

Independent Contracting Policy and Management Analysis

Steven Cohen and William B. Eimicke

**Principal Researchers:
Alison Miller and Preston Cox**

**Research Team:
Luke Clause, Dmitriy Shvets, Janelle Sommerville and Anastasia Wright**

**New York City
August 2013**

About the Authors

Steven Cohen and William B. Eimicke are Professors of Professional Practice in International and Public Affairs at Columbia University's School of International Affairs (SIPA). The research team members are all 2011 Master of Public Administration graduates of Columbia's School of International and Public Affairs.

Table of Contents

- Executive Summary..... 4

- Introduction..... 6

- Methodology..... 7

- PART I: Background..... 7**
 - 1.0 What is an Independent Contractor? 7**
 - 1.1 Employment Models..... 9
 - 1.2 The Changing Nature of Employment in the U.S. 9
 - 2.0 Why Choose Independent Contracting? 12**
 - 2.1 Benefits and Costs to Employers..... 12
 - 2.2 Benefits and Costs to Independent Contractors..... 16
 - 3.0 The Problem with Independent Contracting: Misclassification.....20**
 - 3.1 What is Worker Misclassification? 20
 - 4.0 Review of Federal and State Tax, Labor and Employment Laws 22**
 - 4.1 History of Relevant Laws..... 22
 - 4.2 Federal Level Tests..... 24
 - 4.3 State Level Tests – The ABC Tests..... 29
 - 4.4 The Courts and Entrepreneurial Tests..... 31
 - 5.0 Misclassification Confusion and Heighted Legal Scrutiny..... 32**
 - 5.1 *Vizcaino v. Microsoft Corp.* 33
 - 5.2 *FedEx Ground Cases*..... 33
 - 5.3 *Herman v. Time Warner*..... 35
 - 5.4 *Burrey v. Pacific Gas & Electric Co.* 36
 - 5.5 *Salamon v. Our Lady of Victory Hospital*..... 37
 - 5.6 *D’Annunzio v. Prudential Insurance Co. of America and Stomel v. City of Camden*..... 37
 - 5.7 *Christopher v. SmithKline Beecham Corp.* 38
 - 6.0 The Franchise Business Model and Worker Misclassification..... 39**
 - 6.1 *Awuah v. Coverall North America, Inc.* 40
 - 6.2 *Singh v. 7-Eleven Inc.* 41
 - 6.3 *Rainey v. Langen*..... 41

7.0 The Extent of Worker Misclassification in the United States.....	43
8.0 The Context of the Policy Response.....	45
8.1 The “Tax Gap”	45
8.2 A Federal Budgetary Priority.....	46
8.3 Union Pressure.....	47
8.4 Impact of the Patient Protection and Affordable Care Act.....	48
9.0 The Proposed Solutions: Regulatory and Legislative Changes.....	51
9.1 State Legislation.....	51
9.2 State Task Forces.....	55
9.3 Federal Legislation.....	56
9.4 Enhanced IRS Enforcement.....	58
PART II: Analysis.....	59
1.0 Why Should Businesses be Concerned about Misclassification? ...	59
2.0 Situational Analysis.....	60
3.0 Policy Analysis.....	63
3.1 Analysis of Proposed Federal Legislation.....	63
3.2 Analysis of Non-Legislative Federal Enforcement Efforts.....	70
3.3 Analysis of State Legislative and Enforcement Activities.....	75
4.0 Management Analysis.....	79
4.1 Employer Options for Handling Worker Misclassification.....	80
4.2 Audit Prevention.....	82
PART III: Conclusions.....	83
1.0 Conclusions on the Independent Contracting Model.....	83
2.0 Policy Conclusions and Recommendations.....	85
2.1 Policies Addressing Misclassification.....	85
2.2 Policies Supporting Contracting.....	88
3.0 Management Recommendations.....	90
4.0 A Final Word.....	95

Executive Summary

This study provides an in-depth management and policy analysis of the independent contractor model in the modern U.S. economy. We pay extensive attention to the complex issue of misclassifying employees as contractors, a minor, but salient issue on the nation's political and regulatory agenda. The report is divided into three sections:

- Part I discusses the independent contracting model and relevant issues of organizational management.
- Part II analyzes most common types of independent contractors, varied across industries and varied by size and discusses the complex policy and legal environment that independent contractors operate under in the United States.
- Part III concludes with a discussion of independent contracting's place in the current and future U.S. economy amid recently heightened national scrutiny and includes a discussion of best practices for companies who engage with independent contractors.

Today's independent contractor business model resulted from a standard organizational management question posed by every organization when deciding how to operate: the "make or buy" decision. Simply put, "should we perform this function ourselves, or should we buy this good or service from someone else?" Deciding whether to utilize independent contractors or hire employees is a primary operational decision that must align with an organization's current strategy and vision of the future. In our view, this decision is best made on strategic management grounds- not on politics or ego. When the make or buy decision is overly constrained by non-managerial issues, it can distort the organization and impair its ability to succeed.

Our study reviews the extent of misclassification of employees as contractors and the continued expansion of contracting in recent years. The growth of contracting and of independent contractors has resulted in increased scrutiny at both the federal and state levels. A national trend has emerged involving federal and state efforts to crack down on misclassification. However, given the diversity of classification criteria and rules, it is not surprising to see substantial amounts of misclassification. Even a business seeking to comply with the rules will find those rules difficult to understand. The rules on permissible independent contracting vary across states, courts and regulatory agencies. The growth of contracting in this uncertain legal environment is the strongest evidence of the usefulness of this practice to American business and the attractiveness of this option to individuals seeking to establish themselves as small business owners and operators.

The trend toward small, specialized, networked organizations is well documented in management literature. Technology and the interconnected world economy provide the possibility for small contractors to be part of production processes managed by large, global corporations. Independent contracting is part of this global trend.

Independent contracting is a valuable facet of the American economy – as evidenced by its growing use across the country. The benefits to all parties clearly outweigh the disadvantages in most cases. However, there are problems stemming from inconsistent application of definitions

and tests by relevant tax and labor departments at the state and federal level. These discrepancies create two problems: increased business liabilities and worker misclassification. Federal and state attention has, thus far, focused nearly exclusively on the second problem and increased efforts to uncover and punish misclassification.

This report identifies federal and state policy activities to address legitimate concerns of businesses, workers and government. The report also identifies a number of best practices and actions that businesses can undertake in order to minimize their risk of audit and misclassification. These activities can be done with minimal resources and have significant payoff, enabling companies to continue or expand their use of contractors. The American economy depends on businesses that use innovative strategies and methods, including non-traditional employment models, to enhance their competitiveness in the world market. These types of businesses will likely be an increasing source of economic growth in the U.S. in the coming century.

Introduction

This study provides an in-depth management and policy analysis of the independent contractor model in the modern U.S. economy. The report is divided into three sections. Part I provides background on the issue, describing the independent contracting model and relevant issues of organizational management. It discusses the problem of worker misclassification and details the legal confusion that typically leads to such misclassification. Later, we provide cases focused on misclassification and recently proposed policy prescriptions to solve the problem.

Part II begins with a situational analysis of hypothetical independent contractors and their likely classification rulings given each situation. The examples include five of the most common types of independent contractors, varied across industries and varied by size. Also presented are policy actions that have either been proposed or enacted at both the state and federal levels, including legislation, enforcement and related actions. We reviewed these activities to determine their impact on the problem of worker misclassification – that is to say, will they actually contribute to solving the problem – as well as to project their potential impact on independent contracting and the legitimate use of contracting. Finally, we consider how these actions and their impacts would affect the broader U.S. economy.

Part III includes our conclusions on the independent contracting model itself, weighing the importance of the model with legitimate concerns about misclassification. We discuss independent contracting's place in the current and future U.S. economy amid recently heightened national scrutiny. Based on this conclusion, we follow with policy recommendations, as well as a discussion of best practices for companies who engage with independent contractors. These best practices serve as our management recommendations for companies who seek to lawfully utilize the model but may need guidance on ways to minimize their risk of enforcement and audits from the Internal Revenue Service and Department of Labor.

Methodology

We began our study by conducting an extensive literature review. This review included, but was not limited to, relevant academic literature, industry papers and reports, government reports, Congressional testimony, state and federal laws and regulations, court cases and legal opinions.

Second, we conducted key informant and expert interviews. Initial research findings were supplemented by interviews with legal and tax experts and individuals involved in the contracting business from various perspectives. These interviews enhanced our understanding of current contracting practices and provided unique insights into stakeholder and expert views of these practices.

Based on the research findings we analyzed policy options and management action. Concurrent to these two larger analyses, a situational analysis was conducted which examined factors that we expected to impact management decisions and misclassification determinations. These analyses led directly to our final policy and management recommendations.

Part I: Background

1.0 What is an Independent Contractor?

Settling on a single definition for the independent contractor is a challenge, as there are numerous employment models and roles these workers fill. Despite the many technical variations, an independent contractor, in general, can be understood as a worker who provides goods or services to a company or person, generally utilizes their own equipment and has a high degree of autonomy over their work. The contractor is not employed directly by that company or person, but operates through some type of term contract. They are often paid on a freelance basis, provide their services for a number of entities simultaneously and may operate through a franchise. Independent contractors are often said to be small business owners, free from the direction and control of a single employer.

Independent contractors are found in nearly every industry and across all sectors, but it is helpful to identify the types of services that independent contractors typically perform. Occupations considered to be representative of independent contractors include: cab drivers, couriers, caregivers, construction workers, truck drivers, financial advisors, information technology (IT) specialists, physicians, athletes, authors and artists, and lawyers. In 2005, 23 percent of contractors were employed in professional services, and 22 percent were employed in construction. The two largest occupational categories included sales and related occupations at 17 percent and management at 16 percent (U.S. Government Accountability Office 5). Research from Elance.com, an online platform that connects businesses to contractors, in a snapshot of its users in 2013 found a diverse array of skills in demand: 40% creative, 39% IT & programming,

10% marketing, 7% operations and 4% other (Elance 2013). The U.S. Government Accountability Office (GAO) found that, in 2005, independent contractors averaged 46 years of age, were almost twice as likely to be male than female and almost two-thirds had some college or higher education. In addition, 8 out of 10 were white, non-Hispanic (U.S. GAO 5).

The federal government has not surveyed independent workers in any comprehensive way in eight years, when the U.S. Bureau of Labor Statistics Contingent Work Supplement was last administered in 2005. However, alternate studies and surveys have indicated significant growth. “The 2011 Freelancers Union Annual Independent Worker Survey surveyed over 2,500 respondents representing all 50 states and demonstrated that work in this country is evolving away from traditional work and into more flexible, contingent work: almost half of workers (46 percent) earned their income from two or more categories of work in the last year. This is in stark contrast to the government’s monthly jobs numbers, which focus primarily on private wage and salary workers, government workers and the self-employed. These figures don’t account for the nuances and overlap between the different ways people work, nor the episodic nature of independent work” (Freelancers Union “America’s Uncounted Independent Workforce” 2).

Independent contracting is a growing and important contributor to the U.S. economy, particularly among small businesses. According to a 2010 Navigant Economics study, alternative workers in 2010 accounted for approximately \$626 billion in personal income, of which independent contractors accounted for approximately \$473 billion. Comparatively, total private sector wages and salaries were about \$5.2 trillion in the third quarter of 2010 (Eisenach 35). According to the U.S. Bureau of Labor Statistics, the number of independent contractors rose from 6.4 percent of the workforce (8.5 million people) in February 2001 to 7.4 percent of the workforce (10.3 million people) in February 2005 (Harned 3). More and more companies are looking to non-traditional work relationships when making hiring and employment decisions. In fact, a 2008 U.S. Census Bureau release noted that businesses with no paid employees reached 19.5 million between 2003 and 2004, a growth rate of 4.7 percent over the one-year period. Overall, businesses without a payroll account for more than 70 percent of the nation’s 27 million-plus firms (U.S. Census Bureau). And the growth continues. According to a September 2012 report by MBO Partners, there were roughly 17 million independent workers in 2012, up from 16 million in 2011 (MBO Partners 3). It also found a diverse workforce with roughly equal male and female workers and stated that “21% are Gen Y (aka Millennials) (21-32 years old); 35% are Gen X (33-49 years old); 36% Boomers (50-66 years old); and 8% (67 years+) Seniors” (MBO Partners 5-6).

1.1 Employment Models

According to the Internal Revenue Service (IRS), four categories of business relationships exist between individuals providing services and their employer: independent contractor, employee, statutory employee and statutory non-employee. In general, an employee is a worker who performs services for a company while the employer controls how the work will be done. Conversely, independent contractors have control over the details of how the service is performed.

In addition, the franchise relationship is often considered to be another distinct type of business or employment relationship. Franchises are regulated differently from other types of business relationships and are subject to a unique set of federal as well as state laws. They are classically defined by the presence of three elements: 1) a trademark license; 2) assistance or control over the franchisee's business; and 3) payment of the required fee for the right to use the franchisor's brand name. These elements must all be present for the relationship to be considered a franchise. Most commonly, the presence of the third element has been used to distinguish franchises from non-franchises. The payment of the required fee is used to keep the franchising relationship distinct from that of an employer-employee relationship (Spandorf 20). In our interview with Rochelle B. Spandorf, a State Bar of California certified specialist in franchise and distribution law, she observed that: "There is only one main difference between a franchise and a non-franchise independent contractor and that is if the franchisee pays a fee." She went on to add that "there is very little to distinguish franchising from non-franchising. Franchising is simply an independent contractor arrangement with an extra layer of regulation that requires pre-sale disclosure and registration with the state agency in the state that it is operating in."

1.2 The Changing Role of Employment in the United States

Today's independent contractor business model resulted from a standard organizational management question posed by every organization when deciding how to operate – a question often referred to as the "make or buy" decision. Simply put, "should we perform this function ourselves, or should we buy this good or service from someone else?" When an organization is taking on a project or line of business, it is the impetus of the organization to determine the type of employment model that they want to enter into in order to accomplish the task at hand. "Making" in terms of the organization would involve hiring employees, therefore expanding the organization in order to accomplish the task. "Buying" on the other hand would involve contracting out the services – either to another company or individual independent contractors.

Deciding whether to utilize independent contractors or hire employees is a primary operational decision that must align with an organization's current strategy and vision of the future. As we have written elsewhere:

"Before a contract is entered into, managers who are considering the 'make or buy' decision need a framework for analyzing how and when to contract. The first step is assessing organizational goals and the capacity to meet those goals. When organizations lack the capacity to meet their goals, purchasing that capacity from another organization is certainly an appropriate option." Or, where capacity exists, but another organization or person may have a better or cheaper means of providing that capacity, contracting may be a good idea (Cohen, Eimicke and Heikkila 175, 176).

For example, Columbia University no longer runs its own bookstore; it is contracted out to Barnes & Noble. Columbia is a world-class research and education operation, but it lacks the operational expertise required to operate a bookstore. In the early 20th century, at the dawn of the Industrial Age, the Ford Motor Company made nearly every part of their automobiles. Without satellite communication, bar codes, computing and containerized shipping, mass production

required that you control every aspect of production. Today's automakers buy parts from thousands of suppliers and are largely design-and-assembly operations. More and more production and service providers are networks of organizations. In other words, in the modern economy, there is much more specialization and much more buying (or contracting out) than ever before. Studies have indicated that companies that successfully carried out process or production innovations displayed higher levels of non-traditional employment models – including contracting, part-time, freelance and temporary workers (Kratzer 35).

Across the globe, firms are increasing their use of non-traditional employment models, including contractors. Reasons for this change vary by company but include the pressures of the globalized world and the vastly increased competition that comes with it. Firms must constantly search for ways to increase profit and increase flexibility in employment. Advancing technology makes it easier for firms, including small businesses, to organize and utilize temporary workers and independent contractors. Additionally, more workers are attracted to less traditional employment arrangements as they see opportunities for enhanced work-life balance (Kalleberg, *Nonstandard Employment* 341, 356).

After decades of “business first” politics, macro-level changes in the 1990s and deregulation that deemphasized employee protections, promoted capitalism and increased freedom for firms to pursue their unbridled interest, have led to changes in the employment relationship. Management's attempts to achieve flexibility led to various types of corporate restructuring, which in turn has led to a growth in precarious work and transformations in the nature of the employment relationship (Kalleberg, *Precarious Work*, 3). Moreover, the increased importance of the service sector has changed the employment relationship in the United States, resulting in a different mix of occupations utilizing contracting. Contract work has always existed in certain industries (such as construction), but since the 1970s, there has been an increase in purchasing of services by U.S. firms. Firms found that a variety of services could be contracted to outside organizations that could supply the services more cheaply and efficiently. New organizational forms, including networks, joint ventures and strategic alliances are all likely to increase organizations' opportunities to contract (Kalleberg, *Nonstandard Employment*, 351).

The current economic downturn will likely further serve to continue the trend of utilizing independent contractors for an increasing number of services. “These are skilled workers providing services that may be harder for firms to cut than unskilled jobs. During an economic downturn, the benefits of firms to classifying their workers as independent contractors will only grow” (Shaefer 23). Since 2008, many individuals began contracting either because they couldn't find full-time, regular employment or to supplement another job. While this employment mode may be a short-term fix until companies are hiring again, for some the benefits of contracting will outweigh traditional employment and they may continue to do so. There is also a trend toward a young, educated, creative class of workers embracing the contractor model, freelancing their skills across various industries. Many who fall into this category graduated college during the recession and were never able to acquire traditional employment. These young workers are being exposed to the benefits of contracting early in their career and may opt to continue this method of employment even after the economy improves enough to get regular full-time employment. The millennial generation, armed with a MacBook, iPad and iPhone, working out of shared office-spaces, are increasingly attracted to self-

employment and contracting, finding it more interesting, lucrative and adaptable to their lifestyles.

It has been called the “1099 economy,” the “Gig economy,” the “project economy,” “portfolio careers” and a host of others. By any of these, it’s clear that a shift is underway with an entrepreneurial spirit and a fundamental understanding that given current and emerging technology and the global economy, how we define and engage in work has changed. As Sara Horowitz, founder of the Freelancers Union, describes, “Now we find ourselves in the middle of an equally large transition: just as workers left the plow for the assembly line, they are now leaving the cubicle for the coffee shop. Welcome to the Gig Economy, where over 42 million Americans are working independently - as freelancers, part-timers, consultants, contractors and the self-employed. They are simultaneously holding multiple jobs, working for different employers and mastering diverse skills” (Horowitz “A Jobs Plan for the Post-Cubicle Economy”).

A clear indication of this growth is the Freelancers Union itself, which is one of the nation’s fastest-growing labor organizations, with over 200,000 members. The organization’s founder expects it to grow to one million members in the next three years. In noting this significance, Steven Greenhouse points out that the United Automobile Workers union currently has 380,000 members (Greenhouse 2013). The “union,” which does not bargain with employers, advocates for policies that support contractors, and, perhaps most importantly, provides affordable health insurance. “Its health insurance company covers 23,000 workers in New York State and has \$105 million in annual revenue. Impressed by that success, the Obama administration recently awarded Ms. Horowitz’s group \$340 million in low-interest loans to establish cooperatives in New York, New Jersey and Oregon that will provide health coverage to freelancers and tens of thousands of other workers” (Greenhouse 2013).

The growth of the Freelancers Union membership is one indication, but the impact of this shift can be seen in all corners of the economy. Research from Elance.com, an online platform that connects businesses to freelancers or contractors, found that “2012 was a record-breaking year for the part-time or project-based workforce, on their site alone generating more than \$200 million in earnings. Looking ahead, 2013 looks even brighter, and a look at the talent pool and hiring trends point to the rise of the startup as a driver of growth.” The company expects to reach \$1 billion in cumulative freelancer earnings in 2013 (Casserly). Elance’s Q1 2013 Global Online Employment Report cites 300,000 jobs posted, \$60,000,000 in freelancer earnings, 110,000 new clients and 290,000 new freelancers (Elance 2013). A study by MBO Partners in 2012 shows that “more than half of independent workers (57% in 2012 versus 55% in 2011) say it was their proactive choice to become an independent worker. These findings debunk the popular misconception that workers are forced into independence due to job loss or lack of alternatives. Further, 75% indicated that they will either continue as an independent worker (63%) or else build their solo operations into employer businesses (12%)” (MBO Partners 5).

As the marketplace continues to globalize and specialization reaches new heights, the use of independent contractors by businesses is expected to continue to rise. The following section seeks to explain why companies may decide to utilize independent contractors and discusses why individuals may decide to become independent contractors.

2.0 Why Choose Independent Contracting?

Independent contracting provides unique benefits and costs to both the worker and the entity he or she is carrying out that work for. There are many reasons why organizations use independent contractors and likewise why workers choose to work as independent contractors. By design, engaging in alternative work arrangements instead of seeking work from internal labor markets affects both contractor and employer in distinct and sometimes opposing ways.

2.1 Benefits and Costs to Employers

Choosing to contract out services can often be better and cheaper than choosing to perform those services in-house. According to Jeffrey Eisenach, Managing Director and Principal at Navigant Economics, choosing independent contracting may be especially typical in industries where conditions are such that:

“Workers move frequently from project to project, or work multiple projects at once; Firms need to be able to respond to short-run changes in demand, or make up for gaps in supply, by calling on more workers than they could economically maintain as traditional employees; It is efficient to be able to evaluate performance, and hence base compensation, on output, as opposed to direct observations of time spent working; There are efficiency benefits to having workers own their own capital (e.g., a truck or taxi).” (Eisenach 2)

On the hiring side, companies may choose to utilize contractors for any number of reasons, including:

Economic Benefits

Perhaps most importantly, there are significant economic benefits to choosing independent contracting. One of the most frequently cited benefits to employers engaged in independent contracting is the ability to avoid certain fixed costs that are legally required for traditional employees. These include the capital required to support the worker’s activities and providing training, as well as complying with the federal and state laws governing employer-employee relations. When hiring employees, the “employer becomes responsible for minimum wage and overtime payments, payroll taxes, workers’ compensation, medical leave, and workplace safety” (Briney 17). For employees, companies must withhold federal and state income taxes as well as contribute into Social Security, unemployment benefits and Medicare on behalf of each employee. These costs disappear for employers when utilizing independent contractors, unless these costs are built into the contractor’s payment for the services rendered to the contracting entity.

Figure 1: Differences between General Tax Responsibilities of Employees and Independent Contractors (GAO 2009)

Differences between General Tax Responsibilities of Employees and Independent Contractors				
Type of Tax	Individuals Classified as Employees		Individuals Classified as Independent Contractors	
	Businesses' General Responsibilities	Workers' General Responsibilities	Businesses' General Responsibilities	Workers' General Responsibilities
Federal income tax ^a	Withhold tax from employees' pay	Pay full amounts owed, generally through withholding	Generally, none ^b	Pay full amounts owed, generally through estimated tax payments ^c
Social Security and Medicare taxes ^d	Withhold one half of taxes from employees' pay and pay the other half	Pay half of total amounts owed, generally through withholding	None	Pay full amounts owed, generally through estimated tax payments ^c
Federal unemployment tax ^e	Pay full amount	None	None	None
State unemployment tax	Pay full amount, except in certain states ^f	None, except pay partial amount in certain states ^f	None	None

Note: There are various exceptions to the general responsibilities included in this table.

^a Most states also require payment of state income taxes.

^b Employers are generally required to withhold taxes at a rate of 28 percent from independent contractors who do not provide, or provide incorrect, taxpayer identification numbers (this practice is known as backup withholding).

^c For estimated tax purposes, the year is divided into four payment periods.

^d The overall tax rates for Social Security in 2009 were 12.4 percent and 2.9 percent of income, respectively. Social Security taxes are to be paid for earnings up to the established wage base limit (\$106,800 for 2009).

^e Employers are generally required to pay federal unemployment insurance on the first \$7,000 of employee pay at a rate of 6.0 percent (as of 2010), which can be offset by a credit of up to 5.4 percent for timely payment of state unemployment insurance taxes, resulting in an effective rate as low as 0.8 percent.

^f According to DOL, these states are Alaska, New Jersey and Pennsylvania (as of 2009).

In 2007, the Office of the Legislative Auditor for the State of Minnesota developed a scenario to illustrate the cost savings to an employer. This hypothetical situation shows how the labor costs for drywall installation vary based on the installer's classification. As shown in Figure 3, hourly costs for employers increase significantly when the drywall installers are classified as employees. The Minnesota study estimated that an additional \$7.82 per hour must be paid for employees over the median hourly wage due to mandatory costs, including federal employment taxes, state unemployment insurance taxes and workers' compensation insurance premiums. Conversely, employers classifying the same worker as an independent contractor do not pay any of these additional costs. In this scenario, the resulting hourly rate of the worker classified as an employee is 26 percent higher than the employer's cost if the employee were classified as an independent contractor. The cost of employee classification would be even higher if the employer provided benefits, such as paid leave, retirement contributions, or health insurance (State of Minnesota 10).

Figure 2: Hypothetical Impact of Worker Classification

Hypothetical Impact of Worker Classification		
	Employee	Independent Contractor
Hourly Base Rate	\$30.00	\$30.00
MN State Unemployment Insurance Tax ^a	\$1.11	\$0.00
U.S. Unemployment Insurance Tax ^b	\$0.21	\$0.00
Social Security and Medicaid Taxes ^c	\$2.30	\$0.00
Workers' Compensation Insurance ^d	\$4.21	\$0.00
Subtotal Mandatory Costs	\$7.82	\$0.00
Total Base Rate and Mandatory Costs	\$37.82	\$30.00

Note: Unemployment insurance tax rates and workers' compensation costs can vary considerably among industries. As a result, the example is linked to a single occupation – drywall installation because it is an occupation prone to misclassification. According to DEED labor market data, the median hourly wage for drywall installers in Minnesota during the second quarter of 2007 was \$30.45. For illustrative purposes, we assumed that an employer would pay the same base rate to an employee misclassified as an independent contractor.

^a *According to DEED, a new employer in the drywall industry would be subject to an unemployment insurance tax of 9.6 percent on the first \$24,000 in annual wages paid.*

^b *The federal unemployment insurance tax rate for 2007 is 6.2 percent on the first \$7,000 of wages paid. Because Minnesota unemployment insurance laws conform to certain federal standards, Minnesota employers are eligible for a 5.4 percent tax credit (resulting in a net tax rate of 0.8 percent).*

^c *For 2007, employers pay a combined tax rate of 7.65 percent on annual wages of \$97,500.*

^d *According to the Minnesota Workers' Compensation Insurance Association, a new employer in the drywall industry would pay a workers' compensation insurance premium averaging 14.03 percent of annual wages.*

Additionally, many companies would also need to include workers designated as employees in their employee benefit plans, including health insurance and retirement or pension plans. Employers using independent contractors are not responsible for these costs, thereby generating a significant competitive advantage. For example, employer-provided benefits totaled 22.2 percent of the average hourly wage for construction employees, according to March 2007 U.S. Department of Labor data for the construction industry (State of Minnesota 10). Additional financial benefits of independent contracting can also include the decreased liability for accidents made by contractors performing the work contracted by the employer. A 2009 Michigan State University study found that employers can reduce their labor costs by at least 20 percent and possibly as much as 40 percent by avoiding payments for workers compensation, the employer share of social security and pension or medical insurance (Institute for Public Policy and Social Research 11). The financial advantage is significant and is one of the primary reasons that businesses consider contractors.

Additional economic benefits can be provided by limiting employer liability for the actions of its workers. In an employer-employee relationship, employers are held liable for the torts committed by their employees, while employers may not be liable for the torts of independent contractors. If

that is the case, the economic benefits derived from the elimination of tort liability can eclipse those provided by tax savings (Donahue 8). However, in some industries, employers can be held liable for the torts of independent contractors. For example, in the trucking industry, a carrier is liable under federal law for the actions of anyone performing services under its operating authority, which includes both employees and contractors. Further, in cases with general contractors, a client may negotiate into the contract provisions that require the general contractor to be liable for all the work covered under the contract, whether performed by the general contractor's employees or its subcontractors.

Scaling the Workforce

Employers often choose to contract out as a way to efficiently scale their workforce according to demand. Independent contracting and other non-traditional employment models allow businesses greater flexibility in the globalized economy where they need to adapt to a constantly changing world. It allows businesses to adjust their workforce based on demand, seasonal fluctuations and other factors determined by an often volatile market. Contracting also allows companies to benefit from greater efficiency, as contractors are typically experts in the product, market, or service. Contractors may also see the advantage of building a "portfolio of experiences" drawn from a variety of contracted work to enhance their competitiveness and advantage in the labor marketplace.

Pay for Performance

Also, contracting works well in industries where the output is easily measured, and therefore, workers can be compensated based on performance (i.e., truckers paid by the mile or couriers by the package). Paying for performance can be a highly efficient method of incentive when the type of service allows for it. Additionally, employers who utilize independent contractors will operate in an environment with fewer unions, as only employees are legally allowed to join unions. Some companies view this as a significant advantage as it prevents workers from seeking benefits derived from collective bargaining.

Costs to Employers

While utilizing independent contractors for select services benefits employers in many ways, there are also drawbacks associated with the practice. When utilizing independent contractors, employers forfeit a degree of control over their work. In the classic independent contracting model, workers use their own methods and equipment to perform work and dictate when and where work is performed. Thus, while an employee may be discharged or disciplined for a violation of worker rules, such as insubordination or other rules in employee handbooks, an independent contractor is not subject to such discipline. In this arrangement, employers relinquish control over the day-to-day activities of independent contractors.

Employers that do not relinquish this control, thereby treating their independent contractors as employees, are likely to encounter legal problems. For example, an independent contractor generally cannot be prevented from performing services for a competitor without calling into question whether he or she is really an employee. Employee classification has increasingly become a subject of debate both at the federal and state levels. Today, there are a number of risks associated with utilizing independent contractors, including the possibility of misclassification litigation, risk of audit by the IRS and Department of Labor, as well as regulatory risk that

federal or state laws change the existing statutes determining employee status. These risks are discussed in detail later in the report.

2.2 Benefits and Costs to Independent Contractors

Likewise, individuals employed as independent contractors enjoy several benefits. While independent contractors often are able to “be their own boss” and are free to control the methods of their work, they do miss out on the significant benefits full employees are entitled to.

Flexibility and Independence

One of the most frequently cited benefits of engaging in independent contracting is the flexibility and independence that this type of arrangement affords. An independent contractor has the ability to choose his or her own hours, clients and manner in which the work is completed. They are also excluded from detailed personnel policies that apply to traditional employees (Bidwell 200). In many cases, independent contractors also have exclusive ownership over their products and services. Since independent contractors choose their own jobs and clients, the quantity and quality of work is better correlated with the amount of money they make. Independent contractors have more control over their economic destiny, and often highly motivated contractors are more likely to earn more money than regular employees. Additionally, contractors have the ability to acquire several different clients, and, as a result, they are able to diversify their sources of income and are not dependent on a single organization. Further, because they are generally free from the day-to-day activities of their employers, it means that they are less affected by internal politics and poor managerial decisions.

Entrepreneurship

Contracting provides the means for workers to move in and out of the workforce as their situations dictate, and it can also serve as a transition for laid-off workers (Eisenach 42). In addition to workers’ desires to “be their own boss,” there is evidence that self-employment serves as a first step toward entrepreneurship and small business creation. The connection between contracting and small business formation stems from the skills acquired during contracting work – “unlike employees, independent contractors are required to learn how to prepare and send invoices, maintain records, acquire capital, comply with licensing and other regulatory requirements, file taxes, and so on” (Eisenach 37). In fact, evidence suggests that there is a strong relationship between independent contracting, entrepreneurship and small business formation – “of the 10.3 million independent contractors identified in the 2005 CAWA survey, nearly 2.4 million had one or more paid employees – with the vast majority employing five or fewer” (Eisenach 36). Additionally, a 2008 survey of small business owners found that 61 percent of respondents had utilized independent contractors within the last 12 months for construction, transportation or computer work (Dennis 7). According to a 2012 survey, “57% of freelancers reported an increase in earnings by working with businesses online. In addition, 19% said they more than doubled their freelance income in the past year. The majority of freelancers (62%) work on 2-6 projects at any given time” (Elance 2012).

