Worker Misclassification

2024 Evaluation Report

Program Evaluation Division

Office of the Legislative Auditor

State of Minnesota

Program Evaluation Division

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Judy Randall, Legislative Auditor
State of Minnesota

March 2024

Members of the Legislative Audit Commission:

A worker's classification, such as being an employee or an independent contractor, is important because it affects the legal rights and obligations of the worker and their employer. Worker misclassification—which is prohibited by state law—occurs when an employer incorrectly classifies a worker.

Minnesota has neither an adequate nor coordinated approach for ensuring that Minnesota workers are properly classified. State agencies—including the departments of Labor and Industry (DLI), Employment and Economic Development (DEED), and Revenue (DOR)—may make efforts to address worker misclassification, but the extent of their efforts is limited. We estimated that 22 percent of employers subject to an unemployment insurance audit misclassified at least one worker in 2018, which is higher than when we last evaluated worker misclassification in 2007. We make a number of recommendations for the three agencies and the Legislature to improve the state's approach to addressing misclassification.

Our evaluation was conducted by Caitlin Badger (project manager), Stephanie Besst, Heather Grab, and Luke Wood. DLI, DEED, and DOR cooperated fully with our evaluation, and we thank them for their assistance.

Sincerely,

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OLA

Summary

March 2024

Worker Misclassification

Minnesota has neither an adequate nor coordinated approach for ensuring that Minnesota workers are properly classified.

Report Summary

Misclassification Rates in Minnesota

Although several state agencies undertake efforts related to addressing worker misclassification, no state agency calculates a rate at which workers are misclassified in Minnesota. We estimated worker misclassification rates using data from DEED's unemployment insurance audits of employers.

- The overall rate of worker misclassification in Minnesota is unknown. However, according to DEED audit data, estimated rates of worker misclassification were higher in 2018 than when OLA last issued a report on worker misclassification in 2007. (pp. 11, 17)

- Misclassification occurred in many industries. According to DEED audit data, we estimated that 22 percent of employers subject to a random unemployment insurance audit misclassified at least one worker in 2018. (pp. 14-15)

  Recommendation ► The Legislature should direct a state agency (or agencies) to calculate worker misclassification rates in Minnesota on an ongoing basis. (p. 19)

State Agency Efforts to Address Misclassification

State agencies may conduct investigations or audits related to worker misclassification, but the extent of these efforts and their impacts on the entities involved are limited.

- State law assigns DLI, DEED, and DOR limited duties to ensure workers are correctly classified. Generally, the efforts of these agencies to identify and correct worker misclassification result from administering or enforcing other state laws or programs. (pp. 27-28)

  Recommendation ► If the Legislature would like agencies to take a more active role in addressing worker misclassification, the Legislature should direct agencies to do so in law. (p. 29)

Background

A worker's classification, such as being an employee or an independent contractor, is important because it affects the legal rights and obligations of the worker and their employer.

Worker misclassification—which is prohibited by state law—occurs when an employer incorrectly classifies a worker. When worker misclassification occurs, a worker may lose rights that they are afforded in law, employers who properly classify their workers may be forced to compete with misclassifying employers who have an unfair competitive advantage due to lowered labor costs, and the government may lose program and tax revenues.

Several state agencies undertake activities that involve identifying and correcting worker misclassification. We focused on the efforts of the following agencies to address worker misclassification:

- Department of Labor and Industry (DLI)
- Department of Employment and Economic Development (DEED)
- Department of Revenue (DOR)

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- The authority in state law to address issues involving worker misclassification is fragmented across state agencies, and agencies generally do not coordinate investigative efforts or share information about employers that misclassify workers. (pp. 29-30)

  Recommendation ► The Legislature should require state agencies to take a coordinated and collaborative approach to addressing worker misclassification. (p. 39)

- Minnesota law outlines several different tests to determine a worker's classification, which creates challenges to addressing misclassification. (p. 22)

  Recommendation ► To the extent possible, the Legislature should enact common tests for determining worker classification and reduce the number of different classification tests currently in law. (p. 26)

- State agency efforts to identify and address instances of worker misclassification sometimes take years. (p. 31)

  Recommendation ► The Legislature should consider establishing timeliness standards for worker misclassification investigations. (p. 32)

- When state agencies find worker misclassification, employers face limited consequences for misclassifying workers. (p. 33)

  Recommendation ► The Legislature should amend statutes to ensure that agencies are required to penalize employers that repeatedly misclassify workers. (p. 35)

- Workers may be compensated for only a fraction, if any, of the benefits they were denied as a result of being misclassified, and only certain workers can pursue civil action to directly rectify their misclassification. (p. 36)

  Recommendation ► The Legislature should amend statutes to allow civil action by misclassified workers in all industries. (p. 37)

Summary of Agencies' Responses

In a letter dated March 8, 2024, DLI Commissioner Blissenbach said that "DLI considers worker misclassification a significant problem in Minnesota" and the "OLA report highlights some of the challenges inherent in DLI's efforts to enforce statutes specific to worker misclassification." She further stated that "DLI is committed to tackling this issue head-on and always strives to improve its efforts in this area." She explained that DLI is currently working on legislative changes to address misclassification, in addition to taking steps to improve the agency's misclassification enforcement efforts.

DEED Commissioner Varilek stated in a letter dated March 6, 2024, that "addressing misclassification is critical to helping DEED achieve its mission, and we appreciated [OLA's] recommendations for improving education, prevention, detection, and correction of worker misclassification. We look forward to working with our agency partners and stakeholders across the state to ensure that Minnesota employers and workers have access to a level playing field...."

In a letter dated March 8, 2024, DOR Commissioner Marquart commented that the agency appreciated the evaluation's "identification of the challenges and the impacts of employee misclassification to our state…and agree with the value of coordinating this work to effectively administer worker classification laws." The Commissioner continued, "we have taken this opportunity to continue to look for ways to improve and refine our processes."

The full evaluation report, *Worker Misclassification*, is available at 651-296-4708 or:
www.auditor.leg.state.mn.us/ped/2024/worker-misclassification.htm

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Introduction

Misclassifying workers, such as incorrectly reporting that workers are independent contractors instead of employees, affects the state's workforce and economy. Misclassification can deprive workers of wages that they should have legally been paid or workplace protections that prevent injuries or job loss. Additionally, misclassification disadvantages law-abiding employers and results in less revenue for state programs.

In 2007, the Office of the Legislative Auditor released a report, *Misclassification of Employees as Independent Contractors*, which reviewed how workers are classified in Minnesota, determined the extent to which workers were misclassified, and evaluated the state's approach to enforcing proper classification. In May 2023, the Legislative Audit Commission directed the Office of the Legislative Auditor to revisit the topic. We focused our evaluation on the following questions:

- **How frequently do employers misclassify Minnesota workers as independent contractors?**
- **To what extent has Minnesota adopted an effective approach to identifying and correcting worker misclassification?**
- **How effectively has the state addressed misclassification in the construction industry?**
- **To what extent do the current guidelines for classification address "gig" workers?**

To address these questions, we reviewed relevant state and federal laws and administrative rules. We also analyzed data from the state's unemployment insurance program to estimate misclassification rates in Minnesota.[1]

To evaluate Minnesota's approach to addressing misclassification, we reviewed the policies and procedures of key agencies that undertake efforts to address misclassification—the departments of Labor and Industry (DLI), Employment and Economic Development, and Revenue—and interviewed the agencies' staff. We also conducted an in-depth review of documents from DLI's misclassification investigations.[2]

To better understand other perspectives on worker misclassification, we interviewed staff at the Department of Commerce and the Office of the Attorney General and surveyed or interviewed staff from numerous stakeholder organizations. We also attended meetings of a Minnesota task force pertaining to worker misclassification in

[1] We analyzed the results of the Department of Employment and Economic Development's random unemployment insurance audits of the 2018 records of 1,340 employers that contributed to the unemployment insurance program.

[2] We reviewed the files for all investigations that DLI initiated in 2021—open and closed—that involved possible construction worker misclassification or registration violations. Additionally, we reviewed the files of *closed* construction worker misclassification and registration investigations that the agency initiated between January 1, 2022, and June 30, 2023.

addition to meetings for a committee examining the treatment and compensation of certain gig economy workers.[3] Additionally, we reviewed information about other states' efforts to address misclassification, and we sought to better understand how Minnesota's efforts to ensure proper worker classification compare to state efforts to enforce other employment-related laws in Minnesota. Finally, we reviewed literature about worker classification in the gig economy.

Our evaluation focused on Minnesota's approach to classifying workers and ensuring that workers are classified correctly. We did not evaluate whether individual workers were correctly classified on a case-by-case basis. Additionally, although there are various ways in which workers can be misclassified, our evaluation focused on the misclassification of employees as independent contractors.

[3] We sent an e-mail questionnaire to 30 stakeholder organizations, including those that represented workers, employers, and academic or other research or trade organizations. We received 15 responses, for a response rate of 50 percent.

Chapter 1: Background

A worker's classification is a designation that indicates the work situation, or type of "employment relationship," that exists between the worker and the employer that pays them for their services.[1] Workers can be classified differently depending on the nature of the work they perform. For example, a worker can be classified as an employee or an independent contractor.

Key Findings in This Chapter

- The effects of worker misclassification are wide-reaching, impacting workers, employers, and the government.
- In Minnesota, the departments of Labor and Industry, Employment and Economic Development, and Revenue each undertake activities that involve addressing worker

We begin this chapter by providing an overview of "employees" and "independent contractors" as they relate to worker classifications. We then discuss the effects of improperly classifying employees as independent contractors. Lastly, we identify the key entities involved in worker classification determinations in Minnesota and their specific roles.

Employees and Independent Contractors

A worker's classification—whether as an employee or independent contractor—is important because it affects the legal rights and obligations of the worker and their employer. Employees generally have labor rights and protections that law does not grant to independent contractors. Similarly, state law obligates employers to fulfill certain duties for their employees but not their independent contractors. The exhibit on the following page shows some of the labor rights and protections state law grants to employees and the obligations of their employers.

Although independent contractors do not typically receive the same benefits and protections as employees, independent contractors often claim that they receive other benefits not typically enjoyed by employees. For instance, many independent contractors have expressed that they enjoy greater flexibility because they have the freedom and autonomy to determine their work duties, schedules, and payrates. Some independent contractors have found that these benefits protect them from economic downturns and alleged bias in the workplace.

[1] For simplicity, in this report we refer to any entity that pays workers for services as an "employer," regardless of how the term is defined in law.

Employee Labor Rights and Protections, and Associated Employer Obligations

Employee Rights or Protections	Employer Obligations
• Fair labor standards (for example, minimum wage, overtime pay)	• Comply with fair labor standards (for example, minimum wage, overtime pay)
• Work environment that meets occupational safety and health requirements	• Ensure the work environment meets occupational safety and health requirements
• Access to workers' compensation benefits	• Obtain workers' compensation insurance
• Access to unemployment insurance benefits	• Contribute to the unemployment insurance program
	• Withhold income taxes from wages paid to employees and remit taxes to the government

Notes: The lists above are not exhaustive. Employees must meet certain program requirements to be eligible to receive workers' compensation benefits or unemployment insurance benefits. For example, an employee must have a "work-related" injury to receive workers' compensation benefits. Among other things, an employee must have become unemployed or had their hours substantially reduced through no fault of their own to receive unemployment insurance benefits.

Source: Office of the Legislative Auditor, based on analysis of Minnesota statutes.

A worker's classification depends on the circumstances of their work situation, not the type of services they provide nor personal preferences.

Working as an employee or an independent contractor are both legally legitimate means of earning money. Whether someone is classified as an employee or an independent contractor ultimately depends on the circumstances under which the worker provides services. When determining how to classify a worker, one might consider, for example: how the worker is compensated (such as on an hourly basis or after a job's completion), the extent to which the worker must follow an employer's instructions about how to complete tasks (such as where to work and the tools to use), and whether the worker makes their services available to the general public. Thus, the same worker could be classified as an employee under the circumstances of one work situation but an independent contractor under another.

A worker's classification is not determined by the type of services the worker provides, nor the desires of the employer and worker involved. Even if an employer and worker both decide they would like the worker to be an independent contractor, the worker's classification must be determined based on the circumstances under which the worker provides services. We further discuss how to determine a worker's classification in Chapter 3.

Impacts of Worker Misclassification

Misrepresentation of an Employment Relationship

"**No employer shall misrepresent the nature of its employment relationship with its employees**.... An employer misrepresents the nature of its employment relationship with its employees if it makes any statement regarding the nature of the relationship that the employer knows or has reason to know is untrue and if it fails to report individuals as employees when legally required to do so."

— *Minnesota Statutes* 2023, 181.722, subd. 1

Worker misclassification occurs when an employer classifies a worker in a manner that inaccurately represents the relationship between the employer and the worker. For example, misclassification can occur when an employer incorrectly classifies an employee as an independent contractor or some other type of "nonemployee" worker. Although there are different types of misclassification, for the purposes of this report, a "misclassified worker" is an employee that an employer misclassified as an independent contractor.

As shown to the left, state law prohibits employers from knowingly misrepresenting their "employment relationship" with workers.[2] In other words, employers may not misclassify their workers.

The effects of worker misclassification are wide-reaching, impacting workers, employers, and the government.

As we discuss below, the effects of misclassifying workers reverberate across the economy. While misclassification clearly affects the immediate parties involved—the worker and the employer—ramifications of misclassification extend to other employers and the government as well.

Workers. Worker misclassification prevents workers from receiving many employment-related rights and protections granted to employees in law. For example, because independent contractors are generally not subject to minimum wage and workplace safety requirements, a misclassified worker may not receive wages to which they are legally entitled, and they may work in an environment without required safety precautions.

Further, a misclassified worker may face additional financial responsibilities because they must fulfill certain employment-related obligations that their employer avoids by misclassifying them as an independent contractor. For instance, employers must withhold a portion of Social Security taxes from employees' wages to pay to the government, as well as pay a portion of these taxes themselves.[3] For independent contractors, employers need not withhold Social Security taxes *or* pay the employer share of the tax. Instead, independent contractors pay both the employee and the employer portions of the tax.[4] As a result, misclassified workers incur expenses they would not have had they been properly classified.

[2] *Minnesota Statutes* 2023, 181.722, subds. 1-3.

[3] Federal Insurance Contributions Act, 26 *U.S. Code,* Subtitle C, Chapter 21 (2022).

[4] Self-Employed Contributions Act, 26 *U.S. Code,* Chapter 2 (2022).

Employers. By misclassifying workers, an employer reduces its legally required obligations because many of these obligations do not apply to workers who are independent contractors. Avoiding these obligations reduces the employer's associated labor costs. For instance, employers must contribute to the unemployment insurance program based on wages paid to their employees. When employers misclassify workers as independent contractors, the employer is not required to contribute to the program for those workers.

Although an employer may benefit by misclassifying its workers, misclassification harms other employers that classify workers correctly. For instance, because misclassifying workers results in lower labor costs for the employer, employers that misclassify their workers have an unfair competitive advantage over employers that comply with classification requirements and fulfill all required obligations.

Misclassifying workers, however, is not without risk to employers. Certain workers, as well as the state, may pursue legal action against misclassifying employers in court. The state and courts may require misclassifying employers to pay monetary fines or to compensate workers for damages. We further discuss misclassification penalties in Chapter 3.

Government. Worker misclassification also affects state and federal government finances through lower program and tax revenues or increased reliance on government services. As an example, if a misclassified worker is injured on the job and their employer does not carry workers' compensation insurance because the employer misclassified the worker as an independent contractor, the state provides workers' compensation benefits to the misclassified worker.[5] Although state law requires these uninsured employers to reimburse the state for the cost of these benefits, employers may not be financially able to do so, which leaves the state responsible for the cost of benefits and reduces the program's overall funding.

Misclassification may also increase workers' use of social assistance programs. For example, when misclassification prevents workers from receiving all of the compensation they are owed or accessing labor benefits like unemployment insurance, misclassified workers may seek support from other government programs to cover the costs of housing, transportation, or other necessities.

Classification Roles and Responsibilities

A variety of entities—including employers, state and federal agencies, and the courts—play a role in determining worker classification. Typically, an employer is initially responsible for classifying a worker, which establishes the employer's legal obligations to the worker. Certain state agencies may also determine a worker's classification in the course of administering or enforcing certain state laws, as discussed below. Further, the federal government provides guidance that can be used to determine a worker's

[5] Employers are required by law to have workers' compensation insurance for their employees; they are not required to carry such insurance for independent contractors. *Minnesota Statutes* 2023, 176.041, subd. 1(12); 176.181, subd. 2; and 176.83, subd. 11. *Minnesota Rules*, 5224, https://www.revisor.mn.gov/rules/5224/, accessed May 8, 2023.

classification. For example, Minnesota's Department of Revenue determines a worker's classification using criteria outlined by the federal Internal Revenue Service. Additionally, the courts may be involved in determining a worker's classification as a result of litigation, such as when a worker seeks to remedy alleged misclassification through the judicial process.

In Minnesota, the departments of Labor and Industry, Employment and Economic Development, and Revenue each undertake activities that involve addressing worker misclassification.

There are several agencies in Minnesota that undertake activities that involve identifying and correcting worker misclassification. These agencies generally determine classification and correct misclassification as it pertains to their enforcement of various employment-related laws, which we outline below. State agencies may need to determine a worker's classification to assess whether the worker is entitled to certain rights or eligible for labor-related benefits. Agencies may also determine a worker's classification as part of their efforts to ensure that employers have fulfilled their legal obligations to employees.

Key State Agencies Involved in Addressing Worker Misclassification

Agency	Employment-Related Laws
Department of Labor and Industry	• Fair labor standards • Workers' compensation insurance
Department of Employment and Economic Development	• Unemployment insurance
Department of Revenue	• Income tax withholding

Note: While not required by law, the Department of Labor and Industry also conducts investigations into possible misclassification in the construction industry; we discuss these efforts in Chapter 4.

Source: Office of the Legislative Auditor, based on analysis of Minnesota statutes.

Department of Labor and Industry (DLI)

DLI is responsible for enforcing many employment-related laws. Three different units within the department determine worker classification in the course of fulfilling their duties:

> **Wage and Hour Unit.** DLI's Wage and Hour Unit enforces the state's fair labor standards and determines worker classification as part of its investigations into possible violations of these standards. As we discussed earlier, law specifies labor standards that employers must meet for their employees, such as minimum wage and overtime compensation, and directs DLI to enforce these standards.[6] DLI may conduct an investigation that involves determining

[6] *Minnesota Statutes* 2023, 175.20, 177.24-177.25, and 177.26.

whether a worker was misclassified in order to determine whether an employer violated those labor standards.

Special Compensation Fund Unit. As the administrator of the state's workers' compensation program, DLI must ensure that employers have workers' compensation insurance for employees, as required by law.[7] DLI's Special Compensation Fund Unit investigates employers that may not have fulfilled their obligations to acquire such insurance. Through these investigations, the unit may identify that a worker was misclassified.

Construction Misclassification Unit. DLI's Construction Misclassification Unit determines whether certain construction workers were misclassified. We discuss the efforts of this unit in Chapter 4.

Department of Employment and Economic Development (DEED)

When an individual applies to receive unemployment insurance benefits, DEED may determine that worker's classification when the agency assesses whether the worker is eligible to receive benefits. Among other eligibility criteria, state law permits certain employees—not independent contractors—access to unemployment insurance.[8]

DEED also determines a worker's classification as part of its audits of employers that contribute to the unemployment insurance program. Unemployment insurance benefits are primarily funded by employer contributions, and to ensure employers pay the correct amount into the program, DEED audits a sample of contributing employers. Through these audits, DEED may identify misclassified workers, and if necessary, reclassify these workers and revise the total amount owed by the employer.

