Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs

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ABSTRACT

This report presents the results of a study on independent contractors (ICs) conducted in 1998-99. It begins with a description of ICs in the alternative workforce and definitions and tests used by federal and state agencies to classify them. Next, the motivations of employers to use ICs, the motivations of workers to become ICs, and selected industries where they predominate are described. Profiles of employees misclassified as independent contractors are described, and the results of an attempt to determine the extent of misclassification of employees as ICs and its effects on Unemployment Insurance (UI) trust funds are presented. Then the efforts of state administrators in dealing with ICs and other significant workforce issues related to ICs are described. Finally, the report presents the findings and recommendations of the study.

Preface

Planmatics is pleased to offer this final report titled "Study of Alternative Work Arrangements: Independent Contractors." The project was funded under Department of Labor Contract No: K6878-8-00-80-30. The authors are Dr. Lalith de Silva, Mr. Adrian W. Millett, Mr. Dominic M. Rotondi, and Mr. William F. Sullivan. Ms. Elizabeth Fischer and Mr. Mark Sillings also contributed. The Department of Labor project officer for the study was Mr. Wayne Gordon.

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DEFINITIONS OF ALTERNATIVE AND NONSTANDARD WORK ARRANGEMENTS*

Alternative Work Arrangement – Individuals whose employment is arranged through an employment intermediary such as a temporary help firm, or individuals whose place, time, and quantity of work are potentially unpredictable.

Contingent worker – Any worker in a job which does not have an explicit or implicit contract for long-term employment. The BLS uses three different definitions; the broadest of which includes all wage and salary workers who do not expect their jobs to last.

Contract worker – Workers employed by a company that provides them or their services to others under contract and who are usually assigned to only one customer and usually work at the customer's work site. EPI defines a contract worker as anyone who does contract work regardless as to whether they work at the customers' work site or for more than one customer.

Day Laborers – Workers who wait at a location where employers pick up people to work for the day; a type of on-call worker.

Full-time employees – Wage-and-salary workers who work 35 hours or more each week.

Independent contractors – Individuals who are not employees in the traditional sense but who instead work for themselves; someone who obtains customers on their own to provide a product or service

Independent contractors: self-employed – Workers identified in the basic CPS as self-employed who answer affirmatively to the question in the CPS supplement, "Are you self-employed as an independent contractor, independent consultant, freelance worker or something else (such as a shop or restaurant owner)?"

Independent contractors: wage-and-salary – Workers identified as wage and salary workers in the basic CPS who answered affirmatively to the question in the CPS supplement, "Last week, were you working as an independent contractor, an independent consultant, or a free-lance worker? That is, someone who obtains customers of their own to provide a product or service."

Leased employees – A type of contract worker, but "in a classic leasing arrangement, a leasing company provides all the employees to a client firm. In contrast, contract workers usually fill specialized occupational niches within client firms, working closely with the permanent employees of client firms." (see Vroman)

Nonstandard Work Arrangement – any job that differs from standard jobs due to one or more of the following ways: the absence of an employer, a distinction between the organization that employs the worker and the one for whom the person works, or the temporary instability of the job. (see Kalleberg, Arne, and Rasell, Edith, etal)

Part-time employees – Wage and salary workers who work less than 35 hours a week.

On-call workers – Workers who are called to work as needed, although they can be scheduled to work for several days or weeks in a row. (Examples include substitute teachers and construction workers supplied by a union hall)

Outside worker – Where there is a difference between the employer directing the content of the work (the client employer) and the employer who hires and pays the worker (see Vroman). Examples include contract workers and temporary help agency employees.

Self-employed – Workers who identified themselves as self-employed in response to the following question in the basic CPS, "Are you employed by government, by a private company, a non-profit organization, or were you self-employed?" Includes independent contractors as well as other self-employed such as restaurant and shop owners.

Temporary worker – equivalent to a contingent worker; encompasses temporary help agency employees, on-call workers, and wage and salary workers who are temporary direct hires. (see Vroman)

Temporary help agency workers – Workers paid by a temporary help agency, whether or not their job was actually temporary.

*This glossary draws primarily on the original definitions from the Bureau of Labor Statistics but also includes variations as defined by other analysts.

EXECUTIVE SUMMARY

As the economy continues to change, workers seeking a more flexible work environment and some who were displaced by corporate downsizing have become independent contractors. Also, the changing nature of employment and the increased use of those in the alternative workforce by businesses, including independent contractors (ICs), has attracted the attention of policymakers, because the prevailing employment and labor laws often do not cover those in the alternative workforce.

The purpose of the study was to provide a better understanding of the IC work arrangement and its potential impact on Unemployment Insurance (UI). The research design addressed the following questions: Who are ICs? Is there a variance in the IC classification system? Which occupations and industries are they in? Is the IC phenomenon employer driven or worker driven? Do employers deliberately misclassify employees as ICs, and if so, what is the impact on trust funds?

In order to obtain information on ICs from as wide a variety of sources as possible, and in a cost-effective manner, the methodology used included a review of literature, research on the definitions and tests used by states to determine IC status and data collection on a variety of relevant issues. Interviews were conducted with representatives from State Employment Security Agencies (SESAs), Wage and Hour, Workers' Compensation, employer organizations, unions and advocacy groups to obtain insight on IC use, misclassification and the strategies implemented to regulate and monitor ICs.

Based on definitions of standard employer-employee relationships and the classification criteria used by the Internal Revenue Service (IRS) and SESAs, ICs are:

1. Those who are classified as ICs according to their state classification systems and receive the IRS form 1099-Misc from employers reporting receipt of "non-employee compensation,"

2. those employees who should receive the IRS form W-2 reporting receipt of "employee compensation," but are deliberately misclassified by employers as ICs and instead receive form 1099s, and
3. those ICs and workers who operate underground and don't receive either a 1099 or a W-2 from their employers.

The statewide variance in the IC classification system concerns many within the government and business communities. The legal research revealed that the basic rationale in determining IC status is the extent of control exercised by the employer over the manner and means under which an activity is to be performed by the worker. State laws dealing with classification vary and reflect each state's social and economic philosophy and are shaped and clarified by the judicial process. Ultimately, for UI purposes, in the absence of clearly defined standards for determining IC status and employer liability, in each state the administrative agency officials and courts settle disputes by consulting their state's definition, applying their state's test and law (ABC, common law or economic reality test).

The issue of which test is better continues to be debated because each side has a vested interest in safeguarding their legal position. Proponents of change want to introduce a greater degree of certainty and simplification to the classification process, asserting that the current system has outlived its usefulness and is not responsive to the changing ways in which individuals work and business is conducted. Those who oppose changes to the current system believe that the underlying reason is an attempt to shift most of the costs of social benefits and protections from employers to workers.

There is a debate as to whether the IC phenomenon is driven by worker preference or employer demand. Employers and conservative politicians believe that worker preference is driving IC growth. They focus on the benefits of the working arrangement and view ICs as a positive force shaping the economic and social landscape. Union leaders and liberal politicians focus on the human costs of independent contracting, without acknowledging that the new arrangements may also provide more productive

ways of organizing work in today's environment. They view the growth as being primarily employer driven and as a disadvantage to workers. They are troubled by the fact that employees who prefer the stability of regular full-time employment are being compelled by employers to accept IC status or are being deliberately misclassified.

The general consensus of the study respondents on the demographic profile ICs was that there is no typical profile. ICs are males or females and of all ages and of a variety of ethnic origins. They have different education and skill levels. The majority earns middle to low-level wages and has no health insurance or retirement benefits. Construction, trucking, home health and hi-tech industries were frequently mentioned as examples of industries most likely to use ICs or lure workers into becoming ICs and contain high incidences of misclassification.

The number one reason employers use ICs and/or misclassify employees is the savings in not paying workers' compensation premiums and not being subject to workplace injury and disability-related disputes. Another reason is the avoidance of costs associated with employee lawsuits against employers alleging discrimination, sexual harassment, and implementing regulations and reporting procedures that go along with having employees. Understanding and complying with all the labor and worker protection laws is often beyond the capabilities of many small businesses. Even governmental agencies use ICs to avoid conferring employee status and attendant benefits because they have authorization to spend money on contracted services, but not on full-time employees.

The report contains an analysis of aggregate employer audit data from nine states that was extrapolated to each state's workforce to provide a rough measure of the extent of employee misclassification as ICs. The percentage of audited employers with misclassified workers ranged from approximately 10% to 30%. The percentages of UI tax revenues underreported due to misclassification varied from 0.26% to 7.46%.

A national-level estimate of the impact of misclassification on the trust fund was also computed for the period 1990-98. It showed a net impact on trust funds ranging from a

$100 million outflow in 1991 to a $26 million inflow in 1997. Assuming a 1% level of misclassification over the 9-year period, the loss in revenue due to underreporting UI taxes would be an annual average of $198 million. If unemployment remained at the 1997 level, the benefits payable to misclassified claimants would be on average $203 million annually. ***A more significant item of concern is that annually there are estimated to be some 80,000 workers who are entitled to benefits and are not receiving them. One observation expressed by most interviewees was that an increase in the unemployment rate could precipitate an avalanche of IC related issues.*** Workers operating under what at present looks like a good IC agreement would be filing UI claims alleging employee status. The administrative burden associated with a significant rise in contested claims could prove disruptive to orderly claims processing.

A new breed of accountants and attorneys has emerged to counsel employers on how to convert employees into ICs to reduce payroll costs and avoid complying with labor and workplace legislation. In every state that participated in the study, in occupations where misclassification frequently occurs and is discovered by audit staff, these firms have gone to the state legislatures to represent the employers and request exemptions from UI. Such efforts if they are successful, deprive claimants of the coverage they are entitled to and reduce the shared cost intent of the UI trust funds. The current mood in the judicial and legislative systems in many states is very pro-employer and political events are resulting in even more occupations receiving exclusions.

A multi agency dialogue needs to be started to explore the feasibility of extending some or all of the social protections now available to employees to ICs, who are currently denied protection or cannot afford to take full advantage of its availability. For example, should ICs participate in unemployment insurance, including payment of contributions? Should workers' compensation be mandatory for them? Should independent contractor agreements be subject to certain requirements such as the payment of a minimum wage? These are a few of the questions that need to be answered in order to respond to the needs of this increasingly important segment of the nation's workforce.

CHAPTER 1
INTRODUCTION

This report presents the results of a study on independent contractors (ICs) commissioned by the Employment and Training Services Administration (ETA) of the United States Department of Labor (USDOL).

It begins with an overview of the classification systems and tests used by administrative agencies and state court systems to identify independent contractors. It then describes the reasons workers become ICs, why employers use them, demographic characteristics of employees misclassified as ICs and profiles of four industries which have a high concentration of ICs. Next, for selected states, it presents the results of an attempt to determine the extent of misclassification of employees as ICs, the effect of misclassification on unemployment insurance (UI) tax revenues, and the impact on UI trust funds. It then describes the experiences of state administrators in dealing with the phenomenon of independent contractors and other significant issues related to ICs that affect the workforce. Finally, the report presents the findings and recommendations.

1.1 Policy and Economic Context

As the economy continues to change, communications technology advances and more workers search for alternate ways of living their lives, there is greater interest in independent and part time work. Traditional employment used to mean holding a full-time job year round, a 40-hour workweek, an established schedule for reporting to work, and being paid by the firm for which the work was done. In addition, most of the workers were employees of the organization for which they carried out their assignments.

This picture has changed dramatically over the past decade or so, and many former employees, for a variety of reasons, are now working as ICs. Many workers displaced by corporate downsizing, and some of those seeking more flexible work environments, have

formed their own companies. These ICs work for themselves or their own company, obtain their clients, and run their own business.

Based on definitions of standard employer-employee relationships and the classification criteria used by the Internal Revenue Service (IRS) and State Employment Security Agencies (SESAs), there are:

1. those who are classified as ICs according to their state classification systems and receive the IRS form 1099-Misc from employers reporting receipt of "non-employee compensation",
2. those employees should receive the IRS form W-2 reporting receipt of "employee compensation," but are deliberately misclassified by employers as ICs and instead receive form 1099s, and
3. those ICs and workers who operate underground and don't receive either a 1099 or a W-2 from their employers.

In a typical employer-employee relationship, the employer has the right to control and direct the person performing the services, what is to be done, how it is to be done, the place where work is to be done, and the equipment needed to do the work. Where such a relationship exists, the employee is required to pay his or her share of Social Security and Medicare taxes. The business entity is required to pay its' share of Social Security, Medicare, and Federal Unemployment Tax, and the full premiums for workers' compensation and UI. Employees have a legal right to organize in unions, and to receive a minimum wage, overtime pay and UI compensation if laid off.

ICs on the other hand, are self-employed. They are not covered by employment and labor laws that were designed for employees. They are not eligible for unemployment compensation. They must pay the full Social Security and Medicare taxes on their net earnings from self-employment, pay quarterly estimated income taxes if the business entity does not withhold them, and pay for their medical insurance, worker's

compensation etc. because employers do not provide them such benefits. They are also exposed to incurring a financial loss from their business.

Determining who is an employee and who an IC is a question that concerns the business community. Employers are increasingly becoming aware of the issue because of media reports of businesses facing contested employee classification claims. Audits by the IRS and the state UI agency can be economically costly. If found guilty, the employer is subject to back taxes, interest, and penalties. In addition, an erroneous classification raises issues regarding workers' compensation benefits, overtime compensation, medical, retirement and other benefits and rights for which employees are typically eligible.

A burgeoning industry of accounting and legal firms has emerged recently to offer services to employers to determine who is an employee and who is an IC. They show employers how to avoid making mistakes in classifying employees and independent contractors that may lead to problems with the IRS and SESAs.

At the same time, the nature of work and employment arrangements in the United States is undergoing a transformation. Across the country, "workers are abandoning traditional jobs, and instead are moving from project to project, assignment to assignment, untethered to any particular employer, unattached to any large institution, relying on themselves, and living by their wits… Some have been pushed…Others have leaped."[1] On one side are those workers who leave traditional jobs and strike out on their own to write, photograph, design, consult, program computers, or sell insurance and real estate. On the other side are workers with little education, training or skill, who have been forced by employers into accepting independent contractor arrangements with low pay and status and no health, pension, or retirement benefits.

There is a continuing debate as to whether the emergence of independent contractors is driven primarily by employer demand or by worker preference. Those who view the emergence of these new work arrangements as largely employer driven believe they are

[1] Daniel H. Pink, *New Republic*, April 27, 1998, p.19

to the disadvantage of workers and society at large. In contrast, those who believe worker preference is driving many of these changes welcome their appearance as a positive new force shaping the way business is conducted. Additional information on previous research on the phenomenon of ICs is contained in Appendix 2.

1.2 Purpose Of The Study

The changing nature of employment and the substitution of ICs for employees by business entities has attracted the attention of policymakers at the federal and state levels. According to standard measurement indicators, the current unemployment rate of approximately 4% is the lowest in three decades; incomes are rising and the economy is strong. Despite the strong growth in the economy and the labor market, a substantial portion of the workforce, including ICs, lives without job security and workplace protection. No comprehensive studies have been done on this emerging phenomenon.

The politics, needs, and wants of independent contractors, much like the form of their work, do not fit old categories. They operate under less secure job conditions. An organization that provides support services for ICs made the following comment about labor protection laws governing nontraditional workers. "It may have made sense to draw distinctions between employees and independent contractors in the manufacturing age...but with the shift toward more flexible arrangements, independent contractors often resemble workers in the manufacturing age in the tasks they perform, and in their relationships to employers…nearly one-third of the U.S. workforce is actually working under the labor conditions of the 1890's."[2] That was a period when workers had few rights and no employment and workplace laws and regulations to protect them.

Independent contractors are largely distinct from other types of workers engaged in flexible work arrangements according to information gathered from the literature. The purpose of the study was to provide a better understanding of the IC work arrangement

[2] "Your voice in the policy debate," *Working Today*, 1998.

and its potential impact on Unemployment Insurance (UI). The research design addressed the following questions: Who are independent contractors? Is there a variance in the IC classification system? Why do employers hire ICs? Why do workers enter such arrangements? Which occupations and industries are they in? Do employers routinely misclassify employees as ICs, and if so, what is the impact on the UI trust fund?

1.3 Design Of Evaluation

The objective of the study was to obtain information on independent contractors from as wide a variety of sources as possible, in a cost-effective manner. Three major tasks were undertaken:

- a review of available data and literature on ICs from publications, on-line databases, and the Internet,
- a determination of the breadth of variance of worker classification criteria across states, and,
- site interviews and data collection in a sample of states.
    - Site visits were made to Washington, New Jersey, Florida, California, and Maryland. UI benefit and tax administrators, administrative law judges, and appeals staff were interviewed to obtain insight on employee misclassification. The project team conducted in-depth data collection and analyses of employee misclassification on the state UI trust funds.
    - Representatives from workers' compensation, employer organizations, unions, and advocacy groups were interviewed to obtain information on issues specific to the needs and wants of ICs.
    - Data were also collected from UI administrators in Colorado, Connecticut, Indiana, Minnesota, Nebraska, New Mexico, Ohio, Oregon, Pennsylvania, Texas, and Wisconsin on states' legislative and administrative responses to the growth of the independent contractor industry.

Almost all of the interviewees equated employee misclassification with the operation of the underground economy.[3] In their view, there was little substantive difference between

[3] For the purposes of this report the underground economy is defined as composing of illegal activities, informal and unrecorded transactions, and income that is not reported.

reporting an employee as an IC and not reporting him or her at all. Some of those unreported operate in the underground economy. It is for this reason that a discussion of the operation of the underground economy is relevant to the study, especially how it is related to worker's wages.

CHAPTER 2
INDEPENDENT CONTRACTOR CLASSIFICATION

This chapter begins with a summary of research on the alternative workforce. Next, the various tests used by state judicial systems to determine who is an independent contractor, and how state agencies and judicial systems classify individuals as employees or independent contractors are described. It concludes with a discussion on the implications of the current classification system.

2.1 The Alternative Workforce and Independent Contractors

All the research to date on the size and magnitude of the alternative workforce is based on the classification system and data gathered by the BLS for the Current Population Survey (CPS) Supplement of Alternative and Contingent Work Arrangements. The BLS researched ICs in the context of other alternative and nonstandard work arrangements– temporary-help agency workers, on-call workers, and contract workers. The Economic Policy Institute (EPI) and the AFL-CIO also researched the issue of determining the size of the alternative workforce and its components, and used the CPS supplement published by the BLS as the basis for their analyses.

Although all the researchers describe the emergence of exceptions to the typical employer-employee relationship, they have different conceptions of what they believe should be considered typical and what they believe to be exceptions to the norm, which influences whether the phenomena are viewed in a positive or a negative light. What is known about ICs is clouded by the analysis of information on these other categories, especially when considering the varying motives of employers and workers who enter these arrangements.

The BLS published a CPS supplement on the alternative workforce in 1995, 1997 and 1999. The 1995 study was the first attempt to determine what portion of those employed

viewed themselves as being in nonstandard work arrangements. Since there are no significant differences in findings between the 1995 and 1997 surveys, the rest of this section focuses on the 1995 survey data. An additional reason for focusing on the 1995 survey is also to remain consistent with the other two studies that are reviewed here, which base their analyses on the same time period. The 1999 BLS data on ICs was not analyzed because it was not released in time for analysis for the final report.

The Bureau of Labor Statistics

Four alternative work arrangements (AWAs) are specified in the BLS classification: independent contractors, on-call workers, temporary help agency workers, and contract workers. Alternative work arrangements include all part-timers. Part time is defined as less than 35 hours per week. Exceptions to the typical work arrangement are "defined either as individuals whose employment is arranged through an employment intermediary such as a temporary help firm, or individuals whose place, time, and quantity of work are potentially unpredictable."[4] The latter portion of this definition applies to both independent contractors and on-call workers, while the role of an employment intermediary is the crucial element in defining the temporary help agency workers and contract workers.

The BLS defines ICs as those who work for themselves or their own company, bear the responsibility for obtaining clients, see that work assignments are executed, and otherwise run the business. These same criteria could also apply to other self-employed individuals, such as shop or restaurant owners. The BLS usually classifies as a wage-and-salary worker any self-employed individual who incorporates his/her business. However, for the purposes of this supplement, the definition of self-employed was extended to include the incorporated self-employed.

As shown in Table 2.1, almost 10% of the total labor force are in alternative work arrangements. Between 1995 and 1999, more than half of these workers (8.3 million in

[4] Anne E. Polivka,. "Contingent and alternative work arrangements, defined," *Monthly Labor Review*, October 1996, p.7

1995, 8.5 million in 1997, and 8.2 million in 1999) identified themselves as independent contractors, followed by on-call workers. Many individuals classified as wage-and-salary workers in the basic CPS survey also identified themselves as independent contractors in the three supplements.

Table 2.1: The Alternative Workforce

Categories	(Number millions)	% of total employed
Independent contractors	8.3	6.7
On-call workers	2.0	1.6
Temporary help agency workers	1.2	1.0
Contract workers	0.65	0.5
Total alternative workforce	12.15	9.8
Total workforce	123.2	100

Source: Based on data from Sharon R. Cohany, "Workers in alternative employment arrangements," The *Monthly Labor Review*, Oct. 1996, p 31-32.

Economic Policy Institute

Compared with the BLS, EPI's researchers have a different conception of what is considered a typical work arrangement although the same CPS data was used. In their view**,** the typical career paradigm is characterized by lifetime employment with a single employer, steady advances up the job ladder, and a pension upon retirement**.**[5] All exceptions to this picture of regular, full-time employment are "nonstandard work arrangements" (NSWAs), and differ from "standard" arrangements in at least one of the three following ways:

- the absence of an employer (as in self-employment and independent contracting),
- a distinction between the organization that employs the worker and the one for whom the person works (as in contract and temporary work), or

[5] Arne Kalleberg, and Edith Rasell, and others., *Nonstandard Work, Substandard Jobs – Flexible Work Arrangements in the U.S*, Economic Policy Institute, 1997, p.1

- the temporal instability of the job (as "characteristic of temporary, day labor, on-call, and some forms of contract work").

Similar to the BLS, the EPI classification system includes the role of an intermediary as one of its criteria for defining exceptions to the norm. However, the absence of an employer, rather than the unpredictable nature of their work, is the critical factor for including independent contractors in the nonstandard work arrangement. Using this criterion, those workers who do not have an employer, meaning the self-employed, are included in the nonstandard work arrangements. Unlike the BLS classification scheme, the EPI uses contingent or temporary work as criteria for identifying exceptions to standard work arrangements. EPI analysts also highlight the existence of two different categories of independent contractors, the self-employed and wage-and-salary ICs.

Table 2.2: The Nonstandard Workforce

Categories	(Number millions)	% of Total Employed
Regular part-time workers	16.0	13.7
Self-employed	6.4	5.5
Independent contractors/self-employed	6.6	5.6
Independent contractors/wage-and-salary	1.0	0.9
On-call workers/day laborers	1.9	1.6
Temporary help agency workers	1.1	1.0
Contract workers	1.4	1.2
Total NSWA	34.4	29.4
Total workforce	117.04	100.0

Source: Based on data from Arne L. Kallenberg, Edith Rasell, et al. *Nonstandard Work, Substandard Jobs,* Economic Policy Institute, 1997,p.9

As shown in Table 2.2, in its estimate of the total workforce, the EPI uses the smaller figure of 117,040,764 compared with the 123,202,000 reported by the BLS in Table 2.1. However, the inclusion of part-time workers and the self-employed increases the nonstandard workforce from, 9.9% of the total workforce to 29.4%. In addition, in its analysis of the BLS data, the EPI has more than doubled the number of contract workers

from 652,000 to 1,858,030. ICs no longer dominate because the self-employed are included. Nevertheless, ICs remain as one of the three dominant components of the nonstandard workforce.

AFL-CIO

Although part-time work is listed as a major exception to the standard work arrangement, it is not explicitly defined as such by the three criteria listed by EPI. Perhaps for this reason, the AFL-CIO accepts the EPI criteria, but adds a fourth: "the worker is guaranteed less than full-time employment (but may or may not work full-time hours)."[6] As shown in Table 2.3, by doing this, they explicitly include part-time work in nonstandard work arrangements.

Table 2.3: Nonstandard Work Arrangements (AFL-CIO)

Categories	(Number million)	% of total employed
Part-time work (regular only)	20.3	16.6
Work paid by a temporary help agency	1.2	1.0
On-call work	1.3	1.1
Day laborer work	0.1	0.1
Work paid by a contract company	1.7	1.3
Work paid by a leasing company	0.5	0.4
Independent contracting: wage and salary	1.1	0.9
Independent contracting: self-employed	7.0	5.7
Total NSWA	33.1	27.1
Total workforce	122.1	100.0

The inclusion of part-time and contingent work by the EPI and AFL-CIO researchers complicates the workforce classification system, since these are no longer discrete categories. Nevertheless, these analysts believe that the inclusion is necessary to accurately represent their concerns about the changing nature of the workforce. The

[6] Helene Jorgensen, *Nonstandard Work Arrangements: Downscaling of Jobs*, Department of Public Policy, AFL-CIO, March 1998.

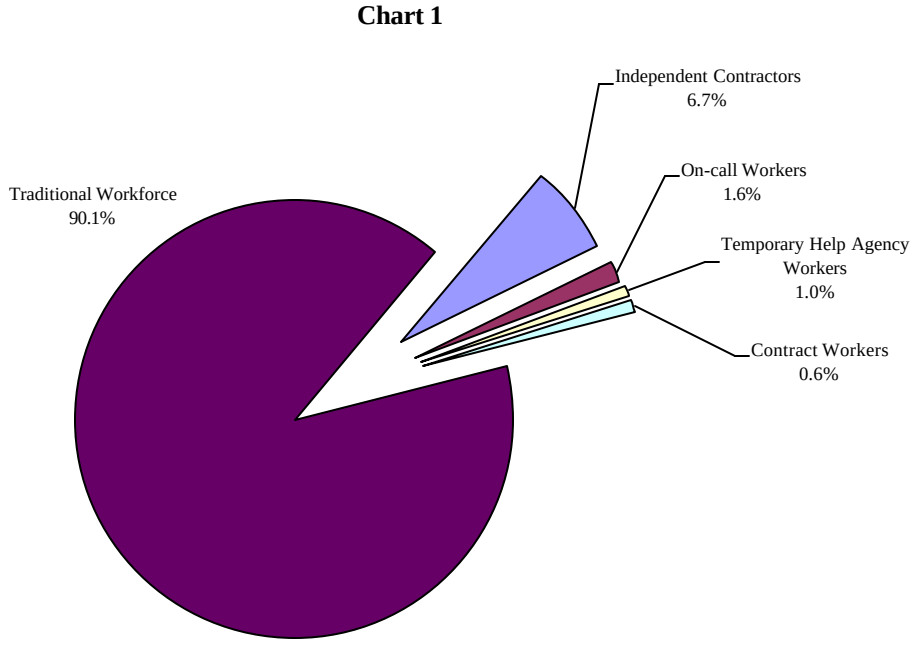
researchers also accept the EPI subcategories of ICs. Unlike the EPI however, except for ICs, self-employed are not included in a nonstandard work arrangement classification.

2.2 Implications of the Classification Differences

These different classification systems affect the understanding of the IC phenomenon because they are inevitably linked to the analysis and interpretation of the other emerging work arrangements. This is shown in the illustrations Figures 2.1 and 2.2.

Figure 2.1 represents the workforce classification system as it is conceived by the BLS, including the percentage of the overall workforce represented by each work arrangement. Alternative work arrangements have over 12 million workers (or 10% of the workforce). All other work arrangements, representing almost 90% of the workforce, are defined as traditional within the BLS classification system.

Figure 2.1: Alternative Work Arrangements

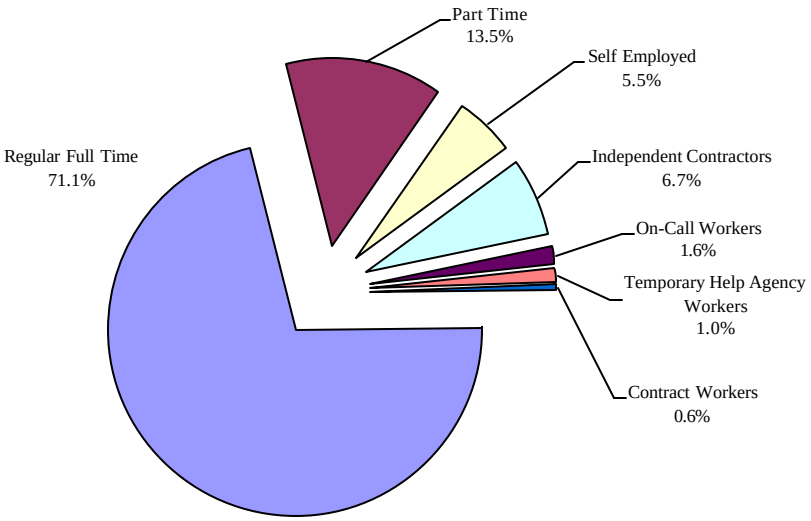


Source: Based on data from Sharon R. Cohany, "Workers in alternative employment arrangements," *The Monthly Labor Review*, October 1996, p36.

The BLS and EPI classification systems are combined in Figure 2.2, which retains the data reported by the BLS in the 1995 supplement. It shows how adding part-time and self-employed workers to the BLS classification system dramatically increases the size of the nonstandard workforce as a percentage of the overall workforce. Independent contractors as a percentage of the workforce are the same in both charts. Within the EPI classification system, all standard work arrangements (primarily regular full-time workers) represent only 71% of the workforce. The nonstandard workforce including part-time and self-employed workers, represent the remaining 29% of the workforce.

Not surprisingly, the larger figure (29%) has a tendency to appear more frequently in publications featuring information on independent contractors and other alternative workers. This may contribute to the perception that the number of ICs is larger than that reported by the BLS.

Figure 2.2: Combination of BLS and EPI Worker Classification Systems



Source: Planmatics analysis based on data from 1995 Current Population Survey Supplement integrating Bureau of Labor Statistics and Economic Policy Institute classification systems

Further discussion on the independent contractor measurement issues is described in appendix 2 of this report.

2.3 Legal Classifications of Independent Contractors

Given its long and tortured history, a certain level of humility is needed in answering the question as to who is an employee and who is an independent contractor, because the line between them shifts over time. It is not a recent question or even one that first arose in this century. Its origins can be traced to fourteenth-fifteenth century England.[7] According to Linder, the judicial distinction between employees and independent contractors has undergone a transformation in its accommodation to radically different socioeconomic and political contexts over the past six centuries.

The arrangements under which services are provided by one individual to another are extremely diverse, are susceptible to immeasurable nuances, and are changing. The prevailing versions are neither new nor self-explanatory. Statutes governing the determination of employee and IC status have been on the books for over half a century. However, there continues to be a great deal of uncertainty in many industries today in making a proper determination. There are no universal rules or ways to apply each state's definition of employee to specific situations because unemployment insurance violations are within the state realm, not the federal realm. In the absence of clearly defined standards for employee status and employer liability, administrative agency officials, administrative law judges, and the state courts must settle disputes. Ultimately, the state determines which individuals are employees and which are independent contractors.

Legal research was conducted to determine how the variance between federal and state law within states and from state to state affects worker classification. The nature of a particular job is immaterial with respect to a claim for unemployment compensation if an

[7] Marc Linder, *The Employment Relationship in Anglo American Law: A Historical Perspective (Contributions in Legal Studies, No 54)*, Greenwood Publishing Group, 1989.

employer supervises and directs an employee and the occupation or profession performed is not exempted from benefits under the relevant unemployment compensation act. The determination of whether independent contractors are covered by a particular labor, employment, or tax law hinges on the definition of "independent contractor." Each state's definition of covered employment, employee and IC were researched. Case law research illustrated how the definitions were applied to a particular set of circumstances and the resulting judicial interpretation; which states employed the most inclusive and least inclusive employee definitions; which states used the ABC test or the common-law test; and which industries had IC related issues.

The various statutes[8] and the reasoning employed by the states and the federal government in determining who is an employee and who is an independent contractor are described below. Fourteen states plus the District of Columbia use the common-law test to define employees for purposes of UI coverage, while twenty-two use the ABC test, ten states use their own test and four states use the IRS's 20-point test.

The Common Law Test

The common law definition is based on a master-servant type of relationship in which the employer (the master) retains the right to control the way work is done by the employee (the servant). Within the context of the Unemployment Insurance Act it is the contractually reserved right rather than the actual exercise of it that defines the relationship contractor. However, if this right has not been reserved, supervision of the person doing the work does not automatically institute the right of control or change the relationship to one of master and servant.

Control is often hard to define due to the individual nature of each job that is completed and state judiciaries often turn to secondary factors and circumstances of the relationship for guidance in making the determination. For example, if an individual is working at his own pace, with his/her own tools, is being paid for the job he/she is completing, and only

[8] The variance in state classification of workers' compensation laws applicable to independent contractors is not covered in this report.

being supervised to ensure the work is being completed according to the contract, then he/she is an IC. If an individual is subject to control in details of employment, is required to report to work at a certain time and to stay for a certain period of time, paid hourly wages, required to use the employer's tools and is supervised, then he/she is an employee. It is these secondary factors, the statutory exemptions already in place and the judiciary's interpretations that contribute to the variance in classification.

