Approved: March 8, 2005
Date

MINUTES OF THE HOUSE COMMERCE AND LABOR COMMITTEE

The meeting was called to order by Chairman Don Dahl at 9:00 A.M. on February 21, 2005 in Room 241-N of the Capitol.

All members were present.

Committee staff present:
Jerry Ann Donaldson, Kansas Legislative Research Department
Norm Furse, Office of Revisor of Statutes
Renae Jefferies, Office of Revisor of Statutes
June Evans, Committee Secretary

Conferees appearing before the committee:
Representative Tom Holland
Representative Anthony Brown
Paul Rodriguez, Contractor
Ken Hayes, Cornerstone Construction Company, Lawrence
Melinda Lewis, El Centrol
Secretary Joan Wagnon, Internal Revenue Service

Others attending:
See attached list.

The Chairman opened the hearing on **HB 2372 - Misclassifying employees as independent contractors to avoid withholding income tax; Class A nonperson misdemeanor, investigations by Department of Revenue and Labor.**

Staff gave a briefing on **HB 2372.**

Representative Tom Holland testified in support of **HB 2372**. The intentions in introducing this legislation are three-fold: 1) to protect honest Kansas small businesses who are having to compete on an unlevel playing field, 2) to protect Kansas workers from suffering continued wage erosion and exploitation, and 3) to stop the resulting loss of income tax collections to the state of Kansas.

1099 (or independent contractor) misclassification occurs when an employer purposefully treats a worker as an independent contractor instead of an employee. This allows the employer to avoid paying social security, workers compensation, unemployment insurance, liability insurance, and both overtime and time-off wages.

The Internal Revenue Service (IRS) has for several years provided a twenty-question test to assist employers in determining whether a laborer should be treated as an employee or independent contractor.

Misclassification puts those businesses that play by the rules at a distinct disadvantage; the responsible employer may end up paying 20% or more in employee-related costs versus the unscrupulous contractor. **HB 2372** provides the Kansas Department of Revenue with a number of tools for investigating and prosecuting those employers who knowingly violate the law under this act (Attachment 1).

Representative Anthony Brown, a proponent to **HB 2372,** testified stating improper and/or misclassifiction of employees as "independent contractor," which is illegal under federal tax law, costs the United States Treasury and the Kansas Treasury potentially billions of dollars annually. According to some studies, more than half of the nine million people who file as independent contractors are currently misclassified at a loss of some $20 billion a year to the federal government. This revenue loss stems from the loss of legally-mandated tax payments, Social Security contributions, etc. that employers must pay for employees, but not for independent contractors (who, in theory, are supposed to pay such taxes themselves). There is an uneven playing field. Honest employers who follow the law find themselves at a competitive disadvantage against unscrupulous business owners who falsely label their employees as independent contractors (Attachment 2).

Paul Rodriguez, President of Rodriguez Mechanical Contractors, Inc., Kansas City, Kansas, testified as a proponent to **HB 2372**. Rodriguez Mechanical has been in the plumbing business for twenty-eight years,

licensed in both Kansas and Missouri. The70 people currently employed are comprised of administrative staff, plumbers, laborers, and operating engineers.

Prior to September 11, 2001, it was reported that our firm was the largest employer of union plumbers in the region. Our firm went from 143 plumbers to a low of 35. The past two years the employment is up to 70. Current competition utilizes a workforce that does not always reside in Kansas permanently and is willing to work for less, with no benefits and in some cases does not pay taxes (Attachment 3).

Ken Hayes, Cornerstone Construction, testified as a proponent to **HB 2372**, stating the bill deals with the deliberate misclassification and abuse of the 1099 independent contractor status. We deal with the issue of competitors and our own sub-contractors using labor that is not classified correctly. The use of 1099 labor instead of employing people directly means in short that an employer does not have to cover social security benefits, workers compensation withholding, health insurance, unemployment insurance, overtime wages and any other benefit at the federal, state, or germaine to the employers. This puts a contractor that obeys the law at a serious disadvantage due to the costs of legally employing a person versus the practice of "spinning off" an employee to 1099 status. On average an employee costs 33 to 40% due to the withholding taxes and programs associated with them than a 1099 independent contractor which incurs no extra costs to salary (Attachment 4).

