February 24, 2010

The Vice President
Executive Office Building
Washington, DC 20501

Re: Independent Contractor Misclassification

Dear Mr. Vice President,

I write on behalf of the National Employment Law Project (NELP) in support of the President’s Fiscal Year 2011 budget proposal to address the problem of employer misclassification of workers as independent contractors.

Ending incentives under current law to misclassify workers as independent contractors, strengthening the capacity of the Departments of Labor and Treasury to penalize misclassifying employers, and restoring the crucial protections robbed from workers is sound policy that is good for working families, good for federal and state coffers, good for law-abiding employers, and good for the economy overall. The only entities whose interests may be adversely affected by these proposals are employers that take advantage of independent contractor loopholes. Protecting or facilitating such misclassification serves no compelling national interest and undercuts the basic worker protection/employee benefits framework that over many decades played a central role in building America’s middle class.

NELP is committed to ensuring that work is a ladder of opportunity and an anchor of economic security for all working families. In recent decades, however, that promise has gone unmet as globalization and domestic policy choices, declining unionization, lax enforcement of workplace standards, and changes in the organization of work have combined to break the link between work and family economic well-being.

Reining in independent contractor misclassification by closing loopholes and enhancing enforcement is a critical step in restoring opportunity and economic security to millions of working families. In addition, cracking down on misclassification will help revitalize basic workplace standards, and will increase federal receipts that shore up critical programs like Social Security, Medicare and unemployment insurance. These steps will benefit states as well, as many follow federal rules governing worker classification, and in those that don’t, employers will be less likely to skirt separate state requirements when they can no longer get by with independent contractor misclassification under federal law.

Genuine independent contractors constitute a small fraction of the American workforce—by definition, an “independent contractor” operates a business—but the number of workers misclassified as independent contractors is large and growing. In 2006, the
General Accounting Office put the estimate of misclassified workers at more than 10 million, an increase of over two million in only six years. The problem is widespread, affecting a large number and broad range of jobs, from high-end high tech positions to blue collar construction work to low-wage janitorial, home health care, hospitality and other service and retail jobs.

For employers, the incentives to misclassify are enormous. Neither payroll tax requirements nor basic workplace standards apply to independent contractors. At the front end, classifying workers as independent contractors enables employers to cut payroll costs by up to 30 percent, simultaneously shaving billions from federal and state payroll tax revenues. Employers reap other savings from misclassification as well, avoiding compliance with minimum wage and overtime requirements or contributions to employer-sponsored employee benefit plans, for example.

For employees, the costs of misclassification are also enormous. Not only are independent contractors denied minimum wage and overtime pay guarantees, they have no safety net to fall back on when they lose their jobs; no access to worker’s compensation when they are injured on the job; no employer contributions into workplace health or retirement savings plans; no access to employer-sponsored paid leave; and they must shoulder huge self-employment taxes for their Social Security and Medicare contributions.

For low wage workers like those NELP counsels and has represented in litigation, the costs resulting from independent contractor misclassification are unaffordable and unsustainable, forcing many into an underground economy where they work all the time but fall farther and farther behind. In one recent high profile case, NELP represented a class of immigrant delivery workers employed by several grocery and pharmacy chains in New York City. The workers regularly put in long hours, often working seven days a week and 10-12 hours a day for weekly earnings averaging as low as $90. The stores contended that these workers were independent contractors, running their own “bag and delivery” businesses. The court, however disagreed, and NELP eventually won $6 million in back wages, plus reclassification as employees, for roughly 1,000 workers.

This was a great victory for these workers, but we know that for every worker who has the courage to come forward with a claim, the fortitude to endure a grueling legal process, and the good fortune to prevail, many more workers continue to labor in the shadows—denied decent wages and basic protections by employers all too willing to use legal loopholes that permit such exploitation, and by an enforcement apparatus with resources inadequate to meet the challenge of ferreting out and ending misclassification. That is why we think the initiative contemplated by the President’s Fiscal Year 2011 budget is so important.

As we understand the President’s proposal, the Administration looks to close the current “safe harbor” under the Internal Revenue Code (Section 530 of the Revenue Act of 1978, as amended) that sanctions and locks in misclassification of workers as independent contractors, preventing the Internal Revenue Service from collecting back payroll taxes or requiring employers prospectively to reclassify workers or even issuing regulations clarifying the agency’s analysis of independent contractor practices for purposes of payroll taxes. As a result, current law incentivizes employers to call employees independent contractors and rewards employer bad behavior, robs employees of crucial protections, and reduces revenues for federal programs funded through payroll taxes.
There is no justification for this loophole. Closing it will strengthen economic security for working families, level the playing field for law-abiding employers, and increase federal (and state) revenues.

The added resources the President’s budget contemplates to step up enforcement against labor standards abuses for independent contractors are also critical—and long overdue. As NELP and our co-authors reported in *Broken Laws, Unprotected Workers* (September 2009), between 1980 and 2007, the labor force grew by 52 percent but there was a 31 percent decline in the number of DOL inspectors enforcing federal minimum wage and overtime laws. By 2004, there was only one federal Wage and Hour investigator for every 110,000 workers covered under the Fair Labor Standards Act. Meanwhile, Occupational Safety and Health Administration funding was cut so deeply between 2001 and 2007 that, according to the AFL-CIO, it would take OSHA 133 years to inspect every American workplace just once.

Starving agencies of enforcement resources compounds independent contractor misclassification abuse, since employers not only enjoy the insulation of the IRC safe harbor (assuming they meet the test), they also have little reason to fear federal government crack-downs. The President’s budget, on the other hand, encourages coordination within DOL and cooperation between agencies to enforce employee protections, efforts that will combat employers’ independent contractor abuse.

Significantly, the President’s budget also goes a long way to build on the promising efforts of the states to rein in independent contractor misclassification. Specifically, the 2011 budget promotes more joint enforcement activities between federal and state officials, especially as applied to major employers that cross state lines, while also providing new competitive grant funding to reward state unemployment insurance agencies that have successfully increased their federal unemployment insurance tax collections, thus raising millions of dollars in revenue that makes its way back into the federal treasury. As reflected in the President’s initiative, effective enforcement requires maximum coordination and collaboration among state and federal officials and funding to support and expand the most innovative and promising collection activities.

With risks so small and benefits so great, employers today have little reason not to misclassify workers as independent contractors. The proposal outlined in the President’s budget will help reverse this situation, taking away the insulation for independent contractor misclassification provided by the existing safe harbor, boosting enforcement resources to combat independent contractor abuse, and restoring crucial protections to workers. NELP wholeheartedly support these proposals, which we believe will move the nation closer to delivering on the promise that work will be a ladder of opportunity and an anchor of economic security for all working families.

Sincerely,

Christine L. Owens
Executive Director