

## The Illinois Employee Classification Act: A primer

By Christopher Keleher

Construction contractors doing business in Illinois will face a new regulation that effectively deems all construction workers as their employees. This seismic shift will occur January 1, 2008, when the Illinois Employee Classification Act ("Act") takes effect. The evil sought to be eradicated is the misclassification of workers as independent contractors. The Act limits a company's ability to designate workers as "independent contractor" in the construction industry. Treating individuals as employees instead of independent contractors will impact taxes, health insurance, benefit plans, and wages. The specter of civil and criminal penalties further accentuates the importance of satisfying the Act's requirements. This Article explains the motivations behind the Act and highlights its salient portions.

### A. Background of the Illinois Employee Classification Act

The target of the Act is transparent, as the singular focus of the law is the construction industry. The AFL-CIO, Laborers' International Union,

and Foundation for Fair Contractors spearheaded the bill. Their views were encapsulated by a representative of the Mason Contractors Association of America who testified to an Illinois House of Representatives committee, "[i]ndependent contractors typically have no formalized training, no quality control, and no access to continuing education." Another catalyst of the Act was the reality that independent contractors are often denied of protections such as workers' compensation insurance, unemployment benefits, and overtime pay. Additionally, contractors typically do not withhold taxes when paying independent contractors. A Department of Employment Security report put a price tag on these realities. Illinois lost \$125 million in income taxes annually between 2001 and 2005 due to misclassification. The report further concluded that each year \$23 million of workers compensation for misclassified construction workers was underpaid. Thus, the law possesses a revenue collecting function, as well as providing a stick to ensure employers will provide workers' compensation

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and health insurance. However, the Act contains no carrot.

### **B. Applicability of the Illinois Employee Classification Act**

The Act defines "construction" in a broad manner, such that it entails any business involving, *inter alia*, the creation, improvement, or destruction of any structure, road, or landscape. A contractor is any entity engaging in construction. In short, all Illinois general contractors and subcontractors will be subject to the Act.

The Act assumes an individual working for a contractor is an employee. The burden is on the contractor to establish the working arrangement falls into one of two statutorily created exceptions: (1) workers who satisfy the Act's independent contractor test; and (2) legitimate sole proprietors or partnerships.

A worker is an independent contractor if:

- the individual is free from control over the performance of the job;
- the work is outside the usual course of services performed by the contractor; and
- the individual is engaged in an independently established trade.

If an individual satisfies these three elements, he is an independent contractor.

Second, a worker may also be granted an independent contractor designation if the individual is deemed part of a "legitimate sole proprietor or partnership." The Act sets forth a dozen criteria that must be met. To qualify, the sole proprietor or partnership must:

- perform the service free from the direction or control of the contractor;
- not be subject to dissolution upon severance of the relationship;
- maintain a substantial investment of capital in the business;
- own the capital goods and gain the profits of the business;
- make its services available to the general public on a continuing basis;
- include services rendered on a federal income tax schedule as a business;
- perform services for the contractor under the name of the business;
- obtain and pay for any necessary licenses in the name of the business;

- furnish the equipment necessary to provide the service;
- hire its own employees without contractor approval, pay them without reimbursement from the contractor, and report their income to the IRS;
- not be held out by the contractor to the public as its own employee; and
- have the right to perform similar services for others.

Failure to meet a single element results in an "employee" designation. Treating an individual as an employee creates contractor responsibilities relating to taxes, unemployment insurance, and workers' compensation insurance for that worker. Overtime pay, and health and retirement benefits may also be required. The provisions of the Act cannot be waived. Workers currently treated as independent contractors may not qualify as such under the Act. Continuing this treatment after January 1, 2008, will have serious consequences.

### **C. Enforcement of the Illinois Employee Classification Act**

The Act provides a plethora of penalties to be assessed against an employer misclassifying workers. While aggrieved individuals can bring suit under the Act, it is the ability of third parties to commence an action that is of particular significance. The Act enables the nebulously phrased "any interested party" to file complaints with the Illinois Department of Labor "if there is a reasonable belief that the entity or employer is in violation of this Act." Thus, unions or a spurned contractor on the losing end of a bid can invoke this clause to register complaints. Persons aggrieved by a violation of the Act, along with "any interested party," can recover lost wages, compensatory damages, and attorney fees.

The Department of Labor has full investigatory authority to probe possible violations of the Act. Offenders will find it difficult to remain inconspicuous with such an array of agencies aligned against them. The Department of Labor, the Department of Employment Security, the Department of Revenue, and the Workers' Compensation Commission will work in tandem by sharing information involving suspected misclassification. To facilitate enforcement,

the Act bestows the Department of Labor with the power to subpoena documents and witnesses. If it finds a violation, the Department can issue a cease and desist order, collect wages due, and assess a civil penalty not to exceed \$1,500 for each violation. A fine of \$2,500 will be assessed for any repeat violations during the next five years. These penalties are doubled in the case of a willful violation, which is a Class C misdemeanor for a first offense, and a Class 4 felony for subsequent offenses within five years. Any contractor that infringes on the Act more than once will also suffer debarment, precluding it from securing any state contract for four years.

The Act could be a harbinger of things to come. In March of 2007, the U.S. House of Representatives conducted hearings on the misclassification of workers. The General Accounting Office estimates that misclassification lightens federal tax coffers by almost \$5 billion. The Federal Independent Contractor Proper Classification Act is legislation proposing to close the federal tax law loophole that enables employers to designate workers as independent contractors rather than employees. Thus, Illinois' classification requirement could be extrapolated to the national level.

### **D. Conclusion**

Prior to January 1, 2008, contractors should have legal counsel conduct a thorough review of the status of each current and potential independent contractor to gauge the feasibility of designating them as independent contractors. Although complying with the Act may frustrate project budgets, increase costs, and consume time, the consequences of violating the Act warrant meticulous compliance and constant vigilance.