Worker Satisfaction

The advantages afforded by contracting appear to lead to greater worker satisfaction. According to a Pew Research Center survey, self-employed workers are “significantly more satisfied with their jobs than other workers. They are also more likely to work because they want to and not because they need a paycheck” (Morin). The survey also showed that 39% of self-employed workers are “completely satisfied” with their jobs, compared to 28% of workers in wage or salary jobs (Morin). In addition, a 2005 Bureau of Labor Statistics CAWA survey found that fewer than 1 in 10 independent contractors said they would prefer a traditional work arrangement (Eisenach 33, 34). A 2011 study conducted by the Mack-Blackwell Rural Transportation Center at the University of Arkansas, funded by the Truckload Carriers Association, looked at the relative advantages and disadvantages of independent contractors using truck drivers as a case study. They conducted telephone surveys, person interviews and online surveys of 154 drivers, and found that: “independent contract drivers operate in that status because they see more advantages than disadvantages. This is specifically illustrated in the fact that 80 percent of the drivers felt that it would be “easy” or “very easy” to be hired on as a company driver. Only ten (10) percent felt that it would be very “difficult” or “very difficult.” As indicated in the report, most independent contract drivers have a basis for comparison in that 85 percent had previously been company drivers” (Johnson 55). A September 2012 survey by Elance.com, the online company that connects clients to contractors, with over 3,000 respondents, found that 69% are happier working as a freelancer, and 23% are equally as happy as working full-time. It also found that “the average freelancer expects to earn 43% more in 2013 than they did this year [2012]. This rise in earnings is translating into more jobs for all as 42% of independent professionals plan to hire other freelancers to build their businesses in 2013” (Elance 2012).

Training and Career Development

Additionally, because contractors have more control over their work, employers often do not train their contractors as they see fit, which can be both advantageous and disadvantageous to the contractors they utilize (Bidwell 1148-1149). Contractors do not benefit from internal training and career development and must seek skill acquisition and career trajectory outside of their employer.

Economies of Scale

In addition to the advantages to employers and contractors, there may also be wider economic benefits. For example, a Navigant Economics study found that because contracting reduces the importance of economies of scale, it allows small businesses to compete with larger ones, thereby increasing competition and lowering prices for all consumers (Navigant ii).

Lack of Benefits

In addition to these advantages, working as a contractor has its costs. Contractors are responsible for reporting their own income to the IRS. Contractors must pay the whole portion of their Social Security and Medicare taxes, which is a shared expense for employees with their employers. They are not legally entitled to the same employment-related benefits and protections enjoyed by employees because they “lie outside the scope of many government programs that aim to support workers, such as unemployment insurance, tax-advantaged medical insurance, access to collective bargaining, and enforcement of minimum labor standards” (Bidwell 1148). As Figure 3 suggests, one of the major disadvantages to contractors is decreased job security. They are not

protected from employment discrimination and wrongful termination, they do not have the bargaining advantages of unions, nor will they receive unemployment benefits if their contract ends. Often workers find out that they were classified as independent contractors when they attempt to collect unemployment benefits; they learn that they have not paid into the program and are therefore ineligible. They are also responsible for the full financial cost of sponsoring their own retirement plans and obtaining their own healthcare coverage. Contractors are excluded from protections against discrimination in the workplace, state and federal family and medical leave laws, and are outside the scope of the Occupational Safety and Health Act (OSHA), which requires a healthy and safe work environment. Additionally, contractors are solely responsible for any damages that may occur in the event of an on-the-job accident. If a contractor is injured, it can be devastating for the worker.

Figure 3: Differences Between Benefit Responsibilities

Differences Between Benefits Responsibilities				
Type of benefits	Employees		Independent Contractors	
Retirement Plans	Employers sponsor benefit plans	Employers and employees contribute	Contractors sponsor plans	Contractors bear the full financial cost of the plans
Healthcare	Employers sponsor on a tax-free basis	Employers and employees contribute	Contractors obtain coverage	Contractors bear the full financial cost, but receive tax deduction
Reimbursed Expenses/ Accountable Plans	Employers can reimburse	Nontaxable to extent paid under an accountable plan	Service recipient can reimburse, although generally expenses are unreimbursed	Reimbursed expenses are nontaxable if under an accountable plan
Unreimbursed Expenses	Many employers don't fully reimburse expenses	Unreimbursed expenses subject to 2% floor and AMT	Businesses don't generally reimburse expenses	Not subject to 2% floor or to AMT

(Bordoni et al.)

Nonpayment

While there are many advantages to contractors, a persistent problem cited by independent workers is client nonpayment. A 2009 survey by the Freelancers Union found “40% had trouble getting paid their owed wages in the last year. In fact, a previous Freelancers Union survey found that 77% of independent worker respondents experienced client nonpayment during their freelance career... Nonpayment inflicts a heavy toll on the individual worker and the broader economy. Cumulatively, the survey respondents spent more than 17,000 hours pursuing unpaid wages over the course of the last year and were unable to collect a total of over \$3 million. For the workers, time spent chasing wages is time that could be spent on current work or obtaining new business” (Horowitz, Erickson and Wuolo 6).

A brief summary of these benefits and costs is displayed below.

Figure 4: Advantages and Disadvantages of the Employer-Contractor Relationship

	Advantages	Disadvantages
Employer	<ul style="list-style-type: none"> • Freedom from employment-related taxes, medical benefits, workman’s compensation, or severance pay • Decreased liability insurance • Ability to scale workforce according to need • Ability to pay for performance (enhanced incentives) • Increased efficiency • No risk of unionization 	<ul style="list-style-type: none"> • Inability to train workers according to desired skill set • Less control over job performance • Increased risk of employee misclassification-related litigation • Increased risk of IRS audit and penalties • Contractor may not prioritize your work over their other clients • Risk of liability for poor work done by contractors • Risk of bad publicity if contractor is found to be a bad employer for its own employees
Contractor	<ul style="list-style-type: none"> • Ability to enter, exit, or participate partially in the workforce • More flexible work hours • Increased control over how work is performed • Supports entrepreneurial activity and business skills • Freedom from office politics 	<ul style="list-style-type: none"> • No entitlement to employer-funded medical benefits, pension or retirement savings plans, workman’s compensation, or severance pay • Less job security • No formal career development or performance evaluations • No job training • No right to collective bargaining

Given the various advantages to workers, employers and the economy, in general, it seems contracting is an ideal situation for many. However, problems arise due to improper or incorrect worker classification. We turn to a discussion of the problem and extent of worker misclassification and describe how the issue is being addressed in the following section.

3.0 The Problem with Independent Contracting: Misclassification

3.1 What is Worker Misclassification?

Worker classification refers to a company designating its workers as either employees or independent contractors. Misclassification occurs when workers are utilized as independent contractors but work in a way that is more indicative of an employer-employee relationship. Though business contracts may explicitly define the relationship between employer and contractor, questions of definition consistently arise:

“Many companies have written contracts purporting to establish independent contractor relationships, only to find that their actual practice involves many actions (and many controls over the worker) that fly in the face of the contract language. To characterize the relationship one must look beyond the language of the contract” (Wood 46).

The extent of misclassification in the U.S. economy may be difficult to quantify. In 2007, a study conducted by Cornell University on behalf of UNICON, a construction labor management corporation and the New York State Senate Labor Committee found 10.3 percent of New York’s workforce in the private sector were misclassified (Donahue 2). The study also found that “misclassification costs government – at all levels – substantial, uncollected revenues, resources that are needed for vital government programs and services and for the maintenance of a productive workforce and economy” (Donahue 2).

The problem with misclassification is threefold. First, it can result in a distorted market where undue competitive advantage is provided to businesses who improperly classify employees as independent contractors. Misclassification results in artificially low costs for businesses because they do not pay the true cost of their workers, including: workers’ compensation premiums, unemployment contributions, employer’s share of the Federal Insurance Contributions Act (FICA) tax and employee benefits. When these costs are not built into the price of the end product or service, the business can undercut other companies who do include these costs.

On the other hand, many contractors build these costs into their price or the payment/fee they request for their services. Each subcontractor down the line is also likely to price in their tax liability, medical coverage and savings for retirement. These costs are not directly mandated through federal statutes, as many are for employees, but that does not mean that these costs are not accounted for. However, some contractors, admittedly, do not include these costs, and these are also most likely the cases where the worker is misclassified – and ought to be classified as an employee. Unfortunately, data on whether individuals price these costs into their fees is difficult to obtain. This makes it difficult to measure the full extent of contractors who take these costs into consideration.

Furthermore, some argue that employers who *do* properly classify and pay for their employees may end up paying higher costs than necessary, as they subsidize the employers who do not.

States have noted that these employers pay greater workers' compensation premiums, unemployment contributions and higher taxes than if all employers paid their fair share (Maine Annual Report 7).

Second, the general public can become a net loser in the misclassification equation through "cost shifting." This occurs when misclassified workers are injured on the job and need medical care, which increases healthcare costs and health insurance premiums for everyone. Moreover, if a misclassified worker becomes unemployed and is not eligible for unemployment insurance, demand for public assistance increases and is paid for by higher taxes (Maine Annual Report 7). However, this problem only occurs if that worker has not purchased his or her own medical insurance. Certainly not all insured Americans receive medical insurance through their employer – many individuals purchase insurance on their own. This problem assumes that contractors do not pursue insurance independently, which may not be the case in many situations. Moreover, this problem will be diminished through the new health care act, which will provide medical insurance for those individuals who have not purchased it either independently or through an employee-based system.

However, it is difficult to show the extent of these changes in costs to employers, and it has yet to be fully demonstrated. Additionally, the only way costs in these areas (workers' compensation and unemployment insurance contributions), can truly increase is due to actions by the state itself. Unless the state is paying out claims for which it has not collected revenues, it will not increase these costs. When the state does pay claims on improperly classified workers, it routinely assesses the employer that misclassified the worker for any unpaid contributions for prior years. This also often leads to investigations revealing the full extent of misclassification by that company. Therefore, while it can be claimed that the state or the "properly classifying" employers may pay increased costs, the revenue to pay these claims is most typically recovered through the misclassifying employer.

Finally, misclassification can deny the federal government and states rightful revenue. If the true relationship of the worker is that of an employee, then businesses are depriving the government of needed taxes for that employee. This revenue shortfall has broad social costs as less funding is available for necessary programs including funds for school districts, law enforcement, hospitals – typical services paid for by state, county and municipal governments. However, the assumption here is that there is a greater incidence of tax payment among employees than independent contractors. This assumes that many contractors hide income and do not report all earnings on 1099-MISC tax forms. "Going off the books" can be extremely difficult to measure.

Misclassification may happen intentionally when employers seek to avoid the employment-related costs outlined in the previous section, but it may also occur unintentionally due to confusion spurred by the "inconsistent and varying standards" of U.S. labor laws (Donahue 2). Nearly every federal and state law has a somewhat different interpretation of an independent contractor. This means that one scenario for a single company can be found to be an employment relationship by one agency under one law or statute, while another may find the situation to be that of an independent contractor relationship. Both agencies, given their differing laws and interpretative rules, would be legally correct. Figure 5 demonstrates the many legal implications

of misclassification for various agencies— many of which have their own measures for independence.

Figure 5: Key Agencies Affected by Employee Misclassification (GAO 2006)

Legal Implications of Employment Classification		
Entity	Law	Areas potentially affected by employee misclassification
U.S. Department of Labor	Fair Labor Standards Act	Minimum wage, overtime and child labor provisions
	Family and Medical Leave Act	Job-protected and unpaid leave
	Occupational Safety and Health Act	Safety and health protections
U.S. Department of Treasury - Internal Revenue Service	Federal tax law, including: Federal Insurance Contributions Act Federal Unemployment Tax Act Self-Employment Contributions Act	Federal income and employment taxes
U.S. Department of Health and Human Services	Title XVIII of the Social Security Act (Medicare)	Medicare benefit payments
DOL/IRS/Pension Benefit Guaranty Corporation	Employee Retirement Income Security Act	Pension, health, and other employee benefit plans
Equal Employment Opportunity Commission	Title VII of the Civil Rights Act	Prohibitions of employment discrimination based on race, color, religion, gender and national origin
	Americans with Disabilities Act	Prohibitions of discrimination against individuals with disabilities
	Age Discrimination in Employment Act	Prohibitions of employment discrimination against any individual 40 years of age or older
National Labor Relations Board	National Labor Relations Act	The right to organize and bargain collectively
Social Security Administration	Social Security Act	Retirement and disability payments
DOL/State agencies	Unemployment Insurance law	Unemployment Insurance benefit payments
State agencies	State tax law	State Income and employment taxes
	State workers' compensation law	Workers' compensation benefit payments

4.0 Review of Federal and State Tax, Labor, Employment Laws

4.1 History of Relevant Laws

The difference between employees and independent contractors has not always held great importance. “Congress adopted the employee/independent contractor distinction to define the coverage of New Deal-era statutes designed to protect workers” (Jost 314). This distinction has been the subject of litigation ever since. In 1935, the National Labor Relations Act (NLRA) was enacted to protect worker rights and allow and encourage collective bargaining. It also established the National Labor Relations Board that hears cases involving workers, employers, unions and government agencies, including the many independent contractor cases.

Unfortunately, when it was written, the NLRA did not clearly define who the protected employees were: “With a few listed exceptions, an employee is simply ‘any employee’” (Jost 314). In 1938, the Fair Labor Standards Act was passed to regulate child labor and mandate

minimum wage and overtime. In this case, the term “employee” was defined rather broadly again to ensure adequate coverage against child labor violations and employee exploitation. “Standard work arrangements were the norm in many industrial nations for much of the twentieth century and were the basis of the framework within which labor law, collective bargaining and social security systems developed (Kalleberg Nonstandard Employment 342). When the laws were written that established most of the worker protections now disputed, the traditional employer-employee model was nearly universal. It was only later, as independent contractors grew in significance, that the distinction became an issue.

Two major cases, *United States v. Silk* and *Bartels v. Birmingham* helped to clarify the distinction of employee and define independent contracting. Prior to the ruling on these cases, the Social Security Act did not include a precise definition of “employee.” After the Social Security Act was enacted, the U.S. Treasury Department promulgated regulations that adopted the common law control test to decide whether a worker was an employee or independent contractor for federal tax purposes (Weissman, 2). However, despite the Treasury Department regulations, the federal courts were using conflicting tests to determine a worker’s status. The apex of this conflict was the 1947 rulings in two U.S. Supreme Court cases, *United States v. Silk* and *Bartels v. Birmingham* (Weissman, 2).

In those cases, the U.S. Supreme Court held that control was not the only factor to consider but should be considered in light of the purpose of Social Security legislation, and it stated that “employees included those who as a matter of economic reality were dependent upon the business to which they rendered services.” The end result was a new test that defined employer-employee relationships on the grounds of the economic relationship: the economic realities test. However, Congress was concerned that this test would be interpreted too broadly and would include every worker as employees under the Social Security Act. Out of fear this would lead to bankrupting the Social Security system, Congress passed the Gearhart Resolution, in which Congress articulated its preference for the common law interpretation of the employee/contractor distinction but did not reject the Court’s use of economic factors (Weissman 2-3).

Today, a multitude of employee labor, benefit and tax laws and separate agencies’ own interpretations govern employee and independent contractor classifications – no single test applies to all relevant federal and state laws. In general, three principles are used: a common law approach, the economic realities test, or defining specific criteria used to judge the level of control the employer has over an independent contractor (known as the “ABC test”). As these approaches are reflected in state as well as federal law, proper interpretation of the various laws is crucial to understanding how differences in independent contractor status may have both situational and regional disparities. Figure 6 summarizes the primary tests and their application under federal laws.

Figure 6: Tests for Independent Contractor Status Under Various Federal Statutes

Tests for Independent Contractor Status Under Federal Statutes		
Test	Description	Laws under which the test has been applied by courts
Common Law Test	Employment relationship exists if employer has the right to control work process, as determined by evaluating totality of the circumstances and specific factors.	Federal Insurance Contributions Act Federal Unemployment Tax Act Income tax withholding Employment Retirement and Income Security Act National Labor Relations Act Immigration Reform and Control Act
Economic Realities Test	Employment relationship exists if individual is economically dependent on a business for continued employment.	Fair Labor Standards Act Title VII Age Discrimination in Employment Act Americans With Disabilities Act Family and Medical Leave Act (likely to apply)

(Eisenach 6)

4.2 Federal-Level Tests

The primary federal agencies determining employment status are the Internal Revenue Service (IRS), which uses the common law test, and the Department of Labor (DOL), which uses the economic realities test.

The Internal Revenue Service – the Common Law Test

The IRS determines the scenarios for which a worker’s status is either employee or independent contractor and thus the federal taxes for which employers are responsible. The IRS uses common-law rules to establish the type of relationship between the employee and worker, specifically the type and amount of control the latter has over the former (IRS, “Employer’s Tax Guide” 6). The less control the employer has over the worker, the more likely the worker may be classified as an independent contractor.

The IRS has traditionally used what is known as the “20 Factors Test” to determine the classification of employee versus independent contractor. The test aimed to define the nature of the relationship between the employer and worker, specifically attempting to determine how much control the employer had over 20 specific aspects of the relationship (Texas Workforce Commission). While the 20 Factor Test remains a useful guide in determining independent contractor status, the IRS recently attempted to simplify and refine the traditional test as a result of pressure from Congress and representatives of labor and business. The 2013 version of the IRS Employer’s Supplemental Tax Guide (Publication 15 – A) outlines a reorganized version of the 20 Factor Test, which uses 11 factors divided over three categories: Behavioral Control, Financial Control and Type of Relationship (IRS, “Employer’s Supplemental Tax Guide” 7-8). The IRS is clear in pointing out that no single factor can alone determine the nature of the relationship and that judgments must be made on a case-by-case basis. The IRS audit branch has begun using this streamlined version, aimed to encompass the key aspects of the 20 Factor Test.

The Behavioral Control category determines “whether the business has a right to direct and control how the worker does the task for which the worker is hired” (IRS, “Employer’s Tax Guide” 7). Two factors are included in this category:

1. *Instructions that the business gives to the worker.*
2. *Training that the business gives to the worker.*

The IRS laws state “an employee is generally subject to the business’ instructions about when, where, and how to work” (IRS, “Employer’s Tax Guide” 7). The more control the employer has over these factors, the more likely one would be considered an employee over an independent contractor. That is, the greater the degree or detail of instruction, the greater the indication that an individual is an employee. Likewise, the IRS states that while “an employee may be trained to perform services in a particular manner... independent contractors ordinarily use their own methods” (IRS, “Employer’s Tax Guide” 7). Therefore, independent contractors must not only receive minimal instructions from their employer as to *how* to perform their job, but they should also have the skills needed to do so before they begin a relationship with a new employer. Workers requiring training by the employer are more likely considered employees. In addition, the IRS offers that “if an evaluation system measures the details of how the work is performed, then these factors would point to an employee.” Conversely, “if the evaluation system measures just the end result, then this can point to either an independent contractor or an employee” (IRS, “Small Business”).

The Financial Control category includes five factors determining whether the business has a right to control the business aspects of the workers’ job:

3. *The extent to which the worker has unreimbursed business expenses:* independent contractors likely incur business expenses not reimbursed by the employer.
4. *The extent of the worker’s investment:* independent contractors often make investments in their own equipment, facilities and/or tools to perform their services, rather being provided by the employer.
5. *The extent to which the worker makes his or her services available to the relevant market:* independent contractors are free to seek out further business opportunities, advertise, maintain a business location, and be available to work in the relevant market.
6. *How the business pays the worker:* independent contractors are generally paid a flat fee for their services, while employees are paid a set wage over a period of time (hourly, monthly, annually).
7. *The extent to which the worker can realize a profit or loss:* independent contractors can make a profit or loss (IRS, “Employer’s Tax Guide” 7-8).

In general, the IRS requires that independent contractors function somewhat like a business owner and be financially responsible for most (or all) of the costs of doing business. Likewise, employees are not responsible for any expenses incurred by their employer, nor should they be required to make investments in equipment or incur other necessary costs. However, with this increased financial responsibility on the independent contractor comes more freedom for the contractor to expand and grow their business, or less control of the employer to limit the contractor’s ability to do so. This issue is central to many of the misclassification issues explored

in this study, as many independent contractors are limited in their ability to expand their business beyond the scope of the organization they work for, despite the fact that an agreement might allow the independent contractor to do so.

The final category of factors determines the Type of Relationship between the worker and the employer. These four factors include:

8. *Written contracts describing the relationship the parties intend to create.*
9. *Whether or not the business provides the worker with employee-type benefits such as insurance, a pension plan, vacation pay, or sick pay.*
10. *The permanency of the relationship.*
11. *The extent to which services performed by the worker are a key aspect of the regular business of the company (IRS, “Employer’s Tax Guide” 8).*

These factors investigate more subtle distinctions of the nature of the worker-employer relationship. The contracts agreed upon and the benefits received may initially define the relationship, but flawed or inaccurate use of independent contractor status has led to many disputes over the validity of these contracts. If the working relationship between the employer and the worker is expected to continue indefinitely rather than for a specific project or period (IRS “Employers Tax Guide” 8), the worker will more likely be considered an employee rather than an independent contractor. Additionally, independent contractors are more often used to provide a service outside the employer’s regular scope of business; if a worker provides services in-line with a business’s regular activities, then the employer is likely to have a level of control over the worker indicative of an employer-employee relationship (IRS, “Employer’s Tax Guide” 8).

Businesses must weigh all 11 factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. Unfortunately, there is no “magic” factor, or a set number of factors, that makes the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors that are relevant in one situation may not be relevant in another.

Department of Labor - Economic Realities Test

The U.S. Department of Labor (DOL) uses the economic realities test to classify workers under the Fair Labor Standards Act (FLSA), the Equal Pay Act and the Family and Medical Leave Act. The economic realities test uses broader criteria and generally classifies more workers as employees than the IRS tests, which are based on common law standards relating to master and servant. This test, used for labor laws, was established for the New Deal-era worker protections in an effort to extend these protections to the widest net of workers (Halpern 2011).

The DOL looks to the “economic reality” of the business relationship as a whole. The department focuses on whether the worker is economically dependent on the employer. There are six factors (many of which are similar to those used by the IRS) that determine the economic reality test:

1. *The extent to which the worker's services are an integral part of the employer's business.*
 2. *The permanency of the relationship.*
 3. *The amount of the worker's investment in facilities and equipment.*
 4. *The nature and degree of control by the employer.*
 5. *The worker's opportunities for profit and loss.*
 6. *The level of skill required in performing the job and the amount of initiative, judgment or foresight in open-market competition with others required for the success of the worker.*
- (Halpern 2011).

In addition to the factors listed above, the Supreme Court has also included “the degree of independent business organization and operation” among the factors it considers for determining whether an individual is an independent contractor or an employee for purposes of the FLSA (WHD, “Fact Sheet #13” 1). It is critical to understand that all factors are considered important, and no single factor is regarded as controlling. The DOL increases the employee presumption by distinguishing an employee as one who is dependent upon a single employer for income (economic dependence): “In general, an employee, as distinguished from an independent contractor who is engaged in a business of his own, is one who ‘follows the usual path of an employee’ and is dependent on the business that he serves” (Office of the Assistant Secretary for Policy, “Independent Contractors”).

Although there is a clear overlap in much of the criteria in the IRS and DOL’s separate tests, the IRS tends to focus on the direction and control the employer has over a worker, while the DOL focuses on the nature of the economic relationship. While subtle, this difference in focus among the two agencies can lead to conflicting classifications, where one agency’s ruling will conflict with the other’s (Shea).

Joint Misclassification Initiative

Recently, the two agencies have sought to settle this issue by increasing cooperation and information sharing between the IRS, DOL and several other state agencies. This Joint Misclassification Initiative was launched under Vice President Biden’s Middle Class Task Force to prevent, detect and remedy the problem of misclassification, and it has resulted in a number of memoranda of understanding (MOU) strengthening relationships between relevant state and federal agencies. In September 2011, the agencies signed a Memorandum of Understanding (MOU) to promote the goal of “sharing information and collaboration between the parties [to] help reduce the incidence of misclassification of employees of independent contractors” (United States Department of Labor 1). In addition, as of May 2013, the DOL has signed memoranda of understanding with fourteen states: California, Montana, Colorado, Connecticut, Hawaii, Illinois, Iowa, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, Utah and Washington. The DOL continues to actively pursue MOUs with other states. Under the MOUs, agencies work collaboratively and share information to reduce misclassification and enhance compliance with relevant legislation (U.S. DOL). Separately, the IRS has signed agreements with 34 states to coordinate on misclassification prevention efforts including information sharing and enforcement (Reibstein et. al “Independent Contractor Update”).

While the MOUs are still relatively new, they have the potential to drastically change the state of independent contractor law in the United States. Results can already be seen: according to data provided by the U.S. Department of Labor (DOL) in response to a Freedom of Information Act request found that the impact of these partnerships have helped the DOL's Wage and Hour Division complete over 33,000 wage and hour cases in 2011, an increase of roughly 25,000 from 2010. The money paid to employees in back wages from these cases also increased substantially over the same period: roughly \$225 million to over 280,000 employees in 2011, compared to \$175 million collected by 200,000 individuals in 2010 (Icon "Solicitor of Labor Touts Department's Misclassification Initiative at ABA Event").

"Safe Harbor" Rules

In addition to these tests, there exists a set of rules termed "safe harbor" for independent contractors. In the late 1960s and 1970s, the IRS increased tax collection enforcement, leading to employer complaints regarding IRS reclassification of their workers from independent contractors to employees. In response, Congress enacted Section 530 of the Revenue Act of 1978 establishing "safe harbor" rules. It was originally intended as a temporary measure but has since been made permanent through Section 1706 of the Tax Reform Act of 1986 (Weissman 6). These rules allow an employer to treat a worker as an independent contractor for federal tax purposes regardless of their actual status under the common law test if they can meet the following three conditions:

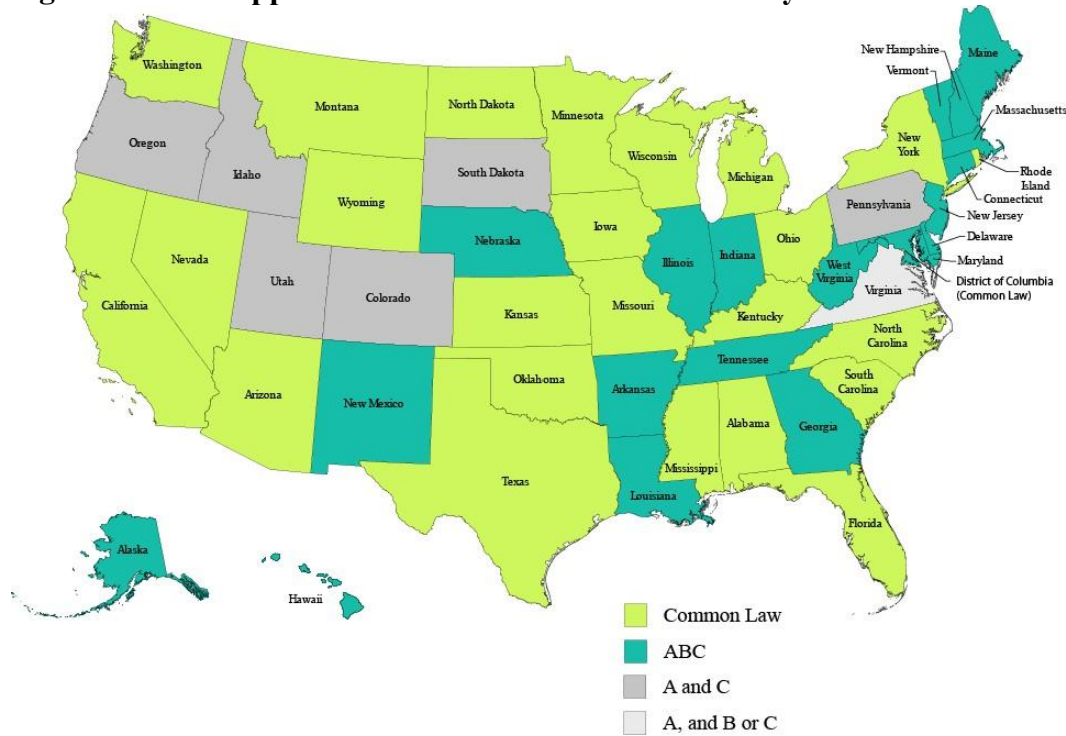
1. *Reasonable basis for not treating workers as employees.* This could be established through court rulings, IRS audits, industry practice, or "other reasonable bases" such as advice of a lawyer or accountant.
2. *Substantive consistency:* All similar workers are classified the same.
3. *Reporting consistency:* All required tax returns are consistent with their workers' classifications (Bickley 2010).

For relief under the provisions, "the initial burden of establishing prima facie reasonableness is on the taxpayer. Once the taxpayer has made a prima facie case of reasonable basis and has fully cooperated with reasonable requests by the IRS, the burden of proof shifts to the IRS to show otherwise" (Nash). Once a company obtains relief under Section 530 for a class of workers, the IRS cannot reclassify them as employees (Hoenig et. al. 1). Receiving "safe harbor" prevents the IRS from retroactively reclassifying independent contractors as employees and subjecting the company to federal employment taxes, penalties and interest for such misclassification (Weissman 6). It is important to note, however, that Section 530 protection is generally not accepted for state income tax withholding or unemployment tax purposes. Therefore, it is possible for an individual to be classified as an independent contractor under federal rules but be considered an employee for state purposes (Lambert). With increasing enforcement of misclassifications and increases in penalties, the future of the Section 530 relief remains unknown; the rule might be subject to full repeal or significant amendment under the Obama administration's deficit reduction plan focused on tax reform (Dold & Pivec).

4.3 State Level Tests - ABC Tests

The U.S. state laws governing independent contractors are generally divided into two categories: those that use the common law approach and those that use what is referred to as the ABC test.

Figure 7: Rules Applied to Determine Worker’s Status by State



(Watkins 5-6)

First, 24 states and the District of Columbia use a common law approach closely mirroring the IRS’s method of classification. In general, these states’ laws dictate that the employers of independent contractors may only control the outcome of the worker’s services, but not the means in which the outcome was accomplished (Watkins 4).

However, 19 states have adopted what is referred to as the “ABC Rule” in reference to the three paragraphs describing the law (Watkins 3). This test differs from the common law approach, as it outlines three specific criteria that must be met before a worker can be considered an independent contractor, potentially conflicting with the common-law classification. An example from the State of New Jersey includes the following:

- A. *Such individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact; and*
- B. *Such service is either outside the usual course of the business for which such service is performed, or that such service is performed outside of all the places of business of the enterprise for which such a service is performed; and*
- C. *Such individual is customarily engaged in an independently established trade, occupation, profession or business.*

While the ABC test mirrors certain factors outlined in the common law approach, the three parts emphasize a stronger level of independence for the worker to be considered an independent contractor. In short, independent contractors must truly be *independent* of their employers and be allowed to use their own methods and have the freedom to further pursue opportunities with other employers. Therefore, workers in ABC test states are more likely to be considered employees rather than independent contractors.

