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News

Independent Contractors

House Panel Hears Testimony on Costs Of Employees Misclassified as 'Contractors'

Employers who misclassify workers as "independent contractors" rather than "employees" cost the federal government billions in tax revenue each year and deprive workers of essential protections under federal and state labor and employment laws, witnesses told a House Education and Labor subcommittee March 27.

Testifying before the Subcommittee on Workforce Protections, John J. Flynn, president of the Bricklayers and Allied Craftworkers, said employer misclassification of workers is a "crisis" that costs the federal government "well over \$3.3 billion" per year. Flynn said that sum does not include billions lost to the Social Security system and state workers' compensation systems.

"It is a crisis of national, universal urgency because it depresses wage markets, threatens the finances of our government, and--most importantly --it undermines the fundamental dignity of workers and degrades the fabric of our society," Flynn said.

Misclassification is "the perfect tool" for "unscrupulous employers" to avoid labor and employment laws, prevailing wage laws, and other measures intended "to ensure that workers are dealt with in a fair and equitable manner," he said.

Catherine Ruckelshaus, a lawyer with the National Employment Law Project in New York, testified that misclassification is not confined to the building trades. She described a case involving delivery workers for a New York City grocery chain who were classified as "independent contractors" and paid \$90 a week despite working full-time hours. Ruckelshaus said low-wage and foreign workers--some illegally in the United States--are particularly vulnerable to being misclassified and deprived of employment and labor law protections.

Ruckelshaus urged better and more coordinated enforcement by the Department of Labor's Wage and Hour Division and the Internal Revenue Service to crack down on employers that misclassify workers in order to evade federal wage and overtime laws as well as payroll taxes, Social Security, and workers' compensation premiums.

In response to a question from Rep. Joe Wilson (R-S.C.), the subcommittee's ranking Republican, Ruckelshaus said legislative action "is not needed now" regarding the tests used to determine whether a worker is an employee or independent contractor, "if current laws are properly enforced." Instead, she urged the Labor Department to adopt a more strategic, targeted approach to enforcement. Ruckelshaus also called for "more information sharing" between DOL and IRS to identify suspicious employers or industries, with the caveat that a "firewall" be maintained not to inquire into the immigration status of workers who might be misclassified.

She explained that in a "complaint-driven" enforcement system, undocumented workers who are potential witnesses might be driven farther underground if they believed talking to a Labor Department or IRS investigator put them at risk of disclosure.

Rep. Lynn Woolsey (D-Calif.), the subcommittee chairwoman, said the panel will be sending a letter to the Labor Department for details on its current enforcement efforts. She added that if the subcommittee is dissatisfied with DOL's response, oversight hearings will follow.

ABC Cites Complexity

Representing the Associated Builders and Contractors, Rich Shavell, an accountant from Boca Raton, Fla.,

who advises construction companies, said complex federal and state regulations can trip up honest employers who want to comply with the law. He pointed out that the IRS uses a 20-factor test to determine employee or independent contractor status, the Labor Department relies on a different test, and state agencies may use yet another variation.

Shavell emphasized that ABC "in no way condones intentional misclassification" of construction industry workers. He said the association backs increased IRS reporting requirements, elevated enforcement by IRS and the Labor Department, and steps to "clarify and simplify" the IRS test and to educate businesses and workers. He said Congress should not eliminate the availability of independent contractor status, which Shavell said permits flexible and mutually beneficial arrangements for workers and employers.

"This would not be a viable alternative in the construction industry," Shavell said. "For significant technical and practical reasons, ABC cannot advocate that independent contractor status be eliminated and no credible consideration can be given to such an option."

When questioned by Rep. Tom Price (R-Ga.), all the witnesses agreed that the option of independent contractor status should be maintained.

Training for Employers?

Woolsey asked if ABC offers training for its members on how to distinguish independent contractors from employees. When Shavell reiterated that such distinctions can be "extremely complex," Woolsey interjected that as a former human resource professional, she knows "it's not that complex." Shavell replied that "I'm sure there are materials" that ABC provides its members to assist them in determining the proper status.

Ruckelshaus said that although the IRS and Labor Department tests differ to some degree, "there are certain factors that are crystal clear." Woolsey said the primary factor is whether a worker classified as an "independent contractor" could work for someone else without being fired. She asked Shavell if ABC discusses with its members the potential penalties for misclassification.

Shavell replied that he "sensed a presumption" from Woolsey that ABC members "are doing something wrong." He added that he is sure the association shares with its 24,000 members the rules and potential penalties. "Everyone wants a level playing field," he said.

Flynn, the Bricklayers's president, noted that the union has collective bargaining agreements with more than 12,000 employers that eliminate the guesswork from deciding whether a laborer is an "employee." Unionized contractors are placed at a disadvantage by others who misclassify workers and avoid paying taxes, Social Security, health benefits, and other costs, he said. "It causes an undermining of the system," Flynn said.

Cliff Horn, president of A. Horn Inc., in Barrington, Ill., echoed Flynn's point in his testimony for the Mason Contractors Association of America. Businesses that misclassify their workers can expect to cut labor costs by 15 percent to 20 percent and put complying employers such as Horn "at a competitive disadvantage," he said.

"There are legitimate independent contractors in the construction industry and it is not my intention to undermine those sole proprietorships and small businesses," Horn said. "The problem is the intentional misclassification of individuals who are in fact employees but are classified as 'independent contractors' by unscrupulous employers."

Horn testified that in addition to depriving workers of their legal rights and government of payroll taxes, such employers raise safety and health issues by not paying workers' compensation premiums. "If some contractors are skirting around workers' compensation, then the firms who properly classify employees are forced to carry the load," he said. "If workers' compensation is unavailable to a worker, then our health care system has to absorb the cost."

States Are Taking Steps

Flynn told the subcommittee that his union is taking steps to combat "fraudulent misclassification." Union organizers working undercover in the Chicago area discovered "a network of accountants and insurance brokers" whose "primary business" is to aid employers in misclassifying workers, he said. Those revelations spurred an investigation by the Illinois state attorney general, according to Flynn. He promised to provide the House panel with additional information, to the extent the state's investigation allows disclosure.

Asked by Woolsey which state laws are most effective, Shavell said California presumes a worker who lacks a license to perform particular work is an employee rather than independent contractor and Florida has "tightened up" its filing requirements for contractors. He said that he concurs with Ruckelshaus that rather than new legislation, better enforcement is needed at the state and federal levels.

Rep. Tim Bishop (D-N.Y.) remarked that state laws in Massachusetts and New Mexico presume an employer-employee relationship and asked if that would work in the construction industry. Shavell replied that it would depend on the particular state regulation. Bishop persisted: How could presuming someone is an "employee" be that complex? "You're making a presumption that everyone is the same," Shavell said.

"If it's at the state level, it can work very well," Ruckelshaus interjected, but she said she was unsure how such a presumption would work at the federal level. She emphasized that federal agencies need to improve enforcement of current law. Making the Labor Department's efforts "more strategic and more targeted" is essential, she said.

Rep. John Kline (R-Minn.) asked Shavell if he was aware of a "large-scale effort" among construction industry employers to misclassify workers. Noting that he has worked in the industry since 1987 and has been a certified public accountant since 1995, Shavell replied, "No one has walked in my office and said 'teach me how to do this' because I would throw them out."

Rep. Tom Price (R-Ga.) asked Horn if Congress needs to define more clearly the independent contractor/employee distinction. "A lot of the rules are in place; they just need to be enforced," Horn replied. More education for workers on the issue also might be helpful, he said. Employers "are well aware when they are doing something wrong," he concluded.

End of article graphic

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