Testimony of
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National Employment Law Project

Hearing Before the
United States Congress
Senate Committee on Health, Education, Labor & Pensions

Leveling the Playing Field: Protecting Workers and Businesses affected by Misclassification

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Senator Harkin and members of the Committee: thank you for this opportunity to testify today on the important subject of independent contractor misclassification and its impacts on workers and their families, law abiding employers, and our economy.

My name is Cathy Ruckelshaus, and I am the Legal Co-Director of the National Employment Law Project (NELP), a non-profit organization that seeks to promote access to and retention of good jobs for workers. In the over twenty years I have spent working with and on behalf of workers around the country, I have been struck by the success some businesses have had in devising ways to evade responsibility for fair pay, health and safety, and other workplace standards. Calling employees independent contractors (“1099-ing” them, so-called because of the IRS Form 1099 issued to independent contractors), and the related tactic of paying workers off the books or in cash, is a top choice of these employers.

I and my colleagues at NELP have worked to ensure that all workers receive the basic workplace protections guaranteed in our nation’s labor and employment laws; this work has given us the opportunity to learn up close about job conditions in a wide variety of industries: garment, agricultural, construction and day labor, janitorial, retail, hospitality, home health care, trucking, poultry and meat-packing, high-tech, and other services. We have seen low, often sub-minimum wages, lack of health and safety protections and work benefits, and rampant discrimination and mistreatment of workers in these jobs.

An important part of our work focuses on simply enforcing the basic fair pay laws already on the books. Because unscrupulous employers use independent contractor schemes to flout these rules, we have worked with allies in state legislatures and agencies to tighten enforcement of core labor standards in those sectors where independent contractor abuses persist. This background in enforcement and state practices informs my testimony today.

Today, I will describe independent contractor misclassification and its impacts on workers, on state and federal government coffers, and on law-abiding employers. I will highlight the heightened activity on this important issue in the states, following the state studies showing staggering public losses due to the practice. I will conclude with comments on the introduced federal Employee Misclassification Protection Act (EMPA), and suggest some further ideas for policy reforms to contend with this unchecked and growing practice.
I. What is Independent Contractor Misclassification and How Common is It?

Employers legitimately contract every day with other independent businesses, typically to perform specialty jobs that the contractor performs for a variety of customers. These routine practices are not the subject of independent contractor misclassification reforms.

Yet, genuine independent contractors constitute a small proportion of the American workforce, because by definition, an “independent contractor” is in business for him- or herself.1 True independent contractors bring specialized skill, invest capital in their business, and perform a service that is not part of the receiving firm’s overall business. Examples are a plumber called in by an office manager to fix a leaky sink in the corporate bathroom, or a computer technician on a retainer with a manufacturing company to trouble-shoot software glitches.

But, with increasing frequency, employers misclassify employees as “independent contractors,” either by giving their employees an IRS Form 1099 instead of a Form W-2, or by paying the employee off-the-books and providing no tax forms or tax reporting and withholding. Many of these employers require workers to sign a contract stating that they are an independent contractor as a condition of getting a job. Here are some reasons why this independent contractor misclassification is on the rise:

- Firms argue they are off-the-hook for any rule protecting an “employee,” including the most basic rights to minimum wage and overtime premium pay, health and safety protections, job-protected family and medical leave, anti-discrimination laws, and the right to bargain collectively and join a union. Workers also lose out on safety-net benefits like unemployment insurance, workers compensation, and Social Security and Medicare.
- Misclassifying employers stand to save upwards of 30% of their payroll costs, including employer-side FICA and FUTA tax obligations, workers compensation and state taxes paid for “employees.”
- Businesses that 1099 and pay off-the-books can underbid competitors in labor-intensive sectors like construction and building services, and this creates an unfair marketplace.