The ABC test also specifies guidelines related to the employer as well as the worker; part B states that workers can only qualify as independent contractors if they provide services “outside the usual course of the business” for which they work. Therefore, a worker can only be considered an independent contractor when they provide a service outside the employer’s regular area of expertise. Many misclassification cases have involved this part, as some businesses employ independent contractors (notably couriers and repair technicians) to provide the general services of their business. Additionally, part C also poses a challenge in misclassification cases, as independent contractors must be sufficiently established as independent by having more than one customer. In these cases, the independent contractor is too controlled by the employer that they remain their only customer, despite their independent contractor classification. Part C is especially troubling for businesses because, as it is typically written, it does not specify requiring more than one customer. However, it is often interpreted in that strict way. Confusing control for economic dependence can be a common mistake. For example, if a general contractor hires an electrical subcontractor and provides sufficient business to keep that subcontractor busy, he may not look for additional clients. In this case, many states may rule that the subcontractor lacks control. In contrast, that contractor could, even with that workload, hire another crew and work for a second general contractor, spreading his risk. Economics, spreading risk and other factors drive these decisions, without considering control.

The remaining seven states not meeting the “common law” or “ABC” generalization have developed special rules or case law that may address specific industries or occupations, but these state-specific treatments still follow either of the two general approaches (Watkins, 4).

The three ABC parts do reduce independent contracting to its clearest definition, with little uncertainty and room for interpretation, as opposed to the other laws. However, it is often difficult for an independent contractor business model to meet all three requirements of the ABC test, particularly being able to meet both B and C at the same time. Contractors often are brought in to help businesses with their regular course of business during busy seasons (a violation of part B), while many contractors work exclusively for one client (violation of part C). While the freedom from direction and control of part A remains essential, some states have introduced a requirement of A, and either B or C. This broader definition of the independent contractor still requires strict adherence to these criteria, but it accommodates some flexibility for the ever-changing roles independent contractors fulfill (Shea).

Problems with the ABC tests stem from the way they are interpreted - that is, inconsistently and expansively. From a consistency standpoint, it is difficult to understand how any general building contractor ever passes part B. The 20-30 various subcontractors routinely used by a general building contractor perform some functions that are within the usual course of the general contractor’s building business, be it drywall, electrical, rough framing, finish carpentry,

plumbing, brick laying, site prep, etc. If building contractors are not held to the part B standard, then why would salons using hair dressers, hospitals using anesthetists, trucking firms using drivers and so on, be any more of a concern to states? Discriminating against a single industry hurts the argument that these tests can be applied consistently across all businesses.

One might also want to ask why part C should be interpreted as precluding work for a single contracting party. The notion that an individual working for one contracting party cannot be an independent contractor is problematic not only for businesses, but from a basic policy point of view as well. It ignores the reality of how small businesses commence operations – often with a single person serving a single customer. If policy does not accommodate this reality, how can it expect small businesses to start? Are such small entities to be converted to independent contractors the moment they hire a second individual or acquire a second customer?

Moreover, although ABC tests are generally aimed at individuals, problems also stem from attempts to apply them to business entities. If an individual is registered with a state as a business and is paying taxes in the business name, is the entity not holding itself out sufficiently to the public to meet part C? Should it concern anybody that the business comprises only one person? After all, the representations made in tax filings are made under the penalty of perjury. If a registered business is also employing persons in the business, is it not also holding itself out to the workers it employs as being in business? If revenue is the state's concern, why would a state be concerned about any entity's status under any ABC test if the entity is registered as a business with the state (whatever form such registration may take), is in good standing with the state, is paying taxes to the state in the business name, and is properly handling its employees, if any, for payroll tax reporting purposes? Under such circumstances, all the legitimate revenue interests of the state are met. What else should concern the state?

4.4 The Courts and Entrepreneurial Tests

The common law test is typically applied in court rulings to federal laws, including the Federal Insurance Contribution Act, Federal Unemployment Tax Act, income tax withholding issues, Employment Retirement and Income Security Act (ERISA) and the National Labor Relations Act. Courts also use the economic realities test in certain cases. Recently, an additional consideration is appearing in court decisions on misclassification: entrepreneurial ability.

A growing number of case rulings have placed stronger emphasis on entrepreneurial factors. In these cases, independent contractors are allowed the opportunity for entrepreneurial gains or losses through their contracts; this fact alone determines their independent contractor status, regardless of whether they take advantage of this opportunity or not. In the 2002 case *Corporate Express Delivery v. National Labor Relations Board (NLRB)*, the U.S. Court of Appeals for the District of Columbia upheld the NLRB's "decision explicitly 'to focus not upon the employer's control of the means and manner of the work,' but instead upon whether the putative independent contractors have a significant entrepreneurial opportunity for gain or loss" (Jost 325).

The precedent set from this decision was integral in the 2009 ruling in *FedEx Home Delivery v. NLRB*. In this case, the International Brotherhood of Teamsters pursued the right for FedEx drivers to unionize under the authority of the NLRB. When the NLRB granted the drivers the right to do so, FedEx refused to bargain with the Union, claiming the drivers were legally

independent contractors. When the case reached the U.S. Court of Appeals for the District of Columbia, it was shown that the FedEx drivers had significant entrepreneurial opportunities, thus were correctly classified as independent contractors. Central to this decision was the fact that the drivers were permitted to use their vehicles for non-FedEx purposes, to incorporate independently, take on multiple routes, hire their own employees and sell routes to other drivers all without permission from FedEx (Jost, 329). Further, the level of control FedEx had over their drivers was found to be “driven merely by ‘customer demands and government regulations’” and therefore “insufficient to demonstrate an employment relationship” (Jost 329).

This entrepreneurial test of the independent contractor classification mirrors many of the IRS and DOL factors for determining independent contractor classification, primarily the opportunity to expand their business in order to increase profits. However, unlike the laws currently in place, these decisions have made the entrepreneurial test the overwhelming factor. It is important to realize that these decisions are made on a case-by-case basis and that the factors of control and entrepreneurial opportunity will differ as such. While in *FedEx Home Delivery v. NLRB* entrepreneurial opportunity outweighed the level of control FedEx had over the contractors, it is significant to note that this may not be true in other cases, particularly where the level of control could be said to more closely resemble an employer/employee relationship. Since *FedEx Home Delivery v. NLRB*, the entrepreneurial test does not appear to have gained much traction in the courts and the decision has not yet been followed in any published opinion on the importance of entrepreneurial opportunity in conducting independent contractor determinations. However, this case will likely still have a significant impact given that the “D.C. Circuit has concurrent jurisdiction to review every order issued by the Board, and its decisions on labor issues are generally held in high esteem by other courts” (“Shift Toward Importance”). Certainly, the relative importance of entrepreneurial opportunity versus the common-law focus of extent of control remains to be seen in future cases.

5.0 Misclassification Confusion and Heightened Legal Scrutiny

These differing tests cause tremendous confusion on the part of businesses as case after case is brought before courts that attempt to interpret worker classification. Not only can a single scenario be interpreted differently by different agencies, but courts at different levels also interpret the laws differently – a ruling from one day may not stand the next. Worker status is therefore not only inconsistent depending on the statute (tax, labor, etc.) and inconsistent spatially, across states and regions, but also temporally.

Many companies have been subject to individual and class action lawsuits targeting the role of independent contracting in their business model. Businesses typical of these cases include construction workers, package delivery and installation services (i.e. Comcast, FedEx Ground, RCN and Verizon), home healthcare services and technical experts and engineers (i.e. Microsoft). The plaintiffs in these suits typically seek damages for unpaid employee benefits, unpaid overtime and unreimbursed employee expenses. Thus far, decisions on these cases are varied, conflicting and have not yet provided a clear answer regarding use of the contracting model, reflecting the unclear and complex definitions of independent contracting.

In recent years, litigation involving contractors has increased steadily, reaching a 20-year high in 2012. According to the Administrative Office of the U.S. Courts, there were 7,064 federal wage-and-hour cases filed in the 12 months ending March 31, 2012. This compares to only 1,854 in 2000 (Grannis). According to the Federal Judicial Center, the research arm of the federal courts, filings under the Fair Labor Standards Act nearly doubled from 2,035 in 2002 to 4,055 in 2003 (Grannis). Some note the stagnant economy and high unemployment for the increase, claiming that employees, after being laid off, seek legal methods to ensure proper procedures were followed.

Several key laws play a role in the following cases. Perhaps the most important is the Employee Retirement Income Security Act of 1974 (ERISA), which establishes minimum standards for pension plans for companies. Enacted to protect employees and their benefit plans, the law also provides rules on the federal income tax effects of transactions associated with employee benefit plans. The following represent a few of the most widely-cited cases considered representative of issues involving independent contracting.

5.1 Vizcaino v. Microsoft Corp. (1997)

In this case, Microsoft utilized workers to perform various services on specific projects including production editing, proofreading, formatting, indexing and testing (Arsenault 2). The workers in this case worked for the company over continuous periods of time, often exceeding two years, and claimed to be fully integrated into the workforce like other Microsoft employees. The workers were on teams with employees, shared supervisors, were given keys to gain access to the facilities, and used the office equipment and supplies (United States Court of Appeals 3). However, since the workers were utilized as independent contractors, the workers were paid for their services through submitted invoices and not through the company's payroll department (United States Court of Appeals 3). Because the workers were not on the payroll, Microsoft did not withhold income or Federal Insurance Contribution Act (FICA) taxes and did not pay the employer's share of the FICA taxes. Microsoft also did not allow the workers to participate in the Savings Plus Plan (SPP) or the Employee Stock Purchase Plan (ESPP) (United States Court of Appeals 3).

In 1989 and 1990, the IRS used common law principles to determine that these workers were in fact employees and that Microsoft should have been withholding and paying taxes. The IRS determined that Microsoft did in fact exercise significant control over the employees despite the employee agreements stating that the workers were not employees. In response to this, Microsoft issued W-2 forms to the workers and paid its share of FICA taxes. Microsoft also offered full employment status to the workers where possible – some workers took advantage of this while others did not (United States Court of Appeals 3).

5.2 FedEx Ground in Various States

FedEx Ground has faced a decade-long legal struggle to determine whether its drivers should be classified as independent contractors or employees. To date, over 60 class action lawsuits have been filed against FedEx Ground under state and federal laws (Reibstein). Plaintiffs in these cases argue that they are actually employees of FedEx and should be provided with the full

benefits of employment, such as unionization rights and inclusion in health and pensions plans (Savelandal 2). They argue that they cannot be independent contractors because they have little control over the way in which they perform their job, asserting that FedEx creates policies for customer interaction, sets specific delivery schedules and regulates their appearance and the design of their vehicles (AFL-CIO 10). FedEx insists that their drivers are independent contractors, pointing to their ability to set their own hours, provide their own vehicles, use their vehicles for personal purposes, hire their own employees and hire replacement drivers without the company's consent (Batten 32). In addition, drivers in these cases have signed operating agreements with FedEx stating that the parties agree the driver will operate as an independent contractor and not an employee for any purpose (Savelandal 2).

Several courts have considered the FedEx Ground driver classification issue, with inconsistent results. In 1999, in *Estrada v. FedEx*, current and former drivers in California filed a class-action lawsuit contending that, "for the limited purpose of their entitlement to reimbursement for work-related expenses, they were employees, not independent contractors" (Hassen). In 2005, the Los Angeles Superior Court ruled that FedEx Ground wrongly classified these single-route delivery drivers as independent contractors (AFL-CIO 10). The court stated that FedEx exercised pervasive control over the drivers and their business practices. The more than 200 drivers in this case were awarded \$5.3 million in reimbursements of business expenses (AFL-CIO 10). In addition, FedEx was required to pay about \$12.3 million in attorney's fees and costs ("Estrada"). In 2007, a California State Appellate Court affirmed the trial court's ruling (Hassen). It is important to note that at the time of the *Estrada* suit, FedEx Ground also contracted with business entities, not just the drivers themselves. The *Estrada* court declined to make the incorporated entities part of the class. The *Estrada* court also declined to include entities with multiple-route drivers in the class and then found that the multiple-route entities, including one of the named plaintiffs, were independent contractors. In such cases, the drivers were considered to be the employees of the entities. The distinction is important, because FedEx Ground now only contracts with entities, and everybody that now performs services for FedEx Ground is an employee, although not an employee of FedEx Ground.

However, in April 2009, the United States Court of Appeals for the District of Columbia Circuit overturned a National Labor Relations Board (NLRB) decision that classified FedEx Home Delivery drivers as employees rather than independent contractors. FedEx Home Delivery, which is a division of FedEx Ground, refused to bargain with Teamsters on grounds that its single-route drivers were not "employees" under the National Labor Relations Act. The NLRB found that the drivers were employees and that FedEx was in violation of the Act for refusing to bargain with the Teamsters. But on appeal, the D.C. Circuit found that FedEx Home Delivery drivers appeared to share many "characteristics of entrepreneurial potential" and should be classified as independent contractors (Hanley). The court acknowledged that previous decisions focused on the extent of control exercised by employers but that those decisions failed to fully capture what was meant by "control" (Welter). The court also stressed that it was not abandoning the common-law agency test. Rather, it was merely shifting emphasis to entrepreneurialism as a mechanism for evaluating the common-law factors (Welter).

In July 2010, the Massachusetts Attorney General's Office announced that it had come to an agreement with FedEx Ground to settle a citation that the company was misclassifying its drivers as independent contractors instead of properly classifying them as employees. By treating its drivers as independent contractors, the Massachusetts Attorney General's Office claimed that FedEx Ground violated the Massachusetts Independent Contractor Law and improperly failed to pay state payroll taxes and workers' compensation and unemployment assistance premiums. FedEx agreed to pay \$3 million to settle the charges against it, and it also admitted no wrongdoing in settling the case (Reibstein "Independent Contractor Misclassification Ruling").

In December 2010, in perhaps the most significant ruling yet, U.S. District Court Judge Robert Miller issued a decision covering 42 lawsuits involving laws in 27 states. These state-law class action claims, brought by drivers alleging that they were "employees" misclassified as independent contractors, had been consolidated in the U.S. District Court for the Northern District of Indiana (AFL-CIO 11). In his decision, Judge Miller found that drivers were properly classified as independent contractors in lawsuits covering 23 states, and that they were employees under state laws in only three states (Reibstein "Independent Contractor Misclassification Ruling"). For the 23 states in which he ruled in favor of FedEx, Judge Miller made clear that "the right to control the methods and means of the drivers' work" was the most important factor for determining whether an individual is an employee or an independent contractor. The court noted that such control indicates an employee status, whereas a company's control over the results to be produced does not indicate employee status (Reibstein "Independent Contractor Misclassification Ruling").

The drivers appealed the decision to the U.S. Court of Appeals for the 7th Circuit. In July 2012, the appeals court has asked the Kansas Supreme Court how drivers are classified under the state's law. Because Kansas law lacks an absolute rule for determining employee status, Kansas courts have varied on their rulings regarding independent contracts. Acknowledging that this case "is of great importance not just to this case but to the structure of the American workplace," the court is looking for guidance in making the determination of employee status before ruling on FedEx (Harris and Grannis). The Kansas Supreme Court is being asked to answer two questions:

1. "Given the undisputed facts presented to the district court in this case, are the plaintiff drivers employees of FedEx as a matter of law under the KWPA?"
2. "Drivers can acquire more than one service area from FedEx. Is the answer to the preceding question different for plaintiff drivers who have more than one service area?" (Craig v. FedEx Ground Package System, Inc., No. 10-3115).

5.3 Herman v. Time Warner (1999)

In this case, the U.S. Department of Labor alleged that Time Warner violated ERISA and misclassified workers as "temporary employees" and "independent contractors" in order to save the costs of providing these employees with employee benefits (Mendelson 2). Previously, suits challenging the denial of benefits were brought by individual plan participants under ERISA § 502(a)(1)(b) "to recover benefits due" (McMillan 859). Instead, this suit against Time Warner

was brought by Secretary of Labor Alexis Herman, following an investigation by the Department of Labor's Pension and Welfare Benefits Administration (McMillan 859). This action was significant because it marked the first time that the federal government took action in the contingent worker area (Waters).

The workers in this case were writers, photographers, graphic designers and others who produced Time Warner's various publications. Workers were classified for payroll purposes as "temporary" employees – this classification excluded the employees from employee benefit plans. The DOL contended that Time Warner had manipulated breaks in service for employees in order to maintain their temporary status, allowing Time Warner to prevent workers from completing the length of service required to be eligible to receive benefits (Waters).

Rather than bring a claim under ERISA Section 502, the U.S. Department of Labor sought an order from the court to appoint an independent fiduciary with the exclusive power and authority to identify the misclassified employees and administer Time Warner's benefit plans. The DOL also sought a court order to require Time Warner to pay all expenses that the independent fiduciary had identified, to retroactively include any eligible workers and to pay the requisite benefits. The court order was also meant to permanently discourage Time Warner from misclassifying employees in the future (Horne 6-20).

In November 2000, Time Warner and the DOL settled the misclassification suit for \$5.5 million. Of the settlement amount, \$5 million was divided between independent contractors and misclassified temporary employees. The remaining \$500,000 went to both categories of contingent workers who had uninsured and unreimbursed medical expenses (Waters). Time Warner maintains that the settlement was not an admission of any liability or wrongdoing ("Legal").

5.4 Burrey v. Pacific Gas & Electric Co

In a 1998 landmark case, *Burrey v. Pacific Gas & Electric Co.*, the plaintiffs were clerical workers employed by outside agencies and leased to Pacific Gas & Electric Company (PG&E). PG&E's employee benefit plans, including health and severance, excluded so-called "leased employees", as defined by Section 414(n) of the Internal Revenue Code (McMillan 3). The district court granted PG&E's motion for summary judgment, finding that the workers were rightly excluded from the retirement and savings plans because they were leased employees (McMillan 3).

The court of appeals reviewed PG&E's interpretation of a leased employee status and applied the common law principle. The court of appeals concluded that if the workers were common law employees, they could not be considered "leased employees" and could not be excluded from benefits under the plan (McMillan 3). The district court, when initially siding with PG&E, had cited the *Abraham v. Exxon* case, which held that that leased workers may be excluded from benefit plans even though they qualify as common law employees (McMillan 3); however, the court of appeals held that when Section 414(n) of the Internal Revenue Code is used, leased workers cannot be classified as common law employees.

5.5 Salamon v. Our Lady of Victory Hospital

In 2008, in *Salamon v. Our Lady of Victory Hospital*, the U.S. Court of Appeals for the Second Circuit ruled that a lower court had erred when it held that a gastroenterologist at an upstate New York hospital was an independent contractor and not an employee for the purposes of her Title VII lawsuit. This case surprised the medical community in New York as historically it was assumed that physicians on medical staff at hospitals were independent contractors (Reibstein “The Risk of Using Independent Contractors”).

The hospital considered Dr. Salamon an independent contractor/staff physician because she billed her patients directly. However, Dr. Salamon had to submit to the hospital’s “Staff Rules and Regulations,” which included a “quality assurance” process whereby the physicians’ medical procedures were reviewed. Cases that were flagged as problematic would be subject to peer review and possibly to the National Practitioners Data Bank (NPDB) (Danaher 2010). After complaining of sexual harassment, Dr. Salamon experienced a significant increase in the number of her cases that were subject to review, and she had to undergo a three-month “re-education” and mentoring program, which if she failed to complete, would be reported to the NPDB. She then was warned that her failure to complete the program would lead to a report to the NPDB (Danaher 2010).

The Court of Appeals found that the hospital exercised “substantial control” over the treatment outcomes of Dr. Salamon’s practice as well as over details and methods of her work, making her an “employee” for purposes of Title VII. In this case, there was evidence that the policies imposed upon Dr. Salamon that illustrated enough control to classify her as an employee may have been motivated by the hospital’s goal of maximizing revenue, and/or in reaction to Salamon’s complaints of harassment (Danaher 2010). While in most cases doctors are still considered independent contractors, this case serves to illustrate that no profession can be considered exempt from scrutiny over this definition.

5.6 D’Annunzio v. Prudential Ins. Co. of America and Stomel v. City of Camden

In 2007, the New Jersey Supreme Court issued two significant decisions regarding independent contractors in *D’Annunzio v. Prudential Ins. Co. of America* and *Stomel v. City of Camden*. It found that both a chiropractic medical director of Prudential Life Insurance and a public defender for the City of Camden were employees for claims under a state employee protection act. The court ruled so after considering the fact that both of the workers had signed independent contractor agreements (Reibstein “The Risk of Using Independent Contractors”). It is becoming clear that while a contractor agreement can assist with a ruling of independent contractor status, it does not guarantee one.

5.7 Christopher v. SmithKline Beecham Corp.

On June 18, 2012, the U.S. Supreme Court decided 5-4 that pharmaceutical sales representatives were “outside salesmen” and, as such, were exempt from the employee protections of the Fair Labor Standards Act. The decision was a significant one, which, had it gone the other way, could have unleashed billions of dollars of liabilities on the pharmaceutical industry (Liptak). The decision overruled a 2010 2nd U.S. Circuit decision (*In re Novartis Wage & Hour Litigation*) that held that sales representatives were not exempt under the Fair Labor Standards Act. In January 2012, Novartis Pharmaceuticals Corp. settled the class action suit, awarding \$99 million for 7,000 Novartis sales representatives (Voreacos and Van Voris).

Drug sales representatives promote the sale of prescription drugs through marketing directly to doctors, obtaining nonbinding commitments from those doctors to prescribe the drugs. The salesmen do not sell the drugs directly to patients or doctors. While the sales representatives are paid both a base salary and incentive pay for sales, they do not receive overtime pay, and for that reason, plaintiffs alleged that the employer violated the Fair Labor Standards Act. At issue in this and similar cases is whether what these sales representatives do constitutes an actual sale. The Act exempts workers employed “in the capacity of outside salesmen.”

In the majority opinion, Justice Samuel A. Alito writes that although the representatives did not directly sell the drugs themselves, the nonbinding commitments were enough to consider them sales, which may include exchanges, consignments, or “other disposition” (Liptak). In the dissent, Justice Breyer argued that such commitments were not sales, noting that even though a representative could convince a doctor to prescribe the drug in an appropriate situation, a number of additional steps would need to occur before an actual sale occurred (Liptak).

Interestingly, there was one point of agreement in the case, with majority and dissenters agreeing that: “the government’s interpretation of the laws and regulations at issue, expressed in supporting briefs filed in various courts, had been a moving target and were entitled to little deference” (Liptak).

The Department of Labor issued a number of *amicus* briefs encouraging the Court to consider the case using its own interpretation of the Fair Labor Standard Act regulations on what constitutes a sale. In the first two briefs, this meant that the sale requires a “consummated transaction directly involving the employee for whom the exemption is sought.” In a later brief, the DOL claimed the exemption for “outside salesman” applied only makes a sale if the salesman “transfers title to the property at issue” (Arnold & Porter 2).

The Supreme Court typically grants deference to an agency’s interpretation of its own regulations. The Court pointed out that the pharmaceutical industry had employed sales representatives as exempt employees for decades, and the DOL had never undertaken enforcement action against the industry or suggested that treating sales representatives as exempt was unlawful until the *amicus* brief in 2009. “The Court declared that ‘where, as here, an agency’s announcement of its interpretation is preceded by a very lengthy period of conspicuous inaction, the potential for unfair surprise is acute’” (Arnold & Porter 2). Further, the Court stated that the Department’s interpretation was “wholly unpersuasive” and that under FLSA, a “sale”

can include a “consignment for sale,” which does not require a transfer of title. The Court found that the DOL’s interpretation then was “flatly inconsistent” with the actual regulation. Because the DOL commonly delivers interpretations of its regulations through *amicus* briefs or similar litigation filings, this decision may have broader implications, as the Court may review those interpretations more closely rather than simply deferring to the Department. Government *amicus* briefs may be less important in litigation than they have been.

In addition, it may encourage the DOL and other agencies to be more consistent in their enforcement activities and in litigation (Arnold & Porter 3). “The Court strongly implied that the agency’s historical lack of prosecution of an alleged violation can constitute evidence that a practice is, in fact, legal. This principle may provide strong support for the legality of long-held industry practices in this area, especially in situations where specific guidance has been unavailable” (Arnold & Porter 3-4). The Court suggested that non-enforcement over a long time period indicates its acceptance as a widespread industry practice. The decision will likely make it more difficult for the department to change its position without giving the impacted regulated industries fair notice and opportunity to respond (Gibson Dunn).

Finally, in the majority opinion, Justice Alito noted that workers earning over \$70,000 were “hardly the kind of employees that the FLSA was intended to protect.” While employee earnings have no relevance to eligibility for FLSA, the inclusion of this note highlights, according to Jeremy J. Glenn, a partner in Meckler Bulger Tilson Marick & Pearson in Chicago, that this decision may be an important decision that other industries should pay attention to: that the Supreme Court is considering the “industrial reality” of the case. This demonstrates that the Courts are applying an approach to interpretation that considers the general purpose of the FLSA – which is to protect works from exploitation (Dubé).

6.0 The Franchise Business Model and Worker Misclassification

The franchise business model is important to the U.S. economy. Franchise businesses are expected to employ 8.3 million people in the U.S. by the end of 2013 and generate \$802 billion in revenue, according to a report by economic analysis company IHS Global Insight. Additionally, nearly 11,000 new franchise units are expected to open doors in 2013, growing the number of franchise businesses in the U.S. to over 757,000 (Clifford). And before growth stagnated following 2005, the franchising sector outgrew most other sectors of the U.S. economy between 2001 and 2005, with direct economic output expanding by over 41% while economic output of other businesses grew by 26% during that period (“Trends in Franchises: Growth”). However until recently, franchises had not often been involved in employee misclassification cases. But as government budgets dwindle, these types of cases have been catching the attention of lawmakers. Both the federal government and state governments may receive millions of dollars in extra revenue if they can prove that employers have misrepresented their workers.

Franchises, once thought as immune to “misclassification” employment cases, are increasingly subject to classification confusion and increased litigation and enforcement. To distinguish themselves from an employment-type relationship, many franchisors require their franchisees to sign agreements that specify the franchisee’s work classification (Frank 3). Typically, these

agreements state that the franchisee is an independent contractor and not an employee of the franchisor. Many agreements include provisions limiting the liability of the franchisor and its control over the day-to-day operations of the franchisee. For example, franchisees are often required to display signage indicating that the business is owned by an independent contractor and not the franchisor (Wood 1484). Along with operating manuals, these agreements establish the level of control the franchisor exerts over the franchisee, an important element that is scrutinized by courts in worker misclassification cases.

For some time, the franchising business model seemed to guarantee a franchisee's legal status as an independent contractor. However, recent court decisions have undermined the franchisor's immunity to worker misclassification lawsuits. The most prominent of these is the *Awuah v. Coverall North America, Inc.* case ruling that found a franchisor liable for misclassifying its franchisees as independent contractors (Spandorf). In our interview with Ms. Shannon Liss-Riordan, a Boston lawyer representing the plaintiffs against Coverall, she observed that: "Our recent Coverall case shows that it [the franchise business model] does not provide protection. The companies that use the franchise model think that by slapping the label of franchisee on their workers they do not have to worry about any of the employment or wage laws. The Coverall case proves that that is not the case."

Subsequent cases have reaffirmed this finding, indicating that the franchise designation does not automatically protect a company from worker misclassification liability (Wood 1485). Additionally, courts have bypassed franchise agreements that identified franchisees as independent contractors in making their rulings. They instead have based their decisions on a variety of employment tests to determine the franchisee's status (Spandorf 21). These tests form the framework for how a company will be judged in a case but can leave room for judgment. According to Ms. Liss-Riordan: "A lot of times the facts of the situation are going to be the driving force in what affects the judge's decision. They can go through the whole legal analysis but at the end of the day a lot of judges are looking at whether these people who are doing the work in a particular case look like employees." The following cases illustrate the susceptibility of franchises to worker misclassification problems.

6.1 Awuah v. Coverall North America, Inc.

The case of *Awuah v. Coverall North America, Inc.* began in 2004, when a single franchisee sued Coverall for unemployment compensation. In 2007, this case turned into a class action lawsuit on behalf of Coverall's Massachusetts franchisees (Spandorf 21). In this case, the Massachusetts court applied the ABC test to determine whether the franchisee was an employee or independent contractor. Under Massachusetts law, the burden was on the principal business to establish all three elements, otherwise the independent contractor would be reclassified as an employee (Branam 1).

In the end, Coverall failed to prove to the court that its franchises performed a service outside of Coverall's normal course of business and was found guilty of worker misclassification. It was found guilty despite having a franchise agreement that identified the franchisee as an independent contractor (Spandorf 21-22). Ms. Liss-Riordan informed us that "the Massachusetts Supreme Judicial Court issued a ruling at the end of August finding that Coverall franchisees (or

those who the company has called franchisees) are actually entitled to a lot of money back under the wage laws. It was not a defense that they had been called franchisees and that they had made payments in order to buy their franchise.” The court also determined that the costs of workers’ compensation insurance premiums could be recovered by the employees based on the intent of the Worker’s Compensation Act (Ceniceros). In addition, the court found that employers cannot deduct franchise fees from an employee’s wages (Ceniceros). When talking about what the Coverall verdict means for the franchise community, Ms. Liss-Riordan remarked that “certain types of franchises are going to be more vulnerable than others” and that the verdict of the Coverall case “was not an indictment of franchises in general.”

In response to the *Awuah v. Coverall* case, the Massachusetts House of Representatives introduced Bill 3513 in June 2011. This bill sought to protect the franchising business model from employee misclassification liability by stating, in part, that “an individual who owns a franchise, or is a party to a franchise agreement under which he or she is authorized to sell products and/or services (a) in accordance with prescribed methods and procedures; and (b) under services marks, trademarks, trade names and other intellectual property licensed under such agreement, shall not be considered an employee of the franchisor” (Kent). While the franchisor community supported this bill, it was unlikely to pass and eventually was placed in study, thereby putting further legislative action on hold for at least one year (“Bill H.3515”).

6.2 Singh v. 7-Eleven Inc.

In this case, the line between franchisee and employee was considered in the context of the Fair Labor Standards Act (FLSA). In 2007, workers at a California 7-Eleven sued both the storeowner (the franchisee) and 7-Eleven (the franchisor) under the FLSA. The FLSA defines an employer to include “any person acting directly or indirectly in the interest of an employer in a relation to an employee” (Wood 1485). Using the FLSA as guidance, the California court applied the economic reality test to determine whether 7-Eleven was acting as an employer. This test considered a number of factors regarding the level of control the franchisor had over its franchisee, including the power to hire and fire; supervision and control of work schedules or conditions of employment; the rate and method of payment; and maintenance of employment records (Wood 1485).

The 7-Eleven franchise agreement stated that the franchisee had discretion or control over its own employment policies and means of operation, as well as work schedules and conditions. Although 7-Eleven provided payroll services to its franchisees, the court did not find this to demonstrate the franchisor was an employer, stating that “providing a payroll service to a franchisee’s employees does not in any manner create an indicia of control over labor relations sufficient to demonstrate that the franchisor is a joint employer.” By applying the economic reality test, the court did not find an employer-employee relationship between the franchisor and the franchisee (Wood 1485).

6.3 Rainey v. Langen

The franchisee as employee argument is also starting to surface in tort litigation. *Rainey v. Langen* is one of the landmark cases on the growing issue of vicarious liability in the franchisor-

franchisee context. Vicarious liability is liability that a supervisory party, often an employer, incurs for the tortious conduct of a subordinate or employee. Franchise law attorney Kristina Balbo states that “the existence of an employer-employee relationship typically must be shown in order to impose vicarious liability upon a party. Where the subordinate party is deemed to be an independent contractor instead of an employee, the employer is generally shielded from liability for the subordinate’s acts. For this reason, determining the nature of the relationship between the supervisor and his subordinates is crucial in establishing or disproving the existence of vicarious liability” (Balbo 1).

In the Maine Supreme Court case *Rainey v. Langen*, a motorcyclist injured in an accident with a pizza franchisee's driver sued the franchisor, Domino's Pizza, as well as its franchisee, TDBO Inc., alleging that Domino's had imposed so many quality-control and operational standards over the franchisee's business that the driver, an employee of the franchisee, was in effect a Domino's employee. If the driver was found to have employee status, then Domino's would be liable for the employee's acts. However, the court held that “the quality, marketing, and operational standards present in [the franchise agreement] do not establish the supervisory control or right of control necessary to impose vicarious liability” (Wood 1486). In this case, the court determined that Domino's did not exert enough control over its franchisee for the arrangement to be considered an employee-employer relationship. Consequently, the franchisor was not liable for the accident caused by an employee of its franchisee.