Melinda K. Lewis, Director of Policy Advocacy and Research, El Centro, Inc., testified as a proponent to **HB 2372**. This is a serious issue of the misclassification of workers as independent contractors and which has significant implications for our state's revenue outlook as well as for workers rights. This bill is not about those individuals who work as legitimate independent contractors; who set the terms of their own work and compensation and organize their work product in a way that makes sense for them and those with whom they do business. Clearly there is no interest in hindering their operation.

El Centro, Inc. first became aware of the problem of misclassifiction of employees as independent contractors in the process of helping immigrant workers file their taxes. It was clear from their description of their work environment that they were employees of the landscaping company. Where they worked they were told what time to get to work, they drove in a company truck to jobs, used their employers' tools, were told how much they would be paid per hour, wore uniforms identifying them as part of the company, and were threatened of dismissal if they took a sick day. However, at tax time, they did not receive a W-2 and it was discovered that they had signed a 1099 form identifying them as an independent contractor. For tax purposes, this meant that no taxes had been withheld or paid on their behalf, so they owed a significant liability. Since then many more cases of misclassification have become evident, i.e., workers who are injured on the job who have difficulty filing a workers' compensation claim because they are not considered employees, those paid much less than minimum wage because the employer pretends that they are not really employees, and employees logging more than 80 hours per week without overtime because they are not entitled to the protections that normally accompany employment.

HB 2372 first and foremost recognizes this abusive practice and denounces it. It sets up penalties for those found misclassifying their employees and thereby creates a deterrent that we hope would end such activity (Attachment 5).

Joan Wagnon, Secretary, Kansas Department of Revenue, stated the Department has the responsibility to collect taxes and fees. It is of great concern if employers skirt the rules and do not report wages in accordance with the Fair Labor Standards Act. Since the Department only has the authority to pursue civil actions to enforce the collection of taxes, this bill gives the Department new powers.

Section 2. of the bill creates a hot line so that persons and businesses that wish to report this unfair labor practice can call into one place. Revenue and Labor would work together to design a method of investigating all reports received through this tip line. Another feature of this section is the creation of an Assistant Attorney General position in cooperation with the Department of Revenue to investigate such crimes. This position should be allowed to investigate tips and prosecute employers who commit these crimes.

Section 3. allows the Department to share confidential income tax information with the Department of Labor,

but only for purposes of investigating misclassifiction of employees. There have been many anecdotal reports of employers trying to avoid the payroll taxes by treating their employees as independent contractors. Not only does this create an unfair advantage, particularly for those businesses that use a competitive bid process such as in the construction industry, but it also deprives workers of important coverage if they are injured, laid off, or retire (Attachment 6).

The Chairman closed the hearing on **HB 2372**.

The Chairman asked the Sub-Committee Chair of **HB 2142 - Workers compensation; date of accident, employer's maximum liability for disability compensation, attorney fees** to give the Sub-Committee Report to the Committee.

Representative Kevin Yoder stated the Subcommittee carried out its charge by asking the opposing parties to meet and confer, and come up with a resolution regarding the contents of **HB 2142**. As a result, the Subcommittee offers a compromise that does the following:

Deletes sections two and three from the bill; and
Focuses on a single issue, i.e., the date of accident as embodied in Substitute for **HB 2142.**

"In cases where the accident occurs as a result of a series of events, repetitive use, cumulative traumas or microtraumas, the date of accident shall be the date the authorized physician takes the employee off work due to the condition or restricts the employee from performing the work which is the cause of the condition. In the event the worker is not taken off work or restricted as above described, then the date of injury shall be the earliest of the following dates: (1) the date upon which the employee gives written notice to the employer of the injury; or (2) the date the condition is diagnosed as worker related, provided such fact is communicated in writing to the injured worker. In cases where none of the above criteria are met, then the date of accident shall be determined by the administrative law judge based on all the evidence and circumstances; and in no event shall the date of accident be the date of, or the day before the regular hearing. Nothing in this subsection shall be construed to preclude a worker's right to make a claim for aggravation of injuries under the workers compensation act" (Attachment 7).

Representative Ruff moved and Representative Grange seconded to accept the compromise Substitute for **HB 2142**. The motion carried.

Representative Jack moved and Representative Pauls seconded on page 4, sub (d) (2) line 11, change "worker" to "work". The motion carried.

Representative Ruff moved and Representative Grant seconded to move Substitute **HB 2142** out favorably as amended. The motion carried.

