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PROVIDING FAIRNESS TO WORKERS WHO HAVE BEEN MISCLASSIFIED AS INDEPENDENT CONTRACTORS

HEARING

BEFORE THE

SUBCOMMITTEE ON WORKFORCE PROTECTIONS

COMMITTEE ON
EDUCATION AND LABOR

U.S. HOUSE OF REPRESENTATIVES

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PROVIDING FAIRNESS TO WORKERS WHO HAVE BEEN MISCLASSIFIED AS INDEPENDENT CONTRACTORS

Tuesday, March 27, 2007
U.S. House of Representatives
Subcommittee on Workforce Protections
Committee on Education and Labor
Washington, DC

The subcommittee met, pursuant to call, at 10:34 a.m., in Room 2175, Rayburn House Office Building, Hon. Lynn Woolsey [chairwoman of the subcommittee] presiding.

Present: Representatives Woolsey, Bishop, Hare, Wilson, Price, Kline, McKeon, and Holt.

Staff present: Aaron Albright, Press Secretary; Tylease Alli, Hearing Clerk; Jordan Barab, Health/Safety Professional; Lynn Dondis, Senior Labor Policy Advisor; Michael Gaffin, Staff Assistant, Labor; Jeffrey Hancuff, Staff Assistant, Labor; Brian Kennedy, General Counsel; Thomas Kiley, Communications Director; Alex Nock, Deputy Staff Director; Joe Novotny, Chief Clerk; Megan O'Reilly, Labor Policy Advisor; Michele Varnhagen, Labor Policy Director; Andrew Weltman, Legal Intern, Labor; Mark Zuckerman, Staff Director; Steve Forde, Communications Director; Rob Gregg, Legislative Assistant; Jim Paretti, Workforce Policy Counsel; Molly McLaughlin Salmi, Deputy Director of Workforce Policy; and Linda Stevens, Chief Clerk/Assistant to the General Counsel.

Chairwoman WOOLSEY [presiding]. Good morning. The Subcommittee on Workforce Protections hearing on "Providing Fairness to Workers Who Have Been Misclassified as Independent Contractors" will come to order.

Pursuant to Committee Rule 12A, any member may submit an opening statement in writing, which will be made part of the permanent record.

I now recognize myself, and I will be followed by Ranking Member Joe Wilson, for an opening statement.

I want to say good morning to all of you. Thank you for the bright shirts. That will keep us awake.

And welcome to the witnesses. Thank you for being on time and in your place so we can get going.

This is the first subcommittee hearing in this 110th Congress of the Workforce Protections Subcommittee, and today we are going to be examining the misclassification of workers as independent contractors.

We know, of course, that there are true independent contractors in the business world. So don't think for a minute we don't understand that. But the thrust of this hearing will be on workers who are misclassified, who are really, truly employees within the law.

So our witnesses are principally from the building trade today. They are going to tell us what is happening in that industry. But it is clear that there is a problem about misclassification in many, many other sectors of employment. So we are not saying it is here and only here. We are just going to learn from you and go from there.

And, of course, we all know that this practice affects the most vulnerable workers among us, many of whom are part of the underground economy, where there is no documentation of the workers' relationship with the employer and where workers actually are paid in cash. This practice hurts every one; workers who are not afforded protection of labor laws, honest contractors who can't compete with contractors who misclassify their workers in order to have lower costs and all of society because state and federal government lose billions of dollars in revenue each year if employees are misclassified.

As our economy changes, and it is, and employers are increasingly seeking ways to lower their costs, misclassification can become a prevalent trend, and we want to stop that.

I am especially concerned that misclassifying workers as independent contractors would keep those workers from essential employee benefits. One of these benefits is Workers Compensation and the U.S. Department of Labor has stated that the number one factor for employers in misclassifying workers is the desire to avoid paying Workers Comp premiums and to otherwise avoid workplace injury and disability disputes. And we all know what that does to workers. They are cut out from their Workers Comp if they are indeed in need.

In my own state of California, the problem is widespread. The California State Department of Insurance has reported that of 800,000 employers in the state, 30 percent do not carry Workers Comp. Well, that is a state issue, of course, but if employees are misclassified, that just adds to that.

So there is a national problem with implications for federal laws and our federal coffers, and we must solve this problem.

And, again, I welcome you, all of you, and I am looking forward to your testimony and learning exactly what it is you have to tell us.

I now yield to the ranking member for his opening statement.

Mr. WILSON. Madam Chairwoman, ladies and gentlemen, and particularly those of you in the orange shirts, I have a son who is a freshman at Clemson University, and so I feel like I am at a Clemson student meeting. The orange is very much Clemson orange. And you can see it.

And so I want to extend a warm welcome to visit South Carolina any time, and if you wear that shirt people will be very happy—about half of them will be very happy. The others are Gamecocks, so just understand.

Good morning.

Let me first commend my colleague, the gentlelady from California, on assuming the chairmanship of this subcommittee. Our committee has already had a full agenda this year, and I welcome this meeting of the Workforce Protection Subcommittee this morning.

Our subcommittee has jurisdiction over a broad range of issues that affect more than 100 million workers in this country every day, from hours of pay to over time to leave requirements to trade and immigration policy. I also know this subcommittee will follow the lead of the full committee, both under the new chairman, Miller, and under the prior leadership of Chairman McKeon, Boehner and Goodling in making sure that our first principle is we may sometimes agree, but we need not be disagreeable.

With respect to the hearing before us today, I expect there are many areas in which we agree and areas in which we disagree. I look forward to hearing from our distinguished witnesses and in particular welcome a discussion of the current state of law as it relates to the classification of workers as employees or independent contractors.

I expect that each of our witnesses will explain the current system as complicated and as an administrative burden that does not serve employers, employees or the federal government very well. If a team of lawyers is necessary to determine whether a worker is an employee or an independent contractor, an employer working in good faith is saddled with the time, energy and expense of trying to classify them correctly, often with no guarantees that down the road they won't be found to have gotten it wrong.

If an employee is misclassified, the federal government faces revenues lost to unemployment and other taxes that should have been paid to the Treasury. But perhaps most important, if the system is such that it is complicated if not impossible to know how anyone should be classified, it is the workers who suffer. The employee who is misclassified as a contractor may not get the benefits to which he or she is entitled. A contractor who is misclassified as an employee faces increased costs and loss of flexibility that may be the lifeblood of his or her business.

In short, it benefits all parties, workers, employers, contractors and others, to ensure that our laws are as clear and as straightforward as they can be, and they are evenly enforced and fairly enforced. Indeed, as I have traveled around the district I represent and spoken to business owners, particularly small business owners, that is a common thread I hear, that most businesses want to follow the law and want to do what is expected of them. Sometimes it seems we as policymakers make it harder than it needs to be for that to happen, something I hope we will consider going forward.

As we get into the details, I expect we may hear arguments for different ways to go about that, but that, frankly, is what the legislative process and particularly the committee process is for.

So with that said, I hope and trust today we begin the start of a thoughtful examination of this important issue and, in particular, the close scrutiny of what if any changes Congress should consider or adopt with respect to these important workplace laws.

I welcome our witnesses today and yield back the remainder of my time.

[The statement of Mr. Wilson follows:]

Prepared Statement of Hon. Joe Wilson, Ranking Minority Member, Subcommittee on Workforce Protections

Good morning. Let me first commend my colleague, the Gentlelady from California, on assuming the chairmanship of this Subcommittee. Our Committee has already had a very full agenda this year, and I welcome this meeting of the Workforce Protections Subcommittee this morning. Our Subcommittee has jurisdiction over a broad range of issues that directly affect more than 100 million workers in this country every day—from hours of pay, to overtime, to leave requirements, to trade and immigration policy.

I also know that this Subcommittee will follow the lead of the full Committee both under new Chairman Miller and under the prior leadership of Chairmen McKeon, Boehner, and Goodling, in making sure our first principle is that we may sometimes disagree, but we need not be disagreeable.

With respect to the hearing before us today, I expect that there may be areas in which we agree, and areas in which we disagree. I look forward to hearing from our distinguished witnesses, and in particular welcome a discussion of the current state of the law as relates to the classification of workers as employees or independent contractors.

I expect that each of our witnesses will explain that the current system is complicated and an administrative burden that does not serve employers, employees, or the federal government very well. If a team of lawyers is necessary to determine whether a worker is an "employee" or an "independent contractor," an employer working in good faith is saddled with the time, energy, and expense of trying to classify them correctly—often with no guarantee that down the road they won't be found to have gotten it wrong. If an employee is misclassified, the federal government faces revenue lost on employment and other taxes that should have been paid to the Treasury. But perhaps most important, if the system is such that it is complicated if not impossible to know how someone should be classified, it is workers who suffer—the employee who is misclassified as a contractor may not get the benefits to which he or she is entitled; a contractor who is misclassified as an employee faces increased costs and a loss of flexibility that may be the lifeblood of his or her business.

In short, it benefits all parties—workers, employers, contractors, and others—to ensure that our laws are as clear and as straightforward as they can be, and they are enforced evenly and fairly. Indeed, as I've traveled around my district and spoken to business owners, particularly small business owners, that's a common thread I hear: that most businesses want to follow the law, and want to do what is expected of them. Sometimes, it seems, we as policymakers make it harder than it needs to be for that to happen—something I hope we will consider going forward.

As we get into the details, I expect we may hear arguments for different ways to go about that—but that, frankly, is what the legislative process—and particularly the committee process—is for.

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I welcome our witnesses today, and yield back the remainder of my time.

Chairwoman WOOLSEY. I thank the ranking member.

I now would like to ask without objection all members will have 14 days to submit additional materials or questions for the hearing record. Are there any objections?

And now it is going to be my honor to introduce our witnesses. I would like to introduce our very, very distinguished panel this morning and I would like to welcome you all.

First of all, and I am going to introduce you right down the line here and then I will talk to you a little bit about the timing and lighting and then we will get on with it. You will go one at a time. And then we will ask our questions.

First I would like to introduce John Flynn, the president of the International Union of Bricklayers and Allied Craftworkers. He has

worked in the trade as a journeyman, foreman and superintendent. President Flynn is on the executive council of the AFL-CIO and serves on numerous labor boards. He is a graduate of the Harvard Trade Union Program.

Cliff Horn. Mr. Horn is president of A. Horn, Inc., a masonry contracting firm in Barrington, Illinois. He has worked in the masonry and construction industry for over 20 years as a bricklayer and a foreman. Mr. Horn holds a BA degree in business finance from DePaul University in Chicago, Illinois.

Mr. Horn.

Mr. Shavell. Richard Shavell will be testifying on behalf of the Associated Builders and Contractors, ABC. Mr. Shavell is the president of Shavell & Company, an accounting and consulting firm located in Boca Raton, Florida. He is also chair of ABC's national tax advisory group. Mr. Shavell is a graduate of Drexel University.

Ms. Ruckelshaus. Catherine Ruckelshaus is the litigation director at the National Employment Law Project. Her primary areas of expertise are wage and hour law, the rights of immigrant and nonstandard workers, work and family and the employment rights of Work Fair participants. Ms. Ruckelshaus is a graduate of Princeton University and Stanford Law School.

I welcome you all.

Before we get started, if you have never testified here before, here is how this committee works.

The lighting system: You will have 5 minutes. We run on the 5-minute rule. Everyone, including the members, all the members, are limited to 5 minutes of presentation or questioning. As a matter of fact, if the members spend their whole 5 minutes pontificating, then you don't have to answer anything.

So the green light is illuminated when you begin to speak. When you see the yellow light, it means you have 1 minute remaining, and that is a good time to start wrapping up. And when you see the red light, it means your time has expired, and you need to conclude your testimony. You don't have to stop in mid-sentence, believe me, but you know that means you have already spoken for 5 minutes.

So please be certain as you testify to turn on and speak into your microphone.

Now we are going to hear from our witnesses, beginning with Mr. Flynn.

STATEMENT OF JOHN FLYNN, PRESIDENT, INTERNATIONAL UNION OF BRICKLAYERS AND ALLIED CRAFTWORKERS

Mr. FLYNN. Good morning, Madam Chair. My name is John Flynn. I am president of the International Union of Bricklayers and Allied Craftworkers. We are usually referred to as the BAC.

