

The ABC's of Worker Classification in New Jersey

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One of the many issues that New Jersey businesses with workers face is whether individual workers are classified as employees or independent contractors. Independent contractors in New Jersey are not entitled to the same benefits as employees, such as minimum wage, overtime, paid leave, and unemployment benefits. Businesses have a financial incentive to classify individuals as independent contractors. While there are additional costs associated with employee benefits, there are no additional costs associated with independent contractors. In New Jersey, the ABC Test is used to decide if an individual is an employee or if they qualify as an independent contractor.

Under the ABC test, which is part of New Jersey Unemployment Compensation law, an individual worker is considered an employee unless **all three** parts of the test are met. In other words, a worker must meet all three parts of the test to be considered an independent contractor.

Part A requires that “such individual has and will continue to be free from control or direction over their performance of such service, both under his contract of service and in fact”. For example, an independent contractor may have a deadline, but is free to provide a substitute, set his own hours, bring helpers, and complete a job without supervision. An employee usually has a supervisor, must work scheduled hours, and must follow company codes for dress and behavior.

Part B requires that “such service is either outside the usual course of the business for which such service is performed, or that such service is performed outside all of the places of business of the enterprise for which service is performed”. For a service to be outside the usual course of business, it can't be part of a service the business provides. A plumber working for a plumbing contractor would not be considered an independent contractor, nor would a mechanic in a repair shop. For the service to be outside all places of business, it can't be on the business premises. A delivery driver might be considered a contractor in this case even if the business provides delivery services.

Part C requires that “such individual is customarily engaged in an independently established trade, occupation, or business”. The facts have to support this; it isn't enough to simply sign a contract that states that an individual is an independent contractor. An independent contractor would have to essentially prove that it can operate outside its relationship with the business and that it doesn't solely depend on the revenue from the business to survive. Factors include possession of a required license, a separate business location, specialized equipment, other customers, and advertising.

When a business is audited by the New Jersey Department of Labor & Workforce Development, payments to all of its individual service providers will be reviewed for up to a four year period. Auditors will send a questionnaire with questions like: What type of work was performed? Do you have any helpers? Do you provide your own tools and materials? They will ask for proof of advertising, separate business location, and also request a copy of the business tax return for proof of other customers.

An individual is considered an employee if the questionnaire is not returned. Most businesses find out too late that it isn't enough to sign an independent contractor agreement and issue a 1099 instead of a W-2. A business that fails this type of audit is not only liable for taxes plus penalties & interest, it can't recover taxes that would have been withheld if an individual was paid as an employee. It can also expect a repeat audit to make sure it stays compliant.

As a final note, the state government is focused on this area. It is in the process of increasing enforcement and is considering proposed legislation could make the ABC test more restrictive, apply it to other areas, and increase penalties. Business owners that use contractors should make sure they meet the ABC test to make sure they are compliant and avoid problems in the future. In my experience it is almost always better to address this type of issue beforehand than to be unprepared for an audit.