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# EMPLOYEES VERSUS INDEPENDENT CONTRACTORS: WHY STATES SHOULD NOT ENACT STATUTES THAT TARGET THE CONSTRUCTION INDUSTRY

Jane P. Kwak\*

## INTRODUCTION

Defining the working relationship between “employees” and “independent contractors” has been described as “one of the most troublesome and important issues facing businesses today.”<sup>1</sup> Classifying workers as independent contractors allows companies to avoid paying minimum wage and overtime,<sup>2</sup> the employer’s portion of Social Security and Medicare taxes,<sup>3</sup> unemployment insurance taxes, workers’ compensation premiums, and circumvent federal antidiscrimination laws.<sup>4</sup> Therefore, misclassification implies that workers are being denied basic rights and protections. At the same time, avoiding payment of certain taxes and wages gives employers a competitive advantage and an incentive to misclassify. According to workplace experts, many companies have sought to cut costs by wrongfully classifying regular employees as independent contractors.<sup>5</sup> Due to the strained economy and poor job market, workers have become increasingly reluctant to challenge such employer practices.<sup>6</sup>

The purpose of this note is to examine the recent federal attempts at addressing worker misclassification and The Illinois Employee Classification Act (“ECA”) – a state statute specifically targeting misclassification in the construction industry. This note argues that other states should not enact laws similar to the ECA. First, I begin with a review of how the definition of an “employee” versus “independent

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1. John Bruntz, *The Employee/Independent Contractor Dichotomy: A Rose is Not Always a Rose*, 8 HOFSTRA LAB. L. J. 337, 337 (1991).

2. The Fair Labor Standards Act establishes national minimum wage and overtime standards, but only applies to “employees,” not “independent contractors.” 29 U.S.C. § 203 (2006). Nonetheless, the Davis Bacon Act requires that employers pay local prevailing wages to contractors and subcontractors performing on federally funded or assisted contracts. 40 U.S.C. § 3142 (2006).

3. The Internal Revenue Service Code does not require employers to withhold income taxes, withhold and pay Social Security and Medicare taxes or pay unemployment taxes on payments paid to independent contractors. See *Independent Contractor (Self-Employed) or Employee?*, [http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-\(Self-Employed\)-or-Employee3F](http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-(Self-Employed)-or-Employee3F) (last visited Jan. 2, 2013).

4. Title VII of the Civil Rights Act of 1964 prohibits discrimination on the basis of race, color, religion, sex or national origin, but only applies to “employees,” not “independent contractors.” 42 U.S.C. § 2000e-2 (2006).

5. Steven Greenhouse, *U.S. Cracks Down on ‘Contractors’ as a Tax Dodge*, N.Y. TIMES, Feb. 18, 2010, at A1, available at <http://www.nytimes.com/2010/02/18/business/18workers.html>.

6. *Id.*

contractor” has changed throughout history, and then move on to the recent regulatory crackdown on worker misclassification – what state and federal governments have been doing to curtail companies from incorrectly treating a worker as an independent contractor. Next, I discuss Congressional, legislative attempts at controlling worker misclassification and examine the difference between taxation considerations and wage and hour laws. Finally, the note reviews the ECA and discusses why other states should not pass similar legislation because existing laws already address the issue, and merely targeting the construction industry is unfair to construction companies.

## I. A BRIEF HISTORY OF WORKER CLASSIFICATION

The definition of independent contractor originated from the phrase, “independent calling” in the late 1800’s. This phrase essentially referred to the fact that an independent contractor was his own master; he was not devoted to a single master, but was free to serve several clients simultaneously or in seriatim.<sup>7</sup> The distinction between an independent contractor and an employee derived from common law concepts of master and servant and agency law.<sup>8</sup> Historically, the courts have played the largest role in determining the definition of an employee.<sup>9</sup> Judges have traditionally used an “ever-expanding catalogue” of tests containing numerous criteria to pinpoint exactly what constitutes an employee.<sup>10</sup> This common law test has failed to provide a concrete, consistent result.<sup>11</sup> Throughout the years, the test for determining *respondeat superior* (a common law doctrine that holds an employer liable for the actions of an individual when the actions take place within the scope of employment) became the most important factor in determining employee status under protective legislation.<sup>12</sup> Known as the “employer control test”/“right-to-control test,” the degree of the master’s control over his servant became the key consideration.<sup>13</sup> However, differences arose concerning the weight given to the “control” factor when determining tort liability versus protective legislation. For example, even if a worker could be classified as an independent contractor for tort purposes (i.e. being held individually liable for his own actions, rather than the employer being liable), he could be classified as an employee for purposes of protective legislation (e.g. requiring the employer to provide social welfare).<sup>14</sup> Nonetheless, the common law approach to determining employee versus independent contractor status typically turned on the “right to control”: whether the employer

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7. Richard R. Carlson, *Why the Law Still Can't Tell an Employee When it Sees One and How it Ought to Stop Trying*, 22 BERKELEY J. EMP. & LAB. L. 295, 303 (2001).

