

## MINUTES OF THE SENATE COMMERCE COMMITTEE

The meeting was called to order by Chairperson Karin Brownlee at 8:30 A.M. on March 8, 2006 in Room 123-S of the Capitol.

All members were present.

## Committee staff present:

Kathie Sparks, Kansas Legislative Research Department  
Helen Pedigo, Revisor of Statutes  
Jackie Lunn, Committee Secretary

## Conferees appearing before the committee:

Tom Whitaker-Kansas Motor Carriers Association  
Sandie Ghilino-Greater Kansas City Mason Contractors  
Corey Peterson-Association of General Contractors of Kansas  
Marlee Carpenter-Kansas Chamber  
Representative Anthony Brown  
Jim Stelle-Safety Director, Falewitch Construction Services, Inc.  
JE Dunn Construction Company  
Gary Seaton Sr.-Total Interiors, Inc.  
Kelly Pinkham-UMKC  
Judy Ancel-UMKC  
Paul Rodriquez-Rodriquez Mechanical Contractor, Inc.  
Jim Wilkinson-Olathe, KS Floor Contractor

## Others attending:

See attached list.

Chairperson Brownlee opened the hearing on **HB 2772-Employment relationship between owner-operators and licensed motor carrier operators for employment security law purposes** by introducing Kathie Sparks from Legislative Research to review the bill. Ms. Sparks reviewed **HB 2772**. Upon completion of her review, Chairperson Brownlee stated **HB 2772** started out with a narrow scope and ballooned. The amendment added was the same as SB 531; the Committee will evaluate which language will be preferred. Ms. Sparks outlined the differences between **HB 2772** and **SB531-Misclassification of employees as independent contractors to avoid withholding income tax; investigations by departments of revenue and labor**. During her explanation there was discussion with the Committee regarding their concerns about the definition of independent contractor.

Chairperson Brownlee introduced Tom Whitaker, Executive Director of the Kansas Motor Carrier Association to give his testimony as a proponent of **HB 2772**. Mr. Whitaker presented written testimony. (Attachment 1) Mr. Whitaker stated in the trucking industry, an owner/operator will lease his/her equipment to a licensed motor carrier to operate under the carrier's operation authority granted by the state or federal government. In return, the owner/operator receives a percentage of the freight revenue generated by such equipment lease. Owner/operators are small businesses. **HB 2772** does not change the factors used to determine whether an owner/operator is an independent contractor or employee. The bill merely removes any doubt that required compliance with federal and state safety rules shall not enter into the determination of an owner/operator's status. He stated the Employment Security Advisory Council stated they took no position on the bill. In closing, Mr. Whitaker stated the Kansas Motor Carriers Association respectfully requests the Senate Commerce Committee report the motor carrier portion of **HB 2772** favorably.

Chairperson Brownlee introduced Sandie Ghilino to give his testimony as a proponent for **HB 2772**. Mr. Ghilino presented written testimony. (Attachment 2) Mr. Ghilino stated he was testifying on behalf of the Greater Kansas City Mason Contractors Association. He stated 1099 abuse has made the taxpaying contractors non competitive in today's shrinking market. They would like to recommend that the penalties extend to the general contractor, home builder and project owners who encourage, and profit greatly from 1099 abuse. He stated he would like to recommend maximum penalties so that this abuse will stop. He went on to say there was another area of abuse and that was unregistered contractors working in the State of Kansas and not paying any taxes. They come to Kansas build a few projects and leave with the State of Kansas never knowing they were here working. They don't pay state and federal taxes.

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Chairperson Brownlee introduced Corey Peterson representing the Associated General Contractors of Kansas, to give his testimony as a neutral party. Mr. Peterson presented written testimony. (Attachment 3) Mr. Peterson stated that AGC of Kansas stands neutral on **SB 531** and **HB 2772** as written but with concerns. The concerns with **HB 2772** are regarding the offering of a first time warning for offenders. AGC is concerned the bill would create problems for legitimate small businesses that believe they are doing business properly to be found to have interpreted the law incorrectly and thus face penalties that could put them out of business. He also stated there is a small segment of the construction industry, primarily companies from out of state, which is apparently skirting current IRS and state laws by intentionally misclassifying workers as independent contractors. AGC agrees that the state and federal government should enforce the existing law and bring these companies to justice.

Upon conclusion of Mr. Peterson's testimony there was discussion with the Committee and Mr. Peterson regarding his concerns with the bill.

Chairperson Brownlee introduced Marlee Carpenter representing the Kansas Chamber, to give her testimony as an opponent of **HB 2772**. Ms. Carpenter presented written testimony. (Attachment 4) Ms. Carpenter stated the Kansas Chamber believes the bills were drafted with the best of intentions of addressing a problem in Kansas, but has gone too far in doing so. Ms. Carpenter offered amendments for both **HB 2772** and **SB 531**. Ms. Carpenter explained her amendments to the bill; on New Section 2. (a) would read "No person shall knowingly and intentionally misclassify an employee as an independent contractor for the sole and primary purposes of avoiding either state income tax withholding and reporting requirements or state unemployment insurance contributions reporting requirements". She would also like to strike part of Section 2, (b) and add language stating there shall be no penalty for first time violators.

Upon the conclusion of Ms. Carpenter's testimony there was discussion with the Committee regarding the amendments she is offering on the bill. The Committee has concerns regarding the hiring of independent contractors and when you are audited you find out the independent contractor is an employee according the federal guidelines used to determine independent contractor.

Chairperson Brownlee introduced Representative Anthony Brown to give his testimony as a proponent of **HB 2772**. Representative Brown offered written testimony. (Attachment 5) Representative Brown stated that worker misclassification is a large problem in the state of Kansas. It is harmful to business. Most contractors do comply with good business practices but those that do not comply and do so intentionally to avoid paying the necessary taxes makes it difficult to compete in the market place. Representative Brown called the attention of the Committee to Representative John C. Grange's written testimony and stated Representative Grange could not be in the Committee meeting today. (Attachment 6) Representative Brown went on to say that in Representative Grange's written testimony he stated he owns a small mechanical contracting company with 12 employees. Representative Grange went on to say, in his written testimony, his payroll for 2005 was over \$497,000. He further stated if he had purposely misclassified these employees as independent contractors, he would have saved his company \$70,000. Additionally he would not have to collect federal or state income tax and this in turn would allow him to offer their services at a reduced rate.

Upon completion of Representative Brown's testimony there was discussion with the Committee regarding independent contractor and the difference between employee and independent contractor.

Chairperson Brownlee closed the hearing on **HB 2772** and opened the hearing on **SB 531-Misclassification of employees as independent contractors to avoid withholding income tax; investigations by departments of revenue and labor.**

Chairperson Brownlee announced Joe Hudson, Political Director for the Carpenters Union would be showing a video regarding misclassification of employees. (Video on file in the office of the Senate Commerce Committee Secretary's Office)

Upon completion of the video, Chairperson Brownlee introduced Jim Steel, Safety Director for Falewitch Construction, Inc. of Omaha, Nebraska to give his testimony as a proponent of **SB 531**. Mr. Steel offered written testimony. (Attachment 7) Mr. Steel gave a brief summary of his testimony stating business owners

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and managers who are willing to cheat in this way are also the type people who shortcut the safety, health and welfare of their workforce and the workers and citizens in near proximity to their workforce. The more business these companies get, the more dangerous the work environment becomes.

Chairperson Brownlee introduced Mr. Tyler Henson, Counsel for J.E. Dunn Construction Company, to give testimony on behalf of J.E. Dunn. (Attachment 8) Mr. Henson stated that J.E. Dunn supports **SB 531** as amended to help prevent those employers that knowingly and intentionally misclassify employees as independent contractors for purposes of avoiding income tax withholdings or unemployment insurance contributions, as well as other related costs associated with maintaining a work force.

Chairperson Brownlee introduced Gary Seaton Sr., President of Total Interiors, Inc. Of Kansas City, Kansas to give his testimony as a proponent of **SB 531**. Mr. Seaton presented written testimony. (Attachment 9) Mr. Seaton stated any unscrupulous contractors that misclassify employees as independent contractors and don't pay the appropriate taxes and insurance are creating an uneven playing field for competition in their industry. He stated he is in support of **SB 531** and urged the Committee to give it their support.

Chairperson Brownlee introduced Mr. Kelly D. Pinkham, MS with the Department of Economics for the University of Missouri-Kansas City (UMKC) to give his testimony as a proponent of **SB 531**. Mr. Pinkham presented written testimony. (Attachment 10) Mr. Pinkham gave a brief review of his testimony stating the issue of misclassification is a growing problem around the county. He stated UMKC has done studies on this issue and stated misclassification negatively impacts the citizens in many ways. In his study the results verified the main reason for misclassifying is the savings of the insurance premiums.

Chairperson Brownlee introduced Judy Ancel, Director of the Institute for Labor Studies, a joint project of UMKC and Longview Community College, to give her testimony as a proponent of **SB 531**. Ms. Ancel presented written testimony. (Attachment 11) She gave a brief review of her testimony stating one increasingly common illegal practice is the misclassification of workers. Where this has historically been common in day labor and agriculture and in certain services, today it is spreading to new sectors of the economy, especially where low-wage jobs proliferate like janitorial work, home health care, delivery services and construction. She stated **SB 531** is a good start on trying to deal with the ever increasing problem. The passage of this bill will say to Kansas employers and workers that our state stands for fairness and responsibility and that it seeks to create a climate for business and workers in which the law is respected and applied to all on an equal basis.

Chairperson Brownlee introduced Ron Rodriquez representing the Rodriquez Mechanical Contractors, Inc. in Kansas City, Kansas, to give his testimony as a proponent of **SB 531**. Mr. Rodriquez presented written testimony. (Attachment 12) Mr. Rodriquez gave a brief review of his testimony stating Rodriquez Mechanical Contractors, Inc. is a plumbing business which has been operating for 30 years. He stated that because his company is competing with companies that misclassify he is losing work due to the fact he cannot compete with them in the market place.

Chairperson Brownlee introduced Jim Wilkinson, Vice-President of Image Flooring, LLC, a Lenexa based floor covering contractor, to give his testimony as a proponent of **SB 531**. Mr. Wilkinson presented written testimony. (Attachment 13) Mr. Wilkinson stated the misclassifying of workers and independent self-contractors is an ever-growing obstacle that many firms in the construction industry are facing. Unscrupulous contractors who are not providing benefits, pensions, liability and Worker's Compensation insurance, business licensing fees or fair wages and the associated taxes put fair contractors at a huge competitive disadvantage. He is in support of **SB 531**.

Upon completion of Mr. Wilkinson's testimony, Chairperson Brownlee announced the Committee would continue the hearing to tomorrow and instructed anyone that wished to testify tomorrow on **SB 531**, should tell the committee secretary.

Meeting was adjourned at 9:30 a.m. with the next scheduled meeting to be tomorrow, March 8, 2006 at 8:30 a.m. in room 123S.



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**Tom Whitaker**  
Executive Director

**LEGISLATIVE TESTIMONY****In Support of House Bill No. 2772****Presented by the Kansas Motor Carriers Association****Before the Senate Commerce Committee****Senator Karin Brownlee, Chairman****Wednesday, March 8, 2006****MADAM CHAIRMAN AND MEMBERS OF THE  
SENATE COMMERCE COMMITTEE:**

I am Tom Whitaker, executive director of the Kansas Motor Carriers Association. I appear here this morning representing our 1,250 member-firms seeking your favorable consideration of House Bill No. 2772. We are testifying only to the provision of HB 2772 concerning motor carriers.

HB 2772 clarifies in Kansas law that a motor carrier complying with the requirements of the Federal Motor Carriers Safety Regulations shall not be considered as the motor carrier's exercise of control over an owner/operator. Language accomplishing this clarification is found on Page 2 of the bill, lines 2 through 9.

In the trucking industry, an owner/operator will lease his/her equipment to a licensed motor carrier to operate under the carrier's operating authority granted by the state or federal government. In return, the owner/operator receives a percentage of the freight revenue generated by such equipment lease. Owner/operators are independent small businesses.