Vicarious liability can be a real dilemma for franchisors. If they exert too much control, they might be held liable for the franchisees' conduct. If they do not exert enough control, they might be considered complicit, or seen as not properly training and educating the franchisee. Additionally, “if the franchisor does exert sufficient control over the franchisee to be vicariously liable for the franchisee's conduct, aggressive franchisee attorneys may then push the issue of franchisor control for employment classification purposes” (Mulcahy).

This case once again illustrates the importance of drafting and structuring a franchise agreement with keen consideration given to potential employee status. A franchisor wishing to limit its liability with respect to franchisees and their employees should limit the amount of control it specifies in the franchise agreement. Franchisors should also explicitly state that the franchisee is an independent contractor, and the franchisor will not be liable for a franchisee's acts. Although such language will not be conclusive, it is evidence of a franchisor's intent to avoid vicarious liability, which the *Rainey* Court valued highly (Balbo 3).

As previously discussed, a franchise agreement alone will not protect franchisors from worker misclassification liability. More and more states are scrutinizing franchisor-franchisee relationships and considering or passing legislation that would give greater protection to franchisees, reflecting the current trend toward bills promoting and protecting employees as part of the employer-employee relationship (Nigut). However, the Georgia Legislature recently enacted legislation that should encourage franchisors. With the enactment of House Bill No. 548, Georgia became the first state to adopt legislation formally recognizing the franchisor-franchisee relationship as a contractual relationship by statute rather than an employment relationship. The law states that “individuals who are parties to a franchise agreement as set out by the Federal Trade Commission Franchise Disclosure Rule...shall not be deemed employees” (Weiss,

“Georgia Enacts Bill”). Although the effort has been applauded by pro-franchisor groups for protecting franchisors from liability for workers' compensation claims made by their franchisees, it is still unclear whether the new law will settle the franchisor-franchisee relationship for all purposes, such as questions of agency or tort liability.

Misclassification claims against franchisors are scrutinized using the same type of legal tests as in cases against non-franchisors. Franchise agreements or the payment of the required fee have not been effective in shielding the franchisor from liability (Spandorf 22). Though a variety of legal tests have been applied in worker misclassification cases, with varying and sometimes conflicting results, the issue comes down to the level of control. The difficulty then for franchisors is to balance the level of control necessary to protect the brand name and to ensure quality while reducing the potential for worker misclassification liability.

7.0 The Extent of Worker Misclassification in the United States

Several state and federal agencies have conducted studies over the years to gauge the extent of employee misclassification. The GAO issued a 2009 report on misclassification where it stated that “the national extent of employee misclassification is unknown; however, earlier and more recent, though not as comprehensive, studies suggest that it could be a significant problem with adverse consequences” (Tennessee Employee Misclassification). For example, in 1984, the IRS made its last national estimate of misclassification. The results indicated that about 15 percent of employers misclassified 3.4 million workers as independent contractors (U.S. Library of Congress 1). Given the fact that the use of independent contractors has risen in recent years, it is likely that the percentage of misclassification is similar or greater today than it was in 1984. Additionally, a study of nine states conducted on behalf of the U.S. Department of Labor in 2000 found that the percentage of audited employers with misclassified workers ranged from approximately 10 to 30 percent (Colorado Department of Labor and Employment 6).

However, recently the most activity to determine the extent of employee misclassification has occurred at the state level. Figure 7 illustrates the results of six state estimates of the number of workers misclassified statewide (Canak and Adams 3).

Figure 8: Extent of Employee Misclassification: Summary of Leading State Studies

	State					
	IL	MA	ME	MI	NY	PA
Percentage of Workers Misclassified	7.5%	13%	11%	8.4%	10%	9%

In August 2012, the National Employment Law Project (NELP) summarized the findings from multiple state-level studies and reports on the percent of employers who misclassify. The information gathered resulted in the findings presented in Figure 8. The state studies used a range of data to develop their resulting estimates. While most used unemployment insurance (UI) and/or workers compensation audits, some studies developed estimates using the records of

multi-level government agencies and worker interviews. Moreover, some studies focused on pre-determined industries while others examined the workforce as a whole. Some analysts believe that state studies most likely underestimate the true scope of misclassification because the studies rarely identify employers who fail to report worker payments to state authorities or workers paid completely off-the-books – in the “underground economy” – where misclassification is considered by many to be even more prevalent (“Independent Contractor Misclassification” 2). However, others contend that many state studies, or individuals interpreting the studies, misrepresent the findings by generalizing them to the broader employer population although most states do not use a random selection strategy as the basis for their audits.

Figure 9: Extent of Employer Misclassification; Summary of Leading State Studies

	State										
	CO	IL	ME	MA	MD	MI	MN	NJ	NY	PA	WI
Percentage of Employers Who Misclassify	33.9%	19.5%	11% 14%*	12% 14%*	20%	30%	14% 15%*	38-42% of audited cases	10.3% 14.9%*	9%	44% of audited employers

**Indicates figures for the construction industry.*

States also measure the degree or severity of misclassification within employers found to have misclassified workers. Recent state studies have indicated that when employers misclassify, the misclassification is generally widespread and not a random occurrence. For example, 28.8 percent of workers in Illinois were misclassified by employers who were found to be misclassifying for the period 2001-2005 (Sturgeon, Kelsay and Pinkham 16). In Indiana in 2008, an estimated 27.4 percent of workers were found to be misclassified by employers that were found to be misclassifying (Kelsay and Sturgeon 27). And a Massachusetts study found that between 25 to 39 percent of workers were misclassified among misclassifying employers from 2001-2003 (Carré and Wilson 11). In other words, when many businesses misclassify, they tend to do so for an entire type of worker or section of their business.

Worker misclassification is also more common in some industries than others. A 2007 report undertaken by the Minnesota Office of the Legislative Auditor outlines some characteristics of industries more prone to misclassification including: the use of unskilled labor, minimal capital investment requirements and seasonal business cycles (State of Minnesota 18). Several studies have shown worker misclassification to be especially prominent in the construction sector. Misclassification in the construction industry has been found to be more common than other industries because of competitiveness, mobility of employers and the workforce, the temporary nature of the work and the multiple layers of contractors and subcontractors (Tennessee Employee Misclassification). A 1996 report by the General Accounting Office noted that while the percentage of misclassified workers in all industries was 15 percent, the percentage of misclassified workers in the construction sector was 20 percent (Kelsay and Sturgeon 2010).

Additionally, studies to determine the extent of worker misclassification have been conducted in Maine, Massachusetts, Minnesota and New York. These studies found higher rates of

misclassification in the construction industry when compared to the workforce as a whole (“Independent Contractor Misclassification” 4).

Misclassification is widely considered to be on the rise nationwide. The Maine Department of Labor, through a review of unemployment audits, found that misclassification of employees occurred in 29% of employers audited across all industries in 2004. That figure rose to 39% in 2005 and 43% in 2006 and 41% in 2007. The study also noted that the figures are consistent with evidence from across other states (Maine Task Force 11). Summary data reported to the U.S. DOL by states “showed that from 2000 to 2007 the number of misclassified workers uncovered by state audits had increased from approximately 106,000 workers to over 150,000 workers... While these counts reveal an upward trend, they likely undercount the overall number of misclassified employees, since states generally audit less than two percent of employees each year” (GAO 12).

8.0 Context of the Policy Response

8.1 The “Tax Gap”

Given the extent of misclassification and its continued expansion over recent years, independent contractors have been subject to increased scrutiny at both the federal and state levels. There is growing concern about the number of misclassified employees treated as independent contractors. A national trend has emerged involving federal and state efforts to crack down on misclassification. Given the diversity of classification criteria and rules, it is not surprising to see substantial amounts of misclassification. Even a business seeking to comply with the rules may find them difficult to understand.

The IRS and more than two-dozen states have recently investigated cases to determine whether organizations are cheating the tax system by claiming that employees are contractors. Following a number of state studies illustrating the extent of misclassification and the associated economic losses, there has been a heightened interest in penalizing employee misclassification as an effort to close the tax gap. The tax gap refers to the difference between the expected amount of tax revenue and what is actually received; the IRS defines the tax gap as “the difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time. The tax gap can also be thought of as the ‘sum of non-compliance with the tax law’” (IRS “The Tax Gap” 2009). Misclassification is assumed by many to be a significant portion of this deficit, and efforts to increase compliance with proper classification are believed to present an opportunity for substantially increased revenues to the states and federal government.

For example, the Ohio attorney general has estimated that in this state alone, 92,500 workers are misclassified as contractors, costing the state up to \$35 million a year in unemployment insurance taxes, up to \$103 million in workers’ compensation premiums and up to \$223 million in income tax revenue (Greenhouse 2010). A Massachusetts study found it lost \$91 million annually in workers’ compensation premiums and \$12.6-\$35 million annual in unpaid employment taxes due to misclassification. An Illinois study found its loss to be \$53.7 million annually, and a 2007 New York study showed its tax gap to be \$500 million to \$1 billion (Maine 8). The U.S. Government Accountability Office estimated that misclassification cost the federal

government \$2.72 billion in revenue in 2006 alone (GAO 2009). However, it is important to note that most of the tax gap and lost government revenue comes from underreporting of taxes on individual income tax returns. A 2012 study on tax evasion by two professors of economics, Richard Cebula, of Jacksonville University, and Edgar L. Feige, of the University of Wisconsin, estimated that between 18-19 percent of total reportable income is not properly reported to the IRS. According to the professors, the estimated \$2 trillion of unreported income gives rise to an annual tax gap of \$450-500 billion (Cebula and Feige 17). Clearly the nearly \$3 billion in annual lost revenue to the federal government due to worker misclassification, according to the GAO, is a significant dollar figure. However, this academic report on tax evasion illustrates that reducing misclassification alone would not result in the revenue windfall many expect (Toder 2). But certainly, given recent difficult fiscal realities, many states have stepped up enforcement of independent contractor classification, including enacting stricter penalties such as disbarment from state contracts and loss of licenses to do business in a state (Greenhouse 2010).

In addition to the desire to close the tax gap and increase federal and state revenues, there is increasing pressure from unions to crack down on misclassification. Accurately classifying workers could result in greater classification of workers as employees, thereby increasing potential membership in unions. This comes as unions are facing reduced membership. We interviewed Ms. Linda H. Donahue, a Senior Extension Associate at the Cornell University School of Industrial and Labor Relations, who coauthored “The Cost of Worker Misclassification in New York State” study. She concludes that: “Unions, who have been beating this drum for a while, are primarily concerned with the effect on workers and legitimate contractors who lose work to firms that cut costs by deliberately misclassifying.”

8.2 A Federal Budgetary Priority

There has been a clear trend over the last few years toward increasing resources to uncovering and reducing misclassification. The recent sequestration, or “across the board” fiscal spending cuts, however, can impact the amount of funding allocated toward this effort.

Fiscal year 2011 through 2014 budgets are reflections of this increased scrutiny and illustrate that worker misclassification is a priority of the Obama administration. The FY-11 budget allocated \$25 million to the DOL for targeted investigations, training and enforcement. It also included a joint Labor-Treasury initiative designed to strengthen and coordinate efforts at both the federal and state level to enforce penalties and deter misclassification. This joint initiative is estimated to increase Treasury revenue by over \$7 billion over 10 years (Maine Task Force 30). The FY-12 budget proposed a DOL budget decrease of 5% from the FY-10 allocation. However, it increased investment in a number of important strategic priorities for the Obama administration, including worker misclassification. Building on the FY-11 proposal to address misclassification, the budget included \$46 million in a multi-agency initiative to combat misclassification at the federal and state levels. The plan included \$25 million in funding for state competitive grants to assist states develop their audit strategies, increase capacity for interagency data sharing, and develop education and outreach programs. These funds would also be used to create a pilot high-performance bonus incentive for states with the most effective or most improved detection and enforcement programs (U.S. “DOL FY 2012 Budget in Brief” 29). It also provided the Wage and Hour Division with \$15 million for 107 new investigators to perform targeted audits (totaling an

additional 3,250 investigations) of industries with high misclassification rates, including construction, home health care and janitorial services (U.S. DOL “FY 2012 Budget in Brief” 47). The FY-13 budget included \$14 million in funding for the Labor Department to focus on “detecting and deterring” misclassification – including \$10 million to go to States for their efforts on the issue and \$4 million to the Wage and Hour Division to add 35 new full-time investigators (U.S. DOL “FY 2013 Budget in Brief” 3, 38).

The President’s FY-14 budget makes clear the established efforts on worker misclassification will continue to be a priority to the administration in the second term. The budget includes \$14 million to combat misclassification, including \$10 million for grants to states to identify misclassification and recover unpaid taxes and \$4 million for personnel at the Wage and Hour Division to investigate misclassification (OMB 146).

With the sequester that began on March 1, 2013, the IRS and DOL each saw budget cuts. The sequester, or sequestration, is a program of “across the board” budget cuts across most categories of government spending, including defense spending. This austerity fiscal policy was enacted after the bipartisan Senate “super committee” failed to reach an agreement to reduce the federal debt. This failure triggered the sequester – a compromise made in the Budget Control Act of 2011. It cuts approximately \$600 million of funding from the IRS, resulting in furloughed, or unpaid leave, for its employees this summer. In the first of up to seven days of furlough, the IRS shut down its offices on May 24, 2013, amidst a public controversy over IRS targeting conservative groups for audits. Both could have an impact as key services are cut, diminished or moved to other priorities. Four other closings are planned through August 2013. A number of other agencies were closed as well on May 24, representing the largest closing since the government shutdowns of the 1990s. The Department of Labor is similarly impacted by the sequester, with cuts to programs and services, and furloughs planned for the summer. These cuts diminish the ability of these agencies to carry out the identification and enforcement of worker misclassification. On the other hand, the failure of Congress to agree to a deficit reduction plan, and the need for new sources of federal revenue, indicate that finding worker misclassification where it exists will remain a priority.

8.3 Union Pressure

In addition to a desire to close the tax gap, unions are exerting pressure on the federal and state governments to crack down on misclassification. Union officials are pushing Congress to pass misclassification legislation, to file lawsuits against companies accused of misclassification and to strengthen enforcement of applicable tax, employment and safety laws. Because independent contractors are excluded from the definition of employee under the National Labor Relations Act, unions are not able to organize or represent independent contractors, and employers have no obligation to bargain over their working conditions. Unions, by pushing for enforcement, hope for significant increases in employee classification – thereby increasing potential membership in unions. They are putting significant resources to work to expand their potential base, including supporting workers in lawsuits against companies.

Unions claim that many workers wrongfully classified as contractors are entitled to unionize, while businesses claim that unions are trying to exploit this blurred distinction to their advantage

in the face of declining union power and membership. From 1973 to 2007 union membership in the private sector declined from 34 percent to only 8 percent for men and 16 percent to 6 percent for women (Western and Rosenfeld 513). Businesses, facing increasing pressure from global competition, are less likely to hire union workers and seek to avoid unionization of their workers. States, too, are limiting the influence of public-sector unions in ways that were inconceivable a few decades ago.

Beginning with Wisconsin Governor Scott Walker's 2011 plan to cut the bargaining rights and benefits of public workers, a number of states have followed suit in various forms including Ohio, New Jersey, Tennessee, Indiana, Maine, Pennsylvania and many others (Cooper and Seelye). Unions, faced with increased opposition to public sector worker benefits, correctly fear that their power is diminishing. To address that issue they will continue to pursue opportunities for new members in the form of re-classified workers. While there is no guarantee that workers who are re-classified from independent contractors to employees will unionize, unions are betting on the odds that the legislation they are supporting will result in more workers classified as employees.

8.4 Impact of the Patient Protection and Affordable Care Act

One of the most commonly cited problems for independent contractors is the lack of employer-based medical coverage. Independent contractors cite the cost and availability of private insurance as a significant barrier to attaining medical coverage. In fact, "from 2005 to 2010, the number of independent contractors and other workers who aren't covered by unemployment insurance swelled by 4 million to 40 million, or 23% of the U.S. workforce, the research firm EMSI estimates" (Nadler and Barras).

With the March 2010 passage of the landmark healthcare legislation, the Patient Protection and Affordable Care Act, commonly referred to as simply the Affordable Care Act or "Obamacare," contractors will have a new, more affordable method of obtaining healthcare. Accompanying the requirement that individuals purchase health insurance (or face penalties), the law establishes the creation of state-based (or multi-state) insurance exchanges for individuals and small businesses to purchase insurance. Cutting out middlemen, the exchanges are expected to be a lower cost option than individuals purchasing insurance previously. In addition to the cost advantage, insurers can no longer deny coverage due to pre-existing conditions, opening up an option for independent contractors who were previously refused on the open market.

One potential outcome of the Affordable Care Act is that smaller employers might shift more work to contractors to avoid complying with the regulations. If employers do reclassify their workers it could send a red flag to the federal and state agencies, opening up employers to considerable risks. Under the law, employers with 50 or more full time equivalent employees are responsible for providing health insurance. Therefore, those close enough to that 50 employee threshold might be tempted to intentionally misclassify workers to circumvent these new healthcare expenses. Acknowledging this potential, a "U.S. Department of Labor spokeswoman recently said 'the ACA is going to significantly affect the way employers hire and make hiring decisions, and it definitely increases the desire to hire more independent contractors and the temptation to misclassify them'" (Joerg). Moreover, "Urban Institute scholar Gene

Steuerle speculates that many lower-wage employers will shift more work to contractors to avoid compliance problems with the bill. The employees in turn will use the exchange, potentially making the government subsidies more expensive than projected--and forcing workers to change plans” (Whelan and Wingfield).

In addition to existing penalties and fines, beginning in 2014 as a result of the new legislation, employers who misclassify may be subject to an additional penalty. “Large employers” that fail to offer health insurance to their employees are subject to an excise tax. This tax is triggered if any employee seeks insurance on an exchange and receives a subsidized benefit for that insurance - a tax credit or cost sharing reduction. And, due to the excise tax’s structure, this can be a significant penalty for misclassifying employers even if only one worker is misclassified (PricewaterhouseCoopers LLP 2). The penalty would be a “monthly excise tax equal to the number of full-time employees minus 30, times 1/12th of \$2,000, that is, \$166.77 per month for each employee (after the first 30), not just for the misclassified worker” (PricewaterhouseCoopers LLP 2). This can be considerable. The following examples illustrate the risk:

Potential Impact of “Obamacare” Example

“For all of 2014, an employer reports it has forty-five full-time employees and thirty-five independent contractors. On audit, it is determined the independent contractors are actually full-time employees and, therefore, the employer is a ‘large employer.’ If one reclassified employee receives a tax credit, the employer becomes subject to the 4980H(a) penalty because it fails to offer minimum essential coverage and has eighty full-time employees.

“For 2014, (for eighty employees) the penalty would be $(80 - 30) \times \$2,000$, or **\$100,000**. In other words, for each employee over the thirty-employee threshold, the employer owes \$2,000 ($\166.67×12 months), for a total penalty of \$100,000 ($\$2,000 \times 50$ (that is, $80 - 30$))” (Barer, Brant and Kaufman).

“This penalty could be triggered by an unsuspecting, otherwise compliant employer, if the government reclassifies one or more of its independent contractors as employees” (Barer, Brant and Kaufman).

This is particularly relevant for employers that have obtained or rely on section 530 “safe harbor” relief. “Concern arises because the relief offered by section 530 applies only to Subtitle C of the Internal Revenue Code (i.e., employment taxes) and does not protect against other taxes, including those in Subtitle D (i.e., excise taxes, including the section 4980H excise tax)” (PricewaterhouseCoopers LLP 2). Therefore, with regard to worker classification, even companies that receive relief from section 530 for employment taxes may still be subject to what can be a stiff penalty if those workers do not meet common law standards. Many companies that have been relying on “safe harbor” have not fully examined whether they meet these standards, since they’ve already determined that they meet the requirements for section 530. “Thus, it is often the case with a business that has section 530 protection that neither the business nor the IRS has analyzed fully whether its workers are properly classified under common law as employees or independent contractors” (PricewaterhouseCoopers LLP 2). Cases may arise where workers are considered independent contractors under section 530, but employees under

the common law rules, and therefore employees under the Affordable Care Act regulations and penalties. “In light of Congress' silence as to whether [the excise tax] 4980H applies to employers relying on section 530, the IRS and Treasury similarly may remain silent as to the applicability of the 4980H excise tax with respect to employers relying on section 530. Unless IRS directly addresses the issue, the lingering threat of IRS asserting the excise tax may cause businesses relying on section 530 to reconsider their position and consider reclassifying workers as employees prospectively or participating in the new IRS Voluntary Classification Settlement Program” (PricewaterhouseCoopers LLP 3). This could be a significant liability to companies relying on contractors and on section 530, putting a premium on correct determination, as only a single misclassification triggers the entire tax.

While the IRS has made clear it will use common law standards for its definition of employee, a comment period on the employer shared responsibility provisions under the Affordable Care Act that concluded on March 18, 2013 included over 100 comments from employers and various groups interested in this issue of section 530 (Olsen). Comments from business industry groups requested that the definition of “employee” be clarified to incorporate the principles of “safe harbor” and to apply generally to payroll tax withholding situations where an employer has consistently and in good faith classified workers as non-employees (Reibstein et al “Worker Classification Issues Are Raised by Affordable Care Act Proposed Regulations”). In another comment, a “University of California labor research center has urged that workers supplied through a third party staffing organization be treated as the employees of the service recipient, whereas other comments seek exclusion from the service recipient’s headcount for agency workers and a safe harbor where the worker has access to affordable minimum coverage through the agency” (Reibstein et al “Worker Classification Issues Are Raised by Affordable Care Act Proposed Regulations”). There is some concern that companies may try to use temporary employment agencies to shift employer status to a third party, thus avoiding some costs of the law.

Given the current direction of the federal government toward heightened interest in worker misclassification and increased enforcement, it seems unlikely that the final regulations will include significant relief. However, it remains to be seen, and employers should keep a close eye on this issue. Regardless of the ultimate IRS decision on definition clarification and applicability of section 530 relief, “the comments reconfirm that the resolution of worker classification issues can have significant financial consequences, and that classification strategies that may be effective for one purpose may have limited effectiveness for other purposes” (Reibstein et al “Worker Classification Issues Are Raised by Affordable Care Act Proposed Regulations”). The Affordable Care Act is a complex and complicated piece of legislation with many moving parts. How and to what extent it will truly impact independent contractors and worker misclassification remains to be seen. It will be an important issue to watch.

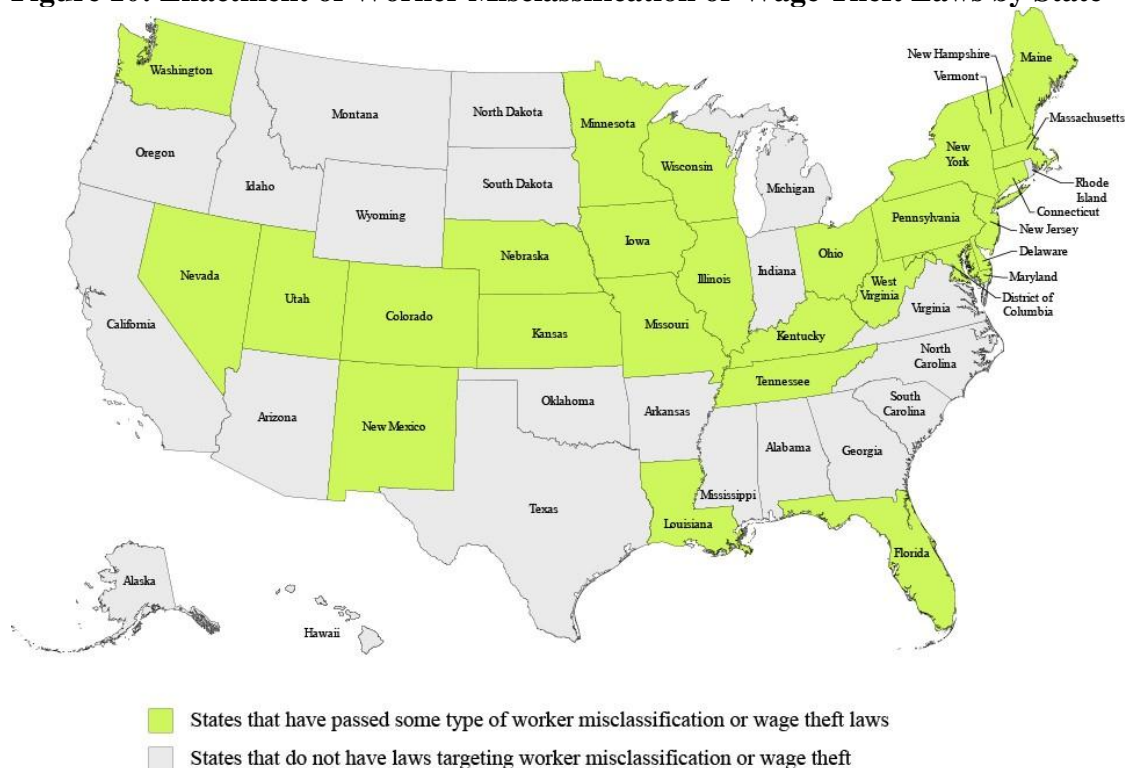
9.0 The Proposed Solutions: Regulatory and Legislative Changes

The recent efforts to address misclassification can be categorized in the following: state legislation and state task forces, federal legislation and IRS enforcement efforts. It is important to note that while the proposed and enacted legislation vary fairly widely, none have attempted to ban the use of independent contractors. Rather, they seek to reduce misclassification and clarify confusion.

9.1 State Legislation

States have been aggressive in their attempts to address worker misclassification. As of May 2013, 34 states have passed some type of legislation addressing worker misclassification or wage theft. In 2010 and 2011 alone, 11 states passed laws limiting the use of independent contractors or increasing penalties for misclassification. And in 2012 alone, 10 states enacted such legislation: Alabama, Arizona, Delaware, Louisiana, Maine, Maryland, Minnesota, New Hampshire, Rhode Island and Utah. In addition, at least 16 state legislatures considered further legislation on employee misclassification during the 2012 legislative session (“2012 Introduced and Enacted Legislation”).

Figure 10: Enactment of Worker Misclassification or Wage Theft Laws by State



While state efforts all seek the same goal - reducing illegal classification of independent contractors - their means vary widely. Some, as evidenced by recent laws enacted in New

Hampshire and Maine, attempt to prevent misclassification by merely simplifying their definition of employee. In the case of Maine, the Maine Department of Labor and Workers' Compensation Board changed their definitions to closely align with the Maine Revenue Services definition, which is already aligned with the federal IRS definition. Previously, the multiple definitions "caused confusion for businesses, some who may have been told by one agency that their independent contractors were legitimate while another cited them for worker misclassification," observed a spokeswoman for the labor department (Richardson). Now, the new standard will be the same across unemployment, wage and hour and workers' compensation laws.

Others go much farther in their attempts to combat worker misclassification. For example, recently passed laws in New Jersey, New Mexico and Massachusetts create a presumption that every worker is an employee. To utilize independent contractors, it is up to employers to prove the worker is not an employee through the various control tests. In 2009, Maryland passed such legislation, thereby putting the burden of proving the existence of an independent contractor relationship on business owners. However, in August 2012 it altered its presumption of employment to allow employers to rebut that an employer-employee relationship exists whenever a payment is made for services performed by allowing the employer to produce documents in support of an independent contractor relationship. Examples of the necessary documents include, among others: a written contract between the employer and the contractor, a certificate of good standing and a signed affidavit by the contractor that states that it is an independent contractor and is available to work for business entities other than the employer (United Business Media). A positive aspect of the Maryland Amendments is that they allow for clear guidelines for employers to ensure compliance with the law and help to resolve any alleged claims of misclassification prior to facing any potential penalties.

Additionally, these laws and many more in other states create new and increased penalties for misclassification (Randall 2). For example, in Illinois, if an employer is found to have misclassified employees, it will be subject to civil penalties and may be subject to debarment from state contracts for up to four years and could also face criminal penalties. In addition, the misclassified employee may sue for lost wages and benefits, damages and attorney fees based on the new laws classifying a worker as an employee (Randall 2). A recently enacted bill in Louisiana amends the state unemployment insurance code making the failure to properly classify a worker as an employee a violation of the law. After a warning and payment of past due contributions and existing penalties for the first negligent violation, subsequent violations result in fines up to \$250 and \$500 per individual. There is also a criminal penalty of \$100 to \$1,000, or a prison term of 30 to 90 days, or both (Tennessee Employee Misclassification).

Some states have focused their efforts on specific industries, most notably the construction industry. New York passed the New York State Construction Industry Fair Play Act in 2010, which creates a presumption of employment for the construction industry and requires employers to show that their workers meet each of three specified criteria to be considered independent contractors. Employers that willfully violate the act are subject to civil penalties of up to \$2,500 per employee for first violations and \$5,000 per employee for second violations. Additionally, employers may be subject to criminal penalties including 30 days in jail, a \$25,000 fine and debarment from state contracts for one year for first offense. These penalties increase to 60 days in jail, \$50,000 fine and debarment for five years for second offenses (New York State

Department of Labor). In addition, the New Jersey state Senate passed legislation creating a presumption of employment in the drayage trucking or parcel delivery trucking industries, unless the party receiving the services can overcome the legal presumption of employment. While not yet signed into law, the bill includes stiff criminal and administrative penalties for businesses that misclassify truckers and would allow drivers who think they have been misclassified to sue for damages. It would also allow labor organizations to bring class action lawsuits on behalf of workers over alleged violations (Bricketto).

In some cases, laws prohibit only “willful” misclassification, such as California’s Senate Bill 459, enacted in October 2011. The law, which carries heavy financial penalties, defines willful misclassification as “avoiding employee status for an individual by voluntarily and knowingly misclassifying that individual as an independent contract.” It also imposes joint liability on any consultant or other advisor who knowingly advises a client to misclassify a worker as an independent contractor to avoid employee status. Interpretation of what can be considered “knowingly” will likely be cause for considerable dispute. (Reibstein et al “California Joins Growing Number of States”).

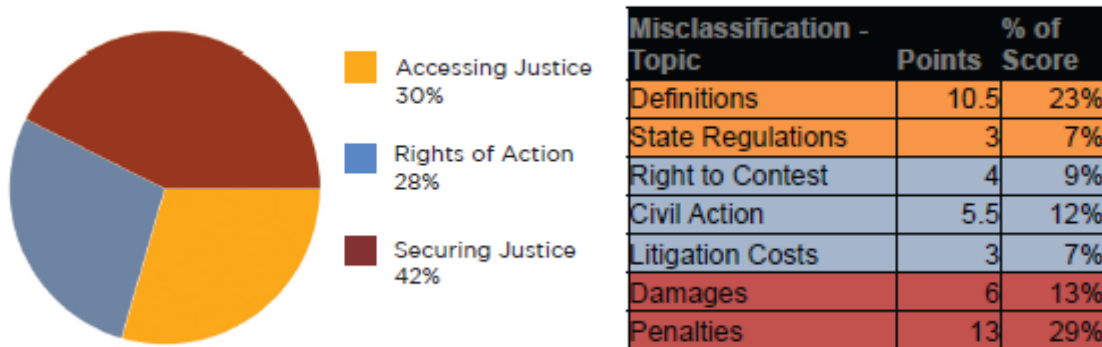
In addition to the states noted above, many other states have introduced misclassification legislation. Many of these bills died in their respective legislatures, while still others are pending. States that continue to work on passing misclassification laws include Nevada, North Carolina, Oregon and Virginia.