Department of Revenue (DOR)

DOR may determine if workers were correctly classified when it conducts certain audits of tax records. State and federal law require employers to withhold a certain amount of employees' wages to pay to the government as taxes on those wages.[9] Employers are not required to withhold such taxes on wages paid to independent contractors. DOR audits employer records to ensure employers properly withheld income taxes and remitted them to the state. Examining worker classification is often a key part of these tax withholding audits.

Other State Entities

Although this report primarily focuses on the activities that DLI, DEED, and DOR conduct related to misclassification, the Department of Commerce's Fraud Bureau and the Office of the Attorney General also play a role.

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[7] *Minnesota Statutes* 2023, 175.17; and 176.181, subd. 2.

[8] *Minnesota Statutes* 2023, 268.035, subds. 12, 13(1), 15(a)(1), 27, 29; 268.069, subd. 1(1); and 268.07, subd. 2(a).

[9] *Minnesota Statutes* 2023, 290.62, and 290.92; 26 *U.S. Code*, secs. 3401-3403 and 6151 (2022); and 26 *CFR*, secs. 31.3401(a)-1, (c)-1, (d)-1; 31.3402(a)-1; and 31.3403-1 (2023).

Department of Commerce's Fraud Bureau. The Fraud Bureau may identify misclassified workers through its investigations into suspected workers' compensation insurance fraud. These investigations focus on whether there was an intention to defraud by (1) workers who illegally collect workers' compensation benefits or (2) employers that avoid paying workers' compensation insurance premiums. Unlike DLI's activities for the workers' compensation program, the Fraud Bureau conducts criminal investigations.

Office of the Attorney General. The Attorney General's Office may identify misclassified workers through its investigations of alleged violations of employment-related rights or protections. Statutes also grant the Attorney General the authority to enforce state laws prohibiting the misclassification of workers.[10] Additionally, the office represents DLI, DEED, and DOR in court during hearings about violations of employment-related laws, including instances where violations appear to result from worker misclassification.

[10] *Minnesota Statutes* 2023, 181.1721 and 181.722-181.723.

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Chapter 2: Misclassification Rates in Minnesota

The Legislature has expressed ongoing concerns about worker misclassification and a continued interest in understanding its prevalence. Misclassification rates—such as how many employers misclassified workers, or how many workers were misclassified—can provide helpful information about the extent to which misclassification is an issue in Minnesota, if at all.[1]

Key Findings in This Chapter

- The overall rate of worker misclassification in Minnesota is unknown.
- An estimated 22 percent of employers subject to an unemployment insurance audit misclassified at least one worker in 2018.

We begin this chapter by outlining the challenges in measuring misclassification. Then, to provide a sense of how frequently misclassification occurs in the state, we present three different estimated rates of misclassification based on existing unemployment insurance data.

Overview

Despite ongoing interest in the topic of worker misclassification, limited data exist about the extent to which it is an issue in Minnesota.

The overall rate of worker misclassification in Minnesota is unknown.

Even though the departments of Labor and Industry (DLI), Employment and Economic Development (DEED), and Revenue (DOR) conduct investigations that involve identifying misclassified workers, the agencies do not use the information they gather to calculate worker misclassification rates. Neither DLI nor DOR collect misclassification data in a way conducive to calculating a misclassification rate. Staff at both agencies said that one would need to manually review the individual files for each investigation in order to determine whether staff identified misclassified workers and to calculate how frequently misclassification occurred. DEED, on the other hand, maintains its audit results in a database that one could use to calculate a misclassification rate, but the agency does not do so.

[1] As we discussed in Chapter 1, for simplicity, in this report we refer to any entity that pays workers for services as an "employer," regardless of how the term is defined in law.

While DLI, DEED, and DOR could calculate rates of misclassification using the relevant information each agency collects, these calculations would have limitations. First, as we discuss in Chapter 3, the agencies use different criteria to determine a worker's classification, making it difficult to calculate a single misclassification rate for the state. Second, the data agencies gather on misclassification cannot currently be generalized or applied to the larger statewide population. For example, although DEED randomly audits a sample of employers, these audits are only of the employers that participate in the state's unemployment insurance program—not all employers in the state.[2] On the other hand, DOR collects tax-related information from all taxpaying employers in the state, so its data are likely more representative of all employers in Minnesota; however, DOR does not conduct random audits of these employers. As a result, its findings likewise cannot be generalized across all employers in the state.

Challenges to Determining the True Misclassification Rate

- State agencies do not calculate rates of misclassification.
- Minimal documentation exists about independent contractors.
- Rates of misclassification in the cash-based economy are unknown.

Additionally, the state requires limited or no documentation from employers and workers about independent contractors. For example, employers must submit to DEED only information about their employees in certain types of employment, not independent contractors they may have paid for services.[3] Additionally, none of the state agencies involved in addressing worker classification require independent contractors to proactively report the instances in which they have provided services.

Finally, determining the full extent of misclassification is difficult because the total number of workers in the cash-based economy who may be misclassified is unknown. An employer in the cash-based economy may not formally register with the government as a business or may pay workers in cash to avoid records of these payments. An employer may take such action to avoid reporting their workers and assuming employer-related responsibilities, such as paying workers' compensation insurance premiums and making contributions to the unemployment insurance program. Workers may be drawn to the cash-based economy in an effort to avoid paying taxes on their wages or having the government withdraw financial obligations, such as child support payments, from their paychecks. When employers and workers do not report payments to the government through tax returns or wage reports, cash payments and the workers that receive these payments are often absent from state employment records.

Cash-Based Economy

The "cash-based economy" typically refers to employers that pay workers entirely in cash. Employers may pay wages in cash to avoid reporting or to underreport information about their workers.

[2] Certain employers do not participate in or contribute to the unemployment insurance program. For instance, independent contractors are not eligible for unemployment insurance benefits in state law, so employers that classify all of their workers as independent contractors are not required to contribute to the unemployment insurance program. *Minnesota Statutes* 2023, 268.035, subds. 9a, 12, 13(1), 14, 15(a)(1), 25b, 27, 29; 268.069, subd. 1(1); and 268.07, subd. 2(a).

[3] *Minnesota Statutes* 2023, 268.035, subds. 12, 13-15; and 268.044, subd. 1.

Misclassification Estimates

Despite the limitations mentioned above, we estimated rates of misclassification in the state based on data from DEED's unemployment insurance audits of employers.[4] The estimates we present in this section measure (1) the share of employers that misclassified workers, (2) the share of employees that were misclassified, and (3) the rates of misclassification in different industries.[5] We also compared our estimated rates to those that we calculated in our 2007 report.[6]

There are several important limitations to the estimates we present below. First, aspects of DEED's audit process limit the extent to which our estimates can be generalized across all employers, employees, and industries in the state. As discussed earlier, DEED audits only employers that participate in the unemployment insurance program—not all employers in the state. The estimates do not include employers that did not participate in the unemployment insurance program because—whether legitimately or illegitimately—they did not classify any of their workers as employees. The estimates also do not include employers that operated strictly in the cash-based economy, such as those that pay workers only cash to illegally avoid reporting wages.[7] As a result, the estimates below likely underestimate the true rate of misclassification in Minnesota.

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[4] We analyzed the results of DEED's random audits of the 2018 records of 1,340 employers that contributed to the unemployment insurance program. DEED largely suspended its random audits in March 2020 due to the COVID-19 pandemic and did not resume its standard auditing approach until October 2022. As a result, employers' 2018 records represented the most recent, complete year of DEED's random audit data available. Although a DEED auditor may "expand" an audit to include more than one year of an employer's records, to ensure our estimates were specific to 2018, we included audits of only 2018 records. We did not verify the accuracy of DEED's findings for each audit.

We also did not include the results of DEED's "selected" audits. DEED conducts selected audits that involve a more targeted approach, typically in response to reported concerns—such as an individual asserting an employer had not reported their wages to the unemployment insurance program. Selected audits accounted for a small share (1 percent) of DEED's total audits of employers' 2018 records.

[5] For the purposes of the misclassification estimates we present below, "employers" includes only entities with at least one worker who meets the definition of an "employee" according to unemployment insurance guidelines. The unemployment insurance program considers a worker "to be misclassified when the employer erroneously characterizes an employee's service as something other than employment," specifically when the worker is incorrectly classified as an independent contractor or unreported by the employer. Thus, our estimates include both of these types of misclassification. U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Program Letter No. 30-10, *Proposed Effective Audit Measure for State Unemployment Insurance (UI) Employer Audit Programs*, issued September 2, 2010, https://www.dol.gov/sites/dolgov/files/ETA/advisories/UIPL/2010/UIPL30-10.pdf, accessed October 12, 2023.

[6] Office of the Legislative Auditor, Program Evaluation Division, *Misclassification of Employees as Independent Contractors* (St. Paul, 2007).

[7] These employers are unlikely to be in DEED's unemployment insurance system, and thus unlikely to be audited. A DEED staff member expressed that the employers that participate in the unemployment insurance program are generally less likely to misclassify workers on a large scale.

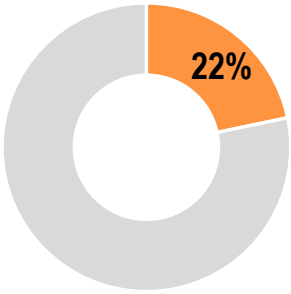
Employers

In a typical work situation, the employer will determine whether a worker is classified as an employee or an independent contractor. We heard from agency staff and other stakeholders that employers may misclassify workers intentionally, for example to reduce operating costs, or unintentionally out of confusion or misunderstanding.[8]

An estimated 22 percent of employers subject to an unemployment insurance audit misclassified at least one worker in 2018.

As shown to the right, we estimated that 22 percent (291) of the employers that contributed to the unemployment insurance program that DEED audited misclassified at least one worker in 2018. In other words, slightly more than one in five audited employers either classified at least one worker as an independent contractor when the worker should have been an employee, or the employer failed to report the worker at all. It is unclear whether these instances of misclassification were intentional, because DEED's auditors do not systematically determine the employer's intent.

Approximately one in five audited employers misclassified at least one worker in 2018



Source: Office of the Legislative Auditor, based on analysis of the results of DEED's random unemployment insurance audits of 2018 data from employers that contributed to the unemployment insurance program.

Workers

In addition to estimating the share of employers that misclassified their workers, we also sought to estimate how many workers those employers misclassified.

Minnesota employers misclassified a relatively small share of their total employees in 2018.

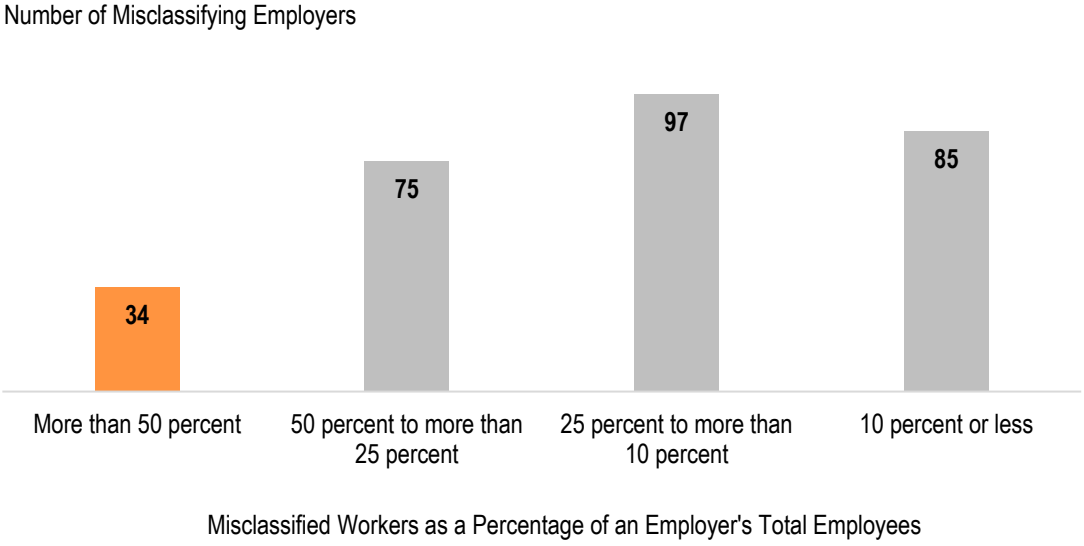
According to DEED's data, employers misclassified a relatively small proportion of employees in 2018. Of the roughly 25,300 total employees included in DEED's audits for that year, employers misclassified about 4 percent (990). In other words, about 1 in 25 employees that DEED examined were misclassified as independent contractors or unreported to the unemployment insurance program.

We also reviewed the extent to which individual employers misclassified their workers. Employers often misclassified a small number of workers; roughly two-thirds (68 percent) of misclassifying employers misclassified one or two workers. However,

[8] In addition to various stakeholder interviews, we sent an e-mail questionnaire to 30 stakeholder organizations to gather their feedback on worker misclassification in Minnesota. We received 15 responses, for a response rate of 50 percent.

sometimes these misclassified workers constituted a substantial share of the employers' total employees. As shown below, of the 291 employers that misclassified workers in 2018, 34 (12 percent) of them misclassified a majority of their employees.

Thirty-four misclassifying employers incorrectly classified a majority of their employees



Note: DEED auditors identified 291 employers that misclassified at least one worker in 2018.

Source: Office of the Legislative Auditor, based on analysis of the results of DEED's random unemployment insurance audits of 2018 data from employers that contributed to the unemployment insurance program.

Industry

Because we heard from stakeholders and state agency staff that misclassification occurs more frequently in certain industries, we also analyzed misclassification rates by industry.

Audits of employers that contributed to the unemployment insurance program show that misclassification occurred in many industries.

Based on DEED's audit data, misclassification occurred across various industries, as shown on the following page. For instance, about 36 percent of the employers DEED audited in the transportation and warehousing industry misclassified at least one worker in 2018. The construction industry ranked sixth, with approximately 23 percent of audited taxpaying employers misclassifying at least one worker in 2018.

Worker misclassification rates varied by industry in 2018

Industry	Percentage of Employers that Misclassified Workers
Transportation and Warehousing	36%
Administrative and Support and Waste Management and Remediation Services	31
Accommodation and Food Services	30
Agriculture, Forestry, Fishing, and Hunting	30
Health Care and Social Assistance	26
Construction	23
Retail Trade	20
Manufacturing	17
Professional, Scientific, and Technical Services	16
Wholesale Trade	14
Finance and Insurance	13
All Industries	**22**

Notes: We categorized industries above based on the North American Industry Classification System (NAICS). The "Other Services" industry and industries with fewer than 40 audited employers are not shown in the table, but are included in "All Industries."

Sources: Office of the Legislative Auditor, based on analysis of the results of DEED's random unemployment insurance audits of 2018 data from employers that contributed to the unemployment insurance program; and U.S. Census Bureau, *North American Industry Classification System*, https://www.census.gov/naics/, accessed February 2, 2024.

Employers in some industries misclassified workers at a disproportionately high rate. If misclassification occurred in an industry at a proportional rate, we would expect the industry's proportion of misclassified workers to be consistent with the industry's proportion of total employees across all industries. For example, if an industry had 15 percent of all reported employees, we would expect that same industry to also have 15 percent of all the misclassified workers found through DEED's audits. However, as shown on the next page, the proportion of misclassified workers in some industries was disproportionately high compared to the industry's share of total employees reported to the unemployment insurance program in 2018. For instance, in 2018, 10 percent of the total reported employees worked in the retail trade industry, but 17 percent of the total misclassified workers worked in that industry.

Some industries had disproportionately high rates of misclassified workers in 2018

Industry	Percentage of Employees Reported in Industry	Percentage of Misclassified Workers in Industry
Retail Trade	10%	17%
Construction	8	16
Accommodation and Food Services	11	13
Other Services	7	10
Administrative and Support and Waste Management and Remediation Services	2	9

Notes: The table above includes only the industries for which DEED audited 40 or more employers and for which employers misclassified workers at disproportionately high rates. The "Other Services" industry includes automotive repair and maintenance, personal care services (for example, beauty salons and nail salons), and business and labor organizations, among others.

Sources: Office of the Legislative Auditor, based on analysis of the results of DEED's random unemployment insurance audits of 2018 data from employers that contributed to the unemployment insurance program; and U.S. Census Bureau, *North American Industry Classification System*, https://www.census.gov/naics/, accessed February 2, 2024.

Misclassification Rates Over Time

In our 2007 report, *Misclassification of Employees as Independent Contractors*, we also estimated misclassification rates based on DEED's unemployment insurance audit data. Below we discuss the extent to which misclassification rates have changed since we issued that report.

Estimated rates of worker misclassification were higher in 2018 than when OLA last issued a report on worker misclassification in 2007.

Based on DEED's unemployment insurance data, worker misclassification rates were higher across several metrics.[9] According to the 2007 report, about 17 percent of randomly audited employers misclassified at least one worker.[10] In 2018, 22 percent of randomly audited employers misclassified at least one worker—five percentage points higher than in the 2007 report.

When we examined data on the employers that misclassified workers, we also found that those employers misclassified workers at a higher rate. In 2007, we found that misclassifying employers incorrectly classified about 6 percent of their total

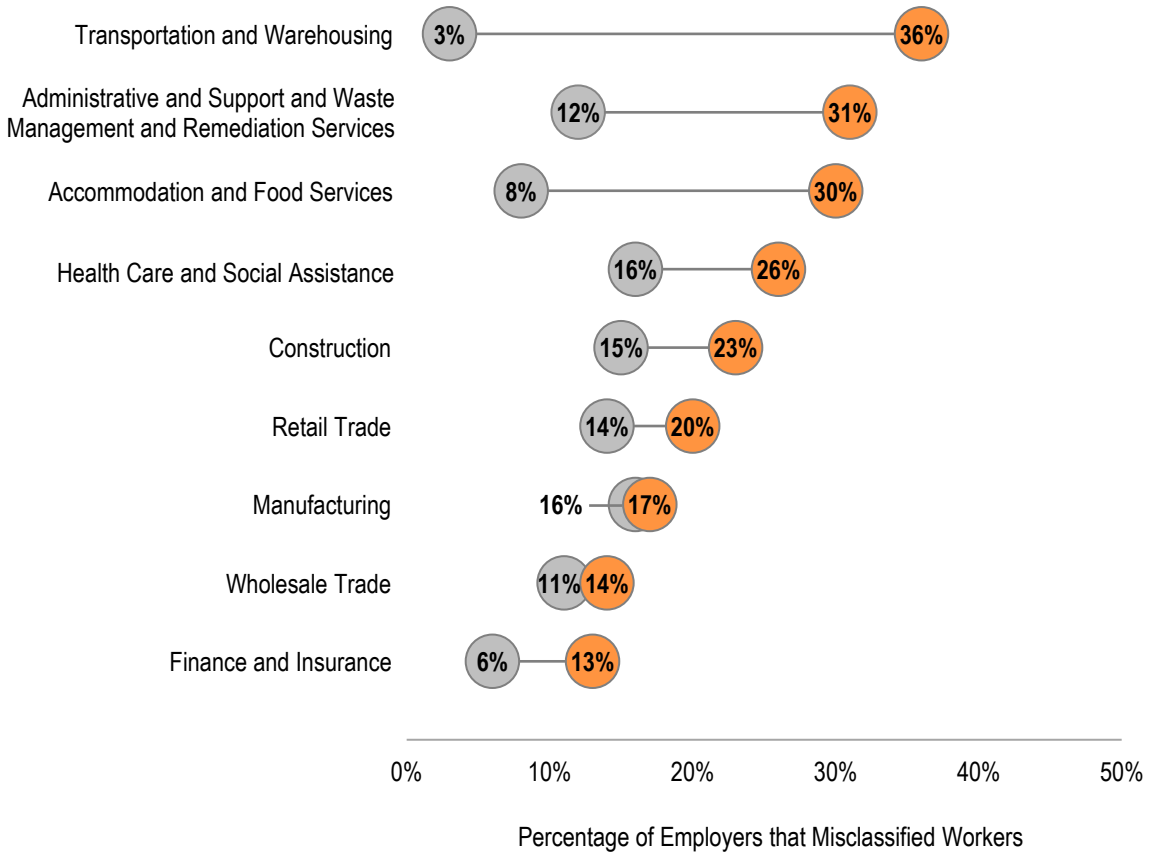
[9] DEED told us that changes to its internal processes may have affected its audits of employers in the unemployment insurance program since OLA last evaluated worker misclassification, which could affect estimated rates of worker misclassification when comparing rates over time.

