

A PLAIN-ENGLISH GUIDE

to the

ILLINOIS EMPLOYEE CLASSIFICATION ACT

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The Illinois Employee Classification Act

Purpose

The Employee Classification Act (820 ILCS 185/1-999) was signed into law August 6, 2007 and became effective January 1, 2008. The stated purpose of the law is to address the practice in the construction industry of some contractors misclassifying individuals as independent contractors in order to avoid payroll taxes, unemployment insurance contributions, workers' compensation premiums and minimum wage and overtime payments, because this practice puts contractors that comply with tax and employment laws at a competitive disadvantage. The Illinois Department of Labor's Administrative Rules for the Act were adopted and made effective as of July 31, 2008.

Coverage

The Act applies to all public and private "construction" work performed within the State of Illinois on or after January 1, 2008.

The misclassification of an employee as an independent contractor prior to January 1, 2008 shall not serve as the basis for a violation under the Act.

Expanded Definition of Construction

The Act greatly expands the definition of what is traditionally understood to be construction. The definition includes:

- constructing
- altering
- reconstructing
- repairing
- rehabilitating
- refinishing
- refurbishing
- remodeling
- remediating
- renovating
- custom fabricating
- maintenance
- landscaping
- improving
- wrecking
- painting
- decorating
- demolishing
- adding to or subtracting from any building, structure, highway, roadway, street, bridge, alley, sewer, ditch, sewage disposal plant, water works, parking facility, railroad, excavation or other structure, project, development, real property or improvement
- moving construction related materials on the job site to or from the job site

Who Is an “Individual Performing Services” - Independent Contractor

An “individual performing services” for a contractor is deemed to be an employee unless:

- the individual meets all three conditions of the 3 Part Test;
- the sole proprietor or partnership is deemed legitimate by meeting all twelve criteria of the 12 Part Test; or
- the corporation or limited liability company meets the criteria of a bona fide corporation or a bona fide limited liability company.

Each is a very strict test. It appears that it will be difficult to meet all of the criteria.

3 Part Test - Individuals

An individual performing services for a contractor is deemed to be an employee unless:

- 1) the individual has been and will continue to be free from control or direction over the performance of the service for the contractor, both under the individual's contract of service and in fact;
- 2) the service performed by the individual is outside the usual course of services performed by the contractor; and
- 3) the individual is engaged in an independently established trade, occupation, profession or business.

In determining whether direction or control exists, the Department will consider the following factors. No one factor is dispositive of the issue of whether an individual, sole proprietor or partnership is an employee or an independent contractor. The Department will review the totality of circumstances in making a decision on direction and control.

- 1) Is the individual eligible for a pension, health insurance, bonuses, paid vacation, or sick pay?
- 2) Does the contractor carry Workers' Compensation insurance and pay Unemployment Insurance taxes on the individual?
- 3) Does the contractor deduct Social Security taxes from the individual's compensation and report the worker's income to the Internal Revenue Service (IRS)?

- 4) Does the contractor furnish the individual with transportation, samples, business cards, or an expense account?
- 5) Does the contractor require the individual to turn down work from other contractors or assign or limit the territory in which the individual performs services?
- 6) Does the contractor set the price and credit terms for the product or the services being performed by the individual?
- 7) Does the contractor require attendance at meetings or provide training?
- 8) Does the contractor have the right to set rules and regulations?
- 9) Does the contractor require the individual to perform services a specific number of hours per day or per week?
- 10) Does the contractor issue assignments, schedule work or set quotas with time requirements?
- 11) Does the contractor require the individual to follow a routine, order or sequence set by the contractor in performing the services?
- 12) Does the contractor engage the individual with the expectation that the relationship will continue indefinitely, rather than for a specific project or period of time?

“Usual course of services” means that the services rendered by the individual are necessary to the contractor's business and not simply incidental to the business. **If a task is performed by both a contractor's employees as well as its independent contractors, the task is considered to be in the usual course of the contractor's services.** Though we do not yet know how this will be interpreted and enforced, it is reasonable to assume that if a contractor has trucks for removing debris from a work site, but the contractor must hire a subcontractor for overflow work, that individual will be considered an employee.

"An independently established trade, occupation, profession or business" means the individual performing the services has a proprietary interest in such business, to the extent that the individual operates the business without hindrance from any other person and, as the enterprise's owner, may sell or otherwise transfer the business.

12 Part Test – Sole Proprietor or Partnership

A sole proprietor or partnership performing services for a contractor is deemed legitimate if it is shown that it:

- 1) is performing the service free from the direction or control over the means and manner of providing the service, subject only to the right of the contractor for whom the service is provided to specify the desired result;
- 2) is not subject to cancellation or destruction upon severance of the relationship with the contractor;
- 3) has a substantial investment of capital in the sole proprietorship or partnership beyond ordinary tools and equipment and a personal vehicle;
- 4) owns the capital goods and gains the profits and bears the losses of the sole proprietorship or partnership;
- 5) makes its services available to the general public or the business community on a continuing basis;
- 6) includes services rendered on a Federal Income Tax Schedule as an independent business or profession;
- 7) performs services for the contractor under the sole proprietorship's or partnership's name;
- 8) obtains and pays for the license or permit, where required, in the sole proprietorship's or partnership's name;
- 9) furnishes the tools and equipment necessary to provide the service;
- 10) hires its own employees, if necessary, without contractor approval, pays the employees without reimbursement from the contractor and reports the employees' income to the Internal Revenue Service;
- 11) is not represented by the contractor as an employee of the contractor to the contractor's customers; and
- 12) has the right to perform similar services for others on whatever basis and whenever it chooses.