In June 2012, the Progressive States Network released a report that evaluated states on their efforts to address worker misclassification. Here, they looked not just at whether the state had some type of statute addressing the issue, but their ability to administer labor standards and enforce penalties. They measured and ranked states’ legislation on the following:

- “What industries and workers are covered by the law.
- Their definitions of employment and independent contractor.
- Whether workers are permitted to file claims.
- Whether workers can recover damages.
- The extent of penalties for violations.” (Judson & Francisco-McGuire 18.)

Points were allocated to states based on three areas: “Accessing Justice, Rights of Action, and Securing Justice.”

Figure 11: Misclassification Criteria for Progressive States Network Ranking



(Judson & Francisco-McGuire 18)

Their research found that most states still have little to no enforcement of misclassification:

- “18 states and the District of Columbia scored no points.
- 11 states have some provisions related to misclassification, but no recourse for workers.
- 11 states only permit workers to report claims to the state agency.
- 9 of the 21 states where workers can file reports or claims limit this protection to specific industries.” (Judson & Francisco-McGuire 18.)

The “best” and “worst” states from their analysis are indicated below:

Figure 12: Progressive States Network Worker Misclassification Grades (Best/Worse)



(Judson & Francisco-McGuire 17)

9.2 State Task Forces

In addition to increased legislative activity at the state level, there has also been increased enforcement effort, most notably through statewide task forces. As of May 2013, 25 states have formed task forces by legislation, executive orders, or administrative action. These states include California, Connecticut, Florida, Hawaii, Iowa, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oklahoma, Oregon, Rhode Island, Tennessee, Utah, Vermont, Washington, Louisiana, West Virginia and Wisconsin (Tennessee Employee Misclassification). Other states, such as Virginia, have proposed bills to create employee misclassification task forces that have yet to pass. These task forces focus on a variety of goals including, but not limited to, researching the extent of misclassification and the level of revenue loss, understanding the impact on worker protections, examining misclassification across different industries, enhancing enforcement, improving outreach and education and improving cooperation, coordination and data sharing between departments. In many cases it was a task force recommendation that led state legislatures to enact misclassification laws.

Task forces differ among states in their level of authority and ability to coordinate with state agencies and offices, in part due to the method of their formation. While some are charged with research and making recommendations, other task forces are able to perform enforcement in addition to study work. Listed below are a few sample outcomes achieved by state task forces.

New York

New York's Joint Enforcement Task Force on Employee Misclassification (JETF) has been one of most aggressive task forces since its formation by executive order in 2007. From September 2007 through December 2010, the JETF identified 50,000 misclassified workers, discovered \$704 million in unreported wages and assessed \$42 million in unpaid wages, unemployment insurance contributions and workers compensation penalties. In 2011, the JETF found 19,600 misclassified workers, uncovered \$412 million in unreported wages and assessed over 14.5 million in unemployment insurance taxes (Tennessee Employee Misclassification).

Florida

Florida's Workers' Compensation Fraud Task Force was created jointly by the Florida Department of Financial Services' Division of Insurance Fraud and the Broward Sheriff's Office. As part of Operation Dirty Money, a task force investigation of fraudulent transactions in the construction industry, the task force uncovered numerous companies alleged to have used shell companies and check cashing stores to hide payrolls as part of a scheme used by construction employers to avoid workers' compensation premiums. So far, the task force has shut down twelve shell companies and identified over \$140 million in fraudulent transactions (Office of Chief Financial Officer Jeff Atwater).

Iowa

While some state task forces only cover one or a selected number of industries, such as transportation or financial services, Iowa's task force covers all industries. From July 2009 through December 2011, the task force found that 307 employers had misclassified 3,522 workers and \$75.6 million in unreported wages. It also identified \$2.8 million in unpaid insurance contributions and assessed \$980,000 in penalties and interest. The Iowa task force

found that construction employers were the most non-compliant, accounting for 57% of all misclassified employees (Tennessee Employee Misclassification).

9.3 Federal Legislation

Federal legislation addressing this issue has been introduced in nearly every session of Congress over the past five years. The goals of the proposed legislation are twofold: to increase revenue and to “level the playing field” for all businesses. In the difficult economic climate of the past five years, it is seen as even more important for businesses to get a “fair shot.” Businesses that properly classify their workers are at a competitive disadvantage to those that do not. The claim inherent in this argument is that in such a competitive market, where companies compete not only nationally, but internationally, every competitive edge counts, and perhaps losing the economic battle of worker misclassification can mean the difference between staying in business and going out of business. There is yet to be specific evidence showing that cracking down on misclassification results in a more “level playing field” or that a business has ever put its competition out of business simply due to misclassifying its workers.

However, despite continued efforts in the Senate and House, and broad support from the Obama administration, these bills continue to fail, dying in committee before being brought to a vote. The proposed bills consistently attempt to address misclassification in two ways: amending tax law and amending labor law. In the case of the former, the bills seek to amend or eliminate Section 530 of the Revenue Act of 1978, or the “safe harbor” rules. Proponents of these bills claim that safe harbor is a tax loophole that allows businesses to misclassify employees. In the second case, the bills would amend the FLSA, which establishes worker protections including minimum wage, overtime pay and recordkeeping and employment standards.

In 2007, then-Senator Barack Obama introduced the “Independent Contractor Proper Classification Act.” In an effort to ensure workers are treated correctly, this bill sought to amend Section 530 by eliminating certain justifications for classifying workers. It also called for increased recordkeeping requirements and an increased role for the Secretaries of Treasury and Labor (US Congress).

In 2009, the “Taxpayer Responsibility, Accountability and Consistency Act” was introduced into the Senate and House. This bill was designed to seriously limit safe harbor by restricting an employer’s means for establishing reasonable basis in determining worker’s status. To receive safe harbor under the Act would require a written determination from the Department of the Treasury or the IRS that the worker was not an employee. Furthermore, it would allow IRS greater ability to reclassify workers, increase penalties for failure to properly classify workers, require annual reports on misclassification by the Treasury, and enable individuals to petition the IRS to review their classification (Charnas).

In 2010, the “Fair Playing Field Act of 2010” and the “Employee Misclassification Prevention Act” bills were introduced. The Fair Playing Field Act set out to eliminate Section 530 of the Revenue Code and instead add a new section to the Revenue Code with a much narrower safe harbor. Under the narrower rules, business would not be able to use specific court cases, IRS rulings, industry practice or “other reasonable basis” to establish safe harbor. Moreover, this new

rule would place the burden of proof on the employer to satisfy safe harbor requirements. Additionally, it would require businesses that pay any amount greater than \$600 per year to corporate providers of services or property to file a Form-1099 and would significantly increase penalties for failing to file the Form-1099 (Charnas and Garner). Finally, it would lift a moratorium on IRS issuing guidance in the form of regulations and rulings on worker classification (Reibstein “Congressional Approach to Misclassification Would Confuse Rather than Clarify”).

The proposed Employee Misclassification Prevention Act attempted to amend FLSA by adding recordkeeping and other requirements. It would have made misclassification a new labor law offense, making it against the law for the first time. The bill required employers to provide written notice to workers on their classification, directing employees to the DOL website, as well as to create and keep records on hours worked and compensation for independent contractors, and increased penalties for up to \$5,000 per employee for repeated violations. It permits the Wage and Hour Division (WHD) of the DOL to report misclassification to the IRS and directs WHD to conduct targeted audits of specific industries (Reibstein “Congressional Approach to Misclassification Would Confuse Rather than Clarify”).

In 2011, the “Payroll Fraud Prevention Act” was introduced as a trimmed-down version of the “Employee Misclassification Prevent Act,” which was also reintroduced in full at the end of 2011. Following the lead of successful state laws that label wage violations as payroll theft or payroll fraud, Congress attempts to characterize misclassification as payroll fraud in this newest version of misclassification legislation. The bill takes a new turn and seeks to expand the FLSA to cover misclassification and create a new type of worker – “a non-employee.” “Non-employee” workers provide services through a corporation or LLC if they are required to create or maintain such entities as “a condition for the provision of such labor or services” (Reibstein “Independent Contractor Misclassification Ruling in Favor of FedEx Ground”). These “non-employees” would be covered under FLSA even if they were properly classified as independent contractors. The law would include notice requirements supported by fines and penalties for all business, whether or not they use independent contractors. It would require employers to notify workers of their status, direct them to the DOL website with information on employee rights, direct the Treasury Secretary to create a misclassification website, direct DOL to conduct targeted audits and authorize the DOL to report misclassification to the IRS. It would not however, require the extensive recordkeeping requirements proposed in the Employee Misclassification Prevention Act (Reibstein “Independent Contractor Misclassification Ruling in Favor of FedEx Ground”). Both the “Payroll Fraud Prevention Act” and the “Employee Misclassification Prevent Act” failed to pass.

In early 2012, the “Fair Playing Field Act” was reintroduced, making it the second time in only 18 months that Congress introduced a bill intended to eliminate the “safe harbor” provisions. Again, the bill failed. In December 2012, Republican Congressman, Erik Paulsen of Minnesota proposed a new bill – the “Independent Contractor Tax Fairness and Simplification Act.” The bill also died after being referred to committee. While it is similar to the “Fair Playing Field Act” in that it would eliminate “safe harbor” provisions, there are some important distinctions between past efforts. One interesting difference is that the “Fair Playing Field Act” would have required “the Secretary of the Treasury to issue regulations or other prospective guidance

clarifying the employment status of individuals for federal employment tax purposes. H.R. 6653 (Independent Contractor Tax Fairness and Simplification Act), on the other hand, specifically prohibits the issuance of new regulations or Revenue Rulings by the Department of the Treasury with respect to the employment status of any individual for employment tax purposes” (Reibstein et al “New Misclassification Bill Introduced in Congress”). It is interesting, though unsurprising, that the role of the Treasury is opposite for the Republican-proposed bill as compared to the Democrat-supported one. In another difference, the new Republican bill, “H.R. 6653 (unlike the Democrats’ bill) would codify a new form of ‘safe harbor’ if the worker meets all four of the following factors:

- a. Incurs significant financial responsibility for providing and maintaining equipment and facilities;
- b. Incurs unreimbursed expenses or risks income fluctuations because remuneration is ‘directly related to sales or other output rather than solely to the number of hours actually worked or expenses incurred;’
- c. Is compensated on such factors as percentage of revenue or scheduled rates and not solely on the basis of hours or time expended; and
- d. ‘Substantially controls the means and manner of performing the services’ in conformity with regulatory requirements, or ‘the specifications of the service recipient or payor and any additional requirements’ in the parties’ written IC agreement” (Reibstein et al “New Misclassification Bill Introduced in Congress”).

While none of these bills have become law, members of Congress continue to introduce and reintroduce legislation dealing with misclassification despite their lack of success to date. We see no indication that these efforts will cease.

9.4 Enhanced IRS Enforcement: Employment Tax National Research Project

In 2010, the IRS began the Employment Tax National Research Project, in which they will audit a total of 6,000 companies over three years (2,000 per year) in an effort to gather statistical information to determine the overall compliance with independent contractor classification laws, to evaluate taxpayer compliance failures in the context of employment taxes and to determine how to best address the employment tax gap (Hoenig et al 2).

This, in conjunction with the Joint Misclassification Initiative, as well as the recent MOUs with the DOL and various states further reflects the increased federal priority to reduce misclassification.

Part II: Analysis

1.0 Why Should Businesses be Concerned about Misclassification?

The increased enforcement of misclassification affects all businesses – firms that utilize contractors through appropriate classification, businesses that utilize workers improperly and the contractors themselves.

For the misclassifying business, employers are putting themselves at risk of being exposed to increasing consequences the longer they misclassify. If it is determined that an employer's independent contractors should have been classified as employees, the employer may experience major financial consequences, including penalties, higher tax assessments and periodic audits. Possible employee benefit plan disqualification by the IRS and payment of retroactive benefits to participants can also be imposed (Keselenko). In addition, one audit by the federal or state government generally triggers action by the other, further burdening an employer (Perry 70).

Major problems frequently develop as a result of a departed worker “blowing the whistle” on a company's classification practices. “People who report wrong classifications can get up to 33% of what is recovered,” according to Dr. Edward E. Hernandez, Associate Professor of Management at California State University in Stockton, California. Such large financial incentives serve to motivate whistle-blowing (Perry 70). It is important to keep in mind that “all worker status disputes can be protracted and expensive, and they can involve bet-the-company stakes” (Wood 46).

In addition to direct litigation from misclassified workers, companies are at risk of random audits from the state and federal government. As a result of the increased scrutiny by Congress and the IRS to perceived worker misclassification abuses, employers should expect both increased penalties in the event of an audit and fewer opportunities for mitigating adjustments through settlements (Bonano 1). However, even those companies who take steps and precautions to appropriately classify their workers should be concerned as the focus on misclassification can cause increased scrutiny on their business.

Even businesses that are properly classifying workers should be concerned with the heightened scrutiny. If a worker initiates a claim or files a lawsuit, the resulting resources poured into an audit or legal battle could be devastating, particularly to small businesses. It can mean the difference between solvency and bankruptcy.

The heightened government interest in misclassification requires businesses that utilize contractors to focus attention on this issue. The growing confusion and conflicts across agencies make it difficult to know what the rules are and can cause complications to one's business. The conflicting tests that allow a worker to be an employee one day and an independent contractor the next are inadequate in the complicated employment marketplace and global economy. In many cases, the workers can legitimately exhibit some characteristics of employees but also

characteristics of independent contractors. In ambiguous cases like this, businesses are in a difficult position and make a judgment based on their business model and an assessment of costs, benefits and risks. Businesses cannot conduct proper long-term planning without a reliable and consistent definition of contractors. The make or buy decision, so central to business strategy in an increasingly outsourced global economy, is highly constrained by this extreme degree of regulatory uncertainty.

2.0 Situational Analysis

The application of independent contractor law must always be made on a case-by-case basis. While the principles of each law and the mission of the agency enforcing them can be used as a guide, determining independent contractor status requires an assessment of a large number of variables unique to each case. Regional disparities must always be considered due to the inconsistency of state laws and become important when businesses use independent contractors in multiple states or on a national level. Likewise, the size of a business will draw either more or less attention to their activities, as can the type of industry itself.

The following is a situational analysis of five hypothetical independent contractors and the *likely* ruling on their status given each law – whether they are likely to meet the requirements of the factor tests or are not likely to meet those requirements. The industries vary across five of the most common as well as controversial use of independent contractors: couriers, construction workers, home caregivers, cleaners and accountants. Each business type varies in size, reflecting both their need to comply with multiple state laws, as well as the resources they can access for legal and tax advice.

Each of these hypothetical situations has received a ruling for state and federal laws, ABC and Common Law tests for state law, and the IRS and DOL tests for federal laws. Due to both the varying, as well as overlapping, themes between these four laws, assumptions regarding their interpretation had to be made for this analysis. We assume that an IRS judgment will focus on direction and control as the most important factor, while the DOL will focus on the ability to make a profit or loss. The ABC test is broken down by each of its three parts, demonstrating the difficulty of meeting all three requirements of this law, while state common law tests maintain a focus on direction and control.

Courier

Scott is a courier for a national package delivery company. He was required to purchase and maintain his own truck, fix the company's logo on the truck and wear a company uniform. He is given daily delivery assignments along a specific route but is free to make his own delivery schedule each day. Scott's contract allows him to purchase, sell or trade delivery routes with other drivers without consulting with his employer, as well as hire his own employees. He is free to use his vehicle for other purposes, but this is difficult to do as his contract requires him to remove the company logo. Scott is paid per package he delivers on a monthly basis.

In Scott's case, he is, for the most part, free from direction and control from his employer, thus he should pass the IRS and Common Law Tests. Although he may not be taking advantage of it, his freedom to be entrepreneurial in order to increase his profits should pass the DOL tests.

However, his work is within the regular course of business of the delivery company, and he has only one employer, meaning Scott could be considered misclassified under the stricter ABC test.

Construction Worker

Joe is a construction worker hired to be a foreman on a construction site. He is assigned what tasks to complete and given a timeline to complete them, but he is free to manage the laborers working under him in the manner he sees fit. Joe is required to provide his own general use tools and equipment, although specialty equipment is provided by the company at the construction site. He is required to be on the construction site during active hours and is paid an hourly wage for the time he is on site. He does not receive an overtime pay rate, and if his project falls behind schedule he will be required to work overtime to get the project back on track.

Although Joe may be free from direction and control in the way he manages his work, the control his employer has over his hours and scheduling may make him more an employee than an independent contractor. Similarly, because he is required to work full time in a schedule determined by his employer, he does not have the chance to make a further profit by expanding his services to other construction sites. Because of this employer control, it is likely that Joe is a misclassified independent contractor according to all state and federal laws.

Home Caregiver

Zach is an in-home caregiver. He is employed by two local hospitals, and he visits patients in their home to provide general care to homebound patients recovering from surgery or other major procedures. Zach is assigned patients by the hospitals, but he schedules his home visits independently. He is not required to wear any identification representing the hospitals for which he works. He also received training independently, purchases his own supplies and he is responsible for his own transportation. Additionally, Zach is paid per the amount of visits and types of services he provides each month.

Although Zach fails the B test in an ABC test, he would be legally considered an independent contractor in any common law states and in the eyes of the IRS and DOL. This is due to his freedom of direction and control, and also his ability to increase his profits by working for more than one hospital. This example demonstrates the difficulty of meeting all three aspects of the ABC rule, even when all other tests show proper independent contractor classification.

Cleaning Service

Mary and Patrick provide cleaning services for the local offices of a law firm. They purchase their own cleaning supplies and clean the office facilities after the firm's regular business hours. They are paid a flat monthly rate and work exclusively for one law office, although they could enter into work with another office without consulting with their current employer.

Mary and Patrick are free from control of their employer, and they perform services well outside their employer's normal course of business but, because they work for only one employer, there still may be misclassification issues. They fail the C aspect of the ABC test. Even though they have the ability to expand their business, the DOL may still consider them too economically

dependent on the single law firm to make additional profit elsewhere. Therefore, they would likely be treated as full employees.

Accountant

Susan runs her own private accounting service, and she is contracted to take on the extra work of a national accounting company during tax season. She works out of her own personal office and charges the company a flat rate per the volume of work she completes. Susan continues to provide services for her regular clients, and she takes on the additional work for the company at her discretion.

Susan passes the majority of the independent contractor tests, as she has established her own business and is free from direction and control of her new client. Still, her employment with another accounting firm fails the B part of the ABC test, as she provides services within their normal course of business. This example again demonstrates the strength of the ABC test and the need to take caution when using independent contractors in those states that administer it.

Figure 13: Situational Analysis for Hypothetical Companies

		STATE TESTS – Likely Ruling				FEDERAL TESTS – Likely Ruling	
		A	B	C	Common Law	IRS (Direction and Control)	DOL (Economic Reality/ Profit and Loss)
INDUSTRY	Courier	Meet	May Not Meet		Meet	Meet	Meet
	Construction Worker	May Not Meet			May Not Meet	May Not Meet	May Not Meet
	Home Caregiver	Meet	May Not Meet	Meet	Meet	Meet	Meet
	Cleaners	Meet		May Not Meet	Meet	Meet	May Not Meet
	Accountant	Meet	May Not Meet	Meet	Meet	Meet	Meet

What is a company to do? Businesses need worker and financial stability. Businesses who operate in more than one state must determine which tests they should follow, and, ultimately, they may need to follow the most stringent control test. In the end, they may be forced to abide

by the most stringent definition or court ruling to avoid penalties and lawsuits. For companies who are unwilling or unable to change the level of control, this can mean a choice between having to willingly misclassify, and accept the risk of audit and litigation, or re-classify contractors to employees, potentially resulting in an overall reduction in employment. If that is the case, then we will increasingly see both fewer independent contractors, and perhaps fewer employees, as businesses (particularly smaller businesses) opt not to hire at all if their only available option is hiring a full employee. Moreover, smaller businesses may not have the resources to adequately research and analyze the tests that are applicable to them, giving a competitive advantage to larger businesses with greater resources.

3.0 Policy Analysis

The preceding analysis demonstrates how ambiguous employee/contractor situations can be and the difficult dilemma facing businesses. A national solution is likely needed to resolve this problem, and while many policy options have been proposed at the state and federal levels, the majority of these measures seek first to uncover and penalize misclassification. Where efforts to clarify this confusion on contracting exist, they typically are secondary measures and ultimately result in increased classification of employee status. Most reform efforts to date have increased rather than reduced the legal complexity defining independent contractor status. The following section analyzes the current and proposed policy actions that have been suggested to alleviate instances of abuse and misclassification.

3.1 Analysis of Proposed Federal Legislation

The proposed federal bills consistently attempt to address misclassification in two ways: by either amending tax laws, or amending labor laws, and, sometimes, through concurrent tax and labor bills. While it might seem somewhat unnecessary to attempt to pass two bills concomitantly that address the same issue, there are some who feel that simply closing the tax loophole, or “safe harbor,” will not adequately address the misclassification problem. Closing the loophole, for instance, would not make misclassification an illegal act as some labor law amendments would do. Making misclassification a violation under federal law would strengthen federal enforcement of misclassification but may prove more difficult to get passed through Congress.

The focus on misclassification itself may be one source of the problem. By changing the definition of contractor, and making the criteria distinguishing it from employment clear and simple, it might be possible to provide worker protection, tax compliance and greater management access to independent contractors.

One problem with the current bills on the legislative agenda is that their attempt to reduce the problem of misclassification may also ultimately reduce the legitimate use of independent contracting – an outcome that the U.S. economy cannot afford now or in the future.

Changes to the Tax Code: Revisions to Section 530 “Safe Harbor”

Section 530, part of the Revenue Act of 1978, provides safe harbor in unique instances to certain taxpayers when they are audited for classifying workers as independent contractors. Various bills that have been introduced in Congress attempt to revise Section 530 in a way that would essentially narrow its definition in order to exclude a greater amount of employers from qualifying for relief. These include the Independent Contractor Proper Classification Act, the Taxpayer Responsibility, Accountability and Consistency Act, the Fair Playing Field Act and the Independent Contractor Tax Fairness and Simplification Act.

Efforts to change or eliminate parts of “safe harbor” would not radically change the independent contractor model. These bills do not attempt to give independent contractors the same rights as employees, nor do they attempt to impose new restrictions on employers. Rather, these bills simply narrow the definition of who can be classified as an independent contractor under the three “safe harbor” rules. The most contentious of the three “safe harbor” rules under IRS Section 530 states that if employers have a reasonable basis for not treating contractors as employees, then they are not beholden to the common law test. Currently, “other reasonable basis” can be viewed as an unnecessarily broad interpretation for contractor status including such open interpretations as public accountant and attorney advice or broad industry practice. It permits companies to classify workers as independent contractors even if they would be considered employees under common law or ABC standards.

The proposed revisions would eliminate some of these “other” ways for employers to classify their workers as independent contractors. Some may consider this a fair maneuver on the part of Congress, arguing that if the worker cannot pass the normal tests that would apply for a given statute then it seems reasonable that the worker should not be classified as an independent contractor. Employers could not rely on safe harbor’s “other reasonable basis” to sidestep the classification tests. Under this proposal, companies could only classify their workers as contractors if they can pass relevant tests, unclear as they may be currently. Relying on “safe harbor” puts companies at risk for legal action down the road as these rules potentially shift and courts issue different interpretations of “reasonable basis.” Legislation to amend this rule could encourage employers to either re-classify their contractors who would not pass a control test or change their contracts to reflect decreased levels of control that would allow such contractors to pass a control test.

Moreover, amending and narrowing “safe harbor” could streamline audits, making it easier for both the IRS and companies to understand what is applicable and what is not. Currently, although agents are following the rules outlined by Section 530, application of “safe harbor” can be difficult and time - and fact - intensive. Agents may have difficulty assessing the determination and may not be clear on how to apply it to a given set of facts.

Arguments persist that the three requirements of “safe harbor” are already sufficiently restrictive to prevent abuse. First, some argue that the “other reasonable basis” is weighed satisfactorily by the tax court and is not liberally granted. It was also amended in 1996 by section 1122 of the Small Business Job Protection Act, which clarified and narrowed bases for qualifying for “other reasonable basis” (Weissman 6). For example, to meet industry practice, there is a highly demanding evidentiary burden that taxpayers need to show including, among others, establishing

the existence of industry practice through a means other than personal experience (i.e. by commissioning a third-party industry survey) and specifically identifying each of the other companies that allegedly follow the industry practice. What's more, the industry practice only qualifies if it is "long standing" by existing at least 10 years and a "significant segment" of the industry, which is defined as constituting at least 25 percent of the industry (Hollrah 22-23).

In addition, the reporting requirement requires strict adherence to filing 1099s for contractors. Therefore, the companies that are granted "safe harbor" are likely compliant with tax law already for their contractors. In fact, according to the GAO, restricting "safe harbor" would be unlikely to contribute to the tax gap because the tax compliance rate for recipients of Form 1099 (independent contractors) is 97% compared to 99% for recipients of Forms W-2 (employees) (Hollrah ii). Rather, it is those who do not report 1099s ("off the books") who are the largest contributors to the tax gap – and these individuals and companies would not receive safe harbor for missing that important requirement for eligibility.

Section 530 acts as a powerful incentive for companies to comply with 1099 filings so that, in the event of an IRS audit, they will meet this reporting requirement. This can be especially important to businesses given the confusion over the various employee tests. If a company cannot be sure of its risk, though it attempts to meet the various control tests of different statutes, the knowledge that, if it follows the reporting requirement, it is more likely to receive safe harbor can be a significant measure of certainty for businesses in an uncertain world.

Ultimately, if the existing rules are sufficiently strict to prevent abuse of "safe harbor," these new amendments to narrow the definition of Section 530 may be unnecessary and only likely to scare businesses away from the contracting model out of fear of further government restriction of the model.

Outside of narrowing the "safe harbor" definition, there are other elements of recent legislation aimed at Section 530 that may contribute to alleviating the misclassification problem. Some of these items are also included in legislation that would amend labor law. First, some amendments include lifting the Section 530 moratorium on the IRS issuing guidance in the form of regulations and rulings on misclassification. According to the IRS, this moratorium prevents the IRS from examining many of the suspected cases of misclassification it identifies and acts as an impediment to its ability to educate taxpayers (GAO 2009 26). It limits their ability to examine cases because they must first verify whether the employer qualifies for Section 530.

Additionally, the IRS regularly receives inquiries for guidance on how to classify workers, but the IRS cannot provide such guidance and instead recommends they file Form SS-8, which can take additional time and resources for the business and the IRS to process (GAO 2009, 26). The SS-8 form is the "Determination of Worker Status Program" by the IRS and can take months to complete. Enabling additional guidance from the IRS would allow them more freedom to provide education to workers and employers without going through the full SS-8 for each inquiry.

Second, proposed legislation seeks to increase penalties for repeated violations. In some amendments, employers found in non-compliance would be subject to civil penalties up to \$5,000 per worker for repeat offenders. While increasing penalties across the board can be excessive, unnecessary and burdensome to businesses, increasing penalties for repeated violations may be seen as a reasonable policy option. It would provide additional resources for the government and should not impose unnecessary burdens on businesses that are unknowingly misclassifying as the increased penalties are only for repeat offenders. For those companies that are found to repeatedly misclassify, it may seem fair to impose an increased burden, because they chose to take the risk after knowing they had misclassified. It would also send a message that the government is serious and will not tolerate willful misclassification by employers who may be tempted to take the risk. However, in many cases existing penalties are not levied when misclassification is found to occur, so rather than attempt to legislate additional stricter penalties, it seems more efficient for the IRS to simply utilize the authority it already has and levy existing penalties in more cases where misclassification is found to occur.

Third, bills have proposed authorization for the IRS to conduct targeted audits to uncover misclassification as well as authorization for enhanced DOL outreach efforts and the creation of a DOL misclassification website with information on employee and contractor rights. These are significant proposals that would likely contribute to reducing misclassification. However, it may not be necessary to specifically address these efforts in legislation. Funds are being allocated specifically toward targeted investigations at the WHD of DOL. Therefore, adding these items into legislation may be redundant; however, they may have been included as measures to generate support for the bills and aid in their passage.

Finally, while the DOL and IRS have signed an MOU for enhanced cooperation, Section 6103 in the tax code protects against improper disclosure of tax data, thus limiting the IRS's ability to share tax information with federal agencies. This threatens to pose a one-way information-sharing problem (i.e. information can only go from DOL to IRS and not vice versa), which could create resentment among other agencies (GAO 38). A legislative change would allow for enhanced two-way sharing of tax information between the IRS and other agencies, provided there are appropriate privacy protections (GAO 41).

Changes to Labor Law: Amendments to the Fair Labor Standards Act

Attempts to amend the FLSA by either extending its protections to independent contractors, or creating a new class of workers, or simply imposing new recordkeeping requirements, while having the right intentions, are likely to incur significant opposition from businesses as they are likely to reduce both misclassification, the intended purpose, but also legitimate use of independent contracting, a troublesome side effect. These bills include the Employee Misclassification Prevention Act and the Payroll Fraud Prevention Act.

Many see these legislative efforts to curb misclassification as excessive and likely to hinder business operations. In the case of the Payroll Fraud Prevention Act, it would create a new class of worker, the non-employee, who would be covered under the FLSA even if the worker is *properly* classified as an independent contractor. "Non-employee" workers are those who provide services through a corporation or LLC that they are required to create or maintain as "a condition for the provision of such labor or services." This is a highly significant provision. This

new category of employee has the potential to undermine the independent contractor model. Employers and workers enter into contracts for various reasons, but if certain contractors are treated as employees under FLSA, as this would do, some of the benefits would disappear. Furthermore, there is no way of knowing whether this “non-employee”/contractor would potentially be covered under other labor and benefit statutes that historically apply to employees but not contractors. This change could set off a chain reaction that can completely change the model – potentially destroying its use in the United States.

Additionally, one may take issue with the definition of a “non-employee” in this bill. It is simply good business practice for a company to require their independent contractors to be incorporated entities or LLCs to ensure that these contractors are legitimate small businesses that will pay taxes and report appropriate income. Proponents of this provision point to a so-called “corporate veil” whereby individual workers are creating LLCs to appear like they are a business when, in fact, they are a single worker. While this may be a problem in certain instances, employers seeking to only contract with LLCs and incorporated entities can help to ensure they are not misclassifying workers. To create a specific category of worker for the very purpose of removing the benefits to these contractors seems counterproductive. Moreover, individuals are legitimately entitled to operate as independent contractors, whether they are incorporated or not, and should not be treated as an employee for the FLSA or any other statute because they are a single worker – and not small business owner with multiple workers. Given the advancing technology of production and business administration, it is increasingly possible for future small contractors to accomplish a great deal on their own or with a small staff.

Furthermore, whether it is this bill’s specific definition of “non-employee,” or some other new category of worker, the impact is likely to be the same – more confusion, less clarity and considerable changes to the independent contractor model. Creating a class of worker that falls somewhere in between a contractor and an employee seems like it would be a smart compromise, but would likely only add new levels of complexity and confusion for employers, workers, auditors and courts.

Creating a new category of worker will make it harder for workers to understand which category they fall under. It may invite new conflict as varying levels of contracting could create new situations where contractors have differing relationships over time as their status could potentially change back and forth. Moreover, if a new category is created that provides some benefits, but not all, who is to say that those workers will be satisfied with getting only those benefits? They may find that the model does not work for them anymore and decide they want the full benefits of the employee status. Or, businesses may not utilize contractors at all and outsource to larger firms or not at all.

Some bills, including the Employee Misclassification Prevention Act, would also impose strict recordkeeping and notice requirements. These are similar to the proposed “Right to Know” regulations the DOL is pursuing. They would require employers to provide written notice to all workers on their status and direct them to a DOL website for more information. While this notice requirement may require added effort by the employer, it does not seem to be an exceptionally burdensome condition. It could be done fairly easily through an office-wide memorandum for existing employees and contractors, through the initial hiring paperwork for future employees, or

with the independent contractor agreement for new contractors. It may be that only companies who know they are misclassifying will particularly oppose this rule, as it may promote a more level “playing field.”