The United States Government Accountability Office (GAO) concluded in its July 2006 report, “employers have economic incentives to misclassify employees as independent contractors because employers are not obligated to make certain financial expenditures for independent contractors that they make for employees, such as paying certain taxes (Social Security, Medicare, and unemployment taxes), providing workers’ compensation insurance, paying minimum wage and overtime wages, or including independent contractors in employee benefit plans.”

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1 See, Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification, GAO-06-656 (July 2006), at p. 43.
2 Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification, GAO-06-656 (July 2006), at p. 25.
Most workers in labor-intensive and low-paying jobs are not operating a business of their own. As the U.S. Department of Labor’s Commission on the Future of Worker-Management Relations (the “Dunlop Commission”) concluded, “[t]he law should confer independent contractor status only on those for whom it is appropriate—entrepreneurs who bear the risk of loss, serve multiple clients, hold themselves out to the public as an independent business, and so forth. The law should not provide incentives for misclassification of employees as independent contractors, which costs federal and state treasuries large sums in uncollected social security, unemployment, personal income, and other taxes.”

A. Misclassification is Found in Nearly Every Low-Wage Job Sector.

Calling employees “independent contractors” is a broad problem and affects a wide range of jobs. It could be happening to someone you know. A 2000 study commissioned by the US Department of Labor found that up to 30% of firms misclassify their employees as independent contractors. Many states have studied the problem and find high rates of misclassification, especially in construction, where as many as 4 in 10 construction workers were found to be misclassified.

Most government-commissioned studies do not capture the so-called “underground economy,” where workers are paid off-the-books, sometimes in cash. These workers are de facto misclassified independent contractors, because the employers do not withhold and report taxes or comply with other basic workplace rules. Many of these jobs are filled by immigrant and lower-wage workers.

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In my practice, I have met workers who were misclassified. Here are a couple of examples:

- Faty Ansoumana, an immigrant from Senegal, worked as a delivery worker at a Gristede’s grocery store in midtown Manhattan. He worked as many as seven days a week, 10-12 hours a day and his weekly salary averaged only $90. He and his fellow delivery workers, who had similar pay and hours, were all hired through two middlemen labor agents, who in turn stationed the workers at grocery and pharmacy chain stores throughout the City. The workers all reported directly to the stores and provided deliveries pursuant to the stores’ set delivery hours and under the stores’ supervision. Many delivery workers were required to bag groceries and to do other non-delivery work, including stocking shelves. When NELP challenged the abysmally low pay, the stores said the workers were not their employees, and the labor brokers said the deliverymen were independent contractors.7 We were able to recover $6 million for the over 1,000 workers in the lawsuit, but only after overcoming the stores’ claims that they were not responsible.

- Janitors from Central and South America and Korea were recruited by a large building services cleaning company, Coverall, Inc., to clean office buildings in MA and other states. The janitors were “sold” franchise agreements for tens of thousands of dollars, permitting them to clean certain offices assigned by Coverall. The janitors were told where to clean, what materials to use, and were not permitted to set their own prices for the cleaning services. When one janitor quit when she couldn’t make ends meet, she applied for unemployment benefits in MA and was told she was an “independent contractor” and not eligible. She challenged that decision and Massachusetts’ Supreme Judicial Court ruled in her favor. NELP wrote an amicus brief in Coverall and provided assistance.8

- Home health care workers in Pennsylvania were hired as employees by a home health care agency to place them in individual homes, where they cared for elderly and disabled people. The employees were not paid overtime or for their time spent traveling from household to household during their workdays, and they brought a lawsuit with NELP’s help to claim their unpaid wages. Several months after the lawsuit was filed, the home care agency told each of these employees that they had to sign an agreement calling them “independent contractors” if they wanted to keep their jobs. Nearly all of the workers did so to keep their jobs, even though none of the other aspects of their job conditions, pay, or assignment and direction changed, and none was running an independent business.9

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9 Lee’s Industries, Inc. and Lee’s Home Health Services, Inc. and Bernice Brown, Case No. 4-CA-36904 (Decision by National Labor Relations Board Division of Judges), 2/25/10.
Independent contractor misclassification occurs with an alarming frequency in:
construction,\textsuperscript{10} day labor,\textsuperscript{11} janitorial and building services,\textsuperscript{12} home health care,\textsuperscript{13} child
care,\textsuperscript{14} agriculture\textsuperscript{15}, poultry and meat processing,\textsuperscript{16} high-tech,\textsuperscript{17} delivery,\textsuperscript{18} trucking,\textsuperscript{19}
home-based work\textsuperscript{20}, and the public\textsuperscript{21} sectors. These are the sectors that should be
targeted by any enforcement efforts.