On behalf of the nearly 100,000 members at BAC, I want to thank you and the committee for convening these hearings on the employee misclassification crisis.

This morning I would like to briefly speak about what misclassification of employees as independent contractors means to the U.S. government, to BAC's members and to American workers in general.

The misclassification of employees as independent contractors has become such a rampant problem, so great in its scope that it can no longer be thought of as just a labor issue. To the contrary, Madam Chair, it is a crisis. 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.

But the most insidious element of the misclassification crisis is this: the vast majority of Americans have no idea that it exists. Ask the average American the difference between an employee and an independent contractor, and you would probably get a blank look. For that matter, ask the average member of Congress how much tax revenue is stolen from the federal government by deliberate misclassification of employees as independent contractors, I doubt they would know that it is well over $3.3 billion per year. And that is an estimate that is nearly a decade old.

But even that dated estimate is roughly 20 times the annual budget of the agency that is supposed to prevent misclassification, the Department of Labor's Wage and Hour Division. That is a significant loss to our government. And that doesn't even begin to account for the untold billions of dollars that have been lost to our Social Security system due to employee misclassification.

How much of the alleged Social Security crisis is really due to the misclassification crisis, we just don't know, because the government hasn't been asking the question.

Madam Chair, the first step in solving the crisis is making sure that the American people and their representatives know just how grave it is.

At this point, I think it might be helpful to outline just what employee misclassification is and what it costs to all of us. When an employer takes a worker and treats that worker as an independent contractor rather than as an employee, despite the fact that the employer controls and directs how the worker performs his or her work and exercises financial control over the economic aspects of the worker's job, then the employer is misclassifying the worker.

In so doing, the employer is evading tax obligations and Workers Compensation insurance. As I remarked earlier, the federal government is denied well over $3 billion every year in tax revenue because employees are misclassified as subcontractors.

Social Security loses out on a similarly large amount and the state and local government shoulder a huge financial burden as a result of misclassification. And the Workers Compensation and Unemployment Insurance systems are starved of vital funds when employers misclassify workers as independent contractors.

Furthermore, by misclassifying employees as independent contractors, unscrupulous employers avoid legislation intended to ensure that workers are dealt with in a fair and equitable manner. These employers deny their workers the opportunity to obtain the benefits regularly available to employees, such as unemployment insurance.

Employers who misclassify their employees as independent contractors don't pay for their employees' health insurance, and that contributes to the public health crisis and the Medicaid crunch. And, finally, when misclassified employees seek to organize to fight

for their rights and they are told they can't do so because they supposedly aren't employees under the National Labor Relations Act.

In short, Madam Chair, employee misclassification is the perfect tool for permanently disenfranchising working Americans. It creates an inescapable circle of low wage work and a bottomless pool for desperate workers. For all of these reasons, BAC has made addressing the misclassification crisis our top legislative priority in 2007 and beyond the legislative arena our union has been very aggressive in developing programs to help end the practice of fraudulent misclassification.

We are engaged in a number of efforts to combat misclassification throughout various states, but today I would like to focus on Illinois because we found that this is a state with some of the country's most serious and best organized fraudulent misclassification schemes.

As part of our effort to collect data on the scope of the crisis, we reviewed a University of Missouri study on the——

Chairwoman WOOLSEY. Mr. Flynn, are you about ready to tie this up? You are beyond your 5 minutes.

Mr. FLYNN. Oh, okay.

Chairwoman WOOLSEY. Can you bring it to a conclusion? And then maybe somebody can ask you a question.

Mr. FLYNN. Okay. Let me just finish a little bit here.

Chairwoman WOOLSEY. Okay.

Mr. FLYNN. The study* was sponsored in part by the National Alliance for Fair Contracting and the data contained in the study in that report confirmed the practical realities that our members are experiencing throughout Illinois and the country as a whole.

Several of our union organizers went undercover to see just how the misclassification worked—and one of them, Joe Provola, is here in the gallery—and I would like to tell you what they learned.

They discovered a network of accountants and insurance brokers, a network whose primary business is to aid and abet the fraudulent misclassification of workers. They found that this network would teach employers about how easily they could cheat the system. Accountants would actually coach employers how to use misclassification to exploit undocumented immigrants.

And the most amazing part of it all was how easy it was to get this network to give up their tricks. It was as if they had no fear of being caught, of being exposed as a conspiracy to evade labor and tax laws.

Chairwoman WOOLSEY. Okay, Mr. Flynn. Now, what we are going to do is ask you to finish that when we are in our question-and-answer period.

Mr. FLYNN. Okay.

Chairwoman WOOLSEY. I promise you, you will get to finish that thought.

Mr. FLYNN. I guess really what we want to ask is that the committee look into this.

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*The report, "The Economic Costs of Employee Misclassification in the State of Illinois," is available on the National Alliance for Fair Contracting website at the following URL: *http://www.faircontracting.org/NAFCnewsite/prevailingwage/pdf/Illinois—Misclassification—Study.pdf*

Chairwoman WOOLSEY. Oh, we are not through. You are going to get to say a lot more things on this this morning.

Mr. FLYNN. Okay.

[The statement of Mr. Flynn follows:]

Prepared Statement of John J. Flynn, President, International Union of Bricklayers and Allied Craftworkers

Good morning, Madam Chair. My name is John J. Flynn, and I am President of the International Union of Bricklayers and Allied Craftworkers, or BAC. On behalf of the nearly 100,000 members of BAC, I want to thank you and the Committee for convening these hearings on the worker misclassification crisis. This morning, I would like to briefly speak about what misclassification of employees as independent contractors means to government, to BAC's members, and to American workers in general.

The Hidden Dangers of the Misclassification Crisis

The misclassification of employees as independent contractors has become such a rampant problem, so great in its scope, that it can no longer be thought of as just a "labor issue." To the contrary, Madam Chair, it is a crisis. 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.

But the most insidious element of the misclassification crisis is this: the vast majority of Americans have no idea that it exists. Ask the average American the difference between an employee and an independent contractor, and you'll probably get a blank look. Ask the average American—for that matter, ask the average Member of Congress—how much tax revenue is stolen from the federal government by deliberate misclassification of employees as independent contractors, and I doubt that they'll know that it's well over 3.3 billion dollars per year. Over 3 billion dollars—and that's an estimate that's nearly a decade old. But even that dated estimate—3.3 billion dollars—is roughly 20 times the annual budget of the agency that's supposed to prevent misclassification, the Department of Labor's Wage & Hour Division. That's a significant loss to our government. And that doesn't even to begin to account for the untold billions of dollars that have been lost to our Social Security system due to employee misclassification. How much of the alleged Social Security crisis is really due to the misclassification crisis? We just don't know, because the government hasn't been asking the question. Madam Chair, the first step in solving this crisis is making sure that the American people and their representatives know just how grave it is.

The Devastating Effects of Misclassification on Workers and Government

Now at this point, I think it might be helpful to outline just what employee misclassification is, and what it costs all of us. When an employer takes a worker, and treats that worker as an independent contractor rather than an employee—despite the fact that the employer controls and directs how the worker performs his or her work, and exercises financial control over the economic aspects of the worker's job—then the employer is misclassifying the worker. In so doing, the employer is evading tax obligations and worker compensation insurance obligations. As I remarked earlier, the federal government is denied well over 3 billion dollars every year in tax revenue because employees are misclassified as subcontractors. Social Security loses out on a similarly large amount. State and local governments shoulder a huge financial burden as a result of misclassification. And the nation's workers' compensation and unemployment insurance systems are starved of vital funds when employers misclassify workers as independent contractors.

Furthermore, by misclassifying employees as independent contractors, unscrupulous employers avoid labor and employment laws, prevailing wage laws, and other legislation intended to ensure that workers are dealt with in a fair and equitable manner. These employers deny their workers the opportunity to obtain the benefits regularly available to employees, such as unemployment insurance. Employers who misclassify their employees as independent contractors don't pay for their employees' health insurance—and that contributes to the public health crisis and the Medicaid crunch. And finally, when misclassified employees seek to organize to fight for their rights, they're told that they can't do so—because they supposedly aren't "employees" under the National Labor Relations Act. In short, Madam Chair, employee misclassification is the perfect tool for permanently disenfranchising working Americans. It creates an inescapable circle of low-wage work, and a bottomless pool of desperate workers.

BAC's Efforts to Combat the Misclassification Crisis

For all of these reasons, BAC has made combating the misclassification crisis our top legislative priority in 2007. And beyond the legislative arena, our union has been very aggressive in developing programs to help end the practices of fraudulent misclassification. We are engaged in a number of efforts to address misclassification throughout the various states, but today I'd like to focus on Illinois, because we've found this is a state with the some of the country's most serious and best organized fraudulent misclassification schemes.

As part of our effort to collect data on the scope of the crisis in Illinois, we reviewed a University of Missouri-Kansas City study of the economic costs of misclassification in the State of Illinois. The study was sponsored in part by the National Alliance for Fair Contracting. The report confirmed the practical realities that our members were experiencing in Illinois, particularly in the Chicago area. From the worker point of view, there are several key findings:

• The state's unemployment insurance system "lost an average of $39.2 Million every year from 2001 to 2005 in unpaid unemployment insurance taxes."

• The incidence of misclassification has risen in Illinois from 5.5% of employees in 2001 to 8.5% in 2005. This represents a 55% increase in the misclassification rate from 2001-2005.

• Finally, the number of workers misclassified statewide averages nearly 370,000 per year—and that number is growing.

Now this report—like a similar report that was just issued by Cornell University which detailed the devastating effects of misclassification in New York—didn't tell us anything our members didn't already know. Because the construction industry is so sensitive to prices, our members are all too aware that they are losing jobs to companies that cheat. And so we felt that we needed to augment our research with a practical understanding of the crisis. Several of our union's organizers went undercover to see just how misclassification worked—one of them, Joe Probola, is here in the gallery today. What he and his fellow organizers learned was shocking.

They discovered a network of accountants and insurance brokers—a network whose primary business is to aid and abet the fraudulent misclassification of workers. They found that this network would teach employers about how easily they could cheat the system. Accountants would actually coach employers how to use misclassification to exploit undocumented immigrants. And the most amazing part of it all was how easy it was to get this network to give up their tricks. It was as if they had no fear of being caught, of being exposed as part of a conspiracy to evade labor and tax laws. Madam Chair, our organizers' story is chilling—because it illustrates how commonplace misclassification has become. And that's why we're here today—asking this committee to fight for the basic right to be recognized as an employee, with all of the rights of an employee.

And that is exactly what we asked of Illinois public officials when we started reaching out to them with the facts that we had learned. Perhaps the most striking thing that our representatives discovered in speaking with the officials was how so many of them lacked an initial understanding of how pervasive and how dangerous misclassification had become. But with time, we've been able to work with Illinois officials, including the state Attorney General, to develop a plan to fight misclassification. We're hoping that today is the first step in the federal government's fight.

With that, Madam Chair, I want to thank you for providing us the opportunity to appear here today. We're glad that this Committee is taking the misclassification crisis seriously, and I can assure you that as you confront the crisis, you will have the unswerving support of BAC, and of all the union building and construction trades.

Chairwoman WOOLSEY. Mr. Horn?

STATEMENT OF CLIFF HORN, PRESIDENT, A. HORN, INC.

Mr. HORN. Good morning, and thank you, Chairwoman Woolsey, Ranking Member Wilson and members of the subcommittee for inviting me today to discuss the deliberate misclassification of workers as independent contractors and the effect on our nation.

My name is Cliff Horn, president of A. Horn, Incorporated. We are a commercial mason contractor working in the Chicagoland area, and I am testifying today on behalf of the Mason Contractors Association of America, a national trade association representing

mason contractors across the country and whose membership accounts for $2 billion in masonry sales annually.

My father arrived in the United States in 1957 not knowing a word of English with just $26, a suitcase and a dream of a better life. He worked his first day in America as a construction laborer. After 14 years of employment as a union tradesman, my dad and mom started their own masonry contracting business, A. Horn, Incorporated.