8. Bruntz, *supra* note 1, at 338; RESTATEMENT (SECOND) OF AGENCY § 220 (1958).

9. Carlson, *supra* note 7, at 298.

10. *Id.* at 299; *see also* RESTATEMENT (SECOND) OF AGENCY § 220 (1958).

11. Carlson, *supra* note 7, at 299.

12. *Id.* at 310.

13. Bruntz, *supra* note 1, at 338-39; *see generally* *Boswell v. Laird*, 8 Cal. 469 (1857).

14. Carlson, *supra* note 7, at 311.

has the right to direct and control when, where and how the worker performs his tasks.<sup>15</sup>

Courts were frequently inclined to give added weight to factors other than control when the effect was to extend protection to needy workers, rather than to impose tort liability on employers.<sup>16</sup> This tendency to define employee expansively for purposes of protective legislation led to the “economic realities test,” created by Judge Learned Hand.<sup>17</sup> The economic realities approach looked at (1) the company’s control over capital, and (2) the company’s control over the specific project.<sup>18</sup> Applying the economic realities approach, the Supreme Court promoted an expansive view of employee classification. In *National Labor Relations Board v. Hearst Publications*, the Court expanded the criteria to be considered to determine if an individual was an employee entitled to coverage.<sup>19</sup> The policies surrounding the Court’s decision were centered on alleviating the consequences of employer domination of the workforce, and to use the employment relationship to deliver certain social welfare benefits.<sup>20</sup> Nonetheless, the Court made it clear that it was not abandoning the common law separation between employees and independent contractors.<sup>21</sup>

Despite the Supreme Court’s efforts to apply a broad statutory method of interpretation by using the “economic realities test” and applying statutory purpose,<sup>22</sup> Congress restored the traditional view of the employee/independent contractor dichotomy by passing several legislative acts. In 1947 Congress passed the Taft-Hartley Act, which amended the National Labor Relations Act (“NLRA”), and specifically excluded independent contractors from the protections of the Act.<sup>23</sup> Taft-Hartley denounced the holding of *Hearst*, and Congress criticized the Court for single-handedly expanding the definition of employee “beyond anything that it ever had included before.”<sup>24</sup> Congress further defined the mutual exclusivity between employee and independent contractor:

15. Bruntz, *supra* note 1, at 342; *see also* *Marvel v. United States*, 719 F.2d 1507, 1514 (10th Cir. 1983) (noting that it is sufficient for an employer to have the right to control, without actually exercising control).

16. Carlson, *supra* note 7, at 311.

17. *See* *Lehigh Valley Coal Co. v. Yensavage*, 218 F. 547 (2d Cir. 1914) (Judge Hand was fearful to classify workers in the mining industry as independent contractors because the nation’s basic industries might cease to be employers, and he worried about employee protection).

18. *Id.* at 552-53.

19. *See* 322 U.S. 111 (1944) (deemphasizing the importance of “employer control” and focusing on the statutory purpose of the National Labor Relations Act (“NLRA”) in order to hold that newsboys were in fact employees for purpose of collective bargaining protections of the NLRA).

20. Carlson, *supra* note 7, at 319; *see generally* *United States v. Silk*, 331 U.S. 704 (1947) (applying the economic realities test to independent contractor/employee classification for purposes of the Social Security Act).

21. Carlson, *supra* note 7, at 319.

22. The Supreme Court adopted a broad analysis of remedial New Deal era legislation, attempting to give effect to the social justice goals of such laws.

23. Labor Management Relations (Taft-Hartley) Act, Pub. L. No. 101, 61 Stat. 137 (1947) (codified as amended at 29 U.S.C. §§ 152(3) (1994)).