II. What is The Impact on Workers and Their Families?

Just because an employer calls a worker an “independent contractor” does not make it
legally true. But, these labels carry some punch and deter workers from claiming rights
under workplace laws that rely on individual complaints for enforcement.\textsuperscript{22} Because

\textsuperscript{10} Christian Livermore, \textit{State Fines Hospital Subcontractor in Pay Scheme}, Times
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\textsuperscript{11} Abel Valenzuela and Nik Theodore, \textit{On the Corner: Day Labor in the United States}
(January 2006).
\textsuperscript{13} \textit{See Bonnette v. Cal. Health & Welfare Agcy.}, 704 F.2d 1465 (9th Cir. 1983).
\textsuperscript{14} \textit{See, e.g.}, IL Executive Order conferring bargaining status on child day care workers
\textsuperscript{15} \textit{Sec’y of Labor v. Lauritzen}, 835 F.2d 1529 (7th Cir. 1988).
\textsuperscript{17} \textit{Vizzcaino v. Microsoft Corp.}, 97 F.3d 1187 (9th Cir. 1996).
\textsuperscript{20} \textit{Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification}, GAO-06-656 (July 2006), at p. 31.
\textsuperscript{21} Phillip Mattera, “Your Tax Dollars at Work… Offshore,” Good Jobs First (July 2004)
http://www.goodjobsfirst.org/publications/Offshoring_release.cfm
\textsuperscript{22} The vast majority of DOL’s Wage & Hour Division’s (WHD) enforcement actions are
triggered by worker complaints. \textit{See, e.g.} U.S. Gov’t. Accountability Office, GAO-08-962T, \textit{Better Use of Available Resources and Consistent Reporting Could Improve Compliance} 7 (July 15, 2008) (72 percent of WHD’s enforcement actions from 1997-2007 were initiated in response to complaints from workers); David Weil & Amanda
misclassified independent contractors face substantial barriers to protection under labor and employment rules, workers and their families suffer. The same occupations with high rates of independent contractor misclassification are among the jobs with the highest numbers of workplace violations. The result is our “growth-sector” jobs are not bringing people out of poverty and workers across the socio-economic spectrum are impacted.

Workers could lose out on: (1) minimum wage and overtime rules; (2) the right to a safe and healthy workplace and workers’ compensation coverage if injured on the job; (3) protections against sex harassment and discrimination; (4) unemployment insurance if they are separated from work and other “safety net” benefits; (5) any paid sick, vacation, health benefits or pensions provided to “employees;” (6) the right to organize a union and to bargain collectively for better working conditions, and (7) Social Security and Medicaid payments credited to employee’s accounts.

III. What is the Impact on Federal and State Government Receipts?

Federal and state governments suffer hefty loss of revenues due to independent contractor misclassification, in the form of unpaid and uncollectible income taxes, payroll taxes, and unemployment insurance and workers’ compensation premiums.

Federal losses.

A 1994 study by Coopers and Lybrand estimated the federal government would lose $3.3 billion in revenues in 1996 due to independent contractor misclassification, and $34.7 billion in the period from 1996 to 2004.24

A 2000 study commissioned by the US DOL found that between 10% and 30% of audited employers misclassified workers.25 Misclassification of this magnitude exacts an enormous toll: researchers found that misclassifying just one percent of workers as independent contractors would cost unemployment insurance (UI) trust funds $198 million annually.