Staff rebriefed the committee on **HB 2299**, stating the membership on the advisory panel increases the membership from 7 to 8 by adding physical therapists to the panel.

Representative Huntington moved and Representative Jack seconded to amend **HB 2299** and add "occupational therapists" and increase the panel to 9. (R. E. "Tuck" Duncan requested amendment.) The motion carried.

Representative Sharp stated the scope of these therapists is very broad and there is duplicate service, so she doesn't feel they should be included.

Representative Jack said this panel helps set the fee schedule, not policy, and so he believes it would be helpful to include all of them.

Representative Sharp requested to be recorded as voting "NO".

Representative Grant moved and Representative Swenson seconded to move **HB 2299** out of committee

MINUTES OF THE House Commerce and Labor Committee at 9:00 A.M. on February 21, 2005 in Room 241-N of the Capitol.

favorably as amended. The motion carried.

The meeting adjourned at 10:25 a.m. The next meeting will be called by the Chairman.

COMMERCE AND LABOR COMMITTEE

Date February 21, 2005

PAUL BICKNELL	KDOL
RICK HEFLEY	KDOL
Wil Leiker	Ks. AFL-CIO
Bill Curtis	Ks Assoc of School Bds
Joe Hudson	Carpenters' District Council of KC&V
Melinda Lewis	El Centro, Inc.
Ken Seeber	Hein Law Firm
Madyson Kilpatrick	citizen
Zachary Kilpatrick	citizen
Ashley Sherard	Lenexa Chamber
Andy Shaw	Goodyear Tire & Rubber
Wayne Maichie	KDOL
John Hoff	Kansas AFL-CIO
Alex Kotsiantz	PIA
Natalia Haag	Security Benefit
Ed Redmon	KS of F I
TERRY FORSYTH	KNEA
Joan Wagnon	KDOR
RICHARD THOMAS	KDOL-WC
Dick Cook	KS Ins. Dept.
Anthony R. Brown	Rep 38th Dist.
Ken Hayes	Cornerstone Const. Co of Lawrence, Inc.
Paul Rodriguez	Rodriguez Mechanical

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TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
RANKING DEMOCRAT: GOVERNMENTAL ORGANIZATION AND ELECTIONS
MEMBER: EDUCATION
HEALTH & HUMAN SERVICES
LEGISLATIVE EDUCATION PLANNING COMMITTEE

February 21st, 2005

Chairman Dahl and Committee Members:

Good morning! My name is Tom Holland and I am the State Representative for the Kansas House 10th District serving the communities of south Lawrence, Baldwin City, Wellsville, and north Ottawa. I am here today to ask for your support of House Bill 2372, the "1099 Misclassification Act". My intentions in introducing this legislation are three-fold: 1) to protect honest Kansas small businesses who are having to compete on an unlevel playing field, 2) to protect Kansas workers from suffering continued wage erosion and exploitation, and 3) to stop the resulting loss of income tax collections to the state of Kansas.

1099 (or independent contractor) misclassification occurs when an employer purposefully treats a worker as an independent contractor instead of an employee. This allows the employer to avoid paying social security, workers compensation, unemployment insurance, liability insurance, and both overtime and time-off wages. It also often results in the so-called independent contractor failing to properly withhold and report his / her personal federal and state income tax withholdings. 1099 misclassification is rampant throughout the nation and our own state of Kansas, particularly in the commercial and residential construction industries. PriceWaterhouse Coopers, in a report titled "Projection of the Loss of Federal Tax Revenue due to Misclassification of Workers", projected annual losses of between $2.5 billion and $4.7 billion in federal revenues between 1996 and 2004 due to the misclassification of workers. Estimates for the Commonwealth of Massachusetts in 1997 alone indicate that $68.3 million was lost in state income tax revenue due to 32,000 workers being misclassified in the construction industry.

There are certain legitimate work situations where an employer may not know how to classify a worker. In response, the IRS has for several years provided a twenty-question test to assist employers in determining whether a laborer should be treated as an employee or independent contractor. In the case of the residential and commercial construction industries, however, the simple fact is that if a construction worker takes direction from an employer's representative and is installing employer-supplied material, then that worker should be treated as an employee. The only reason that the worker is misclassified is to realize substantial savings for the employer.