While notice requirements seem fairly benign, the recordkeeping requirements can be seen as a significant problem. Companies would be required to keep records of hours worked and payments for independent contractors in addition to their employees, for whom these records are already required. This recordkeeping requirement can potentially be a large burden on businesses – both small and large. Others have suggested strengthening recordkeeping even more to require companies to file 1099s with the IRS on payments made to independent contractors that are incorporated. This creates a burden not only on businesses but also on the IRS who would have additional items to review during audits. These rules punish employers for utilizing independent contractors whether or not those companies have misclassified. Companies may decide that the recordkeeping requirement is not worth the effort and may not utilize the contractor at all. Moreover, unscrupulous employers who feel overburdened by the new restrictions may decide to pay these workers under the table, preventing the IRS from collecting taxes from independent contractor arrangements all together.

Analysis of Other Federal Legislative Options

In addition, other legislative solutions not included in the recent rounds of bills have been proposed. Some have suggested requiring companies to withhold taxes for certain or all independent contractors. Either would likely be detrimental to the use of independent contractors, increasing the burden on businesses and reducing the use of contractors. Some have suggested this could be limited to certain industries, such as construction; however, limiting the requirement to certain industries creates an unfair burden on those industries. Additionally, the construction industry is already having an especially difficult time in this economy. To extend a withholding requirement to all contractors and companies would significantly change the independent contractor model in the same manner that extending FLSA benefits to contractors or new categories of workers would.

These ideas, while well meaning, would not likely contribute much to solving the problem and would change the model so significantly that it would no longer be independent contracting, but something else. It would lose many of the benefits and advantages that people who contract seek.

Political Feasibility of Legislative Action

For the near-term, it appears that amendments to tax law, or legislation that attempts to address misclassification through revisions to Section 530, or “safe harbor,” have the greatest chance for passage. Because Section 530 allows employers to gain the tax benefits of utilizing an independent contractor, regardless of actual status under the common law test, some may view this as a “tax loophole.”

In the current political climate where budget deficits and government debt is part of the average American’s everyday conversations, opportunities to increase revenue are important. While Republicans pledge that they will not allow the government to increase revenue through higher taxes, closing “loopholes” in the tax code seems to generally garner bipartisan support. Additionally, although the IRS sees the opportunity to increase revenue, the current economic

climate is such that any proposed legislation whose outcome threatens to curb job creation is probably politically infeasible.

Given this current economic climate, the proposed labor amendments have provoked pushback from businesses and the public alike. This opposition is not likely to go away as contracting becomes ever more important to the U.S. economy. This is evidenced by the October 2011 House passage of a modest measure to end a never-implemented tax-withholding program that would have impacted some contractor businesses. The requirement was for the government to withhold three percent of the payments it makes to contractors, in the event that contractors overcharged for their services. The bill to repeal this new withholding requirement was part of President Obama's jobs package (Condon). The bill, while small, reflects the Obama Administration's and Congress' focus on job creation and economic recovery over enhanced enforcement of contracting requirements and revenue generation. The larger, more comprehensive attempts to crack down on misclassification and reduce the use of independent contractors are, therefore, likely to be met with substantial pushback.

Moreover, due to the recent tendency toward gridlock in Congress, most of these bills are unlikely to pass under any circumstance.

Economic Analysis of Legislative Changes

Many policy experts and analysts claim that these new rules may pose unnecessary and excessive burdens on businesses, hindering job creation and economic growth, particularly among small businesses, which remain crucial to a strong economic recovery. Policies that make it more difficult for firms to enter into contracting relationships can potentially lower overall employment levels (especially non-traditional forms) and job creation, and result in slower economic growth. This is due to the fact that many employers, if they do not have the option to contract, or that option is no longer appealing, will simply not hire anyone to do that work or service. Eisenach, in a recent economic analysis on contracting, claims that restricting independent contracting would result in reduced competition, lowering consumer choice and ultimately higher prices (Eisenach 38). By raising the cost and complexity of doing business it may also provide an additional incentive to outsource overseas whenever feasible.

There is the risk that requiring workers to be reclassified as employees would actually increase the tax gap – employers would simply take those workers “off the books” altogether. Rather than utilize contractors as employees, they will simply pay them “under the table” and not record income on either a W-2 or a 1099, reducing tax revenue. If curtailing use of independent contractors did indeed result in lowered economic growth, this could also potentially negatively impact tax revenue (Eisenach 41). If, rather than going “off the books,” the business simply decided to hire no one and either do the work themselves or utilize existing workers, then fewer people are put to work, lowering job creation and economic growth.

The current state of the economy has focused extra attention on the role of small businesses in creating economic growth. According to the U.S. Census Bureau, small businesses represent 99.7 percent of all employer firms and have generated 64 percent of new net jobs over the past 15 years. Furthermore, small business outputs make up more than half of gross domestic product and over 30 percent of all exported goods and services (McFarland, McConnell and Geary 1).

Accelerating job creation requires fostering a business environment in which entrepreneurs can easily start and expand new companies. Limiting small business options by restricting the use of independent contractors will limit their ability to grow and spur economic activity in general.

While there are elements from each of these bills that would likely improve the misclassification problem, as whole pieces of legislation they are likely to do more harm than good – restricting the use of legitimate contracting by making the option to contract far less appealing. The increased regulatory risk associated with the bills would limit companies from engaging with contractors and would limit individuals from establishing contracting businesses.

3.2 Analysis of Non-Legislative Federal Enforcement Efforts

Passing legislation at the federal level is one avenue that can be considered for curtailing employee misclassification. However, enhancing current, existing federal enforcement can also be pursued. The following analysis looks at efforts within the current federal structure to limit the extent and occurrence of misclassification.

Enhanced Coordination and Information Sharing

One option for reducing misclassification without new legislation is through enhanced cooperation between the DOL and the IRS as well as with state labor and tax agencies. In an August 2009 report by the GAO titled “Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention” the GAO recommended enhancing coordination and information sharing between and among federal and state agencies.

The GAO report surveyed stakeholder groups to gauge their support for their recommendations and found that labor groups supported this enhanced collaboration initiative and that independent contractor groups were neutral to it (GAO 36). Considering that cooperation and data sharing is a relatively non-controversial recommendation, it is not surprising that many state and federal agencies support this initiative. Because independent contractor groups signaled their neutrality to the recommendation, they are unlikely to resist actions to adapt this policy option. In addition, steps have already been taken to study the advantages and disadvantages of this option and to negotiate agreements between the various agencies to ensure coordination as well as information sharing. The development of the Memoranda of Understanding in 2011 between the DOL and IRS and with various states was one such step.

As identified in the GAO report and confirmed by our analyses, coordination and information sharing has the potential to deter intentional misclassification, increase voluntary compliance and make enforcement more efficient. Businesses that are willingly misclassifying may decide that the new risk of audit is too great with the combined resources of the agencies working together. They know that an infraction found at a state labor department, for example, could lead to an IRS audit and potentially substantial penalties. Agencies would have improved access to a wider variety of information on audits and violations of different statutes. Enhancing cooperation would enable agencies to be more consistent in formulating their policies and carrying out enforcement. While there may never be a common, single policy, enhanced cooperation may serve to provide some consistency in policies. More consistent policies can benefit companies by reducing the effort needed on their part to make sense of what is required of them.

However, a disadvantage to this approach is that it may result in a large amount of unusable data being shared between the agencies. This could put a strain on existing resources and slow down enforcement efforts. Additionally, information sharing could reduce privacy for individuals and there are some tax code restrictions on data sharing between the IRS and other agencies. These restrictions can perhaps be settled through future agreements between agencies but may require changes to the tax code. The differences in employee status definitions among the agencies may also hamper actions to fight misclassification.

Increased Resources for Enforcement Efforts

In order to effectively enforce violations arising from misclassification, many agencies have requested and continue to request additional funding. Federal and state studies commonly suggest that current levels of resources (both staff and monetary) are insufficient to provide the level of enforcement required to deal with the extent of worker misclassification among employers. These studies point to the amount of foregone revenue from misclassification as a justification to increase expenditures for enforcement. State and federal agencies see this as a necessary investment that needs to be made in order to reclaim this lost revenue. While a portion of this funding is needed to ensure that programs which are currently underfunded have the resources they need to perform their duties, most of the funding could go toward paying for new initiatives to enhance enforcement efforts.

The move to increase funding to fight misclassification was first seen in President Obama's proposed budget for fiscal year 2012. This budget included a record \$240 million for independent contractor compliance and worker misclassification enforcement initiatives. Of that amount, the DOL requested \$5 million to enforce worker protection laws. \$50 million (double the amount provided in 2011) was requested to prosecute worker misclassifications. In the budget request, the IRS asked for a nine percent increase in its budget. The WHD, OSHA, the Office of Solicitor and the Employment and Training Administration requested an additional \$46 million to fund a "multi-agency initiative" to enforce labor laws. A request of \$24.7 million was made to fund state grants that fight misclassification within the unemployment insurance program. This sum was set to fund initiatives that facilitate data sharing with the IRS and other federal and state agencies; implement targeted audit strategies; establish a cross-state agency task force to target egregious misclassification schemes by employers; and to develop education and outreach programs (Collabrus). This trend continued in subsequent budget requests, as noted earlier.

Businesses that properly classify their workers are set to benefit if they are no longer competing against businesses that undercut their pricing through the use of misclassified workers. Businesses, however, generally view this as an initiative that will lead to higher financial costs/burdens for doing business (GAO 37). More oversight from federal and state efforts would likely result in businesses being audited more frequently and result in an increase in bookkeeping requirements. Businesses may view the escalation in enforcement as a liability and be reluctant to hire workers if it puts additional burdens on them. It may act as a deterrent by dissuading startup businesses with few resources from entering the market. Extra funding has the potential to be misspent and may put a financial strain on federal and state agencies. If this is the case and the estimated benefits are not realized, this has the potential to undermine the political push for

fighting worker misclassification. An additional challenge will be to ensure that the funding stays adequate in the long run once the political attention has shifted elsewhere.

Greater Misclassification Enforcement

This policy option stems from the fact that the DOL's Wage and Hour Division (WHD) levied penalties in less than two percent (two out of 131) of investigations involving misclassification in fiscal year 2008. GAO research found that WHD's investigators did not always follow up to make sure that misclassified employers were paid back wages. In addition, the WHD would record that back wages were paid and close the investigation case even in instances where the employer did not provide documented proof. It did not generally conduct follow-up investigations to ensure that employers properly classified their workers (GAO 19-20).

In response to this situation, the GAO recommended that the "Secretary of Labor direct the WHD Administrator to increase the division's focus on misclassification of employees as independent contractors during targeted investigations" (GAO 41). The WHD responded favorably to this recommendation, stating that it would "... reexamine its training documents and field guidance to ensure that employee classification was addressed during all stages of an investigation [and]... focus on increasing compliance for workers in industries where misclassification is prevalent" (GAO 42).

The mutual agreement between the GAO and the WHD may lead to increased misclassification enforcement. By reexamining its enforcement procedures and applying appropriate fixes the WHD can maximize the amount of penalties it collects from companies that misclassify. By increasing the number of follow-ups it conducts, WHD will increase the number of workers that are properly reclassified. If the changes to its enforcement approach are successful they can serve as a model for other agencies to follow.

The success of bolstering WHD's enforcement efforts will largely come down to ensuring supply of adequate resources for its enforcement operations. If adequate resources are not available, WHD may not be able secure additional staff and funding needed to conduct investigations and follow-ups. If WHD does get the funding it needs, companies may face additional administrative burdens as more of them will be subject to follow-ups by the agency. Efficiency in penalty collection will mean that more resources will be taken away from companies that are found guilty of misclassification. However, this provision seems the most likely to impact the actual problem of misclassification without changing the model. Those companies that intentionally misclassify would be the most likely affected.

In addition, the DOL is actively pursuing the "Right to Know" rules that mirror some of the notice requirements that have been proposed in certain federal bills, such as the Employee Misclassification Prevention Act. The DOL originally considered the rules in its Regulatory Agenda in 2010, but never acted upon it. The department announced its intention to update its recordkeeping rules under FLSA to require companies that have classified a worker as an independent contractor to provide written notice to that worker on why they are classified as a contractor. It would require the employers to provide similar notice to employees on how their pay is calculated. The notices would also go to the DOL. There seems to be disagreement about the burden of this potential requirement. Some note that employers should already have some

records demonstrating the reasoning behind their worker classifications. However, others claim, “preparing the classification analysis required for each worker will impose substantial administrative costs and burdens. This requirement would be the first of its kind, and so most companies have no experience in undertaking such a task and would be starting from scratch” (Nadler and Barras).

The DOL failed to act on this intention and moved the rules proposal to the status of a “Long Term Action” which indicated that the agency is not expected to have action on the item within 12 months of the published agenda (VedderPrice 2).

However, in January 2013, the DOL published a notice in the Federal Register requesting public comments on a survey to “collect information about workers’ knowledge of employment laws and rules, as well as their experience with employee misclassification” (Federal Registrar 2477). This is the first survey effort by the DOL on misclassification. The public comment period for the proposal ended on March 13, and the WHD is setting up the survey with the planned completion date sometime in 2014. During the comment period, some interested parties expressed reservations. In one example, for instance, the Society for Human Resources Management raised concerns about the design of the survey and the methodology of its implementation, as well as the goals. “Questions throughout the survey, for instance, reflect a bias that assumes the respondent is in fact an employee, would prefer to be an employee and is better off as an employee,” SHRM’s Michael Aitken wrote.” (Icon “With Comment Period Closed, Feds Set to Move Forward with Worker Classification Survey”).

It is too early to tell what the impact of the survey results will be. They could provide the agency with valuable insights into workers’ understanding of the issue that could inform its future enforcement efforts as well as legislative priorities by Congress. However, it is notable that the survey focuses on misclassification only, not broader issues of confusion on the classification of workers and the associated myriad tests. “The Department’s focus on workers’ understanding of their classification as employees or independent contractors, to the virtual exclusion of employers’ misunderstanding of the confusing array of tests for independent contractor status under both federal and state laws, seems to be a profound misapplication of the budgeted funds for the survey” (Reibstein et al “New Federal Worker Misclassification Study”). Inclusion of these issues could provide a stronger basis for rulemaking for the DOL and the federal government in general. Without it, it seems like a missed opportunity to address the broader issue around independent contracting and employment tests.

Many view the survey as an indication that the Administration is preparing to renew and continue its efforts toward “Right to Know” rules, a seemingly high policy priority. While these efforts have failed in the past, the survey may be an effort to bolster political and public support for these changes. It certainly indicates that this will continue to be a priority for the DOL throughout the second Obama term.

In another indication of the federal government’s commitment to the issue in general, and the “Right to Know” rules more specifically, in May 2013, the Occupational Safety and Health Administration (OSHA) launched a new enforcement initiative to ensure that temporary workers receive safety training and instructions. New coding was also incorporated into its software to

track temporary workers, including those under a host employer or staffing agency. OSHA inspectors are now asked to document the name of temporary agencies and to determine the nature of the employment relationship. This new information gathering requirement could lead to enhanced investigative and enforcement activities at all levels and across all regulations (Icon “OSHA Steps Up Enforcement”).

Finally, Obama’s nominee for Labor Secretary, Thomas Perez, brought worker misclassification issues to light as head of Maryland’s Labor Department and is likely to continue these efforts on the federal level. However, as seems typical of any high level appointment, Congress dragged its feet through the confirmation process, taking roughly five months from nomination to confirmation. Support for Perez was split primarily along party lines. Despite delays and roadblocks, Perez was confirmed in the Senate in July 2013. With President Obama’s support, and the mechanisms put in place by former Secretary Solis, Perez could have a significant impact on the continued expansion of enforcement of worker misclassification. Perez would lead the DOL at a critical time in its employee misclassification initiative, as a number of the MOUs with the states are set to expire during Obama’s second term. Continuing and expanding these MOUs are critical to the DOL’s initiative. Secretary Perez is in a position to critically shape the future of U.S. policy on this issue, including the emergence of the “Right to Know” rules (Icon “Confirmation Vote for Obama’s Labor Secretary Nominee Pushed Back Again”).

Enhanced Federal Outreach and Education

This policy option calls for the enhancement of outreach and education by the DOL. The department can provide brochures, posters and pamphlets detailing the differences between an employee and a contractor. This information can be provided to businesses to distribute to their workers. While it would be up to the business whether they utilized them, if they are properly classifying their workers there should be no reason why they would not disseminate the information. The DOL could also increase its outreach efforts through an enhanced website and utilization of new media tools. The agency can also expand its efforts to include educational seminars or programs open to businesses, particularly in industries and sectors that heavily utilize contractors. These efforts serve to expand the knowledge base about advantages and disadvantages of contracting, how to set up a contract properly and what the consequences are for misclassification. It can also be included in workshops and programs that help entrepreneurs set up small businesses, as this can be a crucial issue for these businesses. By providing this information upfront, companies can set up their worker relationships properly from the start – whether they choose to hire employees or utilize independent contractors. The government should be allocating as many resources as possible to supporting small businesses and this is another example where it can show support for these entrepreneurs and small companies. However, like all government programs, additional resources will be necessary for the agency to step up these types of activities. Approval of increased resources allocated specifically for misclassification is crucial to develop these types of programs.

Main Street Sweeps Program

Supporters of enhanced enforcement of worker misclassification have called for a wider adaptation of main street sweeps, also referred to as enforcement sweeps. This type of program is modeled on the enforcement action carried out by the New York Joint Enforcement Task Force

on Employee Misclassification where investigators walk door-to-door along a retail strip inspecting for proper worker classification (NYS DOL 9).

Under the New York program, the Task Force conducted four sweeps in different parts of New York State. It visited 303 businesses and found that 40 percent of them had unemployment insurance misclassification violations, nearly 25 percent had labor standards violations and six percent were issued stop-work orders for lack of worker's compensation coverage (NYS DOL 9). Other state task forces, such as Iowa's Misclassification Task Force, have taken note of the success of NYC's street sweep efforts when making their own recommendations (IMTF 36).

The advantage of these types of investigations is that street sweep teams may uncover cases of misclassification that are missed by standard audits. They act as a deterrent for businesses that operate "under the radar" and to date have not been affected by efforts to crack down on misclassification. Street sweeps also have the potential to gather valuable data about the extent of misclassification. This data may provide new insight that will allow agencies to manage their resources more efficiently.

However, the street sweep method may single out certain industries with higher percentage of violations, such as construction, while ignoring others. This may unfairly impact some industries more than others and undermine the credibility of enforcement efforts. Unless a system is put in place that ensures an even targeting of businesses and provides oversight over the street sweep teams, an opportunity exists for corruption. Additionally, this initiative will likely have more of an effect on small "mom-and-pop" businesses than on corporate establishments that have greater legal resources.

3.3 Analysis of State Legislative and Enforcement Activities

Despite much activity at the federal level, most of the recent enforcement action focusing on worker misclassification has occurred at the state level. Academic studies and government reports have indicated that large sums of potential revenue are lost each year due to misclassification; in response, many states have made targeting it a priority. The following section contains analysis of commonly proposed items that many states have adopted or are considering adopting to combat employee misclassification.

State Task Forces Targeting Misclassification

To date, 25 states have formed task forces to address the problem of worker misclassification. These task forces serve as centralized bodies that coordinate activities related to fighting misclassification at the state level. Task forces provide three main functions: they study the extent of misclassification, conduct outreach and education, and carry out enforcement. They are largely composed of members of various state agencies that coordinate their efforts to fight misclassification.

There are many apparent advantages to having a task force, the most important being the existence of a centralized body that is responsible for and coordinates all the misclassification enforcement activities. This prevents the problem of having an uncoordinated effort by letting various agencies deal with the problem independently. Task forces also provide an efficient way

to study the extent of misclassification, conduct outreach and education, and carry out enforcement. By being composed of members of various state agencies, task forces foster participation of multiple stakeholders and facilitate coordination among them.

However, when multiple participants are involved, the challenge is to maintain a single focus and achieve consensus amongst the various groups. Certain participants in the task group may see their initiatives suppressed in an effort to satisfy the goals of the majority. When this leads to compromised policy decisions it may have adverse effects on the business community. Inadequate funding and staffing is another challenge that may result in inefficient enforcement. Additionally, data shared among the various agencies may serve to hamper enforcement efforts if the data is not useful to the receiving party and requires many resources to process.

Establishing State-level Voluntary Classification Settlement Programs

The recently enacted IRS Voluntary Classification Settlement Program (VCSP) allows companies to voluntarily comply with employment laws (re-classify) while receiving partial amnesty for past violations. However, the benefits of the program apply only to IRS liabilities, leaving companies potentially liable for state payments, such as employment contributions (Davis & Gilbert LLP), as well as open the company up to potential lawsuits by their workers. For this reason, many employers may choose not to participate in the program in order to limit their liabilities.

States have many reasons to consider the creation of a similar program. The advantages may include greater participation by companies that have misclassified their workers, greater future tax revenues from reclassification, leveling the playing field for businesses that do not misclassify and greater amount of workers receiving employment benefits. Additionally, this policy option may save states enforcement expenses that they would have incurred if they had to go after companies that would have otherwise voluntarily reclassified.

However, the disadvantages to this approach include foregone taxes and fees on past misclassifications. Companies that choose to reclassify their workers may expose themselves to additional tort liability. Businesses may also abuse the VCSP by misclassifying workers in the short run with the intention to reclassify them in the future and take advantage of the partial amnesty. Additionally, this initiative may send a wrong message to the business community by allowing misclassifying competitors, who had a competitive advantage over companies that properly classified their workers in the past, to now pay less than their share of owed taxes.

State 'Stop-Work Order' Legislation

The use of stop-work orders has been growing as a method of fighting worker misclassification in the construction industry. Its intent is to punish the violator by disrupting the employer's cash flow and current and future contractual relationships (Furman and Kimbel 10). State agencies apply the stop-work order after they make the determination of worker misclassification by a construction company. The stop-work order is only released after the responsible agency has determined that the employer has come into compliance. States that are using stop-work order enforcement include Massachusetts, Florida, New York, Washington, Maine, Wisconsin, Connecticut and Pennsylvania. In many instances the states are being asked by union leaders to implement stop-work orders on projects that use misclassified workers (NFIB).

Adopting stop-work order provisions will give states more power in misclassification enforcement and provide added power to unions. As the construction industry is one of the greatest offenders, stop-work orders can provide an opportunity to ensure compliance. A contractor that misclassifies will have greater incentive to reclassify its workers, pay penalties and pay back owed taxes if its revenue streams are cut off.

Disadvantages of this approach include the economic damage from the disruption of construction projects and increased liability for companies that use subcontractors with misclassified workers. It may also seem as an excessive punishment for companies misclassifying unintentionally, and may need some time to recover the funds necessary to pay the penalties. By cutting off revenue, it may make it very difficult or near impossible for a business to pay those penalties, lengthening the stop-order restriction and delaying work further. Stop-work orders may have a greater economic effect on smaller contractors giving larger competitors an unfair advantage. The damage may be too great and force some businesses to shut down. Companies may also choose to increase their service fees to hedge themselves from potential disruption to operation, be it from their own misclassification of workers or potentially another contractor's on the project. The stop-work order power can also be abused if it is applied on the basis of political reasons or favoritism. It may prove politically unpopular if disruptions caused by stop-work orders result in project delays.

State Legislation that Withholds Payment

Delaware and Maryland have passed laws that allow state agencies to withhold payment from employers engaged in contracts with a public body that misclassify their workers. These payments are withheld "... in the amount sufficient to pay back wages, benefits, taxes or other necessary contributions to the affected workers" (Fan). Largely targeting construction and landscaping companies, these laws seek to create an additional deterrent to worker misclassification (Schrier and Rubinstein).

Efforts to withhold payment may provide an effective method to ensure that public money does not go into the hands of companies that misclassify. The deterrent provided by this method may motivate contractors that rely on public contracts to reclassify their misclassified workers. Using it, state agencies can ensure that the companies they hire do not violate the same employment laws that they themselves are trying to uphold. It can serve as a symbol of a state's dedication to fighting misclassification.

However, similar to stop-work efforts, a withhold payment policy may disrupt the cash flow of a company that misclassifies and can adversely impact the company's ability to pay off owed contributions. It may also act as a deterrent for companies from entering into public contracts because of the extra risk that it poses. The number of bidders for public contracts may be reduced if companies choose not to expose themselves to the added liability. This may result in less competition for contracts and lead to higher construction project costs. The fairness of this initiative may be challenged if certain contractors are perceived as being targeted more than others and if small contractors are put at a greater disadvantage than larger entities.

Linking Penalties to Repeated Misclassification

Responsible employers may unknowingly misclassify workers due to confusing and inconsistent standards. It is entirely possible for reasonable people to differ when interpreting and weighing varying factors for classification. However, other employers are intentionally misclassifying workers, assuming the risk of incurring penalties, as a strategy to avoid wage-related tax provisions and limit their liability.

State legislators in California, Colorado, Connecticut, Massachusetts, Maryland, Illinois, Louisiana and New Hampshire have enacted legislation to impose harsher penalties on employers who repeatedly misclassify their workers. Legislators from these states believe a penalty linked specifically to employers who repeatedly misclassify their workers serves to underscore the seriousness of the offense. This sort of legislation stems from the assumption that, while misclassification can result from misunderstanding, repeated misclassification is the result of intentional action and should therefore be considered an independent offense.

However, opponents believe such legislation, while well meaning, is unnecessary. States typically have existing penalties in place (which they contend can be strengthened if need be) that can be used to penalize employers who misclassify. In many states, these penalties are rarely imposed due to resource limitations for conducting audits, collecting evidence and responding to the likely challenges of such decisions. In the states that have passed more severe penalties, oftentimes the standards for what constitutes repeated or “willful” misclassification are left undeveloped. This lack of certainty creates another layer of complexity and confusion.

Rather than address the issue of misclassification with an additional regulatory, enforcement and review scheme, state efforts could more judiciously be spent encouraging all relevant state agencies to address misclassification in a coordinated approach. Even if such legislation is passed, opponents note, the issue of confusion over the multiple state definitions and factor tests remains. When considering the current funding realities of states, resources may be better spent improving the ability of businesses to make accurate decisions regarding the classifications of their workers.

State-Led Targeted Misclassification Audits

The purpose of performing targeted, or non-random, audits is to search for incidents of worker misclassification where a high degree of misclassification is likely to be observed. In most states, an employer can reasonably expect a low likelihood of being audited. For this reason, there have been calls for an increased effort to uncover cases of misclassification with more precision. If the conduct of an employer suggests potential issues with worker misclassification, particularly in an industry where the practice is believed to be widespread, then targeted audits may serve as a powerful deterrent against intentional misclassification. Examples of actions by employers that might suggest issues with worker misclassification include delinquent filings, late registration and past violations of state law (especially with respect to employee misclassification). The 2000 Planmatics study encouraged states to maintain additional audit selection criteria that may reflect noncompliance, such as the type of industry, high employee turnover and prior reporting history (Kelsay and Sturgeon 22).

A concern over the increased use of targeted audits is the ability to ensure a level of fairness and true justification for the performance of an audit. Such procedures are intrusive, and they require a great deal of time and effort for the business under examination. Additionally, audits can disturb the productivity of a business, heighten stress levels and create a cloud of concern for workers. Certainly, requirements would need to be set in place that would ensure targeted audits follow appropriate investigative procedures. In addition, a remedy would need to be made available for employers who are intentionally targeted for frivolous, harassing, or retaliatory reasons. Given these protections, engaging in targeted audits could potentially help to allocate department resources more efficiently and identify more cases of misclassification than would be discovered through random audits alone.

“Presumptive Employee Status” State Legislation

Recently, some states have passed laws creating a strong presumption that a worker is an employee rather than an independent contractor. For some states, this presumption extends to “individuals performing any service,” while in others it only covers workers in the construction industry. These states generally have a test, such as the “ABC test,” with factors that must be satisfied in order for an individual to be classified something other than an employee.

A presumptive employee status for workers would likely make it more difficult for unscrupulous employers to misclassify employees as independent contractors to avoid state payment obligations. Supporters of the new system also contend that the traditional system too easily allows employers to evade federal and state anti-discrimination laws. In addition, the ABC test is simpler than the IRS or the common law test, as it has only three factors, making it easier to decipher for employers. Supporters believe such legislation would be an easily administered “fix” for problems of employee misclassification.

While creating a presumptive employee status would reduce classification uncertainty by clarifying the determination process, opponents feel such a legislative action would produce too many undesirable outcomes. Workers who are employees under state ABC tests may be independent contractors under federal statutes. This situation creates confusion for both employers and workers. In addition, a presumptive employee status makes it more difficult for employers to enter into non-traditional working arrangements with workers. Some employers, if faced with the choice to either hire an individual protected by all the rights of an employee or not hiring anyone one at all, may decide to not to hire anyone, which would negatively affect both the state’s overall unemployment rate and its total output level.

4.0 Management Analysis

We believe that it is every business’s decision to determine what employment model is best for them. In the conclusion to this report, we provide recommendations and best practices for businesses that opt to engage with contractors. The following section analyzes what companies can do if they are found to have misclassified as well as how to avoid an audit in the first place.

4.1 Employer Options for Handling Worker Misclassification

This section provides an analysis of options available for employers who have determined, through self-evaluation, or through an external audit, that they have misclassified their workers. It is important to emphasize that every situation is unique; thus, there are multiple solutions to misclassification cases. However, by following a number of best practices and understanding the available reclassification options, a business can achieve the best possible outcome.

One potential, yet risky, option is to simply do nothing. So long as a business's contractors are content or indifferent with their misclassification, and its own assessments have determined a low risk of an audit, drawing more attention to the issue is unnecessary. While some businesses may take this option, knowingly carrying on in violation of the law is never advisable.

IRS SS-8 Determination of Worker Status

With the increased national focus on the misclassification issue, we assume that most businesses will seek to avoid misclassification. While businesses certainly may determine for themselves if they have misclassified through their own interpretation of the various laws, there is the option to participate in the IRS Form SS-8: Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding. The form, which is free, may be submitted by either an employer or worker, and uses the IRS Behavior Control, Financial Control and Type of Relationship tests to determine employee or independent contractor status. This takes the decision making out of the hands of the business and can be a good option for businesses confident in the legality of their independent contractor business model; with an SS-8 ruling in the business's favor, they are more secure against individual claims and lawsuits and will be in good standing with the IRS for tax collection purposes. However, filing Form SS-8 would not be a wise option for businesses uncertain or at risk of misclassification. Therefore, businesses should be cautious when considering this option. A ruling against the business will only create a body of evidence that can be used against it during an audit or by workers claiming misclassification (Dold and Pivec).

In practice, however, most SS-8 forms submitted are by workers – close to 90 percent – and most forms produce an IRS ruling that the worker is an employee. For fiscal year 2008, in 72 percent of all Form SS-8 requests received, the IRS ruled that the workers were employees. Twenty-five percent of the forms were closed without any ruling, and in only three percent did the IRS rule that the workers were independent contractors (Wood “Miranda-Like Warnings To Independent Contractors?”). While this may appear that the IRS favors a ruling that will lead to withholding and employment tax, the results may also reflect the bias of the submitters, who are likely workers who have already self-assessed that they should be employees.

IRS Tax Relief

Assuming misclassification is certain, the IRS offers tax relief options for qualifying businesses. The IRS Section 530 “safe harbor” rule exempts qualifying businesses from federal employment tax obligations if they meet the necessary requirements (reasonable basis, substantive consistency, reporting consistency). Businesses under IRS investigation or audit can take advantage of this rule, receiving full tax relief, given they can show evidence of their qualification. Qualifying will also require that the business has been keeping consistent practices

and tax reporting throughout its operation. Thus a business may not alter their practices in order to take advantage of Section 530 after the fact. However, as indicated previously, the future of Section 530 is uncertain (Dold and Pivec).