[10] Office of the Legislative Auditor, Program Evaluation Division, *Misclassification of Employees as Independent Contractors* (St. Paul, 2007), 15.

employees.[11] However, in 2018, misclassified workers comprised about 12 percent of those employers' total employees.

Finally, as shown below, rates of misclassification were higher in certain industries. The share of employers that misclassified workers was higher in all but one of the industries that we reviewed both in our 2007 report and this report.[12]

The share of employers that misclassified their workers was higher for many industries in OLA's 2024 review of worker misclassification than in its 2007 review



Notes: The graphic above includes only the industries (1) for which the rates of misclassification were higher and (2) that OLA evaluated in both its 2007 report and this report. Findings from our 2007 report reflect 2005 employer data that DEED audited, and findings presented in this 2024 report reflect 2018 employer data that DEED audited.

Sources: Office of the Legislative Auditor, based on analysis of the results of DEED's random unemployment insurance audits of 2018 data from employers that contributed to the unemployment insurance program; U.S. Census Bureau, *North American Industry Classification System*, https://www.census.gov/naics/, accessed February 2, 2024; and Office of the Legislative Auditor, Program Evaluation Division, *Misclassification of Employees as Independent Contractors* (St. Paul, 2007), 19.

[11] Office of the Legislative Auditor, Program Evaluation Division, *Misclassification of Employees as Independent Contractors* (St. Paul, 2007), 17.

[12] According to DEED's data, the rate of misclassification in the Professional, Scientific, and Technical Services industry went from 18 percent, as presented in our 2007 report, to 16 percent. *Ibid.*, 19.

Discussion

There are numerous benefits to tracking worker misclassification rates and trends. State agencies could use such rates to determine whether employers in certain industries would benefit from additional education about properly classifying workers. Agencies could also use such information to evaluate whether initiatives to deter misclassification are effective. A better understanding of the workers and industries impacted by misclassification could also aid the Legislature with budget and policy decisions.

Several other states require state entities to report misclassification rates. For example, in Vermont, the legislature directed certain state entities to report how many of their investigations found misclassification, resulted in a penalty, involved an employer that had previously misclassified workers, and more.[13] In New York, a task force composed of state and city departments is required to report annually about its activities to address misclassification, including—but not limited to—how many employers were cited for misclassifying workers and how many employees were affected.[14]

RECOMMENDATION

The Legislature should direct a state agency (or agencies) to calculate worker misclassification rates in Minnesota on an ongoing basis.

There are several possible approaches to estimating misclassification rates, each requiring different levels of agency resources. For instance, the Legislature could direct DEED to calculate misclassification rates based on its random audits of taxpaying employers in the unemployment insurance program, similar to our analyses presented above. DEED must already conduct annual audits to meet federal reporting requirements; the Legislature could simply direct DEED to calculate and report misclassification rates over time using data the agency already must collect per federal requirements. Although this approach does not resolve the limitations we faced in our analyses—specifically that unemployment insurance data are not representative of all employers in the state—this approach would be the least resource intensive and add the fewest number of new duties for the state agencies that undertake misclassification-related efforts, while still providing some information regarding worker misclassification rates over time.

If the Legislature wants a more comprehensive view of misclassification rates, it could direct DLI, DOR, *and* DEED to calculate rates based on their existing agency efforts. Given that the focus of each of these agencies' efforts to address misclassification differ, this would provide the Legislature with a more holistic understanding of the extent of misclassification identified across state agencies. However, this approach also has limitations. DLI and DOR do not currently conduct random audits, so

[13] *Acts and Resolves Passed by the General Assembly of the State of Vermont* 2020, act 85, sec. 9.

[14] State of New York Executive Order 6, "Continuation and Expiration of Prior Executive Orders," October 8, 2021; State of New York Executive Order 159, "Establishing a Permanent Joint Task Force to Fight Worker Exploitation and Employee Misclassification," July 20, 2016; and State of New York Executive Order 17, "Establishing the Joint Enforcement Task Force on Employee Misclassification," September 5, 2007.

misclassification rates calculated by those agencies could not be applied or generalized to all employers or workers in the state. Additionally, directing DLI and DOR to calculate such rates would require additional state investment as these agencies do not currently have systems that efficiently track or report misclassification data.

If the Legislature is interested in an even more comprehensive understanding of misclassification rates, it could direct an agency to conduct a more rigorous analysis that is better representative of employers and workers in the state. For example, the Legislature could direct DOR to randomly audit tax filings on a regular basis to identify misclassification and calculate a misclassification rate. DOR is likely best suited to conduct such an analysis because of its access to tax data about compensation that may have been paid to independent contractors. The agency's tax data likely includes more employers and workers than the unemployment insurance program. And, in contrast to DOR's current approach, random audits would generate more generalizable misclassification rates. However, this approach would likely be the most resource intensive, and DOR's analysis would still likely not reflect employers or workers operating in the cash-based economy who do not file taxes.

Chapter 3: Agency Efforts to Address Misclassification

As we described in Chapter 1, the departments of Labor and Industry (DLI), Employment and Economic Development (DEED), and Revenue (DOR) each undertake efforts related to addressing worker misclassification. In this chapter, we discuss these efforts in greater depth, including how statutes direct agency work, how agency efforts affect employers and workers in the state, and the extent to which agencies collaborate with each other.[1]

Key Findings in This Chapter

- Minnesota has neither an adequate nor coordinated approach for ensuring that Minnesota workers are properly classified.
- Generally, state agency efforts to identify and correct misclassification result from enforcing or administering other state laws or programs.
- Some states have adopted a more coordinated approach to addressing worker misclassification.

Overview

In our 2007 report, *Misclassification of Employees as Independent Contractors*, we found that Minnesota did not have an adequate approach to ensure that Minnesota workers were properly classified.[2] Many of the issues discussed in the 2007 report persist today.

Minnesota has neither an adequate nor coordinated approach for ensuring that Minnesota workers are properly classified.

Minnesota law requires state agencies to do little to address misclassification specifically. As a result, agency activities pertaining to worker misclassification are modest and generally occur as the result of administering other state laws or programs—not for the sake of addressing misclassification in and of itself. Further, state agencies do not adequately coordinate their efforts to address misclassification. We discuss these issues—and others—in greater depth throughout the remainder of this chapter.

[1] As we discussed in Chapter 1, for simplicity, in this report we refer to any entity that pays workers for services as an "employer," regardless of how the term is defined in law.

[2] Office of the Legislative Auditor, Program Evaluation Division, *Misclassification of Employees as Independent Contractors* (St. Paul, November 2007), 24.

Worker Classification Tests

As we discussed in Chapter 1, determinations about a worker's classification—whether made by employers or state agencies—are based on the degree to which certain circumstances or factors are present in the relationship between the worker and their employer. For example, one might evaluate how much control the employer has over a worker's behavior by considering the level of training the employer provides to the worker. The greater the level of control the employer has over the worker, the more likely that worker is an employee rather than an independent contractor.

Minnesota has several different tests to determine a worker's classification, which creates challenges to addressing misclassification.

State law outlines many different worker classification "tests," or sets of factors, to determine how to classify workers. Some of the classification tests are specific to an industry or occupation. As we discuss more in Chapter 4, for instance, statutes outline a specific test to determine the classification of certain construction workers. Other classification tests are specific to a state program. For example, state laws outline one test to determine a worker's classification for the purposes of determining eligibility for unemployment insurance and a different test for the purposes of determining eligibility for workers' compensation.[3]

Because there are different classification tests for different programs, state agencies use different tests to determine a worker's classification. The two-page exhibit towards the end of this section outlines three key tests used by DLI, DEED, and DOR for the purposes of workers' compensation, unemployment insurance, and taxes, respectively.

Using these classification tests to determine a worker's proper classification can be challenging. First, any attempt to determine a worker's classification using these tests is somewhat subjective given the qualitative nature of many of the individual test factors. Also, although two of the tests described above prioritize certain factors, there is not a specific threshold or quota to distinguish an employee from an independent contractor. There is no rule, for instance, that a worker should be classified as an employee if more than 50 percent of the factors indicate an employment relationship. It is possible, therefore, that employers or agencies might classify the same worker differently simply because they weighed the various factors differently.

Further, although the classification tests in law are similar, they are not the same, which poses yet another challenge to ensuring that workers are properly classified. For instance, the classification test for the unemployment insurance program lists two factors that are the "most important" when determining a worker's classification: (1) the right to control a worker's performance, and (2) the right to discharge the worker

[3] *Minnesota Rules*, 3315.0555, https://www.revisor.mn.gov/rules/3315/, accessed May 8, 2023; and *Minnesota Rules*, 5224, https://www.revisor.mn.gov/rules/5224/, accessed May 8, 2023.

without incurring liability for damages.[4] In contrast, under the classification test for the workers' compensation program, the degree of control over the worker's performance is the sole "most important factor" in determining worker classification.[5] Although these differences are subtle, it means that a worker could be classified as an employee for one state program and classified as an independent contractor for another program.

In the case of DLI, worker classification tests even differ between the various programs and laws within that agency's jurisdiction. For the purposes of determining eligibility for workers' compensation, DLI uses the classification test outlined in the previous exhibit.[6] Yet, to determine whether an employer violated the state's prohibition against misclassifying workers, statutes direct DLI to use a different standard, stating:

> …the nature of an employment relationship is determined using the same tests and in the same manner as employee status is determined under the applicable workers' compensation *and* unemployment insurance program laws and rules *[emphasis added]*.[7]

In other words, statutes direct DLI to determine a worker's classification using two different tests with differing priorities.

The multitude of classification tests in law also complicates any potential interagency effort to address misclassification. Staff from DLI, DEED, and DOR said that, because they generally use different tests or standards to determine a worker's classification, even if one agency confirmed that an employer misclassified a worker, the other agency would still need to make its own determination. Staff from DLI and DOR said they would have to conduct their own separate investigations to confirm that the worker was misclassified under their respective agency's classification test. A DEED supervisor explained that DEED would use information from DLI and DOR investigations, as appropriate, but that DEED would still come to its own classification determination.

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[4] *Minnesota Rules*, 3315.0555, https://www.revisor.mn.gov/rules/3315/, accessed May 8, 2023.

[5] *Minnesota Rules*, 5224.0330, https://www.revisor.mn.gov/rules/5224/, accessed May 8, 2023.

[6] In some instances, DLI may need to use other classification tests specific to workers in certain industries, such as workers in the construction industry or the "trucking and messenger/courier industries." *Minnesota Statutes* 2023, 176.041, subd. 1(12).

[7] *Minnesota Statutes* 2023, 181.722, subd. 3.

Key Worker Classification Tests in Minnesota

Workers' Compensation
(Department of Labor and Industry)

By law, "the most important factor in determining whether a person is an independent contractor is in the degree of control which the purported employer exerts over the manner and method of performing the work contracted." State law lists several factors to determine the level of control:

- Authority over the worker's assistants
- Requirements for the worker to comply with the employer's instructions
- Regularly required oral or written reports to the employer
- Place of work
- Requirements that the worker personally perform the work
- Existence of a continuing work relationship
- Whether the employer sets hours of work
- Whether training is provided to the worker
- Amount of time the worker must devote to the job
- Whether the worker holds multiple contracts with different entities
- Employer provides tools and materials
- Reimbursement of the worker's expenses
- Need to satisfy requirements of regulatory and licensing agencies

In addition to the factors of control, state law further outlines eight factors "to be considered" when determining a worker's classification:

- Right of the employer to discharge the worker
- If the worker's services are available to the public
- If the worker is compensated on a job basis
- If the worker may realize profit or loss
- Extent to which the worker can terminate the working relationship
- If the worker made a substantial investment in facilities
- Whether the employer is responsible for the worker's actions
- If the services are fundamental to business

In addition to the general criteria discussed above, state law outlines specific classification tests for at least 30 different industries or occupations.

Notes: Generally, the more control an employer has over the worker, the more likely the worker is an employee; the more control the worker has over their work, the more likely the worker is an independent contractor.
For the classification tests outlined above, there is not a set number of factors that indicate whether a worker is an independent contractor; one must weigh the totality of evidence, taking into account any factors that should be weighed more heavily as required by law. Statutes also outline specific classification tests for certain workers in the construction, trucking, and "messenger/courier" industries. *Minnesota Statutes* 2023, 181.723, subd. 4; and 176.043.

Key Worker Classification Tests in Minnesota (continued)

Unemployment Insurance *(Department of Employment and Economic Development)*

"When determining whether an individual is an employee or an independent contractor," one must consider the following five factors:

A. The right "…to control the means and manner of performance;

B. The right to discharge the worker without incurring liability for damages;

C. The mode of payment;

D. Furnishing of materials and tools; and

E. Control over the premises where the services are performed."

By law, items A and B are the "two most important factors" and other factors, not specifically identified, "may be considered if the outcome is inconclusive when applying the factors in items A to E."

Income Tax Withholding *(Department of Revenue)*

State law does not outline a classification test specific to income tax withholding requirements.[a] Instead, according to a DOR staff member, DOR uses IRS guidance to determine worker classification. The IRS states that "all information that provides evidence of the degree of control and the degree of independence must be considered" when determining whether an individual is an independent contractor. The IRS lists several "facts that provide evidence of the degree of control and independence" to consider:

Behavioral Control

- Instructions that the employer gives to the worker
- Training that the employer gives to the worker

Financial Control

- The extent to which the worker has unreimbursed business expenses
- The extent of the worker's investment
- The extent to which the worker makes their services available to the relevant market
- How the business pays the worker
- The extent to which the worker can realize a profit or loss

Type of Relationship

- Written contracts describing the working relationship
- Whether the business provides the worker with employee-type benefits
- The permanency of the relationship
- The extent to which services performed by the worker are a key aspect of the employer's regular business

[a] For the purposes of determining withholding tax requirements, however, statutes specify that wages are defined by the Internal Revenue Code. *Minnesota Statutes* 2023, 290.92, subd. 1.

Sources: *Minnesota Rules*, 5224.0330-5224.0340, https://www.revisor.mn.gov/rules/5224/ (workers' compensation), accessed May 8, 2023; *Minnesota Rules*, 3315.0555, https://www.revisor.mn.gov/rules/3315/ (unemployment insurance), accessed May 8, 2023; and Internal Revenue Service, Department of the Treasury, Publication 15-A (2023), *Employer's Supplemental Tax Guide*, updated December 19, 2022, https://www.irs.gov/publications/p15a (income tax withholding), accessed September 6, 2023.

RECOMMENDATION

To the extent possible, the Legislature should enact common tests for determining worker classification and reduce the number of different classification tests currently in law.

A stakeholder organization representing employers commented that having "a million different standards" is a challenge, and that people are not aware that the different classification tests exist, nor are they aware of the specifics of those tests. The stakeholder explained how this lack of knowledge is a barrier to addressing worker misclassification.

As we did in 2007, we recommend that the state enact common criteria for determining worker classification when possible.[8] One of the reasons agencies do not currently coordinate their efforts to address misclassification—an issue we discuss further below—is because they use different tests to determine if a worker is misclassified. Additionally, the existence of differing classification tests makes it more difficult to determine a single misclassification rate for the state. It also means that one agency could classify a worker as an employee and another agency could classify the same worker as an independent contractor, creating confusion for both workers and employers.

However, it may not be appropriate to have only one worker classification test in Minnesota. For instance, DOR's current classification test conforms with the Internal Revenue Service (IRS) classification test. Directing DOR to use a different classification test that did not align with IRS guidance would require employers to determine the classification of their workers based on DOR's classification test for state tax purposes and based on the IRS classification test for federal tax purposes. Additionally, it may be beneficial to maintain certain occupation-specific classification tests; as we discuss in Chapter 4, some agency staff and stakeholders commented that it was helpful to have a test to determine the classification of certain construction workers specifically.

Nevertheless, given the issues mentioned above, we recommend that the state decrease the total number of misclassification tests established in law. As we previously discussed, not only do statutes direct DLI to use different classification tests for the different programs and laws under its jurisdiction, statutes direct DLI to use *two differing* tests to enforce *one* law. The Legislature should address this inconsistency and—in consultation with state agencies—consider whether there are additional opportunities to align misclassification tests across programs and agencies.

Agency Duties in Law

Efforts to address worker misclassification are made complicated not just by the different tests that guide classification determinations, but also by the number of state entities involved.

[8] Office of the Legislative Auditor, Program Evaluation Division, *Misclassification of Employees as Independent Contractors* (St. Paul, November 2007), 33.

The departments of Labor and Industry, Employment and Economic Development, and Revenue have limited duties to ensure workers are correctly classified.

Statutes assign DLI, DEED, and DOR relatively few duties specific to preventing, identifying, or correcting misclassification, as shown in the exhibit below. For example, statutes do not specifically direct DEED or DOR to identify instances of worker misclassification, and many of DLI's duties to address misclassification are at the agency's discretion.

DLI, DEED, and DOR have few duties in law specific to addressing worker misclassification

Agency	Duties Specific to Misclassification

Department of Labor and Industry	• May investigate possible misclassification
	• May order an employer to properly classify employees
	• May pursue civil action "to enforce or require compliance with orders issued" regarding proper classification[a]
	• If DLI determines misclassification occurred and ordered the employer to properly classify employees, then DLI:
	  ○ Must "order the employer to cease and desist" from misclassifying workers and "take such affirmative steps" to properly classify employees[b]
	  ○ Must issue penalties in certain instances

Department of Employment and Economic Development	• Must issue penalties in certain instances
Department of Revenue	• Must issue penalties in certain instances

Notes: The duties above are not exhaustive. We discuss penalties later in this chapter. Statutes include additional duties for DLI that are specific to the construction industry; we discuss those duties in Chapter 4. For the construction industry only, statutes require DOR to review certain tax documents when notified by DLI of misclassification violations, although state law does not direct DOR to take specific action from its review. *Minnesota Statutes* 2023, 181.723.

[a] *Minnesota Statutes* 2023, 177.27, subd. 5.

[b] *Ibid.*, subd. 7.

Source: Office of the Legislative Auditor, based on review of Minnesota statutes.

Generally, state agency efforts to identify and correct worker misclassification result from administering or enforcing other state laws or programs.

Although statutes generally do not explicitly require DLI, DEED, or DOR to address misclassification directly, each agency addresses misclassification indirectly, typically as a byproduct of fulfilling other agency responsibilities in law. We discuss DLI, DEED, and DOR's efforts to address misclassification below.[9]

Department of Labor and Industry. With one exception, DLI addresses worker misclassification as a result of administering or enforcing other state programs or laws—not for the purpose of solely addressing misclassification.[10] For instance, as the administrator of the workers' compensation program, DLI conducts a variety of activities to ensure that a worker gets the benefits they should receive for work-related injuries. In situations where it appears an employer did not have workers' compensation insurance as required, DLI may evaluate whether a worker was misclassified only for the purpose of assessing whether the worker should receive benefits and whether to penalize the employer for not having insurance.

