January 18, 2013

TO: Certifying Officers of Local Government and Local Education Employers participating in the Public Employees’ Retirement System or the Defined Contribution Retirement Program

FROM: Florence J. Sheppard, Acting Director, Division of Pensions and Benefits

SUBJECT: Professional Services Contracts and Review of PERS Enrollment

On July 17, 2012, the Office of the State Comptroller (OSC) released its report, Improper Participation by Professional Service Providers in the State Pension System. In the report the OSC cited continued instances of improper pension enrollment by local employers of individuals working under Professional Services Contracts.

Individuals who meet the definition of an “independent contractor” as set forth in regulation or policy of the federal Internal Revenue Service (IRS) for the purposes of the Internal Revenue Code are not considered to be “employees” and have never been eligible for membership in the Public Employees’ Retirement System (PERS) or the Defined Contribution Retirement Program (DCRP) as a result of the contracted services.

In 2007, the New Jersey Legislature passed Chapter 92, P.L. 2007, enacting significant reforms recommended in the Final Report of the Joint Legislative Committee on Pension and Health Benefit Reform. These reforms, specifically those codified at N.J.S.A. 43:15A-7.2 and 43:15C-2b(4) expressly provide that, effective January 1, 2008 and after, persons performing professional services 1) under a contract awarded pursuant to N.J.S.A. 40A:11-5, 18A:18A-5, or 18A:64A-25.5 (no bid contracts) and/or 2) under an independent contract as determined in accord with the rules and policy of the IRS, are ineligible for membership in the PERS based on that service, and correspondingly are ineligible for participation in the DCRP (pursuant to Section 20 of Chapter 92).

Professional services are defined in N.J.S.A. 40A:11-2(6) to be services performed by a person authorized by law to practice a recognized profession, whose practice is regulated by law, the performance of which requires knowledge of an advanced type in a field of learning acquired by a prolonged formal course of specialized instruction and also the performance of services that are original and create in character in a recognized field of artistic endeavor. Accordingly, attorneys, physicians, engineers, architects, accountants, auditors and other individuals providing "professional services" who perform services as a result of a Professional Services Contract with a public employer are ineligible for participation in the PERS or DCRP as a result of those services.

1 www.state.nj.us/comptroller/news/docs/pr_pensions.pdf
EMPLOYER REVIEW REQUIREMENTS

In its report the OSC indicates that many employing locations have apparently failed to implement Chapter 92 and remove ineligible individuals from the PERS or DCRP who are performing services under no bid Professional Services Contracts or who are performing professional services as independent contractors. Employing locations will now be required to review the employment status with regards to these professionals and take corrective actions regarding improper pension enrollment.

In reviewing the eligibility for membership of individuals performing professional services under no bid contracts, or as independent contractors, the employer must first review the pre-Chapter 92 service, i.e. the status of the individual prior to January 1, 2008, to determine whether the individual was an employee or an independent contractor in accord with IRS guidelines. If the enrollment was based solely upon work as an independent contractor in accordance with the Internal Revenue Code, these individuals were not employees and therefore were not eligible for membership in the PERS (or DCRP). In these cases, the pension service is subject to review of the facts by the Division of Pensions and Benefits to determine if the individual was in fact an employee or an independent contractor.

There are also no “grandfathering” provisions under N.J.S.A. 43:15A-7.2 to permit individuals who were already enrolled in the PERS, to remain PERS (or DCRP) members after January 1, 2008, if the enrollment was based solely upon work as a professional services provider. All individuals with Professional Services Contracts, or who met the definition of a professional services provider, were required to be removed from PERS or DCRP membership after January 1, 2008 (June 30, 2008 for fiscal year contracts).

In both of the situations described above, individuals found to have been improperly enrolled will be issued a return of pension contributions and any pension service based upon an ineligible position will be canceled by Division of Pensions and Benefits.

ENROLLMENT CERTIFICATIONS

The review and correction of these professionals’ status is of added importance under the requirements of Chapter 52, P.L. 2011 (N.J.S.A. 43:3C-15), insofar that law requires:

“the certifying officer and the officer's immediate supervisor to certify...
...annually for each member of the retirement system, that the person enrolled is eligible for enrollment in the pension fund or retirement system in accordance with the relevant law and the rules or regulations promulgated thereto”

and that:

“any person who knowingly makes a false statement, or falsifies or permits to be falsified any record, application, form, or report of a pension fund or retirement system, in an attempt to defraud the fund or system as a result of such act shall be guilty of a crime of the fourth degree.”