After 19 years in the business, they employed 15 people and achieved annual sales revenues of $3 million. In 1990, I started with A. Horn as an apprentice mason. After I completed my apprenticeship in 1994, I became president in 1998. By 2001, sales had increased to $10 million and our sales projections for 2007 are $15 million. Currently we have 75 employees.

Obviously, a growing business needs profitable contracting. However, for contracting bidding to be fair, the playing field has to be even. When a contractor misclassifies his employees as independent contractors, he gets a competitive advantage over the contractors who are playing by the rules and classifying their employees properly.

Misclassification of workers has impacted business and the construction industry at the local, state and federal level. By misclassifying employees as independent contractors, unscrupulous employers are able to avoid paying taxes and insurance. Businesses that misclassify employees as independent contractors expect to reduce their labor costs by between 15 and 20 percent. This places contractors like myself at a competitive disadvantage in an industry with 20 percent gross margins.

The American construction industry is being threatened by the misuse and abuse of independent contractors. Independent contractors typically have no formalized training, no quality control and no access to continuing education. There are legitimate independent contractors in the construction industry and it is not my intention to undermine those sole proprietorships and small businesses. The problem we are here to address today is the intentional misclassification of individuals who are in fact employees but are classified as independent contractors by unscrupulous employers.

Furthermore, there is a serious question of operators' liability coverage in case of a claim or public health scare. Who is responsible? If business owners are taking shortcuts with payroll taxes and liability insurance, would shortcuts in construction methods and design specifications be out of the question? Most likely not.

As some contractors are skirting around Workers Comp, then the firms who properly classify employees are forced to carry the burden. If Workers Compensation is unavailable to a worker, then typically our health care system has to absorb the cost.

The masonry industry made the American dream real for my family and for myself. However, I am worried that some contractors are undercutting the industry by misclassifying workers. This is leading to a race to the bottom, which will ultimately hurt the industry and in the end leave all contractors at a competitive disadvantage.

I strongly encourage Congress to take action to clearly define who is and who is not an independent contractor.

Thank you.

[The statement of Mr. Horn follows:]

Prepared Statement of Cliff Horn, President, A. Horn, Inc.

Good morning, and thank you Chairwoman Woolsey, Ranking Member Wilson and members of the subcommittee for inviting me today to discuss the deliberate misclassification of workers as independent contractors, and the effects on our nation. My name is Cliff Horn, President of A. Horn Inc. we are a commercial mason contractor, working in the Chicago-land area. I am testifying today on behalf of the Mason Contractors Association of America, a national trade association representing Mason Contractors across the country and whose membership accounts for $2 billion in masonry sales annually.

My father arrived in the US in 1957 not knowing a word of English with just $26, a suitcase and a dream of a better life. He worked his first day in America as a construction laborer. After 14 years of employment as a union tradesman, my dad and mom started their own masonry contracting business, A. Horn Inc. After 19 years the business employed 15 people and had achieved annual sales revenues of 3 million. In 1990 I started with A Horn Inc. as an apprentice mason. After I completed my apprenticeship in 1994, I became president in 1998. By 2001, sales had increased to $10 million and our sales projections for 2007 are $15 million. Currently we have 75 employees.

Obviously, growing businesses need profitable contracts. However, for contracting bidding to be fair, the playing field has to be even. When a contractor misclassifies his employees as independent contractors, he gets a competitive disadvantage over the contractors who are playing by the rules and classifying their employees properly.

The misclassification of workers has impacted my business and it is impacted the construction industry at the local, state and federal level.

By misclassifying employees as independent contractors, unscrupulous employers are able to avoid paying taxes and insurance. Businesses that misclassify employees as independent contractors can expect to reduce their labor costs by between 15 and 30 percent. This places contractors like myself at a competitive disadvantage in an industry with 20% gross margins.

The American construction industry is being threatened by the misuse and abuse of independent contractors. Independent Contractors typically have no formalized training, no quality control, and no access to continuing education. There are legitimate independent contractors in the construction industry and it is not my intention to undermine those sole proprietorships and small businesses. The problem which we are here to address today is the intentional misclassification of individuals who are in fact employees but are classified as "independent contractors" by unscrupulous employers. Furthermore, there is the serious question of operations liability coverage in case of a claim, or public health scare. If business owners are taking shortcuts with payroll taxes and liability insurance, would shortcuts in construction methods and design specifications be out of the question? If some contractors are skirting around worker's compensation, then the firms who properly classify employees are forced to carry the burden. If workers compensation is unavailable to a worker, then our health care system absorbs the cost.

The Masonry Industry made the American Dream real for my family. However, I am worried that some contractors are undercutting the industry by misclassifying workers. This is leading to a race to the bottom which will ultimately hurt the industry in the end and leave all contractors at a competitive disadvantage.

I strongly urge Congress to take action to clearly define who is and who is not an independent contractor. Thank you for your time.

Chairwoman WOOLSEY. Thank you.

Mr. Shavell?

STATEMENT OF RICH SHAVELL, PRESIDENT, SHAVELL & CO.

Mr. SHAVELL. Good morning, Madam Chair and honorable members of this subcommittee. My name is Rich Shavell, and I am president of Shavell & Company.

Today I represent the Associated Builders and Contractors, which is a national trade association representing more than

24,000 merit shop contractors, subcontractors and related firms from across the country. ABC appreciates the opportunity to address the committee on the issue of independent contractors.

Now, while congressional action may be necessary to clarify the entire independent contractor regime, we caution this committee and Congress to carefully consider the impact of any such action to ensure that good, honest, hardworking businesses and their workers are not overrun with increased and costly regulatory requirements.

I intend to address three topics.

First, all parties desire a level playing field. All parties must function under a confusion framework of rules that inadequately addresses the classification of workers. It is critical to distinguish between wrongful classification and misclassification. In construction, wrongful classification, as you heard, by a competitor, can result in a competitive disadvantage to other contractors.

Contrast this with misclassification, which easily can occur because current laws and rules are extremely complex. Intentional misclassification by businesses is wrong. We endorse a level playing field for all businesses and workers. For those workers who are faced with improper misclassification, we believe they should be accorded every opportunity to have their financial situation corrected.

Employment agencies that do not properly pay workers should face severe enforcement. Under current—and I will focus on tax laws—subjective 20-factor common law test leads to disputes between the IRS and businesses. Even if misclassification is unintentional, the ramifications can be dramatic to both the worker; the business owner in the form of back taxes, interest, applicable penalties and even the possible disqualification of retirement plans. Adding further confusion, in addition to the IRS methodology, a business owner may confront other methodologies for differing governmental purposes.

Secondly, independent contractors are integral to the construction industry and are often the perfect answer to a pressing need for special skills and experience needed on short-term projects. The independent contractor has the freedom to choose his or her work schedule, while the small business owner maintains the flexibility to adjust work demands with current business activity.

And the third topic is what are the potential resolutions to this issue. There are four such resolutions commonly discussed. The first is the increased reporting requirement. Within the context of the federal tax gap, it has been proposed to Congress that increased information reporting may provide part of the solution.

A second resolution is to elevate enforcement. IRS indicates that for every dollar invested in enforcement, $4 in increased revenue to treasury is returned.

Thirdly is to clarify and simplify the 20-factor and the other subjective tests and to educate businesses and workers.

And, lastly, you may even hear eliminate the availability of independent contractor status.

ABC supports the three initial resolutions listed with the understanding we remain concerned that any action taken by Congress should ensure businesses and their workers are not overrun with costly regulatory requirements. However, the mechanics of the

fourth resolution, that is to eliminate independent contractors from our economy, is fraught with technical problems and these technical issues may be the reason you don't hear, for example, the IRS constructively discussing the option of eliminating independent contractor status.

This would not be a viable alternative in the construction industry for several reasons. The fundamental concern, of course, is that cash flow would be impaired for the independent contractor that is properly reporting under that methodology. So for significant technical and practical reasons, ABC cannot advocate that independent contractor status is eliminated and no credible consideration can be given to such option.

I thank you for the opportunity to testify today on behalf of ABC. I look forward to your questions. Thank you.

[The statement of Mr. Shavell follows:]

Prepared Statement of Rich Shavell, CPA, President, Shavell & Co.

Good morning Madam Chair and honorable members of this subcommittee. My name is Rich Shavell and I am President of Shavell & Company, P.A. We are an accounting and consulting firm that specializes in construction with offices in Florida. I serve as Chair of the Tax Advisory Group for The Associated Builders and Contractors, Inc. (ABC).

ABC is a national trade association representing more than 24,000 merit shop contractors, subcontractors, materials suppliers, and related firms from across the country and from all specialties in the construction industry. Our diverse membership is bound by a shared commitment to the merit shop philosophy in the construction industry. This philosophy is based on the principles of full and open competition unfettered by the government, nondiscrimination based on labor affiliation, and the award of construction contracts to the lowest responsible bidder through open and competitive bidding. It is an honor to be their voice before you today.

ABC appreciates the opportunity to address the Committee on the issue of independent contractors.

While Congressional action may be necessary to clarify the entire independent contractor regime, we caution this Committee and Congress to carefully consider the impact of any such action to ensure that good-honest hard working businesses and their workers are not overrun with increased and costly regulatory requirements.

I intend to address three topics:

- First, ABC supports a level playing field for all businesses and ABC supports efforts to ensure that workers who are misclassified receive appropriate relief;
- Secondly, Independent Contractors are integral to our industry and our country's dynamic economy; and
- Lastly, what potential resolutions are available to address worker misclassification.

1. All Parties Desire a Level Playing Field

While the construction industry provides significant opportunities for independent contractors, all parties must function under a confusing framework of rules that inadequately address the classification of workers as either employees or independent contractors. Initially, it is critical to distinguish between wrongful classification and misclassification. In construction, wrongful classification by a competitor can result in a competitive disadvantage to other contractors. Contrast this with misclassification, which can easily occur because current law and rules are extremely complex.[1]

Those companies not paying employee taxes or worker' compensation by wrongful classification can undercut the competition by offering lower bids. ABC in no way condones intentional misclassification by businesses that shirk their duties to society and their workers. We endorse a level playing field for all businesses and workers. For those workers who are faced with improper misclassification we believe they should be accorded every opportunity to have their financial situation corrected. Also employment agencies that do not properly pay workers should face severe enforcement.

Under current tax law, taxpayers use a 20-factor common law test that can be controversial and cumbersome because it is so subjective, leading to disputes between the IRS and businesses. Even if misclassification is unintentional the ramifications can be dramatic to both the worker and business owner in the form of back

taxes, interest, applicable penalties, and even the possible disqualification of retirement plans.

Adding further confusion is that in addition to the IRS methodology for determining status a business owner may confront other methodologies for differing purposes.[2] For example, the Common Law "Right to Control" test which is often used by courts to determine employee status in various types of cases, including employment discrimination and benefit cases, tax cases, and tort liability cases. And, the Department of Labor uses a model of analysis known as the "economic realities test" to determine coverage under, and compliance with, the minimum wage and overtime requirements of the Fair Labor Standards Act. Further many states have similar but not identical methods for state purposes.

Independent Contractors are Integral to the Construction Industry

Independent contractors are often the perfect answer to a pressing need for special skills and experience needed on short-term projects. The flexibility an independent contractor provides to a small, fledging operation as well as larger enterprises creates numerous advantages for all parties involved. The independent contractor has freedom to choose his or her work schedule, while the small business owner maintains the flexibility to adjust work demands with current business activity, and the consumer enjoys the benefit of a reasonably priced, quality product. Lawful utilization of independent contractors provides a good source of labor for projects where the contractor does not need to exercise the type of control that would necessitate the hiring of an employee.[3]

Potential Resolutions

Four resolutions are commonly discussed:

1. Increase Reporting Requirements—Within the context of "The Federal Tax Gap" it has been proposed to Congress that increased information reporting may provide part of the solution.[4] IRS statistics indicate that when reporting requirements such as Forms 1099 are required, compliance increases from approximately 57% to 96%.[5] Eliminating the exemption from 1099 reporting for corporations would facilitate elevated reporting for independent contractors. By approaching the issue this way, less emphasis is placed on unclear classification rules while emphasis is shifted to the relatively clear laws of filing annual information returns.