DLI also may determine worker classification as part of investigations that the agency conducts in order to enforce certain labor laws that may relate—but are not specific—to misclassification.[11] For instance, DLI may investigate whether a worker was eligible for and received overtime pay. However, again, DLI conducts these investigations to ensure that employers complied with certain labor laws; DLI does not conduct these investigations for the sole purpose of identifying and correcting misclassification.

Department of Employment and Economic Development. DEED addresses worker misclassification when it conducts audits as part of its administration of the state's unemployment insurance program.[12] However, the purpose of these audits is to ensure that employers complied with unemployment insurance—not worker classification—requirements.[13] A program supervisor explained that the primary goals of the audits are to establish the accuracy of information reported and contributions made by employers to the program. When DEED auditors identify misclassification, they address the violation only within the context of the program, such as by correcting the information reported and rectifying any over- or underpayments made by the misclassifying employer.

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[9] As discussed in Chapter 1, the Department of Commerce's Fraud Bureau and the Attorney General's Office each also undertake efforts that involve addressing misclassification.

[10] DLI's Construction Misclassification Unit is the only state entity we identified for which one of its purposes is to identify and correct misclassification directly. We discuss this unit in Chapter 4.

[11] For example, the agency needs to establish whether the worker is an employee in order to determine if the worker received the rights or protections granted to employees in law.

[12] As we discussed in Chapter 2, DEED conducts both random and selected, or "targeted," audits. DEED conducted approximately 1,500 total audits from April 2019 to April 2020.

[13] DEED audits employers to fulfill federal government requirements, which dictate many aspects of how DEED conducts these audits. U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Directors' Guide, *Essential Information for Unemployment Insurance Directors*, 36, March 2020, https://oui.doleta.gov/unemploy/, accessed January 8, 2024.

Department of Revenue. DOR staff may determine a worker's classification as part of the agency's withholding tax audits, as discussed in Chapter 1.[14] The purpose of these audits, however, is to ensure that entities complied with tax withholding requirements in law. If DOR staff identify misclassification through the course of an audit, they address it only as the violation relates to ensuring proper tax withholding. DOR generally does not address misclassification outside of these audits.

RECOMMENDATION

If the Legislature would like agencies to take a more active role in addressing worker misclassification, the Legislature should direct agencies to do so in law.

Statutes give state agencies few duties to address misclassification specifically. For example, statutes do not direct state agencies to investigate misclassification in and of itself, and the only current efforts to do so are limited. Statutes also do not direct agencies to provide public outreach or education about misclassification. Further, statutes do not direct state agencies to track misclassification rates, and as we discussed in Chapter 2, state agencies are not currently doing so systematically. If the Legislature wants state agencies to play a larger role in addressing worker misclassification in Minnesota, we recommend that the Legislature establish in law specific responsibilities for agencies to do so.

Agency Coordination

Although DLI, DEED, and DOR each undertake some efforts related to addressing misclassification, their efforts tend to be agency-specific and lack coordination.

Authority in law to address issues involving worker misclassification is fragmented across state agencies.

While state agencies sometimes address misclassification, efforts to do so are generally modest due to the fragmented authority across agencies to administer and enforce certain laws. DLI, DEED, and DOR only have the authority to resolve misclassification within the scope of the employment-related law each administers or enforces. As an example, statutes grant DLI—not DEED or DOR—authority to enforce employment laws regarding minimum wage and overtime pay.[15] As a result, even though DEED or

[14] Rather than conducting random audits, DOR uses an analytical process to select auditees based on a number of criteria. DOR completed 110 total withholding tax audits per year, on average, over the past three years. This average is based on totals provided by the agency from October 21, 2020, through October 20, 2023. DOR told us that between 70 to 79 percent of these audits reviewed the issue of worker classification.

[15] *Minnesota Statutes* 2023, 175.20. State law requires employers to provide employees minimum wage and overtime pay; these requirements do not apply to independent contractors. Employers that misclassified workers as independent contractors and did not pay those workers minimum wage and overtime pay would be in violation of minimum wage and overtime laws. *Minnesota Statutes* 2023, 177.24-177.25 and 177.28; and *Minnesota Rules*, 5200.0221, https://www.revisor.mn.gov/rules/5200/, accessed May 10, 2023.

DOR may identify misclassification that could involve violations of minimum wage and overtime requirements, these two agencies do not have the authority to address these violations. DEED and DOR can only address the effects of misclassification on the unemployment insurance program or state taxes, respectively.

This separation of authority might not present a problem to identifying and correcting worker misclassification if agencies coordinated their efforts to address misclassification. However, although state law generally allows DLI, DEED, and DOR to share information on individuals and employers for the purpose of determining a worker's status, DLI is the only agency statutorily required to notify other agencies about certain instances of misclassification.[16] Statutes do not require other agencies to share misclassification findings or otherwise coordinate their efforts to address misclassification.

State agencies generally do not coordinate investigative efforts or share information about employers that misclassify workers.

While DLI, DEED, and DOR undertake investigations or audits that analyze whether workers were misclassified, they do so within their agency silos. For instance, each agency accepts tips or complaints from the public regarding possible instances of misclassification. Yet, rather than providing one central tip line that individuals can use to report misclassification, each agency separately provides ways to report tips or complaints. If an individual wanted the state to remedy alleged misclassification under all applicable laws, the individual would have to contact at least three different agencies (DLI, DEED, and DOR), depending on the nature of their complaint.

As another example, DLI, DEED, and DOR do not collaborate on their investigations. Many of the activities the agencies undertake that involve investigating misclassification are similar across agencies—for example, gathering documents or records, holding interviews, and conducting site visits. Yet agency staff undertake these activities separately.

State agencies also share limited information with each other when they identify instances of misclassification. State law requires DLI to notify DEED and DOR when DLI "has reason to believe" that someone in the construction industry was misclassified.[17] Despite this requirement, DLI, DEED, and DOR staff could not recall DLI sharing such information.[18] As seen on the following page, when we asked staff at DLI, DEED, and DOR whether they share information about misclassification, only DOR staff were able to recall sharing information with one of the other agencies.

[16] *Minnesota Statutes* 2023, 181.723, subd. 15. If a court determines that a worker was misclassified, it must report its findings to DLI, which must in turn report the violation to "relevant state and federal agencies." *Minnesota Statutes* 2023, 181.722, subd. 5.

[17] This requirement only pertains to misclassification in the construction industry. *Minnesota Statutes* 2023, 181.723, subd. 15.

[18] As we discuss in Chapter 4, however, DLI has not identified any construction worker misclassification violations in recent years.

DLI	DLI staff said that they were not aware of DLI sharing information about misclassification with DEED or DOR.
DEED	A DEED supervisor said the agency does not share information about misclassification with DLI or DOR.
DOR	DOR staff said that they were not aware of DOR sharing information about misclassification with DLI, although one staff member said they share their audit findings with DEED.

Investigation Timeliness

State agency efforts to identify and address instances of worker misclassification sometimes take years.

We heard from staff at multiple agencies that their investigations—which include efforts to address specific misclassification violations—can take months or years. A DLI supervisor, for instance, described an investigation that DLI opened before the supervisor took a different position; when the supervisor returned two-and-one-half years later, DLI still had not resolved the case. Similarly, a DOR supervisor told us that some of their audits that address issues of worker misclassification can take more than 18 months.[19]

Agency investigations and audits involving worker misclassification can take

one year or more

Even if agencies complete their investigations quickly, the information used to identify misclassification often reflects the circumstances of prior years. DEED and DOR investigations occur as part of an audit—an inherently retrospective activity. For these investigations, DEED and DOR staff said they typically review data that are at least one to two years old. As a result, if either agency finds misclassification, the agencies' actions to address those violations would occur long after the actual violations began.

Some agency staff commented that investigations into worker misclassification are complex and therefore require significant time. Staff explained how investigators sometimes must review a large volume of documents, conduct interviews with workers and employers, and more. Staff also explained that the length of time needed to complete an investigation can vary depending on the size of the entity being investigated, the scope of the investigation, or the length of time it takes entities to respond to the agency's requests. DLI, for example, explained that investigations may

[19] Also, a supervisor at the Department of Commerce's Fraud Bureau told us the bureau's investigations into worker misclassification can take between one to three years.

be complicated by workers who are reluctant to participate in the investigation and employers that do not respond to agency requests.

However, lengthy investigations further complicate the state's efforts to effectively address misclassification. An organization representing workers told us that it is difficult for workers to recall information about their case or to produce documentation and other evidence of misclassification when investigations take a long time.

Lengthy investigations also harm workers and law-abiding employers. Employers may continue to misclassify workers throughout the duration of the investigation; during that time, misclassified workers may not receive the benefits or protections to which they are legally entitled. For example, during the investigation, the employer may not pay workers overtime wages or meet workplace safety requirements. At the same time, because the misclassifying employer does not provide workers the wages and protections to which they are legally entitled, the misclassifying employer continues to have an unfair competitive advantage over law-abiding employers who classify their workers correctly. The longer an agency takes to determine whether workers are misclassified, the longer misclassified workers and law-abiding employers are harmed.

RECOMMENDATION

The Legislature should consider establishing timeliness standards for worker misclassification investigations.

As we discussed above, some state agencies take many months—even years—to investigate allegations of worker misclassification. Currently, however, there are no standards in law that agencies conduct investigations or audits of misclassification within a certain timeframe—or even that state agencies investigate or audit misclassification at all.

We recommended above that the Legislature outline specific agency duties in law if the Legislature would like state agencies to take a more active role in addressing worker misclassification. If the Legislature directs agencies to investigate or audit issues of misclassification, we recommend that the Legislature also consider amending the law to establish timeliness standards for investigations. These standards should, at a minimum, include the total length of time within which an agency is expected to complete an investigation. The Legislature could also establish timeliness standards for other investigation steps—such as directing an employer to respond to an agency's information request within a certain amount of time—to help ensure that agencies are able to proceed with their investigations in a timely manner.

The Legislature has already enacted timeliness standards in law for some other types of agency investigations. For example, statutes establish a number of standards regarding the promptness with which the Minnesota Department of Human Rights (MDHR) conducts investigations into discrimination allegations. MDHR has 12 months to make a determination as to whether discrimination likely occurred, and the entity accused of

discrimination has 30 days to send a reply to the discrimination charge to MDHR.[20] There are also timeliness standards in law for occupational safety and health (OSHA) investigations. By law, DLI must conduct an inspection "as soon as practicable" if the agency determines there are reasonable grounds to believe a violation exists and issue a citation no later than six months after the inspection if DLI discovers a violation of law.[21]

If the Legislature decides to establish timeliness standards, it should consult with agencies to determine reasonable timelines for completing misclassification investigations and related steps. Although one staff person described ways in which timeliness standards would be helpful, other agency staff at DLI and DOR expressed concerns about establishing investigation timeliness standards in law. A DOR supervisor questioned whether a timeliness standard in law would force the agency to conclude an audit before the agency had the information it needed to make an accurate determination. A DLI supervisor said that timeliness is important, but that a "one-size-fits-all" approach could be difficult. While we are sensitive to these concerns, we are troubled by how long it takes some agencies to investigate allegations of misclassification. These delays harm misclassified workers and law-abiding employers and negatively affect the state's ability to conduct effective investigations.

Misclassification Penalties

Employers face limited consequences for misclassifying workers.

State law establishes relatively few penalties specifically for misclassifying workers, as shown on the next page. DEED, for example, must penalize an employer that made "a false statement…without a good faith belief as to the correctness of the statement…or knowingly failed to disclose" information in order to avoid paying or reduce their payments to the unemployment insurance program.[22] However, a DEED supervisor told us that, while this requirement would theoretically apply to misclassifying employers, it is difficult to show that an employer intentionally misclassified a worker and that DEED rarely assesses penalties for misclassification. DLI must similarly assess a penalty if the agency determines the employer knew or had reason to know the employer was misclassifying workers and yet still did so repeatedly or willfully; however, DLI staff likewise commented that it is challenging to determine whether an employer misclassified its workers intentionally.

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[20] Specifically, for cases for which MDHR is not required by law to "make an immediate inquiry," and for cases that are not a "priority" by law, MDHR must determine within 12 months of a complainant filing a charge whether there is probable cause to believe discrimination occurred. *Minnesota Statutes* 2023, 363A.28, subds. 1 and 6(a)-(b).

[21] *Minnesota Statutes* 2023, 182.659, subd. 4; and 182.66, subd. 1.

[22] In these cases, by law, DEED must levy a penalty that is the greater of the following: $500 or "50 percent of the following resulting from the employer's action: …(ii) the amount of unemployment benefits not paid to an applicant that would otherwise have been paid; or (iii) the amount of any payment required from the employer" that the employer did not pay into the unemployment insurance program. *Minnesota Statutes* 2023, 268.184, subd. 1(a).

Statutes authorize agencies to levy few penalties in response to worker misclassification, specifically

Department of Labor and Industry	Department of Employment and Economic Development	Department of Revenue
• Must order the employer to pay "back pay, gratuities, and compensatory damages," and liquidated damages to the misclassified worker. • Must penalize the employer up to $10,000 for each misclassified worker, if the employer "repeatedly or willfully" misclassified a worker when the employer knew or had reason to know they were misclassifying.[a] • May order the employer to reimburse the state for litigation costs.	• Must impose a penalty if an employer "knowingly failed to disclose" information in order to avoid paying or reduce their payments to the unemployment insurance program.	• Must impose a tax on the employer totaling 3 percent of the wages paid to the misclassified worker.

Note: State law outlines additional penalties for misclassifying certain workers in the construction industry. *Minnesota Statutes* 2023, 326B.081-326B.082.

[a] Prior to July 1, 2023, the penalty was $1,000 per misclassified worker. *Laws of Minnesota* 2023, chapter 53, art. 13, sec. 3, codified as *Minnesota Statutes* 2023, 177.27, subd. 7.

Source: Office of the Legislative Auditor, based on review of Minnesota statutes, including 177.27 and 268.184.

Further, a misclassifying employer could be penalized by only one agency, not by multiple agencies for the full scope of laws it violated. As shown in the example on the following page, depending on the circumstances of a case, a misclassifying employer could be in violation of labor and workers' compensation, unemployment insurance, and tax laws. These laws are administered or enforced by different agencies, and, as we discussed above, the agencies with jurisdiction over these laws do not coordinate their efforts to address misclassification. As a result, one agency could investigate and identify misclassification and then penalize a misclassifying employer, while the other two agencies neither investigate nor penalize the same employer for violating the laws under those agencies' jurisdiction.

Misclassified Worker Scenario: Misclassification Penalties

Situation: Jane Smith is misclassified as an independent contractor by her employer. While working for her employer, she is paid at a rate below minimum wage. She occasionally works more than 40 hours per week, but she is not paid at an overtime rate for these additional hours. Additionally, Jane's employer does not (1) carry workers' compensation insurance for her, (2) pay unemployment insurance taxes on the wages paid to Jane, or (3) withhold taxes from Jane's pay.

In this scenario, by misclassifying Jane as an independent contractor, her employer has violated laws, including those related to:

- Fair labor standards (for example, minimum wage and overtime pay)
- Workers' compensation
- Unemployment insurance
- Income tax withholding

Jane contacts DLI's Wage and Hour Unit to make a complaint about being misclassified; she does not contact DEED or DOR.

Investigation and Outcomes: DLI's Wage and Hour Unit decides to investigate Jane's case and determines that she was misclassified.

DLI issues an order requiring Jane's employer to comply with classification requirements. DLI also orders the employer to pay Jane for the wages she did not receive as a result of being misclassified—specifically, unpaid wages due to not receiving minimum wage and overtime pay—and to pay Jane liquidated damages equal to the amount of unpaid wages. DLI is unable to determine that Jane's employer misclassified her intentionally and determines that Jane's employer has not previously misclassified workers; as a result, DLI does not assess an administrative penalty on the employer for misclassifying Jane.

Unresolved Effects: DLI does not notify its other units, DEED, or DOR about Jane's misclassification. Therefore, DLI's workers' compensation program, DEED, and DOR do not conduct their own investigations to assess whether Jane was misclassified. As a result:

- DLI does not penalize Jane's employer for its **failure to maintain adequate workers' compensation insurance**.
- DEED does not collect **unpaid unemployment insurance contributions** from Jane's employer.
- DOR does not penalize Jane's employer for **tax withholding violations**.

RECOMMENDATION

The Legislature should amend statutes to ensure that agencies are required to penalize employers that repeatedly misclassify workers.

Determining the proper penalties for employers that misclassify workers is challenging. First, it can be difficult to determine what type or size of penalty would be an adequate deterrent. DOR staff explained, for example, that the 3 percent tax DOR levies when an employer misclassifies its workers is a substantial penalty for some companies and a "drop in the bucket" for others. DLI staff told us that some companies would rather pay a fine than comply with DLI's demands. On the other hand, given the many classification tests and their somewhat subjective nature, determining the proper classification for workers can be complicated; an agency staff member explained that some employers genuinely mistakenly misclassify workers.

Despite these challenges, we recommend that the Legislature amend law to ensure that employers that misclassify workers on a repeat basis are subject to mandatory penalties—regardless of whether the employer intended to misclassify. As we discussed above, DLI and DEED must only penalize misclassifying employers if they determine that an employer intentionally misclassified. We are sensitive to the fact that determining worker classification can be challenging for employers; however, we believe it is reasonable to expect employers to properly classify their workers after one violation. If an agency finds that an employer has repeatedly misclassified their workers, the agency should be required by law to penalize that employer.

While we believe that ensuring repeat violators are penalized is a reasonable first step, we acknowledge limitations to this approach. A DLI supervisor told us that some employers that DLI found to have violated the law simply closed their business and opened a new one under a different name. Such a practice would make it more difficult to determine if an employer is a repeat offender. Additionally, given how few investigations most state agencies complete, it is unlikely that agencies would frequently find repeat offenders.

In addition to establishing a penalty for repeat worker misclassification, the Legislature could consider implementing other penalties. At least a few states either allow or have proposed allowing state agencies to issue stop work orders when an employer misclassifies workers. One state's taskforce recommended requiring the violator to pay state investigatory and legal fees. Further, the Legislature could consider revising statutes to remove any requirement that employers must have knowingly misclassified their workers before they can be penalized. Such a change would more closely align DLI and DEED with the penalty requirements outlined in state law for DOR in penalizing all instances of identified worker misclassification, regardless of an employer's intent. Whatever approach the Legislature takes, we urge the Legislature to ensure it does not unduly burden law-abiding employers in its efforts to address worker misclassification.

Worker Restitution

Workers may be compensated for only a fraction, if any, of the benefits they were denied as a result of being misclassified, and only certain workers can pursue civil action to directly rectify their misclassification.

The extent to which a worker receives restitution for being misclassified depends heavily on which agency identified the misclassification. DEED and DOR's efforts to address the effects of misclassification primarily focus on ensuring that employers comply with state law, not on obtaining compensation or damages for workers who were misclassified. When DOR identifies a misclassified worker, for example, the agency assesses a tax on the misclassifying employer because it failed to comply with state law. DOR does not seek to rectify the effects of misclassification on the worker, such as by correcting Social Security taxes that the worker may have overpaid as a result of being misclassified. Generally, DLI is the only agency that focuses on obtaining restitution for misclassified workers. As we described earlier, under certain

circumstances the agency must seek back pay, gratuities, and compensatory damages for misclassified workers.[23]

Further, statutes give most workers few other courses of action to address misclassification specifically. While statutes grant workers the right to file a civil action in court against an employer that misrepresents the nature of their employment, statutes only grant that right to certain workers in the construction industry.[24] This means that misclassified workers outside of the construction industry are unable to pursue a case in court to directly correct the misclassification. Instead, these workers must rely on the various state agencies to investigate their case and address any misclassification that may have occurred.