Beginning in early 2013, the Chapter 52 Annual Certification of Enrollments will be required of all employing locations. (Additional information about the Chapter 52 Annual Certification of Enrollments will be distributed when the certification application becomes available for use.) However, in advance of the Annual Certification, and in order to avoid potential penalties under Chapter 52 for the improper enrollment of professional services providers or independent contractors into the retirement system, Certifying Officers
should review the employee/independent contractor status of their staff and take immediate corrective action for any individuals who may be improperly enrolled.

On the recommendation of the OSC, the Division of Pensions and Benefits has developed the accompanying Employee/Independent Contractor Checklist form to certify the PERS eligibility of employees and exclude from enrollment ineligible professional service contractors and independent contractors. Certifying Officers should complete this checklist for each individual who has provided professional services and was reported as a member of the PERS or DCRP since January 1, 2008, regardless of whether the individual is still working at your location. Submit the completed forms to the Division of Pensions and Benefits no later than February 15, 2013.

In addition, upon completion of this form employing locations must take all appropriate action to remove ineligible individuals from PERS or DCRP membership, prior to completing the Chapter 52 Annual Certification of Enrollments.

To remove an ineligible individual from PERS enrollment:

- Stop reporting pension contributions for the individual on the quarterly Report of Contributions; and
- Immediately notify the Division of Pensions and Benefits, External Audit Unit in writing or by sending e-mail to pensions.nj@treas.state.nj.us with “External Audit” in the e-mail subject line. When writing, please identify your employing location, a contact name and phone number, the name of the independent contractor or professional service provider, the position held, and the original date of hire or appointment.

**ADDITIONAL INFORMATION**

For specific questions regarding the classification of employees or Independent Contractors, please refer to the information provided by the Internal Revenue Service at: [www.irs.gov](http://www.irs.gov) or seek the advice of an attorney.

A Certifying Officer Letter of August 2007 regarding Chapter 92, P.L. 2007, — including the ineligibility of Professional Services Contracts — can be found on the Division's Web site at: [www.state.nj.us/treasury/pensions/coltr07.shtml](http://www.state.nj.us/treasury/pensions/coltr07.shtml)


Employers with general questions about this letter, PERS enrollment, or the provisions of Chapter 92, P.L. 2007 or Chapter 52, P.L. 2011, can contact the Division of Pensions and Benefits, Employer Education unit at (609) 292-7524, or send e-mail to: pensions.nj@treas.state.nj.us

Enclosures

Fact Sheet #84, *Professional Services Contracts, Independent Contractors, and Pension Enrollment*

*Employee/Independent Contractor Checklist*
PROFESSIONAL SERVICES CONTRACTS, INDEPENDENT CONTRACTORS, AND PENSION ENROLLMENT

Public Employees’ Retirement System | Defined Contribution Retirement Program

Individuals are prohibited from membership in the Public Employees’ Retirement System (PERS) or the Defined Contribution Retirement Program (DCRP) if employed under a Professional Services Contract or if the individual meets the definition of an “independent contractor” as set forth in regulation or policy of the federal Internal Revenue Service (IRS) for the purposes of the Internal Revenue Code.

- Independent contractors are not considered to be “employees” and have never been eligible for membership in the PERS or DCRP as a result of the contracted services.
- N.J.S.A. 43:15A-7.2 and 43:15C-2b(4) expressly provide that, effective January 1, 2008 and after¹, persons performing professional services 1.) under a contract awarded pursuant to N.J.S.A. 40A:11-5, 18A:18A-5, or 18A:64A-25.5 (no bid contracts) and/or 2.) under an independent contract as determined in accord with the rules and policy of the IRS, are ineligible for membership in the PERS based on that service, and correspondingly are ineligible for participation in the DCRP.

Professional services are defined in N.J.S.A. 40A:11-2(6) to be services performed by a person authorized by law to practice a recognized profession, whose practice is regulated by law, the performance of which requires knowledge of an advanced type in a field of learning acquired by a prolonged formal course of specialized instruction and also the performance of services that are original and create in character in a recognized field of artistic endeavor. Accordingly, attorneys, physicians, engineers, architects, accountants, auditors and other individuals providing "professional services" who perform services as a result of a Professional Services Contract with a public employer are ineligible for participation in the PERS or DCRP as a result of those services.

In cases where evidence exists to indicate an individual may be improperly classified as an employee, the PERS or DCRP membership is subject to a review of the facts to determine if the individual was, or is, an employee or a professional services provider or independent contractor. Individuals who are found to have been improperly enrolled, will be issued a return of pension contributions and any pension service based upon an ineligible position as an independent contractor or professional services provider will be canceled by Division of Pensions and Benefits.