ABC Test

The distinction between an employee and an IC under the ABC test depends on the existence or nonexistence of the right to control the means and the method of work. Employment consists of service performed by an individual, regardless of whether the common-law relationship of master-servant exists, unless and until it is shown to the satisfaction of the agency that (A) the individual has been and will continue to be free from any control or direction over the performance of services both under his contract and in fact; (B) the service is either outside the usual course of the business for which it is performed, or is performed away from its business; and (C) the individual is customarily engaged in an independently established trade, occupation, profession, or business that is of the same nature as that involved in the service.[9] These three requirements must be concurrently satisfied; the inability to satisfy any one requirement may result in the unavailability of unemployment compensation.[10]

While the first criterion requires proof that the individual is in fact free from control and direction in the performance of the services, the courts have never held that there must be an absolute and complete freedom from control.[11] The second criterion requires an enterprise to demonstrate that in order to prove that an individual is not an employee and enterprise has no liability, that the enterprise performs activity on a regular or continuous basis, without regard to substantiality of activity in relation to enterprise's other business activities. The enterprise must prove that all services by the individual were performed

[9] *Tachick Freight Lines, Inc. v. Department of Labor, Employment Security Division,* 773 P.2d 451 (Alaska 1991); *New Hampshire, Labor, Unemployment Compensation Act,* Section 282-A:9

[10] *Jack Bradly, Inc. v. Department of Employment Security,* 585 N.E.2d 123 (Ill. 1991).

away from the enterprises' business or that the services provided by the individual were outside the enterprise's usual course of business. To satisfy the third criterion, it must be established that the individual has an enterprise created and existing separate apart from the relationship with the particular employer, that will survive termination of the current relationship.

The three requirements under the ABC test are the same for all states. How one becomes labeled an employee or an IC depends upon how the judiciary interprets the facts of the case concurrently with the prongs of the ABC test. The primary concern is not with the language in a contract that characterizes an individual as an IC, but on what the IC does and whether requirement has been met. The courts look at the actual circumstances of employment to discover whether the relationship falls within ambit of statutory exclusion of relationship from the definition of "employment" for UI tax purposes.

IRS Test

The IRS uses a common-law standard that focuses on a business's control over a worker.[12] A worker may be treated as an independent contractor only if the business she or he works for does not direct and control or have the right to direct and control the means and methods used to do the work. In other words, if an employer can tell a worker how, when, and where to work, that worker is an employee.

The IRS uses 20 factors to determine if an employer directs and controls its workers. A worker does not have to satisfy all of the factors to be classified as an independent contractor. It is the totality of the responses to the 20 factors that identify the correct legal status of the worker. Some factors carry more weight than others do. They are: (1) the business does not give detailed instructions on how to perform the job; (2) the business does not provide job training; (3) the worker realizes a profit or a loss from

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[11] *American Transp. Corp. v. Director*, 39 Ark.App. 104 (1992). See also, *Twin States Pub. v. Indiana Unemployment*, 678 N.E.2d 110 (Ind.App. 1997), *Hill Hotel Co. v. Kinney*, 138 Neb. 760 (1940).
[12] *Bureau of Business Practice*, "Independent Contractor or Employee? The Practical Guide to IRS Worker Classification," (1998).

working for the business; and (4) the business does not give the worker benefits such as health insurance and vacation pay.

Economic Realities Test

Some states use the economic realities test, which is the broadest test for worker classification. If a worker is financially dependent upon one business for a substantial part of her or his livelihood, then an employer-employee relationship exists. Courts have used some of the following IRS common-law factors to determine the extent to which a worker is financially dependent on a business. They are: (1) the nature and degree of control a business has over the way the worker performs a job; (2) the extent to which the services rendered are an integral part of the business; (3) the permanency of the relationship between a business and a worker; (4) the amount of a worker's investment in facilities and equipment; (5) a worker's opportunity for profit and loss; and (6) the amount of initiative, judgment, or foresight that a worker needs to show or use in order to be successful in open market competition with others.

AC Test

Some states use a two-part test that takes criteria one and three from the ABC test. For purposes of UI, services performed by an individual for remuneration are considered employment, unless it is shown that: (1) the worker has been and will continue to be free from control or direction in the performance of his work, both under contract of service and in fact; and (2) the worker is engaged in an independently established trade, occupation, profession, or business.[13] "Employment" is not confined to common-law concepts, or to the relationship of master and servant, but is expanded to embrace all services rendered for another for wages.[14]

The requirement that the individual be free from control can be met by establishing that the individual: (1) is not an agent of the company (does not have an employer name tags), (2) can work extra hours or change hours without clearing it with the company, (3) can

[13] *Oregon Unemployment Insurance Act*, Title 51, Section 657.040 and Section 670.600 (1998).
Sewing M[14] Singer ach. Co. v. Industrial Commission, 104 Utah 175 (1943).

control the means and direction of his day, and (4) could work for any of the employer's clients following termination of the arrangement with the employer.[15] The requirement that the employee's occupation be independently established and that he be customarily engaged in it, means that the business must be created and exist separate from the relationship with the particular employer. It also means that the individual's business must survive the termination of the relationship and that the individual must have enough of a proprietary interest so that the business can be operated without any help from any other individual. In deciding whether an individual is an IC, each case must be determined on its own facts and all the features of the relationship must be considered.[16]

ABC plus 123

The state of Washington subscribes to the three criteria of the ABC test, but adds three additional criteria. These require that (1) on the effective date of the contract of service, the individual is responsible for filing a schedule of expenses with the IRS; (2) the individual has established an account with the Department of Revenue; and, (3) the individual is maintaining a separate set of books or records that reflect all items of income and expenses of the business that the individual is conducting.

The types of classification tests used by states are summarized below in Table 2.4. Additional information on the variance in classification is provided in appendix 1 of this report.

[15] *In re Hendrickson's Health Care Serv.*, 462 N.W.2d 655 (S.D. 1990). See also, *Unemployment Compensation Fund. Black Bull, Inc. v. Industrial Commission,* 547 P.2d 1334 (Utah 1976); *J.R. Simplot Co. v. State,* 110 Idaho 762 (1986).
[16] *Egemo v. Flores,* 470 N.W.2d 817 (S.D. 1991).

Table 2.4: Use of Tests and Statutes

STATE				
	LEGAL CLASSIFICATION			
	COMMON LAW TEST	ABC TEST	IRS TEST	OTHER TESTS
ALABAMA	✓			
ALASKA		✓		
ARIZONA				✓
ARKANSAS		✓		
CALIFORNIA	✓			
COLORADO		✓		
CONNECTICUT		✓		
DELAWARE		✓		
FLORIDA	✓			
GEORGIA		✓*		
HAWAII		✓*		
IDAHO				✓
ILLINOIS		✓		
INDIANA		✓		
IOWA	✓			
KANSAS	✓			
KENTUCKY	✓			
LOUISIANA		✓		
MAINE		✓		
MARYLAND				✓

Table 2.4: Use of Tests and Statutes (Cont)

STATE	*LEGAL CLASSIFICATION*			
	COMMON LAW TEST	ABC TEST	IRS TEST	OTHER TESTS
MASSACHUSETTS	✓			
MICHIGAN				✓
MINNESOTA	✓			
MISSISSIPPI	✓			
MISSOURI			✓	
MONTANA		✓		
NORTH CAROLINA				✓
NORTH DAKOTA	✓			
NEBRASKA		✓		
NEW HAMPSHIRE		✓		
NEW JERSEY		✓		
NEW MEXICO		✓		
NEVADA				✓
NEW YORK	✓			
OHIO		✓		
OKLAHOMA	✓			
OREGON				✓
PENNSYLVANIA		✓		
RHODE ISLAND			✓	
SOUTH CAROLINA	✓			
SOUTH DAKOTA				✓
TENNESSEE	✓			

Table 2.4: Use of Tests and Statutes (Cont)

STATE	*LEGAL CLASSIFICATION*			
	COMMON LAW TEST	ABC TEST	IRS TEST	OTHER TESTS
TEXAS			✓	
UTAH		✓		
VERMONT		✓		
VIRGINIA		✓		
WASHINGTON				✓
WASHINGTON DC	✓			
WEST VIRGINIA		✓		
WISCONSIN				✓
WYOMING			✓	

*Georgia and Hawaii employ a slight variation.

Source: Simon & Chuster, “Independent Contractor or Employee”, The Practical Guide to IRS Classification, p74.

2.4 Implications of the Variance in Classification

The issue of which test is better continues to be debated because each side has a vested interest in safeguarding their legal position. Some of the administrative law judges who were interviewed viewed the ABC test as being somewhat rigid and failing to move with the times and respond to the changing conditions of the workplace. Under the ABC test, to be classified as an IC, all three requirements must be satisfied. They viewed the common-law test as less rigid, moves with the times because it deals only with the issue of direction and control. However, the proponents of the ABC test stated that applying the common-law test in employment tax issues does not yield clear, consistent, or even satisfactory answers, and reasonable people may differ as to the correct classification.

The prevailing classification system is a major issue of concern to the business community and to regulators. The 2000 small business owners that attended the 1995 White House Conference on Small Businesses voted a change in these determinations as a top priority. Critics of the current classification systems point to the differences among the federal and state rules as well as the differences within a state, particularly between the UI laws and workers' compensation laws. It is these differences, they maintain, that create the uncertainties that can place employers in financial peril.

Those who understand the current classification system point out that there are valid reasons for the differing approaches. First, the varying systems are much more alike than they are different. The basic rationale among them includes a determination of the extent of the control exercised over the manner and means under which an activity is to be performed. Another fundamental criterion is whether the individual performing the services is in fact in business for himself, and exposed to the financial risk commonly associated with operating a business.

Contributing to the differences in approach to classification is the fact that the criteria and their relative importance are constantly under review by the courts. The laws in the

individual states dealing with UI vary and, in the main, reflect the state's social and economic philosophy. These laws are then shaped and clarified by the judicial process established in that state. The end result can highlight the perceived differences, reinforcing the critics' claim of inconsistency. It should be pointed out that although the state legislatures are empowered to bring the differing IC criteria into uniformity, there is no evidence in the recent past that this is their inclination.

Many proponents of change have asserted that the present system has outlived its usefulness and is not responsive to the ever-changing ways in which business is being conducted. Those who oppose wholesale changes in the process argue instead that the underlying reasons are a thinly disguised attempt to shift most of the costs of social benefits and protections to the workers. The increasing use of all types of nontraditional workers, including ICs, has created renewed interest in changing the classification criteria so as to introduce a greater degree of certainty and simplification to the process. In any event, once a dialogue begins, it becomes readily apparent that a "one-size-fits-all" criterion cannot be applied to the dynamics of the workplace. As discussed later in Chapter 6, both the federal and state governments are revisiting the issue.

CHAPTER 3
EMPLOYER DEMAND OR WORKER PREFERENCE?

This chapter describes why employers use independent contractors, why workers enter such arrangements and the economic and social environment conducive to using ICs.

3.1 Employer Demand or Worker Preference?

There is a continuing debate as to whether IC use is driven primarily by employer demand or by worker preference. It is inevitable that the findings derived from any research study will create a context that affects how the analyst will interpret the phenomenon being investigated. The focus of this study was on all types of ICs and information pertinent to both sides of the debate was gathered. The results corroborated some of the findings on independent contractors contained in previous research.

Those researchers who believe that worker preference is driving employer use of independent contracting, view it as a positive force shaping the economic and social landscape, reflecting the changing ways in which business is conducted. Business owners and conservative politicians focus on the benefits of the IC working arrangement and de-emphasize the human cost aspect.

Union leaders and liberal politicians on the other hand, focus on the human costs of independent contracting, without acknowledging that the new arrangements also provide more productive ways of organizing work in today's environment. They view the use of the ICs as being primarily employer driven, and as a disadvantage to workers and society at large. They are troubled by the fact that employees who prefer the stability of regular full-time employment are being compelled by employers to accept IC status or are being misclassified. The misclassification issue is discussed in Chapter 4.

Employers' motives for using ICs and workers' motivations for entering such arrangements are complex and vary according to need and circumstance. In addition, the motives of employers who hire existing ICs are somewhat different from those who reclassify and convert their employees to ICs. Identifying the underlying motives of both types of employers and workers was crucial to objectively assess this work arrangement.

3.2 Employer Motivation

Commonly cited reasons for employers hiring independent contractors include:

- Flexibility to:

  - respond more quickly to rising demand and avoid layoffs of permanent staff
  - replace absences of regular staff
  - accomplish specific tasks for specific sums of money
  - gain access to workers with highly specialized skills on an as-needed basis
  - focus on core competency and supplement core staff on an as-needed basis
  - eliminate the time and expense involved in training employees and,
  - screening candidates for regular jobs.

- Saving in labor costs through savings on payroll tax and fringe benefits.

  - Employers increase short-term profits by replacing skilled workers with those less skilled, and by substituting full-time employees for more flexible, just-in-time workers. Union representatives of the trucking industry in Washington and Florida, and the construction industry in New Jersey and Maryland cited that it is a legal way for employers to restrict costly fringe benefits to a certain segment of their staff.

  - UI staff viewed the fact that employers are not required to pay their share of FICA and FUTA taxes and provide fringe benefits to ICs as a significant motive to misclassify employees as ICs and also to hire ICs. Employer and worker advocacy groups were unanimous in their complaint that businesses paying mandatory taxes on employees are unable to compete with those having small numbers of employees or no employees and large numbers of ICs. In fact, it induces otherwise complying employers to engage in such practices.

  - By hiring ICs, employers reduce costs directly by not being required to pay state unemployment taxes and workers' compensation insurance, and indirectly by reducing their exposure to costs associated with potential severance and

disability-related issues such as employee termination and workplace injuries. The savings generated by not paying the UI tax on ICs was not viewed as a significant motive in employer hiring. It was the savings gained in not paying workers' compensation premiums and not being subject to workplace injury and disability-related disputes that were cited as the most significant reasons to misclassify employees and hire independent contractors.

- In some industries and occupations (insurance, financial services), employers recruit employees, train them for a year, then make them switch status to independent contractors, but continue to use them under the same terms and conditions as before. Minneapolis-based financial advisors of American Express filed a lawsuit alleging this practice. In another federal lawsuit in California (AllState Insurance) agents alleged that the employer retained the authority of an employer without shouldering the accompanying financial responsibilities. The agents who sell products only for AllState got slightly higher commissions by switching employment status, but lost most of their benefits and business-expense reimbursements, while the employer maintained all prior elements of direction and control.

- Office space and equipment-related costs of conducting business operations are not incurred because employers do not provide ICs with office space or equipment.

- Reduced cost of doing business through circumventing compliance with federal and state labor and workplace legislation.

  - Especially in the case of small businesses, by hiring ICs, the size of the business entity can be kept below the number of acknowledged employees that triggers the need for compliance with many state or federal laws. For example, the Family Leave Medical Act becomes operative when a firm employs 50 or more employees. By hiring ICs, the business can stay below 50 employees and also deprive the legitimate employees of the benefits of the Act.

  - According to SESA administrators, what drives misclassification is the effort by employers to avoid the costs associated with employee lawsuits alleging discrimination, sexual harassment, and workplace injury; and the regulations and reporting procedures that go along with having employees. Understanding and complying with all the labor laws and worker protection laws is often beyond the capabilities of many small businesses.

- Access to a new breed of accountants, attorneys, and advisors on how to reduce payroll costs and avoid complying with federal and state labor and workplace legislation by converting their employees into independent contractors.

- UI appeals and tax personnel were concerned and agitated by the legal counsel provided by a new breed of law firms operating at state and national levels who specialize in advising employers on "circumventing but not breaking unemployment insurance laws." In some instances, former employees of SESAs staffed these firms. They represent employers before administrative law judges and state courts on employee status conversion, UI tax issues, and misclassification disputes.

- In occupations where misclassification frequently occurs and is discovered by UI auditors, these firms counsel and represent employers in lobbying state legislatures to request exemptions from unemployment insurance. If successful, they deprive claimants of the coverage they are entitled to as well as reducing revenue to the UI trust funds. All the study participants from UI agencies referred to at least one, but frequently to many such instances.

3.3 Worker Motivation

Interviews revealed two broad categories of workers entering employer-independent contractor relationships, those who did voluntarily and those who did not. Commonly cited reasons from both categories are discussed here:

Voluntary Choices

In the BLS surveys, there is little evidence that workers were forced to leave their regular, full-time jobs to start working for themselves as ICs. According to the BLS, independent contractors are "somewhat more likely to have voluntarily left their previous employment than were traditional workers." [17] "Among men, most said they worked as an independent contractor because they liked being their own boss"[18], whereas the common reasons given by women for being an IC included "the flexibility of scheduling and the ability to meet family obligations that the arrangement afforded."[19]

The CPS supplements showed that the vast majority of ICs (76%) cited personal reasons for becoming ICs. Less than 10% of respondents cited economic reasons. Nearly 84% of

[17] Polivka, Anne E. "Into Contingent and Alternative Employment: By Choice," Monthly Labor Review, October 1996, p58.
[18] Sharon. R. Cohany, "Workers in Alternative Employment Arrangements: A Second Look." Monthly Labor Review, November 1998, p6.
[19] Ibid

ICs stated that they preferred their alternative arrangement to a more traditional one. Less than 10% expressed a preference for a more regular, full-time position as a wage-and-salary worker. Finally, these ICs do not view their work as contingent, because they see their primary work relationship being with their occupation and other colleagues in their professional network, and not with any specific employer or organization. Nor do they view their current job arrangement as temporary.

Specific occupations that are represented by those who voluntarily became ICs include writers and artists, insurance and real estate sales agents, software and Web page designers, construction trade employees, and managers and administrators.

UI administrators in Colorado pointed out that they often encountered workers, particularly in construction, who have little knowledge of tax laws and who perceive the IC classification as an alternative or choice. The idea of being 'in business for yourself' sounds positive to these workers. The IC classification means that there is no tax withholding and the full salary is paid up front. They are not aware of the income and Social Security tax consequences until they have to file their income tax returns.

IC status gives workers the ability to claim business expense deductions from federal and state taxes. They can maintain a qualified retirement plan that permits greater annual contributions than regular IRAs available to employees, and deduct a portion of the cost of the health insurance premium. These workers also see their job situation as more secure than their traditional workforce counterparts.

Involuntary Changes

No data are kept on workers who have been compelled to becoming independent contractors since the UI agencies do not have the staff to maintain these records. Their staff described the following situations:

- In most cases, workers who should be legitimate employees were hired from the outset as ICs.

- Staff in Minnesota, Ohio and New Mexico reported that in most cases new hires, temporary, probationary, or part-time workers are initially misclassified as ICs. Some employers later change the status to employee once they are satisfied with the individual's work performance.
- Staff in Colorado and Oregon stated that problems arise when a claimant believes that he or she is not eligible for UI and does not contact the agency. Sometimes a claimant contacts the agency and then tells the benefit claims person that he was an IC or self-employed, and the agency may not investigate any further. Some employers intimidate workers not to file for unemployment by implying that they would never be rehired in the future. During the audits, the staff discovers employers that pay employees off the books, but it is often hard to prove because the claimants are afraid to speak out against their employer. "Without cooperation, we are many times unable to resolve these issues."
- Large employers "fired" mid-and upper-level managers with high levels of compensation and hired them back as ICs without benefits. Maryland, Texas, Colorado and New Jersey UI staff reported many cases where people "retired" and returned as independent contractors doing essentially the same work. The forced conversion occurred in all types of industries and all sizes of businesses.
- Reconversion from IC to employee status also occurs in order to avoid paying high worker's compensation premiums on all employees. Workers compensation representatives in California described how employers hire high-risk workers (such as roofers, construction workers, bicycle couriers) as ICs and convert them to employees if they get injured on the job, in order to claim coverage under the company's workers' compensation policy. This practice was prevalent in the other states also.
- The re-emergence of the take-home piecework concept is occurring in the semi-conductor industry in California and Washington State. Employers give work to employees to take home. Instead of paying overtime for take-home work, the employer categorizes the same employee as an IC and pays by the piece for work done in the home. Family members "help" and never show up on company books as employees or ICs.

- UI tax administrators discussed the collusion between independent contractors and employers in service industries to cheat on federal and state taxes. Employers misclassify employees and issue them Form 1099s instead of W-2s to save on payroll taxes. Misclassified employees believe they are better off by not having income taxes withheld from payments for their services. By being classified as ICs rather than as employees, they claim work-related tax deductions that were not incurred.

3.4 Economic and Social Environment Conducive to IC Growth

Most of the research on the alternative workforce attribute technological change, heightened international competition, new management paradigms, deregulation, and the increasing costs of payroll tax and fringe benefits as the leading economic factors generating the growth in the alternative workforce.

The forces increasing economic competition are creating new opportunities for workers prepared to take proactive advantage of them. Internet-based placement firms have emerged as brokers to locate independent contractors to work on projects for client employers.[20] The increased use of "long-term temps," described as a seeming oxymoron, is in fact a new and growing phenomenon in the American workforce and has been embraced by many corporations, especially high tech ones, including Microsoft, AT&T, Intel, Hewlett-Packard, and Boeing."[21]

Knowledge-based workers have increasingly become independent contractors to capitalize on the demand for their specialized services in order to take charge of their economic destinies.[22] These "free agents" no longer accept the idea that loyalty is given to an organization in exchange for job security. According to Terri Lonier of Working Solo, Inc., a company that advises independent contractors, "What we have today is not job security but skills security…. Being an individual entrepreneur, you are a lot more

[20] Anita Sharpe, "'Free Agent' placement firms flourish," *Wall Street Journal,* November 17, 1998.
[21] Steven Greenhouse, "Equal Work, Less-Equal Perks: Microsoft Leads the Way in Filling Jobs with "Permatemps," New York Times, March 30, 1998.
[22] Daniel H Pink, "The politics of free agents," *Blueprint: Ideas for A New Century*, Fall 1998

secure because you can diversify your income… If you work independently, you have many clients; your business is more resistant to market change."[23] According to William Halal, a professor at George Washington University, "It's a redefinition of the employment contract… Jobs once reserved for full-time workers are being done…by consultants, independent contractors…who act as free agents trading on their skill, time or knowledge. They operate much like SWAT teams, moving from job to job, project to project and company to company."[24]

Owing to the low setup costs of becoming an IC, workers of varying skill levels and wage rates populate the industry. On one end of the spectrum are "cyber agents" who work from home, using their own computers and telephones, often for distant employers. The employers are "offering what may be the workplace of the future: people using their computers, operating out of their homes paid minute-by-minute, as some distant employer needs them."[25] Cyber agents are frequently women with little education, homemakers, retirees, or welfare mothers who are classified as independent contractors by their employers. At the other end of the spectrum are the knowledge-based ICs who enjoy higher levels of remuneration, with similar basic requirements to establish themselves, a computer, answering machine, telephone, Web site, and an e-mail account.

Some believe that the changes in the family structure and work ethic are helping to maintain the momentum in the IC community. The arithmetic of the family has changed fundamentally, although the institutions of the workplace and home have not.[26] The traditional family had two adults and two jobs – the husband with a full-time paid job in the workplace and a wife with a full-time unpaid job at home. It has been replaced by two-career, three-job families still done by two adults, and one-career, two-job families done by one adult. Work is still governed by laws forged over 60 years ago, to address the needs of 40-hour-a-week full-time employees.

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[23] John Carlin, "You Really Can Do It Your Way," *London Independent on Sunday*, November 30, 1997, copyright 1997 Newspaper Publishing P.L.C.
[24] Tammy Joyner, "Contingency Workers Go Where They Are Needed," *Atlanta Journal and Constitution*, Knight-Ridder Tribune Business News, October 13, 1997.
[25] John Dorschner, "Miami Company Plans to Add Clients, Help Agents," *Miami Herald*, Knight-Ridder Tribune Business News, January 17, 1999.

More women are joining the ranks of independent contractors because self-employment for at least one partner gives them employer-provided benefits and the autonomy and flexible work level they need. Between 1988 and 1996, the number of self-employed women grew at five times the rate of self-employed men and three times the rate of salaried women.[27] Employers, for whom the 40-hour week was once a mandated novelty, are now coping with variable careers. The new arrangements are increasingly being experimented with, not to replace the traditional workforce, but simply to supplement it.[28]

Some advocates of the alternative workforce are calling for public policy changes. In some occupations and industries where freelancing is common (construction, writers, screen actors), fringe benefits largely unavailable to workers outside the traditional employer-employee relationship are becoming available to ICs, to accommodate the periodic nature of their employment. "Working Today" an organization representing independent contractors, provides a variety of benefits at group rates, including health insurance, retirement planning, and low-cost Internet access services to its white collar professional ICs. However, worker protections such as UI and workers' compensation remain limited to employees. Advocates believe that such benefits should be tied more to the individual and become less dependent on the nature of their economic relationships. This would enable employers to enjoy the continued advantages of labor force flexibility, but not at the expense of individual workers.[29]

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[26] Kathleen E. Christensen, and Ralph E. Gomory, "Three Jobs, Two People", *Washington Post*, 6.2.99
[27] Karin Schill, "Independent Spirits," *News & Observer*, Raleigh, NC
[28] Edward A. Lenz, "Flexible employment: Positive strategies for the 21st Century," *Journal of Labor Research*, 1996.
[29] Sara Horowitz, "Making Flexibility Fair," *Working Today*, 1998, Daniel A.Pink, "Free Agent Nation," *Fast Company*, December/January 1998 p.142.

CHAPTER 4
PROFILES OF MISCLASSIFIED INDEPENDENT CONTRACTORS AND THEIR EMPLOYERS

This chapter describes the demographic characteristics of employees who are misclassified as independent contractors. Four profiles are presented of industries with a higher than average use of ICs.

4.1 The Misclassified Independent Contractor

This section is based primarily on information provided by State Employment Security Agency personnel. UI administrators who make status determinations for unemployment insurance purposes were questioned about the typical demographic profile of misclassified ICs. Their response was:

"There is no typical demographic profile." – UI Connecticut, Maryland and New Jersey
"All social-economic levels of workers are part of the profile." - UI Nebraska
"The most common ICs are workers who can sell their services with minimal investment. –UI Wisconsin
"Mostly part-time workers and individuals paid by one piece rate." – UI New Mexico
"Many workers with low job skill levels in such occupations as residential framing contractors and landscapers … We also find technical workers such as x-ray technicians and dental hygienists." – UI Ohio
"Low wage workers in construction/agricultural labor jobs." – UI Texas
"General labor …followed by sales, technical and professional labor" – UI Minnesota

Misclassified ICs may well be male or female, and of White, Black, Hispanic, Asian or Eastern European origin. They come in all age groups, with different education and skill levels. Almost all have no health insurance or retirement benefits, earn middle-to low-level wages, and belong to a variety of occupations and industries.

Figure 4.1 illustrates the data from the BLS 1997 survey on alternative work arrangements. It compares the distribution of independent contractors by industry with traditional workers by industry, to ascertain whether ICs are attracted to certain industries. Services cover a wide array of occupations, including auto and other repair services, personal services, entertainment services, medical services, social services, and educational services. The largest proportion of ICs (39%) is in services. However, 34.5% of the traditional workforce are also in the service sector and there is no great disparity in this category. Twenty-one percent of ICs work in construction according to BLS figures, whereas only 5% of traditional workers are employed in this sector. There is also a greater percentage of ICs than traditional workers in the finance, insurance and real estate sector although the disparity is smaller.

SESA and Wage and Hour staff and advocates of employer groups and unions reported that a significant number of ICs operate in service industries such as home healthcare, landscaping, food preparation and processing and construction industries. Within the construction and home healthcare industries, there are many illegal immigrant workers of Hispanic and Eastern European origin. The garment and electronic assembly industries have high concentrations of ICs of Asian descent. New Jersey, Maryland and California had particularly high levels of Hispanic and Eastern Bloc workers in the residential construction industry. In Washington, in the trucking industry, there are large numbers of recent immigrants from the Ukraine, Russia, and Poland.

Many ICs in residential construction, trucking and home health care businesses possess a relatively low level of education. The independent contractors in the high tech industry who work as software engineers and computer programmers are educated individuals. However, the other category of ICs in the high tech industry consists of piece workers, who are Asian immigrants with little education and few skills.

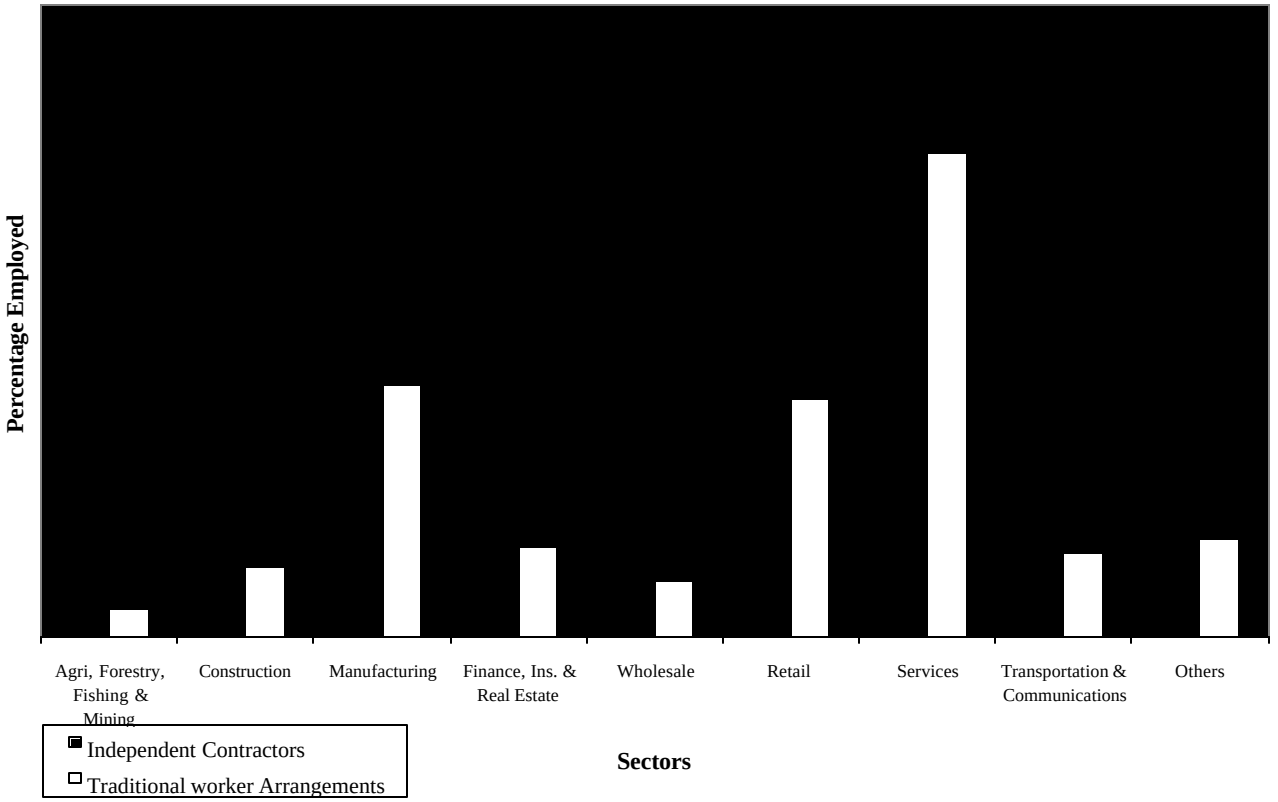
One particular subcategory of ICs, the recent immigrants who are legal and illegal, was resident in almost all the states that participated in the study. They are not their own bosses and do not own businesses or work equipment. These so-called independent

contractors are unaware of American worker arrangements, ethics, rights and laws, and are willing to work for low wages. Employers misclassify this group of employees as independent contractors and do not provide them with any benefits or rights, but maintain direction and control as employers.[30]

These workers are often discriminated against, and most often, exploited by employers belonging to their same racial or ethnic groups. However, the employers came earlier to the United States, sometimes in identical circumstances, and established themselves as legal business entities. These employers are confident that these independent contractors would not dispute their worker status – even if caused by discrimination, termination of the relationship, or a job-related injury – owing to fear of deportation, language barriers and ignorance of worker rights.

[30] Interviews with administrators at SESAs in New Jersey, Washington and California

Figure 4.1: U.S. Independent Contractors vs. Traditional Work Arrangements



Source: Based on data compiled by the BLS from the 1997 Current Population Survey Supplement of Alternative and Contingent Work Arrangements

4.2 Selected Industrial Profiles

Trucking Industry

In 1979, the trucking industry was deregulated, eliminating regulation of interstate and intrastate trucking. Essentially, federal, state, and local governments were prohibited from regulating the rates, routes, or services of any truck carrier. Now 20 years later, the truck drivers in Washington and in many other states appear to have come full circle. Owing to changes in economic conditions such as the increase in competition, declining earnings, and lack of benefits, truckers who once enjoyed their independent contractor status now wish to revert to employee status with union backing. Labor laws prohibit truckers who are independent contractors from forming unions.

Representatives of the labor unions in Washington State, California, and Florida reported that some of the truckers are legitimate employees of the freight companies, operating under the direction and control of the specific trucking company and that company's business license. However, their employers deliberately classify them as independents to reduce tax liabilities and avoid providing benefits.

Washington State

Nikolay Lavrentiev, an Estonian, is one of many immigrant workers who took a truck-driving course upon arrival in the United States to achieve the American dream of affluence and a better life than the one he had left behind. Unlike salaried union workers, Lavrentiev is an owner-operator, paid, not by the hour or by the week, but by the number of containers that he delivers in a day. He often spends half of his day waiting around the ports of Seattle and Tacoma for his next delivery. Sometimes only two or three containers are moved in a day at a rate of $28 to $40 per container. "I cannot afford to wait, but I have no choice" he says.[31] There are many drivers competing for the same work, and much of their day is spent waiting in line to enter the terminals.

[31] Patrick Harrington, "Teamsters tackle Seattle waterfront's low-paid immigrant truckers," *Seattle Times*, Knight-Ridder Tribune Business News May 23 1999.

The freight companies that employ Lavrentiev consider him an independent contractor, paid by the number of containers he hauls and not at an hourly rate. He does not qualify for benefits and is responsible for all the expenses incurred in delivering the containers. He makes $1100 monthly payments on his truck and considers himself lucky that he owns his truck. Others pay as much as 40% of their earnings to lease trucks from brokers. Lavrentiev also has to buy his fuel and works without health insurance and other benefits. He and many other truckers in similar situations are alleged to make only $7 per hour after expenses, which is in stark contrast to the unionized employees on Seattle's waterfront, who are alleged to be making around $100,000 annually. Lavrentiev is frustrated by this. "Some of those people are making three times more money than what we drivers do," he says. "We are like slaves to the big companies."[32]

The owners of the trucking companies say that deregulation has forced them to become heavily reliant on independent contractors. The companies viciously compete for business from shipping lines, driving down profits. For a given job, whether it requires the movement of a handful of containers or hundreds, the trucking companies submit their prices to shipping lines and the shippers award the job to the lowest bidder. The employers cannot afford under these bids to pay for benefits such as health insurance for the truckers and so they hire independents instead of employees.