2. Elevate Enforcement—IRS indicates that for every dollar invested in enforcement four dollars in increased revenue to Treasury is returned. Further, the Commissioner of the IRS has stated, "This 4:1 return on investment does not consider the indirect effect of increased enforcement activities in deterring taxpayers who are considering engaging in non-compliant behavior."[6] Departments of Labor—both Federal and the States—can also elevate enforcement on this issue.

3. Clarify and simplify the 20-factor subjective test and educate businesses and workers.[7]

4. Eliminate availability of independent contractor status.

ABC supports the three initial listed with the understanding that we remain concerned that any action taken by Congress should be measured against the impact on good-honest hard working businesses and their workers to ensure they are not overrun with increased and costly regulatory requirements.

However, the mechanics of eliminating independent contractors from our economy is wrought with technical problems that are not clearly explained by constituencies who have concerns with the legal availability of independent contractors. These technical issues may be the reason you don't hear the IRS constructively discussing the option of eliminating independent contractor status.

Further, this would not be a viable alternative in the construction industry. Consider one fundamental concern for the contractor who is properly functioning as an independent contractor: Cash flow would be impaired for the independent contractor who exceeds FICA limits since each "employer" would withhold up to the limit.[8] For significant technical and practical reasons, ABC cannot advocate that independent contractor status is eliminated and no credible consideration can be given to such option.

I thank you for the opportunity to testify today on behalf of ABC. I look forward to your questions.

ENDNOTES

[1] Consider that the instructions for the three pages Form SS-8 (Rev. 11-2006), Determination of Worker Status for Purposes of Federal Employment Taxes and Income Withholding, that the IRS requires to secure a determination letter on the status of a worker, reflects 22 hours for recordkeeping and two hours to complete.

[2] There are many non-federal income factors that may be relevant to independent contractor vs. employee status: Workers compensation benefits; Federal and state civil rights laws; Fair

Labor Standards Act; National Labor Relations Act; Occupational Safety and Health Act; Americans with Disabilities Act; and State income/unemployment taxes

[3] Many ABC members started their own businesses by initially working as an independent contractor. It is not unusual for these individuals to work as employees during regular hours and as independent contractors during off-hours and weekends. There is no better way to become established as a small business than to begin as an independent contractor. Because of the cyclical nature of the industry, many businesses cannot afford to keep certain specialized trade craftspeople as employees. Sometimes, skilled craftspeople are needed several times throughout the year, but not enough to warrant full-time or even part-time employment. Having to place two or three extra employees on the payroll just to finish a short-term project places a significant and unnecessary burden on companies.

[4] The Causes and Solutions to the Federal Tax Gap: Hearing Before the Senate Committee on the Budget, 109th Cong. (2006) written statement of Nina E. Olson, National Taxpayer Advocate available at: *http://budget.senate.gov/republican/hearingarchive/testimonies/2006/NinaOlsenTestimony.pdf.*

[5] IRS Updates Tax Gap Estimates, IR-2006-28 (Feb. 14, 2006).

[6] Written testimony of Commissioner of Internal Revenue Service, Mark Everson, before The Senate Committee on the Budget (Feb. 14, 2007)

[7] ABC previously testified on July 26, 1995 before the House Small Business Committee in support of increased education and clarification of the 20-factor independent contractor test.

[8] The end result will be increased construction costs. Also consider: a). It would force the independent contractor to adopt a massive record keeping structure that they may not be equipped to handle. At times the independent contractor may be the employer when performing small projects, then switch to an "employee" status when working as a sub. The resulting tax payment requirements would be difficult to monitor; b). Monitoring the unemployment rates in some states would be very difficult and rules would have to be established to help determine which "employer" would be responsible for the unemployed worker; c) Companies in some states may be forced to take on additional exposure in the area of workers compensation for which they may not be familiar and for which duplicative or exorbitant safety program costs may be the result; d) The new "employer" would have to take on all of the financial risks of a project rather than mitigating some of that risk by using the independent contractor for a lump sum job. Bidding jobs would thereby become more complex.

Chairwoman WOOLSEY. Thank you.

Ms. Ruckelshaus?

STATEMENT OF CATHERINE K. RUCKELSHAUS, LITIGATION DIRECTOR, NATIONAL EMPLOYMENT LAW PROJECT

Ms. RUCKELSHAUS. Chairwoman Woolsey and members of the committee, my name is Cathy Ruckelshaus, and I am from the National Employment Law Project. I thank you for the opportunity to testify this morning on the problem of the misclassification of employees as independent contractors.

My organization, the National Employment Law Project, is a nonprofit that specializes in access to and keeping good jobs for all workers. In our basic labor standards enforcement work, in increasing instances we are seeing employers 1099 their employees or paying them in cash and off the books when employers should be issuing W-2s and treating their workers as employees.

This harms workers and their families. It depletes state and federal government coffers, it undercuts law abiding businesses and it hurts our economy overall. I will address each in turn.

For 20 years, I have worked with communities of low income workers in dozens of job categories to ensure that they get the basics: minimum wage and overtime premium pay, safe and healthy worksites and fair treatment on the job. This is more than a full-time job.

More and more, independent contractor abuses appear in these workplaces, creating grim jobs and causing enforcement snags. I will give you two recent examples.

Faty Ansoumana, an immigrant from Senegal, worked as a delivery worker in Gristede's store in midtown Manhattan. He worked

as many as 7 days a week, 10 to 12 hours a day, and his weekly salary struggled to reach $90.

He and his fellow delivery workers were all hired through two middleman labor brokers who in turn stationed the workers at grocery and pharmacy chain stores throughout New York City. The workers all reported directly to the stores and provided deliveries during the stores' delivery hours and under the stores' supervision. Many delivery workers were required to bag groceries and do other non-delivery work, including stocking shelves.

When we challenged these abysmal conditions, the first thing the store said was the workers are not our employees. We turned to the individual labor brokers and they said the workers are each an independent contractor, and so they don't have rights to minimum wage and overtime pay.

We were able to recover $6 million for the over 1,000 delivery workers in the lawsuit, but only after overcoming the claims that no one was responsible for the working conditions and that the workers were not employees covered by labor employment laws.

My second example is a variation on a theme. Janitors from Central and South America were recruited by a large building services cleaning company, Coverall, Inc., to clean office buildings in Massachusetts and other states. The janitors were sold franchise agreements permitting them to clean certain offices for Coverall. They paid tens of thousands of dollars for these franchise agreements. They were told were to clean, when to clean and what materials to use and they could not set their own prices.

When one janitor quit when she couldn't make ends meet, she applied for unemployment benefits in Massachusetts. She was told she was an independent contractor and not eligible. She challenged the decision and the Massachusetts highest court found in her favor.

I could go on, but you get the idea. The problem is so broad, it is probably happening to somebody you know. It happens at jobs at all income levels, and I get calls from workers all over the United States with these questions.

The Department of Labor's 2000 study estimated that 30 percent of employers misclassified their employees. At my office at NELF, we have worked on independent contractor problems in construction, day labor, janitorial, home health care, child care, agriculture, poultry and meat processing, high tech, delivery and trucking.

This hurts workers because if it is successful, workers lose out on minimum wage and overtime, health and safety and Workers Compensation rights, protections against sex harassment and discrimination, unemployment insurance, the right to organize and bargain collectively and Social Security and Medicaid payments. This is a profound impact.

Federal and state governments suffer hefty loss of revenues due to independent contractor misclassification. The GAO estimated that those tax revenues at the federal level were $4.7 billion. This is a staggering impact. It harms law-abiding employers in our economy because employers who misclassify stand to save upwards of 30 percent of their payroll costs, allowing them to underbid their competitors.

I have some policy suggestions for enhancing Department of Labor's enforcement ability, but I will save those for the question-and-answer because I see my time is up. Thank you.

[The statement of Ms. Ruckelshaus follows:]

Prepared Statement of Catherine K. Ruckelshaus, Litigation Director, National Employment Law Project

Madam Chairwoman 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 Litigation Director for the National Employment Law Project (NELP), a non-profit advocacy organization that specializes in access to and keeping good jobs for low-income workers. In the twenty years I have spent working with and on behalf of low-wage 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) 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 garment, agricultural, construction and day labor, janitorial, retail, hospitality, home health care, poultry and meat-packing, high-tech, delivery, and other services. We have seen low, often sub-minimum wage pay, lack of health and safety protections and work benefits, and rampant discrimination and mistreatment of workers in these jobs.

NELP focuses on simply enforcing workplace laws on the books. In addition to bringing job standards actions against employers, NELP has partnered with labor and immigrant community groups in the states to promote good models for closing independent contractor loopholes. This background in direct workplace laws enforcement and crafting 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 illustrate its effects in all sectors of our economy, including the so-called "underground economy" where workers labor in the shadows. I will conclude with some ideas for policy reforms to contend with this unchecked and growing practice.

I. What is Independent Contractor Misclassification and How Common is It?

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 them off-the-books. Businesses also insert subcontractors, including temporary help firms and labor brokers, between them and their workers, creating another layer of potentially-responsible entities and creating confusion among workers. Here are some reasons why 1099-ing 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." [1]

Genuine independent contractors constitute a small proportion of the American workforce, because by definition, an "independent contractor" operates a business. True independent contractors have specialized skill, invest capital in their business, and perform a service that is not part of the receiving firm's overall business.[2] 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." [3]

The problem is so pervasive that states have begun mandating studies of the problem and lead the way in reforms; in the last five years, at least nine states have collected data on the problem. In addition:

• Many states create a presumption of employee status so that workers providing labor or services for a fee are "employees" covered by labor and employment laws. This is already law in over ten states' workers' compensation acts[4] and in Massachusetts' wage act.[5]

• A few states have created inter-agency task forces to share data and enforcement resources when targeting 1099 abuses.[6]

• Several states create "statutory employees" in certain industries (construction, trucking) where independent contractor schemes prevail.[7] 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).[8] Three states have laws regulating employment in the garment industry (CA, NJ and NY).[9] One state has specialized laws regulating the meat packing industry (NE).[10] Six states have laws that regulate day labor (AZ, FL, GA, IL, NM and TX).[11]

A. Misclassification is Found in Every 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.[12] 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.[13]

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.[14]

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. 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.[15]

Independent contractor misclassification occurs with an alarming frequency in: construction,[16] day labor,[17] janitorial and building services,[18] home health care,[19] child care,[20] agriculture,[21] poultry and meat processing,[22] high-tech,[23] delivery,[24] trucking,[25] home-based work,[26] and the public[27] sectors. I could relate stories to you of independent contractor abuses in each of these job categories.

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. Because 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. This is because of the labor standards loopholes created by improper use of 1099-ing. 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 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.

Recent government studies find as many as 50—100% of garment, nursing home, and poultry employers in violation of the basic minimum wage and overtime protections of the Fair Labor Standards Act.[28] Community group surveys in the day labor, restaurant and domestic service industries find similar sweatshop conditions.[29] Immigrant workers predominate in many of these jobs, creating more barriers to enforcing labor standards where complaints trigger agency action.[30] Immigrant and other workers fear retaliation and other reprisals, chilling them from coming forward to lodge complaints of unfair workplace conditions. Without overt agency action to ferret out the violations, many 1099 abuses go unnoticed.

Low wages and unsafe conditions persist in these jobs.[31] The Bureau of Labor Statistics found that 2.2 million hourly workers were paid at or below the federal minimum wage in 2002.[32] The federal minimum wage at its current level of $5.15/hour nets an earner a little over $10,700 annually, hardly enough to make ends meet. The employer-backed Employer Policy Foundation estimated that workers would receive an additional $19 billion annually if employers obeyed workplace laws.[33] A 2000 U.S. DOL-commissioned study of employer tax evasion in the unemployment insurance system found lost unemployment insurance benefits to 80,000 workers annually from employer misclassification of workers as independent contractors.[34] These studies, while showing important losses, are in dire need of updating with new data and information.

