil penalty – 5/20/2013

*REG1212-00020/WJW

Signed Painting, Inc. and Luis Cardenas

Maple Grove, MN

*Consent Order: \$30,000 civil penalty with \$20,000 stayed – 8/21/2013

*REG1305-00018/MG

Sogn Valley Masonry, LLC and Ron J. Rechtziogl

Cannon Falls, MN

*Consent Order: \$10,000 civil penalty with \$9,600 stayed – 3/18/2013

*REG1212-00021/WWH

Sopkowiak, Monty Louis

Buffalo, MN

*Consent Order: \$5,000 civil penalty stayed – 3/20/2013

*REG1212-00018/WWH

Springer Exteriors, LLC, dba Springer Construction Services, and Travis W.

Herritz and Gregory Lubansky

Prior Lake, MN

*Consent Order: \$15,000 civil penalty with \$14,000 stayed – 8/14/2013

*REG1304-00005/MG

Steenberg Construction, LLC and Douglas Steenberg

South St. Paul, MN

*Consent Order: \$10,000 civil penalty with \$9,700 stayed – 7/12/2013

*REG1305-00004/WWH

Stubbs Drywall, Inc. and Shannon Stubbs and Marlo Stubbs

St. Louis Park, MN

*Consent Order: \$10,000 civil penalty with \$9,700 stayed – 3/26/2013

*REG1212-00007/WWH

Superior Construction Services, Inc.

Maple Grove, MN

*Consent Order: \$25,000 civil penalty with \$20,000 stayed – 10/04/2013

*REG1305-00011/WWH

T & D Flooring, LLC and Jonathan R. Dennis and Anthony Castle

Eden Prairie, MN

*Consent Order: \$14,000 civil penalty with \$13,250 stayed – 8/14/2013

*REG1305-00016/WWH

T. Lecy Siding, LLC and Todd G. Lecy

Rochester, MN

*Consent Order: \$10,000 civil penalty with \$9,500 stayed – 4/18/2013

*REG1301-00025/MG

The Joseph Company, Inc.

Austin, MN

*Consent Order: \$10,000 civil penalty stayed – 5/14/2013

*REG1302-00005/MG

Towns Foaming, Inc. and Wayne Townsend

Grasston, MN

*Administrative Order: \$2,500 civil penalty – 10/7/2013

*REG1212-00022/WWH

Tracy Drywall, Inc. and Ammon LeBaron

Apple Valley, MN

*Consent Order: \$10,000 civil penalty with \$9,800 stayed - 8/21/2013

Twin Decorating LLC

Rosemount, MN

*Consent Order: \$5,000 civil penalty with \$4,800 stayed – 9/10/2013

*REG1053-00033/WWH

Westside Tile LLC and Gary Dressel

Shorewood, MN

*Consent Order: \$3,000 stayed civil penalty – 12/05/2013

*REG1305-00052/WWH

Wutschke, Shane L.

Owatonna, MN

*Consent Order: \$5,000 civil penalty with \$4,700 stayed – 7/08/13

*REG1305-00001/WWH

Zavet Construction, Inc. and Mikhail Simonovich

Otsego, MN

*Consent Order: \$10,000 civil penalty with \$9,000 stayed 4/16/2013

*REG1212-00009/WWH

Total civil penalties assessed: **\$121,750**

Registrations revoked: **9**

Appendix B

Internal Revenue Service Guidelines

2. Employee or Independent Contractor?

An employer must generally withhold federal income taxes, withhold and pay over social security and Medicare taxes and pay unemployment tax on wages paid to an employee. An employer does not generally have to withhold or pay over any federal taxes on payments to independent contractors.

Common-Law Rules

To determine whether an individual is an employee or an independent contractor under the common law, the relationship of the worker and the business must be examined. In any employee-independent contractor determination, all information that provides evidence of the degree of control and the degree of independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties. These facts are discussed next.

