Approved: Anthony R. Brown
Date: 03/09/2011

MINUTES OF THE HOUSE COMMERCE & ECONOMIC DEVELOPMENT COMMITTEE

The meeting was called to order by Chairman Anthony Brown at 1:35 p.m., on February 14, 2011, in Room 785 of Docking State Office Building.

All members were present.

Committee staff present:
Jason Long, Office of the Revisor of Statutes
Ken Wilke, Office of the Revisor of Statutes
Reed Holwenger, Kansas Legislative Research Department
Raney Gilliland, Kansas Legislative Research Department
Joyce Bishop, Committee Assistant

Conferees appearing before the Committee:
Pamela Ann Ward, Bus Driver, Blue Valley School District
Lorianne Fisher-Koneczny, Bus Driver, First Student
Eric Stafford, Sr. Director Governmental Affairs, Kansas Chamber of Commerce
Luke Bell, Vice President Governmentalaffiars, Kansas Association of Realtors
Richard Cram, Director, Kansas Department of Revenue
Karl Hansen, Chief Legal Counsel, Kansas Department of Labor
Bruce Tunnell, Executive Director/Vice President, Kansas AFL-CIO

Others attending:
See attached list.

Chairperson Brown opened the hearing on **HB 2092, Employment security law; benefits for school bus drivers.**

Ken Wilke gave the Revisor's overview of the bill.

Chairperson Brown asked for proponents.

Pamela Ann Ward, Bus Driver for Blue Valley School District, Overland Park, Kansas (Attachment 1).

Lorianne Fisher- Koneczny, Bus Driver for First Student (Attachment 2).

There were no opponents.

Chairperson Brown closed the hearing on **HB 2092**.

Chairperson Brown opened the hearing on **HB 2135, Eliminating penalty for misclassification of employees as independent contractors to avoid tax withholding, contribution and reporting requirements.**

Renae Jefferies gave the Revisor's overview (Attachment 3).

Chairperson Brown called for proponents testimony.

Eric Stafford, Senior Director Governmental Affairs, Kansas Chamber of Commerce (Attachment 4).

Luke Bell, Vice President, of Governmental Affairs, Kansas Association of Realtors, provided written testmony (Attachment 5).

Katherine Karker-Jennings, P.A., provided written testimony (Attachment 6).

Chairperson Brown called for neutral testimony.

Richard Cram, Director, Kansas Department of Revenue. (Attachment 7).

The minutes of Commerce & Economic Development Committee at 10:30 a.m. on February 14, 2011, in Room 785 of the Docking State Office Building.

Karl Hansen, Chief Legal Counsel, Kansas Department of Labor (Attachment 8).

Chairperson Brown called for opponents testimony.

Bruce Tunnell, Executive Director, Vice President, Kansas AFL-CIO (Attachment 9).

Opponents submitting written testimony were:

Joan Wagnon, former Secretary of Kansas Department of Revenue (Attachment 10).

Joe Hudson, Businsess Agent/Organizer, Carpenter's District Council of Greater St. Louis &Vicinity (Attachment 11).

Chairperson Brown closed the hearing on the bill.

The next meeting is scheduled for February 15, 2011.

The meeting was adjourned at 3:00 p.m.

HOUSE COMMERCE & ECONOMIC DEVELOPMENT COMMITTEE
1:30pm,
Room 785, Docking State Office Building

GUEST LIST

DATE: February 14, 2011

NAME	REPRESENTING
Pamela Ann Ward	School bus driver
LORIANNE KONECZNY	" " "
KARL HANSEN	KDOL
Justin McFarland	KDOL
Scott Paradise	HOC
David Clauser	KDOR
Richard Crem	KDOR
Bryce Tunnell	AFL-CIO
Jane Carter	KOSE
Andy Sanchez	KS AFL-CIO
Levi Henry	Coalition for Workplace Safety
SEAN MILLER	CAPITOL STRATEGIES
Melissa Ward	
Kelly Navinsky-Wenzl	Kearney & Assoc.
Zac Kohl	Federico Cons.
Chad Bettes	KDOR
Mindy Brissey	AFT - KS
Ratmanov Michail	Russia Delegation.

NAME	REPRESENTING
Berezkin Ilya	Russia, Ivanovo
Joan Wagnon	self
[illegible]	Intern
Joe Mosimann	RMCA of KS
Tom Burgess	ASA
JOHN POLZAR	KCWS
Ron Seeber	KGFA

Dear Kansas State Legislators,

Thank you for your consideration of House Bill 2092 and Senate Bill 137. My name is Pam Ward. I drove a school bus for the Blue Valley School District from 1981-89 and therefore was employed as a school bus driver when the current law when into effect in 1985. I found a better paying job in 1990 and worked there until 2000. I became a school bus driver again in 2000 and still drive Blue Valley School children to and from school. I witnessed the district contract with RW Harmon, Mayflower, Laidlaw and now First Student.

Back in the 1980's, school districts generally owned and operated their own school buses and/or directly sub-contracted with individuals who happened to own their own bus or small family-owned companies. There were not as many buses needed to transport children to and from school as there are in existence today. As an example, the Blue Valley School District operated only about 19 buses in 1985 and today they have over 130 buses.

Furthermore, the cost of living (rent, utilities, groceries and fuel prices) were much less than they are today. Moreover, help wanted ads in newspapers took up many pages back then compared to the few pages we now see today. As time passed and populations grew, school districts in Kansas and across the country began to hire medium- to large-sized, for-profit companies to provide the school bus transportation needs of their district's children.

As the economic climate began to change and cost of living increased, parents with school-aged children found driving a school bus compatible with raising children since preschoolers were allowed to accompany the parent on the school bus in the ride-along-programs developed to attract more school bus drivers.

Typically, school bus drivers are only paid for the hours they are operating the bus. Therefore, compensation during times school is not in session is very rare. This is especially true for drivers that are employed by for-profit private companies that bid on school district contracts. We are not paid for snow days, teacher work days and even some holidays. The impact becomes most troubling during the summer time.

It is important that you understand that a school bus driver's annual income generally keeps them at or just slightly above the poverty line, which means that they do not qualify for social services such food stamps, etc. I am saddened by the stories of single-parent school bus drivers and monitors, usually mothers who will work so hard during the school year trying their best to get in as many hours per week as possible, and then who, come summertime, try to apply for the

WIC program or other services and are turned down because they literally made between $40 and $280 dollars more annually the previous tax year… disqualifying them from this important financial aid.

So as you can see, it is extremely difficult and many times impossible for some families whose parents are school bus drivers to pay for their basic living expenses during the summer months in particular. These people literally go hungry.

Before First Student purchased Laidlaw and took over the Blue Valley District's student transportation contract, Laidlaw allowed school bus drivers who could not find work to apply and receive unemployment compensation. Even though the law was in place, Laidlaw did not challenge it. They were honest about the 'reasonable assurance' clause and did not dispute that they had laid off most of their employees and reduced the wages of those who were lucky enough to win a bid for a summer route or other summer work. Moreover, Laidlaw frequently allowed the most industrious and motivated drivers to work a couple hours overtime. In contrast, First Student very strictly monitors overtime.