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. The GAO estimated that misclassification of employees as independent contractors reduces federal income tax revenues up to $4.7 billion.[35] Coopers & Lybrand (now PriceWaterhouse Coopers) estimated in 1994 that proper classification of employees would increase tax receipts by $34.7 billion over the period 1996-2004.[36]

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.[37] 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.[38]

IV. What Are Some Federal Policy Reform Possibilities?

Much progress can be made to combat independent contractor misclassification by beefing up enforcement of existing labor and employment laws to close independent contractor loopholes. This can be achieved by making the DOL more effective. Another area ripe for reform is in the tax area; but because this Committee has jurisdiction over worker protection rules, I will focus on those areas of potential reform.[39]

A. Make the U.S. DOL More Effective

Workplace enforcement of labor standards for all workers should be at a level designed to send a message that America will not tolerate non-payment and underpayment of wages. This means more emphasis on enforcement: more personnel, and more focus on industries that are known violators of wage and hour laws, so that at a minimum, low-wage workers get the wages that they are entitled to under current law. This focus on enforcement includes ensuring employers do not evade the basic job laws by misclassifying employees as independent contractors.

Enforcement by DOL generally is down. In the face of wholesale violations in particular industries, resources dedicated to enforcement have been falling for many years. For example, from 1975—2004, the budget for U.S. Wage and Hour investigators decreased by 14% (to a total of 788 individuals nationwide) and enforcement actions decreased by 36%, while the number of workers covered by statutes enforced by the Wage and Hour Division grew by 55%.[40] At present, there is approximately one federal Wage and Hour investigator for every 110,000 workers covered by FLSA.[41] By 2007, the U.S. Department of Labor's (U.S. DOL) budget dedicated to enforcing wage and hour laws will be 6.1 percent less than before President Bush took office.[42]

Some particular DOL-based reform suggestions are:

• Direct DOL to be more strategic with existing resources, including conducting proactive audits of problem industries with persistent violations and sharing audit data with the unemployment insurance arm of DOL;

• Require that DOL share information on independent contractor problems and coordinate with the IRS, as suggested by the 2006 GAO Report;[43]

• Mandate "hot goods" seizure of goods produced under substandard conditions and where misclassification has occurred;

• Create an Office of Community Outreach charged with working with community and organizing groups to identify 1099-related problems and witnesses for enforcement targets and to educate workers about their rights;

• Require data collection on wage claim levels and violations, by industry, and on independent contractor misclassifications;

• Enhance DOL's Wage & Hour Enforcement Budget, and earmark it for more targeted industry audits and investigations where independent contractor abuses prevail.

A critical component of any US DOL reform package is to ensure that there is a firewall between immigration and labor law enforcement. All workers should have meaningful access to systems of labor law enforcement: Because labor and employment laws are complaint-driven and because many of the industries with independent contractor abuses are dominated by immigrant workers, workers must feel free to come forward to complain. This means preserving historic boundaries between labor law enforcement and enforcement of immigration law. In 1998, US DOL entered into a Memorandum of Understanding (MOU) with the then-INS establishing that the labor agency will not report the undocumented status of workers if discovered during an investigation triggered by a complaint made by an employee when there is a labor dispute, nor will it inquire into a worker's immigration status while conducting a complaint-driven investigation.[44] This policy must be enforced, and strengthened with clear directives to field staff at the enforcement agencies.

ENDNOTES

[1] Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification, GAO-06-656 (July 2006), at p. 25.

[2] See, Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification, GAO-06-656 (July 2006), at p. 43. 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 shipping and receiving company to trouble-shoot software glitches.

[3] U.S. DEP'T OF LABOR, Commission on the Future of Worker- Management Relations, (1995), available at *http://www.dol.gov/—sec/media/reports/dunlop/dunlop.htm#Table.*

[4] 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).

[5] *http://www.mass.gov/legis/laws/mgl/149-148b.htm.*

[6] See, NELP, Combating Independent Contractor Misclassification in the States: Models for Successful Reform (December 2005). *http://www.nelp.org/docUploads/COMBATING%20INDEPENDENT%20CONTRACTOR%20MISCLASSIFICATION%2Epdf*

[7] Id.

[8] See, NELP, Subcontracted Workers: The Outsourcing of Rights and Responsibilities (March 2004). *http://www.nelp.org/docUploads/subcontracted%20work%20policy%20update%5F072704%5F065405%2Epdf*

[9] CAL. LAB. CODE § 2675 et. seq.; N.J. REV. STAT. § 34:6-144; N.Y. LAB. LAW § 340 et. seq.

[10] NEB.REV.STAT. § 81-404.

[11] ARIZ. REV. STAT. § 23-551 et. seq.; FLA STAT. ANN. § 448.20 et. seq.; GA. CODE ANN. § 34-10-1 et. seq.; 820 ILL. COMP. STAT. 820/175 et. seq.; N.M. Stat. Ann. 50-15-1 et. seq.; TEX. LAB. CODE Ann. § 92.001 et. seq.

[12] Lalith de Silva et al., "Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs" i-iv, prepared for U.S. Department of Labor, Employment and Training Division by Planmatics, Inc. (Feb. 2000), available at *http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf.*

[13] See Fiscal Policy Institute, "New York State Workers Compensation: How Big is the Shortfall?" (January 2007); Michael Kelsay, James Sturgeon, Kelly Pinkham, "The Economic Costs of Employee Misclassification in the State of Illinois" (Dept of Economics: University of Missouri-Kansas City: December 2006); Peter Fisher et al, "Nonstandard Jobs, Substandard Benefits", Iowa Policy Project (July 2005); Francois Carre, J.W. McCormack, "The Social and Economic Cost of Employee Misclassification in Construction (Labor and Worklife Program, Harvard Law School and Harvard School of Public Health: December 2004); State of New Jersey, Commission of Investigation, "Contract Labor: The Making of an Underground Economy" (September 1997).

[14] Francois Carre, J.W. McCormack, "The Social and Economic Cost of Employee Misclassification in Construction (Labor and Worklife Program, Harvard Law School and Harvard School of Public Health: December 2004), at p. 8.

[15] Coverall North America, Inc. vs. Commissioner of the Division of Unemployment Assistance, SJC-09682, 447 Mass. 852 (2006).

[16] Francois Carre, J.W. McCormack, et al., "The Social and Economic Cost of Employee Misclassification in Construction" 2, Labor & Worklife Program, Harvard Law School and Harvard School of Public Health, Dec. 2004, available at *http://www.faircontracting.org/NAFCnewsite/prevailingwage/pdf/Work—Misclass—Stud—1.pdf*

[17] Abel Valenzuela and Nik Theodore, On the Corner: Day Labor in the United States (January 2006).

[18] See Coverall North America, Inc. vs. Commissioner of the Division of Unemployment Assistance, SJC-09682, 447 Mass. 852 (2006); Vega v. Contract Cleaning Maintenance, 10 Wage & Hour Cases 2d (BNA) 274 (N.D. IL 2004).

[19] See Bonnette v. Cal. Health & Welfare Agcy., 704 F.2d 1465 (9th Cir. 1983).

[20] See, e.g., IL Executive Order conferring bargaining status on child day care workers otherwise called independent contractors: *http://www.gov.il.gov./gov/execorder.cfm?eorder=34.*

[21] Sec'y of Labor v. Lauritzen, 835 F.2d 1529 (7th Cir. 1988).

[22] Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification, GAO-06-656 (July 2006), at p. 30.

[23] Vizcaino v. Microsoft Corp., 97 F.3d 1187 (9th Cir. 1996).

[24] Ansoumana et al v. Gristedes et al, 255 F.Supp.2d 184 (S.D.N.Y. 2003).

[25] New York Times, "Teamsters Hope to Lure FedEx Drivers," May 30, 2006 (cataloguing cases).

[26] Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification, GAO-06-656 (July 2006), at p. 31.

[27] Phillip Mattera, "Your Tax Dollars at Work * * * Offshore," Good Jobs First (July 2004) *http://www.goodjobsfirst.org/publications/Offshoring—release.cfm*

[28] (Poultry—100% noncompliance) U.S DEP'T OF LABOR, FY 2000 POULTRY PROCESSING COMPLIANCE REPORT (2000); (garment—50% noncompliance), BUREAU OF NATIONAL AFFAIRS, U.S. DEP'T OF LABOR, LABOR DEPARTMENT: CLOSE TO HALF OF GARMENT CONTRACTORS VIOLATING FAIR LABOR STANDARDS ACT, DAILY LABOR REPORTER 87 (May 6,1996); David Weil, Compliance With the Minimum Wage: Can Government Make a Difference? VERSION (May 2004), available at *http://www.soc.duke.edu/sloan—2004/Papers/Weil—Minimum%20Wage%20paper—May04.pdf;* (agriculture—"unacceptable" levels of noncompliance) U.S. DEP'T OF LABOR, COMPLIANCE HIGHLIGHTS 1,3 (1999); (nursing homes—60% noncompliance), EMPLOYMENT STANDARDS ADMINISTRATION, U.S. DEP'T OF LABOR, NURSING HOME 2000 COMPLIANCE FACT SHEET, available at *http://www.dol.gov/esa/healthcare/surveys/nursing2000.htm.*

[29] More than half of New York City restaurants were violating overtime or minimum wage laws in 2005. Restaurant Opportunities Center of New York and the New York City Restaurant Industry Coalition, Behind the Kitchen Door: Pervasive Inequality in New York City's Thriving Restaurant Industry (New York, 2005), available at *http://www.rocny.org/documents/ROC-NYExecSummary.pdf;* Domestic Workers United and DataCenter, Home is Where the Work is: Inside New York's Domestic Work Industry, (2003-3004); Abel Valenzuela and Nik Theodore, On the Corner: Day Labor in the United States (reporting half of day laborers surveyed experienced wage theft, and many suffer harassment from merchants and arrests by police)(January 2006).

[30] David Weil and Amanda Pyles, Why Complain? Complaints, Compliance, and the Problem of Enforcement in the U.S. Workplace, Comp. 27 Labor Law & Pol'y Journal 59, 60 (2006). U.S. GENERAL ACCOUNTING OFFICE, Worker Protection: Labor's Efforts to Enforce Protections for Day Laborers Could Benefit from Better Data and Guidance, GAO 02-925 (September 2002)("GAO Day Labor Report") (Noting that day laborers rarely complain to DOL due to fear and intimidation by employers and perception of inactivity on the part of DOL).

[31] For a list of the statistics on various low-wage industries, see, Holding the Wage Floor: Enforcement of Wage and Hour Standards for Low-Wage Workers in an Era of Government Inaction and Employer Unaccountability, (New York: National Employment Law Project, Oct. 2006), available at *http://www.nelp.org/.*

[32] See, Workers are Paid at or Below Minimum Wage in 2002, BLS Says, 173 Lab.Rel.Rptr. 16, ECONOMIC NEWS, September 1, 2003.

[33] See Craig Becker, A Good Job for Everyone, LegalTimes, Vol. 27, No. 36. (Sept. 6, 2004).

[34] Planmatics, Inc., Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs (February 2000).

[35] U.S. GENERAL ACCOUNTING OFFICE, Tax Administration Information: Returns Can Be Used to Identify Employers Who Misclassify Employees GAO/GGD-89-107 (1989).

[36] Projection of the Loss in Federal Tax Revenues Due to Misclassification of Workers, Coopers & Lybrand (1994).

[37] New York State Workers' Compensation: How Big Is the Coverage Shortfall?, (New York: Fiscal Policy Institute, Jan. 2007).

[38] Francois Carre, J.W. McCormack, et al., "The Social and Economic Cost of Employee Misclassification in Construction" 2, Labor & Worklife Program, Harvard Law School and Harvard School of Public Health, Dec. 2004, available at *http://www.faircontracting.org/NAFCnewsite/prevailingwage/pdf/Work—Misclass—Stud—1.pdf*

[39] A major problem barring 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 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.

[40] Annette Bernhardt & Siobhan McGrath, Trends in Wage and Hour Enforcement by the U.S. Department of Labor, 1975-2004, Economic Policy Brief No. 3 (New York: Brennan Center for Justice at NYU School of Law, September 2003).