EMPLOYEE vs. SELF EMPLOYMENT

Whether an individual is an independent contractor or an employee is the threshold question in determining whether the individual is eligible for membership in the PERS or DCRP. While it is the employer's responsibility to correctly classify an individual's employer-employee relationship, the Division's experience indicates that individuals are frequently identified incorrectly as employees of the agency when they are, in fact, independent contractors (or vice versa).

The Division of Pensions and Benefits applies the tests and standards adopted by the IRS to determine the employer-employee relationship. Historically, this test has been known as the IRS 20 Factors, which have been

¹Contracts Prior to 2008 — A person deemed a bona fide employee retained under a Professional Services Contract established prior to January 1, 2008, who was enrolled in the PERS at that time, was permitted to continue to accrue PERS service credit during the term of the existing annual contract; however, the person was not eligible for PERS service credit for the performance of those services after the contract expired. This limitation on PERS service credit included any extension, modification, or other agreement to continue a Professional Services Contract beyond its original term. In addition, if the person does not meet the definition of a bona fide employee, enrollment will be disallowed regardless of the nature of such an arrangement.
reorganized into the three areas of inquiry which focus on whether the employer has the right to direct and con-
trol the individual as to the manner and means of job performance.

When applying the 20-Factor test, certain factors may weigh more heavily depending on the nature of the duties and position. Employers must make a determination of whether an individual is an employee or independent contractor to determine whether the individual is eligible to participate in the PERS or DCRP.

**Note:** The employer's responsibility to pay employment taxes alone is not the deciding factor in the determination of whether the individual is an employee or independent contractor for purposes of eligibility for enrollment in the retirement system. The IRS requires payment of tax for all positions covered by a Section 218 agreement, and most public employers participate in the Section 218 agreement between the State of New Jersey and the Social Security Administration (see *IRS Publication 963, Rev.11-2011*). The Division of Pensions and Benefits uses the 20-Factor test to assist in determining the employer-employee relationship and ultimately eligibility for members in a retirement system. The Division does not use this test to assist the employer with issues related to federal tax liability and the employer should not rely upon any determination by the Division with regard to the same.

**IRS 20-Factor Test**

Both the employer and the individual worker should give careful consideration to correctly classifying any individual as either an employee or as an independent contractor.

The IRS test to assess the employer-employee relationship includes the following factors:

**Behavioral Control** — This test determines whether the employer has a right to direct and control how the work is performed. At times, when work is satisfactorily performed, it may appear that the employer does not exercise much control. However, the question is whether the employer has the right to control the manner in which the services are performed. Relevant factors include: instructions, training and required procedures, government identification, nature of the occupation, and evaluation systems.

(1) Instructions – if the individual receives extensive instructions on how work is to be done, this suggests an employee relationship exists. Ask how, when, or where the person is asked to do the work; what and who owns the tools or equipment used; what assistants are hired to help with the work and where and by whom supplies and services are purchased. If one receives less extensive instructions about what should be done, but not how it should be done, the person may be an independent contractor. Each of these factors will vary dependent upon the actual position.

(2) Training – If the business provides training about required procedures and methods, this indicates that the business wants the work done in a certain way, and that suggests that the individual may be an employee.

**Financial Control** — This test considers whether the employer controls the business and financial aspects of the individual's services. The factors to be considered include the method of payment of salary, whether services are offered to the public, the corporate form of business, part-time or full-time status, the right to discharge or terminate services, the means of termination of the contract, provisions for non-performance, and the permanency of the relationship between the individual and employer. For example:

(1) If the individual has made a significant investment in a position, this may qualify as an independent contractor.

(2) If the individual is not reimbursed for some or all business expenses, then he or she may qualify as an independent contractor, especially if unreimbursed business expenses are high.

(3) If the individual can realize a profit or incur a loss, this suggests that the person is in business for themselves and may be an independent contractor.
Relationship to Parties – These are facts that illustrate how the business and the individual worker perceive their relationship. This examines the agreement between the individual and employer. For example:

(1) Does the individual receive benefits such as paid leave or insurance? This may indicate employee status.

(2) Written contracts – A written contract may show what both the individual and the employing location intend.

All facts and circumstances are considered. No one of these factors is controlling and the response to all factors is examined together.

There are several IRS documents that discuss how to evaluate individual circumstances that are available at: www.irs.gov

Employers can also use the Employee/Independent Contractor Checklist (see included form) to assist in making an initial determination on whether the individual is an employee for purposes of eligibility to enroll in the retirement system, and properly identify independent contractors and other individuals providing “professional services” who are ineligible.

