Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries

Misclassification of employees as independent contractors exacts an enormous toll on workers, law-abiding employers, and our economy. Accurate information on the prevalence of the problem, and on patterns of violations, can help government officials to direct their efforts at the worst violators and most problematic industries.

Introduction & Background

Employers in an increasing number of industries misclassify their employees as independent contractors, denying them the protection of workplace laws, robbing unemployment insurance and workers’ compensation funds of billions of much-needed dollars, and reducing federal, state and local tax withholding and revenues, while saving as much as 30% of payroll and related taxes otherwise paid for “employees.” If undetected, employees miss out on fair pay, health and safety, workers comp, unemployment insurance, and the right to collectively bargain for better jobs. Misclassification also hurts law-abiding employers who play by the rules but are under-bid by their competitors.

Misclassification can take several forms. Employers call employees “independent contractors,” even when the workers are not running their own businesses; they require employees to form a limited liability corporation or franchise company-of-one as a condition of getting a job; and they pay workers off the books, without any payroll treatment at all. These workers are sometimes required to sign boilerplate contracts attesting to independent contractor status, even where the functional relationships do not reflect true independence. These practices are also called “payroll fraud” because they are intentional and aimed at evading the law. Legitimate business-to-business transactions are not payroll fraud, because true independent contractors have a specialized skill, set their own terms, and have invested in a business that enables them to earn a profit.

Employee misclassification is a persistent problem in many of our economy’s growth industries, including home care, janitorial, trucking, construction, hospitality and restaurants and, more recently, in the rapidly-growing app-based “on-demand” economy. State-level task forces, commissions, and research teams are using agency
audits along with unemployment insurance and workers’ compensation data to
document the scope of independent contractor misclassification. Confirming the
findings of earlier national studies, these state reports show that 10 to 30% of
employers, or even more, misclassify their employees as “independent contractors,”
which indicates that several million workers nationally may be misclassified. State
and federal governments lose billions in revenues annually.

1. National studies and reports

Several government studies document the extent to which misclassification drains
federal revenues. The data is limited, however, and as noted in a 2017 U.S.
government Accountability Office (GAO) report, should be updated to give a more
accurate assessment of the current economic impact.¹

A 2015 GAO report on the contingent workforce, analyzing data from the 2005
Contingent Work Supplements to the Current Population Survey, reported that 7.4%
of the labor force is classified as independent contractors and 4.4% is classified as
self-employed.² The report noted that contingent workers (a category that also
includes temporary workers, staffing agency workers, on-call workers and day
laborers) have lower weekly and annual earnings than standard workers, are less
likely to have work-provided benefits, and are more likely to receive public
assistance.

A 2009 report by the GAO estimated that independent contractor misclassification
cost federal revenues $2.72 billion in 2006.³ 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). From 2000 to 2007, the
number of misclassified workers identified by state audits increased from
approximately 106,000 workers to over 150,000 workers per state. These counts
likely undercount the overall number of misclassified employees because states
generally audit less than 2% of employers each year. The Questionable Employment
Tax Practice initiative, a partnership between some states and the IRS, assessed
approximately $50 million in taxes between June 2009 and June 2012.⁴

A 2010 study by the Congressional Research Service estimated that a proposed
narrowing of the IRS’s “Safe Harbor” rules, which currently allow employers
significant leeway to treat workers as independent contractors for employment tax
purposes, would yield $8.71 billion for FYs 2012-21.⁵

A 2000 study commissioned by the U.S. Department of Labor (DOL) – the
“Planmatics” study – found that between 10% and 30% of audited employers
misclassified workers.⁶ Misclassification of this magnitude exacts an enormous
toll: researchers found that misclassifying just one percent of workers as independent
contractors annually results in a $198 million hit to unemployment insurance (UI)
trust funds. This report also shows that workers would benefit tremendously from
increased scrutiny; up to 95% of workers who claimed they were misclassified as
independent contractors were reclassified as employees following review.
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.\(^7\)

New federal data on the scope of misclassification may be on its way soon: the Department of Labor has engaged in a nationwide field survey of workers and employers that is slated to be published in spring 2018.\(^8\)

### 2. Findings from State Studies and Reports

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, and passing new legislation to combat misclassification. The USDOL has signed Memoranda of Understanding in over half of the states, some of which have created inter-agency task forces or commissions to work on the problem.\(^9\) 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.

The following chart summarizes the findings from over 20 state-level studies.\(^10\) The studies rely on a range of data and methods. Most studies rely on data from unemployment insurance and workers’ compensation audits, targeted or random; some draw on the records of multi-level government agencies; and a few used interviews with workers. Some studies examine the workforce as a whole, while others focus on industries where misclassification is rampant, such as construction.

### 3. Trends in the Findings From State Studies

The findings from these state studies demonstrate 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.

- **A large number of workers are misclassified.** Audits generally uncover numerous cases of misclassification at an individual workplace or employer, resulting in large numbers of workers who are reclassified as employees following review. For example, targeted audits conducted by the Ohio 1099 Task Force resulted in the reclassification of almost 47% of the workers interviewed.\(^11\) At just one company it audited, the Maryland Division of Labor & Industry’s Division of UI Fraud found 537 misclassified workers and a total of $2,257,596 in taxable unreported wages.\(^12\) In 2013, California’s Employment Development Department identified 102,479 workers who had not previously been reported by their employers.\(^13\) According to its latest Taskforce report, the Connecticut DOL identified close to 6,500 misclassified workers.\(^14\) The New York Task Force reported that it identified 26,000 misclassified workers in 2014, with a total of 140,000 since the task force’s start in August 2007.\(^15\) Studies that extrapolate from audit data put the actual numbers of misclassified workers at
much higher levels: an estimated 368,685 workers in Illinois;\textsuperscript{16} 4,792 in Maine;\textsuperscript{17} between 125,725 and 248,206 in Massachusetts;\textsuperscript{18} 704,785 in New York;\textsuperscript{19} between 54,000 and 459,000 in Ohio;\textsuperscript{20} 580,000 in Pennsylvania;\textsuperscript{21} and 214,000 in Virginia.\textsuperscript{22}

### Annual Losses Due to Independent Contractor Misclassification: Summary of Leading State Studies\textsuperscript{23}

* Indicates figures for the construction industry only.