One of the interviewees for this study, Kepler, who represents the General Teamsters Local Union 174, saw it differently. The Teamsters contend that the drivers are employees of the freight companies because they operate under the authority of a specific company and that company's business license. They believe that employers are deliberately misclassifying truck drivers. Kepler said, "If you are supposed to be an IC, then why is someone else's company name on the side of your truck." He also stated that in the case of truckers who are employees, "employers put it into your mind that you are an IC so that you don't even apply for UI; perhaps that you don't feel entitled to receive

[32] *Ibid.*

it." Some employers are alleged to deduct the cost of workers' compensation insurance from the wages paid to their employees.

The situation at the ports has changed dramatically over the past 20 years. In the old days freight companies used company-owned trucks and unionized drivers. Owing to non-union competition, most Teamster carriers have been driven off the waterfront by downward pressures on wages and benefits. Ever since trucking deregulation in 1979, Teamster members and owner-operators have been at each others' throats. According to the Teamsters, in today's economy, freight-moving firms use owner-operated trucks almost exclusively. Only a handful of the freight companies remains unionized.

The Teamsters are joining forces with the owner-operators. The way to protect Teamsters jobs and improve the wages for owner-operators is to put everyone on a level playing field by getting all waterfront companies under a master agreement with common wages and benefits, so that those employers hiring independents will not have a competitive advantage over trucking companies with union employees. That's how it was before deregulation, all waterfront truckers were employees of trucking companies, having the same labor costs. The Teamsters believe that when companies compete with each other they should do so based on efficiency and customer satisfaction, not on how little they can pay their drivers.

Florida

The situation is similar in Florida. Since independent contractors are not allowed to form unions, the Container Movers Association, a group of drivers who move freight from the port of Jacksonville want to form their own trucking company. This will enable them to form a union, and ensure that they will be able to negotiate wages and benefits and better working conditions. Currently the drivers own their own trucks, and contract with existing truck companies to move freight from the port. As majority owners of a trucking firm, the drivers would ask the management team to recognize them as employees, giving them the ability to form a union and to offer health-care plans and other benefits.

According to Hy Cohen, a labor activist, "this independent contractor scam is stripping workers of their rights and benefits. It is a scheme to break the unions."[33]

Construction Industry

The construction industry was the industry frequently cited by interviewees as most likely to use ICs, contain the highest incidence of misclassification, or as one that lures workers into becoming ICs.

In any industry, it makes economic sense to award a contract to the lowest bidder. The construction industry is no different. Many employers believed that hiring independent contractors was a way to cut their costs in order to improve their competitiveness and get more contracts. Employers who misclassify employees as ICs gain a distinct competitive advantage over those who pay taxes, provide benefits to their employees, and are placed on equal footing with employers who operate in the underground economy. The benefits to be gained in this arrangement greatly outweigh the risks associated of being caught.

The ICs in the construction industry belong to the low-skilled, less-educated group, of which many are recent immigrants**.** Employers exploit these workers by paying them very low wages "under the table," because they do not know or understand their rights as employees. The advantages to ICs that are paid "under the table" are:

- they can avoid paying taxes on income
- they can shield income sources from their creditors and/or former spouses
- they can make more per hour if paid in cash rather than by payroll check
- they can draw benefits such as welfare, unemployment insurance, or disability insurance if legally entitled to be employed in the United States

The construction industry is a lucrative source of employment opportunity for illegal immigrants. Work is plentiful because of the current tight labor market for unskilled workers. Most undocumented workers take jobs that are considered the most undesirable

[33] Tim Wheeler, "GOP tax bill strips workers of jobs benefits," *People's Weekly World*, July 26,1997

and unsafe. "In the past, that often meant toiling in the fields. But now other types of manual labor, often entry-level construction jobs, are the most prevalent work for undocumented workers."[34] In Florida, 95% of drywall installers and roofers are independent contractors. Employers who are willing to take risks in order to reap the above-mentioned benefits often ignore checking status to determine eligibility to work.

In 1986, Congress tried to clamp down on the number of illegal immigrants working in the United States by enacting the Immigration Reform and Control Act (IRCA), making it a crime for employers to hire undocumented immigrants. The act requires employers to verify the employment eligibility of a candidate before hiring by examining identification documents such as a Social Security card. The applicant must also fill an I-9 form (Employment Eligibility Verification).

The system has many loopholes. Counterfeiting is rampant and employers are hesitant to challenge all but the most obviously counterfeited documents for fear of being sued by legal workers alleging discrimination for questioning their status. In New Jersey, the INS will fine employers only if they prove that the employer knew the identification documents presented were fraudulent or counterfeit. Another loophole in the federal law is to claim that workers are independent contractors, exempted from filling out the I-9 work form or providing identification. In construction, workers go from job to job and from contractor to contractor, and it is difficult to find out who the actual employer is.

In Maryland, California, and Florida, the union advocates who were interviewed stated that misclassification was high in both residential and commercial construction. Building contractors force their employees to file the IRS 1099 form identifying themselves as independent contractors. Some pay cash. In Maryland and New Jersey, inspectors discovered that workers were being paid cash at federal construction sites. This type of activity is preventing the legitimate firms in the construction industry from competing for

[34] Diane Smith, Andrew Backover, "Working around the law as the government turns its attention elsewhere, North Texas employers increasingly rely on undocumented workers," *Fort-Worth Star-Telegram*, 4/18/99.

contracts. The boom in the industry and inadequate enforcement of standards by state agencies invite employers to circumvent labor laws and violate workers' rights.
In Florida, the unwritten rule in the construction industry is that all workers are considered independent contractors. There is no federal or state statute to mandate this, nor would the construction industry be able to satisfy an inquiry into direction and control with the level of satisfaction necessary to classify their worker as an independent contractor. If the courts determine that the workers of a particular construction company are employees, that company is unable to compete in the market. If a company cannot compete, then it cannot survive. Therefore the courts will not change the classification.

In New Jersey, the representative of the AFL-CIO stated that "misclassification is pandemic in residential construction." Immigrants from Poland, Russia, and other Eastern Bloc nations and Hispanic immigrants are being exploited. Hours worked and wages are falsified. The prevailing wage is often ignored. It is common for independent contractors and crew leaders to provide proof of insurance to start work in construction and then stop paying the premium shortly afterward. Workers are intimidated by their employers, have no desire to encounter enforcement staff from the Department of Labor, and are distrustful of government and its attendant regulations because of previous experiences in their homelands.

State and federal agencies have insufficient staff to crack down on employers who misclassify workers. States' resources need to be used prudently to pursue the "big fish." An example of this is the case against Houston Dry Wall which became the first of a dozen companies to catch the attention of a joint task force set up by the New Jersey Department of Labor and Division of Taxation to monitor the construction industry. Houston had a lot of contracts in New Jersey, but very few employees. They transported legal and illegal immigrants from Texas to New Jersey to work in residential construction sites, as independent contractors "who were closely supervised by crew leaders." The state was seeking around $136,000 in gross income tax and $459,000 in unemployment and disability insurance taxes, plus interest and penalties, from Houston Dry Wall.

According to Houston Dry Walls' attorney Robert Altar, the state agencies have incorrectly classified the workers by confusing the difference between an IC and an employee. He was quoted as saying "the workers were all out-of-staters, and the work in New Jersey was temporary. It all comes down to control. When you hire someone to perform a service for you, do you exercise a degree of control over that person?"[35] Altar argued further that "these guys have trades, they own vans and they work for other people."[36] However, the task force differs in their interpretation of the rules. According to them, if workers use materials purchased by the contractor, and their time is controlled and they are told where to work, they are employees and are subject to taxes.

After the Houston Dry Wall case, the state tax agency added 28 new investigators to ferret out potential violators. The tip that led investigators to Houston Dry Wall came from the Foundation for Fair Contracting, which operates in many states. It was set up by the building trades to ensure that contractors winning public work were complying with state labor laws, and to report to enforcement agencies on industries where fraud and abuse is very high. The executive director of the Building Contractors Association of New Jersey, who was interviewed for this study, stated that "anyone skirting the system and not paying what they are supposed to pay has an unfair advantage over the legitimate guy." This association of 160 small and large commercial contractors supports the efforts of the state task force in attacking this problem.

Home Healthcare Industry

Independent contractors are a visible presence in the home healthcare industry, which is growing rapidly. Some of the highest levels of misclassification prevail in this industry. According to the worker's compensation administrators who were interviewed the home healthcare industry is second only to the transportation industry in terms of the number of on the job accidents each year. This gives employers even more incentive to misclassify

[35] Dan Weissman, "Builder caught in state tax crackdown" *Star-Ledger Newark*, p 35, February 18 1999.
[36] *Ibid*.

employees as ICs in order to avoid the worker's compensation premiums that are synonymous with this industry.

The demand for home healthcare covers a whole range of occupations, from registered nurses and certified nursing assistants to home companions. The greatest demand is for certified nursing assistants. The demand for home health care has skyrocketed over the past decade because of the growing numbers of the population that can no longer take care of themselves in their home environment. An increase in the longevity of the overall population is the primary factor. Those who demand the services are comfortable at home and prefer to remain there, compared with the other options available to them. Many aging members of the relatively affluent population require certified nursing assistance around the clock, which means three people working 8-hour shifts.

Health insurance plans do not authorize extended hospital stays for most illnesses and instead provide in-home care options for patients. Owing to technological advances, today it is possible to provide in-home health services that were impossible a few years ago. These are two subsidiary reasons for the rising demand for home health care. On the supply side, the low unemployment rate and the availability of more lucrative careers have resulted in a shortage of workers in this field.

The difference between healthcare professionals who are employees and those who are independent contractors became unclear in the 1980s. Misclassification was deliberate on the part of employers, for the usual reasons. New Jersey UI staff described the "dry wall phenomenon" in construction and the "companion phenomenon" in home health care. The companion phenomenon occurs when employers in home health care engage independent contractors who are under the direct control and supervision of a senior staff person. It is not outside their usual course of business because it is their only business. The independent contractor does not have an independently established trade because without the work from the employer, he or she has no work.

Washington State UI officials stated that "it was a chronic legislative problem in the state, especially in the growth of personal services through referral agencies." Referral services are a new phenomenon within the home healthcare industry, where the agency pays their so-called ICs low wages and often take large commissions or charge fees from the ICs for finding them work.

Ms. Bestafka, the president of the Home Healthcare Services Staffing Association of New Jersey, who was interviewee for the study, also described the same phenomenon in that state. The growth in referral agencies is 100% greater than any other prior registry-type operation. These agencies are often small independent outfits run by families. Most of them deal with Eastern Bloc workers. ICs are kept "off the books", not issued with Form 1099s, and the I-9 forms are rarely checked. The referral agencies inform workers that no enforcement agency will ever check on them, and this is probably true. Typically, an independent contractor in the home healthcare industry in New Jersey makes approximately $400 per week, with the referral agency collecting $120 of that sum as its fee. Some agents collect daily fees because it has become such a lucrative business.

Ms. Bestafka also stated that there were 58,000 certified home health aides, and estimates that there may be up to 100,000 more independent-contractor companions who are misclassifed employees. She further stated that major hospitals and HMOs post the names of the referral agencies on their bulletin boards and provide them with business leads. The HMOs are apparently unaware that the agencies are exploiting the workers. Similar to the construction industry, it is difficult to track these home health aides and companions because they move from assignment to assignment quickly, and the only way to locate them is through the client. Employers are moving employees to IC status, particularly nurses and those in related occupations in order to compete with referral agencies. Legitimate employers are also "turning in" competitors who have moved employees to IC status because they are taking away significant amounts of business.

The state legislature in Maryland launched a five-month task force investigation of the home healthcare industry. One of their findings was that the workers sent out by the

referral agencies on assignments are frequently not informed that they are independent contractors. These individuals are paid the minimum wage and forced to sign noncompete contracts for 180 days, tying them to the referral agency. Sometimes it is made clear to them that although they are independent contractors, but they cannot make agreements with other agencies during the 180-day period.

High Tech Industry

The high tech industry is also one of the fastest growing industries in the United States and ICs play an important role in its growth. One significant difference between the high tech industry and the rest of the industries that have been profiled is that in the previous three industries, the employer gained most of the advantages of hiring ICs rather than employees. The ICs are mostly semi-skilled and less educated, and many are recent immigrants exploited because they do not know or understand their rights as employees. However, in the high tech industry, there is a combination of both highly and less educated ICs. The majority of workers actually chose to become ICs.

Aside from the usual motives for employers to hire ICs rather than employees, there are other factors associated exclusively with the high tech industry. The competition is intense and unrelenting. Rapid and often unexpected changes in technology have created a dynamic market environment where the advantage goes to those firms that can bring new ideas to the market the quickest. These conditions have encouraged the growth of highly adaptable organizations, but in the process of evolving they are changing the nature of work arrangements.

In Silicon Valley, the use of temporary workers and contractors is rampant. High tech firms need the flexibility to respond quickly to changing market conditions. The use of contractors and other types of contingent workers reduces employers' overall commitments to full-time employees, and enables them to reconfigure operations in response to changes in the marketplace. The independent contractors are entrepreneurial individuals who enjoy being independent specialists in performing such tasks. The

employer does not need to incur training costs on their behalf and it is easier to dispense with their services when the job is completed.

Shaun Walter and Samantha Portiz are employees of Manpower Inc. and specialists in Windows NT and Novell NetWare networking areas. In the past 18 months, they have worked at two different jobs in the chemical and airline industries. "The pay is very good, and the flexibility is definitely welcome,"[37] says Walter. "We avoid the politics of working inside a company, and we get exposed to a lot of different technologies."[38] Their adaptability is vital to the overall success of the high tech industry.

Contingent workers may stimulate the accumulation and creation of knowledge within a firm because they have been exposed to similar situations in other organizations. For example, a software engineer who has worked on specific development projects using concurrent engineering techniques may be able to articulate and transmit some of this knowledge to other organizations. Firms that hire these contractors gain firsthand knowledge of up-to-date technological developments, which enables them to remain as informed as their competitors.

The high tech firms hoping to reap the benefits of such arrangements may also be subject to lawsuits claiming these contractors are misclassified employees who are entitled to benefits. In the early 1990s, the IRS determined that Microsoft Corp. had improperly classified a few hundred ICs who should have been considered employees. According to Stephen Fishman, a self-employment attorney, "Microsoft did pretty much everything wrong. These contractors worked only for Microsoft, were supervised by company managers, received keys to the office, and were allowed to use company facilities for years."[39] Many of the same contractors sued Microsoft for back benefits provided to regular employees, including participation in Microsofts' immensely attractive employee stock purchase program. In 1998, the U.S. Supreme Court upheld a lower court ruling that favored the contractors. In 1999, the Ninth Circuit Court of Appeals ruled that

[37] W.J.H "Meet the 'new economy' temps" *Online U.S. News*, 08/30/99.
[38] *Ibid*.

Microsoft might have to extend its stock purchase program to long-term temporary staff working through temp agencies. Microsoft appealed but the ruling was upheld in early 2000.

Microsoft is far from alone in its temporary worker troubles. San Francisco Bay Area companies such as Pacific Bell and PG&E are also grappling with lawsuits by former temps and contractors who claim they should have received the same perks as regular employees. "This is going to be the next wave of employment litigation,"[40] said Larry Shapiro, editor of the California Employer Advisor newsletter in Tiburon. "The Microsoft case sounds a siren of alarm. Employers should be very careful because, later on, if their contractors or temps are classified as employees, they may be eligible for very expensive retroactive benefits."[41]

There are two types of ICs associated with the high tech industry. The first type are free agents who are skilled professionals, in high demand, moving from project to project. They become ICs because there is a shortage of labor in the information technology (IT) field and they are sought after. Money is not always the motivating factor, it's the need to be masters of their own professional fate. "I could make more money getting a salary, stock options and benefits as a full time employee at a Silicon Valley company"[42] says the 46 year old Mr. Burns, who works out of his home. "But, as an independent contractor who charges $100 an hour, I'm free from the pressures to take vacations at a certain time, work on certain projects and do favors for the boss," he says. "I have control."[43]

The piece workers are often low skilled immigrant laborers, working at home, paid by piece rate for components in apparent violation of labor, tax, and safety laws. They represent the low tech underbelly of the high tech industry, whose work arrangement is a

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[40] Ileana DeBare, "The temps strike back/companies face more lawsuits claiming they misclassified workers," *San Francisco Chronicle*, pB1, May 28 1999.
[41] *Ibid*,
[42] Sheila Muto, "Bill to assist self-employed gets new life," *Wall street Journal*, May 19 1999 p.ca1,
[43] *Ibid*.

throwback to working conditions at the turn of the century. In many ways, home assembly paid by the piece is similar to the way Silicon Valley companies routinely use freelancers for anything from data entry to programming. The same complex guidelines and laws apply to all these situations, with each case hinging on whether the definition of IC is met.

Electronics contract manufacturers, ranging from small firms like Compass to multibillion-dollar giants such as Solectron Corp. have been involved in illegal piecework arrangements. These contract manufacturers build parts and systems for companies such as Hewlett-Packard Co; Sun Microsystems, Inc; and Cisco Systems, Inc. The electronics companies want the flexibility to work without enormous overhead when they need to meet very tight deadlines. "Sometimes when the job is so hot…. even if you add OT you can't make the schedule,"[44] says Kiet Anh Huynh, a Solectron production manager from 1983 to 1992, describing the typical circumstance in which work was sent home. "We give the workers 100 boards and the next day they have to bring back 100 boards. Maybe at home they do it faster if they have brothers or sisters helping them."[45] The companies that pay for piecework generally regard the workers as ICs for whom they would have limited responsibility.

"Whole families, particularly in the Vietnamese immigrant community can be found working late into the night soldering tiny wires, stripping cables and loading hundreds of different colored transistors onto printed circuit boards, at kitchen tables and garage workbenches, for as little as a penny per component."[46] Most of the workers work for the same company during the day as regular employees, whereas at night they become independent contractors. Some employees are afraid to say no to piecework in case they lose their regular day jobs. In other cases, employees who need the additional income view the arrangement as a benefit rather than a burden.

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[44] Miranda Ewell, "California Hi-Tech Firms Employ Hidden Labor," Knight-Ridder Tribune Business News, June 27 1999.
[45] *Ibid*.
[46] *Ibid*.

Paying by the piece for work isn't illegal, but the piece rate is subject to minimum wage and overtime laws. Full-time employees who are given work to take home should be paid at rates of time-and-a-half for such work. Family members help with the work and never show up on company books, making it impossible to calculate if an individual worker is earning the equivalent of California's minimum wage. Giving the work to the employee but paying the spouse for it "does seem to indicate fraud"[47] says Craig Wirth, head of San Jose's employment tax division of the IRS. Despite laws barring children under the age of 14 from industrial work, youngsters often help with electronic assembly done at home.

The employers also violate industrial safety standards under Occupational Safety and Health Administration (OSHA) laws when work is taking place at home. "If work is taking place at the kitchen table then the kitchen table becomes that part of the house subject to the act,"[48] says Michael Mason, chief counsel for the enforcement arm of the state's OHSA program. Some companies advise employees to get a business license for a relative in the same household whom the company can pay for their work as an "independent contractor."

[47] *Ibid.*
[48] *Ibid.*

CHAPTER 5
THE MAGNITUDE OF IC MISCLASSIFICATION

This chapter presents the results of an attempt to estimate the number of employers that potentially have misclassified workers, the impact on state UI tax revenues and the industries where misclassifications occur. It then describes the impact of the misclassification on trust funds.

5.1 The Employee-Independent Contractor Determination

When employees are misclassified as independent contractors, Social Security, worker's compensation, unemployment insurance revenues and their social protections are significantly reduced, and compliance with other labor and employment laws are avoided to their detriment. Much of the commentary contained in previous research described in the Literature Review (appendix 2) covered a variety of workplace issues relevant to independent contractors,[49] the exception being the issue of employee misclassification.

The subjective nature of misclassification does not lend itself to standard survey methods. Direct surveys of employers or workers will at best provide opinion-based information. Classification is often in the eye of the beholder. The BLS researchers recognized this inherent difficulty. Many individuals classified as wage-and-salary workers in the basic CPS survey also identified themselves as independent contractors in the CPS supplements. In the 1995 supplement, 85% (7 million) of ICs are classified as self-employed, the remaining 15% (1.3 million) are classified as wage-and-salary independent contractors. However, it is not possible to conclude from these data that these 1.2 million wage-and-salary independent contractors are misclassified employees.

[49] Susan N. Houseman, "New institute survey on Flexible Staffing Arrangements," *Employment Research*, Spring 1997; Arne Kalleberg, and Edith Rasell, et al., "Nonstandard Work, Substandard Jobs – Flexible Work Arrangements in the U.S." *Economic Policy Institute*, 1997

Cohany[50] recognizes that "it may be tempting to classify …(them) as workers who otherwise would have been employees of the company for which they were working or individuals who were 'converted' to independent contractors to avoid legal requirements." However, she further states that "the basic CPS questionnaire does not permit this distinction…as two individuals who are in exactly the same arrangement may answer the question…differently, depending on their own interpretation of the words 'employed' and 'self-employed.' There is no way to determine which responses are "correct" from a legal perspective and which are not.

An alternative source of data on employees and employees misclassified as independent contractors is available at SESAs which maintains employee wage record information filed by employers. The status units of the agency are charged with the determination of whether services performed for an employer were done as an employee or an IC.[51] Such determinations are triggered by employer site audits and by claims filed for unemployment compensation by discharged employees that are contested by their employers.

The tax division of the agency, as a basic component of its tax compliance effort, conducts annual site audits on a percentage of registered employers in the state. The sample of employers to be audited is drawn either on a random basis, or is selected on a targeted basis because of some prior evidence of possible non-compliance, or as a combination of the two. In addition, tips from a variety of sources (referrals from other agencies, comparison of payroll and workers' compensation records, information from persons regarding employment practices of a specific employer that may be in violation of law) also trigger employer audits. Federally-mandated Quality Control investigations also occasionally detect independent contractor misclassifications.

[50] Sharon R. Cohany, "Workers In Alternative Employment Arrangements: A Second Look," *Monthly Labor Review*, November 1998.

[51] The IRS, the state workers compensation agency and the Department of revenue also make similar classification determinations for their own purposes. Although the issues are relevant to independent contractors, they have not been examined in depth because they are beyond the scope of the study.

During the audit, the auditor examines payroll records and Form 1099-Misc issued by the employer. Expense records are also examined for possible items of unreported or misreported payroll. The auditor may identify a person or persons receiving money for services that have not been included on the employer's quarterly tax report, which alerts him to look for payments to other persons in similar circumstances. The determination may include a single employee or a class of employees.

Status determinations are also triggered when an individual is discharged by an employer and files a claim for benefits. The claimant's employer is notified and requested to provide information regarding employment and the reason for separation. At this time, the employer may raise the issue that the claimant was not an employee, but an independent contractor. Information is then obtained from both the employer and the individual claiming benefits and a determination is issued. If the determination was that the employee was misclassified, the employer is subject to back taxes, interest, and penalties. If there are others working in substantially similar situations, the employer will be required to pay UI taxes on those employees as well. In addition, an erroneous classification makes the employee eligible for workers' compensation benefits, and overtime, medical, retirement and other benefits if offered by the employer to other employees. There is an administrative hearing process in place that affords the employer and the claimant an opportunity to challenge the determination made by the agency.

Contested claims are the principal source for identifying misclassified workers. In many cases the claimants are unaware that their employer did not consider them employees. "In fact over 86% of the time when a claim is filed and the employer alleges that the individual was an independent contractor, the determination of the department is that the individual performed services for the employer in insured employment."[52] In Colorado and Florida, contested claims have led to reclassification of ICs to employees in approximately 90 to 95% of the cases.

[52] Study of Independent Contractor Compliance, Minnesota Department of Jobs and Training, February 1994, page 5

Wisconsin and Connecticut UI staff have witnessed an increasing number of employers' inquiries regarding use of independent contractors and the agency's rules in determining their status. Staff in Minnesota stated that employers in recent times are asking more specific details with regard to classification rules as they apply to a particular industry or type of employment. Oregon has seen a change in employers' attitudes in recent years. In the past, where employers would call for information and accept it, now they are more inclined to challenge or disbelieve the explanation. That may be because they are aware of other employers and their competitors treating employees as ICs. It may also be as a result of the increasing number of professional organizations offering their services in providing advice as to how status changes may be undertaken.

For purposes of estimating the number of employers who misclassify workers, the unpaid UI taxes, and the industries they are found in, this study relied on audit data provided by the UI agencies in a selected number of states.

5.2 The Measurement Process

The availability of data for analysis was entirely dependent on the willingness of state UI tax administrators to allocate their scarce resources to cooperate in our study. Some states were willing to cooperate, but their audit data were not stored in a manner that allowed easy access to the formats required for the study.[53]

The process outlined below represents an effort to estimate misclassification from the available employer audit data and extrapolate the data on misclassified workers to each state's workforce. Some inherent constraints in the audit data limit the accuracy of the estimates. In most states, the selection of employers for audits is conducted partially on a purely random basis and partially on a pre-determined or targeted basis. The targeting is a function of prior audit results and/or the probability of reporting error. Generally, audit results are not maintained by the method of selection. Therefore, in states where the

[53] The UI Tax staff in Maryland went the extra mile to convert vast amounts of data stored in paper audit records to an electronic format to comply with the study request.

audits are selected predominantly on a nonrandom basis or a combination of random and nonrandom, the estimates are not representative of the entire state employer population. Despite these limitations, the measurements were done to provide a rough magnitude of the scope of the misclassification.

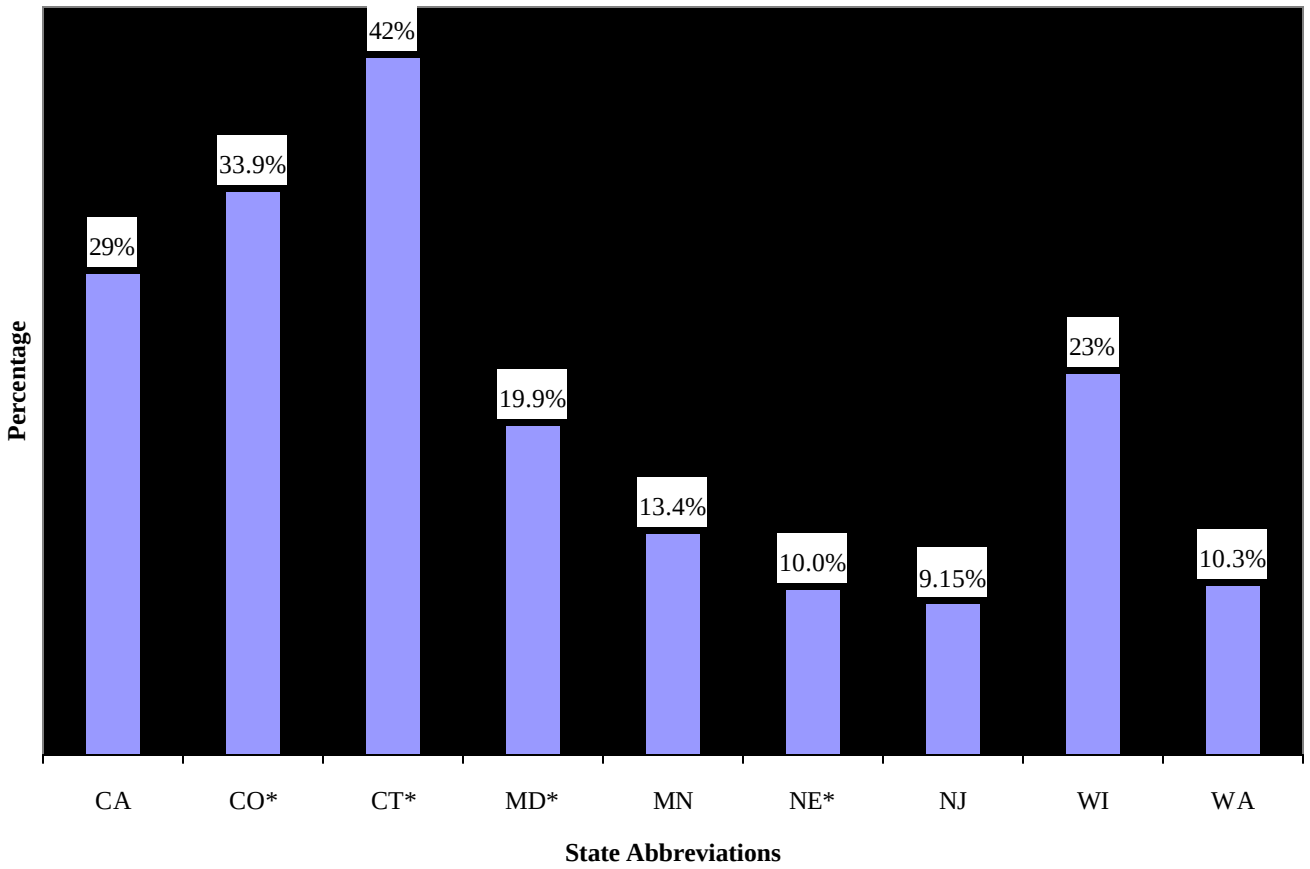
The types of data used, the computations and results for selected states are provided in appendices 3, 4 and 5.

5.3 Misclassified Employees and the impact on UI Tax Revenue

Among the states who provided data, there is a wide variation in the percentage of audited employers with employees misclassified as independent contractors. A random audit is likely to uncover fewer misclassified workers, whereas a targeted audit approach uncovers many more because specific employers and industries where misclassification is perceived to be higher are given priority in the audit selection process. Figure 5.1 displays 1988 data relating to random audits only. Targeted audits are not included.[54]

[54] NB: These results are based purely on each state's audit program in compliance with DOL audit recommendations. These results do not reflect states' own targeted audits. For example, California's percentage would change from 29% to 65% by incorporating targeted audits into the calculation.

Figure 5.1: Percentage of Audited Employers with Misclassified Workers



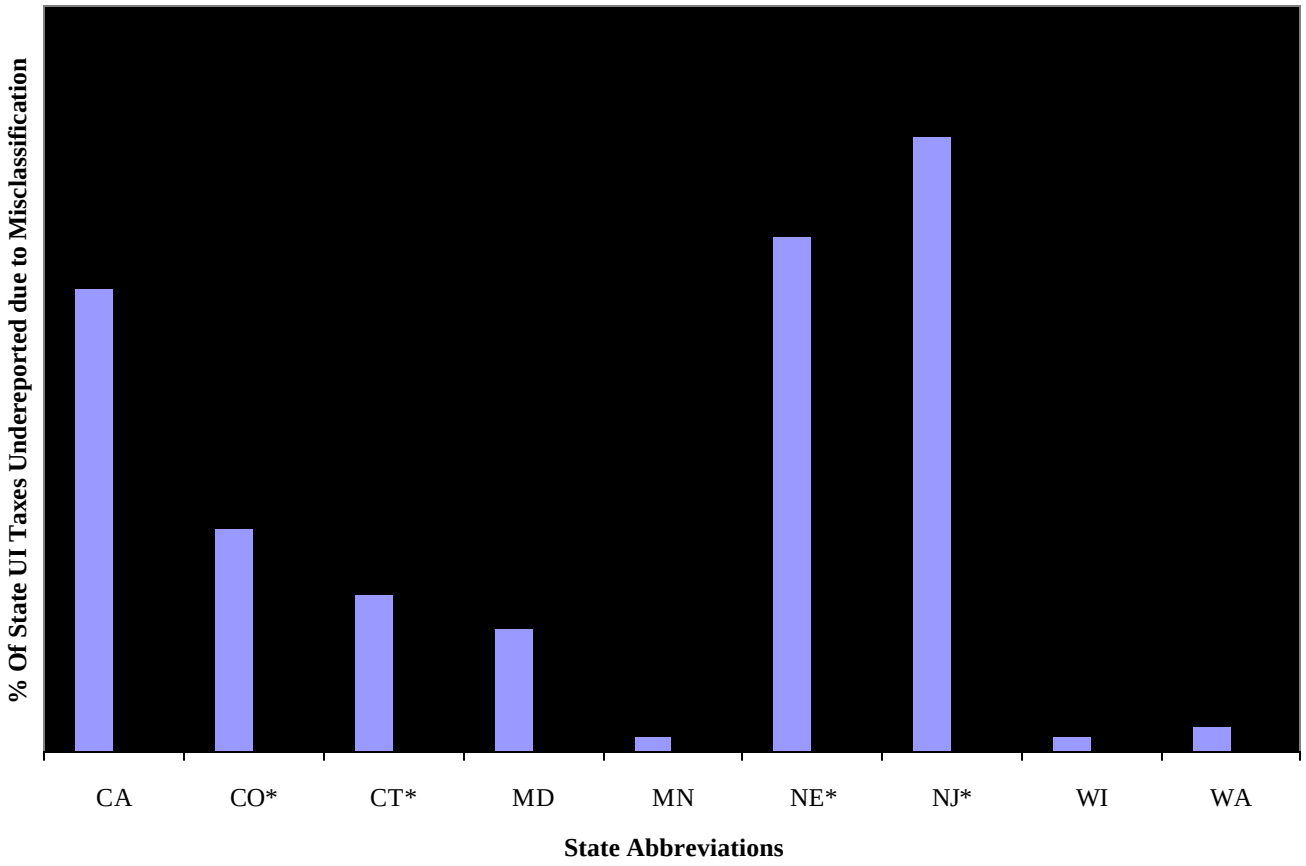
Source: Data supplied by each respective state Unemployment Insurance Department. * Only partial data was provided. The rest was estimated..