**OTHER FACTORS IN DETERMINING ENROLLMENT ELIGIBILITY**

The rules and regulations governing enrollment in the retirement systems have changed significantly so it is important that employers know the proper enrollment procedures, and keep abreast of any future changes.

PERS eligibility and enrollment information — including newly established PERS Membership Tiers — is detailed in the PERS Member Handbook, on the Division of Pensions and Benefits Web site at: www.state.nj.us/treasury/pensions

Detailed employer training in enrollment is also provided by the Division under the provisions of Chapter 52, P.L. 2011.

**Chapter 52 Requirements and Training**

N.J.S.A. 43:3C-15 (enacted as Chapter 52, P.L. 2011) requires that all enrollments and/or transfers into a New Jersey State-administered retirement system must be certified by the employing location’s Certifying Officer and the immediate Supervisor of the Certifying Officer.

The law also requires the Certifying Officer and the immediate Supervisor of the Certifying Officer to annually certify, for each member of the retirement system, that the person enrolled is eligible for enrollment in the retirement system in accordance with the statutes and regulations of the retirement system.

Under N.J.S.A. 43:3C-15, the certification process also requires acknowledgement that any person who knowingly makes a false statement, or falsifies or permits to be falsified any record, application, form, or report of a pension fund or retirement system, in an attempt to defraud the fund or system will be guilty of a crime of the fourth degree.

Online training in retirement system enrollment is provided by the Division of Pensions and Benefits through the eLearning program designed by the State of New Jersey’s Human Resources Development Institute (HRDI). Additional information about Chapter 52 and enrollment training is available on the Division’s Web site at: www.state.nj.us/treasury/pensions/coltr11.shtml
EMPLOYEE/INDEPENDENT CONTRACTOR CHECKLIST

Use this form and checklist as a guide to determine the employer-employee relationship and properly classify Independent Contractors and other individuals providing “professional services.”

1. Employing Location: ____________________________ 2. PERS Location #: ____________________________

3. Name of Individual: __________________________________________________________________________

4. Social Security #: ____________________________ 5. PERS Membership #: ____________________________
   (if applicable)

6. Position Held: _______________________________________________________________________________

7. Hours Worked per Week: ___________________ 8. First Appointment Date: ____________________________
   mm / dd / yyyy mm / dd / yyyy

   mm / dd / yyyy mm / dd / yyyy

10. Is the individual working under a Professional Services Contract pursuant to the New Jersey statutes
    N.J.S.A. 40A:11-5, 18A:18A-5, or 18A:64A-25.5 (no bid contracts)? □ No □ Yes  (If “Yes”, this individual is not
    eligible for PERS or DCRP enrollment through this position.)

INSTRUCTIONS: Complete the Employee/Independent Contractor questions by answering “Yes” or “No” as indicated. Some facts may support an Employee relationship while other facts indicate Independent Contractor status. The final determination rests on the weight given to the factors as a whole, with the degree of importance of any particular factor dependent on the occupation and circumstances. In all cases, the Division of Pensions and Benefits may review the facts to determine if the individual is an Employee or an Independent Contractor and additional supporting documentation may be required from the location. Individuals who are found to have been improperly enrolled, will be issued a return of pension contributions and any pension service based upon an ineligible position will be canceled by Division of Pensions and Benefits. For more information see Fact Sheet #84, Professional Services Contracts, Independent Contractors, and Pension Enrollment.

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<tbody>
<tr>
<td>1. Does the location have the right to control, supervise or direct the individual performing the services, not only as to result but as to how assigned tasks are to be performed?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>2. Hiring. Was the individual appointed by an administrator (rather than appointed by the governing body) and is there a written job description?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>3. Was the individual hired based on the submission of a Request for Proposal?</td>
<td>☐ No</td>
<td>☐ Yes</td>
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<tr>
<td>4. Performed Personally. Is the individual permitted to provide substitute personnel in his or her absence?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>5. Is the individual required to personally attend Court sessions or meetings arranged by the location?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>6. Is the individual authorized to hire others at his own expense or that of a third party, to assist the individual in performing work for the location?</td>
<td>☐ No</td>
<td>☐ Yes</td>
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<tbody>
<tr>
<td>7. <strong>Hours.</strong> Does the individual work established and fixed hours structured by or with approval of the location?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>8. Does the location conduct performance evaluations for the individual?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>9. <strong>Instructions.</strong> Is the individual given instructions and directions on tasks to perform?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>10. <strong>Integration.</strong> Does the individual report to a certain person at the beginning of the work day or other regular basis or otherwise is required to account for attendance?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>11. Does the location maintain timekeeping records or a system of keeping time for the individual (other than via the submission of payment vouchers)?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>12. <strong>Premises.</strong> Is the individual's work mostly performed on the location's premises?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>13. <strong>Training.</strong> Does the location require the individual to be trained related to their position (e.g. sexual harassment, ethics, etc)?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>14. <strong>Tools and Equipment.</strong> Does the location provide the individual with permanent workspace and facilities (e.g. office space, tools, secretarial support, computer, etc. at the expense of the location)?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>15. <strong>Sequence.</strong> Does the location direct the order and sequence of the duties to be performed by the individual?</td>
<td>☐ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>16. <strong>Reports.</strong> Is the individual required to prepare regular reports?</td>
<td>☐ Yes</td>
<td>☐ No</td>
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**B. FINANCIAL CONTROL**