<table>
<thead>
<tr>
<th>State</th>
<th>% Employers who misclassify</th>
<th>Loss to UI</th>
<th>Loss to Wkrs Comp</th>
<th>Unpaid state income taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>CA\textsuperscript{24}</td>
<td>2015: identified 96,039 unreported employees</td>
<td></td>
<td></td>
<td>$201 mil (collected) (2015)</td>
</tr>
<tr>
<td>CO\textsuperscript{25}</td>
<td>43.0% of audited employers (2010)</td>
<td>$755,359 in unpaid unemployment premiums and interest</td>
<td></td>
<td>$1.67 mil (lost in income tax revenues annually)</td>
</tr>
<tr>
<td>CT\textsuperscript{26}</td>
<td>42% of audited employers</td>
<td>$17 mil</td>
<td>$57 mil</td>
<td>$65 mil $611,600 (collected)</td>
</tr>
<tr>
<td>GA\textsuperscript{27}</td>
<td>Over 4,000 misclassified employees (2015)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IL\textsuperscript{28}</td>
<td>19.5% (2005) 2013: identified 20,000 misclassified workers</td>
<td>$53.7 mil (2005) $8.9 mil* $5.1 mil (unreported contributions that fund UI benefits) (2013)</td>
<td>$97.9 mil $23.2 mil*</td>
<td>$124.7 - $207.8 mil $14.8 mil* $250 mil in unreported taxable wages (2013)</td>
</tr>
<tr>
<td>IN\textsuperscript{29}</td>
<td>16.8%</td>
<td>$36.7 mil</td>
<td>$24.1 mil</td>
<td>$147.5 mil</td>
</tr>
<tr>
<td>IA\textsuperscript{30}</td>
<td>2016: identified 442 misclassified workers</td>
<td>$2.5 mil recovered $738,554 in unpaid contributions, penalties, and interest</td>
<td></td>
<td>$16,485,897 in unreported wages (2016)</td>
</tr>
<tr>
<td>LA\textsuperscript{31}</td>
<td>2015: identified 19,956 misclassified workers</td>
<td>2015: $1.5 mil in unreported and unpaid UI taxes</td>
<td></td>
<td>2015: $50 mil unreported taxable wages</td>
</tr>
<tr>
<td>ME\textsuperscript{32}</td>
<td>11% 14%* 2016: identified 257 employees</td>
<td>$314,000* 6.5 million*</td>
<td>$162,798.07</td>
<td>$2.6 - 4.3 mil* $2,456,919.17 (2016)</td>
</tr>
<tr>
<td>MA\textsuperscript{33}</td>
<td>12% 14%* 2015: identified 1,100 misclassified workers</td>
<td>$35 mil $3.9 mil* $15.7 mil (collected 2014)</td>
<td>$91 mil $7 mil* $1.1 (collected 2014)</td>
<td>$91 - 152 mil $6.9 mil* $856,000 (collected 2014)</td>
</tr>
<tr>
<td>MD\textsuperscript{34}</td>
<td>20-30% DOL study: 30% 2015: identified 8,346 misclassified workers in mandated audits; 1,648</td>
<td>$22 mil $3.5 mil (collected) $289,038 (unreported tax to Trust Fund)</td>
<td></td>
<td>$1.894 mil (assessed 2014) $4.17 million in unreported taxable wages</td>
</tr>
<tr>
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<td>% Employers who misclassify</td>
<td>Loss to UI</td>
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</tr>
<tr>
<td>MI</td>
<td>30%</td>
<td>$17 mil</td>
<td>No longer updated</td>
<td>$20-33 mil</td>
</tr>
<tr>
<td>MN</td>
<td>14%</td>
<td>No longer updated</td>
<td>No longer updated</td>
<td></td>
</tr>
<tr>
<td>MO</td>
<td>7,517 misclassified employees at 1,118 employers identified in 2014</td>
<td>$1.4 mil (owed)</td>
<td>$2.1 mil taxes due in 2016</td>
<td></td>
</tr>
<tr>
<td>NE</td>
<td>10%</td>
<td>$124,000 (collected 2012)</td>
<td>$19,000 (collected 2012)</td>
<td></td>
</tr>
<tr>
<td>NH</td>
<td>23% of employers audited</td>
<td>$677,000</td>
<td>Taxes on $37.76 million in wages</td>
<td></td>
</tr>
<tr>
<td>NV</td>
<td>31,000 misclassified employees</td>
<td>$8.2 mil</td>
<td></td>
<td></td>
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<tr>
<td>NJ</td>
<td>38-42% of audited cases</td>
<td>$15 mil (UI and disability)</td>
<td>$5 mil</td>
<td></td>
</tr>
<tr>
<td>NY</td>
<td>10.3% *</td>
<td>$198 mil annually</td>
<td>$170 mil</td>
<td></td>
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<tr>
<td></td>
<td>26,000 (identified by JETF in 2014)</td>
<td>$13 mil (IDed by NY DOL audits)</td>
<td>Taxes on $316 mil of wages (2014)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>140,000 misclassified employees identified since August 2007</td>
<td>$8.8 mil assessed in 2014</td>
<td>$1.1mil (incl. penalties)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$198 mil annually</td>
<td>$13 mil (IDed by NY DOL audits)</td>
<td>$640,000 (collected 2011)</td>
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<td>NY</td>
<td>10.3% *</td>
<td>$198 mil annually</td>
<td>$170 mil</td>
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<td>--------------------------</td>
</tr>
<tr>
<td>OH</td>
<td>45%</td>
<td>$12 - $100 mil</td>
<td>$60-510 mil</td>
<td>$21-$248 mil</td>
</tr>
<tr>
<td>State</td>
<td>Misclassification Rate</td>
<td>Identified Workers</td>
<td>Costs</td>
<td></td>
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<td>------------------------</td>
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</tr>
<tr>
<td>PA</td>
<td>25%</td>
<td>29,327</td>
<td>$200 mil, $4.3 mil (recovered), $10.4 mil (recovered)</td>
<td></td>
</tr>
<tr>
<td>RI</td>
<td>2016: 590 Rhode Island employees improperly classified</td>
<td>$200,988 assessed in additional taxes (2016)</td>
<td>$415K collected, $290K collected</td>
<td></td>
</tr>
<tr>
<td>TN</td>
<td>37%</td>
<td>1,930</td>
<td>$8.4 - $15 mil, $52 - 91.6 mil</td>
<td></td>
</tr>
<tr>
<td>Austin, TX</td>
<td>Texas between 2010-2012: identified 34,846 misclassified workers</td>
<td>$2,398,737 additional tax due</td>
<td>$8,618,869 (state and federal combined), $229,086,702 in misclassified worker wages</td>
<td></td>
</tr>
<tr>
<td>UT</td>
<td>25,063 misclassified employees over 54 months (identified by the UI Div. of the Dept. of Workforce Sves) 2016: identified 6,873 misclassified workers</td>
<td>2016: $741,135 collected</td>
<td>$18,198 mil in unreported wages over 54 months, $54.8 mil in unreported wages in 2016</td>
<td></td>
</tr>
<tr>
<td>VT</td>
<td>10-14%</td>
<td>1,066</td>
<td>2015: $230,000 in employer contributions, 2015: $10,307.91 collected</td>
<td></td>
</tr>
<tr>
<td>VA</td>
<td>27% of audited cases 30%*</td>
<td>2016: 12,300 unreported or misclassified workers identified through audits</td>
<td>$2.51 mil (collected), 2016: $37,880 (collected), $25.4 mil</td>
<td></td>
</tr>
<tr>
<td>WA</td>
<td>62% of audited cases 54</td>
<td>2016: $384,900 assessed</td>
<td>$29.7 mil (collected), 2016: More than $2,630,288.97 in unreported wages.</td>
<td></td>
</tr>
<tr>
<td>WI</td>
<td>44% of audited employers</td>
<td>2016: identified 997 workers misclassified</td>
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</tbody>
</table>