A sole proprietor or partnership not deemed legitimate under this 12 Part Test, shall be deemed an individual for purposes of the Act.

Bona Fide Corporation

In determining whether a corporation is a bona fide corporation and not an “individual performing services,” the Department may consider whether the corporation:

- is capitalized;
- has issued corporate stock;
- maintains a corporate bank account;
- intermingles corporate and personal accounts or funds;
- holds itself out as a corporation;
- maintains corporate books and records, including corporate meeting minutes and corporate tax returns that are current and complete; or
- Articles of Incorporation have been filed with the case of Illinois Secretary of State or, in the case of foreign corporations, as directed by the laws of that jurisdiction.

Bona Fide Limited Liability Company

In determining whether a limited liability company (LLC) is bona fide for purposes of the Act, the Department shall consider, among other factors, whether the LLC:

- has assets;
- maintains a company bank account;
- there is an intermingling of company and personal accounts or funds;
- holds itself out as an LLC;
- makes necessary tax filings that are current and complete; and
- Articles of Organization have been filed and the LLC is in good standing, in the case of Illinois LLCs with the Illinois Secretary of State or, in the case of foreign LLCs, as directed by the laws of that jurisdiction.

Recordkeeping Requirements

Every contractor and subcontractor shall maintain records for all individuals performing services for the contractor or subcontractor, regardless of how those individuals are classified. The records shall be maintained **for a period of three (3) years** unless the records relate to an ongoing investigation or enforcement action under the Act, in which case the records must be maintained until their destruction is authorized by the Department or by court order. Records to be maintained by the contractor shall include all documents related to, or tending to establish the nature of, the relationship between the contractor and individuals performing services. Records that **must be maintained** for each individual performing services for the contractor include, but are not limited to:

- 1) names, addresses, phone numbers, Social Security numbers, Individual Tax Identification Numbers and Federal Employer Identification Numbers;
- 2) type of work performed and the total number of days and hours worked;
- 3) method, frequency and basis on which wages were paid or payments were made;
- 4) all invoices, billing statements or other payment records, including the dates of payments, and any miscellaneous income paid or deductions made;
- 5) copies of all contracts, agreements, applications and policy or employment manuals; and
- 6) any federal and State tax documents.

Posting of Notice

An entity for whom one or more individuals perform services who are not classified as employees under the Act shall post and keep posted, in a conspicuous place on each job site where those individuals perform services and in each of its offices, a notice in English, Spanish, and Polish, prepared by the Department, summarizing the requirements of the Act. Where it is not practicable to post a notice on the job site, notices shall be provided to all individuals performing services who are not classified as employees.

The contractor's **failure to post the Notice** shall constitute a violation of the Act. The contractor may be **subject to all civil and criminal penalties** of the Act for failing to post such Notice.

The Department of Labor shall, upon request and without charge, furnish copies of the notices to contractors. Copies of the notice may be downloaded from the Department's website.

No Waiver

There can be no waiver of any provision of the Act. An employer who attempts to induce an individual to waive any provision of the Act shall be guilty of a Class C misdemeanor. The Act further provides for an extension of the three (3) year statute of limitations for any contractor who forces or deters any individual from seeking application of the Act.

Subcontractor Agreements

It cannot be conclusively state that drafting a subcontractor agreement to clearly identify and define the relationship with your subcontractors will provide a contractor with complete protection from liability under the Act. However, the business relationship should be memorialized in a written subcontractor agreement. The subcontractor agreement should contain representations and warranties that address the provisions set forth in the two tests in the Act. Among other terms, the subcontractor agreement should contain requirements that the subcontractor maintain adequate insurance, remain in good standing with the Illinois Secretary of State, and that the subcontractor shall be required to provide adequate and prompt notice if the relationship and/or status of the subcontractor changes during the course of the subcontractor agreement.

Retaliation

An employer or entity, or their agent, shall not retaliate against any person for exercising any of his/her rights under the Act. Exercise of rights under the Act shall include:

- (1) making any complaint to an employer or entity, to a co-worker, to a community organization, before a public hearing, or to a State or federal agency that rights guaranteed under the Act have been violated;
- (2) causing to be instituted any proceeding under or related to the Act; or
- (3) testifying or preparing to testify in an investigation or proceeding under the Act.

Any such retaliation shall subject the contractor to **civil penalties** and/or **a private cause of action**.

Who May File a Complaint - Any Interested Party

If there is a reasonable belief that the entity or employer is in violation of the Act or any rule adopted under the Act, any interested party (defined as "a person with an interest in compliance with the Act") may file a complaint with the Department of Labor, or may file suit in circuit court without first exhausting any alternative administrative remedies provided in the Act.