Voluntary Reclassification

The IRS also offers tax relief options businesses may choose to take advantage of before an audit occurs. In this case, a business *voluntarily* admits misclassification and is permitted to pay only a portion of the unpaid taxes, provided they reclassify and pay full employment taxes going forward. The purpose of these tax relief programs is to entice businesses to admit the misclassification, avoiding the IRS's need to conduct an audit themselves, with the reward of reduced tax penalties.

The IRS currently has two such programs available. IRS Section 3509 allows any business to voluntarily reclassify, requiring a portion of missed tax payments over the previous three years:

- Federal Income Tax Withholding (FITW) equal to 1.5 percent of wages
- 100 percent of the employer's share into Federal Insurance Contribution Act (FICA)
- 20 percent of the employee's share into FICA (Dold and Pivec).

The IRS has recently furthered its voluntary reclassification programs by announcing the Voluntary Classification Settlement Program (VCSP) in September 2011. This program, like Section 3509, allows businesses to voluntarily reclassify with reduced tax penalties. It attempts to “facilitate voluntary resolution of worker classification issues and achieve the resulting benefits of increased tax compliance and certainty for taxpayers, workers and the government... outside of the examination context and without the need to go through normal administrative correction procedures” (IRS “Voluntary Classification Settlement Program” 2). In the case of the VCSP, the relief is greater than Section 3509, requiring only 10 percent of employment liability tax for the previous year, a total which amounts to approximately 1.4 percent of employee wages (Dold and Pivec). The VCSP does come with stricter requirements, as the business must show they have consistently filed their 1099–MISC for the previous three years, cannot be under investigation and must agree to extend the statute of limitation for future returns up to three years (Dold and Pivec).

The VCSP was expanded in February 2013, modifying several eligibility requirements, making more employers, especially larger ones, eligible for the program. In the announcement, the IRS stated that close to 1,000 employers have already applied for the VCSP. Notably, one temporary provision was included to attract employers who would very likely not apply otherwise. It allows for employers that failed to file Forms 1099 for workers to apply for the program, but the offer only lasts through June 30, 2013 (IRS “IRS Expands Voluntary Worker Classification Settlement Program”). The waiver, however, does require that employers who apply for the program who failed to file Forms 1099 pay a slightly higher amount than other participants plus some penalties. They must also file delinquent Forms 1099 for the workers they are reclassifying (Wood “IRS Expands Independent Contractor Amnesty”).

While taking advantage of the voluntary tax relief programs may seem advantageous on the outset, businesses must evaluate their situation closely before doing so. The programs require

reclassification of their workers going forward, changing their independent contractor business model and requiring full reporting and payment of employee taxes. Businesses submitting to voluntary reclassification must be fully committed to move forward with a new business model (Dold and Pivec). Additionally, workers must be convinced that they will be better off in their new classification as employees, and employers should take steps to avoid wage and labor lawsuits based on their previous misclassification.

An important consideration for employers is the fact that the DOL does not offer any comparable relief programs for wage and labor laws. Participating in voluntary reclassification may be considered by the DOL an admission of guilt, and the DOL then may pursue audits on wage and labor law violations (Dold and Pivec). Previously this may not have been cause for concern, as IRS and DOL claims were fairly isolated. However, the new IRS and DOL Memorandum of Understanding (MOU) have the potential to change this relationship. The Memorandum calls for information sharing among the two agencies and various state agencies. While it is unknown what impact this increased level of communication will have, there is the possibility for multiple claims against businesses to be filed as the agencies share information (Shea). As the VCSP and MOU are in their infancy at the time of this study, businesses should exercise great caution and attempt to learn more about these two programs before pursuing voluntary reclassification.

4.2 Audit Prevention

With the initiation of the “National Research Project,” employers engaged in independent contracting relationships are more at risk of audits than ever before. One of the easiest and most cost effective ways to ensure that employers avoid misclassification claims is to avoid audits in the first place. The following list describes specific business practices that will help employers deter misclassification-related agent inquiries:

1. ***Confirm that the company is complying with the various federal and state tax and labor requirements for all employees.*** Though relatively intuitive, it behooves employers to regularly monitor their compliance with the issuance of forms such as W-2, 940 and 941, etc., as well as overtime requirements under wage and hour laws (Bonano).
2. ***Identify and monitor independent contractors using SSNs on tax documentation.*** In the event of an audit, companies that utilize service providers that use personal SSNs, as opposed to EINs, in tax documentation are at increased risk of more agent inquiries.

Part III: Conclusions

1.0 Conclusions on the Independent Contractor Model

As outlined in Part I, when executed correctly, independent contracting can be advantageous to businesses, workers and the broader economy. Globalization, along with the expansion of containerized shipping, bar codes, the Internet and handheld mobile devices, has created a new and ever-changing workplace. In the U.S., traditional employee-employer arrangements have been in decline, exacerbated by the financial collapse and ensuing recession. This evolving marketplace has resulted in significant growth in non-traditional jobs that are likely to contribute substantially to the recovery of the weakened U.S. economy.

Creativity and entrepreneurship traditionally have been key factors in America's ability to remain an economic leader in an increasingly interconnected and competitive global marketplace. Innovation has consistently been one of the country's greatest competitive advantages. In simply one example of thousands, nearly a decade ago, two American undergraduate students operating out of their college dorm room were able to turn their idea of connecting students on campus into an international phenomenon that changed the way the world interacts online. Facebook has changed the face of the Internet, how people communicate and how businesses can operate. In many ways, the ease of independent contracting encourages these types of new and game-changing ideas.

Independent contracting similarly encourages the growth of small business, which has proven to create jobs and is a key ingredient to overall economic recovery. Operating a successful business no longer requires companies to employ every type of worker necessary to deliver their good or service to end users. More and more, specializations such as product design, advertising, accounting and information technology are being contracted out rather than being performed in-house. The dawn of the information age and the increasing importance of the Internet allow small businesses to access the best and the brightest from across the world. Moreover, specialized services are not only offered by independent contractors to established companies but are often provided to other independent contractors, who in turn are able to build small businesses of their own.

For established companies, the ability to utilize independent contractors helps them compete in the global marketplace while keeping more jobs in the U.S. Hiring external workers gives employers the ability to add and subtract workers in response to their forecasted need, a flexibility that is increasingly relied upon and necessary in current times. When businesses can choose what employment method is best for them, they can improve their bottom line and potentially utilize both traditional employees and contractors for varying services.

In addition to giving companies the flexibility to choose the size of workforce needed for a specific task, independent contracting also gives companies the ability to hire the highest quality of worker needed for a specific task. In many cases, employers may utilize independent

contractors as an “audition” or “extended interview” for permanent employment. Companies may contract out a certain service, review the level of competence and value added to the business and decide later that the worker and his service is something that can be incorporated more fully into the business as a full-time employee. This may happen with IT specialists, designers and media or finance specialists. Employers can also ensure that workers, who may interview well, perform in a similar fashion. With a surplus of workers in the current economy, utilizing independent contractors with an eye toward permanent employment down the road allows businesses to ensure that they are hiring the best candidate for the job and prevents them from committing precious time and resources to a sub-par worker.

Moreover, in addition to benefiting employers, small businesses, entrepreneurs and large companies alike, independent contracting can be beneficial for workers as well. Just like their employer counterparts, American workers must compete in an increasingly global market. Today, workers are not only competing with their neighbors for jobs but with workers across the globe. In the current economy, millions of Americans are unemployed or underemployed. Independent contracting allows workers to supplement their income through alternative labor markets. In some cases, this arrangement may be their only option. This is especially true with workers who find they are less desirable in the current labor market, such as older workers, people with health issues and those with a narrow field of expertise.

This type of arrangement also provides flexibility for workers who are unable to relocate for jobs due to personal or otherwise external reasons. Given continuing problems in the housing market, many people are unable to sell their homes at prices they can afford to accept, which makes it much more difficult for workers to travel to other cities or states to find jobs that match their skills. Contracting can provide a temporary solution to this problem.

However, the inconsistent application of control tests and definition of contractors across the U.S. puts American businesses that employ contractors at a concrete disadvantage. They must either put resources to work understanding the various statutes’ tests in each of the states and regions they operate in, or for small companies without the resources to do this, make their best guess and go about their business, taking what sometimes amounts to a large risk in the face of increasing federal and state scrutiny over misclassification. Businesses, whether they are small “mom and pop” shops or large multi-national corporations, must compete globally today with the expansion of goods and services offered through the Internet. A coherent, cohesive solution to this issue would enhance these business’ abilities to compete on such a scale.

Further, though the benefits of independent contracting to employers, workers and the broader economy are numerous, when executed incorrectly, this type of arrangement can be disadvantageous to those same groups. The research supporting this report has revealed that although independent contracting is an important and powerful part of the U.S. economy, misclassification can also be bad for workers, employers and the U.S. economy. Misclassification is a legitimate problem that should be managed.

2.0 Policy Conclusions and Recommendations

The contractor model is a valid, important employment model, and its use is expanding across the country because it works – because both sides see enough benefits to outweigh the costs and risks. However, when individuals, small businesses and other companies see a constant assault on the model from Congress and other government agencies, they may decide that the regulatory risk of entering into a contract for their services is simply too high. Whether these bills pass or not, their continual introduction can be detrimental to the model as companies determine how resolute Congress will be in its efforts to target the contracting model.

2.1 Policies Addressing Misclassification

Ultimately, the tradeoff for government’s heightened enforcement of misclassification seems to come down to choosing between ease of tax collection on the one side and job creation and economic growth on the other. For its dual goals of debt reduction (partially through increased revenue) and economic growth, Congress should not rely on “gimmicky” legislation that attempts to make small potential gains in revenue without appreciating the true value that contractors provide to the U.S. economy.

It is certainly important to collect revenues that are unpaid from contractors. And it is also important to provide employee protections to workers if they are rightfully entitled to them. However, it remains to be shown that heightened enforcement of worker misclassification would actually add to revenues. There remains a good possibility that it would decrease revenues. What is evident is the role that contracting plays in the current economy and the increasingly important role it can play in the U.S. economy as it strives to compete globally in the future. Enacting various new laws and amendments to limit the use of contracting may lead to job loss, lower economic productivity and decreased competitiveness in the global market as well as reduced economic growth in general.

There has been no concerted effort to support this model in the manner it needs most – clarification over its legal usage. While the payroll tax cuts, tax credits for hiring the unemployed and other measures in President Obama’s jobs plan are certainly beneficial for small businesses, the issue of independent contractor clarification should also be an administration jobs priority. The federal government should focus efforts on supporting small businesses, bolstering entrepreneurship and enhancing American competitiveness in the global economy. The government should make efforts not to extend employee benefits to contractors in a show of support for the model; it should focus on clarifying the lingering and widespread confusion about the definition of employee versus contractor and the associated control tests. These are efforts that are far better spent if the goal is to support these businesses.

Ideally, federal legislation would be developed that would clarify, once and for all, the definition of an independent contractor. Congress could legislate a single control test to be followed by the IRS, the DOL and state tax and labor agencies. This would simplify employment decisions and reduce risk and liabilities for businesses across the country, while also making enforcement of misclassification an easier task for government. Such an effort to streamline and unify guidelines for determining whether a worker is an independent contractor or employee would help

businesses to make better classification decisions. It would then allow these businesses to focus on other important strategic decisions and operations, allowing them the opportunity to better perform competitively.

Unfortunately, a federal legislative solution is politically unfeasible. If such an option were so simple and clear, we suspect Congress would have already pursued it. Rather, it is unrealistic to assume that states will defer to the federal government and opt into a unified definition of the IRS or DOL's choosing. States' rights advocates would not likely let such a movement progress very far. Moreover, one would assume that the different tests were put in place for specific reasons in each agency, and those agencies are unlikely to give up those choices without a very significant policy approach by the federal government. An interesting suggestion made by Todd Saveland in his analysis of the issue was to approach it like federal highway fund money and states' legal drinking age (Saveland 118). In this way, funding would be withheld from states that did not apply the same control test as the federal agencies. This would eliminate the patchwork of legislative solutions across the country. While an interesting idea, and perhaps something that could be developed with a more legislatively active and cooperative Congress, this is impractical to attempt today. It would require immense work and committed resources that are simply not there today. Moreover, the IRS and DOL have not settled on a single federal test with a clear definition of a contractor. To focus efforts today on trying to legislate a single definition and test across federal and state agencies would likely be wasting resources that could be more wisely spent addressing the problem in other meaningful ways.

There also remains the legitimate problem of misclassification. Worker rights are impaired when people who really are employees are misclassified as contractors. The recent Congressional attempts to legislate a solution to the problem of misclassification are not only inadequate to address the actual problem, but they potentially create a new problem worse than the one they are trying to fix – reduced contracting use, resulting in limited economic growth. Moreover, given the Congressional gridlock of recent years and hyper-partisan atmosphere in Washington, it seems unlikely that Congress will be able to craft an effective, efficient and passable law to address misclassification.

At the state level, there may be more opportunity for a policy course that can achieve the substantial benefits the independent contractor model offers to employers, small businesses, entrepreneurs, large companies and workers alike. Such a policy prescription would have to promote the dual objectives of economic growth and the job creation that comes from it, while at the same time addressing the legitimate problem of misclassification and the equally legitimate need of the states to collect the revenue owed them. We believe a state-level policy solution is possible, and, in fact, a few states are already taking steps to craft it (Illinois, for example), but their steps have been tentative and limited to specific industries.

A state-level policy solution would require an independent contractor to:

- 1) Be registered with the State as a business and be in good standing;***
- 2) Pay taxes to the State under its business name; and***
- 3) Properly treat its employees, if any, for payroll tax purposes.***

If states can pass legislation that requires these three criteria to be met in order for contractors to operate in that state, then the issue of misclassification should then be moot. What conceivable difference can it make to a state if the entity comprises but one person or works for only one contracting entity? All the legitimate revenue needs of the state will be met if independent contractors can be encouraged to do these several things.

A state can take this approach without undoing the statutory tests it already has on its legislative books. In most cases, a state would not have to undo any misclassification legislation already in place or change any enforcement processes it has to deal with classification scofflaws. Moreover, once this approach is in place, it is almost certain to prompt companies that use independent contractors to become de facto enforcement mechanisms for the state. As discussed in other sections of this study, under current regulatory schemes companies face uncertainty no matter which direction they turn. If companies know what they can do to avoid misclassification disputes, most will likely do it. In fact, we are aware of companies that are already monitoring the compliance of the contractors with whom they do business.

We believe this is a promising policy solution that has the potential to address misclassification; however, it fails to directly address or reduce the level of confusion on the many state statutory tests that vary across the country. Moreover, passing legislation of this type in each state may also meet resistance from legislatures and could take time to spread across the nation in any substantial way, limiting its success.

For these reasons, in conjunction with the state-level policy outlined above, we believe government activities on the federal and state level should focus immediately on enhancing and optimizing their existing misclassification enforcement authority. The IRS, the DOL and state agencies can utilize their authorization under existing statutes to uncover and reduce worker misclassification as well as set the stage for a unified solution. This includes:

- ***Increased cooperation, collaboration and data sharing, including through MOUs between the IRS, the DOL and state labor and tax agencies;***
- ***Enhanced outreach and education on the differences between employees and independent contractors as well as the penalties for misclassification;***
- ***Increased enforcement of existing penalties for misclassification where it is found;***
- ***Targeted audits on companies and industries that are most likely to misclassify their employees;***

Agencies, ideally with increased budgetary resources, can expand their operations to uncover true misclassification where it exists rather than focus on expanding employee benefits to contractors or adding new regulatory risk to the model. Optimizing these efforts, through smarter strategic decisions and efficient processes would cut down on misclassification without restricting the legitimate use of independent contractors, which is so vital to the U.S. economy.

Furthermore, increasing collaboration among the federal and state agencies affected by this problem is likely the closest solution to a unified, clarified definition and test that the country will get in the near to midterm. We believe that through expanded use of MOUs and increased collaboration, federal and state agencies can, over time, converge on the issue of the contractor model, thereby reducing confusion on the part of businesses, contractors and regulators alike. Often an incremental approach to policymaking is the best approach, particularly when it may involve a large number of stakeholders and a complicated, complex issue. Resources, time and political capital are not spent on efforts that can fail to deliver on results. In this case, beginning with enhanced cooperation, collaboration and information sharing today can lead eventually, albeit more slowly than some might like, to a more unified approach to both misclassification enforcement and independent contracting clarification.

2.2 Policies Supporting Contracting

A government that purports to have job creation as its number one priority should make it easier for companies to make their own strategic decisions about their employment models. Given the stagnant economic situation and a policy goal of domestic economic growth, it is puzzling that virtually all of the policy action has focused on efforts that would limit the model, thereby limiting growth. Legislation and policy discussions about independent contracting is nearly entirely about enforcing and cracking down on misclassification. Jobs remain a key political priority, yet policy options to encourage these alternate employment models are absent. “In addition to trying to kick-start the economy and bring back the sort of ‘traditional’ jobs lots of Americans want, they ought to be making it easier on people to seek out what it isn't right to call non-traditional work, because decades ago lots of folks got by selling stuff or stringing together gigs. This ought to be done to help the unemployed. And also to hedge the nation's bets, for it would be foolhardy to bet everything on bringing back an economic reality that may be gone for good” (Friedersdorf). It may be that the economy of the future is better suited for an increased percentage of the workforce engaged in contracting work. Government policy should aid in facilitating its workers to take part in this “1099 economy.”

What kind of policies can encourage contracting? One example that the Freelancers Union advocates to address the unemployment problem for independent workers is to allow contractors, consultants, freelancers and similar workers to contribute to a pre-tax savings fund during flush times that they could draw from during lean times (Horowitz “A Jobs Plan for the Post-Cubicle Economy”). “A savings vehicle better meets the realities of independent workers’ episodic income flow. Freelancers Union proposes a two-year pilot to test the viability and scalability of tax-advantaged accounts as a means to protect independent workers during periods of unemployment” (Horowitz, Erickson and Wuolo 10). Another would be expanding access to capital for contractors, freelancers, etc. – and educating banks about these types of workers. Financial institutions need to understand the risks of this emerging business/employment model to be able to lend to them.

Another common problem among contractors is client nonpayment. Rather than focusing all policy efforts on cracking down on employers that misclassify workers, some effort should be devoted to cracking down on clients who fail to pay for services provided by contractors. Some

proposed policy options to address this issue include states amending labor laws to include independent contractors in their wage claim systems, or to prevent companies that have a history of contractor nonpayment from receiving government contracts. “While state labor laws differ, most only provide protections to traditional employees. These laws give the state department of labor the right to investigate and penalize employers who do not pay their employees – a right that should be expanded to include independent contractors who are stiffed by companies. New York State has already set a precedent by passing legislation in its Assembly in 2011 that would allow the New York Department of Labor to investigate cases where self-employed workers are not paid by their clients” (Freelancers Union “Creating a “New” New Deal: Evolving Worker Protections for the 21st Century” 2). Independent contractors do not need the full range of labor protections afforded to traditional employees, but in cases like client nonpayment, it can make sense to expand certain aspects of labor laws to cover contractors.

Recognizing that simply extending New Deal type worker protections, such as unemployment insurance, is not feasible for workers whose work may be infrequent, Horowitz and others call for new systems to support this growing part of the economy. State and federal action to encourage contracting include:

- ***Establish unemployment savings programs for independent workers;***
- ***Expand access to capital for independent contractors;***
- ***Empower labor departments to pursue nonpayment by clients of independent contractors;***
- ***Revive the Contingent Work Supplement to the U.S. Bureau of Labor Statistics survey.***

These changes and policies can make it easier for bona fide independent contractors to do their work, expand their businesses and provide some basic assurances against times of slow work or client violations of payment. The fourth recommendation above points to the need to have accurate and updated measures of this workforce and its impact on the broader economy. You can't manage what you can't measure. “The federal government, which has the greatest infrastructure and scalability for measuring national workforce statistics, must evolve how they understand, measure and support the workforce as it exists now and in the future. Until the federal government develops an ongoing, comprehensive and consistent way of tracking independent workers, they are ignoring a crucial, and growing, segment of the economy that is transforming the U.S. workforce” (Freelancers Union “America’s Uncounted Independent Workforce” 5).

3.0 Management Recommendations

The use of independent contracting can be of great benefit to both employers and workers. However, given that worker classification is on the radar of both state and federal governments, employers must be prepared to face challenges by tax and labor agencies. Therefore, employers should be proactive in reviewing independent contractor relationships and be prudent when entering into contracts with independent contractors. The following is a list of management actions employers should strongly consider undertaking to help prevent a challenge to their model and defend worker classifications when challenged.

1. Conduct a self-audit to determine legal exposure.

Businesses must look within their own practices to determine the laws in which they are not compliant. Drawing attention to the misclassification may facilitate both more claims from workers for wage and labor disputes as well as IRS and DOL investigations. Businesses aware of laws (such as federal/state tax and FLSA) they are violating can then properly move forward to correct those issues. This self-audit should serve as a risk assessment for determining which penalties they liable to face in the case of federal and states investigations, as well as lawsuits filed by workers (Shea).

2. Enhance clarity about the working relationship.

Employers should write an Independent Contractor Agreement, if they do not have one already, and make sure that each form of contract helps to establish why such a service provider is an independent contractor under the IRS 11-factor and other relevant tests.

Developing an independent contractor agreement will ensure that the roles and relationship of the independent contractor and the employer are clearly defined. This will proactively help to avoid confusion over the classification of the worker or benefits that the worker may qualify for. Additionally, it is advised to have a third-party legal advisor review the agreement. A legal advisor specializing in these types of issues should be able to catch any potentially confusing or ambiguous language that could lead to a dispute regarding the classification of the worker.

Prior to signing an independent contractor agreement, the contractor needs to acknowledge that he or she will not be entitled to any benefits, stock plan rights, medical coverage, etc., which are limited to employees. While an employer may want to put independent contractors into an employee benefit plan in order to assuage some of their discontent about lack of benefits, it is important to maintain a line between employee and independent contractor. This could be verified through a memorandum of understanding signed by the employer and worker and included in the agreement. This additional step is intended to enhance clarity of understanding between the employer and the independent contractor of the agreed upon roles and responsibilities before the agreement is signed, which should help to avoid potential litigation in the future (Bonano).

Employers with existing independent contractor agreements should also review all their agreements to determine whether they can make any changes in the agreement to reduce some

elements of control that will not have material impacts on their business. If a worker is classified as a contractor through an independent contractor agreement, but it is questionable if the worker would qualify under certain factors tests, it may be useful to revise the agreement to more closely reflect contractor classification as defined by the tests.

3. Ensure the working reality reflects the intention set forth in the agreement.

Having an independent contractor agreement has been found by the courts to be inadequate to establish classification when the reality does not reflect what is in the agreement. Third-party auditors can ensure that the real world situation of the working relationship matches what is defined in the independent contractor agreement. Employing an auditor to ensure that the agreement is accurately reflected in the roles and responsibilities of the employer and the worker should help catch any missteps in day-to-day actions that can be corrected and may help to potentially avoid litigation about misclassification in the future. Also, conducting interviews with workers, surveying them and generally engaging in discourse about the working relationship will encourage honesty about the situation and bring any possible questionable circumstances to light.

4. Ensure consistency throughout the company.

Larger companies that require workers to fulfill a variety of different roles are likely to use independent contractors in multiple aspects of their business. A company that engages in this practice should ensure that all their service providers employed as independent contractors are handled in the same manner throughout their business in order to avoid misclassification allegations. Such an internal audit should be twofold. First, determine within each division of the company which services should be provided by traditional employees and which may be given to independent contractors. Secondly, ensure that across all divisions the treatment of independent contractors providing similar services is consistent. Taking these steps to ensure consistent, proper treatment of all independent contractors will help maintain compliance with applicable laws, particularly DOL labor and wage laws.

5. Only utilize independent contractors that can prove self-employment or are established small businesses

By working exclusively with incorporated contractors, businesses can show that their contractors are in business for themselves and are independent of direction and control. Likewise, incorporated contractors can better pursue entrepreneurial opportunities, which are emphasized in worker classification tests, such as hiring their own employees. This relationship enhances both the hiring business and their contractors. Contracting with firms with more than one employee is key.

The benefits of working solely with incorporated businesses are numerous. Businesses, corporations and partnerships require a Federal Tax Identification Number, also known as an Employer Identification Number (EIN). This number is used to identify businesses officially recognized by the federal government for taxation purposes. Utilizing contractors with an EIN will ensure that they are legally recognized business entities separate from the employer. The EIN is a free service provided by the IRS and is also required if incorporated contractors plan to hire their own employees.

Businesses should also choose to work with contractors that can prove self-employment. Documents that prove that an individual is self-employed may include, but are not limited to, business cards with a business name on them, a federal employer ID number for purposes of issuing 1099s, invoices for each service performed and 1099s from other client companies to demonstrate that the contractor has other customers.

Requiring documents from independent contractors that prove self-employment has a number of benefits for a company that engages with independent contractors. First, it keeps all relevant documents on file that, in the case of an audit or lawsuit, will demonstrate that the company is in accordance with policies and conditions for independent contractors. Second, it drives independent contractors to gather the necessary documentation for self-employment. Third, requiring these documents allows the company to reiterate that independent contractors must indeed be “self-employed” and are not employees of the company.

6. Educate middle managers and workers internally about misclassification

It is important to educate middle managers and workers about the dangers of misclassification and how they can be avoided. Educating employees about whom to hire and who not to hire can help a business in the long run. Former employees should rarely be hired back to a company as an independent contractor – they should typically be hired back in their former status. If a former employee is hired back by a company, it is likely that that worker will be performing a function similar to the one he/she was performing in the past. If this former employee is subsequently utilized as an independent contractor, it will appear as though the company is attempting to switch employee functions to independent contractor functions, which can raise red flags to the IRS, DOL, employees and other stakeholders.

The procurement office or division is often where final hiring decisions are made and resources allocated for contracts. Procurement offices are also where independent contractors can ask questions about their contract and submit invoices. Because the procurement office is the main point of contact for questions from independent contractors, it is best to provide these employees with comprehensive training on the difference between employees and independent contractors and what should be contained within the contractor agreement in order to ensure that the company is not accused of misclassification.

Employers should make the procurement officers familiar with the different types of classification and what should be contained in contracts in order to specify that a contractor is indeed an independent contractor. This means training procurement employees to build low levels of control into contracts and to ensure that the procurement office never tells contractors *how* to do their job but rather *what* to do.

7. Alert Independent Contractors to organizations like the Freelancers Union that provide group health insurance benefits

On October 1, 2013, the Affordable Care Act's insurance exchanges will go live online, and suddenly millions of Americans will be able to log on to a website and choose their own healthcare coverage from a menu of subsidized options for prices and coverage levels. Until that time, employers should notify their independent contractors about organizations like the Freelancers Union so that they can address their need for affordable health insurance coverage.

Many businesses which have bona fide independent contractor relationships are surprised when they have to defend claims by those workers for unemployment benefits, overtime pay, statutory termination benefits and an array of other types of employee benefits. Many of these claims are filed by such bona fide independent contractors because they believe they have no means of securing benefits, especially health care insurance, unless they are reclassified as an employee of a business. With access to the group benefits made available to members of organizations like the Freelancers Union, some of those workers properly treated as 1099ers may be less inclined to pursue legal claims.

Best Practices: Maximizing Contractor Freedom

As described in previous sections, independent contractors are, by definition, free to complete work in a manner that suits their individual preferences. The following list describes specific business practices that can be incorporated into contractor agreements that will maximize contractor freedom, thus minimizing employer control, over work performed by independent contractors (Watkins 6-8):

- 1. *Require that contractors own their own equipment.*** Verify that the contractor, not the employer, owns the primary equipment that is used to perform work. Contractors may also lease equipment from a third party, as long as the lease is not contingent on the contractor performing services for the company.
- 2. *Require that contractors purchase or rent all ancillary equipment.*** Any additional equipment that becomes necessary to complete work over the course of the work arrangement should be owned or rented by the contractor that is performing the work. If the equipment is bought or leased by the employer, ensure that the equipment is priced at a fair market or rental value.
- 3. *Contractor is paid based on performance, not by the hour or any other time period.*** When possible, require that contractors be paid for the actual work being accomplished instead of on a salaried or hourly basis.
- 4. *Allow contractors to substitute other workers to complete tasks.*** If the primary contractor is unable to perform work, employers should allow them the freedom to substitute other workers at their discretion. This is subject to any government regulations requiring licensing, specific or minimum standards, etc. The courts have repeatedly held that requirements imposed by government regulations and consumer demands are not indicia of control or intrusion into methods, manner or means.
- 5. *Require that contractors pay all expenses.*** To further the divide between contractor and employee, companies should maintain that the contractors, who presumably own the equipment, are responsible for costs associated with equipment maintenance, even if some of these costs are passed onto customers.

6. ***Allow contractors to set their own work schedules.*** Note, however, that some companies may contract for specific results, which can include customer driven requests for services at specified times.
7. ***Allow contractors to accept requests for jobs through multiple clients or directly from their customers.***
8. ***Do not impose restrictions on appearance.*** As a third-party entity, contractors should not be required to wear a company uniform or be beholden to other superficial restrictions on facial hair, tattoos, etc. However, employers may require contractors to carry company badges, I.D. cards, business cards, etc., for identification and security purposes. However, companies should be able to contract for uniforms on an optional basis. To a degree, uniforms can go hand-in-hand with other identification and security measures.
9. ***Do not require non-compete agreements.*** Employers seeking to maximize contractor freedom should not require independent contractors to sign non-compete agreements. However, employers may require contractors to sign confidentially or other nondisclosure agreements.
10. ***Limit company-specific training.*** As the manner in which work is completed should be at the discretion of the independent contractor, employers should not require these workers to complete training related to company business practices, customer relations, safety issues, etc. This is also subject to any government regulations requiring licensing, specific or minimum standards, etc. The requirement that companies provide certain safety related information may extend to independent contractors.
11. ***Limit follow-up requirements.*** Employers should not require contractors to follow up or report on leads provided by the company or to attend regular meetings (Watkins 6-8).

Again, while none of these can guarantee that misclassification will not be found, they aid in reducing the risk that companies will be found in non-compliance with relevant statutes.

4.0 A Final Word

Independent contracting is a valuable facet of the American economy – as evidenced by its growing use across the country. The benefits to all parties clearly outweigh the disadvantages. However, there are problems with the model stemming from inconsistent application of definitions and tests by relevant tax and labor departments at the state and federal level. These discrepancies create two problems: increased business liabilities and worker misclassification. Federal and state attention has, thus far, focused nearly exclusively on the second problem and has increased efforts to uncover and punish misclassification. While the activities are well meaning, we believe that most of the proposed legislation to combat misclassification will cause more harm than good – stifling job creation, particularly among small businesses. They would add confusion to the issue and only marginally impact the revenue gap, which the efforts claim to resolve. Where efforts have attempted to legislate a solution to the first problem, the result is likely to be more contractors being reclassified as employees, resulting in diminished use of the model and the associated negative economic consequences. Government has nearly entirely ignored any calls for policy action that might encourage contracting, rather than focus on its shortcomings.

This report has analyzed the independent contractor model, its history, its importance to the economy and the legitimate problems with its usage. We believe that collaboration and other softer policy activities, combined with increased resources and a targeted approach can not only work toward resolving the misclassification problem, but we believe that it can also eventually lead to a more coherent application of factor tests, reducing overall confusion over the model thus expanding its use.

We have identified a number of best practices and actions that businesses can undertake in order to minimize their risk of audit and misclassification. These activities can be done with minimal resources and have significant payoff, enabling companies to continue or expand their use of contractors. The American economy depends on businesses that use innovative strategies and methods, including non-traditional employment models, to enhance their competitiveness in the world market. These types of businesses will likely be an increasing source of economic growth in the U.S. in the coming century.

