

NEW JERSEY SHARPENS FOCUS ON MISCLASSIFICATION ISSUES, INCHES CLOSER TO ADOPTING “ABC TEST” REGULATIONS: WHAT BUSINESSES NEED TO KNOW

Insights
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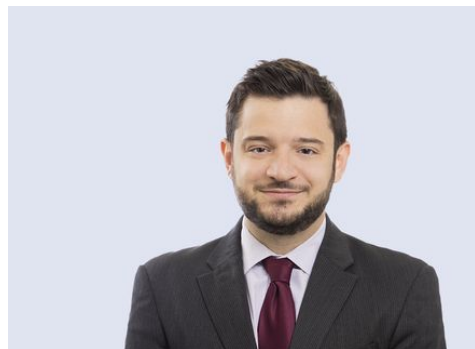
As independent contractor misclassification enforcement eases up at the federal level, New Jersey is doubling down on the state’s strict test for determining how a worker should be classified under various state laws. The New Jersey Department of Labor and Workforce Development (NJDOL) just took the first major step toward codifying how the agency interprets the “ABC test” and evaluates independent contractor relationships – a move that will not make it easier for New Jersey businesses to treat workers as contractors but will at least provide some much-needed guidance to help you stay compliant. Here’s everything you need to know and three steps you can take next.

Quick Background on New Jersey’s Independent Contractor Rules

For New Jersey business owners, properly classifying workers as employees or independent contractors has long presented legal and operational challenges. Here’s why:

- **New Jersey uses the stringent “ABC test”** for determining whether a worker can be classified as an independent contractor under various state laws, including the [Wage and Hour Law](#) (WHL) and the [Wage Payment Law](#) (WPL).
- **The WHL and WPL do not address the ABC test at all.** Rather, in 2015, the New Jersey Supreme Court established that the ABC test in the state’s [Unemployment](#)

Related People



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- **Until now, the NJDOL had not formalized any clear rules** on applying the ABC test, and the parameters for when an individual can be properly classified as an independent contractor have remained unclear. Instead, businesses had to rely mostly on a hodgepodge of case law and administrative decisions.
- **New Jersey’s legal standard differs from the tests used in federal wage and hour enforcement matters**, which are dizzying enough to follow due to the regulatory whiplash that’s come with each recent presidential administration. For example, [President Trump’s Labor Department just announced it would be relaxing its enforcement approach to worker classification issues](#). But that change applies only to USDOL enforcement of the federal Fair Labor Standards Act – New Jersey’s rules will continue to apply to state-level wage and hour claims.

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However, the NJDOL published a [notice of proposal for new rules](#) on May 5 in an effort to provide “clear, reliable guidance” regarding application of the ABC test. This is critically important, because misclassification can expose companies to significant liability — including unpaid wages, tax assessments, penalties, and aggressive audits by the NJDOL.

New Jersey’s ABC Test and the New Proposed Rules

Under the ABC test, a worker is considered an employee unless the hiring entity can prove that:

- The worker is free from control or direction;
- The work is outside the usual course of the company’s business or performed away from its business locations; **and**
- The worker is engaged in an independently established business.

While the test may seem clear, it can become murky in application. For example, what does it mean to be truly “free from control or direction,” what specific type of work is considered “outside the usual course” of business, and what exactly constitutes an “independently established business”?

The NJDOL's new proposed rules are intended to provide clarity by codifying the agency's interpretation of the ABC test, as well as the factors used to apply it in seminal court decisions. These proposed rules, if adopted, would mark a significant compliance and enforcement development for businesses that rely on freelancers or the "gig economy."

Determining Independent Contractor Status Under the Proposed Rules

The proposed rules lay out specific factors to be considered when evaluating each prong of the test, as well as scenarios that would or would not satisfy the test. By understanding how to apply the ABC test in line with the NJDOL's interpretation, you can reduce the risk of misclassifying an employee as an independent contractor. Consider the following:

Prong A: Freedom From Control

You would need to show that you do not exercise – or even reserve the right to exercise – control over the individual's work. The fact that you don't control *every* facet of an individual's responsibilities would not be enough to satisfy this prong. Here are some key factors to consider (*note that this list is non-exhaustive, and some factors might not always be relevant*):

- Does the individual set their own hours?
- Do you require the individual to use specific tools, supplies, or materials?
- Do you require the individual to wear a uniform or use a digital application or software that you primarily or unilaterally control?
- Do you require the individual to report on any aspect of their services at certain times or intervals?
- Must the services be rendered by this individual personally?
- Do you negotiate for and acquire the work performed by the individual?
- Do you fix the individual's rate of pay?

- Does the individual bear any risk of loss for the work they perform?
- Is the individual required to be on call, on standby, or otherwise available to perform services at set times you've determined?
- Do you limit the individual's performance of services for other parties?
- Do you provide training to the individual?

Example: A contractor required to wear a branded uniform, use company software, and report daily likely fails Prong A and is more likely an employee.

Prong B: Work is Outside the Usual Course or Place of Business

You would need to show that an individual's work is either:

- **Outside the usual course of business.** The "usual course of business" may include activities you regularly engage in to generate revenue or develop, produce, sell, market, provide goods or services (and you may have more than one usual course of business).
- **Performed entirely outside your places of business.** Your places of business may include locations where your enterprise has a "physical plant" (such as an office, store, or factory) or conducts an integral part of your business (such as customer sites if the services performed by the individual at such location are an essential component of, rather than ancillary to, your business).

Example: A restaurant hiring a musician for one night likely satisfies Prong B, but a drywall company hiring drywall installers does not.

Prong C: Independently Established Business

You must show that the contractor operates a viable independent business that can exist separately and survive the termination of the work relationship. Key factors:

- Does the worker have other clients?
- Do they advertise services or set their own rates?

- Do they invest in their own equipment or operate under a distinct business entity?

Example: A worker who merely forms an LLC or carries insurance because the employer required it likely fails Prong C.

The proposed rules make clear that the NJDOL plans look at the real substance of the relationship, not just the paperwork. Given the new clarity, proactive compliance is essential for businesses seeking to reduce risk.

3 Steps Businesses Can Take Now

With the NJDOL sharpening its focus on misclassification issues, business and leadership teams should consider taking these three steps:

1. **Conduct proactive audits** of current independent contractor relationships.
2. **Review internal policies, contracts, and practices** for compliance with the ABC test and the proposed rules.
3. **Consider submitting public comments**, particularly if the proposed rules raise operational concerns in your industry. The 60-day comment period began on May 5.

Conclusion

We will monitor these developments and provide updates as warranted, so make sure you are subscribed to [Fisher Phillips' Insight System](#) to get the most up-to-date information directly to your inbox. If you have questions about how New Jersey's proposed rules affect your business, or if you need help reviewing your independent contractor arrangements, reach out to your Fisher Phillips' attorney, the authors of this Insight, any member of our [Wage and Hour Practice Group](#), or any attorney in our [New Jersey office](#).