RECOMMENDATION

The Legislature should amend statutes to allow civil action by misclassified workers in all industries.

State law prohibits the misclassification of workers generally, across all industries and for all workers. However, statutes only grant workers in the construction industry the right to take legal action to directly address their misclassification in court.

As we discussed in Chapter 2, worker misclassification occurs in many industries, and we think that all workers—not just those in the construction industry—should have the right to seek a remedy in court for their misclassification. As we recommended in our 2007 report, the Legislature should revise state law to ensure that all workers can pursue civil action if they believe they were misclassified.[25]

Other States' Efforts to Address Misclassification

Some states have adopted a more coordinated approach to addressing worker misclassification.

Like Minnesota, authority to address worker misclassification is fragmented in many states; however, several states have established permanent task forces that facilitate a more coordinated approach to addressing misclassification.[26] Task force duties often

[23] *Minnesota Statutes* 2023, 177.27, subd. 7.

[24] *Minnesota Statutes* 2023, 181.722, subd. 4.

[25] Office of the Legislative Auditor, Program Evaluation Division, *Misclassification of Employees as Independent Contractors* (St. Paul, 2007), 36.

[26] In 2023, Minnesota's Attorney General convened a task force to address worker misclassification—the Advisory Task Force on Worker Misclassification. As we discuss in Chapter 5, Governor Walz also convened the Governor's Committee on the Compensation, Wellbeing, and Fair Treatment of Transportation Network Company Drivers in 2023. Both of these bodies are scheduled to disband in 2024. State of Minnesota Executive Order 23-07, "Establishing the Governor's Committee on the Compensation, Wellbeing, and Fair Treatment of Transportation Network Company Drivers," May 25, 2023.

> As a result of the Task Force, state agencies are now beginning to do things never done before, such as sharing information to enable each agency to better target enforcement, sharing audit results, and working together to develop effective enforcement strategies….
>
> Because each agency doesn't have to start from scratch and duplicate the work of other agencies, greater results can be achieved. The Task Force and its subcommittees provide the opportunity to evaluate with a critical eye the way partner agencies do business, assisting each agency to figure out how to best use its resources, and how to take advantage of the resources and work products of other agencies.
>
> **— Maine Department of Labor and the Maine Joint Enforcement Task Force on Employee Misclassification[27]**

include some combination of cross-agency information sharing and enforcement, referrals, and complaint hotlines. For instance, Wisconsin established its Joint Enforcement Task Force on Payroll Fraud and Worker Misclassification to enhance enforcement, share information, raise public awareness, and more.[28] The task force's members include state and company representatives, staff from various state agencies, and others. Similarly, in 2011, Utah created the Worker Classification Coordinated Enforcement Council to investigate the nature and extent of worker misclassification in Utah, assess enforcement efforts, improve information sharing, and recommend legislative changes.[29]

Several other states have also sought to facilitate greater information sharing among agencies with regard to real or suspected misclassification violations. Maryland, for example, developed a worker misclassification database that allows certain agencies to centrally track misclassification cases, share information, and better coordinate case referrals. Nevada law requires several state agencies—including, but not limited to, the offices of the Labor Commissioner, the Department of Taxation, and the Attorney General—to "communicate between their respective offices information relating to suspected employee misclassification…."[30]

In some other states, agencies conduct joint worker misclassification investigations or audits. Rhode Island's Underground Economy and Employee Misclassification Task Force—whose members include representatives from the state's Department of Labor and Training, Attorney General, Tax Administrator, Workers' Compensation Court, and others—conducts "joint, targeted investigations and enforcement actions against violators."[31] In Massachusetts, unemployment insurance auditors conduct joint audits with other entities, including the state's Division of Labor and Industry.

Some states have taken yet additional steps to coordinate agency efforts to address misclassification. In addition to sharing information about noncompliant entities, Oregon's Interagency Compliance Network "shares success stories, and discusses

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[27] Maine Department of Labor and Maine Joint Enforcement Task Force on Employee Misclassification, *Annual Report of the Joint Enforcement Task Force on Employee Misclassification* (February 25, 2010): 20, http://digitalmaine.com/mdol_docs/4, accessed January 4, 2024.

[28] Wisconsin's task force was established by executive order in 2019. State of Wisconsin Executive Order 20, "Relating to the Creation of the Joint Enforcement Task Force on Payroll Fraud and Worker Misclassification," April 15, 2019.

[29] Members include representatives from Utah's Labor and State Tax commissions, Unemployment Insurance Division, Department of Commerce, and Attorney General's Office. *Laws of Utah* 2011, Chapter 15, codified as *Utah Code*, 34-47-101 through 34-47-202.

[30] *Nevada Revised Statutes* 2022, 607.217.

[31] Underground Economy and Employee Misclassification Task Force, *2021 & 2022 Annual Report*: 5, https://dlt.ri.gov/regulation-and-safety/worker-misclassification, accessed February 8, 2024.

State Example: Oregon's Interagency Compliance Network

In 2009, Oregon established the Interagency Compliance Network (ICN) to improve compliance with state tax and employment laws.

Membership: Seven state agencies are members of the ICN. Each agency "shares some nexus with issues around worker classification…, under-the-table cash payments to workers, or related workplace and tax issues."

Activities: Member agencies "share information, collaborate on enforcement, and conduct educational outreach." The ICN steering committee meets on a quarterly basis, while groups on enforcement and communications meet monthly.

— Oregon Bureau of Labor and Industries et al[32]

newly identified methods used by noncompliant entities to avoid legal responsibilities."[33] Massachusetts provides a centralized tip line for individuals to report misclassification. According to the state, individuals used to have to file misclassification complaints with up to ten different entities; the centralized tip line allows individuals to file their complaint in one place, and the complaint is forwarded to the relevant agencies.[34]

RECOMMENDATION

The Legislature should require state agencies to take a coordinated and collaborative approach to addressing worker misclassification.

Earlier in this chapter, we discussed the state's legally fragmented approach to addressing worker misclassification. Fragmented authority across agencies would pose fewer challenges to effectively addressing misclassification if agencies collaborated and coordinated their efforts.

As we discussed above, other states have established mechanisms to facilitate a more coordinated and collaborative approach to addressing worker misclassification. In contrast, Minnesota's lack of interagency coordination—an issue we also raised in our 2007 evaluation—results in inefficiencies, inconsistent enforcement against employers that misclassify workers, and inconsistent remedies for workers.

Other states provide models for how Minnesota might improve agency coordination. Regardless of Minnesota's ultimate approach, the Legislature should, at minimum, direct key agencies—including DLI, DEED, and DOR—to share information about complaints, investigations, and findings of worker misclassification.[35] If agency staff identify any existing data practices laws that would limit the effective sharing of misclassification data, the agencies should propose changes to state law to address those limitations.

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[32] Oregon Bureau of Labor and Industries et al., *Interagency Compliance Network Report to the Oregon Legislature* (March 2023): 3, https://www.oregon.gov/ic/Documents/2021-2022%20ICN%20Report.pdf, accessed November 20, 2023.

[33] *Ibid*., 8.

[34] Council on the Underground Economy, *2015 Annual Report*: 9, https://archives.lib.state.ma.us/server/api/core/bitstreams/069ecf1b-bd70-4398-9963-871de56568c3/content, accessed December 29, 2023.

[35] The Legislature should further consider whether additional state entities, such as the Department of Commerce and the Attorney General's Office, should also be included in directives to share misclassification information. As discussed in Chapter 1, the Department of Commerce's Fraud Bureau and the Attorney General's Office also undertake efforts that involve addressing misclassification.

OLA

Chapter 4: Worker Classification in the Construction Industry

Throughout our evaluation, stakeholders and agency staff frequently cited the construction industry as being an industry in which worker misclassification is particularly prevalent. In this chapter, we delve more deeply into the state's efforts to address worker misclassification in the construction industry specifically. We first discuss the criteria in law for determining a construction worker's classification, before examining the work and outcomes of the Department of Labor and Industry's (DLI's) Construction Misclassification Unit.

Key Findings in This Chapter

- The statutory requirement that certain individuals in the construction industry register with the Department of Labor and Industry does not meet its objective of helping the state enforce misclassification laws.
- The Department of Labor and Industry has not adopted standards or processes to ensure that it addresses possible instances of misclassification in the construction industry in a timely manner.
- Estimated rates of misclassification in the construction industry in 2018 were higher than when OLA last evaluated worker misclassification; yet, the Department of Labor and Industry did not identify any instances of misclassification in the construction industry as a result of their recent investigations.

Construction Worker Classification Test

Both the literature and some of the individuals we interviewed described reasons why the construction industry is particularly vulnerable to worker misclassification. For example, a 2019 report stated that industries for which work is awarded by bid and industries with higher injury rates—both of which are the case for construction—are more at risk for misclassification.[1] Some stakeholders described how the frequent use of multiple tiers of subcontractors on construction projects can also make the industry vulnerable to misclassification, in part because it makes it more challenging to enforce classification requirements. For example, it becomes more difficult to determine who is responsible for complying with classification requirements when there are multiple levels of contractors with a role in establishing working conditions.

Minnesota's Legislature has taken some steps to address worker misclassification in the construction industry specifically. In 2012, the Legislature directed DLI to establish a pilot project to assess whether the information gathered from certain people in the construction industry who were required to register with DLI would help state agencies enforce laws pertaining to misclassification.[2] In 2023, the Legislature established new

[1] Dale Belman and Aaron Sojourner, *Illegal Worker Misclassification: Payroll Fraud in the District's Construction Industry* (Office of the Attorney General for the District of Columbia, September 2019), https://oag.dc.gov/sites/default/files/2019-09/OAG-Illegal-Worker-Misclassification-Report.pdf, accessed June 12, 2023.

[2] *Laws of Minnesota* 2012, chapter 295, art. 2, sec. 3.

wage protections for construction workers, making general contractors liable for any unpaid wages and benefits owed to workers and explicitly stating that contractors may not avoid liability by misclassifying workers.[3] The Legislature has also established specific criteria for determining construction worker classification in Minnesota.[4]

Minnesota statutes establish criteria that individuals providing certain construction services must meet in order to be classified as an independent contractor.

By law, an individual "performing public or private sector commercial or residential building construction or improvement services" may only be classified as an independent contractor if the individual meets the nine criteria outlined in the exhibit below.[5] If the individual does not meet all nine criteria, they are considered by law to be an employee.[6]

Independent Contractor Criteria – Construction Workers

An individual "performing public or private sector commercial or residential building construction or improvement services" must meet each of the following criteria to be classified as an independent contractor in Minnesota.

The individual must:

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

(2) Hold or have applied for a federal employer identification number or have 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) Operate under contract to perform the specific services for specific amounts of money and under which the individual controls the means of performing the services;

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

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

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

(7) Have continuing or recurring business liabilities or obligations.

Further:

(8) The individual may realize a profit or suffer a loss under the contract to perform services; and

(9) The success or failure of the individual's business must depend on the relationship of business receipts to expenditures.

— *Minnesota Statutes* 2023, 181.723, subds. 2 and 4

[3] *Laws of Minnesota* 2023, chapter 53, art. 10, sec. 6, codified as *Minnesota Statutes* 2023, 181.165.

[4] *Minnesota Statutes* 2023, 181.723, subds. 2-4.

[5] *Ibid.*, subds. 2 and 4.

[6] *Ibid.*, subds. 3-4.

The test to determine construction worker classification in Minnesota functions somewhat differently than the tests we described in Chapter 3 that are used to determine classification for the purposes of workers' compensation, unemployment insurance, and taxes, generally. As we described in Chapter 3, there is not a specific threshold or quota that dictates how to classify a worker under those tests. Instead, one must weigh all of the test factors and decide, on balance, whether a worker is an employee or an independent contractor. In contrast, the test to determine construction worker classification is more straightforward. A worker must meet each criterion in order to be an independent contractor; if the worker fails to meet even one of the nine criteria, statute states that the worker is an employee.

Agency staff and stakeholders generally said that it was helpful to have specific criteria in law to determine construction worker classification; however, some suggested that the law needs refinement.

Agency staff and stakeholders described a number of reasons why the classification test for construction workers is beneficial.[7] A stakeholder from an organization representing employers told us that they thought the test helps to reduce misclassification and helps entities make good classification judgements.[8] A staff member in the Department of Commerce's Fraud Bureau explained that one of the reasons the Fraud Bureau has primarily focused on investigating worker misclassification in the construction industry—as opposed to other industries—is because of the classification test in law, which helps it to prove when misclassification has occurred. A stakeholder organization representing workers commented that the test is "an improvement on the standard misclassification test" because workers are considered employees unless they meet each criterion.

However, stakeholders and agency staff also identified aspects of the test that could be improved. For instance, a stakeholder organization representing workers commented that the test does not address the complexity of employment relationships on construction projects that involve multiple tiers of subcontractors. Another organization representing workers and employers further explained:

> In our experience with investigations, we have learned that merely establishing that a worker fails to meet the 9-factor test does not do anything to establish who their employment relationship is with. In other words, the test can show that a worker is not in fact an independent contractor, but it does not clarify what entity should be held responsible for misclassifying the worker.

DLI staff described other challenges with enforcing the proper classification of construction workers under this law. A DLI supervisor commented that, although the classification test appears straightforward, there is some confusion about how to

[7] In addition to various stakeholder interviews, we sent an e-mail questionnaire to 30 stakeholder organizations to gather their feedback on worker misclassification in Minnesota. We received 15 responses, for a response rate of 50 percent.

[8] As we discussed in Chapter 1, for the sake of simplicity, in this report we refer to any entity that pays workers for services as an "employer," regardless of how the term is defined in law.

determine whether the criteria have been met.[9] Additionally, as we discuss more in the following section, DLI may only penalize employers for misclassifying workers under this law if the employer did so "knowingly."[10] DLI staff explained that the requirement that DLI prove that an employer knowingly misclassified workers makes it challenging to enforce the law.

RECOMMENDATION

The Department of Labor and Industry should propose to the Legislature updates to the construction worker classification requirements outlined in *Minnesota Statutes* 2023, 181.723.

Both stakeholders and DLI staff described challenges with the construction worker classification test in law. A DLI supervisor, for instance, told us that agency staff have struggled for years with the construction worker classification test and that challenges posed by the law have made it difficult to enforce.

To address these challenges, DLI should develop a list of specific changes necessary to clarify the law and ensure the agency can more effectively use it to identify and correct instances of misclassification. When doing so, DLI staff should consult with organizations in the construction industry—including construction businesses and organizations representing workers—to ensure that proposed changes to law do not have unintended negative effects on the industry. After identifying the needed changes, DLI should work with the Legislature to amend statutes as appropriate.

DLI's Construction Misclassification Unit

As we discussed in Chapter 3, agency activities to address misclassification are typically a by-product of agency responsibilities to administer or enforce other laws. DLI, however, offers one exception.

The Department of Labor and Industry's Construction Misclassification Unit seeks to directly address worker misclassification in the construction industry.

DLI's Construction Misclassification Unit undertakes activities in two areas with the intention of addressing construction worker misclassification. First, the unit administers and enforces a requirement in law that certain construction contractors register with the agency. Second, the unit conducts investigations into possible worker misclassification in the construction industry and enforces certain misclassification-related laws.

[9] For example, DLI said it is difficult for investigators to evaluate aspects of the classification test that pertain to the contractual relationship between parties when there is no requirement that the parties enter into a written contract.

[10] *Minnesota Statutes* 2023, 181.723, subd. 7; 326B.081, subd. 3; and 326B.082, subd. 7(a).

Statutes outline relatively limited duties for DLI with regard to the activities that this unit undertakes. With respect to the registration requirement, DLI must only develop and maintain a website for applicants, process registration applications, and maintain certificates of registration.[11] With respect to misclassification investigations, there is no requirement in law that DLI investigate construction worker misclassification. Additional information about DLI's construction-related misclassification responsibilities in law is in the exhibit below.

Department of Labor and Industry
Duties Pertaining to Misclassification in the Construction Industry

Construction Contractor Registration

DLI must	• Develop and maintain a website on which entities can submit their registration application. • Process registration applications. • Maintain certificates of registration on DLI's website.
DLI may	• Enforce laws regarding construction contractor registration, including the assessment of monetary penalties. • Administer oaths, request and examine records, request testimony, and issue subpoenas in order to administer the program. • Issue a notice of violation, administrative order, licensing order, or stop order to any person who committed a violation. • Deny an application for registration if the applicant does not meet minimum qualifications or has unresolved violations or unpaid registration-related fees. • Suspend or limit a person's registration under certain circumstances.

Construction-Related Misclassification Investigations

DLI must	• Notify the Department of Revenue (DOR) and the Department of Employment and Economic Development (DEED) when DLI has reason to believe that an individual: (1) presented themselves as an independent contractor without meeting the nine classification criteria in law, (2) required someone "through coercion, misrepresentation, or fraudulent means to adopt independent contractor status" or form a business entity, or (3) knowingly misclassified an individual as an independent contractor.
DLI may	• Issue a notice of violation, administrative order, licensing order, or stop order if the agency determined an employer *knowingly* misclassified a worker. • Assess penalties if the agency determined an employer *knowingly* misclassified a worker.

Notes: The list of duties above is not exhaustive. A stop order requires someone to cease and desist from violating the law—such as misclassifying workers. Stop orders are different from stop *work* orders in which an agency might direct someone to cease and desist from continuing work on a specific project.

— *Minnesota Statutes* 2023, 181.723; 326B.081-326B.082; and 326B.701

[11] *Minnesota Statutes* 2023, 326B.701.

Registration Requirement

Registration Application

By law, individuals required to register must submit an application to DLI including specific information, such as the individual's name, business address, and documentation demonstrating that they are in compliance with workers' compensation and unemployment insurance laws.

— *Minnesota Statutes* 2023, 326B.701, subd. 3

Statutes require that individuals register with DLI before providing certain construction services. Specifically, people who "perform public or private sector commercial or residential building construction or improvement services" are required to register before performing those services, with certain exemptions.[12] If an individual performing construction or improvement services does not register as required, they are presumed by law to be an employee.[13] Staff in the Construction Misclassification Unit are responsible for the administration and enforcement of the registration requirement, including reviewing applications, issuing registrations, and conducting investigations of possible registration violations.

The statutory requirement that certain individuals in the construction industry register with the Department of Labor and Industry does not meet its objective of helping the state enforce misclassification laws.

The purpose of the construction contractor registration is "to assist the Department of Labor and Industry, the Department of Employment and Economic Development, and the Department of Revenue **to enforce laws related to misclassification of employees**."

— *Minnesota Statutes* 2023, 326B.701, subd. 2

The Legislature established the construction contractor registration requirement for the purpose of helping state agencies to "enforce laws related to misclassification of employees"; however, it is not clear that the registration requirement does so.[14] First, state law does not require that registrants meet the nine criteria listed in statute that are necessary for an individual to be classified as an independent contractor in the construction industry. Further, although DLI's Construction Misclassification Unit recently began reviewing registration applications, DLI staff do not confirm that registrants meet the nine classification criteria.[15] In other words, individuals who register under this requirement need not—and may not—be independent contractors. In addition, the registration requirement is not job specific, meaning that it is possible for a worker to be an independent contractor on one job and an employee on another.

[12] For example, individuals who are "an employee of the person performing the construction services" are not required to register. *Minnesota Statutes* 2023, 326B.701, subd. 2.

[13] *Minnesota Statutes* 2023, 181.723, subd. 4(a).

[14] *Minnesota Statutes* 2023, 326B.701, subd. 2.

