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Law Project

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1099'd:

Misclassification of Employees as "Independent Contractors"

Employers of low-income workers frequently misclassify their employees as "independent contractors" (either by giving them an IRS Form 1099 instead of a W-2, or by paying them in cash and not withholding any taxes). And who can blame them? The result is that the worker gets *no coverage* of most labor and employment laws. This decreases employers' payroll costs by 15 to 30%. It also lets employers off the hook for rules protecting "employees," including the responsibility to provide workers' compensation and other benefits and to bargain with unions.

Independent contractor misclassification has been common in some sectors historically, including in agriculture and day labor jobs. Its use is on the rise, however, and can now be seen in nearly every sector of today's economy, in particular in the low-wage immigrant-dominated sectors of home health care, construction, delivery services, and janitorial.

Misclassification is Not Just Bad for Workers

Because of their status as non-employees, misclassified "independent contractors" miss out on: minimum wage and overtime requirements, workers' compensation, unemployment insurance, the right to form a union and bargain collectively, and other workplace protections like the right to safe and healthy worksites and to be free from discrimination in employment. Independent contractors have to pay more taxes, too: they are responsible for paying the employer- and employee-side FICA and FUTA taxes, or 15 % of their gross wages, while employees pay only 7.65%.

States lose out, too, because they don't receive the payroll and related taxes employers contribute on behalf of employees, and workers' compensation premiums are lost. The U.S. Government Accounting Office projections estimated that misclassification of employees as independent contractors would reduce federal tax revenues by up to \$4.7 billion by 2004.¹

A government-sponsored national unemployment audit found \$436 million in underreported wages.² A recent Massachusetts study found unpaid workers' compensation premiums of \$91 million a year due to independent contractor misclassification; \$7 million of those unpaid premiums were in construction.³

Finally, law-abiding businesses that do not misclassify their employees as independent contractors lose out, because they have to compete with those that misclassify and cut their labor costs. This lowers wages and benefits for all workers as firms race to the bottom to underbid each other in today's competitive economies.

What Can Be Done?

Just because employers say a worker is an independent contractor does not make it legally true!

Worker organizing groups have developed a variety of innovative strategies to combat employee misclassification. Some of the more successful ones are:

- **Organize a coalition** of labor, immigrant, business, government and other community groups to publicize the problem and come up with creative solutions, as did Nebraska Appleseed and its allies to combat 1099 abuses in the construction industry. See list of legislative principles to combat abuses of the independent contractor misclassification, including coordinated enforcement across state agencies. For a list of all principles, contact Ed Leahy at Nebraska Appleseed, eleahy@neappleseed.org.

¹ U.S. General Accounting Office, Pub.No. GAO\GGD-89-107, *Tax Administration Information: Returns Can Be Used to Identify Employers Who Misclassify Employees* (1989).

² Planmatics, Inc., *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs* (February 2000).

³ Bernard and Herrick, "The Social and Economic Costs of Employee Misclassification in Construction," A report of the Construction Policy Research Center at Harvard Law School and Harvard School of Public Health (December 2004), at p. 2.

- If you notice many worker rights being violated or benefits being denied, don't give up! Workers can **file claims with administrative agencies**: go to the workers' compensation board, the unemployment insurance office, the state or federal department of labor, or the NLRB and file a claim on behalf of a worker, stating that the worker is a covered employee. Force the employer to prove that the worker is an independent contractor and not protected.

Practice tip: remember different laws have different definitions of who's an employee, so get your facts straight beforehand. See, NELP's Employment Relationships Checklist, <http://www.nelp.org/docUploads/pub8%2Epdf>.

Practice tip: make sure you are aware of immigration status issues. For example, undocumented workers cannot collect unemployment insurance. Immigration status should not impact most other laws. Stand firm against agency pressure to answer immigration status questions. See Talking Points in Support of Challenges to State Agency Use of Social Security Numbers. <http://www.nelp.org/docUploads/StateDOLSSNTalking%20Points%2Epdf>

- **Fill out an IRS Form SS-8**, which requires the IRS to investigate whether a worker is an employee or independent contractor for federal tax purposes. See <http://www.irs.gov/pub/irs-pdf/fss8.pdf>

Practice tip: keep in mind that the IRS will notify the employer of receipt of an SS-8 Form, in order to do its investigation. Workers concerned about employer retaliation should weigh the risks.

- **Organize to pass legislation to study the problem** of employer misclassification, see Washington state legislative report on contingent work, including independent contractors, with key policy considerations and state legislative recommendations; New York state law establishing a study commission.

Some states **prohibit businesses from calling workers independent contractors** in some sectors where it's unlikely that the workers would ever be truly in business for themselves, see California law creating employers of record for home health care workers who had been classified as "independent contractors." Colorado passed a law requiring construction managers to provide workers' compensation for all workers on a construction site.

http://www.leg.state.co.us/CLICS2004A/csl.nsf/fsbillcont3/7F2516C7B4E9B70087256D790073B01D?Open&file=1090_enr.pdf. Wyoming workers' comp law defines worksite "client" companies as the employer of laborers provided by leasing firms.

WY Stat. 27-14-102 (a)(vii). <http://wydoe.state.wy.us/doe.asp?ID=416>.⁴

A few states have created **inter-agency task forces** to increase enforcement against misclassification. See, CA Unempl. Ins. Code § 329; North Carolina Gen. Stat. § 96 *et seq.*

- Go to your state **Attorney General** and ask that it enforce state laws against misclassification, including tax, workers' comp, prevailing wage and other workplace laws. Groups in NY, NC, IL, and MA have found this strategy successful recently.

⁴ Other states have pending bills related to independent contractor abuses. For periodic listing of pending provisions, see

<http://www.nelp.org/docUploads/nswlegsum070104%2Epdf> and publications listed therein.