Federal law (see attached) requires a motor carrier to be responsible for operating leased motor vehicles in compliance with requirements prescribed by the Secretary of Transportation on safety of operations and equipment as if the motor vehicles were owned by the motor carrier. We have attached a list of the federal and state rules and regulations with which a motor carrier must comply.

HB 2772 does not change the factors used to determine whether an owner/operator is an independent contractor or employee. The bill merely removes any doubt that required compliance with federal and state safety rules shall not enter into the determination of an owner/operator's status. HB 2772 has been reviewed by the Employment Security Advisory Council. The Council took no position on the bill.

The Kansas Motor Carriers Association respectfully requests the Senate Commerce Committee report the motor carrier portion of HB 2772 favorably. We thank you for the opportunity to appear before you today and we would be pleased to respond to any questions you may have.

## 49 § 14101

### Note 2

on ground of neglect or refusal to transport goods where although it failed to provide a tractor from Monday through Thursday its failure to do so was due to inclement weather and it made a good-faith effort to provide and eventually did provide service. *John Morrell & Co. v. Frozen Food Exp., Inc.*, C.A.5 (Tex.) 1983, 700 F.2d 256.

A carrier is not required to subject its employees to risk of injury or harm in crossing picket line, established by a shipper's striking employees, in order to comply with statute obligating carrier to furnish transportation on reasonable request therefor by shipper. *Meier & Pohlmann Furniture Co. v. Gibbons*, C.A.8 (Mo.) 1956, 233 F.2d 296, certiorari denied 77 S.Ct. 101, 352 U.S. 879, 1 L.Ed.2d 80.

## § 14102. Leased motor vehicles

(a) **General authority of Secretary.**—The Secretary may require a motor carrier providing transportation subject to jurisdiction under subchapter I of chapter 135 that uses motor vehicles not owned by it to transport property under an arrangement with another party to—

- (1) make the arrangement in writing signed by the parties specifying its duration and the compensation to be paid by the motor carrier;
- (2) carry a copy of the arrangement in each motor vehicle to which it applies during the period the arrangement is in effect;
- (3) inspect the motor vehicles and obtain liability and cargo insurance on them; and
- (4) have control of and be responsible for operating those motor vehicles in compliance with requirements prescribed by the Secretary on safety of operations and equipment, and with other applicable law as if the motor vehicles were owned by the motor carrier.

(b) **Responsible party for loading and unloading.**—The Secretary shall require, by regulation, that any arrangement, between a motor carrier of property providing transportation subject to jurisdiction under subchapter I of chapter 135 and any other person, under which such other person is to provide any portion of such transportation by a motor vehicle not owned by the carrier shall specify, in writing, who is responsible for loading and unloading the property onto and from the motor vehicle.

(Added Pub.L. 104-88, Title I, § 103, Dec. 29, 1995, 109 Stat. 890.)

## MOTOR CARRIERS, ETC. Ch. 141

In action brought by the Commission and the states of Michigan and Wisconsin for a preliminary injunction compelling defendant, a common carrier by water, to operate all three of its Lake Michigan carferries during the 1977 summer sailing season, the record showed that the 1977 demand for defendant's carferry service was at least as high as, and possibly higher than, that of recent years, that August had been and was likely to continue to be the month of heaviest demand, and that, despite defendant's best efforts, it would not be able to satisfy its statutory and administrative mandate of providing adequate service upon reasonable demand with the operation of only two vessels during the month of August, 1977. *I.C.C. v. Chesapeake & Ohio Ry. Co.*, W.D.Mich.1977, 438 F.Supp. 666.

## 141 OPERATIONS OF CAR

### HISTORICAL AND

Revision Notes and Legislative Reports  
1995 Acts. House Report No. 104-3  
House Conference Report N  
422, see 1995 U.S. Code Cong. a  
News, p. 793.

Effective Dates  
1995 Acts. Section effective Jan.  
1996, except as otherwise provided  
L. 104-88, see section 2 of Pub

### CROSS

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American Digest System  
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### WESTLAW EI

Carriers cases: 70k[add key num  
Commerce cases: 83k[add key n  
See, also, WESTLAW guide follo

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Right of action 8  
Rules and regulations 4  
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Strict liability 11

Purpose  
Interstate Commerce Act was st  
to prevent accidents, as well as  
financially responsible defendan  
statutory provision for direction a  
trol of leased vehicles was inte  
insure that interstate operations v  
supervised directly by persons

(2) When possession of the equipment by the authorized carrier ends, a receipt shall be given in accordance with the terms of the lease agreement if the lease agreement requires a receipt.

(3) Authorized representatives of the carrier and the owner may take possession of leased equipment and give and receive the receipts required under this subsection.

(c) **Identification of equipment** — The authorized carrier acquiring the use of equipment under this section shall identify the equipment as being in its service as follows:

(1) During the period of the lease, the carrier shall identify the equipment in accordance with the FMCSA's requirements in 49 CFR part 390 of this chapter (Identification of Vehicles).

(2) Unless a copy of the lease is carried on the equipment, the authorized carrier shall keep a statement with the equipment during the period of the lease certifying that the equipment is being operated by it. The statement shall also specify the name of the owner, the date and length of the lease, any restrictions in the lease relative to the commodities to be transported, and the address at which the original lease is kept by the authorized carrier. This statement shall be prepared by the authorized carrier or its authorized representative.

(d) **Records of equipment** — The authorized carrier using equipment leased under this section shall keep records of the equipment as follows:

(1) The authorized carrier shall prepare and keep documents covering each trip for which the equipment is used in its service. These documents shall contain the name and address of the owner of the equipment, the point of origin, the time and date of departure, and the point of final destination. Also, the authorized carrier shall carry papers with the leased equipment during its operation containing this information and identifying the lading and clearly indicating that the transportation is under its responsibility. These papers shall be preserved by the authorized carrier as part of its transportation records. Leases which contain the information required by the provisions in this paragraph may be used and retained instead of such documents or papers. As to lease agreements negotiated under a master lease, this provision is complied with by having a copy of a master lease in the unit of equipment in question and where the balance of documentation called for by this paragraph is included in the freight documents prepared for the specific movement.

(2) [Reserved]

[44 FR 4681, Jan. 23, 1979, as amended at 49 FR 47269, Dec. 3, 1984; 49 FR 47850, Dec. 7, 1984; 50 FR 24649, June 12, 1985; 51 FR 37406, Oct. 22, 1986; 62 FR 15424, Apr. 1, 1997]

**§376.12 Written lease requirements.**

Except as provided in the exemptions set forth in subpart C of this part, the written lease required under §376.11(a) shall contain the following provisions. The required lease provisions shall be adhered to and performed by the authorized carrier.

(a) **Parties** — The lease shall be made between the

authorized carrier and the owner of the equipment. The lease shall be signed by these parties or by their authorized representatives.

(b) **Duration to be specific** — The lease shall specify the time and date or the circumstances on which the lease begins and ends. These times or circumstances shall coincide with the times for the giving of receipts required by §376.11(b).

(c) **Exclusive possession and responsibilities** —

(1) The lease shall provide that the authorized carrier lessee shall have exclusive possession, control, and use of the equipment for the duration of the lease. The lease shall further provide that the authorized carrier lessee shall assume complete responsibility for the operation of the equipment for the duration of the lease.

(2) Provision may be made in the lease for considering the authorized carrier lessee as the owner of the equipment for the purpose of subleasing it under these regulations to other authorized carriers during the lease.

(3) When an authorized carrier of household goods leases equipment for the transportation of household goods, as defined by the Secretary, the parties may provide in the lease that the provisions required by paragraph (d)(1) of this section apply only during the time the equipment is operated by or for the authorized carrier lessee.

(4) Nothing in the provisions required by paragraph (c)(1) of this section is intended to affect whether the lessor or driver provided by the lessor is an independent contractor or an employee of the authorized carrier lessee. An independent contractor relationship may exist when a carrier lessee complies with 49 U.S.C. 14102 and attendant administrative requirements.

(d) **Compensation to be specified** — The amount to be paid by the authorized carrier for equipment and driver's services shall be clearly stated on the face of the lease or in an addendum which is attached to the lease. Such lease or addendum shall be delivered to the lessor prior to the commencement of any trip in the service of the authorized carrier. An authorized representative of the lessor may accept these documents. The amount to be paid may be expressed as a percentage of gross revenue, a flat rate per mile, a variable rate depending on the direction traveled or the type of commodity transported, or by any other method of compensation mutually agreed upon by the parties to the lease. The compensation stated on the lease or in the attached addendum may apply to equipment and driver's services either separately or as a combined amount.

(e) **Items specified in lease** — The lease shall clearly specify which party is responsible for removing identification devices from the equipment upon the termination of the lease and when and how these devices, other than those painted directly on the equipment, will be returned to the carrier. The lease shall clearly specify the manner in which a receipt will be given to the authorized carrier by the equipment owner when the latter retakes possession of the equipment upon termination of the lease agreement, if a receipt is required at all by the lease. The lease shall clearly specify the responsibility of

PART 376-375

**Part 391.51 Requires the motor carrier to maintain a Driver Qualification File.** The following is a list of the minimum requirements for a Driver Qualification File.

(b)(1) The driver's application for employment completed in accordance with §391.21;

(b)(2) A copy of the response by each State agency concerning a driver's driving record pursuant to §391.23(a)(1);

(b)(3) The certificate of driver's road test issued to the driver pursuant to §391.31(e), or a copy of the license or certificate which the motor carrier accepted as equivalent to the driver's road test pursuant to §391.33;

(b)(4) The response of each State agency to the annual driver record inquiry required by §391.25(a);

(b)(5) A note relating to the annual review of the driver's driving record as required by §391.25(c)(2);

(b)(6) A list or certificate relating to violations of motor vehicle laws and ordinances required by §391.27;

(b)(7) The medical examiner's certificate of his/her physical qualification to drive a commercial motor vehicle as required by §391.43(f) or a legible photographic copy of the certificate; and

(b)(8) A letter from the Field Administrator, Division Administrator, or State Director granting a waiver of a physical disqualification, if a waiver was issued under §391.49.

(c) Except as provided in paragraph (d) of this section, each driver's qualification file shall be retained for as long as a driver is employed by that motor carrier and for three years thereafter.

(d) The following records may be removed from a driver's qualification file three years after the date of execution:

(d)(1) The response of each State agency to the annual driver record inquiry required by §391.25(a);

(d)(2) The note relating to the annual review of the driver's driving record as required by §391.25(c)(2);

(d)(3) The list or certificate relating to violations of motor vehicle laws and ordinances required by §391.27;

(d)(4) The medical examiner's certificate of the driver's physical qualification to drive a commercial motor vehicle or the photographic copy of the certificate as required by §391.43(f); and

(d)(5) The letter issued under §391.49 granting a waiver of a physical disqualification.

**Part 395.8 Requires the motor carrier to maintain the driver's logs and supporting documents.**

(k)(1) Retention of driver's record of duty status. Each motor carrier shall maintain records of duty status and all supporting documents for each driver it employs for a period of six months from the date of receipt.



**Part 390.15 Requires the motor carrier to maintain an Accident File.**

A motor carrier must make all records and information pertaining to an accident available to an authorized representative or special agent of the Federal Motor Carrier Safety Administration, an authorized State or local enforcement agency representative or authorized third party representative, upon request or as part of any investigation within such time as the request or investigation may specify. A motor carrier shall give an authorized representative all reasonable assistance in the investigation of any accident including providing a full, true and correct response to any question of the inquiry.

**Part 40.333 Requires the Motor Carrier to maintain Drug and Alcohol Testing Files.**

(a) As an employer, you must keep the following records for the following periods of time:

(a)(1) You must keep the following records for five years:

(a)(1)(i) Records of alcohol test results indicating an alcohol concentration of 0.02 or greater;

(a)(1)(ii) Records of verified positive drug test results;

(a)(1)(iii) Documentation of refusals to take required alcohol and/or drug tests (including substituted or adulterated drug test results);

(a)(1)(iv) SAP reports; and

(a)(1)(v) All follow-up tests and schedules for follow-up tests.

(a)(2) You must keep records for three years of information obtained from previous employers under §40.25 concerning drug and alcohol test results of employees.

(a)(3) You must keep records of the inspection, maintenance, and calibration of EBTs, for two years.