As long as the law remains in effect as currently written, First Student (as well as any privately-owned for-profit company) can and many will deny all their bus drivers and monitors any chance of receiving unemployment benefits, despite the fact that they do NOT promise reasonable assurance in writing or verbally to their employees. And instead, they tell the unemployment offices that they have given reasonable assurance to the employees. It is important for you to understand that the number of routes in more recent times has diminished due to school budget restraints and fewer parents paying directly to the company for bus transportation of their children. To illustrate the point, at the Blue Valley District, we have 20 drivers from Minnesota driving for us since August. They were laid off in Minnesota due to a severe decrease in available routes with the school districts in Minnesota.

Thank you so much for giving Kansas school bus drivers who are employed by private, for-profit companies a moment of your time to testify how this current law is negatively impacting them and their families, especially during the summer months.

Respectfully yours,
Pamela Ann Ward

Dear Kansas State Legislators,

Please carefully consider **House Bill 2092 and Senate Bill 137**, which provide for a revision that rectifies the disqualification for school bus drivers who are either laid off from work or have a serious reduction of work hours after each academic year is over. Many school districts across the nation as well as right here in Kansas contract out the transportation needs of their students to private, for-profit corporate entities that provide services to not only the school district but to private schools, other corporations, small businesses, organizations, and private parties and individuals.

Some of these services provided are bar hops, in which adults are taken from bar to bar in various areas both in and outside the state of Kansas. Others include, bachelor and bachelorette parties; special events for corporations and organizations, such as veteran reunions/celebrations; church youth group summer camping sessions as well as spring and fall retreats; shuttling services for businesses and conventions; Cub Scouts, Boy Scouts, and Girl Scouts activities; YMCA activities; interstate movement of assets, shuttling services for sports events and theme parks, etc. Therefore, school bus drivers who work at for-profit corporations that are contracted by school districts happen to provide transportation needs to more than just the school contract.

I work for First Student, an international corporation that serves this nation as well as others and brings in billions of dollars in revenues annually through more than just school transportation contracts. As a school bus driver, I have seen my fellow bus drivers suffer mentally, physically, and emotionally during times we are not offered work and therefore, receive very low paychecks or even no paychecks and struggle to feed, shelter and provide for ourselves and our children.

Furthermore, while our corporation tells the unemployment compensation offices that they have given us "reasonable assurance" of giving us work when school resumes, they do not tell us that or provide us that in writing. Moreover, they truly cannot give us any assurances that each and every one of us will still have their route to drive come the start of school in the fall. Case in point: at the Blue Valley District, we have 20 drivers from Minnesota driving for us since August. They were laid off in Minnesota due to a severe decrease in available routes with the school districts in Minnesota. We desperately need them to drive our buses because our own attrition rate is high and we cannot find local drivers to provide the district's needs. These Minnesota drivers are promised 40 hours pay for 20 hours of work per week. Their hotel and transportation needs are paid for by the company and they each receive a per diem for food expenses.

Each summer, drivers and monitors who cannot find work become desperate. They are forced to try to obtain work that is not just seasonal and due to that, they are unable to get the time off from their summer work to drive routes when the new school year begins or resort to completely turning to social welfare and remain there. This contributes to the high attrition rate at our location.

Furthermore, our corporation offers the management and supervisors access to real benefits, but drivers and monitors are offered a seriously reduced benefit plan that only takes advantage of us. In contrast, school bus drivers and monitors who are school district employees have access to the same benefits as teachers and other district employees. Moreover, contracted drivers and monitors are paid lower wages than our counterparts who work for school districts. And, district-employed school bus drivers have the option to spread their compensation over the entire year like the school teachers.

Since our corporation provides transportation services to entities other than the school district that it is contracted to serve, it is a full-fledged transportation business. And as employees of such a corporate entity, we are asking to be treated as equals when it cannot provide work for us.

Kansas Statute 44-706, Disqualification of Benefits, paragraph (p), places many student transportation employees who do NOT work directly for school districts on the brink of bankruptcy during school breaks, especially between academic years. The law as it is currently written is an unfair and out-dated provision in unemployment benefits for school bus drivers working in Kansas, especially for those who work for transportation contractor business entities that provide charters and other transport services throughout the year.

Additionally, I've been told that school bus drivers in Missouri can collect unemployment compensation during times that there is no work or reduce hours offered by their employer. At the Blue Valley District lot each summer, almost all of us take a cut in hours (as much as half the number of hours) and many of us have no work at all. I work between 30-40 hours per week during the school year and get only 16 hours per week during the summer as a school bus driver. Moreover, we must compete for whatever summertime work is available with college and high school students as well as teachers, who are off from teaching so they can work during the summer for an additional paycheck.

In the past, school bus drivers often labored in fields and helped with planting and harvesting each summer. Today, there are few (if any) agricultural jobs in the Kansas

City metropolitan area available for drivers who would seek to become field laborers. The competition for summertime work is very hard and many of us desperately need to be able to receive unemployment benefits to maintain our households between academic years.

During the past twenty years, as the economic climate began to change and cost of living increased, more parents (especially mothers) with school-aged children found driving a school bus compatible with raising children since preschoolers were allowed to accompany the parent on the school bus in the' ride-along-programs' developed to attract more school bus drivers. I am one of those parents. My fourth child was only days old when I put him in his car seat on my bus. However, a couple years ago, First Student developed a policy that prohibits parents from bringing their child on the school bus until the child is at least one year old and weighs at least 20 pounds.

School bus drivers typically cannot afford daycare; they do not make enough driving the bus to even cover daycare costs, so they are forced to quit and wait a year. When they return, they must start over at the beginning of the senority list. (All routes and extra work are bid on and awarded due to seniority, it is a tragedy to lose seniority due to the birth of a child.) If this policy had been in effect when I had my fourth child, I would not have been able to drive for several years. My son did not weigh 20 pounds until he was nearly four years old. In fact, he turned nine years old last April and last fall, he only weighed 42 pounds. So, as you can see, much has changed since large business entities have bought up smaller companies and began servicing the transportation needs of school districts.

Furthermore, the attrition rate at our own bus lot for the Blue Valley District 229 contract is very high, this is a safety concern for me as well. Before I became a school bus driver, I had noticed that in four months there were five different drivers providing my children transportation from elementary school. This concerned me so much that I applied and have been driving since. I have been a constant at my elementary school since 2003. While the high attrition rate is certainly not caused solely by lack of ability for drivers to collect unemployment when no work in available, it is a major contribution to the reasons for the high attrition rate. Are the safety and comfort of our state's school-aged children important enough to help retain experienced drivers who know the needs of the minors in their charge while transporting them?

The impact on the Blue Valley School District's children, especially this year, is that many of them see different people driving them to school every few months. Another example is another bus that drives out of the same elementary school as I do. Since 2003, bus #7 has had six or seven 'permanent drivers' (as well as many substitute

drivers in between new drivers) behind the wheel when it drives through my neighborhood. Of all the buses that drive out of my children's elementary school, I am the only true constant and have been for 8 years. I know each child on my bus by name, who their siblings are, what their dog's name is and I recognize their parents. What does this mean to a child and that child's parents? Security and comfort. Don't Kansans deserve that kind of peace of mind for the children who live in districts that contract out their transportation needs to companies?