Misclassification puts those businesses that play by the rules at a distinct disadvantage; the responsible employer may end up paying 20% or more in employee-related costs versus the

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unscrupulous contractor. This practice also has a direct and negative impact on the worker. Misclassification results in no social security benefits, no workers compensation coverage, no health insurance, no unemployment insurance, no overtime wages, and very often substandard wages and health and safety on the job. Indeed, misclassification has helped to promote an underground economy in many parts of the construction industry. Compounding the problem is the fact that many workers, once classified as independent contractors, are typically reluctant to claim their rightful status as an employee because of unmet tax obligations they have previously incurred.

House Bill 2372 provides the Kansas Department of Revenue with a number of tools for investigating and prosecuting those employers who knowingly violate the law under this act. The bill, if enacted, would:

a) establish criminal penalties fort those employers who misclassify an employee (class A non-person misdemeanor);
b) establish a toll free 800 number and website for the Kansas Department of Revenue and Kansas Department of Labor to jointly receive communications concerning information on persons and businesses misclassifying workers;
c) assign an assistant attorney general to the Kansas Department of Revenue to investigate and prosecute cases; and
d) allow the KDOR to share income tax information with the KDOL.

I thank you for your thoughtful and considerate deliberation on this most urgent matter. I sincerely hope that through your favorable consideration of HB 2372 we can implement this statute and begin to honestly confront this most destructive practice.

Sincerely,

Tom Holland
State Representative – 10th District

HOUSE BILL NO. 2372

Thank you Chairman Dahl and thank you committee for allowing me to talk with you today. I am Anthony Brown for those folks who do not know me and I have listed some bullet points that identify problems related to misclassified workers and those who falsely claim 1099 income.

1. Improper and/or misclassification of employees as "independent contractors," which is illegal under federal tax law, costs the United States Treasury and the Kansas Treasury potentially billions of dollars annually. According to some studies, more than half of the nine million people who file as independent contractors are currently misclassified, at a loss of some $20 billion a year to the federal government.[1]

2. This revenue loss stems from the loss of legally-mandated tax payments, Social Security contributions, etc. that employers must pay for employees, but not for independent contractors (who, in theory, are supposed to pay such taxes themselves).

3. Uneven playing field: Honest employers who follow the law find themselves at a competitive disadvantage against unscrupulous business owners who falsely label their employees as independent contractors.

4. This is due to the fact that honest employers pay taxes on their employees, make contributions to Social Security, and are required to purchase Worker's Compensation Insurance. Unscrupulous business owners avoid these payments by wrongfully labeling their employees as independent contractors.

5. This uneven playing field exerts enormous pressure on legitimate employers by forcing them to find ever more ways of reducing costs. In the worst case scenario, a business may be forced to close, seek bankruptcy protection, or, if it desires to stay in business, to join in the unlawful practice of misclassifying employees as independent contractors.

6. Furthermore, unscrupulous employers who misclassify their employees as independent contractors in order to avoid paying for worker's compensation insurance or health insurance benefits for employees often pass these costs on to taxpayers. If an uncovered worker is hurt on the job and cannot afford to pay his/her medical bills, the American taxpayer will inevitably be forced to pick up the tab.

7. Those employers who willingly skirt their legal duties to employees by misclassifying them are more prone to cutting other corners, such as using deficient materials and utilizing unskilled labor in construction projects, resulting in poorer construction and quality.

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[1] *See* "Is a Newscarrier an Employee or an Independent Contractor? Deterring Abuse of the 'Independent Contractor' Label Via State Tort Claims," 19 Yale L. & Pol'y Rev. 489, 491 (2001).

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8. Unscrupulous employers who skirt employment laws are more likely to hire illegal alien laborers in order to save money. This hurts citizens seeking employment, foreign nationals who are legally permitted to work in this country, and even the illegal aliens themselves, who are often exploited by employers in the form of low wages, no benefits and dangerous working conditions.

9. Unscrupulous employers who skirt employment laws are more likely to fail to pay overtime. This is unfair to the workers, as well as the legitimate businesses who pay overtime wages when required. Again, obeying the law puts these businesses at a competitive disadvantage vis-a-vis their unscrupulous counterparts.