- **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. These UI audits miss a large portion of the misclassified workforce, however, because they rarely identify employers who fail to report any worker payments to state authorities or workers paid completely off-the-books – the “underground economy” – where misclassification is generally understood to be even more prevalent.
• **Billions of dollars of payroll are never reported to state governments.** As explained above, many employers underreport their payroll, or pay workers off-the-books and do not report any wages. In California and New York alone, employers fail to report billions of dollars to state agencies each year. Reliance on random audits as the sole investigatory strategy may result in an undercount of violations and unpaid taxes.

• **Misclassification also results in lost income tax revenue to local governments.** Municipal governments supported by payroll taxes are also hit hard by misclassification. This includes some of the nation’s largest and most important economic centers.

• **Misclassification rates are disproportionately high in certain industries, such as construction, real estate, home care, trucking, janitorial, hi-tech and the rapidly growing app-based economy.** Many misclassification studies focus on construction because the industry has been so plagued by independent contractor abuses. The Maine, Massachusetts, Minnesota and New York studies found rates of misclassification up to several points higher in construction as compared with the workforce as a whole. Delivery drivers and truckers have also experienced widespread abuse. FedEx has faced repeated legal challenges over its practice of misclassifying drivers as independent contractors: the delivery company recently settled a California lawsuit for $228 million; drivers in about 40 states have now sued FedEx; and sixteen states have negotiated with the company to end its practice of misclassifying drivers as independent contractors. An estimated two thirds of port truck drivers are misclassified. App-based, on-demand companies Lyft, Uber, Handy and many others treat their workers as independent contractors and are facing lawsuits by workers challenging this practice.

• **Misclassified workers make significantly less than workers paid as employees.** One government expert calculated that a construction worker earning $31,200 a year before taxes would be left with an annual net compensation of $10,660.80 if paid as an independent contractor, compared to $21,885.20 if paid properly as an employee. A study on port truck drivers found that annual median net earnings before taxes were $28,783 for drivers paid as contractors as compared with $35,000 for employees.

• **Targeted audits are cost-effective and have the potential of returning hundreds of millions of dollars to state coffers.** Audits conducted by California’s Employment Development Department between 2011 and 2013, for example, recovered roughly $105 million in payroll tax assessments. In 2014, the New York Joint Enforcement Task Force assessed nearly $8.8 million in unemployment insurance contributions. The Washington State Labor & Industry Fraud Prevention and Compliance Program (focused on workers’ compensation) reported that it brought in over $7 for every dollar.
invested in enforcement efforts. These numbers do not take into account fraud that is deterred before a violation even takes place, when employers take note of aggressive enforcement activities and voluntarily come into compliance.

**Conclusion**

Misclassification of employees as independent contractors exacts an enormous toll on workers, law-abiding employers, and our economy. Accurate information on the prevalence of the problem, and on patterns of violations, can help state officials to direct their efforts at the worst violators and most problematic industries. The growing body of research summarized here has been vital to recent efforts in the states to combat misclassification; new research will further facilitate enforcement.

**Endnotes**

1. U.S. Government Accountability Office, *Employment Taxes: Timely Use of National Research Program Results Would Help IRS Improve Compliance and Tax Gap Estimates*, GAO-17-371 (April 2017), available at [http://www.gao.gov/assets/690/684446.pdf](http://www.gao.gov/assets/690/684446.pdf). The report recommends that the IRS analyze the results of the National Research Program study on employment tax returns filed from tax years 2008 to 2010. Following the study, the IRS has failed to analyze the results. The GAO report notes that the study was the first the IRS had done on employment taxes in over 30 years. The report states that “[w]ithout completed analysis of the NRP employment tax results, IRS risks using outdated data to make decisions about compliance and areas of the tax gap to pursue.” The GAO report reviewed the NRP data and notes that independent contractor misclassification (“worker classification issues”) is among the issues most frequently requiring adjustment.