I'm humbly asking that you and the other members of the Kansas State Legislature to remove the "private contractor" and "reasonable assurance" clauses in the statute. Please correct this unfair legislation. The new wording benefits not only the families of the drivers and monitors who need to be sheltered and fed, but also helps to maintain quality of care to our state's school children by helping to lower the reasons for the high attrition rate for school bus drivers and monitors who are employed by transportation contractors.

Thank you for your time and consideration of your support to enact **House Bill 2092 or Senate Bill 137.** Please contact me with questions or comments via the following options: 913-239-8222 (home telephone), 913-220-3900 (cell telephone), Lorianne@Koneczny.com (email), or mailing address at 8509 West 144th Place, Overland Park, KS 66223-1362.

Respectfully yours,

Lorianne Fisher Koneczny

House Commerce & Economic Development Committee
Date: 02/14/2011
Attachment #: 2-4

Office of Revisor of Statutes
300 S.W. 10th Avenue
Suite 010-E, Statehouse
Topeka, Kansas 66612-1592
Telephone (785) 296 -2321 FAX (785) 296-6668

MEMORANDUM

To: House Committee on Commerce and Economic Development

From: Renae Jefferies, Assistant Revisor

Date: February 8, 2011

Subject: HB 2135

HB 2135 deals with employee misclassification. It amends K.S.A. 2010 Supp. 79-3234 by striking the provision on page three of the bill which would have required the Secretary of the Department of Revenue or the Secretary's designee to disclose to the department of Labor persons suspected of violating provisions of K.S.A. 44-766, the employee misclassification statute. It also takes away the criminal penalty for misclassifying an employee by repealing K.S.A. 44-766.

The effective date of the bill if passed would be upon publication in the statute book.

Testimony before House Commerce & Economic Development
HB 2135 – Misclassification
Presented by Eric Stafford, Senior Director of Government Affairs

Tuesday, February 8, 2011

Chairman Brown and members of the Committee:

We appreciate the opportunity to provide testimony in support of House Bill 2135 which repeals the statutory provision of a division under Department of Labor specifically tasked with investigating alleged misclassification of employees.

In 2006, the Kansas Chamber voiced concerns about the creation of a division to investigate claims of misclassification as numerous laws are in place for companies who intentionally fail to withhold or pay taxes for employees (see page 2). Now, as then, we believe that intentionally fraudulent classification of an employee should be penalized but doing so does not require this division or the onerous and undiscriminating penalties outlined.

The Kansas Chamber also voiced concerns over the ability for individuals to, without merit, report their competitors to the Department of Revenue that a potential claim of intentional misclassification has occurred. Because there is no clear litmus test established in statue for easily identifying those intentionally breaking the law and evading their withholdings tax, all of these cases are investigated. Proponents of the 2006 legislation assured committee members that meritless investigations would not occur.

When we contacted the Departments of Revenue and Commerce to inquire into their results after three years of enforcement, we were surprised by the high number of companies who were investigated. Representatives from within this investigative division bluntly stated when one company is investigated for intentionally misclassifying employees as independent contractors they immediately turn in several of their competitors. Those competitors are then investigated by the department to ensure compliance.

Finally, the Kansas Chamber also questioned the severity of the problem. Testimony submitted in 2006 stated that Kansas was missing out on approximately $39 million in unpaid taxes because of employers intentionally misclassifying employees as independent contractors. In three years of investigating these claims from 2006-2008, $548,000 in unpaid taxes were collected. This amount is barely enough to cover the costs of the resources necessary to investigate potential claims. Intentional misclassification is wrong and should be deterred. But the failings of this division are reflected in the information received from its own department.

When asked how many businesses are investigated for misclassification each year, Department of Labor responded that they do not know how many – but they do investigate every claim. This is to say that without merit to the claim, any business which is reported for suspicion of employee misclassification is investigated.

The Kansas Chamber supports HB 2135 repealing the misclassification investigation program because of its lack of evidence required to investigate claims into the intentional misclassification of employees. Additionally, the Kansas Chamber feels there are sufficient laws in place today that if properly enforced, will allow the state to punish employers who intentionally misclassify employees as independent contractors. Thank you for the opportunity to offer these comments on behalf of the Kansas Chamber and its members today.

I am happy to stand for questions.

House Commerce & Economic
Development Committee
Date: 02/14/2011
Attachment #: 4-1

Summary of Existing Penalties for Failure to Pay or Withhold Taxes (Department of Revenue)

- The statute establishing penalties for failure to pay income taxes is 79-3228. In this statute, if one without intent to evade, fails to file a return but voluntarily files a correct return or pay tax due within 6 months, there is a 10% fine of the unpaid balance plus interest.
- If one fails to file a return within 6 months, in addition to the unpaid amount, there is a 25% penalty, plus interest added.
- If any taxpayer who has failed to file a return or has filed an incorrect return, and after notice from the director refuses or neglects within 20 days to file a proper return, the face a penalty of 50% of the unpaid balance plus interest.
- Any person who with fraudulent intent fails to pay any tax shall be assessed a penalty equal to the amount of the unpaid balance plus interest. Such person shall also be guilty of a misdemeanor and if convicted, faces a maximum fine of $1,000 or imprisonment not less than 30 days and no more than one year.
- Any person who willfully signs a fraudulent return shall be guilty of a felony and upon conviction face imprisonment for no more than 5 years.
- A similar statute is in place for withholding tax with the same penalties found in 79-3228.

Department of Labor Provisions

- Penalties currently in place for the Department of Labor to enforce are found in 44-717 and 44-719.
    - 44-717 covers collection of employer payments, penalties and interest for past due payments. The penalty for each month or fraction of a month for the calendar quarter which they failed to pay is equal to .05% of the total wages paid by the employer during the quarter, except no penalty shall be less than $25 or more than $200.
    - Statute 44-719 establishes a penalty equal to 100% of the unpaid taxes if the employer willfully fails to pay contributions.

The Kansas Chamber, with headquarters in Topeka, is the leading statewide pro-business advocacy group moving Kansas towards becoming the best state in America to do business. The Chamber represents small, medium and large employers all across Kansas.

THE KANSAS CHAMBER
835 SW Topeka Blvd. Topeka, KS 66612 785.357.6321

House Commerce & Economic Development Committee
Date: 02/14/2011
Attachment #: 4-2

Luke Bell
Vice President of Governmental Affairs
3644 SW Burlingame Rd.
Topeka, KS 66611
785-267-3610 Ext. 2133 (Office)
785-633-6649 (Cell)
Email: lbell@kansasrealtor.com

To: House Commerce and Economic Development Committee

Date: February 8, 2011

Subject: **HB 2135** -- Protecting the Confidentiality of Tax Information Submitted to the Kansas Department of Revenue by Independent Contractors

Chairman Brown and members of the House Commerce and Economic Development Committee, thank you for the opportunity to submit written testimony on behalf of the Kansas Association of REALTORS® in support of **HB 2135**. Through the comments expressed herein, it is our hope to provide additional legal and public policy context to the discussion on this issue.