In New Jersey,[55] Nebraska, Washington and Minnesota, approximately 10% of the employers audited had employees misclassified as independent contractors. The relatively low percentage may be attributed to the high level of randomness in the audit sample selection processes. Approximately 30 to 50% of these audits were randomly selected. In the case of Wisconsin, a lesser percentage of the audit group (18%) was randomly selected, and as expected a higher percentage (23%) of the audited employers had misclassified employees. The estimates for Colorado and Maryland show that despite the high level of randomly selected audits (90% of Colorado's and 100% of Maryland's) high percentages of the audited employers (34 and 20%) had misclassified workers. However, since Colorado and Maryland were unable to supply all the data required for all the computations, some components of necessity were approximated and the results may not be accurate. California and Connecticut have a much higher proportion of audited employers with misclassified workers, 29% and 42% respectively. In the case of California, the randomly selected 1% of the audits (classified as USDOL compliant) was used for the estimate. One out of every three employers who was audited had employees misclassified as independent contractors, a ratio roughly consistent with Colorado and Maryland where the randomly selected employer sample was over 90%.

The estimated percentage of UI tax revenues underreported due to misclassification of employees is shown in Figure 5.2. Some states were unable to supply all the information required because this level of detail is not required in their reporting systems. They either provided estimates for some of the requested data or the missing components were calculated based on the other audit data that were provided. These computations are presented in appendix 4.

[55] In New Jersey, 30% of all audits are random and the other 70% is made up of a combination of re-audits, referrals from UI agencies, and leads.

Figure 5.2: Effect of Misclassification on UI Tax Revenues (1998)



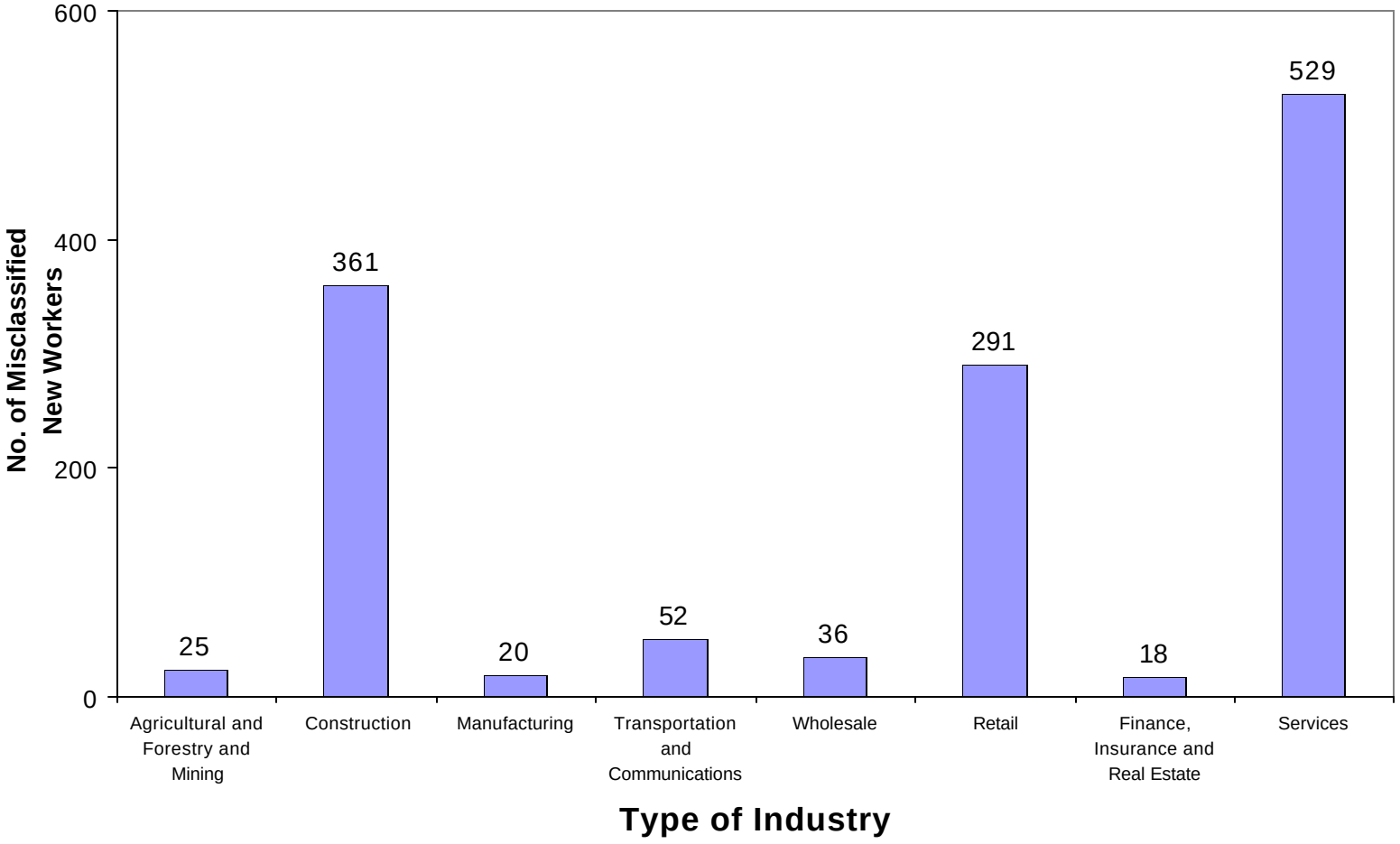
Source: Data supplied by each respective state Unemployment Insurance Department.
* Only partial data was provided. The rest was estimated.

According to the calculations, the effect of misclassification on UI tax revenues also vary significantly among the selected states. New Jersey and Nebraska have the highest percentages of underreported tax revenues, at 9.9% and 8.3%, respectively. However, it must be stressed that these two states were unable to supply all the data needed for the study computations therefore the computations relied more heavily on estimates. Excluding them, the range varied from less than one half of 1% to 7.5%, again a significant range of variance. California had the highest percentage of underreporting at 7.46%. Colorado, Connecticut and Maryland ranged between 2% and 3.6% and Minnesota, Wisconsin, and Washington all were under 1%.

The results essentially validated the opinions of state agency personnel. That is, the percentage of lost revenues derived solely from audit results would be relatively low compared to total revenues. Maryland UI administrators stated that the official audit statistics report captures only a "sliver" of the hidden wages present in the economy. They suggested that a more flexible audit approach might be more effective at identifying the full extent of worker misclassification and its impact on UI revenue. Other interviewees expressed this same viewpoint.

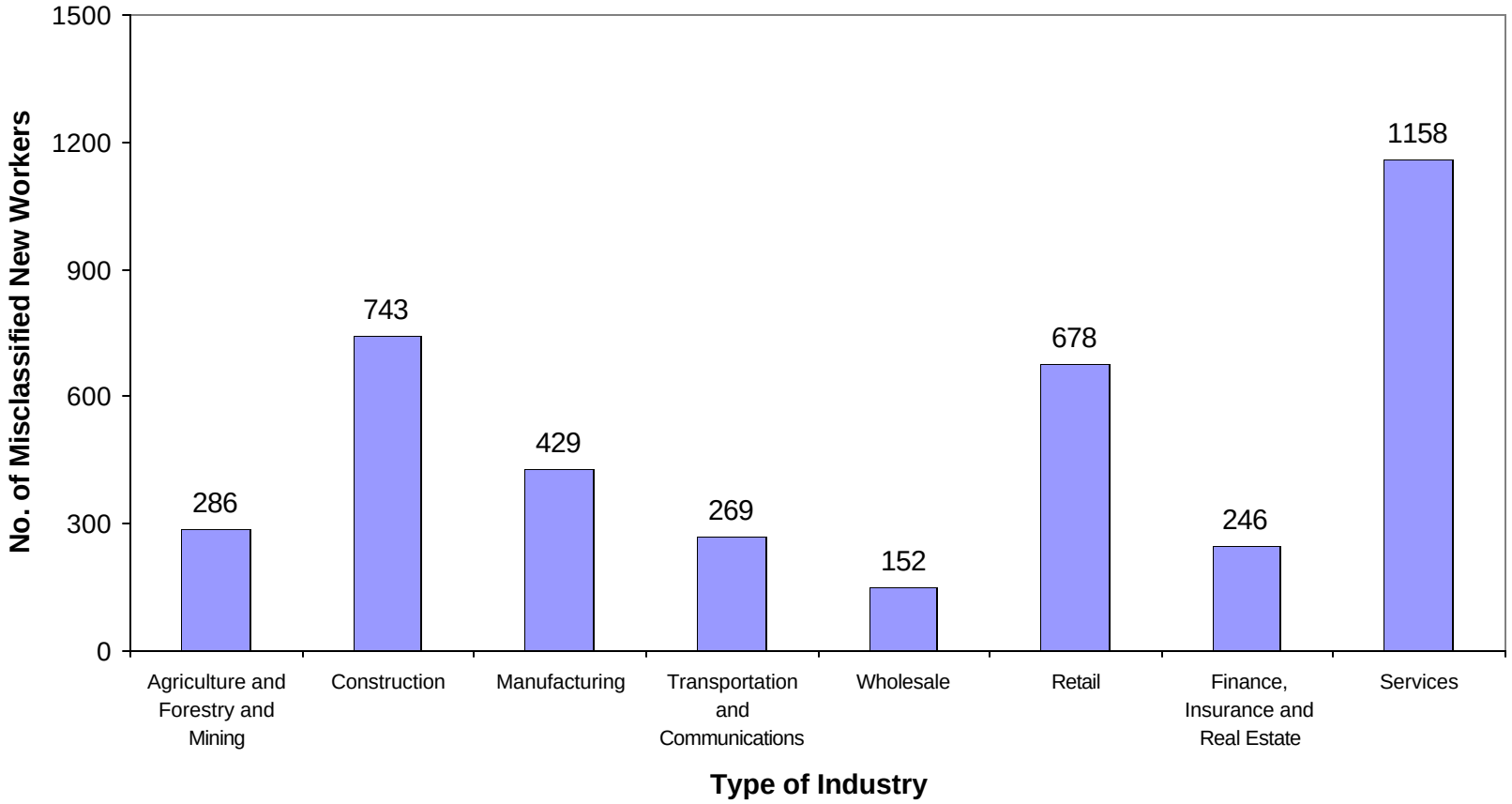
Administrators in Colorado offered an additional reason for states not capturing the full impact of misclassification in the employer audits. When states select the random audits, some of the employers with the lowest UI tax rates (such as .000, .001, and .002) may be dropped from the selection because of the perception that there is a higher probability of misclassification if the employer tax rate is higher. Because of low unemployment and a decline in the claimant population, trust fund balances are higher, and a lot of employers have low tax rates. Therefore in targeting the higher tax rate employers, the audits selected may be eliminating a segment of the misclassified workers in the lowest rated employer categories and minimizing the impact on tax revenues. This effect lends credence to the proposition that if the audits are to be selected on a random basis, then the selection must be truly and completely random if its results are to be used as an indication of the employer universe's compliance

Figure 5.3: Summary of Misclassification by Standard Industrial Classification (SIC) Code - Maryland 1998*



Source: Based on data supplied by the Maryland Department of Labor, Licensing and Regulation. * The information is not for the entire year.

Figure 5.4: Summary of Misclassification by Standard Industrial Classification (SIC) Code - Wisconsin 1998



Source: Based on data supplied by the state of Wisconsin Department of Workforce Development.

5.4 Industrial and Occupational Distribution of Misclassified Employees

Figures 5.3 and 5.4, shown above, provide a summary of employer misclassifications by industry for Maryland and Wisconsin, based on data supplied by their respective audit agencies for 1998. The data validate the opinions of UI staff and advocates for employers and unions. The data are organized by Standard Industrial Classification (SIC) Code into eight industrial sectors. The highest level of misclassification across each state was the service sector, followed by construction, retail and manufacturing which all showed high levels of misclassification.

Tables 5.1 and 5.2 illustrate the type of industry and the total number of new jobs created in 1998 for California and Washington. The highest percentage of misclassified workers in California was in the transport and communications sector, followed by construction and manufacturing. Washington also had high percentages of misclassified employees in construction and manufacturing.

Table 5.1: Misclassification by Industry and percentage in California – 1998

Industry Type	Total No. of New Jobs in 1998	No. of Misclassified Employees*	% of Misclassified
Agriculture, Forestry & Fishing	N/A	586	N/A
Construction	61,200	1741	2.8%
Manufacturing	37,000	964	2.6%
Transport & Communications	5,400	305	5.6%
Wholesale	24,700	121	0.5%
Retail	50,000	751	1.5%
Finance, Insurance & Real Estate	41,100	663	1.6%
Services	199,000	4347	2.2%
Total	**418,400**	**9,478**	**2.3%**

Source: Based on data supplied from the state of California Employment Development Department.
*The number of misclassified employees is derived from the 2% sample of employer audits.

Table 5.2: Misclassification by Industry and percentage in Washington State – 1998

Industry Type	Total No. of New Jobs in 1998	No. of Misclassified Employees*	% of Misclassified
Agriculture, Forestry & Fishing	4,736	148	3.1%
Construction	5,938	260	4.4%
Manufacturing	8,599	329	3.8%
Transport & Communications	3,750	28	0.7%
Wholesale	2,954	85	2.8%
Retail	12,880	290	2.3%
Finance, Insurance & Real Estate	6,956	185	2.7%
Services	31,465	942	3.0%
Total	**77,278**	**2,267**	**2.9%**

Source: Based on data supplied by the state of Washington Employment Security Department.
*The number of misclassified employees is derived from the 2% sample of employer audits.

Since only five of the states maintained an industrial breakdown of misclassified ICs by SIC code, the state audit department staff were asked to list the industries where they frequently encounter misclassifications. Their responses are provided below:

California –Services, landscaping, construction, manufacturing

Colorado - Construction, mortgage loan refinancing, consultants and services

Connecticut - Construction, insurance, real estate, trucking and delivery services, painting, medical offices, product demonstration, amusement companies, computer consulting, telephone and door to door solicitors, newspaper distributors and deliverers

Florida – Trucking, construction, home health

Indiana - Landscaping, trucking, construction, mortgage, insurance, and real estate

Maryland – Construction, cleaning services, home health, trucking, catering, cable and carpet installers, hygienists referred to dentists, secretaries to attorneys,

Minnesota - Service, retail & wholesale and construction, finance, insurance and real estate

New Jersey – Construction, home health, food processing and packaging,

New Mexico - Law firms, medical staffing for hospitals (temp. services), home health care, construction, trucking, product demonstrations, sales, and cleaning

Ohio - Construction, sales and trucking

Oregon - There does not seem to be any industry that does not use ICs. Construction, information systems, training and consulting

Texas - Eating and drinking establishments, trucking, warehousing, oil & gas industry, real estate, farm labor, non-residential building construction, special trade contractors, employment agencies, and general automotive repair shops.

Washington – Home companions, construction, high tech.

Wisconsin - Construction (especially drywall installers and roofers), carpet & tile installers, delivery persons, computer consulting & software development, janitorial, cleaning maintenance service, modeling & talent industry, medical (home health care, nurses, medical insurance examiner, and caregiver), sales, trucking, and entertainment/dancers.

5.5 Impact of Misclassification on Trust Funds

The measurement of the number of misclassified independent contractors in the workforce defies precision because SESAs do not maintain audit records and records of contested claims of discharged workers by category. Anecdotally, the estimates ranged from 1 to 25%. It is believed that this range was a result in part of the interchanging of the terms "misclassified worker" and "underground economy worker."

A national-level estimate of the impact of misclassification on the trust fund was done for the period 1990-1998. This type of aggregate estimate can be used to determine rates of misclassification in any particular state or region. The data used in the calculations for the average monthly covered employment, contributions collected, the number of first payments made, and benefits paid were obtained from the Bureau of Labor Statistics and The Unemployment Insurance Financial Data Handbook (ET 394). To arrive at a baseline estimate of the impact of misclassification on the trust fund, the calculations used certain assumptions:

- A 1% level of worker misclassification[56]; and

- The employment and earnings dynamics of the misclassified worker are expected to be the same as in the remainder of the workforce. These include the amount of taxable wages earned, the contributions on the earnings, the percentage of the workers who are likely to experience a spell of unemployment during the year, the duration of unemployment, and the amount of benefits payable.

The data illustrated in Table 5.3 are for nine consecutive years that encompass both an economic downturn and a sustained period of recovery. They show the outlying annual ranges of the estimated loss in contributions to the trust fund as a result of employers misclassifying workers, the benefits not paid by the fund due to underreporting, and the net potential impact on the trust fund.

As shown in Table 5.3, the net impact on the trust fund ranged from a $100 million outflow in 1991 to a $26 million inflow in 1997. The first 3 years 1990-1993, was a period of economic downturn, where the cumulative impact on the trust fund was an outflow of funds approaching $200 million. The last 3 years (1996-1998) included a period of economic expansion, where the cumulative impact shows an inflow of approximately $50 million. The 9-year cumulative effect, of a 1% level of worker misclassification on the trust fund is shown in line 12. It shows an outflow of $118 million, or an average annual outflow of approximately $13 million.

[56] Since five states provided the data to compute the effect of misclassification on UI tax revenue and four of the five showed an impact of less than 2%, a 1% level of misclassification was assumed.

Table 5.3: Impact of Misclassification on the UI Trust Fund

TAX CALCULATION		***YEAR***			
		1990	**1991**	**1992**	**1993**
1	*Average monthly covered employment*	87,008,189	84,905,782	85,098,137	86,850,536
2	*Contributions for the year*	$15,221,274,000	$14,510,670,000	$16,972,655,000	$19,831,045,000
3=(2/1)	*Annual contributions per covered worker per year*	$174.94	$170.90	$199.45	$228.34
4=(1%of 1)	*Number of misclassified workers*	870,082	849,058	850,981	868,505
5=(4x3)	*UI contributions not paid by employers*	**$152,212,740**	**$145,106,700**	**$169,726,550**	**$198,310,450**
BENEFIT CALCULATION					
6	*Number of first payments*	8,628,557	10,074,550	9,243,338	7,884,326
7	*Benefits paid for the year*	$17,320,777,000	$24,582,501,000	$23,956,510,000	$20,687,678,000
8=(7/6)	*Average benefits per first payment*	$2,007.38	$2,440.06	$2,591.76	$2,623.90
9=(6/1)	*First payment recipients/covered employment*	9.92%	11.87%	10.86%	9.08%
10=(4x9)x8	*Estimated payments not made to claimants due to misclassified workers*	**$173,207,770**	**$245,825,010**	**$239,565,100**	**$206,876,780**
	UI contributions not paid by employers	$152,212,740	$145,106,700	$169,726,550	$198,310,450
	Benefits not paid to claimants	$173,207,770	$245,825,010	$239,565,100	$206,876,780
11	*Net Potential effect on trust fund*	***-$20,995,030***	***-$100,718,310***	***-$69,838,550***	***-$8,566,330***
12	*Cumulative effect on the trust fund*	***-$20,995,030***	***-$121,713,340***	***-$191,551,890***	***-$200,118,220***

Table 5.3: Impact of Misclassification on the UI Trust Fund (Cont.)

TAX CALCULATION		***YEAR***				
		1994	**1995**	**1996**	**1997**	**1998**
1	*Average monthly covered employment*	89,690,770	92,328,088	94,685,734	97,837,884	100,247,482
2	*Contributions for the year*	$21,802,069,000	$21,970,828,000	$21,577,968,000	$21,247,040,000	$19,825,155,000
3=(2/1)	*Annual contributions per covered worker per year*	$243.08	$237.96	$227.89	$217.17	$197.76
4=(1%of 1)	*Number of misclassified workers*	896,908	923,281	946,857	978,379	1,002,474
5=(4x3)	*UI contributions not paid by employers*	**$218,020,690**	**$219,708,280**	**$215,779,680**	**$212,474,567**	**$198,249,258**
BENEFIT CALCULATION						
6	*Number of first payments*	7,959,281	8,035,229	7,989,615	7,325,279	7,331,890
7	*Benefits paid for the year*	$20,433,832,000	$20,122,189,000	$20,634,904,000	$18,605,353,000	$18,433,293,000
8=(7/6)	*Average benefits per first payment*	$2,567.30	$2,504.25	$2,582.72	$2,539.88	$2,514.13
9=(6/1)	*First payment recipients/covered employment*	8.87%	8.70%	8.44%	7.49%	7.31%
10=(4x9)x8	*Estimated payments not made to claimants due to misclassified workers*	**$204,338,320**	**$201,221,890**	**$206,349,040**	**$186,053,560**	**$184,332,779**
	UI contributions not paid by employers	$218,020,690	$219,708,280	$215,779,680	$212,474,567	$198,249,258
	Benefits not paid to claimants	$204,338,320	$201,221,890	$206,349,040	$186,053,560	$184,332,779
11	*Net Potential effect on trust fund*	***$13,682,370***	***$18,486,390***	***$9,430,640***	***$26,421,007***	***$13,916,479***
12	*Cumulative effect on the trust fund*	***-$186,435,850***	***-$167,949,460***	***-$158,518,820***	***-$132,097,813***	***-$118,181,334***

The average annual national impact that would be representative of the 9-year period was also computed. The median annual contribution per person (1993) and the median average benefit (1997) were applied to the most recent number of workers in covered employment (1998). The calculation is shown in Table 5.4 below.

Table 5.4: Estimated Average National Impact on the UI Trust Fund

UNREALIZED REVENUE	
1. 1998 average monthly covered employment	100,247,482
2. 1993 annual contributions (median value for 9 years)	$19,831,045,000
3. Annual contribution per person per year (line 2/ line 1)	$197.82
4. No. Of misclassified workers(1% level of misclassification assumed)	1,002,474
5. Estimated revenue lost (line 4 * line 3)	**$198,309,406**
UNPAID BENEFITS	
6. 1996 number of first payments (median value for 9 years)	7,989,615
7. Ratio of first payments to covered employment (line 6/line1)	8%
8. 1997 average benefits per claimant (median value for 9 years)	$2539.88
9. No. of misclassified workers filing for benefits(line 7 * line 4)	80,197
10. Estimated unpaid benefits (line 8 x line 9)	**$203,690,756**

The results suggested that over this 9-year period, assuming a 1% level of worker misclassification, the loss in revenue from underreporting UI taxes would be an annual average of $198 million. If the unemployment level remained at the 1997 level, the outflow of benefits payable to the misclassified claimants would be on average $203 million annually.

Although the calculation indicates an estimated difference between revenue and benefit payments, such a difference, whether a positive or a negative number, would, over the longer term, likely be overcome by the workings of the experience rating system. This system assigns annual contribution rates to employers based on the existing reserves in the UI system relative to the potential current exposure to worker unemployment. ***A more significant implication of misclassification is that annually there are some 80,000 workers who are entitled to benefits, but do not receive them.***

5.6 Overall Assessment of Misclassification

Misclassification of workers is not new and will continue to occur. Typically, employers are trying to reduce expenses, and labor and its associated costs are easiest to control. The interviewees have expressed several reasons for this. Chief among these is the rising costs of workers' compensation premiums. Other reasons cited were the fact that corporate downsizing has led workers to feel that their long-term financial security rests in their taking control of their careers rather than remaining vulnerable to the perceived vagaries of the economic cycle. Increased automation is changing the manner in which business is conducted lessening the degree of supervision, direction and control that is a fundamental component in determining employment status.

These and other factors noted earlier in this report have contributed to the likely increased incidence of misclassification, although not all interviewees agreed. Connecticut, Oregon and California's staff have seen increases in assessments and reclassifications. Staff in Nebraska, New Jersey and California believes that there are more workers who are readily agreeing to accept IC status, often times out of desperation. It has become more difficult to get claimants to testify against employers, which weakens the agency's case against an employer. According to a member of the Ohio audit staff "misclassification of worker is a never ending cycle that will continue until changes are made to cover all workers performing services for a business. In many cases, employers caught will continue to use the same methods of classifying workers because they get away with it."

If an employer and worker agree to an independent contractor arrangement, the court system seems to condone the agreement. Florida, Nebraska, and Maryland UI staff commented that the current judicial decisions seems to be pro-employer and eroding a basic premise of the UI program. The Florida appeals staff reported that most frequently the courts ruled against the agency and determined that workers were independent contractors. For example, the courts determined that drywall installers and individuals working for cleaning contractors are ICs. In every state that participated in the study, one or more groups are requesting exemptions. The Oregon governor in his veto of a bill to

confer independent status on a segment of the pharmacist profession expressed concerns about this trend of requesting exemptions.

When the economy is strong, workers who lose their job often find new jobs very quickly. In most states this has led to the lowest unemployment rate in more than 25 years. Employer contribution rates are also very low and trust fund reserves are increasing. The number of IC/employee rulings has decreased somewhat in the last 3 years. One observation expressed by most interviewees was that an increase in the unemployment rate could precipitate an avalanche of independent contractor related issues. Workers operating under what at present looks like a good IC agreement would be filing UI claims alleging worker status. The administrative burden associated with a significant rise in contested claims could prove disruptive to orderly claims processing.

CHAPTER 6
ADMINISTRATIVE AND LEGISLATIVE RESPONSES OF STATES TO WORKER PROTECTION ISSUES

The first section in this chapter summarizes recent legislative responses of state legislatures and UI agencies on independent contractor issues. Next the issues of workers' compensation, the underground economy, and information sharing are described. The chapter concludes with an overall assessment of the impact of worker misclassification.

6.1 Legislative Issues and Responses

The issue of misclassification has received an increasing amount of attention in recent years in areas unrelated to unemployment insurance. The absence of a clear definition of contingent workers could affect businesses detrimentally as independent contractors and other contingent workers litigate their status and force courts to decide the issue. This sometimes results in awards of back pay and benefits to plaintiffs who challenged their independent contractor status. According to Employment Benefit Research Institute economists "In the absence of congressional activity, employers of independent contractors could be forced to give up considerable managerial control of these workers to ensure that they are not seen as common law employees. If not, they risk incurring substantial costs for retroactive tax payments and benefit expenditures, in addition to the cost of treating current and future independent contractor as employees."[57]

Chief among these is the Microsoft Corporation case in which the company's policy of excluding its long-term temporary workers from participation in its employee benefit plans was overturned by the court. In a case against Pacific G&E it was also held that employees of temporary service agencies engaged by Pacific G&E were to be considered employees for purposes of rights to the company's employee benefit plan unless they

[57] Contingent Workers and Workers in Alternative Work Arrangements, EBRI, 1999

were specifically excluded by written contract. While not specifically ruled upon, this finding is potentially applicable to independent contractors as well.

In 1998, the USDOL brought suit against the Time-Warner Corporation, alleging that the company misclassified some 1000 workers to avoid their entitlement to the company's retirement and health benefits plans. Many believe that the USDOL's action will be the forerunner of further legal actions in this area.

Governmental entities are not immune from this issue. In 1998, *Washington State's* King County settled a class-action lawsuit brought by temporary employees because of their exclusion from employee benefit plans. The county agreed to a $24 million settlement.

On the legislative front, there is evidence of renewed interest in finding a means to introduce a greater degree of certainty in the classification process. In 1995, a bill was introduced in the U.S. House of Representatives by Congressman Jan Christenson for this purpose. In 1996, senators Nickles, Bond, and Snowe introduced the Independent Contractor Tax Simplification Act. This bill was supported by over 50 trade and industry associations, who asserted that because Americans are becoming more entrepreneurial and are increasingly working at home, it makes sense to classify more workers as independent contractors. Senator Nickles termed the present common-law test "the bane of workers and employers across the country." Labor unions opposed the bill, insisting that it would shift millions of employees to IC status and eliminate basic protection.

In 1999, representatives Jerry Kleczka and Amory Houghton sponsored the Independent Contractor Clarification Act, to bring up the issue of recognizing that workers as well as employers are disadvantaged by the current criteria. Their proposal would replace the present common-law rules with ones that would make determination of IC status less subjective. They propose to get rid of the 20-factor test of the IRS, and classify service providers as employees unless they exercise control over their own work, are free to handle more clients, and assume some entrepreneurial risk.

States, too, are beginning to revisit this issue. In New York, Governor Pataki recently signed Executive Order 78 establishing the Governor's Task Force on Independent Contractors. He cited the need to establish a system by which determinations of employee and independent contractor status are made simply, consistently, and fairly. The task force held public hearings and developed a series of recommendations that are now before the governor for review and implementation.

In 1994, the Montana Legislative Council, in fulfilling the requirements of House Joint Resolution 33, submitted a report to the governor and the legislature on concerns regarding independent contractor status, licensing, and employee leasing. Particular emphasis was placed on the IC exemption from workers compensation. A proposal has been considered in Washington state to fund a study to assess the impact that the increasing use of IC's and other contingent workers, has had on workers, their families, and the economy in general.

It has been observed that most state legislative actions on this issue have been to enact specific exclusions from the definition of employment. One exception was Oregon, where a proposal to exclude certain pharmacists was vetoed by Governor Kitzhaser. In his veto message, the governor commented that many proposals had been introduced and enacted in the past to exclude certain employees from unemployment insurance coverage and that the cumulative effect of these exclusions had been to erode the protection intended by the system. "As the number and scope of proposals to erode coverage has increased over the years, I have become progressively more concerned about the cumulative effect of these exemptions….It is time that we adopt a state policy recognizing the importance of having an inclusive program…"[58]

In California, Assembly Bill 70 (AB70) introduced by Assemblyman Jim Cunneen, and sponsored by the California Chamber of Commerce, proposes a clarification of rules to distinguish employees from ICs. It proposes to changes the state guidelines for determining the tax status of an IC to conform to the "safe harbor" provisions of the

[58] John A Kitzhaser, Letter to Speaker of the House, July 14th, 1999.

federal law of 1996 (Small Business Job Protection Act). AB70 mirrors the federal law, but extends the safe harbor relief to employers who hire technology workers (engineers, computer programmers, systems analysts, and other similarly skilled workers). Businesses and conservative interests support this clarification, which relaxes the UI employee classification criteria by making UI criteria more like those used by the IRS. Unions oppose the bill because it would make it easier for employers to reclassify existing workers and hire new ones as ICs.

Under current federal labor law, independent contractors are not allowed to form or join unions. The AFL-CIO's legislative agenda includes a proposal to protect full-time workers from being labeled by their employers as independent contractors to hold down labor costs. Unions argue that when employees are turned into independent contractors, society at large will have to foot the bill for those without insurance or pensions. Unions have been struggling to maintain membership, and their numbers will not change unless they capture new workers.

Healthcare, high tech, trucking, and temporary workers working on a long-term basis are the biggest groups where worker misclassification abounds. In 1987, the California State courts ruled that some 180,000 homecare aides were independent contractors and thus were without the right to unionize. In 1992, the legislature created authorities to carry out the state's homecare programs utilizing these workers as employees. This year, 74,000 of these workers voted to unionize in order to obtain certain employee benefits that were previously denied. It is anticipated that unionization efforts will extend to other areas in California as well as New York, Oregon, and Washington State.

6.2 Workers' Compensation

In researching this report, the question arose as to the principal factor or factors that were driving the observed incidence of worker misclassification. The avoidance of the payment of unemployment insurance contributions, while a cost factor, did not seem to

be of enough value to warrant the degree of risk associated with misclassification. In discussions, governmental officials were unanimous in citing the present cost of workers compensation as the single most dominant reason for misclassification. Employers avoid the costs of paying workers compensation premiums by allowing or mandating that persons who work for them have an independent contractor exemption. This allows those employers to underbid the legitimate employers who provide coverage for their employees.

There are problems in regulating the proof of workers' compensation or independent contractor exemption status. Workers' compensation agency officials in Florida and California described the retroactive use of workers' compensation, where independent contractors file claims for benefits as employees when they are injured. The insurers have to pay benefits for workers they never received premiums for. Some workers, who have been independent contractors and therefore exempted from workers' compensation for many years, become employees and get covered under workers' compensation without having paid premiums for all of the previous years and claim injury-related compensation.

These officials indicated that the costs of workers' compensation in the construction and homecare industries were among the highest of all industries. These costs contributed to the relatively high incidence of misclassification within these two industries. This issue is not limited to the private sector. State agencies also use independent contractor status to avoid conferring employee status and paying workers' compensation because they are given the authorization to spend money on contracted services, but not on full-time employees.[59]

This opinion was borne out in large measure in discussions with representatives of workers' compensation agencies and staff members of the National Council on Compensation Insurance (NCCI). The workers' compensation officials pointed out that

[59] Workers' Compensation Emerging Issues: Independent Contractors, Contractor Licensing, and Employee Leasing, Montana Legislative Council, November 1994, p 7

medical services were a major component of workers' compensation awards and that the continually rising costs of medical care contributed significantly to the premium costs.

Another factor cited by the NCCI was that the cost of premiums has led to the miscoding of workers by occupation to gain a more favorable rate. The occurrence of miscoding (termed misclassification by the insurance industry) has increased to such an extent in the past 5 to 10 years that the insurance industry has doubled its audit and compliance activities during this period. The miscoding shifts costs to other employers, thus contributing to the increasing rates. This increase, in turn, provides the financial incentive for the misclassification of workers.

6.3 Information Sharing among Agencies

State Employment Security Agencies and the IRS

SESAs have data-sharing agreements with the IRS under state law and Internal Revenue Code Section 6103 which pertains to confidentiality and disclosure restrictions related to release of information to assist in tax enforcement efforts. Both agencies collect taxes; both rely on voluntary compliance in order to meet revenue forecasts; and both conduct employer audits, some random and some targeted. In addition, both the IRS and the states determine employer-employee relationships based on their respective laws, regulations, and policies. However, little information is in fact shared.

Employers report employee wages to the IRS on Form W-2, whereas payments to ICs are reported on IRS Form 1099-Misc. The IRS also receives reported income (Form 1040s) from employees and independent contractors. Employers are only required to report wages to the SESA. Unless the state conducts an audit, or a worker files a claim for unemployment insurance benefits that results in a blocked claim, the only other recourse available to a UI agency in determining an employer-employee relationship is to conduct an investigation. In discussions with state officials, it was understood that the extent of the information sharing was generally limited to providing unemployment insurance audit results to the IRS. It was an exception when information flowed in the other direction.