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23 See, National Employment Law Project, Holding the Wage Floor, http://nelp.3cdn.net/95b39fc0a12a8d8a34_iwm6bbv2.pdf
A 2009 report by the Government Accountability Office (GAO) estimated independent contractor misclassification cost federal revenues $2.72 billion in 2006. The GAO’s estimate was derived from data reported by the IRS in 1984, finding that 15% of employers misclassified 3.4 million workers at a cost of $1.6 billion (in 1984 dollars).

According to a 2009 report by the Treasury Inspector General for Tax Administration, the IRS’s most recent estimates of the cost of misclassification are a $54 billion underreporting of employment tax, and losses of $15 billion in unpaid FICA taxes and UI taxes. The $15 billion estimate is based on 1984 data that has not been updated. The report explained, “Preliminary analysis of Fiscal Year 2006 operational and program data found that underreporting attributable to misclassified workers is likely to be markedly higher than the $1.6 billion estimate from 1984.”

State losses.

A growing number of states have been calling attention to independent contractor abuses by creating inter-agency task forces and committees to study the magnitude of the problem. Along with academic studies and other policy research, the reports document the prevalence of the problem and the attendant losses of millions of dollars to state workers’ compensation, unemployment insurance, and income tax revenues.

A review of the findings from the twenty state studies of independent contractor misclassification demonstrates the staggering scope of misclassification, the difficulties in reaching precise counts of workers affected and funds lost, and the potential for enforcement initiatives to return much-needed funds to state coffers.

- **States are losing hundreds of millions of dollars.** Audits conducted by California’s Employment Development Department between 2005 and 2007 recovered a total of $111,956,556 in payroll tax assessments, $18,537,894 in labor code citations, and $40,348,667 in assessments on employment tax fraud cases. Each year, Connecticut’s state income tax receipts were reduced by $65 million; the workers’ compensation system lost $57 million in unpaid premiums; and the

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28 Treasury Inspector General for Tax Administration, While Actions Have Been Taken to Address Worker Misclassification, and agency-Wide Employment Tax Program and Better Data Are Needed (February 4, 2009).


30 California Employment Development Department, Annual Report: Fraud Deterrence and Detection Activities, report to the California Legislature (June 2008).
unemployment insurance fund lost $17 million. In Illinois, a 2006 study estimated that independent contractor misclassification resulted in a loss of $39.2 million in unemployment insurance taxes, and between $124.7 million and $207.8 million in state income taxes each year from 2001 to 2005. From 1999 to 2002, 11% of all Maine employers and 14% of construction employers misclassified their workers, resulting in an annual average loss of $314,000 in unemployment compensation taxes, $6.5 million in workers compensation premiums, between $2.6 million and $4.3 million in state income taxes, and $10.3 million in FICA taxes from construction alone. A recent study of the Massachusetts construction industry found that misclassification of employees resulted in annual losses of up to $278 million in uncollected income taxes, unemployment insurance taxes, and worker’s compensation premiums. A recent analysis of workers’ compensation and unemployment compensation data in New York state found that noncompliance with payroll tax laws means as many as twenty per cent of workers’ compensation premiums—$500 million to $1 billion—go unpaid each year. A 2009 report by the Ohio Attorney General found that the state lost between $12 million and $100 million in unemployment compensation payments, between $60 million and $510 million in workers compensation premiums and

31 William T. Alpert, *Estimated 1992 Costs in Connecticut of the Misclassification of Employees*. Department of Economics, University of Connecticut (1992). The first annual report from the Joint Enforcement Commission on Worker Classification reported that the Labor Department reclassified 7,900 workers as employees, uncovered more than $53 million in wages and additional unemployment tax of $750,000, assessed over $2 million in additional tax, and collected $90,000 in civil penalties against violating employers. *State of Connecticut Joint Enforcement Commission on Worker Misclassification, Annual Report*, (February 2010).