5. A 2010 study by the Congressional Research Service built on earlier national studies to compare the costs and benefits of improved classification if President Obama’s proposed modification of Section 530 of the Revenue Act of 1978 were passed. The modification would


8 DOL's study was to gather information about workers' employment classification and pay arrangements and measure workers' knowledge about their current job classification, and their knowledge about the rights and benefits associated with their job status. Proposed Information Collection Request (ICR) for the Worker Classification Survey; Comment Request, Fed. Reg. 78, 2247 (Jan 11, 2013) http://www.gpo.gov/fdsys/pkg/FR-2013-01-11/pdf/2013-00389.pdf. The project was slated to be published in spring 2018. See https://blog.dol.gov/2016/06/17/the-future-of-work-diving-into-the-data.


10 See also, Françoise Carré, *(In)dependent Contractor Misclassification*, Economic Policy Institute Briefing Paper #403 (June 8, 2015), available at http://www.epi.org/publication/independent-contractor-misclassification/ (summarizing findings from federal and state studies, academic report, litigation and other enforcement activity).


14 See *State of Connecticut Joint Enforcement Commission on Worker Misclassification, Annual Report* (December 2011), note 10, supra.


23 Some states have created task forces but have not conducted a quantitative study, demonstrating the difficulty in compiling data on misclassification. For example, New Hampshire established the Joint Agency Task Force on Employee Misclassification Enforcement in September of 2010 and published its first report in September of 2011, but the report did not contain state-specific data on the incidence or cost of independent contractor misclassification. Joint Agency Task Force on Employee Misclassification Enforcement, First Report of the Joint Agency Task Force on Employee Misclassification Enforcement (September 1, 2011), available at http://www.nh.gov/nhworkers/documents/1stReportofthejaeme.pdf.


24 In 2013, California’s Employment Development Department’s (EDD) Tax Audit Program conducted 6,749 audits and investigations, resulting in assessments totaling $155,808,394, and identified 102,479 unreported employees. The Compliance Development Operations (CDO) within the EDD Tax Branch, which includes several programs that concentrate on the underground economy, conducted 1,876 joint inspections, which led to 919 payroll tax audits. These audits identified 18,024 previously unreported employees, assessed over $35 million in payroll tax assessments and nearly $4 million on fraud cases.


In 2015, California’s EDD Tax Audit Program conducted 7,209 audits and investigations, resulting in assessments totaling $201,620,977, and identified 96,039 unreported employees. The CDO conducted 1,488 joint inspections, which led to 1,248 payroll tax audits. These audits identified 22,352 previously unreported employees, assessed over $45 million in payroll tax assessments and $7.8 million on fraud cases.


25 The US DOL reported that 33.9% of audited employers in Colorado misclassified employees as independent contractors; 41,915 employers in the state had misclassified new workers as independent contractors; 8.5% of workers at audited employers were found to have been misclassified; 172,609 workers statewide misclassified; total taxable wages underreported statewide for new workers misclassified as independent contractors: $36,291,042; tax underreported statewide for new workers misclassified as ICs: $6,429,685; average UI tax rate: 17.7%; percent of state UI taxes underreported due to workers misclassified as ICs: 3.6%. See Planmatics report, note 5, supra.

Between July 1, 2009 and December 31, 2010, the Unemployment Insurance Audit unit conducted 2,162 audits, which included 406 targeted audits and 1,725 random audits. About
7,557 workers were misclassified, which amounted to 14.2% of workers being misclassified. Moreover, 930 employers misclassified, constituting 43% of audited employers. As a result, the state lost $167 million in income tax revenues and $744,359 in unemployment contributions.


26 A 1992 study estimated that the state and the federal governments were losing $500 million annually as a result of worker misclassification. Each year, state income tax receipts were reduced by $65 million; the workers’ compensation system lost $57 million in unpaid premiums; and the unemployment insurance fund lost $17 million. William T. Alpert, Estimated 1992 Costs in Connecticut of the Misclassification of Employees, Department of Economics, University of Connecticut (1992). The 2011 annual report from the Joint Enforcement Commission on Worker Classification reported that from March 1, 2010 through February 28, 2011 the Tax Division’s Field Audit Unit completed approximately 1,600 audits and another 9,000 individual wage complaint investigations. Those investigations resulted in the reclassification of approximately 6,500 workers and the discovery of roughly $50 million in previously unreported or underreported payroll. During the same period, the Department of Revenue Services conducted audits that resulted in the assessment of $611,568 in additional taxes, penalties and interest. The Department of Revenue Services assessed an additional almost $611,600 in unpaid taxes, penalties and interest. State of Connecticut Joint Enforcement Commission on Worker Misclassification, Annual Report, Prepared for the Honorable Dannel Malloy, Governor and the Labor and Public Employees Committee of the General Assembly (December 2011), available at http://www.ctdol.state.ct.us/wgwkstnd/IEC/IEC.pdf. Figures on incidence of misclassification among audited workers from Planmatics report, note 5, supra.


28 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 incomes taxes each year from 2001 to 2005. Close to 18% of audited employers, about 56,650, misclassified employees as independent contractors. The study estimated that an average 368,685 employees were misclassified each year. The rate of misclassification by violating employers increased 21% from 2001 to 2005. Michael P. Kelsay, et al., The Economic Costs of Employee Misclassification in the State of Illinois, Department of Economics, University of Missouri-Kansas City (2006), available at http://www.carpenters.org/EmployerPayrollFraud/studies_reports.aspx. Other reports for which there no URL is listed can be found on the United Brotherhood of Carpenters website. In 2013, Illinois audited 3,635 employers and identified that Illinois employers wrongly classified nearly 20,000 workers as independent contractors rather than full-time employees, which resulted in over $250 million in unreported taxable wages and $5.1 million in unreported contributions that fund unemployment insurance benefits. Misclassified Employees Force Taxpayers to Subsidize Costs, Harm Economy, Illinois Department of Employment Security (Aug. 11, 2014), available at http://www.ides.illinois.gov/SitePages/NewsArticleDisplay.aspx?NewsID=227.