There is no doubt that the sharing of 1099-Misc information on a systematic basis would enhance the operations of the UI tax operation. If the IRS routinely provided the SESA with 1099-Misc information, the data could be matched with UI tax information to determine if employers were converting employees to IC status. In addition, companies known to have large numbers of independent contractors and very few employees could be investigated for possible misclassification.

In discussions with California UI officials, it was learned that IRS data was an integral component of their multi agency task force efforts devoted to uncovering misclassified employees as well as unreported wages. The primary data used in this effort were from Form 1099-Misc on which non-employee compensation is to be reported to the IRS. Despite the fact that the 1099-Misc data received by the UI agency is one and a half to two years old, this data has proved to be extremely effective in terms of successful rates of discovery. It was pointed out that access to this kind of data was more readily available in California than in other states because UI taxes are collected by the state's Employment Development Department along with the state's withholding tax. Connecticut also uses 1099s from the Department of Revenue Services to assist in selection of audits and in uncovering misclassified employees and unreported wages.

It was not entirely clear as to why this type of information exchange was not routinely used by other states in their unemployment insurance tax enforcement programs. Some state officials (e.g. Ohio) were of the opinion that the disclosure of these data was not permissible under the current data-sharing agreements. Others suggested that their budget resources would not permit an undertaking of any meaningful magnitude. Wisconsin and New Mexico officials acknowledged that having 1099-Misc would be of value and that USDOL should develop software and a computer program to extract the useful data from the IRS 1099 tapes so any state could use them.

In Texas, 1099s issued to ICs over a certain dollar amount and reviewed during the course of an audit are investigated for liability under the Texas Unemployment Compensation Act if they do not have an established account with the agency. UI

officials stated that the results of employment tax audits conducted by IRS were sharable under the agreements. However, it was understood that these kinds of audits were so limited in number as to be an insignificant part of their enforcement efforts. The rationale advanced was that misclassified workers would still be subject to income taxes and self-employment taxes, and that the net financial effect of an audit would be largely offset by taxes reported as independent contractors. This rationale, of course, does not apply to either state UI taxes or the federal unemployment tax.

Other Best Practices

Connecticut conducts joint audits with its departments of revenue services and consumer protection. Indiana passed a change in state law effective July 1, 1999 that enables its UI agency to perform joint audits with other state agencies. Oregon conducts a few joint audits. A staff person who believes an employer is incorrectly reporting to most agencies usually initiates them. Most requests come from the Department of Revenue and UI staff assists the revenue agents by conducting a majority of the audits.

The SESA staff in Connecticut reported that their public relations campaign in educating employers regarding the use of ICs and its aggressive audit program have resulted in a minimal impact of misclassification on their UI program.

In Massachusetts, the Foundation for Fair Contracting, which monitors construction projects across states, run ads on cable networks to warn workers about the illegal labor practices of "unscrupulous contractors who know the law but choose to break it."[60] The TV spots warn workers that contractors who pay below the prevailing wage, refuse to pay overtime, or misclassify employees as ICs are violating state law.

New Initiatives

In addition to the initiatives outlined above, there are several other efforts being undertaken that will improve a state's ability to uncover misclassified workers. Some of

[60]Diane E. Lewis, "Ads warn workers on illegal labor practices," Boston Globe, April 5th 1999

these have been undertaken by the USDOL, while others are joint efforts between state and federal agencies. Some of these are described below:

Effective January 1, 1999 the USDOL modified its Field Audit Function to require that the discovery by the states of misclassifications during the field audit process are to be recorded and reported to the national office on its Form ETA 581. This is an excellent first step in the attempt to quantify the extent of misclassifications and will be valuable when viewed in a timeline reference. It is also valuable in that it utilizes existing data reporting mechanisms thereby contributing little additional burden on the state staffs.

However, there are drawbacks to using the data accumulated under this process. Most states "target" their audits toward employers or industries where past results have indicated that erroneous reporting is likely to occur. Resulting data would have to be carefully analyzed to accommodate the skewing effect of the audit selection process. Additionally, the number of audits conducted in the recent past is quite low and, if this level of audits continue, the resulting data would require extra analytical modification.

Montana has formed a partnership between its Department of Revenue, Department of Labor and Industry, and the Internal Revenue Service to enable employers to file a combined Montana state and federal tax report giving UI tax, state income tax, and withholding data. The state UI tax and income tax units have been combined within the state's Department of Revenue. On the same form that is submitted quarterly, employers report federal income tax withholding, Social Security and Medicare taxes, advance earned-income credit payments, and federal tax deposits made each month during the quarter. All state taxes are submitted on one check. Federal taxes, however, must be submitted separately to the IRS. However, this represents a significant improvement in cross-matching and utilizing data to ensure consistency in reporting. It enhances the state's ability to allocate its scarce audit resources so it can target employers that are potentially misclassifying their workers.

Wyoming has initiated a Joint Reporting Project for Unemployment Insurance and Worker's Safety & Compensation. The project has grown significantly with 12,000 employers now submitting a combined report. The report is submitted to the Wyoming Employment Resources Division. It has greatly facilitated the selection of employers for joint audits.

Inter-Agency Task forces

California created the Joint Enforcement Strike Force in 1993. Two enforcement efforts were implemented - the Employment Enforcement Task Force (EETF) and the Construction Enforcement Task Force (CEP). The goal was to maximize resources in a way that would reach lawbreakers in order to clamp down on those who illegally undercut competitors and deny their workers the benefits that they deserve.

Member agencies include the Employment Development Department, which was also the lead agency; the Department of Consumer Affairs; the Department of Industrial Relations; the Office of Criminal Justice Planning; the Franchise Tax Board; the Board of Equalization; and the Department of Justice.

The strike force has achieved significant results. The collective enforcement capability allows participating agencies to address multiple rather than single violations of law. The multiple enforcement efforts with their associated citations, penalties, and assessments have had a significant effect on businesses in the underground economy. Because of the strike force's actions, these companies are either being driven into the legitimate economy or put out of business. The pressure of unlawful competition is being reduced for honest businesses.

Information sharing between member and nonmember agencies continues to improve. The members have access to each other’s databases. The strike force continues to refine and improve its detection and investigative techniques. This improvement is attributed to new techniques for developing needs, increased joint investigations with other law enforcement agencies, and more experienced EETF staff. The introduction of the CEP

has illustrated how flexible a strike force can be in adopting different enforcement techniques to different industries.

6.4 The Underground Economy

In conducting research for this report, almost all of the interviewees equated employee misclassification with the operation of the underground economy. There was little substantive difference between reporting an employee as an IC and not reporting him or her at all. It is for this reason that a discussion of the operation of the underground economy is relevant here, with particular emphasis on how it is related to worker's wages.

This section reviews some aspects of the underground economy by looking at some of the typical schemes that are currently in operation. As will be seen, misclassification in all the schemes is done to avoid employment taxes and applicable labor laws.

In the underground economy, workers and business owners, both small and large, and from a variety of industries, are breaking labor and tax laws. They need to either gain a competitive advantage on a rival firm, or to catch up with a rival who may have been operating within the underground economy for some time. There are several schemes[61] commonly used by employers including:

- Skimming. Businesses record and report only a percentage of their sales in order to reduce their taxable income and gross receipts.

- Refunds/rebates. A customer intentionally overpays for supplies and receives a refund check for the difference. The refunds are not paid into the business account and are used as a source of cash for paying undocumented wages. This occurs in any business where the purchase of materials is commonplace, e.g. construction.

- Laundering (money exchange). There is usually collusion between two contractors. Checks are issued to the subcontractor and recorded as legitimate expenses in the books. The subcontractor cashes the checks, usually at the prime contractor's bank, keeps a percentage, and returns the balance cash to pay undocumented wages. Alternatively, the subcontractor acts as a paymaster and distributes the checks to the prime contractors employees.

[61] Source: Joint Enforcement Strike Force on the Underground Economy, February 1,1999 by the State of California Employment Development Department

- Payments to crew leaders. A supervisor or other trusted employee is required to disguise the payment of wages. The crew leader receives payments disguised in the company accounts as legitimate business expenses along with his regular paycheck. The crew leader uses the disguised business expenses to issue cash payments to crew members. The crew leader may receive an incentive as a reward for participating in this scheme.

- Fraudulent disbursement records. Fraudulent entries are made in cash disbursement journals, payroll journals, or check registers. These records will agree with reported wages. In reality, these entries will not agree with the amounts on canceled checks. Common discrepancies include different payees, different payment amounts, and missing payments. The result is deliberately underreported wages.

- Dual records. In the underground economy, contractors often maintain two sets of books. One set shows all transactions used for tax purposes, and the other set documents transactions that the contractor wishes to withhold from the IRS. Another device is to pay for an individual's services partially as an employee, (thus making him available for all the social benefits and safeguards, such as social security, worker's compensation and union membership). The other part is paid off the books or as rental for building equipment or trucks.

6.4.1 California's Response

As indicated earlier, California's response to the underground economy was to create two enforcement agencies in 1993. The EETF became operational in February 1994 and as of December 31, 1998 had accomplished the following: 6361 investigations had been conducted resulting in the issuing of 5360 citations for violations of the labor code. The investigations also initiated 3102 payroll tax audits, of which 2522 have been completed, resulting in assessments totaling $35,467,454 in unpaid employment taxes, penalties, and interest. As a further result of the investigations, 22,873 workers who should have been classified as employees were identified. Average EDD Payroll tax assessments resulting from EETF referrals have increased dramatically, from $3397 in 1994 to $21,085 in 1998. In 1998, the average assessment was 1.7 times greater than the average assessment resulting from the regular audit program. Average labor code

citations resulting from EETF investigations also increased from $3118 in 1994 to $6206 in 1998.[62]

The investigative techniques used by the EETF were not effective in the construction industry, which led to the implementation of the construction enforcement task force (CEP). The CEP was initially implemented as a 9-month pilot project in the Sacramento area; however, it was expanded to a statewide effort on December 31, 1995 because of its outstanding success during the pilot period. Since 1994 the CEP has initiated 935 audits in the construction industry, of which 746 have been completed, resulting in assessments of $32,062,263 in unpaid unemployment taxes, penalties, and interest. In addition, 12,320 workers were identified who should have been classified as employees, but were not.

6.4.2 New Jersey's Response

In 1997, New Jersey's Commission of Investigation carried out an investigation into the underground economy and in particular the contract labor business. New Jersey's agricultural and manufacturing industries have been subverted at taxpayers expense by a lucrative underground economy that benefits contractors who trade in cheap, and sometimes illegal immigrant labor.[63]

The employers consist of owners and managers of commercial agricultural processing plants and industrial manufacturing facilities that need workers who will perform menial tasks for which traditional full-time labor or machinery is too expensive. Factory managers informed the commission that they have turned to the immigrant worker supply because they were unable to fill the positions with employees from the local economy, who are not willing to take jobs at or below minimum wage. These tasks include removing bones from poultry, shelling clams, sorting and packing produce and readying finished products.

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[62] *ibid*

The labor pool is made up of immigrants from South and Central America and Southeast Asia who are willing to take jobs at or below minimum wage. These people are picked up at street corners in overcrowded vans and driven to factories to work long shifts.

Labor violations similar to those in California were discovered and recommendations were made to clamp down on the illegal activities. Neither the contract-labor provider, nor the processor or manufacturer using the provider's services took responsibility for the proper withholding and submitting of state income and employment taxes. Each took the stance that the worker was an IC responsible for his or her own filing of taxes, although this was blatantly not the case.

The Case of the Vegetable Processing Industry

The systematic abuses currently being carried out in the underground economy can be illustrated with an example from the vegetable processing industry. Between 1993 and 1996, several firms based in New Jersey, including a leading processor of fresh fruit and vegetables, paid over $18 million for contract labor supplied by a succession of individuals. The individuals were all members of the same extended family, and they have used these family ties as one of several devices in a scheme to plunder the tax system.

During that same 4-year span, no federal or state income taxes were withheld from the wages of thousands of workers who were supplied to the processors. The labor providers substantially understated their own corporate earnings for tax purposes, and failed to pay on behalf of their workers approximately $2.4 million in federal payroll taxes for Social Security and Medicare, and a further $119,000 in state unemployment and disability insurance taxes. Many of the workers possessed bogus Social Security numbers.

[63] Source: Contract Labor - The Making of an Underground Economy, September 1997 by the State of New Jersey Commission of Investigation (pp.3-12)

The provider was a Cambodian immigrant who served as a crew leader, supplying workers to plants in the poultry and vegetable processing industries. A 1993 audit of his books by the New Jersey Department of Labor discovered that he had been underreporting his worker's wages for the previous 5 years. At this point, the labor provider relinquished control of his business to his wife and several in-laws who ran the business in their name before forming a new corporation. Ploys such as this one enabled the crew leader to effectively dodge state efforts to collect the unpaid UI/Temporary Disability Insurance obligations.

Under the current arrangement, the firm provides approximately 195 workers per day to a plant that processes lettuce and other salad condiments pre-prepared for retail outlets. The crew leader receives a lump sum from the plant equating to $6.75 per hour of labor worked by his staff, who are paid at a rate of $5.05 per hour in cash. The labor provider received a gross amount of $18,262,829 for the period 1993-1996 from all processing plants. No money was withheld from workers pay packets for state and federal tax purposes, and payroll taxes were not deducted.

The labor provider takes the position that the workers are independent contractors and are responsible for compliance on their own. However, a written agreement entered into between plant officials and the labor provider clearly states, for example, that the provider is responsible for deducting unemployment and worker's compensation as well as the employee's share of Social Security. Officials of the processing plant, meanwhile, regard the workers as direct employees of the labor provider and play no role in oversight of tax compliance involving the workers.

The commission recommended a joint employer for tax purposes. Other recommendations included a proposal to consolidate contract labor providers under one regulatory scheme, the transfer of UI/TDI collection functions to the Department of the Treasury, and the expansion of employee verification programs.

6.5 The Erosion of UI Coverage and FUTA

Excluding certain employment and wages from state unemployment insurance seems to be popular these days. During recent years, some employers have gone to their state legislatures for special exclusions from UI. These same employers were caught as a result of their ex-employee independent contractors filing unemployment insurance claims and were therefore subject to audit investigations and tax assessments. Political events in many states are resulting in even more occupations receiving exclusions. Advocates of new exclusions have pointed to previous exclusions as the rationale for their group. As the number of federally impermissible exclusions has increased, employment security staff has become concerned about the erosion of UI coverage for workers.

Under the current FUTA, a tax credit is applied against the full FUTA tax of 6.2% only on those wages that are subject to the state's UI tax. The IRS Employer Tax Guide Circular E makes an oblique reference in the deposit instructions as "If any part of wages subject to FUTA are exempt from state unemployment tax, you may deposit more than the .008 rate." These instructions do not inform employers on what rate to use for making deposits and how the total tax is to be computed. If an employer had wages subject to FUTA but **not** subject to the state, then the employer would not be allowed the credit and be required to pay the full 6.2% FUTA tax. Thus, if certain wages are subject to FUTA but not to UI, then no credit is allowed and the full FUTA tax is payable on those wages. It appears that there is no process in place, on either the state or federal level, to ensure that this provision is enforced.

6.6 Overall Impact of Misclassification

The employer community is not totally free of the adverse impacts of misclassification. Cost considerations and aggressive competition are twin pressures that induce an employer to engage in behavior that creates an inequitable playing field in the business community for employers who correctly classify their employees and pay taxes.

Many employers believe the risk is acceptable when viewed against the survival of their business. Their view of the risk involved, however, is mostly limited to the retroactive payment of some payroll taxes and possibly some fringe benefits. Other infringements of the law can carry substantial liabilities. Among these are the retirement and health benefit rules under ERISA, the Age Discrimination in Employment Act, the Americans with Disabilities Act, and the Fair Labor Standards Practices Act, as well as similar laws within the states. Employers, particularly small employers, need to be aware of these risks, which, are potentially of greater impact than payroll taxes.

Misclassification has little impact on workers who file claims. Once a claim is filed, their rights are protected and the employment security agency ensures that the individuals receive benefits if they are eligible. It must be stressed however, that misclassification has a big impact on individuals who believe their employers when they inform them they are not employees, but are independent contractors. Such individuals do not file for unemployment, though they could be eligible. It affects them financially and affects their ability to sustain themselves and their families during times of unemployment.

There are also the independent contractors operating in the underground economy who are often misclassified employees, and who are paid in cash for their services. Most of them do not file for unemployment either. It is difficult to estimate what percentage of unemployed workers do not file claims for the above reasons.

Misclassification imposes real hardships on workers, both in the near term and in the future. In the near term it deprives the worker of the social protections that have long been commonplace in the workplace. Chief among these is unemployment insurance and workers' compensation. These and other workers' benefits are now taken for granted, but they were extremely contentious issues when they were first proposed. The sharing of health insurance costs with employers that has become commonplace over the years, and is often considered a primary condition of employment is unavailable to an IC although it may be partially offset by some pay differentials.

In the long term, it presents another serious issue, particularly for those at the lower end of the pay scale. The issue is one of pensions. The trend in recent years has been to reduce planning for future retirement, particularly without the financial support and discipline of an employer-sponsored program. While it is true that the Internal Revenue Code provides tax incentives for independent contractors, utilization of those incentives is largely out of reach for those with limited earning capacity. According to Horowitz, an advocate for ICs, "We're heading into a two-tiered economy. The first tier has a New Deal safety net, protected by all the different labor laws. Then there is a second tier that's short term, flexible, many of them independent contractors. That tier does not receive benefits..."

CHAPTER 7

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

This chapter provides some recommendations for addressing a problem that may become significant if the economy undergoes a downturn and the level of unemployment increases.

7.1 Summary of Findings

The primary purpose of this study was to supplement existing knowledge on independent contractors and their role in the alternative workforce in order to provide policymakers with a more objective basis for understanding this work arrangement. BLS surveys of nonstandard workers in 1995 and 1997 found that ICs were the largest category, with 8.3 million & 8.5 million workers respectively, or 6.7% of the workforce. In the 1999 BLS survey, ICs were still the largest component of the alternative workforce, however their share had diminished slightly from 6.7% to 6.3%. Although the BLS results show a decline in ICs, the perception of the majority of those interviewed for the study was that independent contractor use is indeed growing.

There are no universal rules to determine who is an employee and who is an IC because the line between them shifts over time. Each state determines which individuals are employees and which are ICs by consulting the state definition and applying the state test (common law or ABC) and the state law. Critics assert that the current system has outlived its usefulness and is not responsive to the ever-changing ways in which business is being conducted.

Many workers displaced by corporate downsizing, as well as those seeking a more flexible work environment, have become independent contractors. Compared with the traditional workers, independent contractors are disproportionately found in construction, insurance, finance, real estate and services.

Some employees voluntarily left their regular jobs to start working for themselves as independent contractors for a variety of reasons. Independence, choice of employer and work hours, control over one's destiny, job stability, and higher levels of remuneration were the reasons frequently given by writers and artists, insurance and real estate sales agents, software and Web page designers, construction trade employees, and managers and administrators. However, there are other workers who left regular employment involuntarily and who prefer the stability of regular full-time employment, but were compelled by employers to accept independent contractor status. These are found in all types of occupations and industries.

In the study reported here, the demographic characteristics of independent contractors compiled from data provided by UI agency staff and advocacy groups indicate a great deal of variability in the makeup of ICs. ICs are males or females and of all ages and of a variety of ethnic origins. They have different education and skill levels. The majority has no health insurance or retirement benefits and earns middle to low-level wages.

One of the major issues of concern to federal and state policymakers at the labor department as well as many employers is the misclassification of employees as ICs. This particular practice is not only denying many workers protections and benefits they are entitled to, but it also has important implications for the financial viability of UI trust funds. Analysis of employer misclassification by industry for five states in this study showed that construction, manufacturing, home healthcare and retail had high levels of misclassification.

There was also a perception among employers and workers, especially those in the medium to high wage occupations that the designation of employee or independent contractor status was an option to be agreed upon by both parties. What mattered was the existence of a written agreement between both parties.

The economic factors that encourage employers to misclassify employees as ICs include heightened competition, new management paradigms, deregulation, and downsizing. The use of ICs allows employers to save on payroll taxes, fringe benefits, and workers compensation. They circumvent compliance with labor and workplace legislation designed to protect employees. They increase their workforce flexibility by hiring ICs to replace and supplement regular employees on an as needed-basis.

The number one reason for misclassifying workers or hiring independent contractors is the savings in not paying workers' compensation premiums and thereby not being subject to workplace injury and disability-related disputes. In high-risk industries, workers' compensation was the single most dominant reason for misclassification. Many employers believe the risk of being caught is acceptable if it means the survival of their business. Their view of the risk involved, however, fails to take into account violations of federal statutes that have substantial penalties.

Misclassification has a significant impact on those individuals who are told by their employers that they are ICs, not employees. These individuals are generally not financially able to make contributions to a retirement program and do not file for unemployment, although they could be eligible. In the long term, their retirement benefits are significantly reduced and in the short term, they do not collect unemployment insurance if they become unemployed. Utilization of IRS incentives such as self-employment plans is not a viable option for ICs because of their limited earnings.

UI employer audit data from selected states were used to estimate the proportion of employers who misclassify employees and the impact of misclassification on UI revenues and the trust fund. States that relied on targeted audits had a range of 30 to 45% of audited employers with misclassified employees. The proportion was around 10% in states with high levels of randomness in their audit selection process. Underreporting of UI tax revenues due to misclassification ranged from less than one half of 1% to 7.5%.

Assuming a 1% level of worker misclassification, and unemployment at the 1997 level, the average loss in revenue to the trust fund resulting from employer underreporting of UI taxes from 1990 to 1998 would be $198 million. The average outflow of benefits, if paid to the misclassified claimants, would be $203 million. These estimates show that the financial impact of misclassification is nominal at present. However, thousands of workers who have a legal right to UI protection are not being afforded such protection because of misclassification. Other social protections are also being denied to these workers, who are often the ones most in need of such protection.

Furthermore, an increase in the unemployment rate could cause enormous increases in independent contractor-related issues that would have to be investigated. The additional claims would also drain the trust fund, and this drain would most likely have to be offset by assigning higher contribution rates to those employers that correctly classify their workers and pay their taxes, placing them at a further economic disadvantage.

7.2 Recommendations

The increasing use of all types of nontraditional workers, including ICs, has created renewed interest in changing the employee classification criteria. To date, state employment security agencies have dealt with this problem by enacting specific exclusions from the definition of employment. There is a need to establish a system that ensures that determinations of employee and ICs are made simply, consistently, and fairly.

To address the issue of misclassification, several states have set up task forces to monitor employers' classification practices and reporting on employees. IRS data are an integral component of these efforts. However, state officials indicated that in the majority of cases, the shared information consisted primarily of UI audit results provided by states to the IRS. This information sharing should flow both ways. The use of Form 1099-Misc on which non-employee compensation is reported to the IRS in California proved to be extremely effective in detecting employee misclassifications. Other states need to make

this type of information part of their unemployment insurance tax enforcement programs. The Employment and Training Administration (ETA) should take a leadership role in forging a strong relationship between the IRS and SESAs to routinely share 1099 data. The USDOL should develop software and a computer program that will extract data that are useful to the states from the IRS 1099 tapes.

The ETA must also develop a dialogue with other agencies within the USDOL and outside it, such as the Immigration and Naturalization Service, which have major interest in employer-employee relationships and other worker protection issues. State agencies that determine employee and independent contractor status, such as workers' compensation and state departments of revenue, should be encouraged to exchange relevant information. Information should be shared, not only among state agencies, but also between states and their neighboring partners. Several states such as Montana, Wyoming, Connecticut, and California have taken the lead in establishing interagency reporting and cooperation, and these efforts can be used as models by other states. There are new technologies (e.g. intelligent collection systems, pattern recognition) that can be used to track independent contractors and their employers.

Another workplace related issue that affects UI revenue and erosion of coverage is the increasing requests by employers for exclusion of certain job classifications and wages from the payment of state UI taxes. If an employer had wages subject to FUTA but **not** subject to the state, that employer should not be allowed a FUTA credit and be required to pay the full 6.2% FUTA tax. To offset the enactment of specific exclusions from the definition of unemployment at the state level, at the federal level there should be a way of fixing this obvious lapse in the process. It is this process that gives the federal government the sanction necessary to insure compliance among the states. (Note: If your state's law is not in compliance with the federal guidelines of the world, an employer's tax is increased eight-fold.) A workgroup should be established to assess whether the intent of this provision of FUTA is being met and how it may be used to prevent further erosion of UI coverage.

The USDOL should undertake a comprehensive campaign to educate employers on voluntary compliance (not only the publication of successful prosecution, but also a systematic continuing educational campaign). The ETA must develop a repository of information on independent contractor issues, best practices, new initiatives, and legislative measures. This information should be updated frequently and publicized, and its contents made accessible to agencies dealing with independent contractors.

The short and long term impact of the IC work arrangement on the individual workers are that social protections now available to employees are currently denied to independent contractors, and the majority of them cannot afford to take advantage of the available measures. A multi agency dialogue needs to be started to explore the feasibility of extending some or all of the social protections to them. For example, should ICs participate in unemployment insurance, including payment of contributions? Should workers' compensation be mandatory for them? Should IC agreements be subject to requirements such as the payment of a minimum wage? These are a few of the questions that need to be answered in order to respond to the needs of this workforce. The way in which they are answered may determine the well being, not only of ICs, but also of the American economy as a whole in the coming century.

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APPENDIX A: LEGAL REVIEW

INTRODUCTION

At the preliminary stage, the primary objective of the legal research in the fifty states was to determine how the variance of common-law fact and circumstances tests between federal and state law, within states, and from state to state affected the level of independent contractor classification. The other objective was to examine and measure the magnitude of misclassification of workers.

The analysis began by researching each state's definition of covered employment, covered employee and independent contractor. To understand how the definition was applied to a particular set of circumstances it was necessary to research the state's case law. Case law research defined the classification criteria and judicial interpretation for each state and provided a basis for understanding the magnitude of IC classifications. Moreover, the research yielded information on which states employed the most inclusive and least inclusive employee definitions; which states incorporated which test, the ABC test or the common-law test; which prong of the states test the judiciary found most important; and what industries were most likely to use independent contractors.

Fourteen states plus the District of Columbia use the common-law test to define employees for unemployment insurance coverage purposes, while twenty-two use the ABC test, ten states use their own test and four states use the IRS's twenty-point test. Alabama, California, Iowa, Kansas, Massachusetts and Tennessee are a few of the common-law states. Alaska, Connecticut, Delaware, Louisiana, and Utah are some of the ABC test states. Idaho, Maryland, Michigan, Nevada and Washington are some of the states that have developed their own test separate from the common-law test or ABC test. Wyoming and Rhode Island are amongst those using the IRS test.

COMMON LAW STATES

Under the common-law test, whether the relationship is that of "independent contractor" or that of "master and servant" depends on whether the entity for whom work is being performed has reserved the right of control over the means by which work is done. It is reserved right of control by the master rather than actual exercise of such control that governs relationship status. However, the one for whom the work is done, may reserve the right to supervise the one doing the work, for the purpose of determining if the one doing the work is performing in conformity with the contract, without converting the relationship to that of master-servant.

Title 25, chapter 4, section 7, Code of Alabama 1975 defines an employee for purposes of the Alabama Unemployment Compensation Act as, "any individual employed by an employer in which employment the relationship of master and servant exists between the employee and the person employing him." It is clear that a master-servant relationship exists where an employer has the right to select the employee, the power to discharge him, the right to direct the type of work to be done, and the authority to prescribe the means and methods by which the employee is to perform the work desired. *State Department of Industrial Relations v. Montgomery Baptist Hospital, Inc.*, Ala.Civ.App., 359 So.2d 410 (1978). Indeed, courts regard the right to exercise control over the performance of the service as predominant in an employer-employee or master-servant relationship. *C.A. Wright Plumbing Co. v. Unemployment Compensation Board of Review*, 27 App.Div. 866 (1948). Thus the nature of a particular job is immaterial with respect to a claim for unemployment compensation provided the employer supervises and directs the employee and the occupation or profession performed is not exempted from benefits under the relevant unemployment compensation act. *Id.* at 412.

North Dakota converted to the common-law test from the ABC test in 1991 when the legislature amended the statute to read as follows: "employment means any service performed by any individual who, under the provisions of subdivision e, has the status of an employee. *North Dakota Social Security Act*, Section 52-01-01(17)(a)(3)(e).

Provision 'e' states: "services performed by an individual for wages or under any contract of hire must be deemed to be employment subject to the North Dakota Unemployment Compensation Law unless it is shown that the individual is an independent contractor as determined by the "common law" test. *Id.* at 199. Prior to the 1991 amendment, an individual who met the criteria of parts (1), (2), and (3), commonly known as the ABC test, was deemed to have independent contractor status for purposes of exemption. *Speedway, Inc. v. Job Serv.,* 454 N.W.2d 526 (N.D. 1990). After the 1991 amendment, an individual controlled in the manner and means by which that individual accomplishes his/her work results is deemed to be an employee for unemployment compensation purposes.

In California, the District of Columbia, Florida, Iowa, Kansas, Kentucky, Massachusetts, Mississippi, New York, Oklahoma, South Carolina and Tennessee an employee means the following: "(a) any officer of a corporation; (b) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; …. ." See *Tennessee Labor and Employment Security Act,* Section 1-210(1)(b); *South Carolina Labor and Employment Act,* Section 41-27-230 (1)(b). Mississippi adds onto this definition by requiring that the "service be performed for wages or under any contract of hire." *Texas Co. v. Wheeless,* 185 Miss. 799 (1939). Minnesota defines an employee/employment as "any individual who is a servant under the laws of master and servant or who performs services for any employing unit, unless such services are performed by an independent contractor." *Employment Security Act,* Section 268.04. In determining whether one who performs services for another is an employee within meaning of the Unemployment Insurance Act, or an independent contractor, the most important factor is right of control over manner and means of accomplishing results desired, and, if employer has authority to exercise complete control, whether or not right is exercised with respect to all details, one performing services is an "employee" not an "independent contractor." *Sudduth v. California Employment Stabilization Commission,* 278 P.2d 946 (1955). See also, *Barnes v. Indian Ref Co.,* 280 Ky. 811 (1939); *Bay State Harness Horse Racing and Breeding Association, Inc. v. Director of the Division of Employment Security,* 327 Mass. 296, 299 (1951).

In addition to the factors mentioned above, secondary factors to be considered are: (a) whether or not the one performing services is engaged in a distinct occupation or business; (b) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by specialist without supervision; (c) the skill required in the particular occupation; (d) whether the workman or the principal supplies the instrumentalities, tools, and the place of work for the person doing the work; (e) length of time for which the services are to be performed; (f) method of payment, whether by the time or by the job; (g) whether or not the work is a part of the regular business of the principal; and (h) whether or not the parties believe they are creating the relationship of employer-employee. *Id.* at 951. The District of Columbia simplified the secondary factors into four factors, which are: (1) the selection and engagement of the individual hired, (2) the payment of wages, (3) the power of the one who hires over the other whom he has hired, and (4) whether the service performed by the person hired is a part of the regular business of the one hired. *Jackson v. Public Service Commission,* 590 A.2d 517 (D.C.App. 1991). Florida, on the other hand, has extended the factors to include ten. The factors are (a) the extent of control which, by the agreement, the master may exercise over the details of the work; (b) whether or not the one employed is engaged in a distinct occupation or business; (c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision; (d) the skill required in the particular occupation; (e) whether the employer or workman supplies the instrumentalities, tools, and a place of work for the person doing the work; (f) the length of time for which the person is employed; (g) the method of payment, whether by time or by the job; (h) whether or not the work is part of the regular business of the employer; (i) whether or not the parties believe they are creating the relation of master and servant; (j) whether the principal is or is not in the business. *Dart Industries, Inc. v. Department of Labor and Employment Security, Division of Unemployment Compensation,* 596 So.2d 725 (Fla.App.5Dist. 1992); *Restatement of Agency*.

In determining whether an individual is an employee it is important to look at the secondary factors. *Id.* at 390. Massachusetts not only looks at the secondary factors

when determining employee status for unemployment insurance purposes but the courts also look at the legislatures intent and workers' compensation principals. *Work-A-Day of Fitchburg, Inc. v. Commissioner of the Department of Employment and Training,* 412 Mass. 578, 581 (1992). Strong evidence in support of an employment relationship is the right to discharge at will, without cause. *Empire Star Mines Co. v. California Employment Commission,* 168 P.2d 686 (1946). Another area to look at is whether or not the parties have entered into a contract defining their relationship. *Moore Associates, LLC v. Commissioner of Economic Security,* 545 N.W.2d 389 (Minn.App. 1996). However, entering into a contract is not determinative of the issue whether an individual is an employee for reemployment insurance purposes. *Id.* at 391. You must look at the surrounding circumstances of the relationship in order to determine the proper status. *Id.*

Workers subject to daily control and direction by supervisory personnel, required to work specific hours, to use time clock, and who were subject to termination at will were employees/servants and not independent contractors. *Louismet v. Bielema,* 457 N.W.2d 10 (IowaApp. 1990). Likewise, where employees are subject to control in dominant details of employment, such as place and time of work, and supervision and direction in many particulars, they were distinguished as "servants" rather than "independent contractors." *National Optical Stores Co., Inc. v. Bryant, Commissioner, et al.,* 181 Tenn. 266 (1944). Control of means and manner in which the work is completed is the most important test when determining employee versus independent contractor status. However, control is often hard to define, due to the individual nature of each job completed. Therefore, the judiciary turns to the secondary factors for guidance. For example, if an individual is working at his own pace, with his own tools and is being paid for the job he/she is completing, then the individual is an independent contractor. Similarly, if the individual is only being supervised to ensure the work is being completed according to the contract, then he/she is an independent contractor. On the other hand, if the individual is required to report to work at a certain time, is required to stay for a certain period of time and is paid hourly wages, then he/she is an employee. Likewise, if the individual is required to use the employer's tools and is supervised then he/she is an employee.