24. Carlson, *supra* note 7 at 321(citing H.R. Rep. No. 80-245, at 3020 (1947)).

Employees work for wages or salaries under direct supervision . . . [i]ndependent contractors undertake to do a job for a price, decide how the work will be done, usually hire others to do the work, and depend for their income not upon wages, but upon the difference between what they pay for goods, materials, and labor and what they receive for the end result, that is, upon profits.<sup>25</sup>

In effect, Congress sent a message to courts and agencies to lean somewhat more toward non-employee status in any close case.<sup>26</sup> A year later, Congress amended the Social Security Act in an attempt to resurrect the common law tests of resolving employee/independent contractor issues.<sup>27</sup> Specially, the amendment stated that the term “employee” would not include “any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an independent contractor.”<sup>28</sup>

Since Congress’ attempts to restore the common law determination of employee versus independent contractor, state and federal courts have been using multiple-factor tests to determine worker classification.<sup>29</sup> Some factors which courts have considered include: (1) whether the “employee” had a reasonable expectation that he would receive benefits under federal protective legislation, (2) that he relied on this expectation, (3) that he lacked the economic bargaining power to contract out of benefit plan forfeiture provisions, (4) skill required, (5) source of instrumentalities and tools, (6) location of work, (7) duration of relationship between parties, (8) hiring party’s right to assign additional projects to hired party, (9) extent of hired party’s discretion over when and how long to work, (10) method of payment, hired party’s role in hiring and paying assistants, (11) regular business of hiring party, (12) provision of employee benefits, and (13) tax treatment of hired party.<sup>30</sup> Application of such multiple-factor tests has led to a lack of continuity between cases. Without a hard and fast rule, judges are left free to utilize their discretion, relying on policy considerations as the ultimate concern underlying their judgments. In fact, with a multitude of factors to choose from, the only real difference between the outcomes of cases resulted from the fact that individual judges tended to favor some factors at the expense of others – based on their eagerness or reluctance to extend coverage to workers in any given circumstance.<sup>31</sup> As the Court explained, “[s]ince the multifactor common-law test here adopted . . . contains no shorthand formula for determining who is an ‘employee,’ all of the incidents of the employment relationship must be assessed and weighed with no one factor being decisive.”<sup>32</sup> Thus,

25. Carlson, *supra* note 7, at 322 (citing H.R. Rep. No. 80-245, at 3020 (1947)).

26. Carlson, *supra* note 7, at 324.

27. Act of June 14, 1948, ch. 468, § 2(a), 62 Stat. 438 (1948) (codified as amended at 26 U.S.C. § 3121(d) (1994)).

28. *Id.*

29. Carlson, *supra* note 7, at 326-27.

30. Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 751-52 (1989) (listing the general common law factors of agency in determining the definition of “employee” for purposes of the Copyright Act of 1976).

31. Carlson, *supra* note 7, at 327-28.

32. *Darden*, 503 U.S. at 318 (citation omitted).

the common law “right to control” approach still remains the prevailing method for defining an employee versus an independent contractor. Similarly for taxation purposes, the Internal Revenue Service (“IRS”) currently defines an individual as an independent contractor “if the payer has the right to control or direct only the result of the work and not what will be done and how it will be done.”<sup>33</sup> The IRS defines a common law employee as “anyone who performs services for you . . . if you can control what will be done and how it will be done.”<sup>34</sup>

## II. INCREASED SCRUTINY ON MISCLASSIFICATION

In 2009, the U.S. Bureau of Labor Statistics estimated that more than 10.3 million workers in the United States (7.4% of the workforce) are treated as independent contractors.<sup>35</sup> A 2000 U.S. Department of Labor (“DOL”) study found that as many as 30% of businesses misclassified employees as independent workers.<sup>36</sup> Since then, the Government Accountability Office (“GAO”) has determined that the number of misclassified workers has increased by 50% in the interim.<sup>37</sup> Former Ohio Attorney General Richard Cordray estimated that misclassifying a worker makes a 20-30% cost difference per worker.<sup>38</sup> In other words, the state of Ohio loses 20-30% in tax revenue when a worker is misclassified as an independent contractor rather than an employee. A study done by the Ohio Attorney General’s office estimated that the state of Ohio loses approximately \$160 million a year in tax revenue due to worker misclassification.<sup>39</sup>

Since 2010, state and federal officials have been aggressively pursuing companies that attempt to mask employees as independent contractors.<sup>40</sup> From 2007 to 2012, the DOL has increased its percentage of directed investigations in industries with a high prevalence of misclassification from 9% to 19.98%.<sup>41</sup> President Obama’s 2010 budget predicted that better record keeping could raise \$7 billion over the next ten years.<sup>42</sup> The federal budget for Fiscal Year 2013 allocates \$14 mil-

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33. *Independent Contractor Defined*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Independent-Contractor-Defined> (10-Jan-2013).