KAR is the state's largest professional association, representing nearly 8,000 members involved in both residential and commercial real estate and advocating on behalf of the state's 700,000 homeowners for over 90 years. REALTORS® serve an important role in the state's economy and are dedicated to working with our elected officials to create better communities by supporting economic development, a high quality of life, sustainable communities and providing affordable housing opportunities, while protecting the rights of private property owners.

HB 2135 would delete the statutory authority of the Kansas Department of Revenue to provide certain confidential taxpayer information to the Kansas Department of Labor and protect the confidentiality of individuals who choose to act as independent contractors. In summary, we believe that this would protect the confidentiality of taxpayer information and prevent the state from discouraging individuals to act as independent contractors in the marketplace.

Unfortunately, it is common to witness discussions in the news media and in public policy circles where negative dispersions are cast on independent contractor relationships in certain industries. In many cases, comments are made alleging that employers force employees to become independent contractors in order to avoid the payment of various fees and taxes.

In the real estate industry, it is extremely common (if not customary) for real estate salespersons to be associated with supervising real estate brokers as independent contractors. As independent contractors, real estate salespersons enjoy a greater degree of flexibility, freedom and control over their individual businesses than employees in a traditional employer-employee setting.

REALTORS® absolutely believe that the state should enact no statutes or regulations that would discourage individuals from choosing to become independent contractors to take advantage of these benefits. By supporting this legislation, the Kansas Legislature will ensure that no state agency provides confidential information that can be used to unfairly investigate independent contractors.

In our opinion, the passage of **HB 2135** would protect the confidentiality of taxpayer information and remove an improper impediment to the formation of independent contractor relationships. For all the foregoing reasons, we would urge the House Commerce and Economic Development Committee to support **HB 2135**.

House Commerce & Economic Development Committee
Date: 02/14/2011
Attachment #: 5-1

LAW OFFICES
KATHERINE KARKER-JENNINGS, P.A.
6030 DAYBREAK CIRCLE
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(410) 531-2622
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January 28, 2011

Anthony Brown
Chairman of Commerce and Labor
151 South State House
Topeka, Kansas 66612

Re: K.S.A.44-703 (i)(3)(D)

Dear Mr. Brown:

Please accept this letter as my testimony that the above-referenced section of K.S.A. 44-703 should be repealed as it is a job killer in the State of Kansas. I am a nationally practicing Medicare lawyer which clients all across the United States, including Kansas, and this law forces all compensated parties to be employees rather than independent contractors unless the "two-prong" test is met. This test requires (i) the individual be free from control or direction for the performance of the services **and** (ii) the service must be outside the usual course of business or outside the place of business where the services are performed. This is an almost impossible test to meet.

There are many reasons why a company would prefer an independent contractor arrangement. In the medical arena it can limit liability. Even the Stark law (also known as the anti-self referral law) under the Medicare regulations recognizes an exception for allowable compensation between referrals sources if there is a "Personal Service Arrangement". These independent contractor arrangements must be in writing, for a period of at least 12 months, negotiated at arm's length for commercially reasonable compensation, and signed by both parties. 42 C.F.R. § 411.357. Yet the Kansas statute disallows this popular exception used by Medicare providers and suppliers nationwide. I truly believe that could cost the state substantial business.

I was recently sent a copy of a proposed statute that purports to repeal the prohibition on independent contractor relationships. However there is no mention of the above-referenced statute in this proposed House Bill (which was not numbered) but it apparently repeals K.S.A. 2010 Supp. 44-766 and K.S.A. 79-3234. I am unaware of the content of these two statues but K.S.A. 44-703 is not affected.

Thank you for your consideration in this matter. I am,

Very truly yours,

Katherine Karker-Jennings

Katherine Karker-Jennings
www.karkerjen.com

KK-J/

House Commerce & Economic Development Committee
Date: 02/14/2011
Attachment #: 6-2

Policy & Research
915 SW Harrison St
Topeka KS 66612-1588

Nick Jordan, Secretary
Richard Cram, Director

Kansas
Department of Revenue

Phone: 785-296-3081
FAX: 785-296-7928
www.ksrevenue.org

Sam Brownback, Governor

February 8, 2011

House Commerce and Economic Development Committee

Testimony Concerning House Bill 2135

Presented by Richard Cram

Chairman Anthony Brown and Members of the Committee:

House Bill 2135 would repeal K.S.A. 44-766, which states that any person who knowingly misclassifies an employee as an independent contractor solely to avoid state income withholding tax requirements or state unemployment insurance contribution reporting requirements is subject to penalty pursuant to K.S.A. 79-3228, the penalty and interest statute applicable to state income or employer withholding tax. House Bill 2135 would also strike certain language in K.S.A. 2010 Supp. 79-3234(b)(13) that enables the Department of Revenue and the Department of Labor to exchange taxpayer information concerning withholding and other payroll taxes in order to facilitate enforcement of K.S.A. 44-766 and the employer payroll withholding laws. The Department's fiscal note is attached.

K.S.A. 44-766 and the language at K.S.A. 2010 Supp. 79-3234(b)(13) were enacted in 2006 House Bill 2772 to facilitate cooperation between the Departments of Revenue and Labor in the enforcement of the employer withholding tax laws administered by the Department of Revenue and the unemployment insurance and workers compensation insurance coverage laws administered by the Department of Labor.

Passage of House Bill 2135 would end the ability of the two agencies to cooperate with taxpayer information exchange in such investigations. An employer found to have improperly failed to withhold employer payroll taxes will still be subject to applicable penalty and interest provisions under K.S.A. 79-3228, but the two agencies will not be able to exchange the information needed to facilitate identifying such an employer.

Since enactment of 2006 House Bill 2772, the Departments of Labor and Revenue have cooperated in exchanging leads on employers who may be misclassifying employees as independent contractors to evade their responsibilities to report state withholding tax on wages, as well as payment of unemployment insurance tax and workers compensation insurance premiums. Department of Labor makes the determination of whether someone is properly classified as an employee or an independent contractor. The determination of an employer-

employee relationship triggers the employer's responsibility for employer withholding tax on wages, as well as payment for unemployment insurance tax and workers compensation insurance premiums. When the Department of Labor informs Department of Revenue compliance staff of misclassification situations, Department of Revenue can then pursue enforcement of unreported employer withholding tax liability against those employers.

Since January 2008, as a result of inter-departmental cooperative efforts, Department of Revenue compliance staff have investigated 411 misclassification cases for withholding tax evasion involving $3,179,144.36 in total wages (89 of those cases began as referrals from the Department of Revenue to the Department of Labor), resulting in assessments of $1,563,939.61 for unreported withholding tax. Our Audit Services Division has completed 130 withholding tax audits arising from these cases, recovering payments of $901,037.

Department of Revenue compliance staff recently (December 2010) received new information from Department of Labor concerning an additional 543 businesses determined to have misclassified workers. The Department of Revenue is currently investigating these businesses regarding compliance with employer withholding tax requirements. Assessments will be issued to those businesses failing to properly report and remit withholding tax.