In sum, the intentional misclassification of workers as independent contractors instead of employees by unscrupulous employers is a serious problem with serious consequences. These include: significant losses in revenue to the federal and state governments; legitimate employers suffering a competitive disadvantage due to the fact that they incur a greater tax burden, contribute to Social Security, and are required to purchase worker's compensation insurance; the likelihood that unscrupulous employers will breach other employment-related rules on overtime, hiring illegal alien laborers, and utilizing unskilled workers.

Clearly, misclassification has negative effects on legitimate employers, workers, and society as a whole. This bill will go a long way in combating this problem as it occurs in the state of Kansas.

RMC

RODRIGUEZ
MECHANICAL CONTRACTORS

House Commerce & Labor Committee
Representative Don Dahl
Room 241N
HB 2372
February 21, 2005

Chairman Dahl and Committee Members,

I am Paul Rodriguez, President of Rodriguez Mechanical Contractors Inc. My company is located in Kansas City, Kansas and I reside at 9000 Rosewood in Prairie Village Kansas, 66207.

Rodriguez Mechanical has been in the plumbing business for twenty-eight years, licensed in both Kansas and Missouri. We currently employ approximately 70 people, comprised of administrative staff, plumbers, laborers, and operating engineers.

Prior to September 11th, 2001, it was reported that our firm was the largest employer of union plumbers in the region. In our area if an apartment project was to be built, it was noted that you needed to call Rodriguez, if you want a quality project and a project built on time and in budget.

Since September 11th, our nation has seen some uncertain times and has seen increased unemployment. Our firm went from 143 plumbers down to 35 and now up to 70 for the past two years.

My company is currently challenged in trying to compete and to secure contracts for its business and employees.

We no longer are the go to place neither for pricing, nor for construction of these types of projects. In the last four years, we have encountered some competition that does not play by the rules nor do they pay all due taxes and acquire all their obligated requirements as a business. This does not allow for fair competition and a level playing field.

My current competition utilizes a workforce that does not always reside in Kansas permanently and is willing to work for less, with no benefits and in some cases does not pay taxes.

My current competition in some cases misclassifies the employees as an Independent Contractor, whereby he can pay them less than the prevailing wage for the area and no other obligations. At the end of the project he simply sends them a 1099, which if he cannot find them, now goes as uncollectible taxes.

My current competition also pays by piece work, where in order to make more money the misclassified employee now brings the children into the work area in order to produce more daily output. The more production the more earned.

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Misclassified Independent Contractors do not sign separate contracts related to the project, do not always have an occupational license, do not pay their full tax obligation, do not pay any benefits, do not pay into the Social Security System, do not carry liability and workers compensation insurance.

It is obvious that if they do not pay any of their obligations, this simply creates an unfair level playing field for those who play by the rules.

I am not here to separate nor take issue with the Hispanic community, Republican Party, Democrat Party, the Union Community, nor the Non Union Community. I am **not** here to address an immigration issue. I am here as a matter of survival and I am asking you to level the playing field.

I appear before you today to urge you to consider the passage of HB2372 and encourage you to implement an enforcement procedure.

What this bill is attempting to address is a complex issue, that if not addressed, my Business as well as others may be forced out of business in the future. Allowing by ignoring other business's to operate and avoid paying taxes and exploiting the workforce is an unfair advantage to those who operate by the rules.

This bill if passed will be the first steps in making an attempt to level the playing field and will enable my business to compete and provide for quality of life with a livable wage, for my employees.

In conclusion I urge you to pass and move this bill forward.

Respectfully Voiced and Submitted

Paul Rodriguez
Rodriguez Mechanical Contractors Inc.

February 21st 2005

Chairman Dahl and Committee Members

I have been asked by the Tom Holland my State Representative from the 10th district to write of my support for House bill 2372, referred to as the "1099 Misclassification Act". This bill deals with the deliberate misclassification and abuse of the 1099 independent contractor status. As the co-owner of Cornerstone Construction Company of Lawrence, Inc. we deal with the issue of competitors and our own sub-contractors using labor that is not classified correctly. This practice has a detrimental effect in many ways.

First the use of 1099 labor instead of employing people directly means in short that an employer does not have to cover social security benefits, workers compensation withholding, health insurance, unemployment insurance, overtime wages and any other benefit at the Federal, State, or germaine to the employer. This puts a contractor that obeys the law at a serious disadvantage due to the costs of legally employing a person versus the practice of "spinning off" an employee to 1099 status. On average an employee costs 33 to 40% due to the withholding taxes and programs associated with them than a 1099 independent contractor which incurs no extra costs to salary.