29 According to a 2010 report, 47.5% of Indiana employers audited by the state in 2007-2008 – approximately 73,629 employers – were found to have misclassified workers as independent contractors; 8,200 of those employers were in the construction industry. The number of Indiana employees affected by improper misclassification is estimated to have averaged 418,086 annually for the period 2007-2008, about 16.8% of employees overall. In each year from 2007-2008, the state lost $147.5 million in state income tax revenue and

30 The Iowa Misclassification Task Force’s 2nd Report noted that 230 employers were found to have flouted the law by misclassifying workers, creating a competitive advantage over some 72,000 law-abiding employers. Through audits and missing wage investigations completed by Unemployment Insurance Tax Bureau field auditors from July 1, 2009 through December 30, 2010, 134 employers were found to have misclassified a total of 544 workers. These employers failed to report $5,692,181 in employee wages to IWD for unemployment insurance tax purposes and owed a total of $130,511 in unpaid unemployment insurance taxes, penalty and interest. *Iowa Misclassification Task Force 2nd Report*, Iowa Workforce Development (December 30, 2010), available at http://www.iowaworkforce.org/misclassification/MisClass2010Report.pdf.


In FY 2016, the Misclassification unit found that 44 employers misclassified 442 workers. These employers failed to report $16,485,897 in wages for UI tax purposes, resulting in assessments of $738,554 in unpaid UI taxes, penalties and interest. *2016 Annual Report*, Iowa Workforce Development (2016), available at https://www.iowaworkforcedevelopment.gov/sites/search.iowaworkforcedevelopment.go

31 In 2015, the Louisiana Workforce Commission audited 1,068 employers and discovered 19,956 misclassified workers. This resulted in $50 million in unreported taxable wages and approximately $1.5 million in unreported and unpaid unemployment insurance taxes. Louisiana Workforce Commission, *LWC sets another record in identifying misclassified workers*, DEPT OF LABOR, Feb. 4, 2016, http://www.laworks.net/PublicRelations/PR_PressReleaseDetails.asp?SeqNo=1927&Year=2016&Month=2


In 2016, the Office of Monitoring, Audit and Enforcement (MAE) completed 20 employee misclassification audits. The audits covered 257 employees, $1,249,032.73 in payroll, $1,988,864.28 in subcontractor wages shown on 1099’s, and $10,911.86 in “casual labor” wages that resulted in $2,456,919.17 in potentially misclassified wages, which may result in $162,798.07 in unpaid workers’ compensation premiums. *Annual Report on the Status of the Maine Workers’ Compensation System*, Workers’ Compensation Board (Feb. 15, 2017), available at http://www.maine.gov/wcb/Departments/administration/2017_TROIKA.pdf.

33 A study of misclassification in the state’s construction industry from 2001-2003 found that at least 14% of Massachusetts construction employers and 13% of all Massachusetts employers misclassified workers. Less conservative methods suggest that construction misclassification could run higher and range up to one in four (24%) of Massachusetts
construction employers. An estimated 7,478 to 15,790 of construction employees were misclassified. In the workforce as a whole, an estimated 125,725 to 248,206 workers were misclassified. The state lost an estimated $91 million to $152 million in income tax revenue and up to $91 million of worker compensation premiums. The study noted that both the prevalence of misclassification and the severity of the impact have worsened over the years. Françoise Carré and Randall Wilson, The Social and Economic Costs of Employee Misclassification in the Construction Industry, Construction Policy Research Center, Labor and Worklife Program, Harvard Law School and Harvard School of Public Health (2004), available at http://www.law.harvard.edu/programs/lwp/Misclassification%20Report%20Mass.pdf. In 2014, Massachusetts' Joint Task Force on the Underground Economy and Employee Misclassification recovered over $20 million through its enforcement efforts: the Department of Unemployment Assistance (DUA) recovered over $15 million in unpaid employer contributions to the UI Trust Fund and Fair Share Contribution; the Department of Revenue recovered $826,000 in unpaid taxes; and the Attorney General's Office brought in $2,314,000 in restitution, penalties, and fines related to violations of the state’s wage and hour and independent contractor laws. The Department of Industrial Accidents (DIA) collected $1.1 million for unpaid workers' compensation taxes. Massachusetts Department of Labor, Joint Task Force on the Underground Economy and Employee Misclassification 2014 Annual Report (2015), available at http://www.mass.gov/lwd/eolwd/cue/jtf-annual-report-2014.pdf.


In 2008, then Secretary of Maryland’s Department of Labor, Licensing and Regulation Thomas E. Perez reported that audits conducted by the agency’s Unemployment Insurance Division found an average of 20% of employers misclassify workers. The Division’s report estimated that misclassification accounts for an annual loss of between $15 million and $25 million to the Unemployment Trust Fund. The Secretary noted that the estimate is likely conservative because audits are random, do not target industries where misclassification is most prevalent, and do not capture the underground economy. Testimony of Thomas E. Perez, Secretary of the Department of Labor, Licensing and Regulation, on HB 1590, before the House Economic Matters Committee (March 20, 2008), available at http://www.dllr.state.md.us/whatsnews/testimonymisclass.shtml. In 2009 Maryland passed the Workplace Fraud Act of 2009 and created the Joint Enforcement Task Force on Workplace Fraud. The Task Force established work-groups on enforcement and education and began coordinating unemployment insurance tax investigations, identifying 8,474 misclassified workers and approximately $50.9 million in unreported wages paid to employees. David W. Stevens, An Estimate of Maryland’s Annual Net Unemployment Compensation Tax Loss from Misclassification of Covered Employees, Baltimore, MD (February 1, 2009). The Taskforce’s 2014 report reported the following activities and accomplishments: from January 1, 2014 to November, 2014, the Workplace Fraud Unit issued 238 citations involving 681 workers and collected $89,000 in penalties and $35,000 in fines; in 2014, the UI Division identified 6,589 misclassified workers and $27 million in taxable unreported wages through US DOL mandated audits and identified 1,403 misclassified workers and $6 million in unpaid taxable wages, and returned $257,000 to the UI Trust Fund through Workplace Fraud audits; and the Comptroller’s Office conducted 34 withholding tax audits and issued assessments in the amount of $1.894 million. Annual Report of the Joint Enforcement Task Force on Workplace Fraud (December 2014), available at http://www.dllr.maryland.gov/workplacefraudtaskforce/wpftfanrep2014.pdf. In 2015, the Task Force reported the following activities and accomplishments: the Workplace Fraud Unit issued 145 citations involving 229 workers and collected $126,216 in
penalties and $18,813 in fines; the UI Division identified 8,346 misclassified workers and $41 million in taxable unreported wages through US DOL mandated audits and identified 1,648 misclassified workers and $11.2 million in unreported taxable wages, and returned $289,000 to the UI Trust Fund through Workplace Fraud audits; and the Comptroller's Office completed one joint audit which resulted in $13,719.81 assessed for Withholding Taxes. 2015 Annual Report: Joint Enforcement Task Force on Workplace Fraud, Department of Labor (Mar. 4, 2016), available at https://www.dllr.state.md.us/workplacefraudtaskforce/wpftfannrep2015.pdf.