(a)(4) You must keep records of negative and cancelled drug test results and alcohol test results with a concentration of less than 0.02 for one year.

(b) You do not have to keep records related to a program requirement that does not apply to you (e.g., a maritime employer who does not have a DOT-mandated random alcohol testing program need not maintain random alcohol testing records).

(c) You must maintain the records in a location with controlled access.

**Part 396 – Inspection, Repair and Maintenance.**

396.1 General – Every motor carrier, its officers, drivers, agents, representatives, and employees directly concerned with the inspection or maintenance of motor vehicles shall comply and be conversant with the rules of this part.

396.3 (a) General — Every motor carrier shall systematically inspect, repair, and maintain, or cause to be systematically inspected, repaired, and maintained, all motor vehicles subject to its control.

(a)(1) Parts and accessories shall be in safe and proper operating condition at all times. These include those specified in Part 393 of this subchapter and any additional parts and accessories which may affect safety of operation, including

but not limited to, frame and frame assemblies, suspension systems, axles and attaching parts, wheels and rims, and steering systems.

(a)(2) Pushout windows, emergency doors, and emergency door marking lights in buses shall be inspected at least every 90 days.

(b) Required records — For vehicles controlled for 30 consecutive days or more, except for a private motor carrier of passengers (nonbusiness), the motor carriers shall maintain, or cause to be maintained, the following record for each vehicle:

(b)(1) An identification of the vehicle including company number, if so marked, make, serial number, year, and tire size. In addition, if the motor vehicle is not owned by the motor carrier, the record shall identify the name of the person furnishing the vehicle;

(b)(2) A means to indicate the nature and due date of the various inspection and maintenance operations to be performed;

(b)(3) A record of inspection, repairs and maintenance indicating their date and nature; and

(b)(4) A record of tests conducted on pushout windows, emergency doors, and emergency door marking lights on buses.

(c) Record retention — The records required by this section shall be retained where the vehicle is either housed or maintained for a period of 1 year and for 6 months after the motor vehicle leaves the motor carrier's control.

#### **Part 396.17 – Periodic inspection**

(a) Every commercial motor vehicle shall be inspected as required by this section. The inspection shall include, at a minimum, the parts and accessories set forth in Appendix G of this subchapter.

Note: The term commercial motor vehicle includes each vehicle in a combination vehicle. For example, for a tractor semitrailer, fulltrailer combination, the tractor, semitrailer, and the fulltrailer (including the converter dolly if so equipped) shall each be inspected.

(b) Except as provided in §396.23, a motor carrier shall inspect or cause to be inspected all motor vehicles subject to its control.

(c) A motor carrier shall not use a commercial motor vehicle unless each component identified in Appendix G has passed an inspection in accordance with the terms of this section at least once during the preceding 12 months and documentation of such inspection is on the vehicle. The documentation may be:

(c)(1) The inspection report prepared in accordance with paragraph §396.21(a), or

(c)(2) Other forms of documentation, based on the inspection report (e.g., sticker or decal), which contains the following information:

(c)(2)(i) The date of inspection;

(c)(2)(ii) Name and address of the motor carrier or other entity where the inspection report is maintained;

(c)(2)(iii) Information uniquely identifying the vehicle inspected if not clearly marked on the motor vehicle; and

(c)(2)(iv) A certification that the vehicle has passed an inspection in accordance with §396.17.

(d) A motor carrier may perform the required annual inspection for vehicles under the carrier's control which are not subject to an inspection under §396.23(b)(1).

(e) In lieu of the self inspection provided for in paragraph (d) of this section, a motor carrier may choose to have a commercial garage, fleet leasing company, truck stop, or other similar commercial business perform the inspection as its agent, provided that business operates and maintains facilities appropriate for commercial vehicle inspections and it employs qualified inspectors, as required by §396.19.

(f) Vehicles passing roadside or periodic inspections performed under the auspices of any State government or equivalent jurisdiction or the FMCSA, meeting the minimum standards contained in Appendix G of this subchapter, will be considered to have met the requirements of an annual inspection for a period of 12 months commencing from the last day of the month in which the inspection was performed, except as provided in §396.23(b)(1).

(g) It shall be the responsibility of the motor carrier to ensure that all parts and accessories not meeting the minimum standards set forth in Appendix G to this subchapter are repaired promptly.

(h) Failure to perform properly the annual inspection set forth in this section shall cause the motor carrier to be subject to the penalty provisions provided by 49 U.S.C.521(b).

**Part 396.19 – Inspector qualifications.**

(a) It shall be the motor carrier's responsibility to ensure that the individual(s) performing an annual inspection under §396.17(d) or (e) is qualified as follows:

(a)(1) Understands the inspection criteria set forth in 49 CFR Part 393 and Appendix G of this subchapter and can identify defective components;

(a)(2) Is knowledgeable of and has mastered the methods, procedures, tools and equipment used when performing an inspection; and

(a)(3) Is capable of performing an inspection by reason of experience, training, or both as follows:

(a)(3)(i) Successfully completed a State or Federal sponsored training program or has a certificate from a State or Canadian Province which qualifies the person to perform commercial motor vehicle safety inspections, or

(a)(3)(ii) Have a combination of training and/or experience totaling at least 1 year. Such training and/or experience may consist of:

(a)(3)(ii)(A) Participation in a truck manufacturer sponsored training program or similar commercial training program designed to train students in truck operation and maintenance;

(a)(3)(ii)(B) Experience as a mechanic or inspector in a motor carrier maintenance program;

(a)(3)(ii)(C) Experience as a mechanic or inspector in truck maintenance at a commercial garage, fleet leasing company, or similar facility; or

(a)(3)(ii)(D) Experience as a commercial vehicle inspector for a State, Provincial or Federal Government.

(b) Evidence of that individual's qualifications under this section shall be retained by the motor carrier for the period during which that individual is performing

annual motor vehicle inspections for the motor carrier, and for one year thereafter. However, motor carriers do not have to maintain documentation of inspector qualifications for those inspections performed either as part of a State periodic inspection program or at the roadside as part of a random roadside inspection program.

**392.60 – Unauthorized persons not to be transported.**

(a) Unless specifically authorized in writing to do so by the motor carrier under whose authority the commercial motor vehicle is being operated, no driver shall transport any person or permit any person to be transported on any commercial motor vehicle other than a bus. When such authorization is issued, it shall state the name of the person to be transported, the points where the transportation is to begin and end, and the date upon which such authority expires. No written authorization, however, shall be necessary for the transportation of:

- (1) Employees or other persons assigned to a commercial motor vehicle by a motor carrier;
- (2) Any person transported when aid is being rendered in case of an accident or other emergency;
- (3) An attendant delegated to care for livestock.

(b) This section shall not apply to the operation of commercial motor vehicles controlled and operated by any farmer and used in the transportation of agricultural commodities or products thereof from his/her farm or in the transportation of supplies to his/her farm.

Greater Kansas City Mason Contractors Association

Testimony

Honorable Senator Karin Brownlee  
Honorable Senator Nick Jordan

My name is Sandie Ghilino, I am speaking on behalf of the Greater Kansas City Mason Contractors Association. We employ over 1000 people in the Metro Kansas City area. Our group would like to go on record as supporting SB531 and HB2772. 1099 abuse has made us taxpaying contractors non competitive in todays shrinking market.

We pay over 15% of our gross sales to the state in the form of payroll taxes. The GKCMCA members need a level playing field to compete in and we look to you to protect us from contractors who abuse the 1099 exemption.

In the construction market I see 1099 abuse at its greatest in the residential market. We would like to recommend that the penalties extend to the general contractor, home builder and project owners who encourage, and profit greatly from 1099 abuse. I would like to recommend maximum penalties so that this abuse will stop.

I have found another area of great abuse and it is unregistered contractors working in the State of Kansas and not paying any taxes. I have personally identified over 50 contractors that employ in excess of 1000 employees. They come to Kansas build a few projects and leave and the State of Kansas never knew they were here working. The pay checks that I have collected from their employees prove they don't pay any state or federal taxes. Just another scheme to get a unfair advantage in a tight market place.

Sandie Ghilino

Senate Commerce Committee

March 8, 2006

Attachment 2-1



*Building a Better Kansas Since 1934*  
200 SW 33<sup>rd</sup> St. Topeka, KS 66611 785-266-4015

**TESTIMONY OF  
ASSOCIATED GENERAL CONTRACTORS OF KANSAS  
BEFORE SENATE COMMITTEE ON COMMERCE  
SB 531 and HB 2772**

March 8, 2006

By Corey D Peterson, Associated General Contractors of Kansas, Inc.

Madam Chair, Mister Chair and members of the committee, my name is Corey D Peterson, Executive Vice President of the Associated General Contractors of Kansas, Inc. The AGC of Kansas is a trade association representing the commercial building construction industry, including general contractors, subcontractors and suppliers throughout Kansas (with the exception of Johnson and Wyandotte counties).

**AGC of Kansas stands neutral on SB 531 as written with concerns. Concerns on HB 2772 were alleviated with the amendment to offer a warning to first time offenders.** AGC supports the concept of identifying companies that are purposely breaking laws in an effort to avoid taxes and making these companies accountable per the laws that currently exist. However, the bill creates too many questions and concerns for full AGC support.

The rules of classifying employees and independent contractors are not clear cut and are open for considerable interpretation. AGC is concerned that any law with such significant penalties should have safeguards to insure that only those intentionally breaking such laws are investigated and penalized.

AGC is concerned the bill would create possibilities for legitimate small businesses that believe they are doing business properly to be found to have interpreted the law incorrectly and thus face penalties that could put them out of business.

It has been brought to the attention of AGC that there is a small segment of the construction industry, primarily companies from out of state, which is apparently skirting current IRS and state laws by intentionally misclassifying workers as independent contractors. AGC agrees that the state and federal government should fully enforce the existing law and bring these companies to justice.

Because of the above noted complexities with the issue of employee classification, AGC would welcome the opportunity to work with proponents of the bill and others to find a fair approach that would enable immigration and tax laws to be enforced, while protecting legitimate companies from unintended consequences.

Thank you for considering AGC of Kansas' perspective on **HB 2772 and SB 531.**

Senate Commerce Committee

March 8, 2006

Attachment 3-1

# Legislative Testimony

HB 2772 and SB 531

March 8, 2006

**Testimony before the Kansas Senate Commerce Committee  
By Marlee Carpenter, Vice President of Government Affairs**

Chairman Brownlee, Chairman Jordan and members of the Committee;

The Kansas Chamber and our over 10,000 members are here today to express concerns with HB 2772 and SB 531. These bills were drafted with the best intentions of addressing a problem in Kansas, but it has gone too far in doing so.

Classifying or misclassifying an employee as an independent contractor is very fact specific and is not an easy thing to determine. There are twenty common law factors in determining the classification of an employee. This area of the law is grey at best. Certain employment circumstances are easily classified and defined, however many others simply are not. There is no clear and authoritative interpretation of employee classifications.

It is also important to note there are federal guidelines for misclassifying an employee and these penalties are in place to address the problems the proponents of the bill are trying to address. The fine provisions are very steep and could potentially put an employer out of businesses. In addition, we have concerns with the sharing of information between the Department of Labor and the Department of Revenue. We have worked with the Secretary of Labor and the Secretary of Revenue on this issue and understand their intent, but if there is a change in the administration or leadership, these understandings may not be followed.

Finally, we have attached some proposed amendments to the bill and we hope that a fair approach to confronting this problem will emerge. Thank you again for the opportunity to voice our concerns of this bill.



**THE KANSAS  
CHAMBER**

The Force for Business

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Topeka, KS 66612-1671

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*The Kansas Chamber, with headquarters in Topeka, is the statewide business advocacy group moving Kansas towards becoming the best state in America to do business. The Kansas Chamber and its affiliate Chamber Federation, have more than 10,000 member businesses, including local and trade organizations. The Chamber represents small, medium and large employers*

Senate Commerce Committee

March 8, 2006

Attachment

4-1

Kansas Chamber Amendments

(Corrected)

[As Amended by House Committee of the Whole]

As Amended by House Committee

Session of 2006

HOUSE BILL No. 2772

By Committee on Commerce and Labor

1-31

13 AN ACT [**concerning employment**] concerning employment security  
14 law; relating to the employment relationship between an owner-op-  
15 erator and a licensed motor carrier[; **relating to misclassification of**  
16 **employees; amending K.S.A. 2005 Supp. 79-3234 and repealing**  
17 **the existing section**].  
18

19 *Be it enacted by the Legislature of the State of Kansas:*

20 [**New**] Section 1. (a) As used in this section:

21 (1) "Driver" means an individual who operates a motor vehicle which  
22 is leased to a licensed motor carrier pursuant to a lease agreement.