The Departments of Labor and Revenue have established a joint website where members of the public can learn about employer misclassification and file complaints concerning suspected violations. The link to that site is at https: //www.kdor.org/misclass/mcfaq.htm Complaints filed on the website are routed first to the Department of Labor for investigation. Misclassification violation information can then be turned over to Department of Revenue for follow-up investigation of any withholding tax violation. Attached is a list of frequently asked questions shown on this website.

2011 House Bill 2135b Revised Fiscal Note

Introduced as a House Bill

MEMORANDUM

To: Mr. Steve Anderson, Director
Division of Budget

From: Kansas Department of Revenue

Date: 02/08/2011

Subject: House Bill 2135
Introduced as a House Bill
Revised Fiscal Impact

Brief of Bill

House Bill 2135, as introduced, amends K.S.A. 79-3234 by eliminating the provision that allows the department of revenue to share taxpayer information with the department of labor regarding employee withholding and payroll information.

The bill also eliminates K.S.A. 44-766 which states that no person shall knowingly and intentionally misclassify an employee as an independent contractor for the purpose of avoiding state withholding or state unemployment insurance.

The effective date of this bill is on publication in the statute book.

Fiscal Impact

Passage of this bill will have a negative but unknown impact on state general fund revenues.

Employers currently are required to report income paid to an employee or an independent contractor. Employers are required to issue a w-2 to all employees and 1099's to anyone not considered an employee.

Since 2008, audits arising from information exchange between the Departments of Revenue and Labor have resulted in about $900,000 in withholding tax collections, or about $300,000 per year. This amount includes the tax plus any penalties and interest due.

Administrative Impact

None.

Administrative Problems and Comments

Without statutory authority to exchange information concerning suspected misclassification violators, the Department of Revenue and Department of Labor will no longer have the ability to cooperate in such investigations.

Taxpayer/Customer Impact

Legal Impact

Approved By:

Nick Jordan
Secretary of Revenue

House Commerce & Economic Development Committee
Date: 02/14/2011
Attachment #: 7-4

What is the misclassification of workers?

Misclassification of workers occurs when an employer incorrectly classifies workers as independent contractors rather than employees.

Why is it important to correctly classify workers?
An employer has different legal, tax and financial obligations depending on how a worker is classified. For example, if a worker is classified as an **employee**, the ***employer*** is required to:

- withhold income, F.I.C.A. (Social Security) and Medicare taxes from the employee's wages;
- pay F.I.C.A. (Social Security) and Medicare taxes in addition to the employee's share;
- pay unemployment taxes (which provides insurance coverage in case the worker is laid off;) and
- buy workers compensation insurance (which provides insurance coverage in case the worker is injured on the job.

If a worker is classified as an **independent contractor**, the employer generally does not have those obligations and the ***worker*** is required to:

- make quarterly estimated payments for income taxes, and;
- pay self employment taxes.

An independent contractor is not entitled to unemployment compensation and, in many cases, will not receive workers compensation if injured on the job.

Most importantly, the intentional misclassification of workers is illegal and constitutes *tax and insurance* evasion. Employers engaging in this practice may be subject to significant penalties and fines.

What is employment?
Employment is defined in K.S.A. 44-703, Chapter 44, Article 7. According to this statute, employment means:

- Services performed by an individual for wages under any contract of hire is employment unless it is shown that:
    1. The individual has been and will continue to be free from control or direction over the performance of the services, both under the individual's contract of hire and in fact;

       AND

    2. The service is either outside the usual course of the business for which the service is performed or that the service is performed outside of all the places of business of the enterprise for which the service is performed.

Who is an employee?
An **employee** is anyone performing services for an employer who controls what will be done and how it will be done by the worker. This is true even if the employee has freedom of action. What matters is the right of the employer to control the details of how the services are performed.

House Commerce & Economic Development Committee
Date: 02/14/2011
Attachment #: 7-5

Who is an independent contractor?

Independent contractors have an independent trade, business, or profession. They offer their services to the public and are generally not employees. However, whether they are employees or independent contractors depends on the facts in each case. The general rule is that an individual is an independent contractor if the employer controls or directs only the result of the work and not the means and methods of accomplishing the result.

Who determines if a worker is an employee or an independent contractor?

The Kansas Department of Labor is responsible for investigating worker classification by employers.

How does the Kansas Department of Labor determine if a worker is an employee or an independent contractor?

The right of control, whether or not exercised, is the most important factor in determining the relationship. An employer-employee relationship exists when an employer has the **right** to exercise control over the manner and means by which the individual performs services. The right to discharge a worker at will and without cause is strong evidence of the right of direction and control. The following factors should also be taken into consideration:

- Is the one performing the services engaged in a separately established occupation or business?
- Is the work usually performed without supervision in that locality?
- What skill is required in performing the services and accomplishing the desired result?
- Who supplies the tools, equipment, and place of work for the person doing the work?
- Is the performance of services an isolated or continuous event?
- What is the method of payment, whether by time, a piece rate, or by the job?
- Is the work part of the regular business of the employer?
- What is the extent of actual control exercised by the employer over the manner and means of performing the services?
- Are the services performed for the benefit or convenience of the employer as an individual or for the employer's business enterprise?
- Can the worker make business decisions that would result in a financial profit or loss for the worker? Investment of the worker's time is not sufficient to show a risk of loss.

A written contract that claims to create an independent contract relationship is worthless if the practice of the parties shows that the employer retains the right to control the means and manner in which services are performed.

Generally an employer-employee relationship is found to exist when the work being done is an integral part of the regular business of the employer and the worker does not furnish an independent business or professional service to the employer.

What difference does it make if workers are misclassified?

A business that intentionally misclassifies employees creates a number of costs for a variety of people. The costs avoided do not go away, they are simply borne by other people.

- A worker misclassified as an independent contractor rather than as an employee suffers several adverse consequences. The worker is responsible for payment of income and self-employment taxes. Self-employment taxes are a higher cost for the worker because self-employment taxes include a portion of the F.I.C.A. (Social Security) and Medicare taxes that would have been paid by the employer.

House Commerce & Economic Development Committee
Date: 02/14/2011
Attachment #: 7-6

If laid off from a job, the misclassified worker must bear the financial consequences and is usually not entitled to unemployment compensation.

If injured on the job, the misclassified worker is often not entitled to workers compensation benefits and must pay medical expenses and bear the financial burden of lost income.

- Businesses that intentionally misclassify workers put other businesses at a competitive disadvantage.
- In the end, honest Kansas taxpayers must pick up the remaining cost.

How can I report employment misclassification?

You can report suspected misclassification to the Department of Labor and Department of Revenue on this website. The Departments will investigate all reports submitted via this website.

https://www.kdor.org/misclass/MisclassForm.aspx

What are the penalties that an employer maybe subject to if the employer misclassifies a worker?