35 *New York State Workers' Compensation: How Big Is the Coverage Shortfall?*, (New York: Fiscal Policy Institute, Jan. 2007). A 2007 study issued by the Cornell University School of Industrial and Labor Relations estimated annual misclassification rates of about 10.3% in the state’s private sector and approximately 14.9% in the construction industry. Average UI taxable wages underreported due to misclassification each year was $4,238,663, and UI tax underreported was $175,674,161. Linda H. Donahue, James Ryan Lamare, Fred B. Kotler, *The Cost of Worker Misclassification in New York State*. Cornell University School of Industrial Labor Relations (Feb. 2007).
between $21 million and $248 million in foregone state incomes tax revenues.\textsuperscript{36} Pennsylvania’s unemployment trust fund lost over $200 million, and its workers compensation fund lost $81 million in 2008.\textsuperscript{37}

- **Studies most likely underestimate the true scope of misclassification.** Many of the studies are based on unemployment insurance tax audits of employers registered with the state’s UI program. The audits seek to identify employers who misclassify workers, workers who are misclassified, and the resulting shortfall to the UI program. Researchers extrapolate from UI audit data to estimate the incidence of misclassification in the workforce and its impact on other social insurance programs and taxes. UI audits rarely identify employers who fail to report any worker payments to state authorities and workers paid completely off-the-books, where misclassification is generally understood to be even more prevalent.

- **Independent contractor misclassification rates are rising.** In California, for example, the number of unreported employees increased by an impressive 54% from 2005 to 2007. In Illinois, the rate of misclassification by violating employers increased by 21% from 2001 to 2005.\textsuperscript{38} A recent report by the Ohio Attorney General reported a 53.5% increase in the number of workers reclassified from 2008 to 2009.\textsuperscript{39} A study of misclassification in Massachusetts’s construction industry from 2001 to 2003 noted that both the prevalence of misclassification and the severity of the impact have worsened over the years.

### IV. EMPA and State Models for Federal Policy Reforms

#### A. States are taking the lead on reforms.

The problem is so pervasive that states have led the way in reforms:\textsuperscript{40}

\begin{itemize}
  \item Richard Cordray, Ohio Attorney General, Misclassification of Employees as Independent Contractors (May 11, 2010).
  \item Testimony of Patrick T. Beaty, Deputy Secretary for Unemployment Compensation Programs, Pennsylvania Department of Labor and Industry, before the House of Representatives Commonwealth of Pennsylvania, Labor Relations Committee on HB 2400, The Employee Misclassification Prevention Act (April 23, 2008).
  \item Richard Cordray, Ohio Attorney General, Misclassification of Employees as Independent Contractors (May 11, 2010).
  \item Each year, NELP summarizes the leading state legislative and executive independent contractor reforms. For the 2009 sessions, see, \textit{See}, NELP, \textit{Summary of Independent Contractor Reforms: New State Activity} (June 2009), and previous round-ups cited therein, available at: \url{http://www.nelp.org/page/-/Justice/SummaryIndependentContractorReformsJuly2009.pdf}
\end{itemize}
Many states create a presumption of employee status so that workers providing labor or services for a fee are presumed to be “employees” covered by labor and employment laws. This is already law in over ten states’ workers’ compensation acts, several states with recently-enacted construction industry-specific laws and in Massachusetts’ wage act.

Several states have created inter-agency task forces to share data and enforcement resources when targeting independent contractor abuses.

Others create “statutory employees” in certain industries (construction, trucking) where independent contractor schemes prevail. Similarly, states have created job-specific protective laws that target persistent abuses to encourage compliance, regardless of the label (independent contractor or employee) attached to the worker. At least five states have farm labor contracting laws (CA, FL, IA, OR and WA). Six states have laws that regulate day labor (AZ, FL, GA, IL, NM and TX).

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41 See definition of “worker” in the WA state workers’ compensation act as an example: http://apps.leg.wa.gov/RCW/default.aspx?cite=51.08.180. At least 10 states (AZ, CA, CO, CT, DE, HI, NH, ND, WI, WA) have a general presumption of employee status in their workers’ compensation acts (regardless of what job the injured worker has).