23 (2) "Lease agreement" means a written contract by which an owner  
24 grants the use of one or more motor vehicles and agrees to furnish a  
25 driver for each such motor vehicle.

26 (3) "Licensed motor carrier" means any person that holds a certificate  
27 of convenience and necessity, a certificate of public service, private carrier  
28 permit or an interstate license as an interstate exempt carrier from the  
29 state corporation commission, or is required to register motor carrier  
30 equipment pursuant to 49 U.S.C. §~~11506~~ **14504**.

31 (4) "Motor vehicle" means any automobile, truck-trailer, semitrailer,  
32 tractor or any other self-propelled or motor driven vehicle used upon any  
33 of the public highways of Kansas for the purpose of transporting property.

34 (5) "Owner" means a person to whom title to a motor vehicle has  
35 been issued.

36 (6) "Owner-operator" means any owner which leases one or more  
37 motor vehicles to a licensed motor carrier pursuant to a lease agreement.

38 (7) "Person" means any individual, partnership, corporation, limited  
39 liability company or any other business entity.

40 (b) For purposes of the employment security law, it is hereby de-  
41 clared to be the policy of this state that, consistent with requirements of  
42 49 C.F.R. §376.12(c)(1), an independent contractor relationship between

27



1 an owner-operator and a licensed motor carrier may exist when the li-  
2 censed motor carrier complies with the applicable statutory and regula-  
3 tory requirements governing a licensed motor carrier's use of leased ve-  
4 hicles in the transportation of property. To that end, in determining  
5 whether an employment relationship exists between a licensed motor car-  
6 rier and a driver, the fact that the licensed motor carrier, pursuant to a  
7 lease agreement, requires the driver to comply with applicable provisions  
8 of the regulations of the state corporation commission, federal motor  
9 carrier safety administration or other federal agency having jurisdiction  
10 of motor carriers shall not be considered as the licensed motor carrier's  
11 exercise of control over the driver.

12 **[New Sec. 2. (a) No person shall knowingly and intentionally**  
13 **classify an employee as an independent contractor for purposes of**  
14 **avoiding either state income tax withholding and reporting**  
15 **requirements or state unemployment insurance contributions re-**  
16 **porting requirements.**

mis-  
the sole or primary

17 ~~[(b) Any person violating subsection (a) shall be liable to the~~  
18 ~~state for a civil penalty of \$500, per misclassified employee and for~~  
19 ~~each day such violation continues shall be deemed to be a separate~~  
20 ~~violation.~~

21 [(b) There shall be no penalty under subsection (b) for a first  
22 violation of subsection (a). Any person violating subsection (a) for  
23 a second or subsequent time shall be liable to the state for a civil  
24 penalty of \$500 per misclassified employee and each day such vi-  
25 olation continues shall be deemed to be a separate violation.]

26 **[New Sec. 3. (a) The department of revenue in conjunction**  
27 **with the department of labor and the attorney general shall estab-**  
28 **lish a website to receive communications concerning information**  
29 **on persons and business entities misclassifying employees in vio-**  
30 **lation of section X and amendments thereto.**

2

31 [(b) Upon receipt of such information, the department of rev-  
32 enue, the department of labor and the attorney general shall work  
33 together to investigate alleged violations. The agencies shall co-  
34 operate and share information as necessary concerning the alleged  
35 violations.]

36 [(c) The secretary of revenue, secretary of labor and attorney  
37 general may apply for, receive and accept moneys from any source  
38 for the purposes of establishing the website.]

39 [(d) The secretary of revenue, secretary of labor and attorney  
40 general shall publicize, distribute and disseminate information on  
41 the availability of the website and concerning employee misclas-  
42 sification violations to employment agencies, law enforcement  
43 agencies and other interested parties.]

1 [(e) The attorney general shall enforce and administer the pro-  
2 visions of this act. Other state agencies shall cooperate and assist  
3 the attorney general in the investigation and enforcement of any  
4 violations of this act. The attorney general is hereby authorized to  
5 adopt rules and regulations concerning the implementation and  
6 enforcement of the provisions of this act.

7 [Sec. 4. K.S.A. 2005 Supp. 79-3234 is hereby amended to read  
8 as follows: 79-3234. (a) All reports and returns required by this act  
9 shall be preserved for three years and thereafter until the director  
10 orders them to be destroyed.

11 [(b) Except in accordance with proper judicial order, or as pro-  
12 vided in subsection (c) or in K.S.A. 17-7511, subsection (g) of K.S.A.  
13 46-1106, K.S.A. 46-1114, or K.S.A. 79-32,153a, and amendments  
14 thereto, it shall be unlawful for the secretary, the director, any  
15 deputy, agent, clerk or other officer, employee or former em-  
16 ployee of the department of revenue or any other state officer or  
17 employee or former state officer or employee to divulge, or to  
18 make known in any way, the amount of income or any particulars  
19 set forth or disclosed in any report, return, federal return or fed-  
20 eral return information required under this act; and it shall be  
21 unlawful for the secretary, the director, any deputy, agent, clerk  
22 or other officer or employee engaged in the administration of this  
23 act to engage in the business or profession of tax accounting or to  
24 accept employment, with or without consideration, from any per-  
25 son, firm or corporation for the purpose, directly or indirectly, of  
26 preparing tax returns or reports required by the laws of the state  
27 of Kansas, by any other state or by the United States government,  
28 or to accept any employment for the purpose of advising, prepar-  
29 ing material or data, or the auditing of books or records to be used  
30 in an effort to defeat or cancel any tax or part thereof that has  
31 been assessed by the state of Kansas, any other state or by the  
32 United States government.

33 [(c) The secretary or the secretary's designee may: (1) Publish  
34 statistics, so classified as to prevent the identification of particular  
35 reports or returns and the items thereof;

36 [(2) allow the inspection of returns by the attorney general or  
37 other legal representatives of the state;

38 [(3) provide the post auditor access to all income tax reports or  
39 returns in accordance with and subject to the provisions of sub-  
40 section (g) of K.S.A. 46-1106 or K.S.A. 46-1114, and amendments  
41 thereto;

42 [(4) disclose taxpayer information from income tax returns to  
43 persons or entities contracting with the secretary of revenue where

7-11

1 the secretary has determined disclosure of such information is es-  
2 sential for completion of the contract and has taken appropriate  
3 steps to preserve confidentiality;

4 [(5) disclose to the secretary of commerce specific taxpayer in-  
5 formation related to financial information previously submitted by  
6 the taxpayer to the secretary of commerce concerning or relevant  
7 to any income tax credits, for purposes of verification of such in-  
8 formation or evaluating the effectiveness of any tax credit program  
9 administered by the secretary of commerce;

10 [(6) disclose income tax returns to the state gaming agency to  
11 be used solely for the purpose of determining qualifications of li-  
12 censees of and applicants for licensure in tribal gaming. Any in-  
13 formation received by the state gaming agency shall be confiden-  
14 tial and shall not be disclosed except to the executive director,  
15 employees of the state gaming agency and members and employ-  
16 ees of the tribal gaming commission;

17 [(7) disclose the taxpayer's name, last known address and res-  
18 idency status to the department of wildlife and parks to be used  
19 solely in its license fraud investigations;

20 [(8) disclose the name, residence address, employer or Kansas  
21 adjusted gross income of a taxpayer who may have a duty of sup-  
22 port in a title IV-D case to the secretary of the Kansas department  
23 of social and rehabilitation services for use solely in administrative  
24 or judicial proceedings to establish, modify or enforce such sup-  
25 port obligation in a title IV-D case. In addition to any other limits  
26 on use, such use shall be allowed only where subject to a protective  
27 order which prohibits disclosure outside of the title IV-D proceed-  
28 ing. As used in this section, "title IV-D case" means a case being  
29 administered pursuant to part D of title IV of the federal social  
30 security act (42 U.S.C. § 651 et seq.) and amendments thereto. Any  
31 person receiving any information under the provisions of this sub-  
32 section shall be subject to the confidentiality provisions of subsec-  
33 tion (b) and to the penalty provisions of subsection (d) (e);

34 [(9) permit the commissioner of internal revenue of the United  
35 States, or the proper official of any state imposing an income tax,  
36 or the authorized representative of either, to inspect the income  
37 tax returns made under this act and the secretary of revenue may  
38 make available or furnish to the taxing officials of any other state  
39 or the commissioner of internal revenue of the United States or  
40 other taxing officials of the federal government, or their author-  
41 ized representatives, information contained in income tax reports  
42 or returns or any audit thereof or the report of any investigation  
43 made with respect thereto, filed pursuant to the income tax laws,

4-6

1 as the secretary may consider proper, but such information shall  
2 not be used for any other purpose than that of the administration  
3 of tax laws of such state, the state of Kansas or of the United States;

4 [(10) communicate to the executive director of the Kansas lot-  
5 tery information as to whether a person, partnership or corpora-  
6 tion is current in the filing of all applicable tax returns and in the  
7 payment of all taxes, interest and penalties to the state of Kansas,  
8 excluding items under formal appeal, for the purpose of deter-  
9 mining whether such person, partnership or corporation is eligible  
10 to be selected as a lottery retailer;

11 [(11) communicate to the executive director of the Kansas rac-  
12 ing commission as to whether a person, partnership or corporation  
13 has failed to meet any tax obligation to the state of Kansas for the  
14 purpose of determining whether such person, partnership or cor-  
15 poration is eligible for a facility owner license or facility manager  
16 license pursuant to the Kansas parimutuel racing act; and

17 [(12) provide such information to the executive director of the  
18 Kansas public employees retirement system for the purpose of de-  
19 termining that certain individuals' reported compensation is in  
20 compliance with the Kansas public employees retirement act at  
21 K.S.A. 74-4901 et seq., and amendments thereto; and

22 [(13) provide taxpayer information to the attorney general for the  
23 purpose of determining compliance by any person with the provisions of  
24 section 2, and amendments thereto, which information shall be limited to  
25 withholding tax and payroll information, the identity of any person that  
26 has been or is currently being audited or investigated in connection with  
27 the administration and enforcement of the withholding and declaration  
28 of estimated tax act, K.S.A. 79-3294 et seq., as amended, and the results  
29 or status of such audit or investigation.

30 [(d) Any person receiving information under the provisions of  
31 subsection (c) shall be subject to the confidentiality provisions of  
32 subsection (b) and to the penalty provisions of subsection (e).

33 [(e) Any violation of subsection (b) or (c) is a class A nonperson  
34 misdemeanor and, if the offender is an officer or employee of the  
35 state, such officer or employee shall be dismissed from office.

36 [(f) Nothing in this section shall be construed to allow disclo-  
37 sure of the amount of income or any particulars set forth or dis-  
38 closed in any report, return, federal return or federal return in-  
39 formation, where such disclosure is prohibited by the federal  
40 internal revenue code as in effect on September 1, 1996, and  
41 amendments thereto, related federal internal revenue rules or  
42 regulations, or other federal law.

43 [Sec. 5. K.S.A. 2005 Supp. 79-3234 is hereby repealed.]

1     Sec. 2 [6]. This act shall take effect and be in force from and after  
2     its publication in the statute book.

6-7

ANTHONY R. BROWN  
 REPRESENTATIVE, 38TH DISTRICT  
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 TOPEKA, KANSAS 66612  
 (785) 296-7632  
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TOPEKA

HOUSE OF  
 REPRESENTATIVES

## COMMITTEE ASSIGNMENTS

TAXATION  
 FEDERAL AND STATE AFFAIRS  
 FINANCIAL INSTITUTIONS  
 ECONOMIC DEVELOPMENT

Chairpersons Brownlee and Jordan, Ranking Minority Kelly and committee, I am pleased to stand in your committee today to discuss an issue that is important to business owners and workers alike. I will not bother to read my testimony to the committee today, I will highlight the brief outline below.