[15] According to a DLI supervisor, historically, the agency did not review registration applications prior to approval. The supervisor stated that individuals could register without providing basic information, such as their complete name; individuals also did not have to provide proof of meeting certain registration requirements, such as having workers' compensation coverage. The supervisor stated that, beginning in summer 2021, DLI staff began reviewing registration applications to verify that they were complete, and that in 2023, DLI staff began collecting and reviewing evidence that applicants met certain registration requirements.

As a result, the registration requirement does not produce a list of independent contractors working in the construction industry. First, the list likely includes individuals who are *not* independent contractors. A DLI supervisor explained that many people register with DLI who do not meet the nine classification criteria, for instance because a job posting says that they have to register before they begin working for that company. Second, the registration list likely does not include all individuals providing construction or improvement services who *are* independent contractors. A DLI supervisor stated that the registration list does not include all individuals subject to the law and said that agency staff have no way of ensuring that all individuals have registered as required. Although statute states that individuals in the construction industry who are not registered as required are presumed to be employees, it is likely that there are individuals who are not registered who are legitimate independent contractors.

Despite the purpose of the registration requirement stated in law, staff from both DEED and DOR expressed that the registration requirement does not help them to enforce misclassification laws. A DOR supervisor said that the registration requirement is "just getting names on the books," and that there is "not much you can do with that." Staff at DEED similarly commented that the registration requirement does not provide the agency with useful information.

Although DLI staff identified a few ways in which the registration requirement helps them to enforce misclassification laws, these were limited. For example, registrants must provide certain basic information, such as their business address. A DLI supervisor said this helps the agency enforce misclassification laws because it increases the likelihood that DLI will be able to locate an individual if it suspects the individual is misclassifying workers. DLI also said that their ability to revoke a registration can be a helpful tool to deter employers from violating the law—including misclassifying workers.[16]

A DLI supervisor told us that the agency recognizes that the current approach to the registration requirement has limitations. The supervisor added that implementing the registration requirement has taken considerable resources, and that when staff work on contractor registration, they are pulled away from other responsibilities. When staff in the Construction Misclassification Unit spend their time administering the registration requirement, for example, they have less time to spend investigating misclassification. The supervisor explained that DLI has begun discussions about how the registration requirement might be improved, or whether the agency should propose eliminating it altogether. In February 2024, DLI notified us that the agency is moving registration-related duties out of the Construction Misclassification Unit to a different division in the agency.

[16] *Minnesota Statutes* 2023, 326B.082, subd. 11(b), permits DLI to "deny, suspend, limit, place conditions on, or revoke a person's" registration if DLI finds the individual violated certain laws, including the prohibition against misclassifying construction workers.

RECOMMENDATION

The Legislature should either repeal or significantly overhaul the registration requirement under *Minnesota Statutes* 2023, 326B.701, for individuals performing certain construction work.

As currently implemented, the registration requirement under *Minnesota Statutes* 2023, 326B.701, does not generally help DLI, DEED, or DOR "enforce laws related to misclassification of employees."

We recommend that the Legislature repeal or make significant revisions to the registration requirement in law. In doing so, the Legislature should solicit feedback from DLI, DEED, and DOR about how the registration requirement could more effectively help the agencies enforce misclassification laws.[17] If the agencies are unable to provide concrete suggestions as to how the registration requirement could be more useful, the Legislature should repeal the requirement altogether.

Construction Industry Misclassification Investigations

In addition to administering and enforcing the registration requirement discussed above, DLI's Construction Misclassification Unit also investigates instances of possible worker misclassification in the construction industry. DLI staff may initiate an investigation as a result of a complaint that the agency receives, or DLI may identify the subject of an investigation as part of a strategic compliance approach.[18] If staff open an investigation, they may request and review records from employers and workers, conduct interviews, visit the construction site, and undertake other tasks.[19] If the investigator finds that worker misclassification occurred, the agency may order the employer to correct the misclassification and may levy a penalty, among other actions.[20]

[17] To better understand what would make the requirement more effective, we asked staff at DLI, DEED, and DOR how to improve the registration requirement; staff generally did not provide concrete suggestions.

[18] DLI initiates complaint-based investigations in response to a tip from a member of the public. In contrast, DLI initiates investigations under its strategic compliance approach when the agency has reasons to suspect that an employer may be misclassifying workers—for example, if a company has a reputation for not complying with the law. A strategic compliance approach is proactive, as compared to a complaint-based approach. According to DLI, the agency implemented its strategic compliance approach to investigations in 2021.

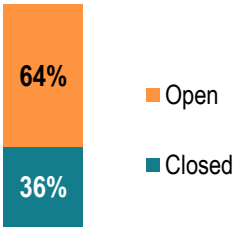
[19] DLI's Construction Misclassification Unit does not investigate all misclassification or registration violation complaints it receives.

[20] We outlined various orders and enforcement actions that DLI could levy against misclassifying employers in the construction industry earlier in this chapter.

Investigation Timeliness

As we discussed in Chapter 3, investigations into worker misclassification can take years; DLI's investigations are no exception. To better understand DLI's efforts to address worker misclassification in the construction industry, we reviewed the files for a sample of investigations recently opened by DLI's Construction Misclassification Unit.[21] Of the 28 construction worker misclassification or registration investigations that DLI initiated in 2021, the agency had closed only 10 investigations (36 percent) as of August 2023; the remaining 18 cases were still under investigation approximately two years later.[22]

The majority of the 28 investigations DLI initiated in 2021 remained open as of August 2023



Source: Office of the Legislative Auditor, based on analysis of DLI's Construction Misclassification Unit investigation data.

The Department of Labor and Industry has not adopted standards or processes to ensure that it addresses possible instances of misclassification in the construction industry in a timely manner.

Even though there are not requirements in law about how quickly DLI should complete its investigations, DLI could establish internal guidelines or requirements to help ensure that staff in the Construction Misclassification Unit process complaints and finish investigations in a timely manner. However, DLI has not done so.

DLI's Construction Misclassification Unit also has not developed case management tools that allow it to systematically oversee investigation progress. The unit does not have a case management system that reliably indicates what action staff last took on an investigation or when they took action.[23] Instead, a DLI supervisor explained that they manually track the progress of the unit's investigations on a spreadsheet based on conversations with DLI staff. However, that spreadsheet did not indicate when staff last took action on an investigation, nor did it include all of the unit's open investigations.

Absent a case management system that tracks investigation progress, we reviewed data from DLI's case database to see when agency staff last updated the official investigation record. Of the 18 open investigations that DLI initiated in 2021, staff had updated the database for only 1 investigation within the prior 12 months. Staff had not updated the investigation record for four of the open investigations in 18 months or more, and there

[21] We reviewed the files for all investigations that DLI initiated in 2021—open and closed—that involved possible construction worker misclassification or registration violations (28 investigations).

[22] DLI reported that during this time period, the Construction Misclassification Unit comprised one part-time supervisor, one lead investigator, and between one and three investigators. The agency further described several challenges that could affect the timeliness of their investigations, including workers and employers that do not respond to agency requests and missing documentation.

[23] A case management system could also, for example, indicate when an investigator submitted an information request to an employer and when the employer's response was due, allowing DLI to systematically monitor if employer responses are overdue and conduct any necessary follow-up in order to prevent further investigation delays.

was no record of staff ever having taken action on three of the open investigations. However, according to a DLI supervisor, the official investigation record does not reflect when staff last worked on an investigation; to determine when an investigator last worked on an investigation, one would need to manually review individual investigation files that investigators store on a shared drive outside of the case database.

A few stakeholders complained about the length of time it takes DLI to complete its investigations. One organization representing construction businesses told us that there is no "swift justice" against those that do not comply with the law, and that employers could get away with misclassifying workers for five or ten years and never be caught. An organization representing workers commented that it is difficult for workers to wait for long periods for a resolution to their case; by the time DLI completes its investigation, the affected workers may no longer be in the state.

RECOMMENDATION

The Department of Labor and Industry should adopt standards and implement a systematic process to monitor and ensure the timely completion of worker misclassification investigations.

As we discussed in Chapter 3, investigation delays disadvantage both workers and law-abiding employers; yet, DLI has not established policies or systematic processes to ensure that its investigations move forward in a timely manner. We recommend that DLI adopt policies and processes that will enable the agency to more systematically, accurately, and easily monitor investigation progress and prevent investigation delays.

Investigation Communication

The Department of Labor and Industry's communication with parties about an investigation is limited and inconsistent; however, state law restricts the information the agency can share about active investigations.

Although DLI has created some form letters to provide to the parties involved in a construction worker misclassification investigation, the agency has not established standards for when investigators should communicate with complainants or respondents about their construction-related misclassification case. For example, the Construction Misclassification Unit does not require investigators to notify parties when they close an investigation.

When we reviewed investigations that DLI's Construction Misclassification Unit had closed in the last few years, we found that their communication with parties about worker misclassification or registration-related investigations was inconsistent.[24] The official case record for 10 (71 percent) of the 14 closed cases did not include any

[24] We reviewed the files for all 14 investigations that DLI initiated between January 1, 2021, and June 30, 2023, involving possible construction worker misclassification or registration violations, that were closed as of August 2023.

evidence that DLI notified either the complainant or respondent that the agency was closing the investigation.[25]

A couple of stakeholders described concerns about DLI's communication and expressed a desire for DLI to provide more regular updates on the progress of its investigations. One stakeholder organization representing workers commented that worker complaints sent to DLI go into a "black box" and that the agency's communication with workers about their investigations is very minimal; the agency's lack of transparency is one of its "bigger failures," they said.

> When we last referred a case…to DLI, we experienced obfuscation and delay. It took several prompting emails to ultimately receive word—five months after first making the referral—that they would not be pursuing the case.
>
> **— Stakeholder**

Although some stakeholder organizations expressed dissatisfaction with DLI's communication about investigations, DLI staff said that the Minnesota Government Data Practices Act limits the information they can share about investigations. Statutes state, "…data collected by a government entity as part of an active investigation undertaken for the purpose of the commencement or defense of a pending civil legal action" are protected nonpublic or confidential data.[26] One DLI supervisor explained that, by law, the agency can neither indicate whether they have opened an investigation nor provide updates on the status of an investigation—even to the original complainant.

RECOMMENDATIONS

The Department of Labor and Industry should:

- **Establish standards for communicating with parties about its worker misclassification investigations.**
- **Consistently communicate with complainants and respondents about key investigation milestones.**

DLI staff acknowledged that complainants can become frustrated by the lack of communication regarding their cases. DLI's lack of communication is exacerbated by the fact that DLI's investigations may take years to complete, leaving complainants to wonder for an extended period how—or even if—DLI is addressing their complaint.

We recommend that DLI develop communication policies and form letters that ensure the agency clearly and consistently provides information to parties about the extent to which the agency will communicate with them about their case. In addition, we

[25] For 3 of the 14 closed cases, the case record indicated that DLI notified at least one party that the agency was closing the investigation. As we mentioned earlier, DLI opens some investigations through its strategic compliance efforts, in which case an investigation may not have a complainant. DLI neither systematically tracks whether it opened an investigation as a result of a complaint nor does it systematically track the identity of a complainant. As a result, we were unable to determine if DLI notified both the respondent *and* complainant that the agency was closing the case, when applicable. There was no record of DLI communicating with either party about one additional case; however, DLI records indicated the agency opened that case in error.

[26] *Minnesota Statutes* 2023, 13.39, subd. 2. Note, however, that there are some exceptions in law. For instance, *Minnesota Statutes* 2023, 260E.10, generally requires that the reporter of child maltreatment be informed whether the maltreatment report was accepted or screened out, even though the investigative data are not public.

recommend that DLI consistently communicate with parties (1) when the agency closes its investigation and (2) if it decides not to pursue a complaint.

Program Outcomes

As we discussed in Chapter 2, DLI does not track worker misclassification rates. DLI neither systematically tracks how often investigators find that employers misclassified workers nor how many workers were misclassified. Likewise, DLI does not systematically track how often it finds that individuals violated the contractor registration requirement. To better understand how often DLI investigators found instances of misclassification or registration violations in the construction industry, we reviewed the case files for the 14 investigations that DLI's Construction Misclassification Unit initiated between January 1, 2021, and June 30, 2023, that the agency had since closed.

Estimated rates of misclassification in the construction industry in 2018 were higher than when OLA last evaluated worker misclassification; yet, the Department of Labor and Industry did not identify any instances of misclassification in the construction industry as a result of their recent investigations.

As of August 2023, DLI had closed 14 of the investigations it began between January 1, 2021, and June 30, 2023; 8 of those investigations pertained to potential misclassification. DLI closed each of those eight investigations without identifying any employers that misclassified workers.[27]

Although DLI closed these investigations without finding any misclassification, that does not necessarily mean that misclassification did not occur. As seen in the exhibit on the following page, DLI closes investigations for many reasons; for instance, DLI may close an investigation without determining whether misclassification occurred because it was unable to locate the respondent or because the case went to court. It is possible that one or more employers that were the subject of an investigation did misclassify workers, but DLI closed the investigation before making a determination.[28]

There are many reasons that could explain why DLI has not identified instances of misclassification in the construction industry in its recent investigations. First, DLI may have simply closed investigations without determining whether or not employers were misclassifying workers, as we mentioned above. Second, given how few investigations DLI has completed during this time period, it is possible that the agency simply has not completed enough investigations to find misclassification. Third, as we previously discussed, two-thirds of the investigations the agency initiated in 2021 remained open as of August 2023. It is possible that DLI will find instances of misclassification in one or more of those investigations that remain open.

[27] The remaining 6 of the 14 investigations addressed possible registration violations. DLI also did not identify any registration violations.

[28] DLI did not document why it closed 5 (36 percent) of its 14 investigations, making it difficult to fully evaluate the outcomes of DLI's investigative efforts.

Reasons for Closure, DLI's Construction Misclassification Unit Investigations

Reasons for Investigation Closure	Number of Investigations
No reason provided	5
Addressed through other means (for example, civil litigation, processed by another DLI unit)	2
Administrative reason (for example, DLI opened case in error, the respondent was not the subject of the investigation)	2
Insufficient evidence	1
Unable to locate respondent	1
No response from complainant	1
Reason provided was unclear	1
Agency resources	1
Total closed cases	**14**

Source: Office of the Legislative Auditor, based on analysis of DLI's Construction Misclassification Unit investigation case files for investigations initiated between January 1, 2021, and June 30, 2023, as of August 2023.

One could also argue that perhaps DLI did not identify misclassification in the construction industry because employers did not misclassify workers; however, data from the unemployment insurance program indicate that the rate of misclassification in the construction industry was higher in 2018 than when we last evaluated worker misclassification.[29] In 2007, we estimated that 15 percent of employers in the construction industry that contributed to the unemployment insurance program misclassified at least one worker; whereas, we estimated that 23 percent of those employers misclassified at least one worker in 2018.[30]

Workers in the construction industry also accounted for a disproportionately high share of misclassified workers in 2018. We found that construction industry employees accounted for roughly 16 percent of the misclassified workers that DEED identified even though they comprised only 8 percent of all employees in DEED's random audits.

Several stakeholders were critical of DLI's effectiveness at addressing misclassification. One organization representing workers commented that DLI "lacks the speed and transparency to meaningfully enforce the law." A former DLI investigator stated that DLI's enforcement of construction-related misclassification law was "rare" and "arbitrary." Another organization representing both employers and workers said that DLI's Construction Misclassification Unit "…has not been very effective at addressing systemic abuse by contractors. In other words, it…does not effectively deter the

[29] We analyzed the results of DEED's random audits of the 2018 records of 1,340 employers that contributed to the unemployment insurance program. DLI uses the same test for determining construction worker classification as does DEED for purposes of its unemployment insurance audits.

[30] Findings from our 2007 report reflect 2005 employer data that DEED audited. Office of the Legislative Auditor, Program Evaluation Division, *Misclassification of Employees as Independent Contractors* (St. Paul, November 2007), 18.

contractors for whom misclassification is the essence of their business model." Given the issues discussed throughout this chapter, we think these stakeholders raise legitimate concerns.

RECOMMENDATION

The Department of Labor and Industry should evaluate and report to the Legislature on the effectiveness of its efforts to address misclassification.

We find it noteworthy that DLI's Construction Misclassification Unit has not identified any instances of misclassification in the cases it has opened in recent years, despite seemingly higher rates of misclassification in the construction industry. Although it may be unreasonable to judge the overall effectiveness of DLI's Construction Misclassification Unit based on the outcomes of its investigations alone, information about the extent to which staff find instances of misclassification is an important piece to evaluating how effectively the unit is addressing worker misclassification.

In February 2024, DLI notified us that they intend to move the Construction Misclassification Unit's work related to misclassification investigations to DLI's Wage and Hour Unit, rather than having a small standalone unit specifically devoted to addressing misclassification in the construction industry.[31] In addition to addressing the other recommendations in this chapter, as the agency undertakes this transition, we recommend that it begin to regularly and systematically measure and evaluate the effectiveness of the agency's efforts to address misclassification. Metrics to evaluate effectiveness should include—but may not be limited to—the rate at which DLI identifies worker misclassification. We further recommend that DLI regularly report to the Legislature on the outcomes of its misclassification-related work so that the Legislature can assess whether DLI's efforts to address misclassification are meeting expectations and whether the agency's use of state resources to address misclassification is having the intended effect.

Regardless of the effectiveness of DLI's Construction Misclassification Unit specifically, our analysis of unemployment insurance data indicates that despite the state's additional focus on addressing misclassification in the construction industry, misclassification in the construction industry continues to be an issue.

[31] As we discussed in Chapter 1, DLI's Wage and Hour Unit enforces the state's fair labor standards, among other responsibilities.

Chapter 5: Worker Classification and the Gig Economy

Since the late 2000s, the proliferation of smart phones and other technology has significantly altered the ways in which some companies provide services to their clients. For instance, historically a restaurant might accept dinner reservations by phone; today, diners might make the reservation through an online application. Similarly, in the past, someone with a cold might visit a doctor's office in person, whereas today that person might meet with their doctor via videoconference. Technological proliferation has also opened the door to new types of work arrangements, including the work arrangement adopted by companies that are part of the "gig economy."

Key Findings in This Chapter

- Statutes do not establish specific criteria for determining the classification of gig workers.
- Unlike Minnesota, some states have explicitly addressed the classification of gig workers—or the benefits gig workers receive—through legislation.

In this chapter, we take a deeper dive into worker classification in the gig economy. We first describe work arrangements in the gig economy before explaining Minnesota's approach to classifying gig workers. We conclude with a discussion about how Minnesota's approach to classifying gig workers compares to classification approaches in other states.

Overview

Gig Workers

For the purposes of this report, a "gig worker" is an individual who performs on-demand services through an internet-based application or "app" provided by a company, such as Lyft or GrubHub. For example, someone is a gig worker if they provide rides through a ride-hailing app or make deliveries that are booked through an app.

In recent years, the gig economy has become synonymous with a collection of companies that rely on workers to provide on-demand services—such as transportation or home cleaning services—through an online platform or application. In the basic model of the gig economy, "gig workers" enter into formal agreements with gig economy companies, such as Uber or TaskRabbit, in order to provide services to the companies' clients. These clients request services through an online application provided by the company, which is used to match clients who are requesting services to gig workers who are looking for "gigs," or opportunities to provide those services. The gig workers provide the requested services on an on-demand basis and are paid for each gig they complete.

There are many reasons why a worker may choose to work in the gig economy. Gig workers, for example, may benefit from increased flexibility to choose their jobs and hours. Greater flexibility could in turn provide gig workers with an opportunity to generate income when life circumstances would not otherwise allow for more traditional forms of employment—for instance, if someone was the primary caretaker

of a family member and could not work regular hours. Further, it is often relatively quick and easy to begin working in the gig economy. For example, rather than going through an interview process, many individuals seeking gig work need only accept the gig company's terms and conditions and upload any required documentation before they begin work; the worker may never meet a human representative of the company.