*This test considers whether the location controls the financial aspects of the individual’s services, the method of payment and whether services are offered to the public.*

| 1. **Payment.** Does the location pay for the performance of services through submission of a voucher? | ☐ No | ☐ Yes |
| 2. Is payment for services made on a regular interval, such as weekly or bi-weekly payroll? | ☐ Yes | ☐ No |
| 3. **Expenses.** Does the location reimburse for travel or business expenses? | ☐ Yes | ☐ No |
| 4. Are state and federal employee taxes and employee benefit deductions taken from the individual’s paycheck and are employer taxes paid? | ☐ Yes | ☐ No |
| 5. Does the individual receive fringe benefits that are provided to other employees of the location (such as vacation, health benefits, administrative leave, sick leave)? | ☐ Yes | ☐ No |
| 6. Has the compensation for the work been established by ordinance or resolution of the governing body establishing salaries for persons in similar positions? | ☐ Yes | ☐ No |
C. RELATIONSHIP TO THE PARTIES
These factors illustrate how the entity and individual perceive their relationship. Is there a continuing, ongoing relationship understood between the parties as one of employer and employee?

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</thead>
<tbody>
<tr>
<td>1. General Public/Other Employers. Is the individual also employed or associated with another entity that provides services to the location by contract, retainer, or other agreement?</td>
<td>☐ No</td>
<td>☑ Yes</td>
</tr>
<tr>
<td>2. Continuing Relationship. Are the parties in a continuing relationship that is ongoing (a specific conclusion date or term indicates there may not be a continuing employment relationship)?</td>
<td>☑ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>3. Is the individual covered by a contract negotiated between a union and location?</td>
<td>☑ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>4. Does the individual offer his services to the public at large (rather than exclusively to the location)?</td>
<td>☐ No</td>
<td>☑ Yes</td>
</tr>
<tr>
<td>5. Does the individual perform essentially the same services for other public employers?</td>
<td>☐ No</td>
<td>☑ Yes</td>
</tr>
<tr>
<td>6. Termination. Can the individual be terminated at the will of the location?</td>
<td>☑ Yes</td>
<td>☐ No</td>
</tr>
<tr>
<td>7. Discharge. Can the individual terminate the relationship at will?</td>
<td>☑ Yes</td>
<td>☐ No</td>
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Review the questions and responses and indicate a determination of the individual’s classification below.

EMPLOYING LOCATION’S DETERMINATION

I have reviewed the factors and have determined that this individual best meets the classification of:

☐ EMPLOYEE  ☑ INDEPENDENT CONTRACTOR

Name of Certifying Officer: ____________________________ Phone: ____________________________
Certifying Officer Signature: ____________________________ Date: ____________________________

Submit this completed and signed form to the External Audit Unit, Division of Pensions and Benefits, PO Box 295, Trenton, NJ 08625-0295.

- Employing locations must notify the Division of Pensions and Benefits immediately of any improperly enrolled individuals and take all appropriate action to remove ineligible individuals from PERS or DCRP membership.

To remove an ineligible individual:

- **Stop reporting pension contributions** for the individual on the quarterly Report of Contributions; and

- **Immediately notify the Division of Pensions and Benefits, External Audit Unit** in writing or by sending e-mail to pensions.nj@treas.state.nj.us with “External Audit” in the e-mail subject line. When writing, please identify your employing location, a contact name and phone number, the name of the independent contractor or professional service provider, the position held, and the original date of hire or appointment.

- The Division of Pensions and Benefits will also review the responses and classification of any individual regarding his/her eligibility for enrollment in the retirement system. Additional supporting documentation may be required.

- See Fact Sheet #84, Professional Services Contracts, Independent Contractors, and Pension Enrollment, for more information.