Appendix A: References

- "2012 Introduced and Enacted Legislation on Employee Misclassification or Independent Contractors." *2012 Employee Misclassification Bills*. National Conference of State Legislatures, 19 Nov. 2012. Web. 31 May 2013.
- AFL-CIO. Department for Professional Employees. *Misclassification of Employees as Independent Contractors*. *Dpeaflcio.org*. AFL-CIO, Feb. 2011. Web. 11 Oct. 2011.
- Arnold & Porter LLP. "United States Supreme Court Rules That Pharmaceutical Sales Representatives Are Exempt From Federal Overtime Requirements." Arnold & Porter LLP. Jun. 2012. Web. 18 Aug. 2012.
- Balbo, Kristina M. "The Right to Control: Extending Maine's Traditional Vicarious Liability Rules to the Franchisor-Franchisee Relationship." *Current Developments in Maine Law* 24 (Winter 2011): 1-3. Norman, Hanson & DeTroy, LLC, 17 Dec. 2010. Web. 30 May 2013.
- Barer, Garvey Schubert, Brant, Larry J. and Karl A. Kaufman. "The Affordable Care Act Creates a Trap for the Unwary- Worker Misclassification." *Lexology*. 9 Apr. 2013. Web. 26 May 2013.
- Batten, Mark W., Elise M. Bloom, and Fredric C. Leffler. *Misclassifying Workers as Independent Contractors: The Price of Independence*. Rep. Proskauer Rose LLP, 24 Mar. 2010. Web. 11 Oct. 2011.
- Belman, Dale, L. and Richard Block. "Informing the Debate: The Social and Economic Costs of Employee Misclassification in Michigan." *Institute for Public Policy and Social Research*. Michigan State University. 2009. Web. 22 Aug. 2011.
- Bidwell, Matthew; Briscoe, Forrest. "Who Contracts? Determinants of the Decision to Work as an Independent Contractor among Information Technology Workers." *Academy of Management Journal*. Vol. 52, No. 6, 1148-1168. 2009. Page 1148.
- "Bill H.3513: An Act Relative to Clarifying Franchises." *Bills & Laws*. The General Court of Massachusetts, 30 Aug. 2012. Web. 29 May 2013.
- Bonano, William E. "Worker Misclassification Penalties Likely to Increase as IRS Audits More Employers." *Employment Tax Bulletin* (May 2011). Pillsbury Law, May 2011. Web. 25 Aug. 2011.
- Bordoni, Daniel, Mary Hevener, Timothy Lynch, Anne Marie Estevez, and Christopher Parlo. "Independent Contractor Misclassification Issues and the 2013 Postelection Risk Landscape." Morgan, Lewis & Bockius LLP, 10 Jan. 2013. Web. 24 May 2013.
- Branam, Walter. "A Franchisee is Deemed to be a Misclassified Employee." *Collabrus*. 16 Sep. 2011. Web. 25 Aug. 2011.
- Bricketto, Martin. "NJ Assembly Clears Bill To Stop Trucker Misclassification." *Law360*. Portfolio Media, 20 May 2013. Web. 31 May 2013.
- Briney, Douglas M. "Federal Express Drivers: Employees or Independent Contractors?" *Journal of Legal, Ethical and Regulatory Issues*. Vol 11, Number 1 (2008): Page 17.
- Canak, William, and Randall Adams. *Misclassified Construction Employees in Tennessee*. Rep. 15 Jan. 2010. Web. 17 Aug. 2011.
- Carré, Françoise, and Randall Wilson. *The Social and Economic Costs of Employee Misclassification in Construction*. Rep. Construction Policy Research Center, Labor and Worklife Program, Harvard Law School and Harvard School of Public Health, 17 Dec. 2004. Web. 20 Aug. 2011.
- Casserly, Meghan. "How The Startup Economy Is Creating \$1 Billion Freelance Paychecks." *Forbes*. 6 Feb. 2013. Web. 30 May 2013.

Cebula, Richard, and Edgar L. Feige. *America's Underground Economy: Measuring the Size, Growth and Determinants of Income Tax Evasion in the U.S. Economic Working Papers*. University of Wisconsin-Madison, 22 Mar. 2011. Web. 31 May 2013.

Ceniceros, Roberto. "Employers Can't Pass Workers Comp Premium Expenses to Employees: Mass. High Court." *Business Insurance*. 31 Aug. 2011. Web. 25 Sep. 2011.

Center for a Changing Workforce. "Legal Action." Web. 12 Oct. 2011.

Charnas, Douglas W. "Legislation Proposed to Modify Rules Regarding Employers' Classification of Individuals as Independent Contractors" *McGuire Woods*. 1 May 2008. Web. 19 Aug. 2011.

Charnas, Douglas W. and Adam H. Garner. "Proposed Legislation Likely to Classify More Workers as Employees." *McGuire Woods*. 7 January 2010. Web. 19 Aug. 2011.

Clifford, Catherine. "Franchise Forecast Continues Strong for 2013." *CNBC.com*. CNBC U.S., 28 Mar. 2013. Web. 28 May 2013.

Cohen, Steven, William Eimicke, and Tanya Heikkila. *The Effective Public Manager*. San Francisco: Jossey-Bass, 2008. Print.

Collabus. "President Obama Proposes to Increase Spending for IC Compliance and Misclassification Enforcement in 2012." Colorado Department of Labor and Employment. *Misclassification of Employees as Independent Contractors*. 2 June 2011. Web. 21 Aug. 2011.

Connelly, Catherine E., and Daniel G. Gallagher. "Independent and Dependent Contracting: Meaning and Implications." *Human Resource Management Review*. 16.2 (2006): 95-106. Print.

Cooper, Michael and Katherine Q. Seelye. "Wisconsin Leads Way as Workers Fight State Cuts." *The New York Times*. 18 Feb. 2011. Web. 8 Oct. 2011.

Craig v. FedEx Ground Package System, Inc., No. 10-3115 (CA7 July 12, 2012). Federal 7th Circuit Court. Civil Court. Web. 1 Sep. 2012.

Danaher, Maria Greco. "Physician Staffing Issues and Employment-Related Lawsuits: A Litigation Epidemic in the Making?" *The National Law Review*. 7 Jun. 2010. Web. 30 Oct. 2011.

Davis & Gilbert LLP. "IRS Announces Voluntary Settlement Program on Worker Classifications." *Davis & Gilbert LLP*. Sep. 2011. Web. 16 Oct. 2011.

Dennis, William J. "NFIB National Small Business Poll: Independent Contractors." 2008. Web. 2 Oct. 2011.

Dold, Elizabeth T., and Mary E. Pivec. "Recent Worker Misclassification Initiatives - What Employers Need to Know." Groom Law Group, 5 Oct. 2011. Web. 5 Oct. 2011.

Donahue, Linda H., Lamare, James Ryan, and Kotler, Fred B. "The Cost of Worker Misclassification in New York State." Cornell University, ILR School, February 2007.

Dubé, Lawrence. "DOL, State Agencies, and Litigants Proceed With Challenges to Worker Misclassification." *Bloomberg BNA*. 14 Aug. 2012. Web. 18 Aug. 2012.

Eisenach, Jeffrey A. "The Role of Independent Contracting in the U.S. Economy." *Navigant Economics* (2010): 1-46. Navigant Economics, Dec. 2010. Web. 28 Aug. 2011.

Elance. "Global Online Employment Report - Q1 2013." *Elance.com*. 2013. Web. 30 May 2013.

Elance. "The State of the Freelance Market - September 2012." *Elance.com*. 2013. Web. 30 May 2013.

Employees, "A State-by-State Survey of Unemployment Compensation Laws." *Messenger Courier Association of America*. Web. 31 Aug. 2011.

“Estrada v. FedEx Ground (Misclassifying Employees).” *Federal Contractor Misconduct Database*. Project On Government Oversight. Web. 12 Oct. 2011.

Fan, Caroline. “Delaware Stands Up for Misclassified Workers.” *Progressive States Network*. 27 Aug. 2009. Web. 16 Oct. 2011.

Frank, David E. “Franchisees Miscast as Independent Contractors.” *Massachusetts Lawyers Weekly*. 5 Apr. 2010.

Freelancers Union. “Creating a ‘New’ New Deal: Evolving Worker Protections for the 21st Century.” *Freelancers Union*. 2011. Web. 2 Jun. 2013.

Freelancers Union. “America’s Uncounted Independent Workforce.” *Freelancers Union*. 2011. Web. 2 Jun. 2013.

Friedersdorf, Conor. “Politicians Ignore the ‘Be Your Own Boss’ Economy at Their Peril.” *The Atlantic*. 27 Sep. 2011. Web. 30 May 2013.

Furman, Marc and Kimbel, Ericson P. “Employee Misclassification: Criminal and Civil Penalties Now Possible for Misclassification of Independent Contractors.” *Construction Today*. Spring 2011.

Gibson Dunn. “In a Ruling with Important Implications for Courts’ Deference to Agencies, U.S. Supreme Court Rejects Department of Labor Position on Overtime for ‘Outside Sales’ Employees.” Gibson Dunn. 19 Jun. 2012. Web. 18 Aug. 2012.

Granis, Emily. “Worker Wage-and-Hour Suits Rise in Difficult Labor Market.” Bloomberg News. 15 Aug. 2012. Web. 18 Aug. 2012.

Greenhouse, Steven. “U.S. Cracks Down on ‘Contractors’ as a Tax Dodge.” *The New York Times*. 17 February 2010. Web. 19 Aug. 2011.

Hanley, Sheryl D. “D.C. Circuit Addresses Independent Contractor Status in A Recent NLRB Petition for Enforcement in A Significant Labor Law Decision.” *Martindale.com Legal Library*. Edwards Angell Palmer & Dodge LLP, 23 June 2009. Web. 12 Oct. 2011.

Harris, Andrew and Emily Grannis. “Top Kansas Court Asked for Guidance In FedEx Drivers’ Case.” Bloomberg. 12 July 2012. Web. 1 Sep. 2012.

Harned, Karen R., Georgine M. Kryda, and Elizabeth A. Milito. *Creating a Workable Legal Standard for Defining an Independent Contractor*. Publication. Web. 27 Aug. 2011.

Hassen, Michael J. “Labor Law Class Action Defense Cases-Estrada v. FedEx.” *Class Action Defense Blog*. Jeffer Mangels Butler & Mitchell LLP, 4 Oct. 2007. Web. 12 Oct. 2011.

Hoening, Lawrence L., Becker, Craig A., Hunt, Peter J. and Alexis M. Petas. “Changes Likely for Section 530 Relief in Employee vs. Independent Contractor Classifications.” *Pillsbury Winthrop Shaw Pittman LP*. 26 July 2010. Web. 19 Aug. 2011.

Hollrah, Russell. “In Defense of Section 530.” *The Coalition to Preserve Independent Contractor Status*. 5 Mar. 2009. Web. 22 Oct. 2011.

Horne, Michael S., Thomas S. Williamson, and Anthony Herman. *The Contingent Workforce: Business and Legal Strategies*. Law Journal, 2000. Electronic.

Horowitz, Sara. “A Jobs Plan for the Post-Cubicle Economy.” *The Atlantic*. 5 Sep. 2011. Web. 30 May 2013.

Horowitz, Sara, Erickson, Althea , and Gabrielle Wuolo. “Independent, Innovative, and Unprotected: How the Old Safety Net Is Failing America’s New Workforce.” *Freelancers Union*. 2010. Web. 2 Jun. 2013.

Icon Professional Services. “Confirmation Vote for Obama’s Labor Secretary Nominee Pushed Back Again”. *Icon Professional Services 1099 Compliance Blog*. 15 May 2013. Web. 26 May 2013.

- Icon Professional Services. "OSHA Steps Up Enforcement." *Icon Professional Services 1099 Compliance Blog*. 16 May 2013. Web. 26 May 2013.
- Icon Professional Services. "Solicitor of Labor Touts Department's Misclassification Initiative at ABA Event." *Icon Professional Services 1099 Compliance Blog*. 25 Apr. 2013. Web. 26 May 2013.
- Icon Professional Services. "With Comment Period Closed, Feds Set to Move Forward with Worker Classification Survey." *Icon Professional Services 1099 Compliance Blog*. 5 Apr. 2013. Web. 26 May 2013.
- Iowa Misclassification Task Force. "Misclassification Task Force Report to Governor Chet Culver, State of Iowa: Findings and Recommendations." Iowa Misclassification Task Force. 17 Dec. 2008. Web. 16 Oct. 2011.
- Rep. National Employment Law Project. Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries. June 2010. Web. 22 Aug. 2011.
- Joerg, Nancy E. "Companies Will Increasingly Use Independent Contractors To Avoid Coverage Under the Affordable Care Act/ObamaCare!" *Wessels Sherman Joerg Liszka Laverty Seneczko*. Mar. 2013. Web. 26 May 2013.
- Johnson, Steven L. "Relative Advantages and Disadvantages of Independent Contractor Status: A Survey of Owner-Operators' Opinions and Rationale." Mack-Blackwell Rural Transportation Center, University of Arkansas. Jan. 2012. Web. 1 Sep. 2012.
- Jost, Micah P.S. "Independent Contractors, Employees, and Entrepreneurialism Under the National Labor Relations Act: A Worker-by-Worker Approach." Washington and Lee University School of Law, 2001. Web. 22 Sept. 2011.
- Jost, Micah Prieb Stoltzfus. "Independent Contractors, Employees, and Entrepreneurialism Under the National Labor Relations Act: A Worker-by-Worker Approach." *Washington & Lee Law Review*. 68.1 (2011).
- Judson, Tim and Cristina Francisco-McGuire. "Where Wage Theft is Legal: Mapping Wage Theft Laws in the 50 States." Progressive States Network. Jun. 2012. Web. 18 Aug. 2012.
- Kalleberg, Arne. L "Nonstandard Employment Relations: Part-time, Temporary and Contract Work." *Annual Review of Sociology*. 26. 2000. Web. 2 Oct. 2011.
- Kalleberg, Arne. L "Precarious Work, Insecure Workers: Employment Relations in Transition." *American Sociological Review*. 74. 1999. Web. 2 Oct. 2011.
- Kelsay, Michael P., and James I. Sturgeon. *The Economic Costs of Employee Misclassification in the State of Indiana*. Rep. Department of Economics, University of Missouri-Kansas City, 16 Sept. 2010. Web. 18 Aug. 2011.
- Kent, Tom. "The Massachusetts Legislature Responds to *Awuah v. Coverall*." *Franchise Law Update*. 14 Aug. 2011. Web. 25 Sep. 2011.
- Keselenko, Jonathon A. "Worker Misclassification: Recent Trends in Independent Contractor Litigation." Proc. of Worker Misclassification: Recent Trends in Independent Contractor Lawsuits, Webinar/Teleconference. Strafford Publications, 27 Apr. 2010. Web. 19 Aug. 2011.
- Lambert, Adam. "Worker Classification: Recent Developments and What You Should Know." *Tax Stringer*. New York State Society of Certified Public Accountants, 30 Apr. 2013. Web. 28 May 2013.
- Liptak, Adam. "Justices Back Drug Industry on Overtime." *The New York Times*. 18 Jun. 2012. Web. 18 Aug. 2012.
- MBO Partners. "The State of Independence in America Report." MBO Partners. Sep. 2012. Web. 30 May 2013.

McFarland, Christiana, McConnell, Katie and Caitlin Geary. "Small Business Growth: U.S. Local Policy Implications." *The National League of Cities*. Oct. 2011. Web. 23 Oct. 2011.

McMillan, III, James G. "Misclassification and Employer Discretion Under ERISA." *University of Pennsylvania Journal of Labor and Employment Law* 2.4 (2000): 837-66. *University of Pennsylvania Law Journals*. University of Pennsylvania Law School. Web. 11 Oct. 2011.

Mendelson, Littler. "Temporary Twilight Zone." *Law Library | Legal Professional*. Thomson Reuters, 1998. Web. 12 Oct. 2011.

Morin, Rich. "Job Satisfaction Among the Self-Employed." Pew Research Center, Sep. 2009. Web. 19 Aug. 2011

Mulcahy, Jim. "Are Franchisees Employees?" *Franchising.com*. Franchise Law News, 5 Sept. 2012. Web. 30 May 2013.

Nadler, Jonathan R. and Joel S. Barras. "If Obama Wins, Corporate America Should Brace For Crackdown On Use Of Independent Contractors." *Forbes*. 2 Oct. 2012. Web. 27 May 2013.

Nash, Claire Y. "Section 530 Relief for Worker Classification Controversies." *AICPA*. American Institute of CPAs. 1 June 2012. Web. 29 May 2013. National Federation of Independent Business. "Stop-Work Law Targets Misclassification." *National Federation of Independent Business*. 2010. Web. 16 Oct. 2011.

National Limousine Association. "NLA Regulatory Update." *National Limousine Association*. 2010. Web. 16 Oct. 2011.

Needleman, Sarah E. and Emily Maltby. "Price of Reclassifying Workers: Small Businesses Face Double-Edged Sword in Deciding to Put Contractors on Payroll." *The Wall Street Journal*. Online. 26 Sep. 2011. 30 Sep. 2011.

New York State Department of Labor. "New York State Construction Industry Fair Play Act: Fact Sheet." March 2011. Web. 10 Sep. 2011.

New York State Department of Labor. "Leveling the Playing Field: Protecting Workers and Businesses Affected by Misclassification." *New York State Department of Labor*. 17 June 2010. Web. 16 Oct. 2011.

Nigut, Rush. "Trend Moving Toward Greater Protection for Franchisees?" *Rush on Business*. Rush Nigut, 5 Mar. 2013. Web. 30 May 2013.

Noonan, Bran. "The Campaign Against Employee Misclassification." *New York State Bar Association Journal*. Oct. 2010. Web. 16 Oct. 2011.

Office of Chief Financial Officer Jeff Atwater. Florida Department of Financial Services. *CFO* "Jeff Atwater and Broward Sheriff Al Lamberti Announce Arrests in 'Operation Dirty Money,' Workers' Comp Fraud Check Cashing Scheme." *Florida Department of Financial Services*, 27 July 2012. Web. 31 May 2013.

Olsen, Florence. "Commenters Focus on Worker Classification, Key Definitions of Proposed ACA Tax Rules." *Bloomberg BNA*. 25 Mar. 2013. Web. 26 May 2013.

Perry, Phillip M. "Business Sense: Costly Tax Penalties When Using Independent Contractors." *The Case Manager* 14.1 (2003): 70-72. Web. 14 Aug. 2011.

PricewaterhouseCoopers LLP. "Will the Affordable Care Act Threaten Section 530 Relief for Independent Contractors?" PricewaterhouseCoopers LLP. 14 Nov. 2011. Web. 26 May 2013.

Randall, Albert J. "National Trends Involving Employee Misclassification." *The US Law Network*. Oct. 2008. Web. 6 Sep. 2011.

Reibstein, Richard. "Congressional Approach to Misclassification of Employees as Independent Contractors Would Confuse Rather than Clarify the Law." *The National Law Review* 2 Dec. 2010. Web. 17 Aug. 2011.

- Reibstein, Richard. "Independent Contractor Misclassification Ruling in Favor of FedEx Ground Confirms Critical Role of IC Agreements and Policies and Procedures in Class Action Litigation." *Independent Contractor Compliance Legal Blog*. Pepper Hamilton LLP, 10 Jan. 2011. Web. 12 Oct. 2011.
- Reibstein, Richard. "The Risk of Using Independent Contractors: Government Initiatives, Employee Challenges Make Companies Review Classification Practices." *Independent Contractor Compliance Legal Blog*. Pepper Hamilton LLP, 15 May 2008. Web. 1 Sep. 2012.
- Reibstein, Richard J. "New York Joins Other States in Suing FedEx for Misclassification of Its Ground Division Drivers as Independent Contractors." *Natlawreview.com*. The National Law Review, 29 Nov. 2010. Web. 11 Oct. 2011.
- Reibstein, Richard J., Petkun, Lisa B. and Rudolph, Andrew J. "California Joins Growing Number of States to Enact Independent Contractor Misclassification Legislation." *Pepper Hamilton, LLP*. 12 Oct. 2011. Web. 1 Sep. 2012.
- Reibstein, Richard J., Petkun, Lisa B. and Rudolph, Andrew J. "Independent Contractor Misclassification Update 2012: How Companies Can Minimize the Risks." *Pepper Hamilton, LLP*. 14 May 2012. Web. 31 Aug. 2012.
- Reibstein, Richard J., Petkun, Lisa B. and Rudolph, Andrew J. "Senate Re-Loads on Independent Contractor Misclassification: New Bill Characterizes Misclassification as 'Payroll Fraud.'" *Independent Contractor Compliance Legal Blog*. Pepper Hamilton LLP.. 13 Apr. 2011. Web. 19 Aug. 2011.
- Reibstein, Richard J., Petkun, Lisa B. and Rudolph, Andrew J. "Worker Classification Issues Are Raised by Affordable Care Act Proposed Regulations." *Independent Contractor Compliance Legal Blog*. Pepper Hamilton LLP. 21 Mar. 2013. Web. 26 May 2013.
- Reibstein, Richard J., Petkun, Lisa B. and Rudolph, Andrew J. "New Federal Worker Misclassification Study: U.S. Department of Labor to Question Workers About Their Knowledge of Independent Contractor Misclassification." *Independent Contractor Compliance Legal Blog*. Pepper Hamilton LLP. 14 Jan. 2013. Web. 27 May 2013.
- Reibstein, Richard J., Petkun, Lisa B. and Rudolph, Andrew J. "New Misclassification Bill Introduced in Congress: The Independent Contractor Tax Fairness and Simplification Act of 2012 Seeks to Eliminate 'Safe Harbor' for Businesses." *Independent Contractor Compliance Legal Blog*. Pepper Hamilton LLP. 13 Dec. 2012. Web. 27 May 2013.
- Richardson, Whit. "Maine Simplifies Legal Definition of 'Independent Contractor.'" *BDN Maine Business*. Bangor Daily News, 3 Jan. 2013. Web. 31 May 2013.
- .
- Roetzel & Andress L.P.A. "Independent Contractor or Employee? Employers Need to Ask Themselves Before the IRS or Department of Labor Asks." *Roetzel and Andress L.P.A.* 2009. Web. 16 Oct. 2011.
- Schrier, Michael and Rubenstein, Joel. "Maryland Gets Tough on Classification of Workers As 'Independent Contractors.'" *K&L Gates LLP*. 2009. Web. 16 Oct. 2011.
- Shadovitz, David. "Clamping Down on Misclassification." *Human Resource Executive Online*. LRP Publications, 6 May 2010. Web. 19 Oct. 2011.
- Shaefer, H. Luke. "Nonstandard Work and Economic Crisis: What Changes Should We Expect?" *Journal of Poverty* 14.1 (2010): 17-32. *Taylor & Francis Online*. 3 Feb. 2010. Web. 18 Aug. 2011.
- Shea, Bob. "DOL and IRS Join Forces to Combat Independent Contractor Misclassification."

Good Company – A Morse, Barnes-Brown & Pendleton Blog. Morse, Barnes-Brown & Pendleton, 7 Oct. 2011. Web. 7 Oct. 2011

"Shift Toward Importance of 'Entrepreneurial Opportunity' in Test for Classifying Independent Contractors Under Labor Law." *Franczek.com*. Franczek Radelet Attorneys and Counselors, 21 May 2009. Web. 28 May 2013.

Spandorf, Rochelle B. "Who's the Boss?" *Los Angeles Lawyer*. March 2011.

Stephenson, Correy. "Domino's Pizza Not Liable for Delivery Car Accident, Rules Maine Supreme Court." *Lawyers USA*. 2 July 2010.

Sturgeon, James I., Michael P. Kelsay, and Kelly D. Pinkham. *The Economic Costs of Employee Misclassification in the State of Illinois*. Rep. Department of Economics, University of Missouri-Kansas City, 6 Dec. 2006. Web. 18 Aug. 2011.

Their, Dave. "Underemployed and Loving It." *Forbes*. 11 May 2012. Web. 30 May 2013.

Tremblay, Jason E. "DOL Set to Share Employee Misclassification Information with the IRS and States." *Arnstein & Lehr LLP*. 30 Sep. 2011. Web. 16 Oct. 2011.

"Trends in Franchises: Growth." *Boundless.com*. Boundless, Mar. 2012. Web. 29 May 2013.

United Business Media. PR Newswire. *Maryland's Workplace Fraud Act Undergoes Amendments to Alter Presumption of Employment*. *Market Watch*. Dow Jones & Co., 15 Aug. 2012. Web. 30 May 2013.

United States Census Bureau. "Businesses With No Paid Employees Increase to 19.5 Million." *Census Bureau Home Page*. 21 Apr. 2008. Web. 11 Sept. 2011.

United States Congress. Senate. 110th Congress, 1st Session. S. 2044: Independent Contractor Proper Classification Act of 2007. Introduced in the U.S. Senate; 12 Sep. 2007. 110th Cong., 1st sess. Congressional Bills, GPO Access. Web. 11 Sep. 2011.

United States. Department of the Treasury. Internal Revenue Service. "Do You Need an EIN?" *Internal Revenue Service*. Web. 12 Oct. 2011.

United States. Department of Treasury. Internal Revenue Service. "Employee (Common-Law Employee)." *Internal Revenue Service*. 6 Jan. 2011. Web. 10 Sept. 2011.

United States. Department of the Treasury. Internal Revenue Service. "Employer's Supplemental Tax Guide." 15-A ed. *Internal Revenue Service*. 2011. Web. 31 Aug. 2011.

United States. Internal Revenue Service. "Independent Contractor Defined." *Internal Revenue Service*. 27 Jan. 2011. Web. 10 Sep. 2011.

United States. Department of the Treasury. Internal Revenue Service. "IRS Expands Voluntary Worker Classification Settlement Program; Relief From Past Payroll Taxes Available to More Employers Who Reclassify Their Workers As Employees: Announcement 2011-64." *Internal Revenue Service*. 2011. Web. 27 May 2013.

United States. Department of the Treasury. Internal Revenue Service. "Small Business & Self-Employed – Behavioral Control." *Internal Revenue Service*. 11 Jan. 2013. Web. 27 May 2013.

United States. Department of Treasury. Internal Revenue Service. "Statutory Employees." *Internal Revenue Service*. 6 Jan. 2011. Web. 10 Sept. 2011.

United States. Department of Treasury. Internal Revenue Service. "Statutory Nonemployees." *Internal Revenue Service*. 6 Jan. 2011. Web. 10 Sept. 2011.

United States. Department of Treasury. Internal Revenue Service. "The Tax Gap." *Internal Revenue Service*. 9 Jul. 2009. Web. 27 Sept. 2011.

United States. Department of the Treasury. Internal Revenue Service. "Voluntary Classification Settlement Program." *Internal Revenue Service*. 27 Feb. 2013. Web. 27 May 2013.

United States. Department of Labor. "Fiscal Year 2012 Budget in Brief." US Department of Labor. Web. 18 Oct. 2012.

United States. Department of Labor. "Fiscal Year 2013 Budget in Brief." US Department of Labor. Web. 18 Oct. 2012.

United States. Department of Labor. "Employee Misclassification as Independent Contractors: The DOL Misclassification Initiative." US Department of Labor. Web. 18 Oct. 2012.

United States. Department of Labor. Office of the Assistant Secretary for Policy. "Independent Contractors." Elaws - Fair Labor Standards Act Advisor. *United States Department of Labor*. 23 Dec. 2009. Web. 28 May 2013

United States. Department of Labor. Wage and Hour Division. "Fact Sheet #13: Employment Relationship Under the Fair Labor Standards Act (FLSA)." *United States Department of Labor*. July 2009. Web. 27 May 2013.

United States. Federal Registrar. Vol. 78. No. 8. 11 Jan. 2013. Web. 17 May 2013.

United States. Government Accountability Office. "Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention." *United States Government Accountability Office*. Aug. 2009. Web. 16 Oct. 2011.

United States. Government Accountability Office, Statement by Sigurd R. Nilsen, Testimony before the Subcommittee on Income Security and Family Support and Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives. *Employee Misclassification: Improved Outreach Could Help Ensure Proper Worker Classification*. Report #GAO-07-859T, (Washington, DC, May 2007).

United States. Government Accountability Office. "Opportunities Exist to Reduce the Tax Gap Using a Variety of Approaches." *United States Government Accountability Office*. July 2006. Web. 22 Oct. 2011.

United States Internal Revenue Service and Department of Labor. *Memorandum of Understanding Between the Internal Revenue Service and the US Department of Labor*. 2011. Print.

United States Library of Congress. Congressional Research Service. *Tax Gap: Misclassification of Employees as Independent Contractors*. By James M. Bickley. 10 Mar. 2011. Web. 26 Aug. 2011.

United States. Office of Management and Budget. "Fiscal Year 2014 Budget of the U.S. Government" *United States Office of Management and Budget*. Apr. 2013. Web. 26 May 2013.

United States. State of Minnesota. Office of the Legislative Auditor. "Misclassification of Employees as Independent Contractors." *Minnesota Office of the Legislative Auditor*. Nov. 2007. Web. 22 Aug. 2011.

United States. Tennessee Employee Misclassification Advisory Task Force. Research & Resources Committee. "2nd Annual Report to Employee Misclassification Advisory Task Force." *State of Tennessee*, 30 Nov. 2012. Web. 30 May 2013.

United States. Texas Workforce Commission. Tax Department. "Appendix E - TWC Independent Contractor Test." *Texas Workforce Commission Tax Department*. Web. 1 Sept. 2011.

VedderPrice. "Labor and Employment Law." VedderPrice. Mar. 2013. Web. 27 May 2013.

Voreacos, David and Bob Van Voris. "Novartis Will Pay \$99 Million To Settle Overtime Lawsuit." Bloomberg. 25 Jan. 2012. Web. 18 Aug. 2012.

- Waters, Joanne E. "The Contingent Workforce: Employer Expectations and Legal Realities." *WilmerHale*. Wilmer Cutler Pickering Hale and Dorr LLP, 14 Apr. 2003. Web. 12 Oct. 2011.
- Watkins, Charles M. "Couriers: Independent Contractors or Employees." Webster, Chamberlain & Bean, 14 Oct. 2003. Web. 11 Nov. 2011.
- Weiss, Deborah S. "Georgia Enacts Bill Affording Franchisors Protection from Employee Misclassification Suits." *Franchise Law Update*. Fox Rothschild LLP, 15 May 2012. Web. 30 May 2013.
- Weissman, William Hays. "Section 530: It's History and Application in Light of the Federal Definition of the Employer-Employee Relationship for Federal Tax Purposes." *National Association of Tax Reporting and Professional Management*. 28 Feb. 2009. Web. 8 Oct. 2011.
- Welter, Eric. "D.C. Circuit Reverses NLRB On FedEx Independent Contractors | The Laconic Law Blog." *The Laconic Law Blog*. Welter Law Firm, 29 May 2009. Web. 12 Oct. 2011.
- Western, Bruce and Jake Rosenfeld. "Unions, Norms, and the Rise in American Wage Inequality." *American Sociological Review*. 76.4 (2011) 513-537.
- Whelan, David and Brian Wingfield. "How Obamacare Will Affect Your Insurance." *Forbes*. 24 Dec. 2009. Web. 26 May 2013.
- Winston & Strawn LLP. "Briefing: Misclassification of Employees as Independent Contractors Draws Heightened Government Enforcement." *Winston & Strawn LLP*. Dec. 2009. Web. 16 Oct. 2011.
- Wood, Robert W. "Can Franchisees Be Recast as Employees?" *Tax Notes*. 21 March 2011.
- Wood, Robert W. "Defining Employees and Independent Contractors." *Business Law Today*. Volume 17, Number 5. May/June 2008.
- Wood, Robert W. "IRS Expands Independent Contractor Amnesty." *Forbes*. 1 Mar. 2013. Web. 27 May 2013.
- Wood, Robert W. "Miranda-Like Warnings To Independent Contractors?" *Forbes*. 21 Sep. 2010. Web. 26 May 2013.