In short, the use of 1099 independent contractors enables a general contractor like myself to win contractor bids because there labor costs are lower. Simply put, the non-payment of the costs associated with employees enables an employer to drop his costs up to 40%.

This results in the loss of monies to the state systems of unemployment, social security, insurance etc. And it means that employers that play by the rules are at an huge disadvantage. These acts of direct violation of state and federal law regarding the 1099 classification are rampant. The employer escapes penalty by placing the burden of reporting income on the employee or independent contractor. This reporting and payment into the system is routinely ignored or circumvented.

The impact on my own company over the last 4 years has been dramatic. In 2001 my company carried eight full time employees as well as myself and my business partner. Today, we have two full time employees and the two owners. We have reduced our force by six people to cut costs and remain competitive with contractors that abuse the 1099 system.

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These measures were necessary for our bids to be competitive in the marketplace and to ensure our survival. I have full knowledge that not all of my own sub-contractors pay employees correctly. They abuse the 1099 independent contractor system in order to remain competitive with other companies in there field. The sad truth is that to do what the state and federal government mandates in dealing with employees means to not survive in a competitive market.

I urge your support in passing bill 2372 in order to end this practice of deceit and direct avoidance of payment into the state established systems to benefit workers. All employers should be required to support the systems of social security, unemployment taxes, and the other mandatory withholding programs. To do so is criminal and in my opinion un-American. Thank you for your time.

Ken Hayes

Ken Hayes

Cornerstone Construction

El Centro, Inc.

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Overland Park, KS 66212
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913-381-2914 fax

Macías-Flores Family Center
290 S. 10th Street
Kansas City, KS 66102
913-281-1186
913-281-1259 fax

Woodland Hills, Inc.
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Kansas City, KS 66103
913-362-8155
913-362-8203 fax

NeighborWorks® CHARTERED MEMBER NCLR

February 21, 2005

Chairman Don Dahl and Honorable Members of the House Commerce and Labor Committee,

El Centro, Inc. wishes to express our support for HB2372, which addresses the serious issue of the misclassification of workers as independent contractors and which has significant implications for our state's revenue outlook as well as for workers' rights. First let me address what HB2372 is *not* about. It is not about those individuals who work as legitimate independent contractors, setting the terms of their own work and compensation and organizing their work product in a way that makes sense for them and those with whom they do business: clearly we have no interest in hindering their operation. It is not about issues related to immigrants' work authorization or to larger questions of immigration policy: misclassification affects citizen and immigrant workers, undocumented and documented. It is not about adding unnecessary regulations to our business climate: we are simply recognizing, labeling, and seeking to prevent an unlawful practice that has dire consequences for our state.

El Centro, Inc. first became aware of the problem of misclassification of employees as independent contractors in the process of helping immigrant workers to file their taxes. It was clear from their description of their work environment that they were employees of the landscaping company where they worked; they were told what time to get to work, drove in a company truck to jobs, used all of the employers' tools, were told how much they would be paid per hour, wore uniforms identifying them as part of the company, and were threatened to be fired if they took a sick day. However, at tax time, they did not receive a W-2 and we discovered that they had signed a 1099 form identifying them as an independent contractor. For tax purposes, this meant that no taxes had been withheld or paid on their behalf, so they owed a significant liability. Since then, we have found many more cases of misclassification—workers who are injured on the job who have difficulty filing a workers' compensation claim because they are not considered employees, those paid much less than minimum wage because the employer pretends that they are not really employees, and employees logging more than 80 hours per week without overtime because they are not entitled to the protections that normally accompany employment. This issue has grown from relatively rare situations to an almost ubiquitous one in some industries. These workers are of different ethnicities and immigration statuses. What they share in common is vulnerability, a desperate desire to work, and an uncertainty about to whom to turn when they are exploited.