How one becomes labeled an employee or independent contractor depends upon how the judiciary interprets the facts of the case. The definitions under common-law are the same. It is the secondary factors, the statutory exemptions already in place and the judiciary's interpretation that attributes to the variance. The majority of common law states find an independent contractor relationship if the answer to control is in the negative and the secondary factors are answered the same on the one end; and an employee relationship if the answer to control is in the affirmative and the secondary factors are answered the exact opposite on the other end. Misclassification in common law states is rare.

STATUTORY STATES

1.1 ABC TEST

Under the ABC test, employment means service performed by an individual, regardless of whether the common-law relationship of master-servant exists, unless and until it is shown to the satisfaction of the department that (A) the individual has been and will continue to be free from any control or direction over performance of such services both under his contract for the performance of service and in fact; and (B) such service is either outside the usual course of the business for which such service is performed, or that such service is performed outside of all the places of business of the enterprise for which such service is performed; and (C) such individual is customarily engaged in an independently established trade, occupation, profession or business. *Tachick Freight Lines, Inc. v. Department of Labor, Employment Security Division*, 773 P.2d 451 (Alaska 1991); *New Hampshire, Labor, Unemployment Compensation Act*, Section 282-A:9. These three requirements must be concurrently satisfied, so that the inability to satisfy any one requirement results in the exemption's unavailability. *Jack Bradly, Inc. v. Department of Employment Security*, 585 N.E.2d 123 (Ill. 1991). The fundamental distinction between an employee and an independent contractor, under the ABC test, depends on the existence or nonexistence of the right to control the means and the method of work. *Latimer v. Administrator*, 216 Conn. 237 (1990).

Alaska, Arkansas, Colorado, Connecticut, Delaware, Illinois, Indiana, Louisiana, Maine, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, Ohio, Pennsylvania, Vermont, Virginia and West Virginia all employ the same test. Georgia and Hawaii, however, employ a slight variation. In Georgia, it is important that services be performed for wages before the ABC exceptions apply. *Huiet v. Great Atlantic & Pacific Tea Co.*, 66 Ga.App. 602 (1942). See also, *West Virginia, Unemployment Compensation*, Section 21A-1A-16. In Hawaii, the master and servant relationship does not need to be met if "services are performed by an individual for wages or under any contract of hire." *Hawaii Labor and Industrial Relations Act*, Section 383-7. If the individual is not

working for wages or under a contract of hire then the common law test applies not the ABC test. Wages are defined as remuneration from whatever source, including commissions, bonuses, severance or terminal pay, gratuities and the cash value of all remuneration in any medium other than cash. *Re Century Metalcraft Corp.*, 41 Haw. 508 (1957); *Maine Labor and Industry Unemployment Compensation Act,* Title 26, Section 1043.

For states employing the ABC test, the first prong requires proof that the individual is in fact free from control and direction in connection with the performance of the services. *American Transp. Corp. v. Director,* 39 Ark.App. 104 (1992). See also, *Twin States Pub. v. Indiana Unemployment,* 678 N.E.2d 110 (Ind.App. 1997). However, the courts have never held that there must be an absolute and complete freedom from control. *Hill Hotel Co. v. Kinney,* 138 Neb. 760 (1940).

Employer's right to terminate the relationship at will is one factor to be considered when determining control. *Rent-A-Mom v. Industrial Commission of the State of Colorado,* 727 P.2d 403 (Colo.App. 1986). See also, *Johnson v. Department of Labor & Industry,* 240 Mont. 288, 293 (1989). For example, Claimant's acceptance of employment from country club under condition that it was for a specific, limited duration when a special occasion created a need for additional bartenders amounted to voluntary termination of employment without good cause, not termination at will and rendered the claimant ineligible for unemployment benefits. *Wilmington Country Club v. Unemployment Insurance App. Board,* Del.Super. 301 A.2d 289 (1973). Other factors to be considered are: (a) the individual's ability to work for others, (b) quality standard, (c) salary or hourly rate versus a fixed or contract rate, (d) provide tools or benefits, (e) dictate time of performance, (f) pay individual personally or make checks payable to the trade or business name of the individual, and (g) combine business operations with the individual or maintain operations separate and distinct. *Colorado Employment Security Act,* Section 8-7-115. See also, *LBK Computer Associates, Corp. v. New Jersey Dept. of Labor,* 95 N.J.A.R.2d (LBR) 13 (1995); *Kelly v. Com., Unemployment Compensation Board of Review,* 528 A.2d 294 (Pa. 1987). Hence, if said individual is required to work

exclusively for employer, has quality standards imposed, is paid hourly or by salary, is provided tools and/or benefits, has time of performance dictated and is paid individually, then that individual is an employee.

To satisfy the second prong of the test, an enterprise must demonstrate, in order to prove that an individual is not an employee and enterprise has no liability, that the enterprise performs activity on a regular or continuous basis, without regard to substantiality of activity in relation to enterprise's other business activities. *Mattatuck Museum-Mattatuck Historical Society v. Administrator,* 679 A.2d 347 (Conn. 1996). Furthermore, the enterprise must prove that all services by the individual were performed away from the enterprises' business or that the services provided by the individual were outside the enterprise's usual course of business. *Gerber Dental Center v. Unemployment Insurance Commission,* 531 A.2d 1262 (Me. 1987). For example, Solar Age correctly classified salespersons as independent contractors when the company did not assign the salesperson a route or schedule, when use of office or phone was available but services were performed outside the office and because salespersons purchased their own sales kit for aid. *Solar Age MFG., INC. v. Employment Security Department,* 103 N.M. 780 (1986). See also, *In re Kaminski,* UCBR T93-00070-0000 (Ohio 1994).

To satisfy the third prong, it must be established that the individual has an enterprise created and existing separate and apart from the relationship with the particular employer, an enterprise that will survive termination of the current relationship. *Clayton v. State of Alaska,* 598 P.2d 84, 86 (Alaska 1979). See also, *Stepherson v. Director, Employment Security Department,* 49 Ark.App. 52 (1995); *Homes Consultant Co., Inc., v. Agsalud,* 2 Haw.App. 421 (1981). What's more is that the trade, occupation, profession or business must be "customarily" engaged in, that it must be "independently established" and that it must be "of the same nature as that involved in the contract of service." *In re Century,* at 518; *VEC v. Thomas Regional Directory, Inc.,* 13 Va.App. 610 (1992). An employees business needs to be capable of operation without hindrance from any other individual. *Murphy v. Daumit,* 387 Ill. 406, 417 (1944) Missouri courts have concluded that where workers were not capable of providing their services without dependence on another

entity, they could not be considered to have met the statutory requirements. *Sample & Sell, Inc. v. Labor and Industrial Relations Comm'n,* 764 S.W.2d 109, 112 (MO.App. 1988).

Finally, language in a contract that characterizes an individual as an independent contractor is not controlling in determining whether a claimant is an employee covered by the Employment Security Act. *Locke v. Longacre,* 772 P.2d 685 (Colo.App. 1989). The court must look to the actual circumstances of employment to discover whether relationship falls within ambit of statutory exclusion of relationship from definition of "employment" for unemployment tax purposes. *State, Department of Labor v. Med. Placement Services, Inc.,* 457 A.2d 382 (Del.Super. 1982). The primary concern is what is done under the contract and whether each prong of the test has been met, not what the contract says. *Id.* at 686. Intention of the parties is irrelevant if the substance of the relationship between the parties creates an employer-employee relationship. *Burchesky v. Department of Employment and Training,* 154 Vt. 355 (1989).

How one becomes labeled an employee or an independent contractor depends upon how the administrative law judge or the judiciary interprets the facts of the case concurrently with the prongs of the ABC test. The three prongs under the ABC test are the same for all states. It is evident from the statutory requirement, of a showing "to the satisfaction of the department," that the Department of Labor is vested with broad discretion in deciding whether an "employment" relationship exists. *Id.* at 86. Therefore, Alaska courts can only reverse the commissioner's decision if the commissioner abused his discretion. *Id.* Whereas, Hawaii courts may reverse or modify the decision if the substantial rights of the petitioners have been prejudiced as a result of the administrative proceedings. *Homes Consultant* at 424. In Louisiana, the reviewing court must accept the findings of the agency because the evidence produced is open to various constructions. *Thomasee v. Administrator, Div. of Emp. Sec., Dept. of Labor,* 204 So.2d 416 (La. 1967). The different standards of review by each state's judiciary and the subjectiveness of the three prongs sets the stage for the variance among states.

Misclassification is common in the ABC states. Misclassification in happening in such industries as home healthcare, computer technology, service (maid, childcare), construction, consulting and trucking. Misclassification is most prevalent in home healthcare.

1.2 IRS TEST

The determination of independent contractor or employee status shall be the same as those factors used by the Internal Revenue Service in its codes and regulations. *Rhode Island, Labor and Labor Relations, Employment Security,* Section 28-42-7. See also, *Wyoming Labor and Employment Unemployment Compensation,* Section 27-3-104. The twenty factors are as follows: (1) instruction, (2) training, (3) integration, (4) personal, (5) assistants, (6) continuity, (7) hours of work, (8) time required, (9) work location, (10) sequence of work, (11) reports, (12) payment, (13) expenses, (14) tools and materials, (15) facility investment, (16) profit or loss, (17) simultaneous work, (18) general public, (19) discharge and (20) termination. *Mount Pleasant Cab Co. v. Rhode Island Unemployment Comp. Bd.,* 76 R.I. 408 (1950).

An individual is an employee when the individual is: (a) required to comply with the employer's instruction as to how to do the job; (b) required to be trained by employer on how to do the job; (c) required to perform services personally; (d) required to perform work within set hours by employer; (e) restricted from working for others because he/she needs to devote full time to employer's business; (f) required to follow order or sequence of work set by employer; (g) required to make regular or periodic, either oral or written, reports to the employer; (h) generally paid by time (hour, week, month); (i) generally reimbursed for business related expenses, implying right of regulation and direction by employer; (j) provided tools and materials needed for the job; and (k) is fired by employer at will and thereby the employer controls the nature and pace of work through threat of firing. Bleir, Brenton A., *An independent contractor or an employee: that is the question*, (1990). Likewise, an individual is an employee when the individual's: (a) services are fully integrated into employer's business, which is significantly dependent

upon them; (b) assistants are hired, supervised and paid by the employer; (c) economic relationship continues at recurring but irregular intervals; (d) work is performed on employer's premises; and (e) investment in facilities is not required to accomplish the work. *Id.* Finally, an individual is an employee when the individual cannot realize a profit or loss on his services, performs work under a single financial arrangement and can quit at any time without liability. *Id.*

An individual is an independent contractor when the individual: (a) follows own instructions; (b) does not require training; (c) is not required to perform services personally; (d) generally hires own assistants, required only to attain a particular result; (e) has no assumption of continuing the relationship; (f) is free to establish own hours of work; (g) may work at any time; (h) is free to accomplish work in any sequence; (i) is not necessarily required to submit regular reports; (j) is generally paid by result; (k) generally covers own expenses; and (l) has own investment facilities. *Id.* Similarly, an individual is an independent contractor when the individual's: (a) services are not integrated into the employer's business; (b) work may be performed anywhere, often at worker's office or location; and (c) services are available to the general public on a regular basis. *Id.* Finally, an individual is an independent contractor when the individual has an exposure to economic gain or loss on accomplishment of work, performs work simultaneously for multiple, unrelated persons or entities, cannot be discharged so long as result is satisfactory and can terminate only with risk of breach of contract liability. *Id.*

Each case involving the question, whether or not relationship is that of independent contractor or employee must be decided upon its own facts. *Unemployment Commission v. Mathews*, 56 Wyo. 479 (1941). Because each question is decided on its facts, uniformity between the states can not be accomplished. Without this uniformity, classification varies greatly.

1.3 OTHER TESTS

Idaho, Oregon, Utah and South Dakota use a two-part test, which takes prong one and prong three from the ABC test. Hence, services performed by an individual for remuneration shall, for the purposes of the employment security law, be covered employment, unless it is shown that: (1) the worker has been and will continue to be free from control or direction in the performance of his work, both under contract of service and in fact; and (2) the worker is engaged in an independently established trade, occupation, profession, or business. *Oregon Unemployment Insurance Act*, Title 51, Section 657.040 and Section 670.600 (1998). "Employment" is not confined to common-law concepts, or to the relationship of master and servant, but is expanded to embrace all services rendered for another for wages. *Singer Sewing Mach. Co. v. Industrial Commission,* 104 Utah 175 (1943).

The requirement that the individual be free from control can be met by establishing that the individual: (a) is not an agent of the company (no employer name tags), (b) can work extra hours or change hours without clearing it with the company, (c) can control the means and direction of his day, and (d) could work for any of the employers clients following termination of arrangement with employer. *In re Hendrickson's Health Care Serv.*, 462 N.W.2d 655 (S.D. 1990). See also, *Unemployment Compensation Fund. Black Bull, Inc. v. Industrial Commission*, 547 P.2d 1334 (Utah 1976); *J.R. Simplot Co. v. State,* 110 Idaho 762 (1986). The requirement that the employee's occupation be independently established and that he customarily engaged in it, calls for an enterprise created and existing separate and apart from the relationship with the particular employer. *Id.* at 657. It also calls for an enterprise that will survive the termination of that relationship and that the individual must have proprietary interest in the enterprise to the extent that the individual can operate the enterprise without any hindrance from any other individual. *Id.*

In determining whether an individual is an employee or an independent contractor, each case must be determined based on its own facts and all the features of the relationship are

to be considered. *Egemo v. Flores*, 470 N.W.2d 817 (S.D. 1991). Due to this, variation in classification is inherent because each state's judiciary places value on different parts of the test. Occupations that are being misclassified are exotic dancers, dry wall laborers, barbers and home healthcare professionals.

In North Carolina, the Supreme Court set forth the primary criteria to be considered in determining whether an individual is an employee or an independent contractor. *Hayes v. Elon College*, 224 N.C. 11 (1944). While the court held that no one particular criteria must be present, the court held an independent contractor: (a) is engaged in an independent business, calling, or occupation; (b) is to have the independent use of his special skill, knowledge or training in the execution of the work; (c) is doing a specified piece of work at a fixed price or for a lump sum or upon a quantitative basis; (d) is not subject to discharge because he adopts one method of doing work rather than other; (e) is not in the regular employ of the other contracting party; (f) is free to use such assistants as he may think proper; (g) has full control over such assistants; and (h) selects his own time. *State v. Paris*, 101 N.C. App. 469 (1991). Whereas, in Michigan, the criteria set forth by the Supreme Court was one of economic reality. *Industro-Motive Corp. v. Wilke*, 6 Mich. App. 708 (1967). The test looks at the tasks performed, whether or not it is part of a larger common task. *Id.* at 712. The test is far from the common-law test of control, since the act concerns itself with the correction of economic evils through remedies unknown at the common-law. *Id.* The ultimate question is whether or not the relationship is of the type to be protected. *Id.* at 713. This is a matter of fact, not of terminology.

Arizona defines "employee" as any individual who performs services for an employing unit and who is subject to the direction, rule or control of the employing unit as to both the method of performing or executing the services and the result effected or accomplished, except employee does not include: (a) an individual who performs services as an independent contractor, business person, agent or consultant, or in a capacity characteristic of an independent profession, trade, skill or occupation; (b) an individual subject to the direction, rule, control or subject to the right of direction, rule or

control of an employing unit solely because of a provision of law regulating the organization, trade or business of the employing unit. *Arizona Labor Employment Security Act*, Section 23-613.01. The Unemployment Compensation Law is remedial, addressed to public policy and ameliatory of evils resulting from lack of employment, therefore, it must be liberally construed to effectuate its purposes, and devices to defeat it must be stricken down. *Southwest Lumber Mills v. Employment Security Commission*, 66 Ariz. 1 (1947). On the other hand, Wisconsin follows five factors for determining independent contractor status. The five factors are: (1) integration or services performed relate directly to activities conducted by the company retaining those services; (b) employer advertises or holds out to the public existence of its independent business; (c) entrepreneurial risk or whether alleged employee assumed financial risk of business undertaking; (d) performance of services independent of alleged employer and then moves on; and (e) proprietary control, such as ability to sell or give away some part of the business enterprise. *Larson v. Labor and Industry Review Com'n*, 516 N.W.2d 456 (Wisconsin 1994). Weight and importance given the five factors used for analyzing whether employer/employee relationship exists varies according to the specific facts of each case.

The state of Washington subscribes to the three prongs of the ABC test but adds three additional prongs to be met. The additional prongs require that (1) on the effective date of the contract of service, such individual is responsible for filing a schedule of expenses with the IRS; and (2) such individual has established an account with the department of revenue; and (3) such individual is maintaining a separate set of books or records that reflect all items of income and expenses of the business which the individual is conducting. Based on the six prongs it is virtually impossible to be an independent contractor, therefore, misclassification is high. Industries misclassified include trucking and fishing. However, a majority of workers are misclassified in the service industry such as maids, barbers, beauticians, newspaper delivery persons, insurance or real estate agents and computer persons.

Exceptions to this variance are found in the comprehensive definitions used in Maryland, Nevada and Texas. In Maryland and Nevada, employment is covered employment if, regardless of whether employment is based on the common law relation of master and servant, the employment is performed for wages or under a contract of hire that is written or oral or expressed or implied; and the employment is performed in accordance with section 8-202 of this subtitle, which is the location of employment. *Maryland Labor and Employment*, Section 8-201 (1991). See also, *Nevada Unemployment Compensation Act*, Section 612.065. Whereas, in Texas "employment" means a service, including service in interstate commerce, performed by an individual for wages or under an express or implied contract of hire, unless it is shown to the satisfaction of the commission that the individual's performance of the service has been and will remain free from control or direction under the contract and in fact. *Johnston v. State*, 303 S.W.2d 520 (Texas 1957). Under the definitions outlined above, very little misclassification occurs.

ANALYSIS

Each state's legislature has specified certain services as "not employment." These services exempted are irrespective of which test is employed. Employment does not include the following services: (1) domestic service in a private home; (2) service performed by an individual in the employ of the individual's son, daughter or spouse, parent or legal guardian if under the age of twenty-one, mother or father; (3) newsboy's services in selling or distributing newspapers on the street or from house to house; (4) service performed in the employ of a foreign government; (5) service performed in the employ of an instrumentality wholly owned by a foreign government; (6) service performed by an insurance agent; (7) service performed by a real-estate agent; (8) service performed by an officer or member of the crew of an American Vessel; (8) service performed on or in connection with a vessel not an American Vessel; (9) service performed in the employ of the United States government or instrumentality of the United States exempt under the Constitution of the United States from contributions imposed by this chapter; (10) service performed in the employ of another state or political subdivision of another state, or an instrumentality of another state exempt under the Constitution of the United States from the tax imposed; (11) service performed in the employ of an international organization; (12) service covered by an election approved by the agency charged with the administration of any other state or federal employment security law; (13) service performed by an individual in agricultural labor; (14) service performed by nurses, technicians, and other employees of hospitals; (15) service performed by an individual on a boat engaged in catching fish or other forms of aquatic life under the arrangement of owner or operator of that boat; (16) service performed as a prospective or impaneled juror in a court; (17) service performed by an individual who drives a taxicab; (18) service of an individual who directly sells or solicits the sale of consumer products and is compensated solely by commission; (19) service performed by a duly ordained, commissioned or licensed minister; (20) service performed in a facility conducted for the purpose of carrying out a program of rehabilitation for individuals whose earning capacity is impaired by age or physical or mental deficiency; (21) service performed as part of an unemployment work-relief or work-training program; (22)

service performed for a state hospital by an inmate of a prison or correctional institution; (23) service performed in the employ of a school, college or university if the service is performed by a student who is enrolled and regularly attending classes at the school, college, or university; (24) by an individual under the age of 22 who is enrolled at a nonprofit or public educational institution that normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance; (25) service performed in the employ of a hospital if the service is performed by a patient of the hospital; (26) service performed in the employ of the state or a political subdivision of the state if the service is performed by an individual in the exercise of duties; (27) service performed as a judicial officer, the governor, lieutenant governor, a person hired or appointed as the head or deputy head of a department in the executive branch, a chair or member of a state commission or board, state investment officers, etc; (28) service performed as a member of the National Guard or Air National Guard or Naval Militia; (29) service performed as an employee serving on a temporary basis in case of fire, storm, snow, earthquake, flood or similar emergency; (30) service performed as an election official or election worker if amount of wages is below $1,000.00 for the calendar year; and (31) services performed in the employ of a church or an organization that is operated primarily for religious purposes. This list is not exhaustive. Some of the state's lists are more extensive, including various other services to be exempted, while other state's lists are less extensive.

Not all states exempt the same services, however, the majority of states do. The only difference among the states is the set of exceptions needed to be met in order to attain "exempt" status for unemployment compensation purposes. For example, in Alaska service performed for a corporation by an employee of a corporation is not employment for unemployment tax purposes IF the corporation is incorporated under AS 10.06; the corporation is not a government corporation; and the employee is an executive officer of the corporation. Whereas, in Arizona service performed by any officer of a corporation is employment. New York exempts from employment any individual, regardless of age, who is enrolled at a nonprofit or public educational institution, whereas Alaska requires them to be under the age of twenty-two. *New York Labor Law*, Section 511, 1998. New

York also exempts golf caddies but does not exclude summer employment for students. *Re Schulman*, 31 NYS2d 205 (1941).

The breadth of variance across states is not dependent on the state's definition of employee versus independent contractor, but is dependent on the state's judicial interpretation and the state's economic viability. The states, which incorporate the common-law test for unemployment compensation purposes, use the same criterion as their neighboring common-law state. This also applies with the states that use the ABC test.

Nonetheless, even though the states follow the same guidelines, depending on which test is employed, each result is different because of the subjectiveness of the state's judges. States that utilize the ABC test are more rigid in their interpretation. This interpretation leads to misclassification because the judiciary rarely finds an independent contractor relationship. The courts, more times than not, find an employer/employee relationship, while common law states are less rigid in their interpretation. This leads to less misclassification and more independent contractor relationships.

In the 1940's almost every state used the common-law test for unemployment insurance purposes. At common law it was more feasible that a person classified as an independent contractor would remain an independent contractor. Exceptions to this rule came with changes in the state's economic stability or when certain industries were declared "covered employment" and written in the statutes that way. Still, several types of employment have always remained outside the realm of "covered employment". The types of work not designated as employment for UI purposes include domestic services for home, school or church, ministry services, political jobs at the federal, state and local level, crews of American or non-American vessels, workers for foreign governments or entities, etc.

It is important to note that a common-law state judiciary is more concerned with the issue of control over how the work is done when determining whether an employee/employer

or independent contractor relationship exists. Whereas, ABC State judiciaries are concerned with each prong of the test.

After the 1950's several states began passing the statutory test, commonly known as the ABC test. The rationale for the statutory test was based on the premise that the ABC test allowed the courts to construe the employer/employee relationship more liberally than what was allowed or able under the common-law master/servant relationship. In layman terms it meant that the courts using the ABC test were more likely to find an employer/employee relationship, than an independent contractor relationship. The statute required that all three prongs of the test be met in order for the employer to exempt himself/herself from taxes. If even one prong was not met, the misclassified independent contractor became an employee and the employer owed back taxes.

There is not much evidence on what motivates an employer to misclassify his/her employee as an independent contractor. One motivation known is that an employer can save money by reclassifying employees as independent contractors. Reclassification saves on benefit packages and tax payouts.

Misclassification is happening in such industries as home healthcare, computer technology, service, trucking and various other industries. However, it is more prominent in the home-healthcare and service (maid) industries. Misclassification is infrequent in the newspaper delivery, fishing, beauty (barbers and beauticians), real estate, insurance and retail sales industries, although this is not the case in the State of Washington. Traditional jobs that were once held to be independent contractor jobs are now being classified as employment jobs for unemployment insurance purposes. More and more industries are being required to pay back taxes for unemployment insurance because of the employer's failure to meet the second or third prong of the ABC test. The independent contractor contracts to produce a given result by methods under his own control, while the employee contracts to produce a given result subject to the lawful orders and control of the employer in the means and methods used. *Whitlock Mtg. Co. v. Egan*, 19 Conn.Sup. 71 (1954). Washington's judiciary utilizes a more liberal/inclusive

interpretation of the state statute. Alabama finds less incidence of misclassification because of its common law definition.

APPENDIX B: LITERATURE REVIEW

INTRODUCTION

Given its long and tortured history, a certain level of humility is best required for anyone attempting to answer the question as to who is an employee and who is an independent contractor. It is not a recent question or even one that first arose in the 20th century. Marc Linder in his book, *The Employment Relationship in Anglo American Law: A Historical Perspective* traces its origins to fourteenth and fifteenth century England. He then presents "the transformation that the judicial distinction between employees and independent contractors has undergone in its accommodation to radically different socioeconomic and political contexts over the past six centuries…and that the currently prevailing versions are neither new nor self-explanatory."[1] In this light it is very interesting to hear representatives from Working Today, an organization which provides support services for independent contractors, make the following comment regarding existing labor protection laws:

> "…it may have made sense to draw distinctions between employees and independent contractors in the manufacturing age, but with the shift toward more flexible arrangements, independent contractors often resemble workers in the tasks they perform and in their relationships to employers. This means that nearly one-third of the US workforce is actually working under the labor conditions of the 1890's." [2]

All this suggests that the line between employee and independent contractor constantly shifts over time and can never be answered once and for all.

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[1] Linder, Marc. "The Employment Relationship in Anglo American Law: A Historical Perspective (Contributions in Legal Studies, No 54)", Greenwood Publishing Group, 1989.

[2] Horowitz, Sara. "Working Today – Making Flexibility Fair," 1998.

ALTERNATE WORK ARRANGEMENTS - ESTABLISH A COMMON FRAMEWORK FOR ANALYSIS

Most researchers and analysts have not focused exclusively on independent contractors. Instead they have studied independent contractors among all the other newly emerging work arrangements that do not fit the traditional employer/employee model. The findings derived from these broader studies inevitably create a context that affects how the analyst will interpret the independent contractor phenomenon. This context is in large part a byproduct of the system used by researchers to classify these alternatives, including the number and variety of such arrangements that they believe exist. In sorting through these varying interpretations, it is important to recognize how these classification systems differ from each other. Doing so, can help establish a common framework that will aid subsequent discussions among all those interested in independent contractors and the other work alternatives. To facilitate this purpose please refer to the glossary defining these alternatives appearing in the appendix.

All the researchers start with the classification system used by the Bureau of Labor Statistics (BLS) for the Current Population Survey Supplement of Alternative and Contingent Work Arrangements, but then modify it as it reflects their analytical bias. The BLS recognizes four "alternative work arrangements."[3] In contrast, the Economic Policy Institute (EPI) identifies seven alternatives that they describe as "nonstandard work arrangements."[4] A similar report from the AFL-CIO includes a taxonomy of eight non-standard work arrangements, not all of which are identical to the EPI report. In turn, the Urban Institute, in a 1998 report to USDOL, defines four broad categories for classifying a variety of "nonstandard employment relationships."[5]

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[3] Cohany, Sharon R. "Workers In Alternative Employment Arrangements," *Monthly Labor Review,* October 1996.

[4] Kalleberg, Arne, and Rasell, Edith, etal., "Nonstandard Work, Substandard Jobs – Flexible Work Arrangements in the U.S"., Economic Policy Institute, 1997.

[5] Vroman, Wayne. "Labor Market Changes and Unemployment Insurance Benefit Availability," Unemployment Insurance Occasional Paper 98-3. Washington DC: U.S. Department of Labor, Employment and Training Administration, 1998.

Although these analysts are all describing the emergence of exceptions to the typical employer/employee relationship, they have varying definitions for what is typical. As a result they have different conceptions for what they believe should be considered exceptions to the norm.

According to the BLS, in the typical work arrangement most workers are employees of the same organization for which they carry out their assignments, and have an established schedule for reporting to work. The exceptions to this are "*defined either as individuals whose employment is arranged through an employment intermediary such as a temporary help firm, or individuals whose place, time, and quantity of work are potentially unpredictable.*"[6] The latter portion of that definition applies both to independent contractors and on-call workers, while the role of an employment intermediary is the crucial element in defining the other two alternatives.

Table 1

BUREAU OF LABOR STATISTICS

Alternative Work Arrangements (AWA)	No. employed	% of total employed
Independent Contractors	8.5 M	6.7%
On-call workers	2.0 M	1.6%
Temporary help agency workers	1.3 M	1.0%
Contract workers	0.8 M	0.6%
Total AWA	**12.6 M**	**9.9%**
Total Workforce	126.7 M	100%

Source: Based on data from Sharon R. Cohany, *Workers in alternative work arrangements: a second look*, The Monthly Labor Review, Nov. 1998 (Bureau of Labor Statistics); an analysis based on the 1997 Current Population Survey Supplement.

As a consequence these "alternative work arrangements" do not include part-time workers, only those part-timers hired through an intermediary or independent contractors

[6] Polivka, Anne E. "Into Contingent and Alternative Employment: By Choice," *Monthly Labor Review*, October 1996.

that work less than 35 hours a week. In this classification scheme, a part-time employee hired directly by an employer and working a regular schedule is not viewed as an alternative to the typical work arrangement.[7] In addition, this definition excludes the self-employed (such as restaurant and shop owners), the nature of whose work is considered more predictable than that of independent contractors. This classification system enables the BLS to maintain discrete work categories which facilitates analysis of these exceptions to the norm.

For similar reasons, the CPS classifies "contingent" workers, i.e. those with temporary jobs, separately from workers in alternative work arrangements. According to the BLS, *"contingent work is <u>any job</u> in which an individual does not have an explicit or implicit contract for long-term employment."*[8] In effect, a temporary job does not automatically qualify as an exception to what the BLS defines as a typical work arrangement. While some workers with temporary jobs are in alternative arrangements (as defined by the BLS), most "contingent workers had regularly scheduled jobs for which they were hired directly and thus were not in an alternative arrangement."[9] In this scheme, contingent work is viewed simply as another job dimension that will affect a subset of individuals in alternative work arrangements as well as many that are in traditional work arrangements.

In contrast to the BLS, the EPI begins its analysis with a broader conception of what it considers to be the typical work arrangement. Unlike the BLS, it also highlights the existence of two groups of independent contractors – among the self-employed and wage-and-salary workers. (See below – independent contractor and self-employment).

In the view of the EPI, "the typical career paradigm was characterized by lifetime employment with a single employer, steady advances up the job ladder, and a pension upon retirement."[10] All exceptions to this picture of regular, full-time employment

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[7] Cohany, Sharon R. "Workers In Alternative Employment Arrangements: A Second Look," *Monthly Labor Review*, November 1998.
[8] Polivka, Anne E. "Contingent and alternative work arrangements, defined," *Monthly Labor Review*, October 1996.
[9] *Ibid.*

Table 2

ECONOMIC POLICY INSTITUTE

Nonstandard Work Arrangements (NSWA)	No. employed	% of total employed
Regular part-time workers	16.0 M	13.7%
Self-employed	6.4 M	5.5%
Independent contractors/self-employed	6.6 M	5.6%
Independent contractors/wage-and-salary	1.0 M	0.9%
On-call workers/day laborers	1.9 M	1.6%
Temporary help agency workers	1.1 M	1.0%
Contract workers	1.4 M	1.2%
Total NSWA	**34.4 M**	**29.4%**
Total Workforce	117.04 M	100.0%

Source: Based on data from Arne L. Kallenberg, Edith Rasell, etal; *Nonstandard Work, Substandard Jobs* (The Economic Policy Institute, Women's Research & Education Institute, 1997); an analysis based on data from 1995 Current Population Study Supplement.

are termed "nonstandard work arrangements, and differ from "standard" jobs in at least one of the three following ways.

- *The absence of an employer (as in self-employment and independent contracting)*
- *A distinction between the organization that employs the worker and the one for whom the person works (as in contract and temp work), or*
- *The temporal instability of the job (as "characteristic of temporary, day labor, on-call, and some forms of contract work"*[11]

Like the BLS, the EPI classification system includes the role of an intermediary as one of its criteria for defining exceptions to the norm. But the absence of an employer, rather than the unpredictable nature of their work, is the critical factor for defining independent contractors as a nonstandard work arrangement. As a consequence of using this factor,

[10] Kalleberg, Arne, and Rasell, Edith, etal., "Nonstandard Work, Substandard Jobs – Flexible Work Arrangements in the U.S"., Economic Policy Institute, 1997.
[11] *Ibid.*

all individuals who do not have an employer, meaning the self-employed, are defined as having nonstandard work arrangements. Also, in sharp contrast to the BLS classification scheme, the EPI uses contingent/temporary work as important criteria for identifying exceptions to standard work arrangements.

Although part-time work is listed as a major exception to the typical work arrangement, it is not explicitly defined as such by the three criteria listed above. Perhaps for this reason, the AFL-CIO accepts these three criteria but adds a fourth – "the worker is guaranteed less than full-time employment (but may or may not work full-time hours)."[12] By doing so it explicitly includes part-time work as one criteria for defining nonstandard work arrangements. The AFL-CIO also follows the example of the EPI and not the BLS in recognizing both groups of independent contractors. Unlike the EPI, however, the AFL-CIO has not included self- employment, except for that of independent contractors, as a nonstandard work arrangement.

The inclusion of part-time and contingent work complicates the EPI and AFL-CIO classification systems, since these are no longer fully discrete categories. But these analysts believe it is necessary to accept this complication to more accurately represent their concerns about the changing nature of the workforce.

[12] Jorgensen, Helene. "Nonstandard Work Arrangements: Downscaling of Jobs," Department of Public Policy, AFL-CIO, 1998.