Unemployment Taxes

K.S.A.44-117 states: (a)(1) Penalties on past-due reports, interest on past-due contributions, payments in lieu of contributions and benefit cost payments. Any employer or any officer or agent of an employer, who fails to file any wage report or contribution return by the last day of the month following the close of each calendar quarter to which they are related shall pay a penalty as provided by this subsection (1) for each month or fraction of a month until the report or return is received by the secretary of labor. The penalty for each month or fraction of a month shall be an amount equal to .05% of the total wages paid by the employer during the quarter, except that no penalty shall be less than $25 nor more than $200 for each such report or return not timely filed.

Contributions and benefit cost payments unpaid by the last day of the month following the last calendar quarter to which they are related and payments in lieu of contributions unpaid 30 days after the mailing of the statement of benefit charges, shall bear interest at the rate of 1% per month or fraction of a month until payment is received...

K.S.A. 44-719 states:
(e) Any employer or person who willfully fails or refuses to pay contributions, payments in lieu of contributions or benefit cost payments or attempt in any manner to evade or defeat any such contributions, payments in lieu of contributions or benefit cost payments or the payment thereof, shall be liable for the payment of such contributions, payments in lieu of contributions or benefit cost payments and, in addition to any other penalties provided by law, shall be liable to pay a penalty equal to the total amount of the contributions, payments in lieu of contributions or benefit cost payments evaded or not paid.

Worker Compensation

K.S.A. 44-5,120 states: (d) Fraudulent or abusive acts or practices for purposes of the workers compensation act include willfully, knowingly or intentionally: (2) misrepresenting to an insurance company or the insurance department, the classification of employees of an employer, or the location, number of employees, or true identity of the employer with the intent to lessen or reduce the premium otherwise chargeable for workers compensation insurance coverage.

Essentially, it is considered a fraudulent act to represent employees as a different classification for the purpose of obtaining a cheaper premium.

House Commerce & Economic Development Committee
Date: 02/14/2011
Attachment #: 7-7

With regard to penalties, K.S.A. 44-5,120(g) provides for a couple different options:
(g)(1) Payment of a monetary penalty of not more than $2,000 for each and every act constituting the fraudulent or abusive act or practice, but not exceeding an aggregate penalty of $20,000 in a one-year period.
(g)(2) Redress of the injury by requiring the refund of any premiums paid by and requiring the payment of any moneys withheld from, any employee, employer, insurance company or other person or entity adversely affected by the act constituting a fraudulent or abusive act or practice.
Based on the two penalty provisions listed above, an employer potentially could be charged according to the number of times he misrepresents an employee and/or the amount of premium that should have been paid had the employees been classified correctly. Determining what penalties to charge depends on the facts of each case.

Withholding Tax
Generally, every employer required by federal law to withhold upon wages pursuant to the federal internal revenue code shall, whenever the wage recipient is a resident of Kansas or the wages are paid on account of personal services performed in Kansas, withhold and deduct from such wages an amount to be determined in accordance with K.S.A. (2005 Supp.) 79-32,100d, and amendments thereto.

Employers who fail to withhold upon their employees' wages or otherwise fail to comply with the provisions of the Kansas Withholding and Declaration of Estimated Tax Act shall be subject to the penalty provisions set forth in K.S.A. 79-3228 and 79-32,107, and amendments thereto. Such penalties range from 1% per month of the unpaid balance of tax due up to 100% of the unpaid balance of tax due, plus interest on the unpaid tax at the rate established by law.

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Karin Brownlee, Secretary

Department of Labor

Sam Brownback, Governor

Testimony of Karl Hansen
Chief Counsel

HB 2135
House Committee on Commerce & Economic Development

February 8, 2011

Mr. Chairman, members of the Committee, I come before you on behalf of the Department of Labor in reference to HB 2135 regarding provisions related to the misclassification of workers. Normally, it would be expected that the Department would testify in favor of or in opposition to proposed legislation. However, HB 2135 presents a unique circumstance, one in which the Department is neutral on the substance of the bill, but necessitates comment on the broader implications of the underlying topic of worker misclassification.

HB 2135 proposes to remove provisions within K.S.A. 79-3234, a Revenue statute, allowing the Department of Revenue to share with the Department of Labor certain taxpayer information for purposes of making a determination whether an employer is in compliance with K.S.A. 44-766 regarding the appropriate classification of workers as employees or independent contractors.

What makes this proposal unusual is that despite the intent of the Legislature when these provisions were originally inserted in statute, rarely have these provisions been exercised. While an agreement currently exists between the Departments as to the procedures for the sharing of information, the Revenue Department, under the previous administration and contrary to this statute, did not participate in the contemplated sharing of information. Rather, the extent of information received by the Department of Labor from Revenue amounted to little more than "tips" generated by Revenue auditors during the course of Revenue audits. The dearth of information provided generally necessitated a separate investigation be performed by Labor. On the other hand, though anecdotal evidence exists indicating a similar reluctance of Labor to share certain information, known cases of misclassification as determined by Labor have been and continue to be periodically compiled and forwarded to Revenue for appropriate action by that department. If the motivation for HB 2135 is a fear that the information sharing provisions of the statute have been abused, then the bill is effectively a solution in search of a problem. But more importantly, HB 2135 misses the opportunity to remedy truly existing problems with regard to the matter of worker misclassification.

Misclassification not only adversely impacts workers through the denial of benefits that may otherwise be due the worker, increased worker tax liabilities, and potentially the disqualification of entitlement to unemployment benefits, but misclassification, too, is costly to compliant employers, as those employers who fail to properly classify workers as employees enjoy an unfair economic advantage over their compliant competitors. Misclassification has implications on a more macro level as well, impacting workers compensation, creating a myriad of costly issues both to certain employers, insurance carriers, medical providers, and of course the individual worker. Further, misclassification is also costly to Kansas taxpayers as it adversely affects various tax revenues and the solvency of the Unemployment Trust Fund.

During 2010, investigations by KDOL uncovered misclassification issues with 293 employers, affecting 1,826 workers. Through these investigations, more than $195,000 in Unemployment Insurance tax debt has been identified, reflecting over $5.4 million in previously unreported taxable wages. The industry with the highest unreported wages was the construction industry (perhaps the impetus behind the recent introduction of HB 2131). During the same period, we understand that the Department of Revenue investigated 566 (inclusive of the aforementioned 293) employers for evading withholding tax involving more than $20 million in wages, of which more than $10 million was subject to withholding tax.

Typically, the Department of Labor, rather than through the information sharing provisions of K.S.A. 79-3234, identifies noncompliant employers through one of three common scenarios: 1) An unemployed worker applies for unemployment benefits, only to discover that his employer claims he was an independent contractor and thus not responsible for being charged for the applied for benefits; 2) Discovery, through routine audit, by the KDOL audit division; or 3) Tips submitted to the Department (in addition to the aforementioned tips from Revenue). It should be noted our recent discovery that the "tip" website set up in conjunction with Revenue, through which Labor was to receive tips from the public, has not been functional for some time. When the public tip site was in operation, anecdotally only half of the tips provided were deemed credible. Without greater cooperation and avenues of obtaining information, the Department's ability to detect worker misclassification is fairly limited.