Sometimes we can turn to the U.S. Department of Labor, Wage and Hour Division to investigate these abuses. They can apply a test to determine that the individual is really an employee, despite what the employer claims. However, their authority is limited, especially in addressing some of the smaller companies using this exploitative practice, and we fear that companies do not consider the penalties exacted, usually just payment of proper wages, a real threat when compared to the profit to be gained from avoiding unemployment insurance, workers' compensation, and, most significantly, federal and state tax costs. HB2372 first and foremost recognizes this abusive practice and denounces it. It sets up penalties for those found misclassifying their employees and thereby creates a deterrent that we hope will end such activity. It facilitates investigations by the Department of Revenue and the Department of Labor and, we hope, will send a message that Kansas does not tolerate the evasion of our laws in the pursuit of excessive profit. The state of Kansas is already paying for investigations of labor abuses by the Department of Labor in many of

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these cases, but the penalties allowed in that process are not sufficient to recoup costs in the way that pursuing unpaid taxes to the state will facilitate.

We know that Kansas stands to benefit economically from passage of HB2372 as more of the tax dollars owed to us flow appropriately to the state and as law-abiding employers no longer have to compete against those who flagrantly break the rules. We welcome this correct infusion of dollars, but we celebrate most enthusiastically the message that HB2372 sends in support of workers' basic rights to at least minimum wage, overtime pay, and recognition of their status as employees. We encourage your favorable consideration of this measure to address the exploitative misclassification of workers in our state. There are some amendments that we believe could be considered as the committee discusses this bill, including giving the Attorney General explicit authority to prosecute offenders and giving concurrent authority to local district attorneys to lessen the investigative and prosecutorial burden on the state. Even in its current form, though, HB2372 is important protection, appropriately targeted, to send predatory employers a message that we expect Kansas businesses to play by the rules. Thank you.

Most sincerely,

Melinda K. Lewis

Melinda K. Lewis
Director of Policy Advocacy and Research
El Centro, Inc.

Independent Contractor Misclassification to Evade Labor, Employment and Tax Laws

Testimony prepared in support of Kansas House Bill No. 2372
February 21, 2005

Catherine K. Ruckelshaus
National Employment Law Project, Inc.
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For almost 30 years, the National Employment Law Project (NELP) has advocated on behalf of the working poor, the unemployed, and other groups that face significant barriers to employment and government systems of support.

A. Independent Contractor Abuses

Employers of low-income workers frequently misclassify their employees as "independent contractors" and who can blame them: the result is *no coverage* of most labor, employment and tax laws for the worker and employer. This saves employers payroll costs ranging from 15 to 30%, avoids out-of-pocket costs, administrative costs, and loss of control that result from the need to pay wages owing to "employees," to comply with regulations protecting "employees," and to bargain with unions representing a business' "employees."

Independent contractor misclassification is rampant in some sectors, including agriculture, garment, delivery services, home care, and day labor jobs. Its prevalence is on the rise, however, and can be seen in nearly every sector of today's economy, making it a critical area for states to scrutinize. Its prevalence creates problems not only for the workers in those sectors, who lose withholdings and benefits that should have been paid by their employers, but also for law-abiding employers who are undercut by their under-bidding competitors, and for the states, who lose billions of dollars in unpaid tax revenues.[1]

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[1] For data on the increased employer misclassification practices, see Planmatics, Inc., *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs* (February 2000). See also, U.S. General Accounting Office, Pub.No. GAO\GGD-89-107, *Tax Administration Information: Returns Can Be Used to Identify Employers Who Misclassify Employees* (1989). The GAO projections estimated that misclassification of employees as independent contractors would reduce federal tax revenues by up to $4.7 billion by 2004.

Because businesses are responsible for complying with labor, employment and tax laws for all workers they "employ," a company may claim that it has no obligation under these laws toward a particular worker because that worker is properly classified as an "independent contractor" operating a business, rather than an "employee." Where a worker is *not* an "employee," the relationship between the worker and the company is considered a commercial one between a company and an independent contractor. This is rarely actually the case in low-wage sectors where workers do not invest capital in a business and where misclassification of employees as "independent contactors" is rampant, including janitorial, dry walling and other lower-skill construction jobs, day labor, agriculture, and home care, to name a few.