A 2008 study of Michigan's unemployment insurance system found that an average of 30% of employers misclassify employees or underreport employee payroll, and that 8% of the state's construction workers are misclassified or receive income that is not reported by their employer. Each year, about $1.5 billion in payroll is not reported to the UI Agency. Misclassification costs the state's unemployment insurance trust fund $17 million each year, and results in an estimated loss of $20 to 33 million in state income taxes. Dale Belman and Richard Block, Informing the Debate: The Social and Economic Costs of Employee Misclassification in Michigan, Michigan State University (2009), available at http://ippsr.msu.edu/publications/ARMisClass.pdf. Michigan established its Underground Economy Task Force in June 2008. The Task Force found that more than 8% of Michigan employees are misclassified, $16.8 million in UI payments went uncollected, and $30 million in wages were not reported. Michigan Supreme Court, Underground Economy (June 2010), available at http://courts.mi.gov/Administration/SCAO/Resources/Documents/Publications/Reports/UTF-2010.pdf.


The Minnesota Office of the Legislative Auditor used UI audit data to estimate that 14% of employers misclassify workers in 2005 – about 17,500 employers. Misclassification rates in the construction industry were higher: 15% of construction employers and 31% of drywall employers misclassify their employees. The estimates are conservative because they exclude employers that operate in the “cash” economy or fail to register in the unemployment program. James Noble, Misclassification of Employees as Independent Contractors, Program Evaluation Division, Minnesota Office of the Legislative Auditor (2007), available at http://www.auditor.leg.state.mn.us/ped/pedrep/missclass.pdf.


Nevada Employment Security Division records indicate that 12.4 percent of benefit claims investigations involved a claim of independent contractor misclassification and 2.7 percent of audited employment was misclassified. This led to a conservative estimate of approximately 31,000 employees in the state that may be misclassified. The estimated annual revenue lost to the Unemployment Trust Fund is $8.2 million. *Employee Misclassification- Bulletin No. 11-07*. Nevada Legislative Counsel Bureau (January 2011), available at http://leg.state.nv.us/Division/Research/Publications/InterimReports/2011/Bulletin11-07.pdf.

New Jersey Department of Labor and Workforce audits found that between 38% and 42% of employers either misclassified workers or paid in cash "off-the-books," and between 25,000 and 28,286 workers were misclassified. *New Jersey State Agency Will Share Employment Tax Examination Results with the IRS*, State of New Jersey Department of Labor and Workforce Development (Nov. 8, 2007).

In FY 2014, field auditors in New Jersey's Division of Employer Accounts, which is part of the Department of Labor and Workforce Development's TOPs offset program, found 7,741 misclassified workers. Over $1.6 billion of gross wages were audited, with $68.3 million of gross wages being underreported. *Assembly Budget Committee Follow-Up Questions*, New Jersey State Legislature, Apr. 24, 2015, http://www.njleg.state.nj.us/legislativepub/budget_2016/LPS_follow_up_response_ABU.pdf.

A 2007 study issued by the Cornell University School of Industrial and Labor Relations, based on audits by the New York DOL UI Division of select industries from 2002-05, estimated annual misclassification rates of about 10.3% in the state’s private sector and approximately 14.9% in the construction industry. Each year, an estimated 39,587 employers within those audited industries misclassified workers. Approximately 704,785 workers were misclassified. 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 (February 2007), available at http://digitalcommons.ilr.cornell.edu/reports/9/. According to the February 2014 report by the Joint Enforcement Task Force on Employee Misclassification, since its inception in 2007, the Task Force has identified over 114,000 instances of employee misclassification and discovered over $1.8 billion in unreported wages. The 2013 sweeps were conducted at construction sites, bars/restaurants, adult entertainment venues,


A 2007 study estimated that between $25 billion and $50 billion in payroll – 20% of total payroll – was unreported for workers’ compensation. The estimate may be conservative, because it was calculated by comparing payroll reported to the state for UI with payroll reported to the WC system, and did not account for payroll that was not reported to either system. Fiscal Policy Institute, *Building up New York, Tearing Down Job Quality: Taxpayer Impact of Worsening Employment Practices in New York City’s Construction Industry* (December 2007), available at [http://www.fiscalpolicy.org/publications2007/FPI_BuildingUpNY_TearingDownJobQuality.pdf](http://www.fiscalpolicy.org/publications2007/FPI_BuildingUpNY_TearingDownJobQuality.pdf).


A 2009 report by the Ohio Attorney General – extrapolating from UI audit data, and using findings from other state studies – estimated that between 54,000 and 459,000 workers were misclassified each year, and 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 between $21 million and $248 million in forgone state incomes tax revenues. Report of the Ohio Attorney General on the Economic Impact of Misclassified Workers for State and Local Governments in Ohio (Feb. 18, 2009), available at [http://www.faircontracting.org/PDFs/prevailing_wages/Ohio_on_Misclassification.pdf](http://www.faircontracting.org/PDFs/prevailing_wages/Ohio_on_Misclassification.pdf).

From January 2015 through December 2015, the Ohio Department of Job and Family Services’ auditing efforts led to the detection of 14,045 workers who had been improperly classified as independent contractors. This resulted in more than $2.6 million in unpaid taxes, including $1.2 million in unpaid taxes for unemployment tax avoidance schemes. *Annual Report: State Fiscal Year 2016, DEP’T OF JOB AND FAMILY SERVICES* (2016), at 24, available at [http://www.odjfs.state.oh.us/forms/file.asp?id=2387&type=application/pdf](http://www.odjfs.state.oh.us/forms/file.asp?id=2387&type=application/pdf).