I. Worker misclassification is a large problem

- A. Hurts the natural competition in business practice
- B. Hurts workers
- C. Hurts the Kansas economy
- D. Decreases the State Revenue

II. Harmful to Business

- A. February 11 at an Eggs and Issues Forum
  - 1. Discussed business outlook/climate
    - a. How to improve
      - i. Cut business tax
      - ii. Fair business Practice
  - 2. Masonry contractor
    - a. 35 years in business
    - b. Closed doors last year
    - c. Son will not try to compete
    - d. Cannot compete with unethical business practice
- B. Most Contractors do comply with good business practice
  - 1. Healthy competition makes free markets work
  - 2. More than happy to compete
    - a. New technology
    - b. Improved efficiency
    - c. Strong work ethic
- C. Contractors can not compete with unethical practice
  - 1. Avoid paying employee income tax
  - 2. Avoid paying unemployment
  - 3. Avoid paying Worker's Comp
  - 4. Injured Worker still receives care
    - a. Emergency Care is expensive
    - b. Does not have insurance

Senate Commerce Committee  
 March 8, 2006

Attachment 5-1

Misclassification of Workers Cont.

c. Legitimate businesses pick up cost through increased rates

5. In most cases 10% to 15% of total cost

III. Harmful to Workers

- A. Unsafe working conditions
- B. Injured worker has no recourse
  - 1. Emergency Care
  - 2. If injured permanently loses earning power
- C. Limits the worker to lower wages and benefits

IV. Hurts Kansas Economy

- A. Drives legitimate contractors out of business
- B. Health Care costs skyrocketing
- C. Kansans have to spend more on Health Services and less in market place

V. Decreased State Revenue

- A. Asked Legislative Research about fiscal note
  - 1. Could not estimate
  - 2. Study in Massachusetts \$10 Billion
  - 3. Leg. Res. Large problem but unwilling to guess
- B. Unscrupulous Contractors do not pay all taxes
- C. Increased public services in Health Care Industry
- D. Workers paid in cash many times avoiding taxes

VI. Worker Misclassification is Bad for Kansas

- A. Natural Competition damaged in free market
- B. Legitimate business put at competitive disadvantage
- C. Workers put at risk
- D. Kansas economy weakened
- E. State revenues held down

JOHN C. GRANGE  
 REPRESENTATIVE, 75TH DISTRICT  
 BUTLER COUNTY



TOPEKA

HOUSE OF  
 REPRESENTATIVES

## COMMITTEE ASSIGNMENTS

COMMERCE AND LABOR  
 ECONOMIC DEVELOPMENT  
 REVENUE, JUDICIAL TRANSPORTATION AND  
 RETIREMENT BUDGET  
 WILDLIFE, PARKS AND TOURISM

Senate Commerce Committee  
 Written Testimony HB 2772  
 March 8<sup>th</sup> 2006

Co-Chairmen Senator Brownlee and Senator Jordan, and members of the committee, I appreciate the opportunity to present written testimony in support of HB 2772 relating to the misclassification of employees as independent contractors.

I am the owner and president of a 28 year old mechanical contracting company in which we employ 12 individuals who provide installation and service on heating, cooling, electrical, and plumbing systems in residential and light commercial structures.

My employees are very valuable to me and as such I provide above average salaries, vacation, holiday pay, health insurance, retirement, and other benefits not required by law. I do this willingly as I appreciate their good work and want them to have a good quality of life in which they can enjoy providing for their families. Our employee payroll for 2005 was over \$497,000.

In addition to these benefits I am required by law to provide workman's compensation insurance coverage, unemployment insurance pay into the social security retirement, liability insurance, and have insurance on my completed operations. Based on my company sales last year if I purposely misclassify these employees as independent contractors, I would save my company over \$70,000 in these types of expenses. Additionally I would not have to collect federal or state income tax and this in turn would allow me to offer our services at a reduced rate.

The customer may get a cheaper price, but he alone would be responsible for damages or injuries sustained by one of these workers. The worker would be responsible for his own insurance and most likely not be aware that he had no workman's compensation or unemployment insurance. Until too late the worker would not know he had a large tax liability and no social security benefits.

This type of activity is an on-going problem within the construction industry. The contractor has the ability to conceal this from the developer, builder, and owner. Until an incident shows itself those individuals affected may not know there is no insurance and it is they who are responsible to pay.

I would submit we need to pass this legislation and level the playing field within the industry that I and many others have devoted their lives to. This will provide good policy to protect the workers, protect the owners, and will provide for payment of taxes due the State of Kansas and the Federal government that are currently being avoided.

Respectfully submitted,

*John C. Grange*  
 Rep. John C. Grange

Senate Commerce Committee

*March 8, 2006*

Attachment 6-1





8729 South 114<sup>th</sup> Street  
LaVista NE, 68128  
(402) 292-8030

March 7, 2005

Senator Karin Brownlee, Chairperson  
Room 123-S  
S. B. 531

Chairperson Brownlee and Committee Members,

My name is Jim Steele, Safety Director for Falewitch Construction, Inc. Our company is located in Omaha Nebraska. I was asked to travel to Kansas to testify on behalf of SB 531 as the issue of "miss-classifying workers" is a serious and unfair challenge for all honorable employers in Nebraska and all across our region. Our hope is that those of us in Nebraska facing this problem can point our legislature to Kansas as an example of measures being taken to fix this problem.

As you are aware, the miss-classification of workers as independent contractors is a lucrative deception employers are tempted to cast to avoid a large portion of labor expenses such as training costs, unemployment insurance, workers compensation insurance, benefits employees might expect such as health insurance, paid vacation, and disability insurance and often federal and state taxes. When Falewitch Construction Inc. bids a job, well over half the revenue is for labor costs. Obviously, when good corporate citizens, such as Falewitch Construction must compete with those willing to dishonestly miss-classify their workforce, we are cheated, the state and federal government are cheated, and ultimately the hard working and honest citizens of our communities are cheated. However, that is not the only effect nor is it the most serious, in my professional judgment.

Business owners and managers who are willing to cheat in this way are also the type people who shortcut the safety, health and welfare of their workforce and the workers and citizens in near proximity to their workforce. Worse yet, the more business these companies get, the more dangerous the work environment becomes. As the safety director for our company, I see this in many stark and chilling ways every time I visit jobsites where such companies work. Here are two examples.



The first involves scaffolding. Our company spends thousands of dollars to train our workers in the proper method of erecting and dismantling scaffolding, and a few weeks ago, it paid off. A wind storm came up suddenly and began to shake our covered scaffold, but it did not fall and our employees were able to safely get off the scaffold because it was built properly by trained, competent workers. However, just across town, the same type scaffold was erected by incompetent workers working for a contractor who did not care about their safety. Large sections of that scaffold blew over into the parking lot where

other workers and pedestrians could have been hit. Fortunately, no one was in the parking lot at the moment and none of the workers were on the sections of scaffold that fell.

Another example happened just a few months ago. I was inspecting a jobsite and as I walked around a corner, I stopped short, as I saw a young worker removing a manhole cover and then walking away. When I asked where he was going, he said to get something he forgot in his truck. I convinced him to cover the hole while he was gone, as people walked through that area all the time. He reluctantly complied saying he was only going to be gone a few minutes. I asked what company he was with, and he said he worked for himself, but he



Senate Commerce Committee

March 8, 2006

Attachment 7-1

would not say who he contracted with. This young man had no comprehension of the basic safety rules that applied to the work he performed, and that state and federal regulations dictate. Worse, I doubt he had insurance to cover the catastrophic consequences his mistakes will ultimately cost.

Of course, I have no proof that these workers were miss-classified, but I can tell you that almost without exception, the most egregious safety hazards I see on the jobsites I've inspected happen with companies that our employees say and I suspect often miss-classified workers. It is bad enough that these unscrupulous companies win contracts by cheating, then increase the dangers of everyone working around them, but this problem is compounded by the likelihood that miss-classified workers carry no insurance to cover the cost of the injuries and property damage they cause when their luck runs out. When this happens, the honorable companies and tax paying citizens are left holding the bag. We are all cheated by the miss-classification of workers.

Sincerely,

Jim Steele  
Safety Director

8  
Commerce Committee  
Kansas Capitol  
Room 123 South  
March 8, 2006

Re: Senate Bill 531, as amended

I am Tyler Henson, Counsel at J. E. Dunn Construction Company. I am here on behalf of Tom Whittaker, Vice President and General Counsel of J. E. Dunn Construction Company. Unfortunately, Tom Whittaker could not be here today as planned. I am prepared to offer the following comments in support of Senate Bill 531, as amended, that Tom would have made if he been able to be here in person.

J. E. Dunn is one of the largest general contractors and providers of construction services in the Midwest. J. E. Dunn builds or manages millions of dollars of work each year on construction projects in the state of Kansas. These construction projects provide jobs for J. E. Dunn's employees and the employees of many other legitimate subcontractors.

We support the passage of Senate Bill 531, as amended, to help prevent those employers that knowingly and intentionally misclassify employees as independent contractors for purposes of avoiding income tax withholdings or unemployment insurance contributions, as well as other related costs associated with maintaining a work force.

Employers such as J. E. Dunn are at a competitive disadvantage when competing on projects against contractors that knowingly and intentionally misclassify employees as independent contractors. Employers that intentionally misclassify employees as independent contractors avoid withholding and paying income tax withholdings, unemployment insurance contributions and premiums for workers compensation insurance. This gives such employers an inequitable advantage over those employers that do not misclassify their employees and pay all the necessary obligations in an employer-employee relationship.

Often, independent contractors are paid based on the amount of work completed and not by the hour or a fixed salary. This allows such an employer to avoid paying overtime or the prevailing wage.

Furthermore, to knowingly and intentionally misclassify employees as independent contractors reduces revenue that is legitimately due the State. Moreover, if a worker is injured and does not receive workers compensation benefits because she or he was misclassified as an independent contractor, State or federally funded medical programs are then at risk for providing needed medical treatment.

We urge you to pass Senate Bill 531 as amended and prevent employers from knowingly and intentionally avoiding their obligations to their employees, to other taxpayers and to the State of Kansas. Thank you.

Senate Commerce Committee

March 8, 2006

Attachment 8-1

# total interiors inc

March 8, 2006

Senate Commerce Committee  
Senator Karin Brownlee  
Room 123-S  
S.B. 531

Chairwoman Brownlee and Committee Members,

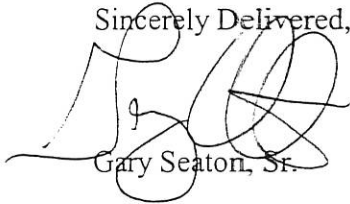
My name is Gary Seaton, Sr., President of Total Interiors, Inc. Our office is located at 110 Greystone Ave, Kansas City, KS 66103.

We have been in the construction business in Kansas City, KS since 1974 and our payroll in 2005 was approximately \$6,400,000. Of that 6 plus million dollars, over 2 million dollars was paid to local, state, and federal agencies for taxes and insurance, not counting what the individual employees paid in taxes and insurance, which could easily be another \$ 350,000 for social security and Medicare.

Any unscrupulous contractors that misclassify employees as independent contractors and don't pay the appropriate taxes and insurance are creating an uneven playing field for competition in our industry.

They are also costing local, state, and federal agencies countless dollars in noncollected taxes and insurance.

Sincerely Delivered,



Gary Seaton, Sr.