Table 3

AFL-CIO

Nonstandard Work Arrangements (NSWA)	No. employed	% of total employed
Part-time work (regular only)	20.3 M	16.6%
Work paid by a temporary help agency	1.2 M	1.0%
On-call work	1.3 M	1.1%
Day laborer work	0.1 M	0.1%
Work paid by a contract company	1.7 M	1.3 %
Work paid by a leasing company	0. 5 M	0.4%
Independent contracting: wage and salary	1.1 M	0.9 %
Independent contracting: self employed	7.0 M	5.7%
Total NSWA	**33.1 M**	**27.1%**
Total Workforce	122.1 M	100.0%

Source: Based on data from Helene Jorgensen, *Nonstandard Work Arrangements: Downscaling of Jobs* (Department of Public Policy, AFL-CIO, March 1998); an analysis based on 1995 Current Population Survey Supplement.

Like the EPI and AFL-CIO studies, the Urban Institute report also integrates the alternative and contingent classification systems that were kept separate in the BLS studies. This results in what he refers to as the "four dimensions of employment:"[13]

- work for fewer hours than the normal weekly schedule,
- temporary work of finite duration,
- use of outside workers where the employer directing the content of the work (the client employer) is not the employer who hires and pays these workers, and
- self-employment

[13] Vroman, Wayne. "Labor Market Changes and Unemployment Insurance Benefit Availability," Unemployment Insurance Occasional Paper 98-3. Washington DC: U.S. Department of Labor, Employment and Training Administration, 1998.

Table 4

URBAN INSTITUTE

Nonstandard Employment Relationships (NER)*		% of total employed
Part-time worker	23.2 M, 29.9 M	19%, 24.7%
Temporary worker	7.7 M, 13.2 M	6.4%, 10.9%
Outside worker	1.9 M , 2.3 M	1.5%, 2.0%
Self employed (unincorporated)	10.5 M	8.7%
Total Workforce	**(est.) 122 M**	**100%**

*Note: per author of Urban Institute study "…the four dimensions of nonstandard employment are not mutually exclusive," therefore these employment figures are not additive and so author did not provide a total NER amount. Also, author provided multiple employment estimates based on different assumptions/criteria

Source: Based on data from Wayne Vroman, *Labor Market Changes & Unemployment Insurance Benefit Availability* (The Urban Institute, Jan. 1998); part-time employment and self-employment come from standard Current Population Survey, temporary worker and outside worker derived from 1995 Current Population Survey Supplement.

These four groups are not equivalent to the categories defined by the BLS, but serve more to describe the essential nature of the varied work arrangements that fall into these categories. For instance, the temporary worker category includes not just temporary help agency employees, but also temporary direct hires and on-call workers. As a result these are also not discrete groupings. As an example, a temporary help agency employee is both a temporary worker and an outside worker, and could also be a part-time worker.

It is important to note that in the Urban Institute classification system the self-employed category includes both independent contractors as well as the unincorporated self-employed. In contrast, in the EPI system, independent contractors are a separate category, and the category for self-employed appears to include both the unincorporated and incorporated self-employed.

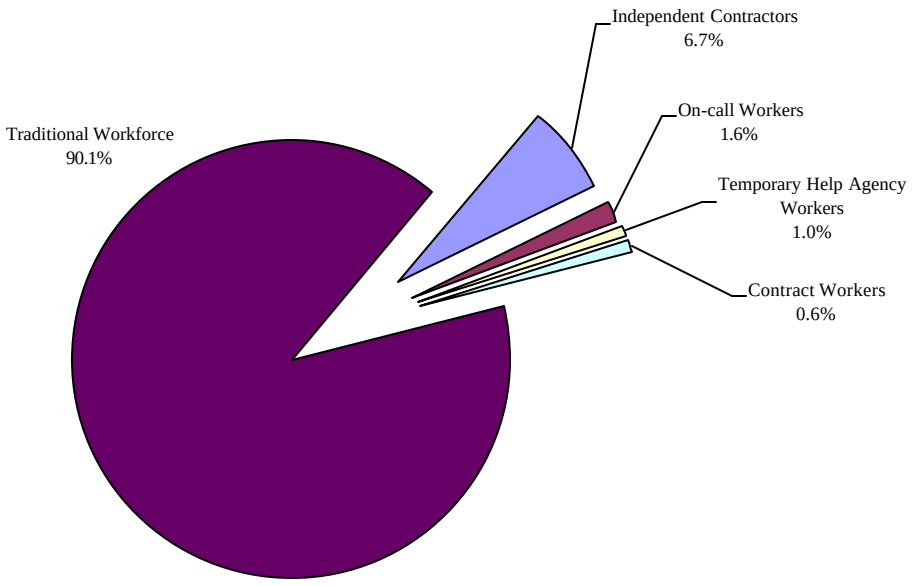
IMPLICATIONS OF THESE DIFFERENCES:

These different classification systems affect the understanding of the independent contractor phenomenon to the extent that it is inevitably linked to the analysis and

interpretation of these other emerging work arrangements. All of these studies acknowledge and explicitly state that based on the CPS data, independent contractors appear to be a group largely distinct from the other alternative or nonstandard work arrangements. However, their analysis of the overall phenomenon of emerging alternatives to the typical work arrangement biases their interpretation of the independent contractor phenomenon. For instance the inclusion of part-time workers, as well as the self-employed, greatly increases the measured size of the nonstandard workforce from 12 to over 29 percent of the total workforce.

The effect of this can be seen in the two charts on the following two pages. Chart 1 represents the workforce as it is conceived by the Bureau of Labor Statistics, including the percentage of the overall work force represented by each work arrangement.

Chart 1

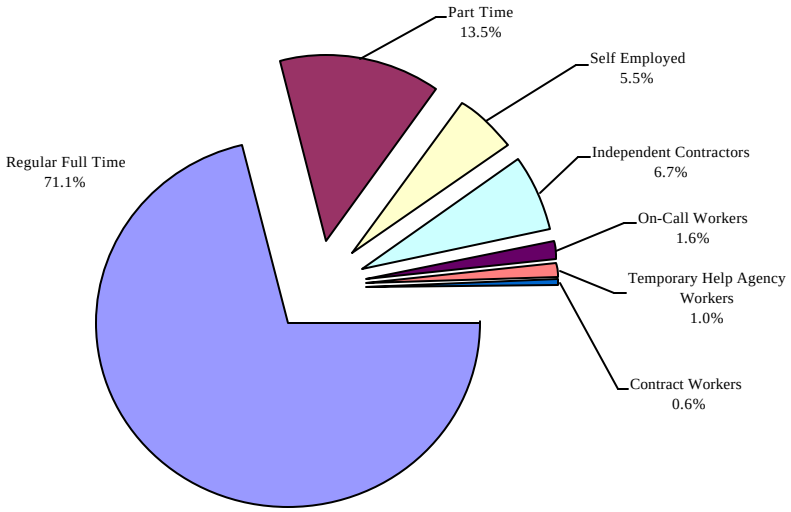


Source: Based on data from Sharon R. Cohany, "Workers in alternative employment arrangements," *The Monthly Labor Review*, October 1996, p36.

Chart 2 combines the BLS and EPI classification systems, while retaining the data reported by the BLS in the 1995 CPS supplement. This second chart demonstrates how

differing conceptions of what is an exception to the norm affects the subsequent analysis and interpretation of what is being studied:

Chart 2



Source: Planmatics analysis based on data from 1995 Current Population Survey Supplement integrating Bureau of Labor Statistics and Economic Policy Institute classification systems

- the BLS classification system, represented by Chart 1 highlights, the Alternative Work Arrangements (AWA), constituting over 12 million workers (or 10% of the workforce). All other work arrangements, representing almost 90% of the workforce,
- are defined as traditional work arrangements within the BLS classification system.

- Chart 2 visually shows how adding part-time and self-employed workers to the BLS classification system dramatically increases the size of the nonstandard workforce as a percentage of the overall workforce. Although Independent Contractors as a percentage of the workforce is the same in both charts, here this work category is part of the larger Nonstandard Work Arrangements (NSWA) representing a total of 35 million workers, or 29% of the workforce. Within the EPI classification system, all standard work arrangements (primarily regular full-time workers) represent only 71% of the workforce.

Not surprisingly, when reporting the size of the alternate work force, the larger 29% figure has a tendency to appear more frequently in the general press when articles about independent contractors and other alternative work arrangements are featured. This linkage may contribute to the general perception that the number of independent contractors is larger than what is supported by the CPS data. Also, because the wage and benefits of part-time workers are significantly less than those of regular full-time workers, it greatly increases the proportion of the alternative/nonstandard jobs that can be characterized as being substandard. In addition, in these studies, the analysis of the other alternatives; temporary help agency workers, on-call workers, contract workers, etc.; will also affect the general perception of independent contractors. This is especially true when considering the varying motives of employers and workers who enter into these arrangements, and play a major role in whether these emerging phenomenon are viewed in a positive or negative light. All of this points to the need to study independent contractors as a phenomenon distinct from other alternative work arrangements.

OTHER DIFFERENCES

Although the BLS has published a CPS supplement in both 1995 and 1997, all of these alternative analyses draw their primary data from the 1st survey. This does not pose a problem since there are no significant differences in findings between these two years, and so this section will focus on data from the 1995 survey. Although these studies draw upon the same source, there are interesting differences, such as the following:

The total number of independent contractors reported by EPI (7,649,121) is nearly 9% less than the number reported in the official 1995 CPS report (8,309,000). At the same time the EPI in its analysis of the CPS data has more than doubled the number of contract workers from 652,000 to 1,858,030. Apparently, the EPI has interpreted some responses to the survey differently from the BLS, classifying some individuals as contract workers that the BLS considers to be independent contractors. According to the EPI, "we classified as 'contract workers' all persons who did contract work regardless of whether

they work at the employer's work site, the work site of a single contractee, or the work site of more than one contractee. This conception of contract work differs from that used by the BLS which does not classify as contract workers persons that did not work at the contractee's work site." (Kallenberg, Rasell, 1997).

Finally, in its analysis of CPS data, for the total workforce, the EPI uses the smaller figure of 117,040,764 compared to the 123,202,000 reported by the BLS.

INDEPENDENT CONTRACTORS AND SELF-EMPLOYMENT

The BLS states that "independent contractors are not employees in the traditional sense but rather:

- work for themselves (or their own company).
- bear the responsibility for obtaining clients,
- see that work assignments are executed, and otherwise
- run the business."[14]

As it turns out, these same criteria could also apply to other self-employed individuals such as shop or restaurant owners. Over a 50-year period the BLS has been collecting data on the self-employed. During this period it has tracked the decline in self-employed as a percentage of the workforce from 17.6% in 1948 to 8.3% in 1996.[15] The 1995 CPS supplement was the first time the BLS attempted to determine what portion of the self-employed viewed themselves as independent contractors. In both 1995 and again in 1997, about half of the self-employed – incorporated and unincorporated combined – identified themselves as independent contractors. In effect, the total number of self-employed is approximately 14 million, of which 7.5 million consider themselves to be independent contractors.

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[14] Cohany, Sharon R. "Workers In Alternative Employment Arrangements," *Monthly Labor Review*, October 1996.

[15] Bregger, John E. "Measuring Self-Employment in the United States," *Monthly Labor Review*, January/February 1996.

Many individuals classified as wage-and-salary workers in the basic CPS survey, also identified themselves as independent contractors in the 1995 and 1997 CPS supplements. For example, only 85% of the 8.3 million independent contractors identified in the 1995 CPS supplement are classified as self-employed. The remaining 15%, or 1.2 million, are classified as wage-and-salary workers.

These "independent contractor/wage-and-salary workers" appear to constitute a significant anomaly bearing further investigation. The BLS does recognize that "it may be tempting to classify …(them)….as workers who otherwise would have been employees of the company for which they were working or individuals who were 'converted' to independent contractors to avoid legal requirements."[16] But the BLS further states that "the basic CPS questionnaire does not permit this distinction…as two individuals who are in exactly the same arrangement may answer the question…differently, depending on their interpretation of the words 'employed' and 'self-employed.'" In effect, individuals classify themselves as they perceive their employment situation, which may or may not be equivalent to how an objective third-party, provided with the same information, might classify them instead.

To complicate matters even further, the BLS classifies as a wage-and-salary worker any self-employed individual who incorporates their business. In effect, they have become an employee of their own firm. As a result, only the unincorporated are classified as self-employed. As Bregger (1996) points, "it is conceivable that many of these owners of incorporated businesses are well aware that they are employed by their own firms."[17] So in response to the question in the main CPS - "Were you employed by government, by a private company, a non-profit organization, or were you self-employed?" – it would be correct for them to state that they are an employee of a private company. But in response to the following question in the CPS supplement – "Last week, were you were working as an independent contractor, an independent consultant, or a freelance worker? That is,

[16] *Ibid.*
[17] *Ibid.*

someone who obtains customers on their own to provide a product or service." – it would also be correct for them to reply that they were working as an independent contractor. This scenario offers another possible explanation for the independent contractor/wage-and-salary anomaly and warrants further study.

Unlike the BLS which has adopted a fairly neutral position on this question, other analysts highlight the fact that there appears to be two different categories of independent contractors. In its report the EPI states that, "…we distinguish these two groups of independent contractors since they appear to differ on a variety of outcomes."[18] Further, as the AFL-CIO reports, over 40% of the independent contractors/wage and salary have college degrees compared to 32% of the independent contractors/self-employed.[19]

[18] Kalleberg, Arne, and Rasell, Edith, etal., "Nonstandard Work, Substandard Jobs – Flexible Work Arrangements in the U.S"., Economic Policy Institute, 1997.

[19] Jorgensen, Helene. "Nonstandard Work Arrangements: Downscaling of Jobs," Department of Public Policy, AFL-CIO, 1998.

INDEPENDENT CONTRACTORS - WHO ARE THEY? WHERE ARE THEY? WHAT ARE THEY DOING?

As shown in the Bureau of Labor Statistics table on page three, compared to the other three alternative work arrangements independent contractors are by far the largest in number. However, because it has only been studied in the context of these other alternatives and nonstandard work arrangements, what is known is clouded by these other arrangements.

All of the commentators tend to agree that the CPS data shows independent contractors as being distinct from workers in other alternate arrangements. The characteristics of independent contractors also vary from workers in traditional arrangements. While the information presented here draws on multiple sources, most of it is based on the BLS CPS Supplement data. Even the most recent articles appearing in the press still refer to data from the 1997 CPS supplement.[20]

The distinct demographic characteristics of the independent contractor population are apparent from a variety of dimensions. Compared with workers in more traditional work arrangements, what emerges when these aspects are combined, is an overall picture of the typical independent contractor as a married, older white male, with a college education.[21] These demographic distinctions are also clear when viewed in terms of each dimension.

In terms of gender, for instance, two out of three independent contractors are male (or more specifically nearly 67% are male and a little over 33% female). In contrast, among workers in traditional work arrangements, there is a more even balance between genders with nearly 53% male and 47% female. However, an even greater difference emerges when independent contractors are compared to temporary help agency workers where females (55%) outnumber males (45%).[22]

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[20] Lewis, Diane E. "New Labor Battle Front: Job Classifications," *The Boston Globe*, December 20, 1998.
[21] Cohany, Sharon R. "Workers In Alternative Employment Arrangements," *Monthly Labor Review*, October 1996.
[22] Cohany, Sharon R. "Workers In Alternative Employment Arrangements: A Second Look," *Monthly Labor Review*, November 1998.

There is also an interesting variation in the gender profile of two groups within the independent contractor population. In its analysis of the 1995 CPS data, the AFL-CIO shows a significant gender difference between independent contractor/wage and salary workers and independent contractors/self-employed. In fact, the gender distribution of IC/wage-and-salary workers, where 52% are male, is more like that of workers in traditional work arrangements than it is to IC/self-employed workers, where 69% are male.[23]

Independent contractors also tend to be older than the working population at large. Over 71% of all independent contractors are in their prime earning years between the age of 35 and 64 years. In contrast, only 57% of workers in traditional arrangements and 44% of workers from temporary help agencies fall into this age range. In addition, 7% of independent contractors are 65 years or older, compared with only 2.5% of workers with traditional arrangements.[24]

The racial breakdown of independent contractors also varies from that of workers in other arrangements. Over 90% of independent contractors are white, while only 85% of those in traditional arrangements and 75% of temporary help agency workers are also white. Only 5% of independent contractors are black, but 11% of those in traditional arrangements and 21% of temporary help agency workers are black. Hispanics account for 7% of independent contractors, and constitute 10% and 12% respectively of workers in traditional arrangements and temporary help agency workers.[25]

Only a minority of independent contractors are single. In fact, nearly 70% of independent contractors are married compared to only 59% among traditional workers. However, most spouses of independent contractors were in traditional work arrangements or were not in the labor force at all. This was not necessarily true, however, for women independent contractors, where 32% of wives who were independent contractors had spouses who were independent contractors as well. Approximately 50% of women

[23] Jorgensen, Helene. "Nonstandard Work Arrangements: Downscaling of Jobs," Department of Public Policy, AFL-CIO, 1998.

[24] Cohany, Sharon R. "Workers In Alternative Employment Arrangements: A Second Look," *Monthly Labor Review*, November 1998.

independent contractors, like women in traditional work arrangements, combine work with raising children.[26]

When compared to the working population at large, independent contractors tend to be better educated. Over 34% of independent contractors have a college degree. In contrast, only 29.5% of workers with traditional arrangements and 22% of temporary agency workers have college degrees.[27] Again, another distinction emerged between the two groups of independent contractors, when the AFL-CIO analyzed the 1995 CPS data. Their analysis points out that 40% of IC/wage-and-salary workers have a college degree, but only 32% of IC/self-employed have one.[28]

In terms of both earnings and benefits, independent contractors tend to enjoy advantages when compared to other workers. On average independent contractors earned 15% more than workers with traditional arrangements ($587 in median weekly earnings vs. $510.) However, this advantage holds true as a group only for male independent contractors. Male independent contractors earn more than male traditional workers ($621 median weekly earnings vs. $578), but female independent contractors ($409) earn less than female workers in traditional arrangements ($450). As a consequence of this gender gap, the earnings of female independent contractors are only 65% of those of their male IC colleagues.[29]

The earnings of independent contractors also varies from that of workers in other alternative work arrangements. For instance, on average independent contractors earned 78% more than temporary help agency workers, who had only $329 in median weekly earnings. However, workers provided by contract firms, earned 5.5% more than independent contractors. ($619 in median weekly earnings vs. $587) This difference was

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[25] *Ibid.*
[26] *Ibid.*
[27] *Ibid.*
[28] Jorgensen, Helene. "Nonstandard Work Arrangements: Downscaling of Jobs," Department of Public Policy, AFL-CIO, 1998.
[29] Cohany, Sharon R. "Workers In Alternative Employment Arrangements: A Second Look," *Monthly Labor Review*, November 1998.

even greater among men, with the average male contract worker earning 10% more than the male independent contractor.

Independent contractors also enjoy some advantages in terms of benefits. For example, when compared to workers in other alternate work arrangements, independent contractors have the highest proportion with health insurance, but they acquire health insurance from non-employment sources.

In contrast to workers with more traditional work arrangements, the work hours of independent contractors show a greater degree of variability. For instance, a greater percentage of independent contractors work part-time, i.e. less than 35 hours per week (26%) than traditional workers (18%) do. At the same time, however, a larger percentage of independent contractors also work longer hours than traditional workers. In the 1997 survey, 30% of independent contractors worked 49 or more hours per week compared to only 17% of traditional workers. Family responsibilities appeared to be a factor influencing the work hours of women independent contractors. A higher percentage of women independent contractors (50%) worked part-time compared to only 25% of women in traditional work arrangements.[30]

There are several industries in which independent contractors are disproportionately represented: construction; finance, insurance, and real estate; and services. This reflects the fact that independent contractors tend to work in high-skilled fields. According to data from the 1997 CPS supplement, over 41% of all independent contractors are in services, nearly 21% are in construction, over 13% in wholesale and retail trade, 8.4% in finance, insurance, and real estate, and 5.7% in agriculture. In contrast, while over 35% of workers in traditional arrangements are also found in the services and 21% in wholesale and retail trades, only 4.9% are in construction, 6.4% in finance, insurance and real estate, and 2.1% in agriculture. Only 5.1% of independent contractors are in transportation and public utilities, 4.7% in manufacturing, and .2% each in mining and public administration. Workers with traditional arrangements are more heavily represented in these industries.

In terms of industry distribution, the AFL-CIO points out that there are some significant differences between IC/wage and salary workers and the IC/self-employed (Jorgensen 1998). A much higher percentage of independent contractors who also identify themselves as wage and salary workers are in the services (62%) than those independent contractors who view themselves as being self-employed (48%). Similarly, only 10% of IC/wage and salary workers are in construction vs. 23% of IC/self-employed.
In terms of industry, there is also gender variation within the independent contractor population. Nearly 30% of all male independent contractors are in construction, and over 60% of female independent contractors in the services industry. It is not known whether there are regional differences in the distribution of independent contractors by industry.

According to the BLS, "quite unlike the occupational profile of traditional workers, that of independent contractors was skewed toward several high-skilled fields. Specific occupations that were heavily represented were writers and artists, insurance and real estate sales agents, construction trade employees, and miscellaneous managers and administrators."[31] As a group, however, the largest proportion of independent contractors are in managerial/administrative positions (20.7%) followed by professionals (17.9%), precision, production, craft, and repair (17.9%), sales (17. 9%), and service occupations (9.1%).[32]

This occupational distinction is also reflected in the analysis performed by EPI that categorized what it calls non-standard jobs into three groups, depending on whether workers in these jobs are paid more, the same, or less than "regular full-time workers with similar personal and job characteristics." Group 3 jobs are the "highest quality nonstandard jobs."[33] Independent contractors are group 3 jobs, along with contract workers and men who are self-employed.

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[30] *Ibid.*
[31] Cohany, Sharon R. "Workers In Alternative Employment Arrangements," *Monthly Labor Review*, October 1996.
[32] Cohany, Sharon R. "Workers In Alternative Employment Arrangements: A Second Look," *Monthly Labor Review*, November 1998.
[33] Kalleberg, Arne, and Rasell, Edith, etal., "Nonstandard Work, Substandard Jobs – Flexible Work Arrangements in the U.S"., Economic Policy Institute, 1997.

Gender also appeared to affect the occupational patterns of independent contractors. Managerial, skilled craft, and sales were the most likely fields for male independent contractors. For women, the most popular fields were services (as cleaners, child care providers, and hairdressers), sales, and professions.[34] According to the EPI analysis of the 1995 CPS supplement data, gender and racial background was correlated with different occupational patterns among independent contractors. For example, a white or Hispanic male independent contractor was most likely to be a manager/administrator. A black independent contractor was most likely to be a truck driver.[35] A white female independent contractor was most likely to be in real estate sales, a Hispanic female IC to be a janitor, and a black female IC a nursing aide.

Once, again, there are some differences between the two groups of independent contractors. For instance, only 9% of IC/wage-and-salary are in managerial positions compared to 20% of IC/self-employed.[36]

[34] *Ibid.*
[35] *Ibid.*
[36] Jorgensen, Helene. "Nonstandard Work Arrangements: Downscaling of Jobs," Department of Public Policy, AFL-CIO, 1998.

CONTRASTING VIEWS/EMPLOYER AND INDIVIDUAL MOTIVES

There is an ongoing debate as to whether the emergence of alternate work arrangements, including independent contractors, is driven primarily by employer demand or by worker preference. Those who view the appearance of these new work arrangements as largely employer driven believe they are to the disadvantage of workers and society at large. In contrast, those who believe worker preference is driving many of these changes, applaud their appearance as a positive new force shaping the economic and social landscape.

Analysts who see an employer driven phenomenon believe the increasing role of alternate work arrangements is due to a decline in employer commitment to long-term, stable employment relationships. This is seen in the increased use of "long-term temps." These were described in the New York Times, "as a seeming oxymoron, but in fact a new and growing phenomenon in the American workforce, embraced by many corporations, especially high-tech ones, including Microsoft, AT&T, Intel, Hewlett-Packard and Microsoft's Seattle neighbor, Boeing."[37] In this view, workers who otherwise would prefer the stability of regular full-time employment are being increasingly compelled to accept substandard alternate work arrangements. In response, others are to trying to head off this perceived deterioration in the quality of jobs. For instance, "Taking a jab at Microsoft Corp., the Washington state Senate appears likely to approve measures that would strengthen the rights of temporary, part-time and 'contingent' workers in the state."[38] In this instance, independent contractors are considered among the contingent workers that require protection.

The underlying economic factors causing this situation include heightened international competition, technological change, deregulation, and the increased costs of fringe benefits. According to critics, these factors together have led employers to increase short-run profits by cutting labor costs. To accomplish this goal, employers are holding

[37] Greenhouse, Steven. "Equal Work, Less-Equal Perks: Microsoft Leads the Way in Filling Jobs With 'Permatemps,'" *The New York Times*, March 30, 1998.
[38] *Wall Street Journal*, "Washington Lawmakers To Weigh In On Microsoft's Temp Worker Policy," Dow Jones Business News, February 10, 1999.

down wages, replacing skilled workers with less skilled, and replacing regular full-time employees with more flexible, just-in-time workers such as temporaries and independent contractors. As a part of this disturbing scenario, some employers (to avoid paying payroll taxes) are believed to be reclassifying their lower wage, unskilled workers as independent contractors, bringing them back with less job security, and few or no benefits. Other employers are "offering what may be the workplace of the future: people using their computers, operating out of their homes, paid minute-by-minute as some distant employer needs them."[39] These "Cyber Agents," as they are called, are frequently welfare mothers that their employer views as independent contractors.

On a more positive note, other commentators believe worker preference is a primary factor in the development of alternate work arrangements. Changes in family structure, such as the massive movement of married women and single-parents to enter or re-enter the labor force, has created a desire for more flexible work arrangements to better balance work and family responsibilities. These observers also believe these new work arrangements are increasingly being used not to replace the full-time, permanent work force, but simply to supplement it.[40] They also believe that workers are not trapped into these temporary work arrangements but that they facilitate their movement into more permanent positions. Some employers, being skeptical of the quality of the public educational system, use alternate work arrangements as a way to screen prospective full-time employees. In commenting on the temporary and part-time staffing, Fortune magazine believed they provide a more efficient job marketplace that facilitates the search for permanent work.[41] More recently, Internet-based placement firms have emerged that specialize in finding freelancers to work on projects for client employers.[42]

The forces increasing economic competition were also creating new opportunities for individuals prepared to take pro-active advantage of them. High-tech and other

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[39] Dorschner, John. "Miami Company Plans to Add Clients, Help Agents," *The Miami Herald*, Knight Ridder Tribune Business News, January 17, 1999.
[40] Lenz, Edward A., "Flexible Employment: Positive Strategies for the 21st Century," *Journal of Labor Research*, 1996.
[41] Aley, James. "The Temp Biz Boom: Why It's Good," Fortune, October 16, 1995.
[42] Sharpe, Anita. "'Free Agent' Placement Firms Flourish," *The Wall Street Journal*, November 17, 1998.

knowledge-based workers have increasingly become "free agents" able to quickly capitalize on the demand for their specialized services in order to take charge of their economic destinies.[43] These free agents no longer accept the idea that you give your loyalty to an organization in exchange for job security. According to Terri Lonier, the head of Working Solo, Inc., a company which advises independent contractors, "What we have today is not job security but skills security….Being an individual entrepreneur, you are a lot more secure because you can diversify your income. As an employee, you have one income source. If the company decides they no longer want you, you're at ground zero. If you work independently, you have many clients; your business is more resistant to market change."[44] According to William Halal, a George Washington University professor, "It's a redefinition of the employment contract…. Jobs once reserved for full-time workers are being done…by consultants, independent contractors, temporary help and part-timers who act as free agents trading on their skill, time or knowledge. They operate much like SWAT teams, moving from job to job, project to project and company to company."[45]

Interestingly, some of these IC advocates also call for public policy changes. They believe the distinction between employees and independent contractors may have made sense in the manufacturing age when the principal forms of labor protection first came about, but no longer fit the more fluid realities of the information age. Under this scenario, benefits largely unavailable to workers outside the traditional employer-employee relationship should become available to more workers by expanding the definition of who constitutes an employee. Protections such as unemployment insurance would be tied more to the individual and be less dependent on the nature of their economic relationships. This would enable employers to enjoy the continued advantages of labor force flexibility but not at the expense of individual workers.

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[43] Pink, Daniel H., "Free Agent Nation," *Fast Company*, December/January 1998.
[44] Carlin, John, "You Really Can Do It Your Way," *London Independent on Sunday*, November 30, 1997, copyright 1997 Newspaper Publishing P.L.C.
[45] Joyner, Tammy. "Contingency Workers Go Where They Are Needed," *The Atlanta Journal and Constitution*, Knight-Ridder Tribune Business News, October 13, 1997.

Unfortunately, much of this commentary is not always addressed specifically to independent contractors but to a wide variety of alternate work arrangements. This points to a need for a study focused specifically on the factors behind the use of independent contractors as opposed to other alternate work arrangements.

MOTIVATIONS TO BECOME/HIRE ICS

EMPLOYER MOTIVATIONS

Identifying the underlying motivations of employers who utilize independent contractors is crucial to any objective assessment of the independent contractor phenomenon. In both the October 1996 and November 1998 issues of the Monthly Labor Review, Sharon Cohany of the Bureau of Labor Statistics provides detailed information on employer motivations as they apply to the other three alternate work arrangements. However, the same level of information is not offered concerning employer motives for using independent contractors, although it does offer extensive information regarding the reasons individuals become independent contractors. The most frequently stated reason employers hire independent contractors is to gain access to workers with highly specialized skills on an as needed basis. This reflects much of current management thinking – focus on your core competency, maintain a lean and flexible staff, and supplement that core staff with contingent workers on a project-by-project basis.[46]

A report by the W.E. Upjohn Institute acknowledges that "our understanding of which employers use these arrangements, why they use them, and why they may have been increasing their use in recent years is incomplete."[47] To help correct this situation, they sponsored a nationwide telephone survey of employers on their use of flexible work arrangements including independent contractors. The most commonly cited reasons include:

- Manage fluctuations in workload
- Replace regular staff absences, and
- Screen candidates for regular jobs

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[46] *Ibid.*
[47] Houseman, Susan N., "New Institute Survey on Flexible Staffing Arrangements," *Employment Research*, Spring 1997

"Savings on wage and benefit costs were cited as important by just 12 percent of employers using agency temporaries, by 21 percent using regular part-time workers, and by under 10 percent using short-term hires and on-call workers." Again, however, the reasons uncovered appear to apply more to other alternate work arrangements and less so, if at all, to the use of independent contractors.

It may also be the case that employer motives for using independent contractors are very complex and vary according to need and circumstance. Specifically, the reasons employers seek to hire existing independent contractors may be very different from the motives other employers have for reclassifying existing employees as independent contractors. According to the BLS, there is little evidence from the CPS supplements that independent contractors were forced to leave their regular, full-time jobs to start working for themselves. But the CPS supplement may not be catching those individuals who have been converted to IC status and still think of themselves as employees. The existence of an apparently thriving cottage industry of accountants and lawyers assisting employers who utilize independent contractors at least suggests that something is going on that is not yet being fully captured by existing data collection efforts.

Assuming that there are two separate classes of independent contractors – those that have become free agents by choice and those that have been converted by their employers - it is conceivable that the employer motives underlying the latter are more like those of affecting the use of other alternate work arrangements. In this regard, the W.E. UpJohn study may be helpful. Although the study showed that employers did not cite labor cost savings as a primary reason for using flexible staffing arrangements, these savings did occur primarily because of savings on benefit costs. What is interesting is that "establishments offering good benefits to regular, full-time workers are more likely to use variously flexible staffing arrangements and/or to use them more intensively." The possible explanation offered is that these employers use flexible staffing arrangements as a legal way for offering costly benefits to only a certain segment of their workforce. In this regard, an article in HR Magazine cites the use of alternative staffing options as a

way for HR professionals to counter inaccurate but widespread perceptions that they are not attentive to bottom-line concerns…"[48]

WORKER MOTIVATIONS

According to data provided by the BLS in both the 1995 and 1997 CPS supplements, the vast majority of independent contractors, in contrast to workers in other alternate arrangements, like their current situation.

- In the 1997 survey, nearly 84% of independent contractors stated that they preferred their alternate arrangement to a more traditional one. Less than 10% expressed a preference for a more regular, full-time position as a wage-and-salary worker.

- In contrast, only 40% of on-call workers and 33.5% of temporary help agency workers preferred their existing situation.

- Less than 10% cited economic reasons (such as "the only type of work I could find") for becoming an independent contractor.

- Instead 76% cited personal reasons for becoming independent contractors. The most popular reason given by men was "they like being their own boss." "Among women, the most common reasons given were the flexibility of scheduling and the ability to meet family obligations that the arrangement afforded."

- Nearly 60% of temporary help agency workers and over 40% of on-call workers cited economic reasons for their current job arrangement.

- Independent contractors do not view their current job arrangement as a temporary one. Only 3.5 % saw their current position as temporary, the lowest percentage of all work arrangements, both alternate and traditional.

[48] Greble, Thomas C., "A Leading Role for HR in Alternative Staffing," *HR Magazine*, February 1997.

- Independent contractors are "somewhat more likely to have voluntarily left their previous employment than were traditional workers," suggesting that they entered into this alternative work arrangement by choice.[49]

Perhaps independent contractors do not view their work as contingent, because they see their primary work relationship being with their occupation and other colleagues in their professional network, and not with any specific employer/organization. Perhaps one factor underlying worker classification disputes is the absence of this perception on the part of the so-called independent contractor who has forged a long-standing relationship with a single employer. Wherever the individual worker perceives that their primary work relationship is with an employer and not their particular occupation, then worker classification disputes are more likely to occur.

[49] Polivka, Anne E. "Into Contingent and Alternative Employment: By Choice," *Monthly Labor Review*, October 1996.