In 2016, the Oregon Interagency Compliance Network (ICN) conducted 9 audits, finding a total of 217 workers were misclassified. The ICN discovered $13,563,149 in unreported wages, and assessed $279,834 in UI tax. The OED also conducted 1,573 audits in 2016, discovering 3,440 workers who were misclassified, $20,237,668 in unreported payroll, and $416,630 in UI tax. *Interagency Compliance Network Report to the Oregon Legislature*, April 2017, [https://www.oregonlegislature.gov/citizen_engagement/Reports/2017%20ICN%20Legislative%20Report_2017_04%20FINAL.pdf](https://www.oregonlegislature.gov/citizen_engagement/Reports/2017%20ICN%20Legislative%20Report_2017_04%20FINAL.pdf).

A 2008 study found that 9% of Pennsylvania’s workforce, or 580,000 workers, are misclassified as independent contractors each year. Misclassification resulted in a loss of over $200 million to the unemployment compensation trust fund and $81 million to the workers compensation system. Testimony of Patrick T. Beaty, Deputy Secretary for Unemployment Compensation Programs, Pennsylvania Department of Labor and Industry,

The Office of Unemployment Compensation Services is conducting audits of registered and unregistered employers in industries, where historically workers have been misclassified. During 2013, OUCTS discovered 14,381 misclassified workers and $4.3 million in underreported contributions. This effort will continue in 2014.


46 Audits by Traveler’s Insurance Company over a 12 month period beginning in October 2011 revealed that only about 63% of employers insured by Travelers classified workers as employees for both workers’ compensation and unemployment purposes. If a business has workers and has obtained a workers’ compensation insurance policy to provide coverage to those workers, the same workers should be eligible for unemployment insurance, and the business should pay unemployment taxes in addition to workers’ compensation insurance premiums. It should be noted that the majority of businesses misclassifying workers are smaller businesses. It is at this “grass roots” level that the misclassification begins and finds its way to the other business sectors such as commercial construction. Only 50% of trucking businesses and 12% of residential construction businesses consistently classified workers as employees for both workers compensation and unemployment insurance. Tennessee’s Employee Misclassification Advisory Task Force recommends sharing information among existing agencies and appointing additional investigators to identify noncompliant employers, but small scale investigations support the assertion that employee misclassification is prevalent in some industries. Investigations of 32 companies in the drywall, painting, framing, general construction, and roofing industry identified 1,035 misclassified workers and half a million in money owed to the state. Investigations of 23 drywall employers identified 884 misclassified workers and $374,652 in money owed to the state.

Employee Misclassification Task Force, 2013 Annual Report 20 (2013), available at http://www.tn.gov/labor-wfd/EMEEF/AnnualReports/2013_EMATF_AnnualReport.pdf. The Employee Misclassification Advisory Task Force’s first annual report in 2012 highlights findings contained in Dr. William Canak and Dr. Randall Adams' 2010 study. The study estimates that between 21,990 and 38,680 construction workers were either misclassified or unreported in 2006 - approximately 17% of all construction workers. The study also estimated losses of between $8.4 million and almost $15 million to the state’s unemployment insurance program, between $52 million and $91.6 million to the state’s workers compensation program, between $15.2 million and $73.4 million in federal incomes

48 Based on estimates using 2006 data, Tennessee lost between $2.1 million and $3.7 million in uncollected workers’ compensation premium taxes. Tennessee’s estimated losses from unpaid unemployment insurance premiums range from $8.4 million to $14.9 million. Workers’ compensation insurers lost an estimated $52.1 million to $91.6 million in unpaid workers’ compensation premiums. Actual TDLWD Unemployment Insurance audit figures related to misclassification for the last two years revealed that in 2013, 1,537 audits were conducted where 1,930 misclassified workers were discovered with net total wages of $36,442,784. In 2012, 1,421 audits revealed 2,510 misclassified workers with total wages of $25,456,799. https://ww3.workcompcentral.com/fileupload/uploads/2014-07-17-030728EMEEF%202014%20Annual%20Report%20to%20Leg.pdf.

49 A 2009 study found that 38% of the construction workers in the Austin area were misclassified. In "vertical construction" alone, this misclassification resulted in an estimated loss of at least $8,618,869 in federal taxes and state unemployment taxes. *Building Austin, Building Injustice: Working Conditions in Austin’s Construction Industry*, Workers Defense Project in collaboration with the Division of Diversity and Community Engagement at the University of Texas at Austin (June 2009), available at http://www.workersdefense.org/wp-content/uploads/2013/04/Building_Austin_Report-2.pdf.

For a 2012 study, researchers from the same organizations surveyed 1,194 construction workers, conducted in-depth interviews with workers and employers, and analyzed government data, finding that at least 41% of Texas construction workers are misclassified as independent contractors or paid off-the-books in cash or by check. The researchers extrapolated from this 41% figure to estimate that approximately 308,793 construction workers in the state are misclassified as independent contractors, costing the Texas UI Fund $54.5 million annually. The researchers also found that 7.6% of construction workers experienced wage theft within the past year, costing the state an estimated $8.8 million in lost sales tax. *Build a Better Texas: Construction Working Conditions in the Lone Star State*, Workers Defense Project in collaboration with the Division of Diversity and Community Engagement at the University of Texas at Austin (January 2013), available at http://www.workersdefense.org/Build%20a%20Better%20Texas_FINAL.pdf.