Behavioral control. Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include the type and degree of:

Instructions that the business gives to the worker. An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work.

- When and where to do the work.
- What tools or equipment to use.

- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow.

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

Training that the business gives to the worker. An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

Financial control. Facts that show whether the business has a right to control the business aspects of the worker's job include: *The extent to which the worker has unreimbursed business expenses.*

Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services that they perform for their employer.

The extent of the worker's investment. An independent contractor often has a significant investment in the facilities or tools he or she uses in performing services for someone else. However, a significant

investment is not necessary for independent contractor status.

The extent to which the worker makes his or her services available to the relevant market. An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

How the business pays the worker. An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is often paid a flat fee or on a time and materials basis for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

The extent to which the worker can realize a profit or loss. An independent contractor can make a profit or loss.

Type of relationship. Facts that show the parties' type of relationship include:

- Written contracts describing the relationship the parties intended to create.
- Whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.
- The permanency of the relationship. If you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that your intent was to create an employer-employee relationship.
- The extent to which services performed by the worker are a key aspect of the regular business of the company. If a worker provides

services that are a key aspect of your regular business activity, it is more likely that you will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

IRS help. If you want the IRS to determine whether or not a worker is an employee, file Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with the IRS.

Industry Examples

The following examples may help you properly classify your workers.

Building and Construction Industry Example 1.

Jerry Jones has an agreement with Wilma White to supervise the remodeling of her house. She did not advance funds to help him carry on the work. She makes direct payments to the suppliers for all necessary materials. She carries liability and workers' compensation insurance covering Jerry and others that he engaged to assist him. She pays them an hourly rate and exercises almost constant supervision over the work. Jerry is not free to transfer his assistants to other jobs. He may not work on other jobs while working for Wilma. He assumes no responsibility to complete the work and will incur no contractual liability if he fails to do so. He and his assistants perform personal services for hourly wages. Jerry Jones and his assistants are employees of Wilma White.

Example 2.

Milton Manning, an experienced tile setter, orally agreed with a corporation to perform full-time services at construction sites. He uses his own tools and performs services in the order designated by the corporation and

according to its specifications. The corporation supplies all materials, makes frequent inspections of his work, pays him on a piecework basis, and carries workers' compensation insurance on him. He does not have a place of business or hold himself out to perform similar services for others. Either party can end the services at any time. Milton Manning is an employee of the corporation.

Example 3.

Wallace Black agreed with the Sawdust Co. to supply the construction labor for a group of houses. The company agreed to pay all construction costs. However, he supplies all the tools and equipment. He performs personal services as a carpenter and mechanic for an hourly wage. He also acts as superintendent and foreman and engages other individuals to assist him. The company has the right to select, approve, or discharge any helper. A company representative makes frequent inspections of the construction site. When a house is finished, Wallace is paid a certain percentage of its costs. He is not responsible for faults, defects of construction, or wasteful operation. At the end of each week, he presents the company with a statement of the amount that he has spent, including the payroll. The company gives him a check for that amount from which he pays the assistants, although he is not personally liable for their wages.

Wallace Black and his assistants are employees of the Sawdust Co.

Example 4.

Bill Plum contracted with Elm Corporation to complete the roofing on a housing complex. A signed contract established a flat amount for the services rendered by Bill Plum. Bill is a licensed roofer and carries workers' compensation and liability insurance under the business name, Plum Roofing. He hires his own roofers who are treated as employees for federal employment tax purposes. If there is a

problem with the roofing work, Plum Roofing is responsible for paying for any repairs. Bill Plum, doing business as Plum Roofing, is an independent contractor.

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¹ Publication 15-A Employer's Supplemental Tax Guide (Supplement to Publication 15 [Circular E], Employer's Tax Guide) For use in 2013, Section 2, p 7-8, Department of the Treasury Internal Revenue Service, <http://www.irs.gov/pub/irs-pdf/p15a.pdf>.