Rather than removing the information sharing provisions of K.S.A. 79-3234, the provision should be revised to clarify and, thus alleviate, the issues posed by confidentiality as required elsewhere in statute, administrative regulations, or internal Department policies. Though these issues were largely dealt with in the agreement between the Departments, it is believed that confidentiality concerns may have been the premise upon which cooperation failed. Similar revised provisions should be inserted into K.S.A. 44-766 so as to clarify a clear authority for sharing information between the Departments for purposes of investigating instances of worker misclassification. Further, the committee may wish to include provisions clearly stating, or re-emphasizing, the authority of the Secretary of either Department, or their designees, to exercise reasonable discretion when investigating these matters. Such authority would be similar to that of prosecutorial discretion exercised by law enforcement, allowing the

respective Departments to prioritize the deployment of resources to ferret out the more egregious offenders, while allowing the Departments to educate, rather than arbitrarily penalize, employers who may have been noncompliant due to mistake or reliance on erroneous information. Clearly defined discretionary authority, perhaps based on a set of factors, would allow the Departments to pursue these matters in a manner more consistent with the original intent of the Legislature.

For those employers intentionally engaged in the practice of misclassifying workers, the penalty scheme needs to be revised. The penalty now assessed is a combination of those found in both the Revenue and Labor statutes. First, there are penalties and interest assessed for failure to timely pay unemployment taxes. Second, the actual penalty for misclassifying workers is also assessed – this penalty being articulated among the Revenue statutes. While we believe the Revenue penalty to be equally enforceable by the Department of Labor, the singular placement of the penalty scheme within the Revenue statutes has generated confusion, if not speculation, whether the Department of Labor truly has the authority to assess and enforce the penalty. Including the penalty scheme in both the Revenue and Labor statutes would alleviate such confusion. Further, there is a growing pattern of repeat offenders in the practice of misclassifying workers. Unfortunately, there is no escalation of penalties for repeat offenders who close up "Company A" and resurface anew as "Company B" shortly thereafter and again engage in the practice of misclassification. We recommend an escalating penalty scheme, including the eventuality of perhaps the permanent loss of eligibility to obtain, or maintain possession of, any business or professional licenses by principals who repeatedly engage in noncompliant conduct.

It should be noted that misclassification is not unique to Kansas. In fact, the issue is of such size and scope that the federal government has recently taken a much larger interest in clamping down on the practice. Federal legislation has been proposed, the Federal Employee Misclassification Prevention Act and the Fair Playing Field Act of 2010, as well as proposed "get tough" audit rules for state unemployment compensation programs to include mandated target goals for auditors to seek out instances of misclassification. The Obama administration in its recent budget proposal has proposed several incentive initiatives to encourage states to crackdown on misclassification practices, but as with most Federal offerings, strings will likely be attached. The best practice for Kansas would be to successfully deal with the matter on its own terms before Federal "one size fits all" legislation comes into play.

The Department of Labor is essentially neutral on HB 2135 in its current form, as it largely has little real effect on the status quo under which the Department is operating. However, the Department strongly encourages the committee to further examine the subject of worker misclassification, and perhaps revising HB 2135 to take into consideration the comments we present here today. The Department stands ready to assist the Committee in this regard.

Kansas AFL-CIO

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Testimony
IN OPPOSITION TO HB 2135
Before the Kansas Committee on Commerce & Economic Development
February 8, 2011
By Bruce Tunnell, Executive Vice President, Kansas AFL-CIO

Mr. Chairman and committee members, thank you for the opportunity to appear in front of you today. My purpose here today is to ask you to reject HB 2135 which makes violating the law attractive and easier.

The current law which HB 2135 is attempting to "gut" was a compromise attempt to level the competitive field for all employers. The vast majority of all Kansas employers are honest tax paying individuals and groups. But, there are those who employ illegal workers and workers they misclassify as contract labor all in an attempt to circumvent paying the proper taxes on these individuals. Each day thousands of illegal workers enter the United States and some are employed in Kansas under very questionable circumstances.

The current law allows the Department of Revenue and the Department of Labor to work together to determine if an employer is violating current law. Why in this time of great State financial challenges would you as lawmakers want to make it easier for a small group of employers to not pay their fair share of taxes? Would it be to give that small group a competitive edge over all the law abiding employers or would it be to allow illegal workers to replace tax-paying Kansas workers; thus, allowing a few scrupulous employers to make more money by not paying state taxes, social security taxes, unemployment taxes and workers compensation taxes.

Calendar year 2008, the Kansas Department of Labor investigated misclassification of worker issues involving 263 employers affecting 2193 workers. Through these investigations, the agency discovered more than $10.8 million in previously unreported wages and could be as much as $40 million in payroll taxes. These investigations resulted in determinations of over $204,000 in UI tax debt. (1)

Instead of making it more difficult for everyone to cheat at paying their share of taxes, HB 2135 would eliminate some of the needed checks and balances which ensure compliance with existing tax laws.

(1) Kansas Department of Labor

Please ask yourselves, do I want to help employ illegal workers? Do I want to advantage the employers who break the laws of this State? Do I, in this time of need for State resources, want to create more ways for the few to not meet their responsibilities?

Please reject HB 2135

Thank you.

JOAN WAGNON

FEBRUARY 7, 2011

Testimony on House Bill 2135
An Act relating to misclassification of employees

Mr. Chairman and Members of the Economic Development and Labor Committee:

I am Joan Wagnon from Topeka, Kansas. For eight years I served as Secretary of Revenue for the State of Kansas and worked on the issue of misclassification of workers out of a belief that there are many dollars in wage withholding and employment taxes that are not being collected because of the misclassification of workers as independent contractors.

However, someone brought HB 2135 to may attention and it concerns me that the program many of us worked to put in place will be terminated if this bill passes. The language which is stricken gives the Department of Revenue the ability to share confidential information with the Department of Labor in order to work together to determine if an individual is classified correctly. Labor does the classification review/audit or a company or an individual and then refers any violations to the Revenue department to investigate the tax consequences.

I don't know if the department(s) will be testifying or not. I certainly am not trying to replace their testimony. However, I became concerned a year or so ago because the Labor department was not sending very many cases to us. The Memorandum of Understanding under which we operated was still in place, but not much was happening. I believe Revenue had assessed between $2 and $3 million for the cases we had, but I felt there was much more that could be done.

Now that I see the bill to completely remove the ability for the two departments to cooperate, I am even more concerned. At a time when the state is desperately short of revenue, we should be increasing our efforts at tax compliance, not hamstringing them.

I would encourage you to take no action on this bill.

Joan Wagnon

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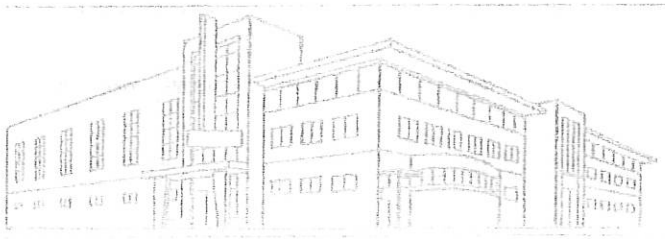


Carpenters' Testimony on House Bill 2135
An Act relating to misclassification of employees

The bill before you today, in repealing key elements of the employee misclassification law enacted in 2006, threatens to strip the Kansas Department of Labor and Kansas Department of Revenue of what are the most effective weapons in their arsenal to combat the scourge of worker misclassification in our State.