50 The Unemployment Insurance Division of the Department of Workforce Services completes both “random” and “targeted” audits of Utah employers. In the four-and-a-half year period between January 1, 2008 and June 30, 2012, the division completed 5233 “random” audits, covering $1.4 billion in total reported wages. The random audits identified $42 million in total unreported wages to 6,949 workers who were misclassified as “independent contractors.” The random audits revealed a variance of 2.9% (.029). During the same time period the division completed 913 targeted audits of Utah employers, covering $970 million in total reported wages. Targeted audits, which primarily use IRS form 1099 information to identify potential unreported workers, yield different results. The targeted audits identified $138 million in total unreported wages to 18,114 workers who were misclassified as independent contractors. The targeted audits revealed a variance of almost 14% (.14). Jody McMillan, Chief of Contributions, Utah Department of Workforce Services, *Effective Methods to Detect and Deter Worker Misclassification* (Oct. 24, 2012). The Labor Commission reviewed 90 specific complaints of misclassification for worker’s compensation in 2016, finding employers noncompliant in 57 of these cases. The Commission assessed the penalties in the amount of $2,474,363 and collected $741,135. In
six and a half years ending June 30, 2016, the Department of Workforce Services Unemployment Insurance Division (DWS/UI) completed 6,985 random audits, covering $1.89 billion in total reported wages. DWS/UI identified $54.5 million in unreported wages paid to 7,955 misclassified workers. In fiscal year 2016 alone, 854 random audits were completed, identifying 961 misclassified workers and $7.5 million in unreported wages. In that same 6.5-year period, DWS/UI completed 2,327 targeted audits of Utah employers, identifying over $172.3 million in total unreported wages paid to 27,493 misclassified workers. In 2016 alone, DWS/UI completed 379 targeted audits, identifying 5,912 misclassified workers and $47.3 million in unreported wages. 


In 2015, the UI Auditors completed 455 full-scale audits, through which the auditors found 1,066 misclassified workers netting approximately $230,000 in employer contributions. Moreover, the Workers’ Compensation investigations unit opened 178 new investigations and issued 20 administrative penalty citations, assessing a total of $71,350 in penalties, and collected $10,307.91 in penalties. Overall, a total of $43,051.07 has been collected in 2015 for WC penalties.


The Virginia Joint Legislative Audit and Review Commission (JLARC) relied on data compiled by the Virginia Employment Commission (VEC) in 2010, finding that of the 1% of employers audited by the VEC, 27% of them had misclassified at least 1 employee. The study acknowledged that the targeted nature of the audits may have resulted in an inflated estimate of the proportion of employees misclassified in all sectors. JLARC's study also found that roughly $28 million was lost in unpaid state income taxes. Joint Legislative Audit and Review Commission, Review of Employee Misclassification in Virginia, Report to the Governor and the General Assembly of Virginia (June 11, 2012), available at http://jlarc.virginia.gov/pdfs/reports/Rpt427.pdf.


The 2010 Washington State Underground Economy Benchmark Report reported that, in FY 2010, the three departments uncovered a combined 1,677 unregistered businesses that were assessed nearly $39 million in unpaid taxes, premiums, penalties, and interest. The Department of Labor & Industries conducted 5,846 audits with an associated $26.4 million in assessments from worker misclassification and unregistered businesses; the Employment Security Division conducted 4,006 audits with an associated $2.51 million in assessments from worker misclassification, unreported wages and unregistered businesses; and the Department of Revenue assessed a total of $29,718,684 in unpaid taxes, penalties and interest from previously unregistered businesses that were involuntarily registered. Underground Economy Benchmark Report: 2010 Report to the Legislature, Joint Report of the Washington State Department of Labor and Industries, Washington State Department of Revenue, and the Washington State Employment Security Division (November 2010), available at http://www.lni.wa.gov/Main/Docs/UEBenchmarkFY2010.pdf. An earlier report by the Washington Department of Revenue studied discrepancies in the number of businesses that had registered with the IRS but not with the State, finding that in-state and

The Joint Legislative Task Force on the Underground Economy in the Construction Industry also found that over $100 million state income taxes were not being paid in that industry. Available at http://www.leg.wa.gov/JointCommittees/UECI/Documents/FinalReport_1-20-2009.pdf.

The 2016 Washington State Underground Economy Benchmark Report reported that, in FY 2016, the three departments uncovered a combined 2,270 unregistered businesses that were assessed nearly $98.5 million in unpaid taxes, premiums, penalties, and interest. The Department of Labor & Industries conducted 820 audits with an associated $9.3 million in assessments from worker misclassification and unregistered businesses. The Economic Security Division found more than 12,300 unreported or misclassified workers through audits and assessed a total of more than $1,383,600 on unregistered accounts. The Department of revenue assessed a total of $87.8 million in taxes from more than 780 businesses, recovered over $180,000 in fraud-related dollars. Moreover, the DOR collected over $46 million through its Tax Discovery Program.


The 2010 Annual Fraud Report to the Legislature: Targeting Fraud and Abuse, Washington State Department of Labor & Industries, reported on the Fraud and Compliance program examining workers’ compensation fraud in Washington State. The program identified unpaid premiums for 62% of employers that were targeted for audits, based on a screening process, and they assessed $26.4 million through employer audits. The Report also noted that the program brought in over $7 for every dollar invested, when the program’s operating costs were compared to the money recovered, collected and avoided during the fiscal year. For FY 2010, nearly 250 FTEs were employed in the program.

The Wisconsin Unemployment Insurance Division found that 44% of the workers investigated in the course of employer audits had been misclassified. Report of the Worker Misclassification Task Force, Submitted to Secretary Roberta Gassman, Wisconsin Department of Workforce Development (June 2009), http://docs.legis.wisconsin.gov/2009/related/drafting_files/wisconsinActs/2009_act_292_sb_672/02_sb_672/09_4432df_pt02of04.pdf.


58 Y. Peter Yang, *FedEx to Drop $228 Million to Settle Driver Wage Row*, Law360 (June 12, 2015).


60 According to a recently updated study on misclassification in the port trucking industry, approximately 49,000 of the nation’s 75,000 port truck drivers are misclassified as independent contractors. Rebecca Smith, Paul Alexander Marvy and Jon Zerolnick, *The Big Rig Overhaul: Restoring Middle-Class Jobs at America’s Ports through Labor Law Enforcement* (February 2014), available at http://www.nelp.org/page/-/Justice/2014/Big-Rig-Overhaul-Misclassification-Port-Truck-Drivers-Labor-Law-Enforcement.pdf?nocdn=1.


62 Crowley, supra note 4.

63 *The Big Rig Overhaul*, supra note 55, at 12

64 See website for the Washington Department of Labor and Industries, at http://lni.wa.gov/ClaimsIns/FraudComp/WCFraud/About/Reports/default.asp.