Attachment

110 Greystone Ave. Kansas City, Kansas 66103 913-621-21

Senate Commerce Committee

March 8, 2006

Attachment 9-1

Year 2005

Wages (Field & Office)	\$4,360,690
Other Payments:	
Social Security (Company Payment)	\$263,718
Medicare (Company Payment)	\$63,207
State Unemployment	\$97,065
Federal Unemployment	\$9,545
Union Fringes (Health Ins., Pensions, ect.)	\$1,438,325
Office Health Insurance	\$33,154
Workers' Compensation Insurance	\$170,824
General Liability Insurance	\$23,500
	<hr/>
	\$2,099,338

Preliminary Summary Discussion\*

# The Economic Costs of Employee Misclassification in the State of Kansas

Michael P. Kelsay, PhD

Kelly D. Pinkham, MS

Department of Economics, University of Missouri - Kansas City

February 17, 2006

\* *Though we have not conducted an independent review of the data provided to us, we believe that the following estimates are reliable for a responsible discussion of the economic effects from employee misclassification in the State of Kansas.*

## Brief Discussion of the Problem of Misclassification

Employee misclassification is defined as the case where employers treat workers as independent contractors that would otherwise be wage or salaried employees. If an employee is classified as an independent contractor, the employers are not required to pay a variety of payroll taxes (e.g. social security, unemployment insurance) and the independent contractor is not fully protected by unemployment laws.

The issue of misclassifying employees as an independent contractor is an emerging issue in Kansas and the nation, as employers remit their unemployment taxes based upon their payroll. Recent studies have shown that misclassification by employers is a growing problem.<sup>1</sup>

Misclassification negatively impacts the citizens of Kansas in several ways. First, the conditions for a fair and competitive marketplace are sabotaged. Firms that misclassify pay no employment insurance on those workers. This places employers who correctly classify their employees at a distinct competitive disadvantage. Misclassification allows employers who violate state statutes to be rewarded. In addition, the Kansas worker who was misclassified by his or her employer also suffers. If this worker needs to apply for unemployment insurance benefits, they are denied those benefits since the state employment agencies have no record of them having worked. Again, the violating employer is rewarded because the laid-off employee is not charged to their

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<sup>1</sup> In a report by the National Employment Law Project, it was reported that US DOL quarterly audits found 30,135 employees misclassified in 2002. This was a 42% increase from the prior year.

unemployment insurance account. Several studies have shown the problem of misclassification to be particularly acute in the construction sector.<sup>2</sup>

Table 1 provides estimates of the percentage of employees that are misclassified in a number of states. For the 13 states where studies have been conducted or in progress (University of Missouri – Kansas City on the State of Illinois and Michigan State University on the State of Michigan), the moderate rate of misclassification was between 13-23%. In two states (Massachusetts and Maine), the incidence of misclassification in the construction industry is higher than all industries in their states. For Massachusetts, the moderate statewide rate is 19%, while the rate of misclassification in the construction sector is 24%; for Maine, the

**TABLE 1**  
**Prevalence of Misclassification in All Industries**  
**and the Construction Sector**

	Low	Moderate	High
All Industries (9 States) <sup>1</sup>	5-10%	13-23%	29-42%
All Industries (United States) <sup>2</sup>		15%	
All Industries (Massachusetts) <sup>3</sup>	13%	19%	
All Industries (Maine) <sup>4</sup>	11%		
All Industries (Illinois – Preliminary)		17.3%	
Construction Sector (Massachusetts) <sup>5</sup>	14%	24%	
Construction Sector (Maine) <sup>6</sup>	14%		
Construction Sector (United States) <sup>7</sup>		20%	

<sup>1</sup> Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs, February, 2000.

<sup>2</sup> United States General Accounting Office, 1996.

<sup>3</sup>The Social and Economic Costs of Employee Misclassification in Construction. December 17, 2004.

<sup>4</sup>The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry, April 25, 2005.

<sup>5</sup>The Social and Economic Costs of Employee Misclassification in Construction. December 17, 2004.

<sup>6</sup>The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry, April 25, 2005.

<sup>7</sup> United States General Accounting Office, 1996.

low statewide estimate is 11% while the incidence rate of misclassification in the construction sector is 14%. In a report by the General Accounting Office (GAO) in 1996, they reported that the percentage of misclassified workers in all industries was 15%, while the percentage of misclassified workers in the construction sector was 20%.

<sup>2</sup> The General Accounting Office (1996) reported that the estimated percentage of employees with misclassified workers was 13.4%, while the estimated percentage in the construction sector was the highest of all industry groups at 19.8%.

Based upon data about construction sector audits in Kansas, unemployment insurance audits were conducted upon 73 contractors with 517 employees in 2004.<sup>3</sup> We do not know if these were random or targeted audits. The purpose of performing targeted audits is to search for incidents of misclassification where they are more likely to be discovered than with random audits alone (for example, targeted audits will be triggered when certain criteria are met such as the delinquent filing of reports, past infractions, late registration, etc.). For the purpose of making informed projections, random audits would provide a lower bound for estimates on the prevalence of misclassification while targeted audits would provide an upper bound.

### Employee Misclassification in Kansas

- During 2004, 16.4% of construction employers misclassified workers as independent contractors.<sup>4</sup> This translates into an estimate of 1,266 construction employers in Kansas. Based upon a misclassification rate of 16.4% statewide, this translates into 12,295 employers statewide.<sup>5</sup>
- When employers misclassify, they do so extensively. A key measure of misclassification is the severity of its impact within employers who misclassify. This measure indicates that misclassification is a common occurrence rather than a random occurrence in companies that do misclassify. According to the data, 24.2% of construction employees are misclassified in employers that are found to be misclassifying for 2004.<sup>6</sup>
- Based upon the data, across all establishments, 4.9% of employees were misclassified in 2004.<sup>7</sup> The total number of employees statewide that are affected by improper misclassification is estimated at 54,384 and is estimated at 3,124 construction employees.<sup>8</sup>
- Misclassification of employees has a financial impact on the workers, the unemployment insurance system, and the private sector in Kansas. Workers are directly impacted by not being the beneficiary of unemployment insurance. The unemployment insurance system in Kansas is adversely affected as well. A proper research study could help to determine the level of uncollected unemployment insurance taxes in Kansas. In a separate study we are conducting on the State of

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<sup>3</sup> These figures for Kansas Department of Labor unemployment insurance audit activity were provided by Dr. Joshua L. Rosenbloom, Kansas University Department of Economics, in his one-page summary, *An Overview of Worker Misclassification in the Construction Industry*, June 7, 2005.

<sup>4</sup> See Footnote No. 3

<sup>5</sup> These estimates are based upon data from The Department of Commerce, County Business Patterns, 2003.

<sup>6</sup> See Footnote No. 3

<sup>7</sup> See Footnote No. 3

<sup>8</sup> These estimates are based upon data from The Department of Commerce, County Business Patterns, 2003.



Illinois, we estimate that the unemployment insurance system lost approximately \$50 million in 2004 due to misclassification.

- According to published data, workers misclassified as independent contractors are known to underreport their personal income as well; as a result, Kansas suffers a loss of income tax revenue. According to the IRS, wage earners report 99% of their wages; self-employed individuals (such as independent contractors) formally report only 68% of their income. This represents a gap of 31%. Other studies estimate the gap to be as high as 50%.
- Based upon the lower IRS estimate that 30% of the income of misclassified workers in Kansas is not reported, we estimate that \$38.8 million in state income tax was lost in Kansas in 2004. For the construction sector, we estimate that \$2.1 million in state income tax was lost in Kansas from 2004.<sup>9</sup>
- Misclassification also impacts the workman compensation insurance system. Among other effects, costs are higher for employers that follow the rules placing them at a distinct competitive disadvantage. Workers compensation premiums are much higher in the construction trades. In Illinois, for example, the statewide rate for all industries is less than \$3.00 (per \$100 of payroll). However, within construction, rates can range from \$8.01 for electrical wiring to \$27.94 for concrete construction. A large, national study reported that the costs of workman compensation are the single most dominant reason why employers misclassify (Planmatics, 2000). Employers can avoid the high cost of paying workman compensation premiums by mandating that persons who work for them have an exemption. This allows employers who misclassify to underbid the legitimate employers who properly classify their employees. In the construction sector, the workers compensation effect from misclassification further destroys the fairness and legitimacy of the bidding process. Furthermore, it has been reported that many previously misclassified workers were later added to their company's workman compensation policy after they were injured, resulting in payment of benefits even though premiums were not fully collected.
- The problem of misclassification is receiving increased attention in many states. The effects of misclassification negatively impact workers, employers, small businesses, insurers, taxpayers and tax authorities. Furthermore, the operation of fair, competitive markets is compromised when the bidding process is undermined by the practice of misclassification. Like other states, Kansas will likely benefit from better documentation on misclassification along with measures that help to improve compliance with state statutes.

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<sup>9</sup> These estimates are based upon average statewide earnings in Kansas and for the construction sub-sector as reported by the Bureau of Labor Statistics, U.S. Department of Commerce. We use an average marginal tax rate of 6.25% (for incomes between \$15,000 and 30,000).

**Preliminary\* Summary Findings Regarding**  
**The Economic Costs**  
**of Employee Misclassification**  
**in the State of Illinois**

James I. Sturgeon, PhD,  
Michael P. Kelsay, PhD  
Kelly D. Pinkham, MS

Department of Economics, University of Missouri-Kansas City

February 10, 2006

**I. \* Introduction to the Preliminary Summary Findings**

This report is a first step toward analyzing the economic implications of employee misclassification for the public and private sectors in the state of Illinois. It is based upon audit data for 2001-2004 provided by the Illinois Department of Employment Security (IDES) and the results of similar studies on misclassification in other states. Here, we analyze the scope and trends of misclassification in Illinois. We provide estimates of the impact of misclassification on Illinois state revenues, the unemployment insurance fund, and for workman compensation in Illinois.

These findings are "preliminary" for several reasons. For one, we anticipate receiving data for the year 2005 from the IDES which will be added to the full study. Two, the full study will contain a fuller description of the problems examined, background information, additional charts and tables, reviews of other studies, a discussion of research methodology, references, etc., etc.. Also, given the timeliness of the legislative session in Illinois, we were asked to provide a summary of our findings as soon as they could be made available. Despite the above, these summary findings are statistically reliable and authoritative.

**II. Brief Discussion of the Problem of Misclassification**

Employee misclassification is defined as the case where employers treat workers as independent contractors that would otherwise be wage or salaried employees. If an employee is classified as an independent contractor, the employers are not required to pay a variety of payroll taxes (e.g. social security, unemployment insurance) and the independent contractor is not fully protected by unemployment laws.

The issue of misclassifying employees as an independent contractor is a growing problem for the unemployment insurance system in Illinois and the nation since employers remit their unemployment taxes based upon their payroll. Recent studies have shown that misclassification by employers is increasing.<sup>1</sup>

Misclassification negatively impacts the citizens of Illinois in several ways. First, the conditions for a fair and competitive marketplace are sabotaged. Firms that misclassify pay no employment insurance on those

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<sup>1</sup> In a report by the National Employment Law Project, it was reported that US DOL quarterly audits found 30,135 employees misclassified in 2002. This was a 42% increase from the prior year.

workers. This places employers who correctly classify their employees at a distinct competitive disadvantage. Misclassification allows employers who violate state statutes to be rewarded. In addition, the Illinois worker who was misclassified by his or her employer also suffers. If this worker needs to apply for unemployment insurance benefits, they are denied those benefits since the state employment agencies have no record of them having worked. Again, the violating employer is rewarded because the laid-off employee is not charged to their unemployment insurance account. Several studies have shown the problem of misclassification to be particularly acute in the construction sector.

The table below provides estimates from other studies of the percentage of employees that are misclassified in a number of states. For the 11 states studied, the moderate rate of misclassification was between 13-23%. In two states, Massachusetts and Maine, the incidence of misclassification in the construction industry is higher than all other industries in their states. For Massachusetts, the moderate statewide rate is 19%, while the rate of misclassification in the construction sector is 24%; for Maine, the low statewide estimate is 11%

<b>Prevalence of Misclassification in All Industries and the Construction Sector</b>			
	<b>Low</b>	<b>Moderate</b>	<b>High</b>
All Industries (9 States) <sup>1</sup>	5-10%	13-23%	29-42%
All Industries (United States) <sup>2</sup>		15%	
All Industries (Massachusetts) <sup>3</sup>	13%	19%	
All Industries (Maine) <sup>4</sup>	11%		
Construction Sector (Massachusetts) <sup>5</sup>	14%	24%	
Construction Sector (Maine) <sup>6</sup>	14%		
Construction Sector (United States) <sup>7</sup>		20%	

<sup>1</sup> Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs, February, 2000.  
<sup>2</sup> United States General Accounting Office, 1996.  
<sup>3</sup> The Social and Economic Costs of Employee Misclassification in Construction. December 17, 2004.  
<sup>4</sup> The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry, April 25, 2005.  
<sup>5</sup> The Social and Economic Costs of Employee Misclassification in Construction. December 17, 2004.  
<sup>6</sup> The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry, April 25, 2005.  
<sup>7</sup> United States General Accounting Office, 1996.

while the incidence rate of misclassification in the construction sector is 14%. In a report by the General Accounting Office, they reported that the percentage of misclassified workers in all industries was 15%, while the percentage of misclassified workers in the construction sector was 20%.

