

Backgrounder: Worker Misclassification Cheats Everyone

The law grants workers many important workplace benefits and protections, as long as the worker is an *employee* of the employer. Those who are self-employed or provide services to an employer as an independent contractor have few rights.

When unscrupulous companies cut corners and misclassify employees as “independent contractors,” everyone else is forced to foot the bill. Workers are cheated out of important benefits and legal protections. Responsible employers are undercut by unfair competition. And the government loses out on billions of dollars in revenue, which means law-abiding employers and taxpayers end up paying more than their fair share.

Not Just a Few Bad Apples

- 10-30% of all employers misclassify their employees, according to a conservative estimate by the U.S. Department of Labor.¹
- Approximately 1.8 million workers were found to have been misclassified in just four of the states that have recently conducted studies – Illinois, Maine, Massachusetts, and New York.² National figures on the total number of misclassified employees are not available.
- It is not just small, shady fly-by-nights that misclassify their workers; major national corporations, and sometimes significant segments of entire industries, use misclassification as a *business model*.

Workers Are Cheated Out of Vital Benefits and Protections

Employees who have been misclassified as independent contractors lose important rights:

- *Wages and Benefits:* No rights to minimum wage and overtime, or to employer-provided health insurance, retirement benefits, paid leave, or other benefits.
- *Access to Government Programs:* No rights to workers’ compensation if injured or killed on the job, and no rights to unemployment insurance after a lay-off. To be eligible for Social Security and Medicare, the worker has to pay both the employer and employee shares of those payroll taxes – double what regular employees pay (15.3% vs. 7.65%).
- *Employment Law Protections:* No coverage under workplace health and safety laws, no legal rights to equal opportunity in the workplace, no rights to job-protected family and medical leave, and no rights to organize and collectively bargain.

Federal and State Governments Are Cheated Out of Billions in Needed Revenue

- \$3-4 billion each year in federal income and employment tax revenue is lost due to misclassification.³
- States also cumulatively lose billions of dollars a year due to misclassification. Illinois alone loses an estimated \$300-400 million a year in income taxes, unemployment insurance taxes, and workers’ compensation premiums due to misclassification,⁴ while Massachusetts loses \$195-278 million a year.⁵

Responsible Employers Are Cheated Out of Business Opportunities

Companies that misclassify their workers save an estimated 30% in payroll costs,⁶ and thus gain an unfair advantage over their more responsible competitors. This uneven playing field not only means that employers who play by the rules are underbid and lose business, it also means that wages and labor standards are depressed across the board, and that law-abiding employers subsidize the freeloaders in the form of increased workers' compensation and health insurance premiums.

Recommendations to Make It Right

Genuine entrepreneurs and independent contractors are an important part of our economy. But the misclassification of workers who are independent contractors in name only is an abuse of the law and must be remedied by Congress.

- *Close the Tax Loophole:* The current IRS “safe harbor” loophole allows employers to misclassify workers with impunity and allows denials of benefits to workers to continue unremedied. This loophole should be closed, and employers that misclassify their workers should have to correct their error.
- *Increase Transparency and Enforcement:* Measures to significantly improve transparency and enforcement are desperately needed, including: strengthened recordkeeping requirements, such as requiring companies to file 1099s with the IRS on payments made to independent contractors that are incorporated; improving complaint procedures that protect workers who identify lawbreakers and encourage both public and private enforcement actions; and implementing stronger penalties for willful misclassification.

¹ Lalith de Silva *et al.*, Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs, p. iii, prepared by Planmatics, Inc., for U.S. Department of Labor, Employment and Training Division, (Feb. 2000), at <http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf>.

² See Michael Kelsay, *et al.*, The Economic Costs of Employee Misclassification in the State of Illinois (2006) [Illinois Study]; Françoise Carré, *et al.*, The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry, p. 13; Françoise Carré, *et al.*, The Social and Economic Costs of Employee Misclassification in Construction, p. 2 (2004) [Massachusetts Study]; Linda H. Donahue *et al.*, The Cost of Worker Misclassification in New York State, p. (2007). All of the above studies are available at http://www.carpenters.org/misclassification/key_studies.html.

³ See U.S. Government Accountability Office, Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification, p. 2 (2006), at <http://www.gao.gov/new.items/d06656.pdf>; The Dunlop Commission on the Future of Worker-Management Relations: Final Report, p. 62 (1994), at <http://www.psa.org.nz/library/other/miscellaneous%20papers/dunlop%20commission%20usa%20-%20on%20the%20future%20of%20worker-management%20relations%20-%201995.pdf> (\$3.3 billion projected loss in 1996 would be equivalent to \$4.3 billion in 2007 dollars).

⁴ See Illinois Study, *supra* note 2, at pp. 6-7.

⁵ See Massachusetts Study, *supra* note 2, at p. 2.

⁶ *Hearing on the Effects of Misclassifying Workers as Independent Contractors*, before the House Comm. on Ways and Means, Subcomms. on Income Security and Family Support and on Select Revenue Measures, 110th Cong., p. 2 (2007) (statement of Rebecca Smith, Staff Attorney, National Employment Law Project), at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5874>.