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HB 2135
House Committee on Commerce & Economic Development

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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.