In Illinois, misclassification has contributed to the negative outcomes experienced by the Unemployment Insurance Trust Fund. A review of the Fund's year-end balances shows the trend. From 1987 through 2002, the Trust Fund ended each year with a positive balance. In 2000, the year-end trust fund balance was a positive \$2.051 billion. However, in 2003, the Fund ended the year with a \$511 million deficit which was projected to increase to a \$627 million deficit in 2004.<sup>2</sup>

States, including Illinois, perform unemployment insurance audits that are both random and targeted. The purpose of performing targeted audits is to search for incidents of misclassification where they are more

<sup>2</sup> The Unemployment Insurance Trust Fund. Illinois Department of Employment Security. August 19, 2004.

likely to be discovered than with random audits alone (for example, targeted audits will be triggered when certain criteria are met such as the delinquent filing of reports, late registration, etc.). For our purposes of making informed projections, random audits will provide a lower bound on the prevalence of misclassification while targeted audits will provide an upper bound on the extent of misclassification.

Based upon data provided by the Illinois Department of Employment Security, the audit department conducted 22,032 audits from 2001-2004. Of those audits conducted from 2001-2004, 14,566 or 76.5% of the audits were random audits. Benefit related audits (e.g. targeted audits) were 4,118 or 21.6% of the audits. These two types of audits account for 98.1% of all unemployment insurance audits in Illinois from 2001-2004.

### III. Preliminary Findings of Employee Misclassification in Illinois

- For the years 2001-2004, state audits found that 17.3% of the Illinois employers audited had misclassified workers as independent contractors. This translates into approximately 55,245 total employers statewide of which 6,052 were in construction. In just 2004, the rate of misclassification was higher at 21.0%. This translates into 67,745 employers statewide with 7,478 in construction.<sup>3</sup> Based upon the fact that 76.5% of these audits were random audits (which provides the lower bound for the prevalence of misclassification) **the rate of misclassification in Illinois is higher than in most other states that have been studied.**
- **When an employer practices misclassification in Illinois, the results show that this behavior is pervasive.** An analysis of the percentage of employees that are misclassified indicates that misclassification is a common occurrence rather than a random occurrence in those companies that do misclassify. According to the data provided by the Illinois Department of Employment Security, 29.0% of workers are misclassified by employers that were found to be misclassifying for the period 2001-2004. The rate of misclassification showed an upward trend as well. In 2001, 22.8% of workers were misclassified at employers who were found to be misclassifying; this had increased to 31.9% in 2004. **The rate of misclassification at violating employers had increased almost 40% from 2001-2004.**
- From our analysis of the labor force of all employers in Illinois (those that misclassify and those that don't), we estimate that 7.3% of employees in Illinois were misclassified as an independent contractor for the period 2001-2004. **The audit results show that misclassification is a growing problem in Illinois.** While 5.5% of employees in Illinois were estimated to be misclassified in 2001, this increased to 9.2% in 2004. **This represents a 67% increase in the misclassification rate in Illinois from 2001 to 2004.**
- The number of employees statewide that are affected by the improper misclassification is estimated to average 360,387 annually for the period 2001-2004. For the year 2004, the estimated number of employees affected by misclassification had increased to 455,187. Within the construction sector for the period 2001-2004, the number of employees affected by misclassification is estimated to average 19,597. In the year 2004, the estimated number of misclassified employees in the construction sector had increased to 24,476.
- **Misclassification of employees has a financial impact on the workers, the unemployment insurance system, and the private sector in Illinois.** The workers are directly impacted by not being the beneficiary of unemployment insurance. The unemployment insurance system in Illinois is adversely affected as well. **We estimate that the unemployment insurance system lost an average of \$36.5 million every year from 2001-2004** in unemployment insurance taxes that are not levied on the payroll of misclassified workers as they should be. **For 2004, we estimate that the unemployment insurance system in**

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<sup>3</sup> According to the Illinois Department of Employment Security, the average number of employers over 2001-2004 was 34,892 in construction and 318,519 in all industries. In 2004, there were 35,666 construction employers and 323,108 in all industries. These numbers exclude local, state, and federal government.

Illinois has lost \$50 million in unemployment insurance taxes. For the construction sector, we estimate that the unemployment insurance system has lost an average of \$2.0 million annually from 2001-2004 in unemployment insurance taxes that are not levied on the payroll of misclassified workers in construction as they should be. For 2004, we estimate that the unemployment insurance system in Illinois has lost \$2.7 million in unemployment insurance taxes in the construction sector.

- According to published data, workers misclassified as independent contractors are known to underreport their personal income as well; as a result Illinois suffers a loss of income tax revenue. According to the IRS, wage earners report 99% of their wages; non-wage earners (such as independent contractors) report approximately only 68% of their income. This represents a gap of 31%. Other studies estimate the gap to be as high as 50%.
- Based upon the IRS estimate that 30% of the income of misclassified workers in Illinois is not reported, we estimate that \$120.3 million annually of income tax was lost in Illinois from 2001-2004. For 2004, we estimate that \$158.0 million of income tax was lost in Illinois. For the construction sector, we estimate that \$8.5 million annually of income tax is lost in Illinois from 2001-2004. For 2004, we estimate that \$11.0 million of income tax is lost in the construction sector in Illinois.
- Based upon the higher estimate that 50% of the income of misclassified workers is not reported, an estimated \$200.5 million annually of income tax was lost in Illinois from 2001-2004. For 2004, the estimate would be that \$263.4 million of income tax was lost in Illinois. For the construction sector, we estimate that \$14.2 million annually of income tax is lost in Illinois from 2001-2004. For 2004, we estimate that \$18.3 million of income tax is lost in the construction sector in Illinois.
- Misclassification also impacts workman compensation insurance. Among other effects, costs are higher for employers that follow the rules placing them at a distinct competitive disadvantage. A large, national study reported that that the costs of workman compensation are the single most dominant reason why employers misclassify (Planmatics, 2000). Employers can avoid the high cost of paying workman compensation premiums by mandating that persons who work for them have an exemption. This allows employers who misclassify to underbid the legitimate employers who provide coverage for their employees. In the construction sector, the workers compensation effect from misclassification further destroys the fairness and legitimacy of the bidding process. It has been reported that many previously misclassified workers were later added to their company's workman compensation policy after they were injured, resulting in payment of benefits even though premiums were not fully collected.
- Based upon statewide average workman compensation insurance premium rates published by the State of Indiana, we estimate that, on average, \$94.8 million of worker premiums are not paid for misclassified workers. For 2004, in Illinois we estimate that that \$104.8 million of worker compensation premiums were not paid.
- Workers compensation premiums are much higher in the construction trades. In Illinois the statewide rate for all industries is less than \$3.00 (per \$100 of payroll). However, within construction, rates can range from \$8.01 for electrical wiring to \$27.94 for concrete construction. Using an average rate of \$15, we estimate \$35.5 million in lost workers compensation premium from the construction trades in Illinois.
- The problem of misclassification is an increasing problem in Illinois. The effects of increasing misclassification negatively impact workers, employers, small businesses, insurers, taxpayers and tax authorities. Furthermore, the operation of fair, competitive markets is compromised when the bidding process is undermined by the practice of misclassification. Illinois will stand to benefit from better documentation on misclassification along with measures that help to improve compliance with state statutes.

# INSTITUTE FOR



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Kansas City, Missouri 64110 – (816) 235-1470  
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Senate Commerce Committee  
Senators Karin Brownlee and Nick Jordan chairpersons  
Members: Senators Barone, Emler, Reitz, Schodorf, Wagle, Wysong,  
Kelly.  
Re: SB 531 Misclassification of Employees  
Date: March 8, 2006

Honorable Co-chairs Brownlee and Jordan and Members of the Committee:

I am Judy Ancel, Director of The Institute for Labor Studies, a joint project of The University of Missouri-Kansas City and Longview Community College. I have lived in Kansas City Kansas for twenty-five years. The Institute for Labor Studies is a labor education program which provides classes about the workplace and labor laws for regular students and working adults. We also research trends in the economy and particular problems involving working people. Our students and research span the Kansas-Missouri state line.

Over the past two decades we have seen a marked growth of what is called the contingent workforce. This includes part-time, temporary, contract, and non-standard forms of employment. Increasingly *traditional* employment relationships: permanent, full-time jobs with employer-provided benefits are being replaced by what some economists call the *just-in-time workforce*. This trend presents significant challenges to government and includes both legal and illegal forms of employment. Competitive pressures have grown on employers who then look for ways to lower their wage bills. Some choose to violate the law, and unfortunately, the frequency of these violations is overtaking the ability of government to enforce our labor laws.

One increasingly common illegal practice is the misclassification of workers. This occurs in two ways: 1) when an employer misclassifies a worker who should be a waged or salaried employee as an independent contractor and reports that worker's earnings on an IRS 1099 form instead of a W-2 form or 2) when an employer fails to classify a worker at all and pays him or her in cash, reporting nothing. Such worker misclassification is injurious to the citizens of our state. It hurts the worker, the government and taxpayers, and law-abiding employers who face unfair conditions of competition. Indeed, misclassification of workers hurts all Kansans by shifting costs which should be properly paid by employers onto the backs of the rest of us. If the incidence of misclassification is left to grow – and it is indeed growing – it will undermine our economy and lead to many more widespread violations.

Misclassification of workers has historically been common in day labor and agriculture and in certain services. Today, however, it is spreading to new sectors of the economy, especially where low-wage jobs proliferate like janitorial work, home health care, delivery services and construction. It is particularly common in industries dominated by employment of immigrants.

Below, I will talk about this cost-shifting phenomenon and then talk about the extent of misclassification in order to give you a better idea of the extent of the problem.

The National Employment Law Project estimates that when an employer treats “a worker as a non-employee [he] immediately saves payroll costs ranging from 15 to 30%.” By misclassifying a worker the employer both saves real employment costs and also avoids responsibility of complying with government regulations which protect the employee. In addition regular employees have certain rights to sue and make claims against employers who fail to pay overtime or provide other forms of compensation and protection. Independent contractors do not have these rights. This puts an additional burden on a misclassified worker to prove the misclassification before he can exercise his rights under the law.

Misclassified workers are denied access to unemployment compensation, workers compensation coverage, employer Social Security and Medicare contributions, overtime pay, common employer-provided benefits like health care, retirement contributions, life and disability insurance, vacations and holidays, sick pay, liability insurance coverage, as well as some expenses incurred while working for the employer. By avoiding such costs the employer shifts the burden onto the employee for his own health care, for the entire amount of Social Security and Medicare contributions – 15% of earnings as opposed to 7.65% - for his own retirement, and leaves him without a safety net if he is injured on the job or is unemployed.

The implications of this are enormous affecting our communities, our schools, other employers, and government at all levels which must bear the costs that misclassifying employers don't pay. In workers compensation alone, even when a misclassifying employer immediately enrolls a worker when he is injured so that he has coverage – a practice that reportedly is common – the rates for law-abiding employers who pay for their workers' coverage throughout their employment end up going up.

Governments are affected by this in two ways: First in a loss of tax revenue and contributions to unemployment and workers compensation funds, and second by increased demand on government services. It's estimated that misclassified workers underreport their personal income by thirty to fifty percent, thus the loss of income tax revenue to state and federal governments is significant. In what now appears to be conservative projection, the U.S. Government Accounting Office in 1989 estimated that misclassification would reduce federal tax revenues by up to \$4.7 billion by 2004.