Many Americans have been a gig worker at some point in time. A 2021 Pew Research Center study stated that 16 percent of Americans had earned money performing certain tasks through an online gig platform.[1] Further, they found that 31 percent of the individuals who were currently or had recently been gig workers (3 percent of total U.S. adults) said that gig work had been their main job over the previous year.

Although there are similarities between the work arrangements of gig workers and independent contractors—greater flexibility in deciding what hours to work, for example—there are also key differences. For example, some gig companies set prices for their services and make job assignments, whereas independent contractors would typically control how much they charge for their work and whether they accept a job. Additionally, some gig companies prohibit gig workers from accepting work outside of the app, whereas independent contractors typically control with whom they work.

As the gig economy has grown, so too have questions about how to classify gig workers. Gig workers have typically been classified as independent contractors. Yet some have questioned whether classifying gig workers as independent contractors accurately reflects the working relationship between gig workers and gig companies. For example, the Federal Trade Commission expressed concern that some companies may closely control gig workers' tasks, despite classifying those workers as independent contractors.[2]

At the root of these questions about how to classify gig workers is often a bigger question about whether the existing classification tests adequately account for the nuances of the work arrangements in today's gig economy. As stated in a 2017 *Minnesota Law Review* article:

> Today's gig workers "do not seem to fit into either of the binary worker categories—though far from traditional employees, they also bear little resemblance to [the] independent, small-business-operating contractors" that were originally envisioned. Gig workers are "square pegs" being forced to fit into employee classification tests consisting of "two round holes."[3]

In the following section, we examine how Minnesota has sought to address the challenges pertaining to the proper classification of gig workers.

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[1] Pew Research Center, "The State of Gig Work in 2021" (December 8, 2021), https://www.pewresearch.org/internet/2021/12/08/the-state-of-gig-work-in-2021/, accessed July 19, 2023.

[2] As we discussed in Chapter 3, the greater the degree of control a company has over its workers, the more likely those workers are employees—not independent contractors.

[3] Emily C. Atmore, "Killing the Goose That Laid the Golden Egg: Outdated Employment Laws Are Destroying the Gig Economy," *Minnesota Law Review* 102 (2017): 889, https://www.minnesotalawreview.org/wp-content/uploads/2018/01/Atmore_MLR.pdf, accessed May 24, 2023.

Minnesota's Approach to Classifying Gig Workers

In 2023, the Minnesota Legislature sought to provide certain gig workers various protections in law. Although the legislation did not explicitly address the classification of gig workers, lawmakers sought to provide transportation network company drivers (such as those working for Uber or Lyft) with a guaranteed minimum compensation, protections against discrimination, and other worker protections.[4] Governor Tim Walz vetoed the legislation before it became law and instead formed a Committee on the Compensation, Wellbeing, and Fair Treatment of Transportation Network Company Drivers.[5]

Statutes do not establish specific criteria for determining the classification of gig workers.

Although state law outlines different factors to use to determine the appropriate classification of workers in certain professions, Minnesota law does not outline a specific test for determining the classification of gig workers. Instead, employers and state agencies classify gig workers using the standard tests described in Chapter 3.[6] For example, if the Department of Employment and Economic Development (DEED) was to determine the classification of an Uber driver in order to determine whether they are eligible for unemployment insurance, DEED would use the five-factor test outlined in unemployment insurance law.[7]

> Minnesota's current approach (and that of most other states) seems to be to passively allow app-based platforms to misclassify workers *en masse* as part of their business model. It could be improved….
>
> **— Stakeholder**

Overall, the stakeholders we contacted as part of our evaluation—including organizations representing workers, employers, and academic or other research organizations—had mixed opinions with regard to whether the state has adopted an effective approach to classifying gig workers.[8] Several stakeholders commented that Minnesota's approach to addressing the classifications of gig workers is ineffective or nonexistent. Several stakeholders representing both workers and employers—including stakeholders directly involved in the gig economy—suggested that Minnesota should adopt a classification test specific to gig workers, with some organizations explaining how traditional worker classification tests are a poor fit for the gig economy. One stakeholder commented that it is particularly important to address classification in the gig economy because many gig workers are bound by arbitration clauses that prevent them from pursuing private legal action if they think they have been misclassified.

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[4] H.F. 2369, 2023 Leg., 93rd Sess. (MN).

[5] Among other objectives, the committee is to "draft recommendations related to compensation and fair treatment" of transportation network company drivers. State of Minnesota Executive Order 23-07, "Establishing the Governor's Committee on the Compensation, Wellbeing, and Fair Treatment of Transportation Network Company Drivers," May 25, 2023.

[6] As we discussed in Chapter 1, for simplicity, in this report we refer to any entity that pays workers for services as an "employer," regardless of how the term is defined in law.

[7] *Minnesota Rules*, 3315.0555, subp. 1, https://www.revisor.mn.gov/rules/3315/, accessed May 8, 2023.

[8] In addition to various stakeholder interviews, we sent an e-mail questionnaire to 30 stakeholder organizations to gather their feedback on worker misclassification in Minnesota. We received 15 responses, for a response rate of 50 percent.

> Minnesota should not consider any additional regulation of worker classification based on whether an industry is "gig." Whether an interaction with a worker is through an app, a website, in person, or over the phone, the interaction, the relationship, the economic costs and benefits, the control, the rights and responsibilities of the parties,…etc. should factor in the classification determination, not whether the interaction occurred through an application-based platform.
>
> **— Stakeholder**

On the other hand, a few stakeholders—particularly those representing the interests of employers—told us that they did not support additional regulation of gig workers in Minnesota. As we mentioned above, gig workers have typically been classified as independent contractors; one stakeholder commented that their organization's members' "unanimous" opinion was that gig workers should continue to be classified as such. Another stakeholder commented on the potential negative effects on both the gig workers and on the businesses served by gig workers (such as restaurants) if Minnesota were to require that gig workers be classified as employees. The stakeholder explained, for instance, that if gig workers became employees, app-based companies might employ fewer gig workers, which could increase wait times for food deliveries and reduce the geographic area that restaurants could serve, thereby potentially decreasing the amount of orders they receive.

Other Approaches to Classifying Gig Workers

As the number of gig workers increases, some have become concerned that a larger and larger number of workers are no longer eligible for the various benefits and protections that have historically been granted to employees. At the same time, there are concerns about how changes to the classification of gig workers might affect gig companies' ability to provide services.

Policy makers can address fundamental questions about worker classification and benefits in different ways. First, policy makers could change who is considered an employee (and therefore who is eligible for the benefits and protections currently granted to employees in law). Policy makers could do this, for example, by changing the classification tests in law to include or exclude more workers as employees. Policy makers could also clarify how to classify specific types of workers explicitly, for example, by clarifying that all workers who produce widgets are employees, while all workers who produce whatsits are independent contractors.

On the other hand, rather than altering or clarifying the *classification* of certain workers, policy makers could alter or clarify the *benefits and protections* provided to workers. According to the National Conference of State Legislatures:

> Some scholars have argued that the debate over whether to classify independent workers as contractors or employees is a red herring. They assert that…not all workers will benefit from a blunt classification as employees. For these scholars, the larger issue is how to modernize employment benefits and labor protections to fit with the realities of how people work today.[9]

[9] National Conference of State Legislatures, *Portable Benefits for Independent Contractors* (February 2023): 10, https://documents.ncsl.org/wwwncsl/Labor/Portable-Benefits-Independent-Contractors-f02_Alicia%20Natwick.pdf, accessed December 14, 2023.

Unlike Minnesota, some states have explicitly addressed the classification of gig workers—or the benefits gig workers receive—through legislation.

Several states have adopted laws that affect the *classification* status of gig workers—either directly or indirectly. Iowa, for instance, mandated that gig workers that meet certain criteria be classified as independent contractors.[10] California, on the other hand, indirectly changed the classification of many gig workers when it adopted a different classification test—the "ABC" test. The ABC test does not explicitly address the classification of gig workers; however, the test expands the definition of who is an employee, thereby reducing the instances in which workers—including gig workers—can be classified as independent contractors.[11]

Portable Benefits

Portable benefits could include "…health care, life insurance, retirement savings, but are attached to a worker instead of the employer. Portable benefits attached to the worker allows a worker to maintain benefits regardless of work arrangement, such as traditional W-2 employment, freelance work or gig work."

Portable benefits systems can take different forms. One example, the "Black Car Fund" in New York, was established to provide for-hire livery drivers with workers' compensation. Riders pay into the fund through a surcharge on each ride, and drivers can receive workers' compensation through the fund—regardless of which company the drivers work for and even though the drivers are independent contractors.

— National Conference of State Legislatures and the Aspen Institute[12]

Some states have clarified in law the *benefits and protections* that gig workers can receive. For example, Washington requires certain types of gig companies to provide benefits to their workers, including workers' compensation, unemployment insurance, and paid sick leave.[13] As another model, rather than *requiring* gig companies to provide workers with certain benefits, Utah *permitted* them to offer workers "portable benefits."[14] Some organizations have argued that gig companies are limited in their ability to provide worker benefits because providing benefits would be evidence of an employment relationship.[15] By permitting companies to provide portable benefits—and stipulating that portable benefits are not an indication of an employment relationship—Utah opened the door to more gig companies providing worker benefits.

We provide a more detailed description of these states' approaches to addressing gig worker classification in the Appendix.

[10] *Iowa Code* 2023, 93.2.

[11] *California Labor Code*, div. 3, ch. 2, art. 1.5, sec. 2775. As we discuss further in the appendix, in California, a ballot initiative has sought to exempt certain gig workers from being classified as employees.

[12] National Conference of State Legislatures, *Portable Benefits for Independent Contractors* (February 2023): 2, https://documents.ncsl.org/wwwncsl/Labor/Portable-Benefits-Independent-Contractors-f02_Alicia%20Natwick.pdf, accessed December 14, 2023; and David Rolf, Shelby Clark, and Corrie Watterson Bryant, *Portable Benefits in the 21st Century* (Aspen Institute, 2016): 10, https://www.aspeninstitute.org/publications/portable-benefits-21st-century/, accessed September 19, 2023.

[13] *Revised Code of Washington* 2023, 49.46.210(5)(b), 50.04.370(1), and 51.08.070(2).

[14] *Utah Code*, 34-57-102.

[15] The IRS, for example, lists "whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay" as one factor to consider when determining whether a worker is an employee or independent contractor. Internal Revenue Service, Department of the Treasury, Publication 15-A (2023), *Employer's Supplemental Tax Guide*, updated December 20, 2022, https://www.irs.gov/publications/p15a, accessed September 6, 2023.

Recommendation

Decisions regarding the proper classification of gig workers have wide-reaching effects on gig companies, their workers, and the government. Some have argued that requiring gig companies to reclassify their workers as employees would increase company costs and force companies to decrease the number of individuals providing services on their platforms. Further, these individuals argue, increased costs may be passed down to the consumer, and gig companies may have to decrease their service levels. In addition to incurring additional wage and benefits costs for gig workers that are reclassified as employees, gig companies could be liable for the misconduct of gig workers classified as employees, whereas they are generally not liable for the misconduct of workers who are classified as independent contractors.[16]

On the other hand, there are ramifications for both workers and the government if gig workers continue to be classified as independent contractors. While gig workers may have greater flexibility and control over their work schedules as independent contractors, they typically do not have access to the same benefits and protections enjoyed by employees, such as workers' compensation or unemployment insurance. Without these benefits and protections, gig workers may be at risk of greater financial insecurity. Additionally, continuing to classify gig workers as independent contractors affects the total taxes collected by certain government programs as well as how many workers are eligible for those programs. For instance, employers are required to pay into certain government programs only for their *employees*; if gig workers were classified as employees rather than independent contractors, the government would collect more revenue for those programs.

RECOMMENDATION

The Legislature should consider whether Minnesota's current approach to classifying gig workers aligns with the state's policy goals and priorities and revise Minnesota statutes, if needed.

There are numerous ways to approach the classification of gig workers and their access to worker benefits and protections. Other states provide models for doing so, whether by amending law to establish or influence how gig workers are classified, focusing on providing benefits to gig workers, or a combination of both approaches.

Each policy approach presents certain advantages and disadvantages. Nevertheless, given the growth of the gig economy, it may be valuable to more directly address the status of gig workers in Minnesota. If the Legislature is currently dissatisfied with the way in which Minnesota addresses gig worker classification, it should consider which policy approach (or policy approaches) best aligns with its policy goals and priorities and amend state law accordingly.

[16] As an example, consider an Uber driver who, as a result of their irresponsible driving, was in a car accident in which a pedestrian was injured. A court may consider the employment relationship between Uber and the driver in determining whether Uber or the driver would be liable for the pedestrian's injuries.

List of Recommendations

- The Legislature should direct a state agency (or agencies) to calculate worker misclassification rates in Minnesota on an ongoing basis. (p. 19)
- To the extent possible, the Legislature should enact common tests for determining worker classification and reduce the number of different classification tests currently in law. (p. 26)
- If the Legislature would like agencies to take a more active role in addressing worker misclassification, the Legislature should direct agencies to do so in law. (p. 29)
- The Legislature should consider establishing timeliness standards for worker misclassification investigations. (p. 32)
- The Legislature should amend statutes to ensure that agencies are required to penalize employers that repeatedly misclassify workers. (p. 35)
- The Legislature should amend statutes to allow civil action by misclassified workers in all industries. (p. 37)
- The Legislature should require state agencies to take a coordinated and collaborative approach to addressing worker misclassification. (p. 39)
- The Department of Labor and Industry (DLI) should propose to the Legislature updates to the construction worker classification requirements outlined in *Minnesota Statutes* 2023, 181.723. (p. 44)
- The Legislature should either repeal or significantly overhaul the registration requirement under *Minnesota Statutes* 2023, 326B.701, for individuals performing certain construction work. (p. 48)
- DLI should adopt standards and implement a systematic process to monitor and ensure the timely completion of worker misclassification investigations. (p. 50)
- DLI should:
  - Establish standards for communicating with parties about its worker misclassification investigations.
  - Consistently communicate with complainants and respondents about key investigation milestones. (p. 51)
- DLI should evaluate and report to the Legislature on the effectiveness of its efforts to address misclassification. (p. 54)
- The Legislature should consider whether Minnesota's current approach to classifying gig workers aligns with the state's policy goals and priorities and revise Minnesota statutes, if needed. (p. 60)

OLA

California

Policy Highlight

Establishes gig worker classification: Indirectly through a new classification test

Classification status: Presumed employee

Provides gig worker benefits or protections: Yes, for employees

Benefits provided: Workers' compensation, unemployment insurance, overtime pay, and more

In 2019, California adopted a different test—the "ABC test"—to determine worker classification.[1] Under the ABC test, a worker is classified as an employee unless the employer can demonstrate that the worker meets three criteria.[2]

Policy Overview

Gig worker classification. While California's ABC test does not explicitly address the classification of gig workers, it effectively reclassified a wide swath of California workers—including gig workers—as employees. The law expanded the definition of who is an employee and more strictly limited who can be classified as an independent contractor. Unlike other commonly used classification tests, the ABC test presumes that a worker is an employee unless proven otherwise.

Although many gig workers were reclassified as employees under California's ABC test, in 2020, California voters passed a ballot initiative that classified specifically "app-based" drivers as independent contractors.[3]

Gig worker protections and benefits. Gig workers that are classified as employees under the new ABC test receive the same benefits and protections established in California law for employees in more traditional work arrangements.

Policy Pros and Cons

Arguments for. Some argue that employers will be less likely to misclassify their workers under the ABC test, because the test presumes the worker to be an employee and places the burden on the employer to prove otherwise. Proponents also argue that the ABC test allows people to more predictably determine a worker's classification because it does not require one to consider as many factors as the other commonly used classification tests.

Arguments against. California's adoption of the ABC test has been the subject of several court cases in addition to the ballot measure mentioned above.[4] Further, the law exempts numerous professions from adhering to the ABC test requirements, resulting in a complicated legal landscape with opponents alleging a lack of equal treatment across professions. Finally, the ABC test does not align with the worker classification tests used by the federal government, meaning that a worker could be classified under California law as an employee and as an independent contractor under federal law. This lack of consistency could create confusion for workers and hiring entities alike in determining the proper classification of workers.

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[1] At least 20 states have adopted some form of the ABC test for the purpose of administering their unemployment insurance programs and/or other employment laws. Jon Shimabukuro, *Worker Classification: Employee Status Under the National Labor Relations Act, the Fair Labor Standards Act, and the ABC Test* (Congressional Research Service, April 20, 2021), https://crsreports.congress.gov/product/pdf/R/R46765, accessed December 18, 2023.

[2] The employer must demonstrate that the worker (A) is "free from the control and direction" of the employer when performing their work; (B) performs work "outside the usual course" of the employer's business; and (C) is "customarily engaged in an independently established trade, occupation, or business of the same nature" as the work performed. *California Labor Code*, div. 3, ch. 2, art. 1.5, sec. 2775.

[3] *Text of Proposed Laws*, California General Election, November 3, 2020, Proposition 22, codified as *California Business and Professions Code*, div. 3, ch. 10.5.

[4] The ballot initiative—Proposition 22—is also the subject of ongoing litigation; the California Supreme Court may rule on the constitutionality of the ballot initiative sometime in 2024.

Iowa

Iowa, like several other states, adopted a "marketplace contractor" law addressing worker classification in the gig economy. Generally speaking, marketplace contractors in Iowa are people who use a digital platform that is operated by another entity in order to connect with and provide services to others.[5]

Policy Highlight

Establishes gig worker classification: Yes

Classification status: Independent contractor

Provides gig worker benefits or protections: No

Benefits provided: Not applicable

Policy Overview

Gig worker classification. Iowa's marketplace contractor law classifies gig workers as independent contractors, assuming four conditions are met.[6] The law explicitly states that gig workers are *not* employees of the gig companies for which they provide services.

Gig worker protections and benefits. As independent contractors, gig workers do not qualify for state and local worker benefits and protections, including workers' compensation, unemployment insurance, minimum wage, and others.

Policy Pros and Cons

Arguments for. One of the commonly cited benefits of marketplace contractor laws in general is that such laws clarify the classification of gig workers. One proponent of the marketplace contractor approach also implied that it is better for companies in the gig economy to change the law to meet their business needs rather than for those companies to try to fit within the existing law.

Arguments against. Critics of marketplace contractor laws in general highlight that the laws typically prevent gig workers from receiving worker benefits and protections. Also, some have argued that businesses operating outside of the gig economy are put at a competitive disadvantage by marketplace contractor laws that exempt gig companies from providing—and paying for—worker benefits and protections that are required of other businesses. Additionally, some have argued that marketplace contractor laws incentivize companies that are not currently operating in the gig economy to incorporate platform-based technology into their business models in order to classify more workers as independent contractors and avoid the costs of worker benefits and protections associated with employees.

[5] For consistency, throughout this overview we refer to "gig workers" and "gig companies"—terms often now synonymous with "marketplace contractor" and "marketplace platform," respectively.

[6] To be classified as an independent contractor: (1) the gig worker and gig company must agree in writing that the worker is an independent contractor, (2) the gig company must not prescribe hours of work, (3) the gig company must not prohibit the worker from engaging in outside employment, and (4) the gig worker must bear their own expenses incurred while providing services. *Iowa Code* 2023, 93.2.

Utah

Policy Highlight

Establishes gig worker classification: No

Classification status: Not applicable

Provides gig worker benefits or protections: Not directly; permits companies to provide "portable benefit plan"

Benefits provided: None

In 2023, Utah passed legislation permitting governmental and private entities to offer portable benefits to workers.[7] Although portable benefits can take many forms, they are typically meant for workers who do not have access to benefits through more traditional employment, such as gig workers.