[41] Id. There are nearly 88 million people covered by FLSA. Id.

[42] Judd Legum, Faiz Shakir, Nico Pitney, Amanda Terkel, and Payson Schwin et.al., Labor—Bush Priorities Hurt Workers, Help Employers (Under the Radar), THE PROGRESS REPORT, June 14, 2006.

[43] Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification, GAO-06-656 (July 2006), at p. 33, 35.

[44] See Memorandum of Understanding Between the Immigration and Naturalization Service (Department of Justice, and the Employment Standards Division, Department of Labor, November 23, 1998).

Chairwoman WOOLSEY. Thank you very much.

Thank you, all four of you, for your testimony.

I would like to start with you, Mr. Shavell. Does ABC have training programs or handouts or information that you send to your members so that they can actually learn the difference between an independent contractor and an employee? And what would you tell them? What are the standards and guidelines that you would tell them, to prove whether they have an employee or an independent contractor?

Mr. SHAVELL. The issue, as you point out in your opening statement, is extremely complex.

The determination of whether somebody is an independent contractor or an employee is going to affect different aspects.

Chairwoman WOOLSEY. I am asking you—it isn't that complex. I am telling you that. I was a human resources manager professional for 20 years. I know the difference between an employee and an independent contractor.

What do you tell your members? Do you have guidelines that you have to be working for more than one, you cannot be under the control of just that one employer.

Mr. SHAVELL. To answer the question directly, I am sure that there are materials that are involved in the different programs that ABC shares with its members for educational purposes.

My point was simply that the definition is different for different purposes. I was focusing on tax. There are different tests for different purposes. The Department of Labor actually uses a different test than the IRS would use, and there are other boards that would use different tests.

At the state level, there are different issues also.

Chairwoman WOOLSEY. Well, except you either are an employee or you are not.

Ms. Ruckelshaus?

Ms. RUCKELSHAUS. Yes, Madam Chair. Mr. Shavell is correct that there are different tests, but there are certain objective factors that are crystal clear. And the main concern is, is this person in business for him or herself? Is there a business there? Is there capital invested? Is there a specialized skill that the person brings to the business? Is the work that is being performed integrated into the worksite employer's business?

Those are the primary concerns that people look to to determine independent contractor status.

Chairwoman WOOLSEY. And also, is this independent contractor able to go to work for somebody else without that employer thinking that they are leaving a job, that they have the right to go someplace else.

All right. So I would suggest also to you, Mr. Shavell, do you talk to your members about what the penalties will be if they are caught? I mean, if they have a whole workforce of "independent contractors," and somebody has a Workers Comp claim, do they know that they are going to have to reach back and make up for all those Workers Comp premiums that they have been ducking all this time? Do they know they have to go back and pay payroll taxes for the state that they have been ducking all this time?

Go ahead, you may answer.

Mr. SHAVELL. I sense a presumption that ABC members are doing something wrong. ABC members are 24,000 businesses across the country. There are many, many other businesses.

So as far as what we are doing, as I indicated, I am sure within some of the materials and education programs, I am sure they share the information with the businesses. The point is that there are a lot of small businesses that start out as independent contractors and a lot of members of ours, as well as many other associations and other industries within the country.

Chairwoman WOOLSEY. Well, yes, indeed, that is true, but they start out as individuals themselves as independent contractors, then they start hiring. That is an entire different bag of tricks. So that is where we have to be able to distinguish between this is my business I can do because it is me and my family. Those are the only people you can take advantage of. You can't legally take advantage of others than yourself and your family.

Mr. Flynn?

Mr. FLYNN. Yes, I guess in our case, we are a union, but we do have collective bargaining agreements with over 12,000 employers with our union. And they are all called subcontractors, generally. They are all independent contractors. But they do run legitimate businesses. They do have employees. They do pay the benefits and the things that are involved with being in business.

And we think that is why this is such an important issue. When other employers, who are hiring people and classifying them as independent contractors and not, you know, paying in the proper taxes on those employees, we think that causes an undermining of the system and the laws that protect employees here in America. And we think that is the big difference in our country. That is

what creates our middle class in order for people to be employees and make fair and decent wages.

And letting this go on simply undermines the ability of Mr. Horn and others in our industry to be able to run their businesses and continue to compete.

Chairwoman WOOLSEY. Thank you. Thank you very much.

Mr. Wilson, from South Carolina?

Mr. WILSON. Thank you very much, Madam Chairman.

Mr. Flynn, thank you for being here. You have an excellent reputation in Washington for effectiveness.

And, Mr. Horn, thank you for coming. You have really brought a great perspective, being a mason, foreman, business owner. Thank you for being here.

I am particularly happy to see a CPA and an attorney sitting together. I am a former real estate attorney, and something I ran into frequently is if you mention the word IRS, I immediately threw my hands up and said, "We have got to get a CPA involved." But it is a good team relationship.

Mr. Shavell, you have identified the 20-factor test and it has also been identified, or I have read, about IRS ambiguity and inconsistency with the 20-factor test, with other tests, that may be used. What are the factors in particular that IRS looks at? And is there a consistency?

Mr. SHAVELL. On the tax side, this 20-factor test has been around for quite a while, and was explained, some of the key factors you are going to be looking at is who is controlling the work, whether or not the independent contractor has the ability to work for other businesses as well, who is controlling the hours, the location, who is making the investment, is there risk of loss, on and on. There are 20 factors.

Are there inconsistencies? As I have pointed out, there are some differences. Maybe not significant, but there are some differences as to how the Department of Labor and some other entities may look at these factors. And probably if you look at the one consistent one is the control factor. Who is controlling how the work is being done? That is a key thing. And also controlling the schedule.

Also, at the state level, various states have different rules as to what the factors may be. They may look at a 10-factor test, a financial reality test. There are a few different ones.

My point was simply that there is a complexity for the business owner in dealing with these things, and the point I want to go back to, if I can just make one last point, there is a consistency sitting here on this panel. Everybody here wants a level playing field. There is no need for people to be doing wrongful acts. Wrongful misclassification is wrong. There is no doubt about it. Everybody, a business owner like myself, we want a level playing field. Mr. Horn wants a level playing field. Everybody wants a level playing field. I think that is the consistency you see here in front of you.

Mr. WILSON. Ms. Ruckelshaus, with your background, with the 20-factor test, the other tests that are used, do you see consistency? Or what can be done?

Ms. RUCKELSHAUS. Yes, in my opinion, legislative action on the actual test is not necessary right now because the way the laws are

drafted, if they were enforced correctly and fully, we wouldn't need any legislative changes.

The laws are sufficiently broad and sufficiently define employee to cover most of the people I have been talking about and most of the people that my co-presenters have been discussing. It is really not a question of changing the law as much as enforcing the laws that are on the books and doing it more strategically, to plug up these loopholes.

Mr. WILSON. Mr. Shavell, you have identified that different states have different efforts. Are there some states that have been more active and effective? Which ones may they be?

Mr. SHAVELL. The expert is right here next to me, but I will give you two examples.

Mr. WILSON. And I was going to ask her that question, too.

Mr. SHAVELL. Two examples would be California, for example, in the construction industry. One of the members of our tax advisory group shared with me before I came here today, he said in California, with contractors, if the worker does not have a license for the service they are going to perform, then that individual worker must be an employee of whom they are doing the work for. So it eliminates a high level of confusion there.

In my home state of Florida, in 2003 they changed some rules on Workers Compensation and the rule changes really weren't significant, but what was truly significant is since that point in time in 2003, when they tightened up some filing requirements and regulator requirements, they have done a pretty good job of enforcement and publicizing where they have been able to catch people that are doing things wrong. And some people have been facing criminal action. And that message permeates the industry and people begin to realize they need to do something differently.

I agree with what was just said. There isn't need for congressional action. There is need for better enforcement and my personal opinion is that at the state levels, that is where action can really occur, and they need help with enforcement. They need more funding. They need to get out there and do things like I am talking about that Florida has done.

Mr. WILSON. Could Ms. Ruckelshaus answer briefly?

Ms. RUCKELSHAUS. Just to clarify, I am not saying that we don't need congressional action, it just may not be legislative action. I think there is a lot that this committee could do to encourage Department of Labor to beef up its strategic enforcement.

But to answer your question, sir, on the state reforms, some states have been very successful at combating these problems by creating presumptions of employee status. It doesn't get away from independent contractor status, but it creates a presumption in certain low-wage sectors where it is pretty clear people aren't in business for themselves.

Another thing states have done that is very effective that we can do at the federal level is to create interagency collaboration for Departments of Revenue and Departments of Labor and Departments of Workers Comp or Unemployment, to work together to try to combat the independent contractor problems and some of those ideas are outlined in my written testimony.

One thing that we would caution at the federal level is, because a lot of these independent contractor problems have undocumented workers in the workplaces and we need to be sure the labor standards are there for everybody, at the federal level, with interagency cooperation, we would highly recommend that there be a firewall between immigration enforcement and the labor and tax enforcement. Because otherwise, you drive people underground, you drive them further away from any regulation, and the problem worsens instead of gets better.

Mr. WILSON. Thank you.

Chairwoman WOOLSEY. Thank you.

The gentleman from New York, Mr. Bishop?

Mr. BISHOP. Thank you, Madam Chair, and thank you very much for holding this hearing and shedding light on this shameful and I suspect growing problem.

Let me start with you, Mr. Shavell. You make the point in your testimony that whatever is done to ensure a level playing field, we would need to be careful not to impose regulations and other requirements that would make it more difficult for legitimate businesses to do their jobs.

The practice that Massachusetts has put in place, for example, in which they simply presume the employer-employee relationship unless certain tests are met or the practice that New Mexico has put in place, which they simply assume the employer-employee relationship for all construction jobs, would you find those to be consistent with maintaining a level playing field? Or would you find those to be falling under the heading of imposing an undue burden?

Mr. SHAVELL. I honestly don't know how to answer that, but let me try and answer that.

I guess to focus on the regulatory concerns, it really depends on how they would go about doing that. In my mind, being a tax guy, I always jump to the tax end of things. I am trying to figure out how that gets done.

Mr. BISHOP. Just for a second—I was a history major, so we look at things rather simplistically. But, I mean, if a person comes to a construction job and just as a matter of practice, as a matter of state law, that is an employee, not an independent contractor, walk me through why that would be complex? That strikes me as pretty straightforward.

Mr. SHAVELL. You are making a presumption that everybody is the same.

Mr. BISHOP. Well, this is New Mexico law, so I guess what my question is——

Mr. SHAVELL. I guess it is very similar to what California did.

Mr. BISHOP. It sounds like it is.

Mr. SHAVELL. Which says that, hey, document that you are different and then you can be treated differently.

Mr. BISHOP. Right.

Mr. SHAVELL. That would probably help level the playing field. My concern would be how we accomplish that at the federal level.

Mr. BISHOP. Perhaps we can't accomplish it at the federal level.

Mr. SHAVELL. Right. I think we are all in—maybe we are all in agreement that from a state level, you know, maybe that is where the action needs to occur.

Mr. BISHOP. Okay.

Ms. Ruckelshaus, how would you approach this issue of using perhaps what is in place in either New Mexico or Massachusetts, or both, as a national model that we might encourage other states to replicate?

Ms. RUCKELSHAUS. I think at the state level it can work very well, because the presumption has been in place, as you mentioned, in New Mexico. Ten states have it in their Workers Compensation acts and it has been working quite well for years under those acts.

I am not sure how it would work at the federal level. I still return to my original point that just enforcing what we have now would do huge things to solve this problem, and I think making the Department of Labor more strategic and targeted for some of these independent contractor abuses and perhaps creating presumptions within the Department of Labor's regulations or enforcement could do the trick.

Mr. BISHOP. Thank you.

Mr. Flynn, you, in your written testimony, talked about how the bricklayers sent people into certain situations to see how they were treated. Did the results of that reveal any differences between how union contractors versus nonunion contractors, how they lined up on this issue? Were union contractors more or less likely to misclassify employees?

