

Employee Misclassification

Impact on Businesses

In addition to the direct negative economic impact to individual workers, these activities also compromise the legitimate business community and the Massachusetts economy. Legitimate businesses are put at an economic disadvantage when competing with other companies who are able to charge less for their work, construction, goods, or services because they are not law-abiding.

Further, legitimate businesses subsidize those entities that do not follow the wage and hour laws, purchase workers' compensation insurance, or contribute to the Unemployment Insurance (UI) system, as their dollars are used to provide benefits when there are no employers of record to charge. Uninsured injuries cost the Commonwealth and its legitimate businesses millions of dollars each year. Similarly, avoiding UI creates unfunded liabilities that cause additional UI premiums for employers.

Employers who are caught misclassifying employees face serious consequences, including liability for:

- federal and state employment taxes, which may include interest and penalties;
- workers' compensation insurance coverage, which may lead to penalties for insurance fraud;
- minimum wages or overtime compensation;
- applicable employee benefit obligations.



Commonwealth of Massachusetts

**Executive Office of Labor
and Workforce Development**

**Joint Task Force on the Underground
Economy and Employee Misclassification**

FOR QUESTIONS OR TO REPORT CONCERNS:

**Call: 1-877-96-LABOR
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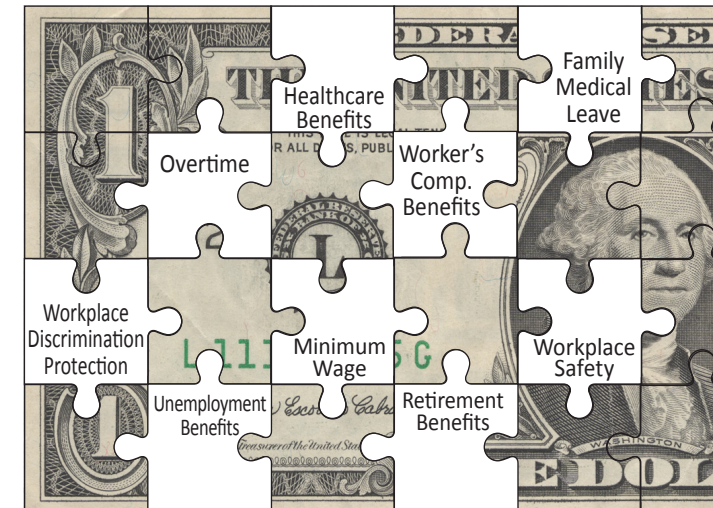
visit: <http://www.mass.gov/lwd/jtf>

or email: jtftips@state.ma.us

This brochure is for informational purposes only and is not a substitute for reviewing the relevant laws or receiving formal interpretations from government agencies.

Puzzled about the cost of employee misclassification?

**Learn more about the impacts of
misclassification to businesses,
workers, and the Commonwealth**



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Wage Theft

What is Employee Misclassification?

Employee misclassification is when a worker is paid as something other than an employee, such as an independent contractor, when by law that worker is really an employee. One of the differences between an employee versus an independent contractor is how these workers are paid. An employee is a “W-2 employee” if he or she is on an employer payroll and having payroll deductions and tax contributions made on his/her behalf by the employer. Conversely, an independent contractor is solely responsible for his/her own tax contributions.

Employee misclassification is a form of employer fraud that has many ramifications. Misclassification reduces an employer’s labor and related costs, thereby allowing a business to significantly underbid competitors. When a company misclassifies its workers, it is misrepresenting the true nature or size of its business to its insurance provider and various government organizations. Although employee misclassification can be the result of a misunderstanding of the law, it frequently occurs when an employer is looking for ways to cut costs. This tactic is illegal and unfair.

Your personal preference is not a factor in determining employment status. The classification is determined solely by applying the relevant legal standards.



Tax Evasion

Misclassified employees are part of the “underground economy”

The underground economy is a term that refers to those individuals and businesses that utilize tactics to conceal their employment activities to abscond from one or more of their employer responsibilities related to wages, payroll taxes, insurance, licensing, safety, and other regulations. The underground economy includes related activities commonly known as tax evasion, payroll fraud, under-the-table work, and wage theft.

Why does misclassification occur?

When a business misclassifies employees, it illegally reduces its costs for insurance, payroll taxes, licenses, employee benefits, safety equipment, and safety conditions. These employers then gain an unfair competitive advantage over businesses that comply with the existing business laws. This causes unfair competition in the marketplace and forces law-abiding businesses to pay greater expenses.

Impact on Workers

Employees of businesses that do not comply with labor, licensing, and tax laws are negatively affected because:

- Wage earnings may be lower than those required by law.
- Working conditions may not meet safety requirements, which can put them in danger.
- Benefits to which they are entitled may be illegally denied or delayed because their wages are not properly reported.



Payroll Fraud

- Neither they, nor their employer, may be paying their share of taxes for Social Security and Medicare, so the employee is not earning credits for Social Security eligibility upon reaching the age of retirement.
- There may be limited causes of action against their employer for issues such as discrimination and on-the-job accidents.

When an employer avoids its responsibilities, it may be paying lower than required wages and exploiting workers who may not be inclined to report such violations to authorities.

Impact on the Commonwealth

Whenever a business operates outside the legitimate economy it may do so to avoid taxes, safety regulations, wage laws, and required insurance policies (i.e. workers’ compensation insurance). Such businesses may also avoid paying their fair share of taxes. Tax revenues are required for the state to provide basic services to its residents. Taxpayers become unduly burdened by these illegal activities, as many workers who are misclassified are paid below minimum wage, or are without employer-provided benefits. These workers then must utilize existing social safety nets that were not intended to support people working full-time jobs.

When added together, operating outside the law allows these businesses to:

- have an unfair advantage by illegitimately lowering costs so they can underbid all others;
- take business away from law abiding businesses and their employees who are trying to make an honest living;
- weaken our social fabric, economic stability, and working conditions in the Commonwealth