Specifically, the bill would eliminate the tax penalties that may be levied against an employer who *knowingly and intentionally* misclassifies workers to avoid its obligation to pay State taxes or unemployment insurance contributions. In addition, the bill would prohibit the Secretary of Revenue from sharing taxpayer information with the KDOL about

employers suspected of misclassifying workers to allow the KDOL to investigate these employers to determine if, in fact, they are in compliance with State reporting requirements.

If this bill passes, unscrupulous employers will have little incentive to properly report the wages of or withhold taxes from their employees in the future. The tax penalty provided for in the 2006 act serves as an effective deterrent to those employers who would otherwise be willing to deprive the State of legally required payroll and withholding taxes.

In addition, the bill would hobble the efforts of the KDOL and KDOR to jointly investigate and audit suspected misclassifiers. By all accounts, the agencies' collaborative enforcement program has been a success. For example, according to data released by the State, in 2010 alone KDOL investigated over 290 employers regarding the misclassification of over 1800 employees which resulted in finding more than $5.4 million in previously unreported wages. By taking away the agencies' capability to share confidential taxpayer data, this bill would lead to unnecessary duplication of audits and other efforts—inefficiencies that will cost the State needless additional expense.

Why would this Committee even consider doing away with the collaborative enforcement program after the success it has had? And why would this Committee even consider waiving tax penalties for employers who are *knowingly and intentionally* evading their tax-withholding obligations?

What is Worker Misclassification?

Kansas employers are required to report wages of its employees to the Department of Revenue and the Department of Labor for the purposes of Withholding Tax, Unemployment Tax, and Workers' Compensation. Worker misclassification occurs when workers who should properly be classified as employees are instead classified as independent contractors. Misclassification wrongfully deprives the State of Kansas of payroll and withholding taxes that are required to be paid by employers on their employees—tax revenue the State can ill-afford to forego as it struggles to fund its budget. The deliberate misclassification of employees to avoid payment of taxes unfairly disadvantages the overwhelming majority of Kansas employers who obey the laws and pay their taxes.

The misclassification laws you are now considering repealing were enacted in 2006 to ensure a fair playing field for employers and protection for workers in our State.

A recent study conducted by the School of Industrial Labor Relations at Cornell University estimates that approximately 10% of workers reviewed from Department of Labor audits were misclassified. In the construction industry, the number of misclassified employees increased to 15%.

Although it is a serious problem, worker misclassification is not a new problem. In 1984, the General Accounting Office estimated that the Federal Government lost $1.6 billion in tax revenue due to employee misclassification. *That's $1.6 billion*. Additionally, the number of independent contractors has been on the increase for more than twenty years. For one three-year period, 1985 to 1988, the General Accounting Office reported a *53%*

increase in the number of individuals who filed their taxes as either self-employed or independent contractor.

So why do businesses misclassify workers? The harsh reality is that ***businesses have an economic incentive to misclassify***. Think about it. Businesses that misclassify employees as independent contractors have significantly lower overhead than law-abiding businesses. If a business employs independent contractors, that business does not have to pay unemployment insurance contributions, workers compensation premiums, or social security tax on those independent contractors. These "add-on" costs make hiring an employee 26-30% more expensive than hiring an independent contractor.

Additionally, businesses do not pay any sort of health insurance benefit to independent contractors. According to the Kaiser Family Foundation Health Benefit Annual Survey, in 2006, the average annual premium for an employer health plan covering a family of four was $11,500.00. Small employers with less than twenty-four workers saw a 10.5% increase in premiums during 2006. These costs are continuing to increase and create a substantial burden on law-abiding employers that properly classify their employees and provide benefits to those employees.

Worker misclassification is not a victimless crime. A myriad of harms stem from misclassification. These harms include harm to law-abiding businesses, harm to the misclassified workers, and harm to the State.

Solid, law-abiding businesses which properly classify employees and offer health benefits to those employees are at a competitive disadvantage when competing directly

against companies which wrongfully classify their employees as independent contractors. The problem is particularly noticeable and rampant in industries like the construction industry, where companies bid for jobs. There can never be a fair and competitive bid process when companies that misclassify can bid for work without having to account for normal payroll costs. The misclassifying company will always have the lower bid and will be able to take work away from the law-abiding company. The result is that the "good" companies receive fewer jobs, employ fewer workers, and may eventually be driven out of business.

Not only does misclassification harm law-abiding businesses, it also harms the misclassified workers themselves. When employees are not properly classified, costs that should be borne by the employer (such as unemployment insurance, social security tax, and workers compensation insurance) are illegally shifted to the individual worker. If the individual worker pays out of pocket for these costs, the worker has less money available for basic living expenses. As a result, many workers do not make contributions to the unemployment, social security or workers compensation systems and are left with little to no safety net in the event of layoff or on the job injury.

Employees misclassified as independent contractors additionally lack the benefit of company-provided benefits such as health insurance and a retirement plan or 401(k). Many are either unable to qualify for individual health insurance or unable to afford the premium for individual health insurance. With no health insurance, and no retirement savings, these workers are stuck in a grim situation from which there is no escape. They work every day

praying to avoid injury and cannot see a time when retirement could be possible. If one of these workers is injured on the job and disabled, the cost for supporting that worker and his family falls back on the state public assistance programs.

This is but one impact of worker misclassification borne by the State. State finances regularly fall victim to employee misclassification. The University of Missouri-Kansas City conducted a study on the economic costs of misclassification in the state of Illinois. The study found that *during every year from 2001 through 2004, the state lost $39.2 million in unemployment taxes due to worker misclassification. During 2005, this number grew to $53.7 million. The state only managed to recover approximately 2% of the unpaid amount.* Of the unpaid unemployment insurance amounts in 2005, $2.5 million was the result of misclassification in the construction sector.

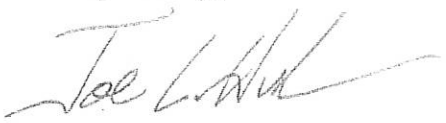
States also collect less income tax from independent contractors. According to the IRS, *workers classified as independent contractors report only 68% of their income (as opposed to employees, who report 99% of income).* As such, *when a worker is misclassified, the state collects taxes on 31% less income than the worker actually earns.*

Conclusion

Worker misclassification takes a heavy toll on law abiding companies, misclassified workers, and the State of Kansas. This bill will exacerbate the problem of misclassification by taking the "teeth" out of the 2006 misclassification law, tying the hands of the KDOL and KDOR agents who are charged with enforcing our State's employment laws. The penalties

and the inter-agency partnership need to be retained, because they remain our most effective methods for fighting worker misclassification. It is in the best interest of business, workers, and the State to stop deliberate employee misclassification. And the best way to do that is by leaving the existing law unchanged. We urge you to defeat this bill. Thank you.

Respectfully,



Joe Hudson

Business Agent / Organizer

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House Commerce & Economic Development Committee
Date: 6/14/2011
Attachment #: 11-7