B. States' Strategies for Combating Independent Contractor Abuses

Recognizing the dire results for workers, law-abiding businesses and the state coffers, many states have enacted laws to combat businesses' "1099-ing" misclassification schemes, ranging from creating study commissions, to sector-specific "fixes," to statute-specific provisions closing loopholes. A few model provisions are:

- In **Nebraska**, a local coalition of groups developed a list of legislative principles to combat abuses of the independent contractor misclassification, including coordinated enforcement across state agencies. For a list of all principles, contact Ed Leahy at Nebraska Appleseed, eleahy@neappleseed.org.
- **Washington** authored a legislative report on contingent work, including independent contractors, with key policy considerations and state legislative recommendations.
- **Massachusetts** broadly defines who is an "employee" under its labor laws, excepting only those who are (1) free from direction and control, *and* (2) providing a service outside the usual place of business of the employee *and* (3) the worker is customarily engaged in an independently established occupation, profession or business. An employer's failure to withhold taxes is *not* relevant to the employee's status.
- **Texas** prohibits employers from inducing employees to sign an "independent contractor" agreement.
- **California** enacted legislation in 1992 creating employers of record for home health care workers who had been classified as "independent contractors."
- **Colorado** enacted legislation in 2004 requiring construction contractors to provide workers' compensation coverage to all workers on a construction site.
- **New York** established a commission to study misclassification of workers as independent contractors.

Other states have pending bills related to independent contractor abuses. For periodic listing of pending provisions, see http://www.nelp.org/docUploads/nswlegsum070104%2Epdf and publications listed therein.

K A N S A S

JOAN WAGNON, SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

Testimony

TO: House Commerce and Labor Committee

FROM: Joan Wagnon, Secretary

RE: HB 2372

DATE: February 21, 2005

Chairman Dahl and other members of the committee:

Rep. Holland has requested the Department of Revenue to testify on his proposed initiative to reduce the misclassification of employees, depriving them of benefits they are entitled to, and depriving the state of income from these workers' wages.

The Department of Revenue has the responsibility to collect taxes and fees; it is a great concern to us if employers skirt the rules and do not report wages in accordance with the Fair Labor Standards Act.

HB 2372 has 3 basic parts. Section 1 creates the crime of misclassifying employees to avoid state and federal income tax withholding provisions. Erroneously classifying workers as independent contractors not only avoids withholding, but also workers compensation and unemployment contributions at the state level, and social security at the federal level.

Since the Department of Revenue only has the authority to pursue civil actions to enforce the collection of taxes, this bill gives new powers.

Section 2 creates a hot line so that persons and businesses that wish to report this unfair labor practice can call into one place. Revenue and Labor will work together to design a method of investigating all reports received through this tip line.

Another feature of this section is the creation of an Assistant Attorney General position, in cooperation with the Department of Revenue to investigate such crimes. This position is similar to the assignment of an Assistant AG to ABC (Alcoholic Beverage Control) within Revenue, and also in the Department of Insurance. This position should be allowed to investigate tips and prosecute employers who commit this crime.

Section 3 allows the Department of Revenue to share confidential income tax information with the Department of Labor, but only for purposes of investigating misclassification of employees.

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There have been many anecdotal reports of employers trying to avoid the payroll taxes by treating their employees as independent contractors. Not only does this create an unfair advantage, particularly for those businesses that use a competitive bid process such as in the construction industry, but it also deprives workers of important coverage if they are injured, laid off, or retire. It also costs the state the lost withholding taxes on the workers wages.

February 15, 2005

To: House Committee on Commerce and Labor

From: Representative Kevin Yoder

Re: HB 2142

The Subcommittee on HB 2142 carried out its charge regarding HB 2142 by asking the opposing parties to meet and confer, and come up with a resolution regarding the contents of HB 2142. As a result, the Subcommittee offers a compromise that does the following:

- Deletes sections two and three from the bill; and
- Focuses on a single issue (*i.e.,* the date of accident as embodied in Substitute for HB 2142).

Substitute for HB 2142 provides the following language:

"In cases where the accident occurs as a result of a series of events, repetitive use, cumulative traumas or microtraumas, the date of accident shall be the date the authorized physician takes the employee off work due to the condition or restricts the employee from performing the work which is the cause of the condition. In the event the worker is not taken off work or restricted as above described, then the date of injury shall be the earliest of the following dates: (1) the date upon which the employee gives written notice to the employer of the injury; or (2) the date the condition is diagnosed as worker related, provided such fact is communicated in writing to the injured worker. In cases where none of the above criteria are met, then the date of accident shall be determined by the administrative law judge based on all the evidence and circumstances; and in no event shall the date of accident be the date of, or the day before the regular hearing. Nothing in this subsection shall be construed to preclude a worker's right to make a claim for aggravation of injuries under the workers compensation act."

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