Mr. FLYNN. Well, a union contractor is a legitimate business person, usually, and they are not trying, as far as I know, I guess there certainly could be occasions when they would, but usually if they have a collective bargaining agreement, it defines anybody working for them is an employee as described in the agreement.

But now what I think our organizers discovered when they began to look into this, they actually went to some of these accounting firms. And they said, oh, sure, we will teach you how to classify everybody as an independent contractor and then you don't have to pay any income tax or social security or unemployment insurance or any of these things, and that is how they discovered that this network of folks is out there, teaching people how to avoid the burdens of the tax system and the insurance.

And Mr. Horn might be able to tell you more about it, because he is from Illinois. That is where the study with our own people was done. And one of those organizers is here, Joe Provola. He is here in the audience.

Mr. BISHOP. Madam Chair, I am out of time, but can Mr. Horn answer?

Chairwoman WOOLSEY. Yes, absolutely.

Mr. Horn?

Mr. HORN. Part of the union audit that they do annually on my books, they look at all my subcontractors, my independent contractors that I contract to, and if any of their work jurisdictions fall under the classifications of the bricklayers, I have to in turn pay full benefits and everything for those individuals, so there is sort of an additional monitoring piece.

I believe that enforcement is the key. The thing that you have to remember is the potential gains of these guys or these employers to operate in this environment is so great. For example, in my business, at the $10 million level, earning the industry average is between 3 percent and 5 percent net margin, you are at 300,000 to 500,000. If I switch to the independent contractor model, I can increase my margins close to 20 percent, that would be $2 million in a $10 million business.

So the potential gain for these guys to cheat is so great, and again, in the Chicagoland area, I am not aware of one incident that there has been enforcement on this issue, and I know as soon as there is, it will spread through the industry and, I think, have a significant impact on it.

Mr. BISHOP. Thank you.

Thank you, Madam Chair.

Chairwoman WOOLSEY. And now the gentleman from Minnesota, Mr. Kline.

Mr. KLINE. Thank you, Madam Chair.

Thank all the witnesses for their testimony today and being here.

I am finding this not quite as simple and straightforward as the chair indicated earlier, because the further we go, the more complicated it seems to me. Let me try to sort of cut through my ability to understand.

One of the claims, and I think Mr. Flynn and Mr. Horn have both addressed this, is there is apparently a very large-scale effort out there to intentionally break the law. By your testimony, you have accountants out there trying to teach employees how to evade the law, which of course would be illegal. So that would be an issue of enforcement, back to Ms. Ruckelshaus' position, and I think Mr. Shavell's.

Let me ask you, Mr. Shavell, are you hearing this from your side, that there are these efforts to teach employers how to evade the law? Or are there efforts to explain a complicated law? Let me just hear another perspective on that, if I could.

Mr. SHAVELL. I have been a CPA since about 1985 and working in construction since about 1987, so I have been dealing with contractors for all those years. Nobody has walked in my office and said, "Teach me how to do this."

Again, there is the saying, "Dishonorable people will do dishonorable things when given the opportunity."

ABC believes wrongful misclassification is just plain wrong. So I would hope that it is not the majority of people out there doing things that are wrong. People don't walk in my office and say teach me how to break the law because I would throw them out.

Mr. KLINE. Thank you.

And if they are, then the law ought to hold them to account about something we are trying to get at here.

But let me just see if I can understand some of the complications here. I have got a sort of hypothetical here, and I will talk to this end of the table, if I could. We would all agree that a general contractor could be in the overall business of, let us say, building houses or something else. They typically have subcontractors, and that has been recognized here, who may be involved in brickwork,

we have got a lot of bricklayers out here, drywall, electrical or something like that.

These subcontractors typically are not employees of the general contractor. Is that not the case? They are not employees?

Mr. SHAVELL. If you are talking about a single individual who is handling one trade, he could or could not be, but the typical situation is they are going to hire a firm who is going to bring the labor with them, and that will be the subcontractor.

Mr. KLINE. So they could have, in theory, and that would be the problem, they could have individuals who were either contractors or employees, and that is the position of enforcement that we are trying to get to.

I found it interesting, you were talking about California and the state law there, and I am just trying to understand this as well, I think it would be pretty clear in the case of the construction trades, but what about other—and here is a kind of bizarre hypothetical that we were doing a little offline chatting up here, as some of you may have noticed.

What about the case of a college kid, 18-or 19-year-old college kid, who decides to be a babysitter? Now, this is a person without any specialized skills. They certainly wouldn't have a license. Would this person be an employee or a contractor under California law? How would that work?

Ms. RUCKELSHAUS. She may be exempt, because there are exemptions under law for babysitters, but let us take that aside. I think that you walk through whatever tests you are looking at. It is complicated, because there are tests for whether or not she is an employee for minimum wage and overtime. It is a different test for tax purposes.

But if you look at some of the core questions, you see, does she have a specialized skill? That could be argued, if she does or not. She probably hasn't invested much capital in a business. She is probably not working—wherever she is working is on the worksite in somebody else's business, because she is working in a home, presumably. She could be working in an institution or in some day care center, which again would change the calculus.

But these are facts-based determinations that you have to make on a case-by-case basis. You can have broad generalizations, as you were just discussing with Mr. Shavell, in construction. But it is important to look at each individual instance and look at the facts and see, is she in business for herself or not? Is she hanging out a shingle? Is she taking out ads in the newspaper or in the want ads to market a business?

Mr. KLINE. The difficulty, of course, becomes that you are the couple getting ready to go out to the ballgame and you are having to determine whether or not this person is an independent contractor, whether they are an employee——

Chairwoman WOOLSEY. Would you yield to me, just a minute?

Mr. KLINE. I would be happy to yield, Madam Chair.

Chairwoman WOOLSEY. Thank you very much.

Isn't it very clear that this young babysitter babysits for more than one family?

Mr. KLINE. Excuse me, reclaiming my time. I don't know how you would know if you were potentially the person hiring.

Mr. Shavell, do you have a comment?

Mr. SHAVELL. No. I just wanted to point out that there is actually an IRS case on a fact pattern with babysitters.

Mr. KLINE. Might want to address it for people who mow lawns as well.

I was very interested—I see my time is about to run out.

You mentioned, Ms. Ruckelshaus, the possibility of some interagency effort, because clearly we have definitions here from the IRS, the Department of Labor, and perhaps ought to be simplified if we are going to try to enforce it, because we have different enforcing agencies here as well, to try to get to the bottom of this. That is an interesting approach.

I don't know how far you have progressed with that, but I have a few seconds left, if you could talk to us about how that might work.

Ms. RUCKELSHAUS. Yes, I am not advocating a simplification of the rules. I am more advocating information sharing and data sharing between the agencies, because if Unemployment Insurance finds that there are misclassifications, they can tell Wage and Hour, and Wage and Hour can go. And similarly, with Treasury, they see when there is a lot of 1099s coming in that there may be a violation there. And usually if you see one violation, you see lots of workplace violations.

So that was the proposal, was to have that——

Mr. KLINE. So not changing the regulations, but changing the—that is a very interesting concept.

Thank you, Madam Chair. I yield back.

Chairwoman WOOLSEY. And the gentleman from Georgia, Mr. Price?

Mr. PRICE. Thank you, Madam Chair. I appreciate that.

And I thank you for holding this hearing on an issue about which I have learned a lot with your testimony and with the information that you have presented, and I appreciate you all coming and sharing your story with us.

Mr. Horn, you present a wonderful American dream story. You truly do. I guess that you became an independent contractor, is that right?

Mr. HORN. I would love to, I just don't like breaking the law.

Mr. PRICE. Your final comments on your prepared testimony is that you strongly urge Congress to take action to clearly define who is and who is not an independent contractor. Do you have any benchmark that you would use for that? Any model that you would use for that?

Mr. HORN. I think a lot of the—like you are saying, a lot of the rules and regulations are already in place. They just need to be enforced.

I don't think it is usually a question—when the individuals or the firms are practicing this procedure, I don't think there is a question in their mind of where they are on the line. They know their way over into that area.

So as far as identifying it for the employee and clarifying it for the employee, that may be helpful, but it is my belief that the individual or institution that is implementing this type of structure is well aware of what is going on.

Mr. PRICE. You think they know what they are doing.

Mr. Shavell, you also provide four different options for us to consider, potential resolutions, as you described them. The final one is to eliminate the availability of independent contractor status, and then you talk about why that is not an appropriate thing to do for a variety of reasons.

And I would assume that everybody else on the panel agrees that the independent contractor status ought to remain in place in some way. Is that accurate, Mr. Flynn?

Mr. FLYNN. Yes. I have no problem with the idea of a subcontractor or an independent contractor. I guess the real issue becomes who controls whether the person is going to work this morning.

If I am an independent contractor and I get up and I am tired, maybe I can go play golf. But if I am an employee, if I don't show up, I am probably going to get fired.

Mr. PRICE. Right, but you don't believe that we ought to do away with an independent contractor status?

Mr. FLYNN. No. I think calling it——

Mr. PRICE. Or do you?

Mr. FLYNN [continuing]. An independent contractor really confuses it. We would usually more describe it or call it a subcontractor.

Mr. PRICE. Subcontractor, okay.

Mr. Horn, do you——

Mr. FLYNN. But everybody that we have a collective bargaining agreement with, or nearly everybody, they are subcontractors to larger companies. They are also all businesses——

Mr. PRICE. Right, and I would concur with that.

Mr. Horn, you believe that independent contractor status ought to remain in some way. Is that correct?

Mr. HORN. Yes.

Mr. PRICE. Ms. Ruckelshaus?

Ms. RUCKELSHAUS. Yes, that is correct. I do.

Mr. PRICE. Good.

Mr. Flynn, it has been alluded to a couple of times, you talk about this network of accountants and insurance brokers whose primary business is to, as you describe, "aid and abet the fraudulent misclassification of workers."

And I find that—I guess that is possible. Would you care to identify who you are referring to?

Mr. FLYNN. Well, let me explain now. You know, I am with the International Union. We have local unions in different communities. This was discovered by our local union and the organizers and business agents who work for the local union in Chicago.

I could probably get more specific information for you——

Mr. PRICE. I would be interested in the specific firms of accountants and insurance brokers who are in fact engaging in that activity. I would appreciate that.

Mr. FLYNN. I will request that our folks get that information. Should we send it to the chair or to each of you individually?

Mr. PRICE. I will give you my card and you can send it to me.

Chairwoman WOOLSEY. And if you would yield——

Mr. PRICE. Sure.

Chairwoman WOOLSEY [continuing]. We could have that as a request to the panel that would come back through the committee.

Mr. PRICE. I appreciate that.

Ms. Ruckelshaus, my time is running short, but I was amused by your topic heading on Page 9 of your testimony, "Making the U.S. Department of Labor More Effective."

In my district, when I talk about the government becoming more effective, I just get chuckles. So I had to make certain that that was clear.

The final paragraph, however, I am struck by your final paragraph in your prepared testimony, which talks about preserving the historic boundaries between labor, law enforcement and the enforcement of immigration law, and I read this to say that you support the Department of Labor, knowing and understanding and appreciating that there are individuals who are working illegally that are identified as individuals who are working here illegally, but to remain mute when they are talking—with that knowledge with relationship to other federal agencies. Is that correct?

Ms. RUCKELSHAUS. Not exactly.

Just to clarify that, and I realize this is counterintuitive, and a lot of people who aren't in labor enforcement don't understand this initially. It is current practice for the Department of Labor not to share any information it may glean when it is doing a workplace audit of the existence of undocumented workers. And the reason for that is that to enable us to have the baseline labor standards in place, we need witnesses. We need workers to come forward. Our system of labor standards enforcement is complaint-driven.

So if you don't have workers willing to come forward and they are intimidated and they are retaliated against, that sends the message to employers let us hire more undocumented workers. They are not going to complain. They are not going to come forward. They will never show their faces at the Department of Labor because they are scared, and I am going to turn them in to the INS or the Immigration Service.

So Department of Labor and Immigration have the memorandum of understanding. It has been reaffirmed numerous times under numerous administrations, that you have to keep this information separate, otherwise the labor standards enforcement cannot happen and the workplaces go underground even more than they are now.