Complaints must be filed with the Department of Labor within 180 days from the date of the alleged violation. The Department may investigate alleged violations for up to three years preceding the date the complaint was filed; however, the Department shall not investigate any complaints for alleged violations that occurred prior to January 1, 2008.

The right of any interested party to file suit in circuit court terminates upon the passing of three (3) years from the final date of performing services to the employer or entity. This limitations period is tolled if an employer or entity has deterred a person's exercise of rights under this Act.

Under the definition any interested party could include other contractors who were underbid on a contract, labor unions, other subcontractors who were underbid, or even fellow disgruntled employees. In addition to general airing of grievances, these third parties have an additional incentive. In any civil action brought by an interested party, the circuit court shall award the interested party 10% of the amount recovered.

A person whose rights under the Act have been violated is entitled to collect:

- the amount of any wages, salary, employment benefits, or other compensation denied or lost to the person by reason of the violation, plus an equal amount in liquidated damages;
- compensatory damages and an amount up to \$500 for each violation of the Act or any rule adopted under the Act;
- in the case of unlawful retaliation, all legal or equitable relief as may be appropriate; and
- attorneys' fees and costs.

Investigation

The Department shall conduct investigations in connection with the administration and enforcement of the Act and shall be authorized to visit and inspect, at all reasonable times, any places covered by the Act and inspect documents related to the determination of whether an individual is an employee under the Act.

The investigation shall include a written notice to the contractor of the substance of the complaint and an opportunity to present any information the contractor wishes the Department to consider in reaching its determination. Before making a final determination of a violation, the Department shall notify the contractors of the substance of the Department's investigation and afford the contractor an opportunity to present any written information for the Department to consider in reaching its determination.

Whenever the Department determines that there has been a violation of any provision of the Act or any rules created under the Act, the Department may:

- a) Seek a voluntary settlement agreement that eliminates the unlawful practice and provides appropriate relief;
- b) Recommend the commencement of a civil action;
- c) Issue a cease and desist order;

- d) Assess civil penalties as set forth in the Act;
- e) Collect the amount of any wages, salary, employment benefits or compensation denied or lost to the individual;
- f) Place the contractor on the debarment list; and/or
- g) Take any other reasonable action to eliminate the unlawful practice and/or remedy the effect of the violation.

Referral to Other State Agencies

If the Department of Labor determines that a contractor has violated the Act by misclassifying employees as independent contractors, the Department must notify:

Department of Employment Security
Department of Revenue
Office of the State Comptroller
Illinois Workers' Compensation Commission

who shall each be required to check the contractor's compliance with their own regulations, utilizing their own definitions, standards, and procedures. The Department of Labor, Department of Employment Security, Department of Revenue, and the Illinois Workers' Compensation Commission shall cooperate by sharing information concerning any suspected misclassification of employees as independent contractors.

Civil Penalties

A contractor that violates any of the provisions of the Act or any rule adopted under the Act shall be subject to a civil penalty not to exceed \$1,500 for each violation found in the first audit by the Department of Labor. For a period of five (5) years following the first violation, a contractor shall be subject to a civil penalty not to exceed \$2,500 for each repeat violation found by the Department of Labor.

Each violation of the Act, for each person and for each day the violation continues shall constitute a separate and distinct violation. This means that a contractor who misclassifies a single employee as an independent contractor for 200 work days (one work year) would have a first time penalty of up to \$300,000.00, or a second time penalty up to \$500,000.00 for a single worker. This penalty is doubled in cases of willful violations, or for any person who "obstructs" an investigation of alleged violations.

In addition to the civil penalties, the individual may collect the amount of any wages, salary, employment benefits or other compensation denied or lost due to the violation, plus an equal amount in liquidated damages. Individuals can also collect compensatory

damages and up to \$500.00 for each violation, and in the case of unlawful retaliation, all legal and equitable relief and attorney's fees and costs.

In addition to the penalties and fines under the Act, the contractor will be liable to these employees for all benefits not provided to them, including, taxes for federal withholding, social security, Medicare/Medicaid and state withholding. Failure to report and pay taxes will subject the contractor to state and federal penalties, interest and potential criminal violations. A finding of a violation of the Act can also lead to claims for:

| | |
|-----------------|-----------------------|
| Prevailing Wage | Overtime |
| Discrimination | Workers' Compensation |
| Retaliation | Insurance |

Debarment

For any subsequent violation determined by the Department within five (5) years of a violation, the Department shall place the contractor on a debarment list to be posted on the Department's official website. No state contract shall be awarded to a contractor placed on the debarment list until four (4) years have elapsed since the date of the last violation.

Criminal Penalties

Any contractor or individual who willfully violates any of the provisions of the Act or any rule adopted under the Act or obstructs the Director of Labor, his or her representatives, or any other person authorized to inspect places of employment under the Act shall be liable for penalties up to **double the statutory amount, punitive damages (in an amount equal to the double statutory amount), and/or criminal penalties** (a Class C misdemeanor, and for a subsequent violation within a five (5) year period a Class 4 felony). Criminal violations of the Act shall be prosecuted by the Attorney General or appropriate State's Attorney.