Policy Overview

Gig worker classification. Utah's portable benefits law does not clarify how to classify gig workers.[8] In fact, it explicitly states that the provision of portable benefits may *not* be used as a factor in determining a worker's classification.

Gig worker protections and benefits. Utah permits—but does not require—gig companies to provide their workers with portable benefits. The law does not specify what benefits companies must include in a portable benefits plan, although the law defines a portable benefits plan as only including certain types of insurance.[9] Portable benefits must be assigned to the worker, not to the company. The law does not specify whether the gig company or the worker contributes to the portable benefits plan; however, it states that contributions to a portable benefits plan must be voluntary.

Policy Pros and Cons

Arguments for. Utah's portable benefits law passed with resounding bipartisan support, indicating that this could be an approach to addressing worker classification issues in the gig economy that is less politically fraught. In general, the concept of portable benefits has been touted as a way to allow workers to continue to be independent contractors while also accessing benefits that have historically been reserved for employees.

Arguments against. Because Utah does not require companies to provide benefits, the effectiveness of this approach depends on the extent to which companies choose to offer portable benefits. Given how recently this legislation was enacted, it is too soon to tell how many companies will offer benefits to their workers. Overall, portable benefits is a somewhat new and untested concept at a large scale in the United States. Several states have introduced portable benefits legislation; however, according to the National Conference of State Legislatures, Utah is the first to adopt a "framework for comprehensive portable benefits."[10]

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[7] *Laws of Utah* 2023, Chapter 517.

[8] Like Iowa, Utah adopted "marketplace contractor" laws addressing the classification of some workers in the gig economy, including "building service contractors" (such as home repair workers) and "remote service marketplace" workers (such as translators).

[9] *Utah Code*, 34-57-101.

[10] Zaakary Barnes, Landon Jacquinot, and Suzanne Hultin, "Show Me the Benefits!" *NCSL State Legislatures Magazine*, Summer 2023, 51.

Washington

Policy Highlight

Establishes gig worker classification: Yes, for transportation network company drivers

Classification status: Not employee

Provides gig worker benefits or protections: Yes

Benefits provided: Workers' compensation, unemployment insurance, minimum wage, and more

In 2022 and 2023, Washington enacted new legislation pertaining to the classification of and benefits for certain gig workers—specifically for individuals working for transportation network companies (TNCs), such as Uber and Lyft.

Policy Overview

Gig worker classification. Washington law clarifies that, if TNC drivers meet certain criteria, they are *not* considered employees. For example, as long as a TNC does not "unilaterally prescribe" specific dates or times of day that the driver must be logged into the TNC's online platform (among other requirements), then the driver is not an employee.[11]

Gig worker protections and benefits. Washington law grants TNC drivers several benefits and protections that are not typically provided to workers who are not employees. For instance, TNCs must pay for and provide workers' compensation coverage for their drivers, and TNC drivers are eligible for unemployment insurance. Additionally, TNCs are prohibited from discriminating against drivers, must pay drivers a minimum wage, and must provide drivers with paid sick leave. Under a pilot program, TNCs must also reimburse certain drivers for the cost of coverage for family and medical leave.

Policy Pros and Cons

Arguments for. Proponents argue that Washington's approach allows drivers to maintain flexibility with regard to when and how they do their work while still getting benefits they would not otherwise receive as nonemployees. Described as a compromise between TNCs and drivers, some explained that the legislation ensures that drivers receive at least some benefits and protections.

Arguments against. Critics of Washington's approach argue that, while drivers receive some benefits, they do not receive the full array of benefits and protections they would if they were employees. For instance, drivers do not have the right to collectively bargain—a right typically extended to employees. Opponents also argue that the benefits drivers do receive under these laws are more limited than they would be if the drivers were employees. For instance, the law only requires TNCs to meet workers' compensation requirements when the driver is on their way to pick up a passenger or is transporting the passenger; it does not include other time drivers may spend waiting for a ride request, obtaining fuel, and other activities. Finally, opponents argue that, in failing to recognize drivers as employees, this approach establishes a bad precedent that could negatively affect the rights of gig workers in other industries in the future.

[11] *Revised Code of Washington* 2023, 49.46.310(i).

DEPARTMENT OF LABOR AND INDUSTRY

March 8, 2024

Judy Randall, Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
658 Cedar St, Room 140
St. Paul, MN 55115

Dear Legislative Auditor Randall:

Thank you for the opportunity to review and comment on the Office of the Legislative Auditor's (OLA's) *Worker Misclassification* report. The Department of Labor and Industry (DLI) values the opportunity to work with OLA to consider improvements to efforts to address worker misclassification. DLI considers worker misclassification a significant problem in Minnesota and is concerned about its spread as noted in the report (pp. 11, 17). DLI also wishes to express its gratitude for the opportunity to provide feedback and this response to the OLA report. OLA's review of DLI's initial comments and subsequent revisions in the interest of accuracy, objectivity, clarity and context are appreciated.

In our response letter, you will find the following:

- additional context for DLI's efforts to address employee misclassification;
- information about recent steps DLI is taking to address misclassification; and
- DLI's responses to specific recommendations in the report.

Additional context for DLI's misclassification work

The OLA report highlights some of the challenges inherent in DLI's efforts to enforce statutes specific to worker misclassification. These challenges include the complex nature of investigations (p. 29), the lack of responsiveness by subjects of investigations (Id.), limited penalty authority (p. 33), violators' ability to abandon businesses and shift work to separate entities (p. 34), difficulties presented by extensive subcontracting (pp. 39-41), the complexity in determining if specific criteria have been met for construction workers (p. 42) and limitations of contractor registration requirements (pp. 44-45).

DLI believes additional context is important when evaluating its efforts to address worker misclassification, particularly as a stand-alone violation. As the report notes, to issue misclassification penalties under the general misclassification statute, Minnesota Statutes 2023, 181.722, an employer must have been found to have misclassified an employee willfully or repeatedly and requires the employer knew or had reason to know it was making false statements regarding employee status. Penalizing an employer for misclassification in the construction industry according to Minnesota Statutes 2023, 181.723 requires DLI to determine the employer engaged in fraud, coercion, misrepresentation or knowingly misclassified employees. This heightened standard is unusual in the statutes DLI enforces. Finding misclassification as a violation in the construction industry also requires use of an entirely separate statutory and administrative enforcement process than other violations related to misclassification, such as failure to pay minimum wage or overtime. This complex and disjointed process requires additional resources to enforce misclassification as a separate violation.

These requirements are particularly challenging to meet, for numerous reasons, but of particular importance is that DLI struggles to obtain the information such a finding would require. For example, it may be difficult to obtain information from workers when they have left the area, may fear retaliation or may simply be reluctant to participate in an investigation where misclassification is not accompanied by wage and hour violations. Employers may be reluctant to respond to DLI's requests for information when any potential consequences of failure to respond are insignificant compared to the consequences of providing information sufficient to allow DLI to find a violation. There is also little incentive to respond to DLI investigations when the employer can easily shift its work to another business entity, thereby avoiding responsibility or consequences.

DLI's recent efforts related to misclassification

DLI is committed to tackling this issue head-on and always strives to improve its efforts in this area. To that end, DLI has worked closely with legislators on House File 4444/Senate File 4483 "Misclassification of employees prohibited," which was introduced on Feb. 29, 2024. This legislation makes numerous changes related to misclassification of employees, DLI's enforcement authority and tools, and addresses interagency cooperation related to worker misclassification, including establishment of an "Intergovernmental Misclassification Enforcement and Education Partnership." This legislation addresses several of the recommendations in the OLA report and takes additional steps to better address misclassification in Minnesota.

In addition to working on legislative changes, DLI is currently in the process of taking steps to improve its misclassification enforcement efforts. As noted in the report, DLI is currently shifting administration of the contractor registration system away from the Labor Standards Division, which will free up investigative resources (p. 46). DLI also intends to move the misclassification investigation work of the Construction Misclassification unit to its Wage and Hour unit (p. 52). DLI believes better aligning this work with the Wage and Hour unit, as opposed to a small stand-alone unit, will provide an opportunity to streamline the investigation of construction misclassification and violations related to misclassification, although legislative changes are necessary to fully streamline the enforcement process.

Recommendation: The Legislature should direct a state agency (or agencies) to calculate worker misclassification rates in Minnesota on an ongoing basis.

Response: DLI agrees with this recommendation. DLI agrees consistent tracking of misclassification can provide a useful tool in evaluating the effectiveness of efforts to address the problem and potentially aid in identifying areas that could benefit from strategic compliance efforts. DLI does not currently have the infrastructure to meaningfully track misclassification trends and would require additional resources to do so. The results of complaint-based and targeted strategic enforcement may not be well suited to provide conclusions about the scope of misclassification generally. Additionally, because many employers fail to classify workers at all by paying in cash "off the books," DLI believes agency efforts to calculate rates of misclassification will underestimate the true scope of the problem. DLI looks forward to working with partner agencies to assist in providing the best possible estimate of the extent of employee misclassification in Minnesota.

Recommendation: To the extent possible, the Legislature should enact common tests for determining worker classification and reduce the number of different classification tests currently in law.

Response: DLI partially agrees with this recommendation. The most effective step to clarify the law regarding employee status and aid in enforcement would be for the Legislature to add a presumption of employee status unless the alleged employer can demonstrate certain criteria are met. DLI recommends the Legislature consider adding such a presumption and a requirement that employers affirmatively demonstrate independent contractor status to all worker classification determinations in law.

Recommendation: If the Legislature would like agencies to take a more active role in addressing worker misclassification, the Legislature should direct agencies to do so in law.

Response: DLI partially agrees with this recommendation. DLI believes mere direction to be more active in addressing misclassification would accomplish little on its own. If the Minnesota Legislature desires more active and *effective* efforts to address worker misclassification it should also define specific actions or activities related to misclassification that are prohibited. To allow agencies to effectively enforce these prohibitions, the Legislature should remove any intent or knowledge requirements related to enforcement actions. These recommendations are incorporated into House File 4444/Senate File 4483.

Recommendation: The Legislature should consider establishing timeliness standards for worker misclassification investigations.

Response: DLI disagrees with this recommendation to the extent it would require agencies to adhere to specified timelines in investigations. Statutorily established investigation timelines will not address the root causes that lead to long investigations. DLI recommends the Legislature take actions that address these root causes. These efforts should focus on resources, streamlining enforcement authority, providing clarity in the law, strengthening enforcement tools and disincentivizing lack of cooperation with, or obstruction of, investigations.

Additional clarity in law and facilitating easier determination of worker status would likely provide the most assistance in aiding more expedient resolution of investigations. As mentioned above, a critical aspect of clarity in this respect is a presumption of employee status unless clear criteria can be established. Requiring employers to demonstrate these criteria are satisfied would also facilitate more timely resolution of investigations. DLI also recommends employers be subject to meaningful consequences for obstructing and failing to respond to or otherwise participate in investigations. These recommendations are reflected in House File 4444/Senate File 4483.

Importantly, imposing rigid timelines for misclassification investigations could undermine investigation and enforcement efforts. Strict deadlines would likely interfere with DLI's ability to make full use of its investigative authority, thoroughly examine misclassification in complex cases involving multiple employers and multi-layered contracting and wholistically address misclassification and related violations. This could disincentivize investigations into complex cases, which often involve the worst actors who pay off the books and fail to classify workers at all, and result in investigations that could have resulted in findings of violations being closed with no findings at all.

Recommendation: The Legislature should amend statutes to ensure that agencies are required to penalize employers that repeatedly misclassify workers.

Response: DLI partially agrees with this recommendation. DLI agrees that making penalties for repeated violators regardless of intent or knowledge is a good recommendation, as long as penalty authority is not limited to repeat violators. Limiting penalties to repeat violators will do little to incentivize proper classification of employees. This is especially true in industries where violators can easily shift work to a separate business entity when violations have been found. As noted in the report, the Legislature could consider better aligning DLI's penalty authority with the Department of Revenue's by removing any requirement that employers must have knowingly misclassified their employees before being subject to penalties. DLI recommends all penalty and enforcement authority, whether for first time or repeated violators, not be contingent on proving knowledge or intent.

To further address the limited consequences violators may face, DLI also recommends the Legislature: 1) strengthen available penalties for misclassification; 2) clarify the conduct that may result in penalties; and 3) impose successor liability for misclassification violations in appropriate circumstances. These recommendations are reflected in House File 4444/Senate File 4483.

Recommendation: The Legislature should amend statutes to allow civil action by misclassified workers in all industries.

Response: DLI partially agrees with this recommendation. DLI supports a private right of action for all misclassified workers. To ensure workers are compensated for the true costs of their misclassification, DLI recommends the Legislature should also provide explicit authority for broad compensatory damages available in both civil litigation and agency enforcement actions. Such remedial authority should include costs to employees resulting from failure to comply with legal requirements, such as payroll taxes and failure to provide the employee with benefits they provide to properly classified workers, such as health, retirement and vacation benefits. House File 4444/Senate File 4483 incorporates these recommendations and provides a civil action for all misclassified employees.

Recommendation: The Legislature should require state agencies to take a coordinated approach to addressing worker misclassification.

Response: DLI agrees with this recommendation. DLI believes improved coordination of efforts, resources and communication between agencies will better address worker misclassification. House File 4444/Senate File 4483 addresses improved coordination between agencies in several respects including, but not limited to, communication and data sharing to facilitate detection and investigation of misclassification, collaborative investigative efforts, interagency referrals, joint education and outreach efforts and the establishment of the Intergovernmental Misclassification Enforcement and Education Partnership.

Recommendation: The Department of Labor and Industry should propose to the Legislature updates to the construction worker classification requirements outlined in Minnesota Statutes 2023, 181.723.

Response: DLI agrees with this recommendation. DLI has worked with legislators and proposed updates to the misclassification requirements outlined in Minnesota Statutes, 2023, 181.723 in House File 4444/Senate File

4483. DLI's proposed changes are intended to shift the focus of the analysis from individual workers to the legitimacy of business entities and relationships. The proposal retains the presumption that workers are employees unless all criteria can be satisfied. The refined criteria are intended to be easier to interpret, making it easier for employers to determine proper classification status and demonstrate legitimate independent contractor status, in part through clear record-keeping requirements.

The refined criteria are also intended to better prevent violators from manipulating the factors to disguise misclassification through the appearance that the criteria are satisfied. Importantly, DLI's proposed changes not only better address if a worker is an employee, but also better define who the worker is employed by. Making this determination is critical to effectively enforcing the construction misclassification statute and, as noted in the report, can prove challenging in a multi-tiered contracting environment (p. 39-41).

Recommendation: The Legislature should either repeal or significantly overhaul the registration requirements under Minnesota Statutes 2023, 326B.8701 for individuals performing certain construction work.

Response: DLI partially agrees with this recommendation. The registration system should be overhauled. DLI recommends registration requirements be modified to better facilitate a determination of whether an applicant is a legitimate and independent business entity, as well as to require comprehensive disclosure of previous enforcement actions taken against an applicant. DLI does not believe the registration requirement should be eliminated. Registration is required for a contractor to perform certain construction work and as noted in the report, DLI believes the ability to act against a contractor's registration can provide a meaningful enforcement tool. DLI's recommendations are reflected in House File 4444/Senate file 4483.

Recommendation: The Department of Labor and Industry should adopt standards and implement a systematic process to monitor and ensure the timely completion of worker misclassification investigations.

Response: DLI partially agrees with this recommendation. DLI always strives to improve its enforcement efforts and capacity, including prompter resolution of complaints and investigations. To the extent DLI can more timely complete investigations through improved internal guidelines, methods and processes, DLI agrees with this recommendation. Recommendations incorporated into House File 4444/Senate File 4483 are aimed at facilitating these improvements, particularly with respect to streamlining investigations, and providing a statutory framework that sets DLI up to be successful in these efforts. As noted above, however, DLI does not believe any rigid timeliness requirements for completion of investigations will improve outcomes and may in fact have the opposite effect.

Recommendation: The Department of Labor and Industry should:

- **Establish standards for communicating with parties about its worker misclassification investigations.**
- **Consistently communicate with complainants and respondents about key investigation milestones.**

Response: DLI partially agrees with this recommendation. DLI acknowledges there is room for improvement in its communication with complainants, especially when it comes to notifying complainants that a case has been concluded. DLI notes its communications related to active investigations are constrained by data practice laws.

Recommendation: The Department of Labor and Industry should evaluate and report to the Legislature on the effectiveness of its efforts to address misclassification.

Response: DLI partially agrees with this recommendation. DLI believes all agencies involved in enforcing misclassification laws would benefit from evaluating their efforts and the Legislature should consider the effectiveness of all agencies and any enhanced partnership efforts. House File 4444/Senate File 4483 provides for the Intergovernmental Misclassification Enforcement and Education Partnership to annually report to relevant legislative committees.

Once again, we appreciate the opportunity to respond to these recommendations and the opportunity to work with your office and staff throughout this evaluation.

Sincerely,

Nicole Blissenbach
Commissioner

EMPLOYMENT AND ECONOMIC DEVELOPMENT

March 6, 2024

Judy Randall, Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St Paul MN 55155

Dear Ms. Randall,

On behalf of the Minnesota Department of Employment and Economic Development (DEED), I would like to offer my thanks to you and your team for their detailed work in completing this program evaluation. As one of the agencies included in the evaluation, we appreciate the professionalism of your staff as they completed their work, and their thoughtful efforts in delivering recommendations.

DEED's mission is to empower the growth of the Minnesota economy, for everyone. When workers are incorrectly classified as independent contractors instead of employees, they often face increased financial vulnerability and lack access to crucial workplace rights, contributing to economic inequality and compromising the overall well-being of the workforce. Additionally, misclassification can create an uneven playing field for businesses, as those who classify workers correctly may face unfair competition from those who exploit misclassification to reduce labor costs.

In sum, addressing misclassification is critical to helping DEED achieve its mission, and we appreciated your team's recommendations for improving education, prevention, detection, and correction of worker misclassification. We look forward to working with our agency partners and stakeholders across the state to ensure that Minnesota employers and workers have access to a level playing field, as well as the benefits and protections to which they are entitled under law.

Yours sincerely,

Matt Varilek
Commissioner
State of Minnesota
Department of Employment and Economic Development

Minnesota Department of Employment and Economic Development
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DEPARTMENT OF REVENUE

March 8, 2024

Judy Randall

Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Ms. Randall:

Thank you for the opportunity to review and comment on your evaluation in the report titled Worker Misclassification. We thank you and your team for the thorough and professional review of this subject, and the care with which this evaluation was undertaken.

We appreciate your identification of the challenges and the impacts of employee misclassification to our state as highlighted in your evaluation and agree with the value of coordinating this work to effectively administer worker classification laws.

In carrying out our mission to work together to fund the future for all of Minnesota, we proactively work to encourage compliance by educating taxpayers. In fact, although not required, we have previously established processes and relationships to improve understanding and compliance of worker classification. These include:

- For over ten years, the Department of Revenue has worked along with our peers at other state agencies to provide regular educational opportunities and outreach to employers, accountants, and payroll professionals, about a variety of topics for businesses, including withholding tax obligations and worker classification.
- On the Department of Revenue website, we publish a fact sheet dedicated to worker classification and have included links to IRS and state resources for more information.

In addition to the Department of Revenue's compliance work around worker misclassification, we also identify potential misclassification occurring with certain businesses and proactively send informational material and provide resources to address questions they may have regarding the proper classification of their workers.

We value the perspective and insight brought forward by this work and recognize the importance of this subject in achieving a fair and equitable revenue system. Moreover, we have taken this opportunity to continue to look for ways to improve and refine our processes.

Sincerely,

Paul Marquart
Commissioner

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