42 IL, MD, DE. See, e.g., Illinois HB 1795, creates a presumption of employee status in construction across several IL state labor and employment laws. An employer may overcome the presumption of employee status by showing an “ABC-Plus” test: (a) the individual is free from control or direction over performance of the work, both under the contract and in fact; (b) the service is outside the usual course of business for which the service is performed, and (c) the individual is customarily engaged in an independently established trade, occupation or business, or (d) the individual is deemed a legitimate sole proprietor or partnership. The law requires cooperation and data-sharing by the state departments of labor, employment security, revenue, and workers’ compensation.


45 Id.


Last year, state Attorneys General in at least three states (MT, NJ, and NY) announced that they intended to file lawsuits against FedEx Ground Package System, Inc., alleging that the delivery company misclassified more than 1,000 truck drivers in the three states.\(^{48}\)

B. The Employee Misclassification Prevention Act (EMPA).

The Employee Misclassification Prevention Act (EMPA) (S. 3254), introduced in the Senate by Senator Sherrod Brown this past April, would amend the FLSA to require employers to keep records of independent contractors engaged to work, provide notice to those workers of their status as an “employee” or “independent contractor,” would require the US DOL to create an “employee rights website,” and would impose a penalty for employer misclassification.\(^{49}\)

If enacted, the EMPA would be an important first step to encourage transparency in employment relationships. If workers know about their employment classification and the impacts of that status, they will be better prepared to report any violations. US DOL will be better equipped to determine whether there is compliance if the employers maintain the basic records of their contractors. These are records employers would likely keep in any event when dealing with outside vendors and contractors, including payments and the labor that was the basis for those payments, including, in some cases, hours worked on the job.

These minimal requirements would help in misclassification cases, when workers are denied basic wage and hour protections; they would also help law-abiding employers playing by the rules who are undercut by misclassifying firms, and provide the information needed to recover much-needed tax and payroll revenues lost when workers are mistreated as independent contractors.

A complementary bill, the Taxpayer Responsibility, Accountability and Consistency Act of 2009 (S. 2882) was introduced by Senator Kerry late last year.\(^{50}\) This bill would amend the Internal Revenue Code to modify the rules giving employers a “safe harbor” when they misclassify employees as independent contractors, and would permit the IRS to issue guidance on the subject. This bill is vital to serious reform seeking to combat independent contractor abuses.\(^{51}\)


50 http://www.govtrack.us/congress/billtext.xpd?bill=s111-2882

51 A major bar to effective enforcement against independent contractor abuses is the safe harbor provision in the Internal Revenue Code, at Section 530 of the Revenue Act of 1978, 26 U.S.C. § 7436. Currently, employers decide whether their workers are employees or independent contractors with little scrutiny from the IRS and no consequences. Under current law, an employer who is found by the IRS to have
Much progress can be made to combat independent contractor misclassification by beefing up enforcement of existing labor and employment laws in those sectors where independent contractor abuses are most prevalent, and enhancing the Department of Labor (DOL)’s enforcement tools. EMPA would assist this effort by creating transparency for workers and employers.

In addition, the Obama Administration’s budget for 2011 seeks $25 million for the DOL’s Misclassification Initiative to target misclassification with additional enforcement personnel and competitive grants to state unemployment insurance programs to address independent contractor abuse. The FY 2011 Budget includes a joint Labor-Treasury initiative to strengthen and coordinate Federal and state efforts to enforce statutory prohibitions, identify, and deter misclassification of employees as independent contractors.\(^5\) It should be supported.

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misclassified its workers can have all employment tax obligations waived. Section 530 also prevents the IRS from requiring the employer to reclassify the workers as employees in the future. Among other factors, a business can rely on its belief that a significant segment of the industry treated workers as independent contractors, thereby perpetuating industry-wide noncompliance with the law.