The same is true for state unemployment compensation funds, since misclassifying employers need not make contributions for their *independent contractors*. A government-sponsored national unemployment audit found \$436 million in underreported wages. A recent study by Harvard University on misclassification in the State Massachusetts found unpaid workers' compensation premiums of \$91 million a year due to independent contractor misclassification; \$7 million of those unpaid premiums were in construction.

The cost shifting created by misclassification also affects the demand on state and local government services for medical care as uncovered costs from workplace injury and routine healthcare costs for workers and their families get shifted to public health facilities and state health programs for the poor. Hidden demands on the public also come from lost child support on underreported income, housing assistance, food stamps and school lunch programs, and the costs of supporting people too old to work who have no or reduced retirement income because they were independent contractors.

As law abiding businesses are forced to compete with an increasing number of misclassifying

businesses, they are on a playing field which is markedly tilted against them. They may face bankruptcy, increased unemployment and workers compensation costs, or they may decide to join the ranks of the misclassifiers in order to survive, just exacerbating the problem and the costs to the State.

How extensive is the problem? The answer is that we don't really know because no one is keeping track. As my colleague Kelly Pinkham will tell you, there have been studies in several states, and more are being done. Unfortunately we have only a snapshot view of the extent of the problem in Kansas. In June of last year, Prof. Joshua L. Rosenbloom from the Department of Economics at the University of Kansas did a limited study of the Kansas construction industry. What he found based on a limited sampling should give you pause because it showed that the extent of misclassification in Kansas is equal to or exceeds the rate in the Harvard study of Massachusetts.

Rosenbloom's study, which is attached to my testimony, covered 73 construction companies employing 517 people during 2004. The sampling represented less than one percent of employees and employers in the industry. What he found was that 16.4% of the construction companies had at least one misclassified worker, and among this group 24.2% of employees were misclassified.

Rosenbloom projected his results for all construction employers in the state to estimate that 1,236 establishments misclassified 3,135 workers. In terms of the percent of misclassifying businesses the rate in Kansas was higher than Massachusetts (16.4% vs. 14%) although each misclassifying Kansas employer tended to misclassify fewer workers than in Massachusetts. While Rosenbloom's study did not measure misclassification over time, the Massachusetts study did and found that there is a significant increase in the practice, particularly in the percent of misclassified workers in construction.

None of these studies, of course, can completely track unreported wages. The practice of employing people "off the books" and avoiding even a paper trail is growing, particularly in the employment of undocumented immigrants, as is the practice of failing to pay wages at all. Needless to say, this leads to the same abuses that misclassification causes and even greater underreporting of wages and payment of taxes to the State.

The phenomenon of misclassification is a nationwide problem and is generating nationwide attempts to craft legislation to meet the challenge. Last year many states, including ours, considered legislation which included bills to increase penalties and to research the extent of the problem. Four states enacted laws: Florida redefined the term "employee" in its workers compensation system, Illinois and New Mexico enhanced penalties, and New Hampshire created a study commission. Many other states considered legislation.

Senate Bill 531 is a good start on trying to deal with the problem. By instituting meaningful penalties, increasing enforcement, and allowing for the sharing of information and cooperation among government entities with responsibility for enforcement, the State can provide much needed and potentially quite effective tools for dealing with the problem. Passage of this bill will say to Kansas employers and workers that our state stands for fairness and responsibility and that it seeks to create a climate for business and workers in which the law is respected and applied to all on an equal basis.

Thank you for permitting me to share my ideas with you.



**An overview of worker misclassification in the Construction Industry**  
**Prepared by Joshua L. Rosenbloom**  
Department of Economics and Policy Research Institute  
University of Kansas

6-7-2005

*Sample Information*

KS DOL conducted audits of 73 construction companies employing a total of 517 persons during 2004. The most recent data on construction industry employment in Kansas are from the 2002 County Business Patterns, which reports total employment of 63,649 persons at 7,519 establishments.

The audit sample then represents about 0.8% of employees and 0.97% of establishments in construction. It would appear that larger employers were somewhat undersampled in this study. Indeed none of the approximately 200 employers with 50 or more employees was audited.

*Worker Misclassification*

The audits reveal the following facts:

- 16.4 percent of audited establishments had at least one worker misclassified as an independent contractor
- in establishments that had misclassified workers 24.2% of employees were misclassified.
- Across all establishments only 4.9% of employees were misclassified.

Projecting these results to the state based on the 2002 County Business Patterns data they would imply:

- 1236 establishments with misclassified workers
- 3,135 misclassified employees

*Comparison to Massachusetts*

- The percentage of establishments in Kansas misclassifying workers is slightly higher than was found in Massachusetts (16.4% vs. 14%);
- But fewer workers were misclassified in these establishments (24% vs. 40%)
- The share of all workers misclassified is comparable to Massachusetts (4.9% vs. 5.9%)

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**RODRIGUEZ**  
MECHANICAL CONTRACTORS

March 8 2006

Testimony in support of  
SB 531  
Senate Commerce Committee  
Paul Rodriguez  
President  
Rodriguez Mechanical Contractors Inc.

Honorable Co Chairs Brownlee, Jordan and Committee

I am Paul Rodriguez, President of Rodriguez Mechanical Contractors Inc. My company is located at 541 South 11<sup>th</sup> in Kansas City, Kansas and I reside at 9000 Rosewood in Prairie Village Kansas, 66207.

Rodriguez Mechanical Contractors has been in the plumbing business for 30 years, licensed in both Kansas and Missouri. We currently employ approximately 150 people, comprised of administrative staff, union plumbers, laborers, and operating engineers.

Prior to September 11<sup>th</sup> 2001, it was reported that our firm was the largest employer of union plumbers in the region. In our, area if an apartment complex was to be built, it was said you need to call Rodriguez if you want a quality project and a project built on time.

My company, today, is currently challenged in trying to compete and to secure contracts for its business and its employees. My company is extremely concerned for what may occur after this current boom of construction ends for our area. We are concerned that those who choose to cheat will continue to cheat and prevail over legitimate businesses and at the end, potentially drive honest businesses out.

We no longer are the go to place neither for pricing, nor for the construction of these types of projects. In the last several years, we have come across some competition that doesn't play by the rules nor do they pay all due taxes. This does not allow for fair competition and a level playing field nor is it intended to be a part of the American Dream.

My current competition utilizes a workforce that does not necessarily reside in Kansas 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 Contractors, whereby he can pay them less than the local prevailing wage. At the end of the project, and in order to be compliant with reporting to the IRS, he simply sends them a 1099 to the address provided, which if it turns out to be an incorrect address and if he cannot find them, the taxes now goes as uncollectible taxes. We simply loose revenue

541 S. 11th Street ■ Kansas City, Kansas 66105  
(913) 281-1814 ■ Fax (913) 621-4354

"Equal Opportunity Employer"

Senate Commerce Committee  
March 8, 2006

Attachment

12-1

My current competition in some instances is willing to employ people by informing them that the only way that they can be hired is if they sign a paper that states that they are an independent contractor, when in reality is the farthest from the truth.. Under this scenario, exploitation of the employee can occur. The employer can and at will, threaten the employee to turn them in if the employee does not comply with what ever unjust request that is made of them, in fear of losing their job or to be turned in to the IRS for not complying with the request made from the employer.

Some examples can be:

Paying little monetary value for, by the piece type work, where in order to make more money the employee now brings the children into the work area in order to produce more for daily output. The more production the more earned. This scenario exposes the children to unsafe conditions, where they have not been trained for workplace safety.

Shortages in the pay check, paying cash in lieu of check in order to hide the wages paid for an employee and the take it or leave or I will report you if you do not.

The immigrant work force in some cases, is at the center of the issue, and do not have knowledge of the taxing system and no knowledge of work safety and job conditions. I feel confident that those employers who choose to break the rules have full knowledge of 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 provide equal access of economic opportunity for my business.

I appear before you today to urge you to consider the passage of SB 531 and encourage you to implement an enforcement procedure.

What this bill is attempting to address is a complex issue but it is an easy one to understand, that if it is 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.

Based on a previous job estimate (with minimal assumption) I listed below a scenario as to how we at times can be in excess of \$200,000 to \$400,000 higher than those who misclassify, on bids, and how even though they are at \$200,000 to \$400,000 lower, they still survive and flourish at our expense.

Sample project estimate with;

28,652.11 hours at 30.03 per equals	\$ 860422.93
860,422.93 at 23.5% burden	\$ 202,199.39
Health Care, pension, vacation, etc. at 15.47 x 28652.11 hours equals	\$ 443,248.18

When someone chooses to misclassify, the disadvantage to a business who complies with their obligation can be in excess of the total of burden plus the total of benefits, which equals \$645,445.57, as a minimum. Clearly loss revenue and clearly a disadvantage in competition.

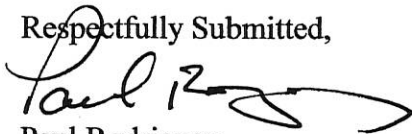
This bill if passed will be the first steps in making an attempt to provide equal economic opportunity for all Kansas Businesses and will enable my business to compete and provide for quality of life with a livable wage, for my employees.

In conclusion:

Republicans in Kansas sponsored and addressed this issue of having workers work for less in 1891, by being the first State in the Union to pass legislation that later became known as The Davis-Bacon Act of 1931. This bill was not intended to be a union nor a nonunion issue, but rather a livable wage issue and a fair competition act.

I urge you to not only pass SB 531, but provide sufficient budgeting for implementation, monitoring, and compliance. No bill passed is effective without the above. At the very least, provide funding of a hot line linked to the Attorney Generals office, for reporting violators. The rewards to the State would be capturing unreported taxes and providing real economic growth opportunities for those who choose to live a life with quality and do business in Kansas. Simply put is that when I loose opportunities, we all loose taxes.

Respectfully Submitted,



Paul Rodriguez  
Rodriguez Mechanical Contractors

13  
March 7, 2006

Senate Commerce and Labor Committee  
Representative Karin Brownlee  
Room 123 S  
Capital Building  
Topeka, KS 66603

Re: Senate Bill 531

Chairman Brownlee and Respected Committee Members,

I am here to offer my support to this committee and to the State of Kansas. By supporting Senate Bill 531, we can improve the conditions of the Great State we call home.

My name is Jim Wilkinson. I am a resident of Olathe, KS (11380 S Woodland St Olathe, KS 66061-8726) and I am also Vice-President of Image Flooring, LLC, a Lenexa based floor covering contractor. I appreciate the opportunity to discuss with you the many problems that can be addressed by moving this bill through committee and ultimately passing it into law.

Many firms in the construction industry, as well as my own, are facing an ever-growing obstacle – **The mis-classification workers as independent self-contractors.**

As a floor covering contractor, it gives me great pride to know the nearly twenty-five **employees** of Image Flooring, LLC are able to earn a living wage, which includes overtime for qualified work. They have benefits for themselves and their families, lessening the burden on the already strained health care system. They are able to receive a sustainable pension through their retirement program and Social Security while we match their contributions. We have liability insurance and Workers' Compensation insurance, yet another way of easing the burden on the health industry. We are proud to offer these and other benefits to our employees and the community while performing some of the best floor covering installations in this and many of the surrounding states!

Unscrupulous contractors who are not providing benefits, pensions, liability and Workers' Compensation insurance, business licensing fees or fair wages and their associated taxes – put 'fair' contractors at a huge competitive disadvantage. Mis-classification affects the Kansas economy on many levels, as well as the solvency of the 'fair' contractors in the various aspects of construction within our state. With each contract awarded to unscrupulous contractors (also known as 1099-ers) and with each day their practices are allowed to flourish, the future of 'fair' businesses in our State becomes more bleak.

Senate Commerce Committee

March 8, 2006

Attachment 13-1

By supporting Senate Bill 531, you can put an end to the injustices allowed by this practice. The playing field will be leveled for all contractors. Families will have more of an opportunity to invest their living wages in the communities they live in - allowing for more sales tax revenue. Public programs (i.e. welfare, school systems, etc...), currently strained to the breaking point can get the money they so very much deserve. In short: This Great State of Kansas will receive the revenue it is entitled to.

Sincerely and Respectfully,

James Wilkinson  
Vice-President – Image Flooring, LLC  
9828 Pflumm  
Lenexa, KS 66215-1208  
(913) 227-0729