Mr. PRICE. So you support one agency in the federal government keeping quiet about their knowledge of illegal status of workers, as I understand you saying it.

Ms. RUCKELSHAUS. No. There is typically not knowledge on the part of the Department of Labor, because they are not equipped to determine who is work authorized and who isn't. That is an immigration enforcement role that the ICE is particularly trained and able to do. Department of Labor doesn't know how to do that. They are not equipped to do that and they are not supposed to do audits on immigration enforcement, so there is no knowledge on their part. They are there to do the workplace audit and they shouldn't blend over into areas that they are not equipped to do.

Mr. PRICE. If I may, Madam Chair.

Mr. Flynn, do you support knowledge gained by an employer or an agency of the federal government about the legality or illegality of a worker being kept quiet?

Mr. FLYNN. I don't really know. Whatever the law is. I mean, we generally support the law.

The problem for us as a union representative is that our employers generally try to comply with the law. It is against the law for them to employ someone who is in the country illegally. And so we don't try to get in the middle of that. I have just never taken a position on it.

Mr. PRICE. Thank you very much.

Thank you, Madam Chair.

Chairwoman WOOLSEY. Mr. Flynn, did you have an answer you would like to complete?

Mr. FLYNN. Yes, I have one point I would like to——

Chairwoman WOOLSEY. That would be fine.

Mr. FLYNN [continuing]. Ask the chair.

One of our staff people just advised me that this situation in Illinois is in the hands of the state attorney general and we will give you whatever information we can, but it is under investigation with the attorney general's office. So we are not sure how much we can supply, but we will give you whatever we can.

Chairwoman WOOLSEY. And that is understandable. And it is appreciated.

And at this time I would like to thank you, witnesses. You have been grand. And members of the committee have asked really wonderful questions.

And I would like to enter into the record, with unanimous consent, the Chicago Sun-Times article, "State Agencies Investigating Significant Problems." So that is as far along as we can get, probably, for what Mr. Flynn can provide us. But if you can provide more, we would sure appreciate it.

[The article follows:]

[From the Chicago Sun Times, March 19, 2007]

State Agencies Investigating 'Significant Problem': Some Employees Unaware Until the Bills Come

By FRANCINE KNOWLES, the Chicago Sun-Times

Misclassification of workers as independent contractors "is viewed as a significant problem" across the country, said Anita Bartels, acting program manager for employment tax policy with the Internal Revenue Service.

She acknowledged investigations are under way in the Chicago area, but wouldn't provide details.

Union leaders say they have met with Attorney General Lisa Madigan several times over the past year to discuss the issue.

According to a state government source, Madigan's office has subpoenaed some Chicago area companies as part of the office's investigation. Cara Smith, deputy chief of staff for policy with the office, would not confirm or deny that's the case. But she said "we've been looking at this issue for quite some time. There's significant dollars at issue * * * and the impact on the worker is incredibly significant."

Often employees aren't even aware they've been misclassified, until "they're stuck with sometimes impossible tax bills to pay" months after being hired, or land in the hospital with workplace injuries to discover they have no workers comp insurance protection, she said.

She said illegal immigrants are taken advantage of by the illegal practice, noting they have a disincentive to come forward to report misclassification because of fears of being deported.

Legislation sponsored by state Rep. Harry Osterman (D-Chicago) affecting the construction industry would require a person performing services for a contractor

to be classified as an employee unless he or she meets certain requirements. Those requirements include that the worker is free from control or direction over the performance of the service, is deemed a legitimate sole proprietor or partnership or is engaged in an independently established trade, occupation, profession or business.

The bill, which was voted out of the Illinois House Labor Committee last week, includes penalties of $1,500 to $2,500 for each violation and provides a path for criminal prosecution in certain cases. Osterman expects the House to vote on the bill in the next two weeks. The legislation is supported by the attorney general's office, Smith said.

The issue of misclassification also is on the congressional radar screen. The U.S. House Education and Labor Committee will hold a hearing next week on misclassification of workers. Members of Bricklayers and Stone Masons Local 21 in Chicago will testify along with national labor leaders.

A. Horn Inc. masonry contracting company President Cliff Horn, who said his Barrington-based business has been left at a competitive disadvantage because of the problem, will also testify at the hearing.

Mr. FLYNN. Okay. Thank you.

Chairwoman WOOLSEY. One thing I want you to know is Joe Wilson and I, representative Wilson and I, are going to write a letter and reach out to the Department of Labor and ask them about this enforcement and give them opportunity to respond back. And, indeed, if they don't respond back or if we are dissatisfied with their response, then that will lead us to an oversight hearing and bring them to this very ominous position of having to answer to us.

You have been all very generous, and we appreciate you very much, but we will be doing that.

So as previously ordered, members will have 14 days to submit additional materials for the hearing record. Any member who wishes to submit follow-up questions in writing for the witnesses should coordinate with majority staff within the requisite time.

Without objection, the hearing is adjourned.

[Additional material submitted by Mr. Flynn follows:]

OFFICE OF THE PRESIDENT,
INTERNATIONAL UNION OF BRICKLAYERS AND ALLIED CRAFTWORKERS,
Washington, DC, April 9, 2007.

Hon. LYNN WOOLSEY,
Chairwoman, Subcommittee on Workforce Protections, Committee on Education and Labor, Washington, DC.

DEAR CHAIRWOMAN WOOLSEY: On behalf of the nearly 100,000 members of the International Union of Bricklayers and Allied Craftworkers (BAC), I want to deeply thank the Workforce Protections Subcommittee for its decision to hold hearings on the employee misclassification crisis. As the testimony that the Subcommittee heard on March 27, 2007 made clear, the rampant misclassification of working Americans as independent contractors is having severe and far-reaching effects. A degree of Congressional action is plainly necessary to effectively combat this crisis.

At the conclusion of the March 27 hearing, you solicited further comments for consideration by the Subcommittee. In light of the fact that the members of the Subcommittee seemed to be searching for ways that Congress could proactively work to reduce the incidence of employee misclassification, BAC is suggesting four key initiatives that Congress might consider as it continues to address this critical issue.

1) Congress should commission a comprehensive study to determine the economic impact of the misclassification crisis on federal tax revenue, the Social Security system, and Medicare and Medicaid. In recent years, respected economists have analyzed the effect of misclassification on the state tax revenues, workers' compensation systems, and unemployment insurance systems in a number of states; I appended Cornell University's study* of the cost of misclassification in New York and the University of Missouri-Kansas City's analysis of misclassification in Illinois to my writ-

*The report, "The Cost of Worker Misclassification in New York State," is available on the Cornell University ILR School website at the following URL:
http://digitalcommons.ilr.cornell.edu/reports/9/

ten testimony to the subcommittee. But as I noted in my testimony, a comprehensive study of the national cost of misclassification has not been conducted in well over 10 years. We simply have no real idea of how big the tax gap caused by misclassification of employees has become. It is almost certainly a number of times greater than the $3.3 billion found in 1995—but we need hard numbers, not guesses. We need to ascertain the true scope of the misclassification crisis before we can determine the best way to attack it. Congress should therefore act swiftly to commission a comprehensive study, similar to the New York and Illinois analyses, to evaluate the degree to which misclassification is defunding the Federal government, the Social Security system, Medicare, and Medicaid.

2) Congress should budget significantly more money for Department of Labor and Internal Revenue Service enforcement of the existing laws governing employment status, and should allow those agencies to better share information regarding misclassification of employees. I pointed out in my testimony that the decade-old $3.3 billion estimate of the tax gap created by misclassification was nearly 20 times greater than the 2006 budget for the Department of Labor's Wage and Hour Division. Wage and Hour is, of course, one of the primary federal bodies charged with preventing misclassification. One of the most obvious causes of the misclassification crisis is the chronic lack of funding for enforcement of the laws that are intended to prohibit misclassification. The Wage and Hour Division simply does not have the personnel necessary to police the profligate misclassification that is plaguing the United States, especially in light of its other responsibilities, which include enforcement of federal prevailing wage law. And the budgets of recent years have not helped Wage and Hour accomplish its mission; over the past five fiscal years, the Department of Labor's Office of Labor-Management Standards (which is primarily responsible for oversight of labor union finances and activities) has received an appropriations increase three times greater than that received by Wage and Hour.

All the best-intentioned, best-crafted legislation in Washington won't really begin to address the misclassification crisis unless there are a sufficient number of properly funded, hard-working federal agents available to enforce the legislation. A significant increase in funding for the Wage and Hour Division, in conjunction with earmarks for increased targeted auditing of dubious employers, will lead to better enforcement of the laws prohibiting misclassification. And that is an investment which will pay for itself in spades.

Another way that Congress could improve enforcement of the laws governing employment status would be to remove any impediments barring federal agencies from sharing information regarding the misclassification of employees. Unless the IRS and Department of Labor—in addition to any other agencies that might uncover evidence of misclassification—are allowed to share that information with each other, the government will never be able to bring the full force of its enforcement power against those employers who have willfully chosen to injure their workers and defraud the American people.

3) Congress should seriously consider federal legislation, similar to that in Massachusetts and New Mexico, adopting a presumption that workers are employees until proven otherwise. All of the panelists who testified on March 27 recognized the confusion presented by the multiple definitions of employees and independent contractors found in the current federal regulatory environment. Although BAC agrees with Chairwoman Woolsey that the distinction between employees and independent contractors is usually intuitive and simple, and although we have found that vast numbers of misclassified workers are "employees" under any test and are clear victims of misclassification, it is true that the present regulatory framework may make the employee/independent contractor determination more complex than it needs to be. Different agencies have embraced different tests, and different laws have defined "employees" in different ways.

One approach to ameliorating this problem would be to consider legislation—like that already adopted by Massachusetts, New Mexico, and a number of other states—which would create a presumption under at least some federal laws that workers are "employees" unless affirmatively shown to be independent contractors. At the March 27 hearing, Congressman Bishop and Catherine Ruckelshaus both discussed the advantages inherent in this approach, although they also recognized that such a law could result in an unintended disruption of existing regulation. For that reason, BAC would suggest that Congress carefully evaluate which areas of federal regulation would best benefit from imposition of a presumption of employee status, and only then move forward with legislation. But we do believe that, carefully implemented, legislation creating a presumption of employee status would go a long way toward eliminating a great deal of existing employee misclassification of workers as independent contractors.

4) Congress should strongly consider amending, or even eliminating, the "safe harbor" provisions of the Internal Revenue Code. Although originally enacted in 1978 to protect the unwitting wrongful misclassification of workers as independent contractors by an employer, this provision has actually emboldened the underground community of misclassifying employers and their enablers. Recent changes to the law have further complicated and protected unscrupulous employers by placing the burden on the IRS to assert the employer misclassified an employee. This additional burden placed on the IRS has rendered an already under funded enforcement effort even less effective.

This unfortunate situation was all too clearly brought to light by the efforts of BAC's Chicago local leadership to involve the IRS in the near-criminal exploitation of the loophole by a residential masonry contractor. This contractor had misclassified his entire workforce, even though industry standards (and practical necessity) require the existence of an employer/employee relationship. The IRS consistently ignored this situation until BAC's local officers petitioned Senator Durbin for an investigation. The Senator's investigation of the situation eventually led to seven and one-half hours of testimony before the IRS by masonry contractor Cliff Horn and BAC Local 21 President Jim Allen. It is unlikely the framers of the original legislation or the most recent revisions to the safe harbor provision anticipated that it would require the IRS to be prodded to intervene into an egregious violation, but as this example indicates, the need for intervention has become the norm rather than the exception.

I would once again like to commend you, Chairwoman Woolsey, as well as Ranking Member Mr. Wilson and the other members of the Committee for your willingness to question the Department of Labor regarding its role in the exponential growth of misclassification in recent years. Your future efforts and those of your colleagues in Congress will hopefully lead to an effective solution to the misclassification crisis. BAC stands ready to assist you in any way that we can.

Sincerely,

JOHN J. FLYNN,
President.

[Whereupon, at 11:45 a.m., the subcommittee was adjourned.]