INDEPENDENT CONTRACTORS AND MISCLASSIFICATION

Given currently available information on independent contractors it is difficult to say to what extent, if any, this data may be applicable to the issue of misclassification. As already discussed, the CPS provides extensive demographic and related information on those individuals who classify themselves as independent contractors. By its design, however, the CPS is not likely to identify employees misclassified as independent contractors. As previously discussed, the CPS does identify an anomaly in the form of over 1 million wage-and-salary workers who also consider themselves independent contractors. The BLS states, however, that it is not possible to conclude from the available data that these are employees somehow misclassified by their employers. Not surprisingly, Edie Rasell, one of the authors of the EPI report, was recently reported to say, "there is little concrete data about the prevalence of misclassifying workers.[50]

Misclassification typically becomes apparent as the result of a classification dispute between employer and worker. Currently, such disputes are only likely to make themselves known as a result of some event arising out of or affecting the employer/worker relationship, such as a termination of the relationship or a job-related injury. Recent evidence in the press, however, suggests this hidden population is starting to make itself known in what is characterized as a "new labor battle front." "With billions of dollars in benefits and pay at stake, unions and workers from academia to high tech to the blue-collar trades are battling misclassification of employees as independent contractors and contingent workers. Many are turning to the courts or, as in the case of unions, to organized campaigns, protests – and salting."[51]

Determining who is an employee and who an independent contractor is also a question that concerns many within the business community. In various magazines and newspapers, business writers provide advice to employers on how to avoid making mistakes that may lead to problems with the IRS. Some writers will discuss "the three

[50] Srinivasan, Kalpana. "Were Workers Misclassified?" *The Associated Press*, October 27, 1999.
[51] Lewis, Diane E. "New Labor Battle Front: Job Classifications," *The Boston Globe*, December 20, 1998.

major categories (used by the IRS) for determining whether someone is an employee or an independent contractor."[52] Other writers offer their interpretation of employee classification criteria based on IRS guidelines.[53] Likewise, accounting and legal firms offer their services to assist employers in this area.[54] Employers are increasingly aware of the issue due to reports of other companies experiencing difficulties as a result of contested employee classification claims now frequently being reported in the press. The cases involving Microsoft and Time Warner are recent high profile examples known around the nation. At the same time many parts of the country have their own unique examples, such as the one involving exotics dancers in Southern California.[55]

There have been past efforts to assess the extent of misclassification. A 1994 Coopers and Lybrand report drew upon earlier federal studies to estimate the number of misclassified workers and assess their impact on federal tax revenues.[56] The primary source for their report was an IRS survey of 3,000 employers based on data from the 1984 tax year. It showed that an estimated 13 percent of these employers had misclassified some of their workers. Collectively, however, the employees misclassified constituted only 2 percent of the workforce of the audited employers. In the construction and service industries, however, the percentage of employees misclassified was 3 ½ percent. In addition, "small companies (those with fewer than 100 workers) were found to employ only about 40 percent of the workers yet were responsible for nearly 90 percent of those misclassified." The tendency for small employers to have a disproportionate share of the misclassification problems was also noted in a later 1990 survey of Illinois employers conducted by Burgess and Associates. They found that

[52] Debare, Ilana, "Line between employee, contractor status a blur," *Denver Rocky Mountain News*, February 7, 1999.
[53] Tulenko, Paul, "Independent Contractors Could Tax Your Withholding," *Bradenton Herald*, December 2, 1998.
[54] Northrup, Anne and Kennan, Brian. *The IRS Attack on Independent Contractors – How It Affects Your Business Plans*, Copyright @1997 Davis Wright Tremaine
[55] Himmelberg, Michele. "California Jury Confirms Labor Classification for Topless Dancers," *The Orange County Register*, Knight-Ridder Tribune Business News, December 31, 1998.
[56] Coopers & Lybrand, "Projection of the Loss In Federal Tax Revenues Due to Misclassification of Workers", prepared for Coalition for Fair Worker Classification, June 1994.

"firms with fewer than 25 reported employees account for nearly two-thirds of total unreported taxable wages."[57]

Other federal studies cited in the Coopers and Lybrand report include a 1985 IRS Tax Compliance Measurement Program. In this study, the "IRS found that independent contractors tended to underreport taxable income by roughly 20 percent…" They went on to say that results from these two IRS surveys, "taken in combination….suggest that taxpayer compliance is lower among independent contractors and still less among workers misclassified as independent contractors (who do not receive Forms 1099). A GAO 1989 study that matched 1985 tax year Forms 1099 returns submitted by employers with income tax returns filed by independent contractors "uncovered evidence of misclassification" by 38 percent of the surveyed employers.

Coopers and Lybrand integrated IRS research and BLS data to "estimate that the number of misclassified non-agricultural, non-mining workers will have grown from 3.3 million in 1984 (the IRS estimate) to 4.1 million in 1994 and over 5 million by the year 2005". Based on this data and other estimates, they estimated that in "calendar year 1996, there will be a $3.3 billion dollar loss in federal revenues due to the misclassification of workers." Efforts to achieve full reclassification over a nine-year period beginning in fiscal year 1996 and ending in fiscal year 2004 would increase tax revenue by more than $3.8 billion per year on average. Of this total, "approximately 5 percent is attributable to increases in FUTA taxes ..", or $190 million per year.

The 1990 Burgess report on "Employer Compliance With Illinois Unemployment Insurance Reporting Requirements" provides additional data on the possible scope of employee misclassification. In its study of Illinois employers, "an estimated 491,000 covered employees…were discovered as unreported workers…. with unreported taxable wages estimated to equal $1.45 billion." In addition, "over two-thirds of the taxable wage reporting errors are attributable to errors in determining independent contractor status or

[57] Burgess, Paul L., "Employer Compliance With Illinois Unemployment Insurance Requirements," prepared for Illinois Department of Employment Security, February 1990.

failure to report casual/part-time workers." They go on to say that "employer compliance clearly is not explained by accidental or random errors, since the underreporting and non-reporting patterns found vary systematically with employer characteristics such as company size, industry, and tax rate."

As previously discussed, misclassification typically becomes apparent as the result of a classification dispute between employer and worker. In his report, Wayne Vroman suggests taking advantage of this event to estimate misclassification levels. Since "UI programs are frequently in the position of having to decide whether such persons are self-employed or employees…it might be possible to derive information directly from the states as to the monthly or annual volume of independent contractor determinations."[58]

In summary, there is a high level of interest in the independent contractor phenomenon. Even among those who believe this is a positive development that should be encouraged, there is concern some employees are being misclassified as ICs. Unfortunately, it is difficult to tell from the current data on independent contractors how much of this information also applies, if at all, to those who are being misclassified. In addition, much of this analysis, even though it portrays a significant problem, is dated. The may be due to the robust economy and more pressing public policy issues. However, the amount of money not provided in UI taxes and the inability of workers to file claims for UI benefits could have serious social consequences.

[58] Vroman, Wayne. "Labor Market Changes and Unemployment Insurance Benefit Availability," Unemployment Insurance Occasional Paper 98-3. Washington DC: U.S. Department of Labor, Employment and Training Administration, 1998.

SUMMARY AND IMPLICATIONS FOR PRESENT STUDY

Past studies did not deal only with independent contractors but have instead examined them in the context of all alternate work arrangements as if they were part of the same phenomenon. This context affects the interpretation of the independent contractor phenomenon. This study, which is focused just on independent contractors, and not the other alternatives, will provide a more objective basis for understanding the nature of the independent contractor work arrangement.

SUMMARY OF CURRENT LITERATURE

It is known from research conducted by the Bureau of Labor Statistics that there are an estimated 8.5 million independent contractors and they are disproportionately represented in certain industries such as construction, finance, insurance, real estate and services. According to data from the 1997 CPS Supplement, over 41% of independent contractors are in services, and nearly 21% are in construction. This reflects the fact that independent contractors tend to work in high-skilled fields. Among men, managerial, skilled craft, and sales are the most likely fields. For women the most popular fields are in services (as cleaners, child care providers, and hairdressers), sales, and professions.

The primary reason cited in the literature for why employers hire independent contractors is to gain access to workers with highly specialized skills on an as needed basis. This reflects current management thinking – focus on your core competency, maintain a lean and flexible staff, and supplement that core staff with contingent workers on a project-by-project basis. It is not known to what extent employers may also use independent contractors to reduce labor costs through the elimination of government and employer-sponsored benefits.

Understanding both employer and worker motivations is important, especially in light of the ongoing debate as to whether the emergence of independent contractors and other alternative work arrangements is driven primarily by employer demand or worker preference. Economic factors such as heightened international competition, technological

change, deregulation, and the increased costs of fringe benefits are cited as reasons why employers are seeking alternative ways of managing their work forces. Others believe social factors such as the movement of married women and single-parents into the labor force has made many flexible work arrangements an attractive option for many. In any case, the advent of the computer has made it economically and technologically possible for many more people to operate professional businesses from home. It is not known whether there are any regional differences in the emergence of independent contractors.

From the perspective of individual workers, it is known from the CPS Supplement that the vast majority of independent contractors cite personal rather than economic reasons for choosing this work arrangement. Men liked being their own boss and women liked having the flexibility to balance work and family responsibilities. In addition, many independent contractors believe they have more security relying on their own skills rather than being dependent on an employer as their single income source.

The evidence for worker preference as a driving force is supported by those independent contractors who think of themselves as "free agents" and view this work arrangement as a way to regain control of their work life. This work style choice is reinforced by data that shows on average, independent contractors earn 15% more than workers in more traditional work arrangements. But this work style has emerged during a long sustained period of economic growth, and its sustainability during a period of high unemployment is untested.

To what extent this work style choice also applies, if at all, to those individuals who are misclassified as independent contractors is not known. It is presumed that misclassification of employees is largely driven by employer factors rather than choices made by individual workers although this may not always be the case. Nor is it known what the full extent of the misclassification of workers might be. The most frequently cited past effort in this regard is a 1984 IRS study which estimated there were 3.3 million misclassified employees. A Coopers and Lybrand study later used this as a basis for projecting an estimated 5 million misclassified employees by the year 2005.

Reclassification of these employees would increase federal tax revenue by more than $3.8 billion per year over a nine-year period. Approximately, 5% or $190 million per year, is attributable to increases in FUTA taxes.

According to the 1997 CPS Supplement, out of the 8.5 million independent contractors, approximately 1 million also identify themselves as wage-and-salary workers. However, this data does not permit a determination as to whether or not any of these are actually misclassified employees. Based on past studies it does appear that misclassification occurs more frequently among small employers, although there have been recent high profile cases involving corporations like Microsoft and Time Warner. In any case, it is known that such individuals are denied access to important benefits such as workers compensation and unemployment insurance and so may be unprepared for those eventualities against which these programs are meant to protect.

IMPLICATIONS FOR PRESENT STUDY

Current CPS data appears to provide an accurate profile of individuals who prefer the independent contractor work arrangement and are not confused or uncertain about their status. However, CPS data does not appear to be capturing the hidden population of misclassified independent contractors who probably have responded to the CPS as if they were wage-and-salary workers. The study proposes accessing existing state labor department resources, such as UI audit records and workers compensation, to develop information on workers who may have been misclassified as independent contractors.

Although independent contractors appear to be a nationwide phenomenon, are there significant regional differences? These might include variations in the percentage of independent contractors in the workforce and in the types of industries or occupations utilizing independent contractors. A study encompassing selected states from around the country may succeed in identifying some of these regional variations, to the extent that they exist.

Understanding the reasons employers hire independent contractors is important to assessing the nature of this phenomenon. Currently available information on employer motivations appears to encompass a variety of alternate and nonstandard work arrangements that may not always be applicable to their use of independent contractors. A study should attempt to gather information from employers to determine why they use independent contractors.

The economic and social factors underlying the use of independent contractors may be very different from those leading to the misclassification of employees, especially the conversion of employees to independent contractor status. Interview questions and other data collection instruments should be designed with this distinction in mind.

To what extent have changes in family structure, such as the massive movement of married women and single-parents into the workforce, contributed to the desire and/or need for more flexible work arrangements such as independent contractors? This is related to the larger question of whether employer demand or individual preference is the prime driver in the utilization of independent contractors?

Current CPS data has identified two groups of independent contractors – the majority who identify themselves as self-employed and another who state they are wage-and-salary workers. The exact nature of this latter group cannot be determined from the CPS data. Accessing state UI data and legal research may be able to shed some light on this distinction.

APPENDIX C: RANDOM VERSUS TARGETED AUDITS

State UI agencies conduct an annual field audit of a sample of employers and report the results to the USDOL in their quarterly 581 report. "The primary objective of the field audit function is to promote and verify employer compliance with state laws, regulations and policies. The Unemployment Insurance Service believes that the following will accomplish successful completion of their primary objective: (1) identify employer noncompliance, (2) direct audit selection at noncompliance, (3) maintain a defined level of audit production, and (4) ensure that the field audits meet the key requirements of the field audit section of the ESM."[1]

The debate between conducting random and targeted audits has been going on for several years. The debate has questioned the underlying purpose of the audit program. Is it to educate the employer about proper reporting practices, is it to be a source of additional revenue to the trust fund or is it to be a combination of both purposes? This debate has been exacerbated because of reductions in funding for state UI tax operations. Currently, states are required to conduct audits on a minimum of 2% of their employers. In addition to the 2% requirement, a minimum number of "large" employers must be included in the sample so that the universe of employers audited is more likely to be representative of the employers in the state and the overall workforce.

Most states prefer to conduct random audits for the following reasons:

- They stress voluntary compliance, all employers in a state had the same "opportunities" to be audited as all others. Field audits are a major component of a state's integrity activities, and are most effective if conducted on a random basis.
- They stressed "education," providing on-site education to employers to ensure that any mistakes found are identified and rectified immediately, and prevented from reoccurring.

[1] Adopting Best Practices Can Improve Identification of Non-compliant Employers for State UI Field Audits, Final Report No. 03-99-006-03-315, Office of Inspector General, page 6

- They avoid the perception that SESAs are unfairly targeting employers either by size, industry, geographic location, tax rate or the number of claims.

On the other side of the debate, the proponents of targeted audits offer the following reasons:

- The audit staff must be used effectively. The yield per audit hour worked should be the major factor in measuring the success of a state's audit program. In a recent audit of twelve states conducted by the Office of Inspector General, the variations in the yield per hour ranged from a low of minus $8 per audit hour to a positive $241 per audit hour.[2] A further measure of the effectiveness of audit selection is the percentage of audits that result in changes in reported payrolls.
- States are encouraged to maintain audit selection criteria that include indices that reflect potential noncompliance, such as high employee turnover, sudden growth or decrease in employment, type of industry, location (geography), prior reporting history, results of prior audit and adjudicated determinations.[3] To ensure that all employers are included in the audit selection process, states are encouraged to randomly select 10% or more audit assignments from the total selection of contributory employers."

States have the opportunity to design a field audit program that meets the overall objectives of their own unemployment insurance program. Guidelines issued by the USDOL are sufficiently broad to allow states to both target and randomly select employers for audits, and the methods used vary among states. The employer audit sample in Maryland, Colorado and Indiana is over 90% random. New Jersey and Minnesota adopt a combination of random and targeted samples, while Connecticut and California have over 90% of their sample as targeted audits.

[2] - *ibid*, page 1
[3] Part V, Section 3679 of the Employment Security Manual (ESM)

APPENDIX D: DATA REQUESTED FROM EACH STATE

Category 1 (number of employers in the state) used the following data elements:

- total number of employers in the state with one or more employees covered under unemployment insurance
- total number of covered workers in the state
- total unemployment insurance revenue collected in the state

Category 2 (number of audited employers) used the following data elements:

- number of employers audited.
- number of workers at the audited employer locations.

Category 3 (number of employers with new workers identified through the audit process) used the following data elements:

- total number of audited employers with new workers
- total number of workers at these employers (including new workers)
- the number of new workers
- taxable wages underreported for these new workers
- tax underreported for these new workers.

APPENDIX E: COMPUTATION METHOD

Task 1 – Calculate # Employers Statewide w/ "New Workers" Misclassified as ICs

Subtask 1a - Divide (# of audited employers w/ new workers misclassified ICs) by the (# of employers audited)

E/C *= % of Audited Employers w/ Misclassified ICs* = **1**

Subtask 1b - Multiply (% of Audited Employers w/ Misclassified ICs) x (Total # of Employers in State)

1 x A *= Total # of Employers in State w/ New Workers Misclassified as ICs* = **2**

Task 2 – Calculate % of Workers Statewide Misclassified as ICs

Subtask 2a – Divide (# of New Workers Misclassified as ICs at Audited Employers) by (# of Workers at Audited Employers)

G/D = % of Workers Misclassified as ICs at Audited Employers = **3**

Subtask 2b – Multiply (% of Workers Misclassified as ICs at Audited Employers) x (Total Number of Covered Workers in the State)

3 x B = % of Workers Statewide Misclassified as ICs = **4**

Task 3 – Calculate Taxable Wages Underreported Statewide for "New Workers" Misclassified as ICs

Subtask 3a – Divide (Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs) by (# of New Workers Misclassified as ICs at Audited Employers)

H/G = Taxable Wages Underreported per New Worker Misclassified as IC = **5**

Subtask 3b – Multiply (Taxable Wages Underreported per New Worker Misclassified an IC) x (# of Workers Statewide Misclassified as ICs)

5 X 4 = Total Taxable Wages Underreported Statewide for New Workers Misclassified as ICs = **6**

Task 4 – Calculate Tax Underreported Statewide for "New Workers" Misclassified as ICs

Subtask 4a – Divide (Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers) by (# of New Workers Misclassified as ICs at Audited Employers)

I/G = Tax Underreported per New Worker Misclassified as an IC = **7**

Subtask 4b – Multiply (Tax Underreported per New Worker Misclassified as an IC from Audited Employers) x (# of Workers Statewide Misclassified as ICs)

7 x 4 = Tax Underreported Statewide for New Workers Misclassified as ICs = **8**

Task 4 – Alternative Method

Alternative Subtask 4a – Divide (Tax Underreported for New Workers Misclassified as ICs from Audited Employers) by (Taxable Wages Underreported for New Workers Misclassified as ICs from Audited Employers)

I/H = Average UI tax rate = **9**

Alternative Subtask 4b – Multiply (Average UI Tax Rate) x (Statewide Taxable Wages Underreported for New Workers Misclassified as ICs from Audited Employers)

9 x 6 = Tax Underreported Statewide for New Workers Misclassified as ICs = **8**

Task 5 – Calculate Percentage of Statewide UI Taxes Underreported Due to Workers Misclassified as ICs

Task 5a – Divide (Tax Underreported Statewide for New Workers Misclassified as ICs) by (Total UI Tax Collected Statewide)

8/J = % of State UI Taxes Underreported Due to Workers Misclassified as ICs = **10**

* The total number of employers and workers may vary significantly during the time period (for example - the most recent four quarters) in which audit data is collected/recorded. The total # of employers & workers will need to be the average during the time period analyzed, or alternatively the # of employers & workers that were present on the final day of that time period.

APPENDIX F: AUDIT DATA ANALYSIS PROCESS

California (DOL required audits/*(all audits*)

REQUIRED INFORMATION

Source – State employment and unemployment insurance data

A = Total number of employers in the state with one or more employees covered under unemployment insurance or the # of employers registered with the state=**881,400**

B = Total number of covered workers in the state, i.e. the number of individuals working for wages in all industry sectors=**16,618,564**

J = Overall unemployment insurance tax collected in the state during the time period analyzed=**$3,004,391,000**

Source – State UI tax audit data

C = Number of employers audited during the time period analyzed=**2,669/*(6,065)***
D = Number of workers at the employers audited=**187,581/(*547,760)***
E = Number of audited employers w/ new workers who had been misclassified as ICs=**775/(*3,947)***
F = Total number of workers at employers w/ new workers who had been misclassified as ICs=**16,428/*(340,530)***
G = Number of new workers misclassified as ICs at audited employers=**12,541/*(65,394)***
H = Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs=**$67,229,420/*($362,889,142)***
I = Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers=**$2,523,505/*($13,026,411)***

INFORMATION DERIVED FROM CALCULATIONS

1 = Percent of audited employers w/ misclassified ICs=**29%/*(65%)***
2 = Total number of employers in state w/ new workers misclassified as ICs=**255,606/*(572,910)***
3 = Percent of workers misclassified as ICs at employers audited=**6.7%/*(12%)***
4 = Number of workers statewide misclassified as ICs=**1,113,444/*(1,994,227)***
5 = Taxable wages underreported per new worker misclassified as an IC=**$5,361/*($5,549)***
6 = Total taxable wages underreported statewide for new workers misclassified as ICs=**$5,969,173,284/*($11,065,965,623)***
7 = Tax underreported per new worker misclassified as an IC=**$201.22/*($199.20)***
8 = Tax underreported statewide for new workers misclassified as ICs=**$224,047,201.70/*($397,250,018)***
9 = Average UI tax rate=**3.75%/(*3.59%)***
10 = Percent of state UI taxes underreported due to workers misclassified as ICs=**7.46%/(*13.22%)***

Colorado

REQUIRED INFORMATION

Source – State employment and unemployment insurance data

A = Total number of employers in the state with one or more employees covered under unemployment insurance or the # of employers registered with the state=***123,643***

B = Total number of covered workers in the state, i.e. the number of individuals working for wages in all industry sectors=***2,030,693***

J = Overall unemployment insurance tax collected in the state during the time period analyzed=***$178,303,173***

Source – State UI tax audit data

C = Number of employers audited during the time period analyzed=***2,948***
D = Number of workers at the employers audited=***47,000(estimate)***
E = Number of audited employers w/ new workers who had been misclassified as ICs=***1,000 (est.)***
F = Total number of workers at employers w/ new workers who had been misclassified as ICs=***16,000 (est.)***
G = Number of new workers misclassified as ICs at audited employers=***4,000 (est.)***
H = Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs=***$841,000 (est.)***
I = Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers=***$149,000 (est.)***

INFORMATION DERIVED FROM CALCULATIONS

1 = Percent of audited employers w/ misclassified ICs=***33.9%***
2 = Total number of employers in state w/ new workers misclassified as ICs=***41,915***
3 = Percent of workers misclassified as ICs at employers audited=***8.5%***
4 = Number of workers statewide misclassified as ICs=***172,609***
5 = Taxable wages underreported per new worker misclassified as an IC=***$210.25***
6 = Total taxable wages underreported statewide for new workers misclassified as ICs=***$36,291,042***
7 = Tax underreported per new worker misclassified as an IC=***$37.25***
8 = Tax underreported statewide for new workers misclassified as ICs=***$6,429,685***
9 = Average UI tax rate=***17.7%***
10 = Percent of state UI taxes underreported due to workers misclassified as ICs=***3.6%***

Connecticut

REQUIRED INFORMATION

Source – State employment and unemployment insurance data

A = Total number of employers in the state with one or more employees covered under unemployment insurance or the # of employers registered with the state=***94,517***

B = Total number of covered workers in the state, i.e. the number of individuals working for wages in all industry sectors=***1,700,000***

J = Overall unemployment insurance tax collected in the state during the time period analyzed=***$599,000,000***

Source – State UI tax audit data

C = Number of employers audited during the time period analyzed=***1,903***
D = Number of workers at the employers audited=***30,000(estimate)***
E = Number of audited employers w/ new workers who had been misclassified as ICs=***800 (est)***
F = Total number of workers at employers w/ new workers who had been misclassified as ICs=***15,000 (est)***
G = Number of new workers misclassified as ICs at audited employers=***1,600***
H = Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs=***$6,000,000 (est)***
I = Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers=***$268,580***

INFORMATION DERIVED FROM CALCULATIONS

1 = Percent of audited employers w/ misclassified ICs=***42%***
2 = Total number of employers in state w/ new workers misclassified as ICs=***39,697***
3 = Percent of workers misclassified as ICs at employers audited=***5.3%***
4 = Number of workers statewide misclassified as ICs=***90,100***
5 = Taxable wages underreported per new worker misclassified as an IC=***$3750***
6 = Total taxable wages underreported statewide for new workers misclassified as ICs=***$337,875,000***
7 = Tax underreported per new worker misclassified as an IC=***$167.86***
8 = Tax underreported statewide for new workers misclassified as ICs=***$15,124,186***
9 = Average UI tax rate=***4.5%***
10 = Percent of state UI taxes underreported due to workers misclassified as ICs=***2.54%***

Maryland

REQUIRED INFORMATION

Source – State employment and unemployment insurance data

A = Total number of employers in the state with one or more employees covered under unemployment insurance or the # of employers registered with the state=***125,000***

B = Total number of covered workers in the state, i.e. the number of individuals working for wages in all industry sectors=***2,700,000***

J = Overall unemployment insurance tax collected in the state during the time period analyzed=***$335,342,960***

Source – State UI tax audit data

C = Number of employers audited during the time period analyzed=***1041***
D = Number of workers at the employers audited=***22,372***
E = Number of audited employers w/ new workers who had been misclassified as ICs=***207(est.)***
F = Total number of workers at employers w/ new workers who had been misclassified as ICs=***7523 (est.)***
G = Number of new workers misclassified as ICs at audited employers=***1,332***
H = Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs=***$2,706,824.35***
I = Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers=***$55,002.43***

INFORMATION DERIVED FROM CALCULATIONS

1 = Percent of audited employers w/ misclassified ICs=***19.9%***
2 = Total number of employers in state w/ new workers misclassified as ICs=***24,875***
3 = Percent of workers misclassified as ICs at employers audited=***6%***
4 = Number of workers statewide misclassified as ICs=***162,000***
5 = Taxable wages underreported per new worker misclassified as an IC=***$2032***
6 = Total taxable wages underreported statewide for new workers misclassified as ICs=***$329,208,300***
7 = Tax underreported per new worker misclassified as an IC=***$41.29***
8 = Tax underreported statewide for new workers misclassified as ICs=***$6,688,980***
9 = Average UI tax rate=***2%***
10 = Percent of state UI taxes underreported due to workers misclassified as ICs=***2%***

Minnesota

REQUIRED INFORMATION

Source – State employment and unemployment insurance data

A = Total number of employers in the state with one or more employees covered under unemployment insurance or the # of employers registered with the state=***122,508***

B = Total number of covered workers in the state, i.e. the number of individuals working for wages in all industry sectors=***2,533,638***

J = Overall unemployment insurance tax collected in the state during the time period analyzed=***$385,056,230***

Source – State UI tax audit data

C = Number of employers audited during the time period analyzed=***2,404***
D = Number of workers at the employers audited=***115,227***
E = Number of audited employers w/ new workers who had been misclassified as ICs=***323***
F = Total number of workers at employers w/ new workers who had been misclassified as ICs=***22,722***
G = Number of new workers misclassified as ICs at audited employers=***1,921***
H = Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs=***$2,414,233***
I = Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers=***$47,189***

INFORMATION DERIVED FROM CALCULATIONS-:

1 = Percent of audited employers w/ misclassified ICs=***13.4%***
2 = Total number of employers in state w/ new workers misclassified as ICs=***16,416***
3 = Percent of workers misclassified as ICs at employers audited=***1.67%***
4 = Number of workers statewide misclassified as ICs=***42,312***
5 = Taxable wages underreported per new worker misclassified as an IC=***$1256.75***
6 = Total taxable wages underreported statewide for new workers misclassified as ICs=***$53,175,606***
7 = Tax underreported per new worker misclassified as an IC=***$24.56***
8 = Tax underreported statewide for new workers misclassified as ICs=***$1,030,183***
9 = Average UI tax rate=***1.95%***
10 = Percent of state UI taxes underreported due to workers misclassified as ICs=**0*.27%***

Nebraska

REQUIRED INFORMATION

Source – State employment and unemployment insurance data

A = Total number of employers in the state with one or more employees covered under unemployment insurance or the # of employers registered with the state=***43,488***

B = Total number of covered workers in the state, i.e. the number of individuals working for wages in all industry sectors=***909,000***

J = Overall unemployment insurance tax collected in the state during the time period analyzed=***$27,292,474***

Source – State UI tax audit data

C = Number of employers audited during the time period analyzed=***999***
D = Number of workers at the employers audited=***19,980***
E = Number of audited employers w/ new workers who had been misclassified as ICs=***100 (est.)***
F = Total number of workers at employers w/ new workers who had been misclassified as ICs= ***not available***
G = Number of new workers misclassified as ICs at audited employers=***200 (est.)***
H = Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs=***$1,000,000 (est.)***
I = Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers=***$50,000***

INFORMATION DERIVED FROM CALCULATIONS

1 = Percent of audited employers w/ misclassified ICs=***10%***
2 = Total number of employers in state w/ new workers misclassified as ICs=***4348***
3 = Percent of workers misclassified as ICs at employers audited=***1%***
4 = Number of workers statewide misclassified as ICs=***9,090***
5 = Taxable wages underreported per new worker misclassified as an IC=***$5000***
6 = Total taxable wages underreported statewide for new workers misclassified as ICs=***$45,450,000***
7 = Tax underreported per new worker misclassified as an IC=***$250***
8 = Tax underreported statewide for new workers misclassified as ICs=***$2,272,500***
9 = Average UI tax rate=***5%***
10 = Percent of state UI taxes underreported due to workers misclassified as ICs=***8.3%***

New Jersey

REQUIRED INFORMATION

Source – State employment and unemployment insurance data

A = Total number of employers in the state with one or more employees covered under unemployment insurance or the # of employers registered with the state=***221,548***

B = Total number of covered workers in the state, i.e. the number of individuals working for wages in all industry sectors=***3,622,873***

J = Overall unemployment insurance tax collected in the state during the time period analyzed=***$1,364,330,321***

Source – State UI tax audit data

C = Number of employers audited during the time period analyzed=***6,972***
D = Number of workers at the employers audited=***181,212 (est.)***
E = Number of audited employers w/ new workers who had been misclassified as ICs=***638***
F = Total number of workers at employers w/ new workers who had been misclassified as ICs= ***not available***
G = Number of new workers misclassified as ICs at audited employers=***16,159***
H = Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs=***$79,307,195***
I = Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers=***$6,790,847***

INFORMATION DERIVED FROM CALCULATIONS-:

1 = Percent of audited employers w/ misclassified ICs=***9.15%***
2 = Total number of employers in state w/ new workers misclassified as ICs=***20,272***
3 = Percent of workers misclassified as ICs at employers audited=***8.9%***
4 = Number of workers statewide misclassified as ICs=***322,435***
5 = Taxable wages underreported per new worker misclassified as an IC=***$4,908***
6 = Total taxable wages underreported statewide for new workers misclassified as ICs=***$1,582,510,980***
7 = Tax underreported per new worker misclassified as an IC=***$420***
8 = Tax underreported statewide for new workers misclassified as ICs=***$135,422,700***
9 = Average UI tax rate=***8.56%***
10 = Percent of state UI taxes underreported due to workers misclassified as ICs=***9.9%***

Washington

REQUIRED INFORMATION

Source – State employment and unemployment insurance data

A = Total number of employers in the state with one or more employees covered under unemployment insurance or the # of employers registered with the state=***180,000***

B = Total number of covered workers in the state, i.e. the number of individuals working for wages in all industry sectors=***2,500,000***

J = Overall unemployment insurance tax collected in the state during the time period analyzed=***$806,000,000***

Source – State UI tax audit data

C = Number of employers audited during the time period analyzed=***3,538***
D = Number of workers at the employers audited=***71,990***
E = Number of audited employers w/ new workers who had been misclassified as ICs=***364***
F = Total number of workers at employers w/ new workers who had been misclassified as ICs= ***14,301***
G = Number of new workers misclassified as ICs at audited employers=***2,267***
H = Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs=***$4,342,101***
I = Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers=***$97,272***

INFORMATION DERIVED FROM CALCULATIONS-:

1 = Percent of audited employers w/ misclassified ICs=***10.3%***
2 = Total number of employers in state w/ new workers misclassified as ICs=***18,540***
3 = Percent of workers misclassified as ICs at employers audited=***3.15%***
4 = Number of workers statewide misclassified as ICs=***78,750***
5 = Taxable wages underreported per new worker misclassified as an IC=***$1,915.35***
6 = Total taxable wages underreported statewide for new workers misclassified as ICs=***$150,833,812***
7 = Tax underreported per new worker misclassified as an IC=***$42.90***
8 = Tax underreported statewide for new workers misclassified as ICs=***$3,378,395***
9 = Average UI tax rate=***2.24%***
10 = Percent of state UI taxes underreported due to workers misclassified as ICs=***0.42%***

Wisconsin

REQUIRED INFORMATION

Source – State employment and unemployment insurance data

A = Total number of employers in the state with one or more employees covered under unemployment insurance or the # of employers registered with the state=***142,882***

B = Total number of covered workers in the state, i.e. the number of individuals working for wages in all industry sectors=***2,555,787***

J = Overall unemployment insurance tax collected in the state during the time period analyzed=***$187,420,582***

Source – State UI tax audit data

C = Number of employers audited during the time period analyzed=***2,400***
D = Number of workers at the employers audited=***64,070 (est)***
E = Number of audited employers w/ new workers who had been misclassified as ICs=***551***
F = Total number of workers at employers w/ new workers who had been misclassified as ICs= ***not available***
G = Number of new workers misclassified as ICs at audited employers=***3,961***
H = Taxable Wages Underreported from Audited Employers w/New Workers Misclassified as ICs=***$13,770,849***
I = Amount of Tax Underreported for New Workers Misclassified as ICs from Audited Employers=***$415,196***

INFORMATION DERIVED FROM CALCULATIONS

1 = Percent of audited employers w/ misclassified ICs=***23%***
2 = Total number of employers in state w/ new workers misclassified as ICs=***32,863***
3 = Percent of workers misclassified as ICs at employers audited=***6.2%***
4 = Number of workers statewide misclassified as ICs=***158,458***
5 = Taxable wages underreported per new worker misclassified as an IC=***$3,476***
6 = Total taxable wages underreported statewide for new workers misclassified as ICs=***$550,896,667***
7 = Tax underreported per new worker misclassified as an IC=***$104.82***
8 = Tax underreported statewide for new workers misclassified as ICs=***$16,609,567***
9 = Average UI tax rate=***3%***
10 = Percent of state UI taxes underreported due to workers misclassified as ICs=***0.26%***