34. *Employee (Common-Law Employee)*, INTERNAL REVENUE SERVICE, [http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Employee-\(Common-Law-Employee\)](http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Employee-(Common-Law-Employee)) (14-Jan-2013).

35. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO 09-717, *EMPLOYEE MISCLASSIFICATION: IMPROVED COORDINATION, OUTREACH, AND TARGETING COULD BETTER ENSURE DETECTION AND PREVENTION I* (2009), available at <http://www.gao.gov/new.items/d09717.pdf>.

36. *Id.* at 11.

37. *Id.* at 11-13.

38. Greenhouse, *supra* note 5.

39. Press Release, Sherrod Brown Senator for Ohio, *Sen. Brown Joins Colleague in Announcing Bill to Ensure that Workers Receive Protection and Benefits They Have Earned* (April 22, 2010), <http://www.brown.senate.gov/newsroom/press/release/sen-brown-joins-colleague-in-announcing-bill-to-ensure-that-workers-receive-protection-and-benefits-they-have-earned>.

40. Greenhouse, *supra* note 5.

41. U.S. DEP’T OF LABOR, *AGENCY FINANCIAL REPORT: FISCAL YEAR 2012 17* (2012), available at [http://www.dol.gov/\\_sec/media/reports/annual2012/2012annualreport.pdf](http://www.dol.gov/_sec/media/reports/annual2012/2012annualreport.pdf).

42. *Id.*; see also Press Release, *Sen. Brown Joins Colleague in Announcing Bill to Ensure that Workers Receive Protection and Benefits They Have Earned* (April 22, 2010),

lion for grants to states to assist in identifying misclassification, recovering unpaid taxes and facilitating inter-agency cooperation.<sup>43</sup> The DOL has recently initiated a “Misclassification Initiative” in which it has entered into memorandums of understanding with 13 states to coordinate enforcement efforts and share information between state and federal agencies about non-compliant employers.<sup>44</sup> Since 2007, the IRS has also entered into agreements with 34 states to share information and enforcement techniques.<sup>45</sup> Furthermore, regulatory agencies have been utilizing the unemployment and workers’ compensation claims processes in order to target independent contractor misclassification. As a result of the prolonged recession, workers who consider themselves independent contractors are nonetheless applying for unemployment benefits. Local claims offices are more frequently issuing initial determinations of “employee” status to claims filed by workers who have signed independent contractor agreements or are receiving compensation based on a 1099 tax form basis.<sup>46</sup> Claims examiners are finding that more and more independent contractors have been misclassified and should be entitled to unemployment benefits as employees. Initially determining a worker as an “employee” can have the same effect as an adverse employee classification audit. If an administrative law judge upholds the determination that a worker has been misclassified as an independent contractor, the employer is then normally charged for unpaid contributions for “all similarly situated” workers, along with being responsible for penalties and fines.<sup>47</sup>

These recent federal undertakings against employee misclassification are the result of three major developments. First, in 2009 the GAO issued a report urging Congress to enact laws that (1) limit the availability of the Section 530 “safe harbor” provisions of the Revenue Act of 1978, which many businesses rely on in order to classify workers as independent contractors; (2) define misclassification as a violation of federal wage and hour laws; (3) enhance IRS and DOL enforcement of misclassification, and (4) improve coordination of information between the IRS, DOL, and state workforce and revenue agencies.<sup>48</sup> Second, in February 2010 the IRS announced that it was commencing an Employment Tax National Research Project to conduct audits of 6,000 businesses focusing on employee classification.<sup>49</sup>

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<http://www.brown.senate.gov/newsroom/press/release/sen-brown-joins-colleague-in-announcing-bill-to-ensure-that-workers-receive-protection-and-benefits-they-have-earned>.

43. U.S. DEP’T OF LABOR, FISCAL YEAR 2013 BUDGET OF THE UNITED STATES 146, available at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/labor.pdf>.

44. See *Employee Misclassification as Independent Contractors*, U.S. DEPARTMENT OF LABOR, <http://www.dol.gov/whd/workers/misclassification/#whd> (last visited Jan. 26, 2013). The 13 states that have signed a memorandum of understanding with the DOL include: California, Colorado, Connecticut, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, Montana, Utah and Washington.

45. Richard Reibstein, Lisa Petkun & Andrew Rudolph, *Independent Contractor Misclassification Update 2012: How Companies Can Minimize the Risks*, PEPPER HAMILTON LLP (May 14, 2012), [http://www.pepperlaw.com/publications\\_article.aspx?ArticleKey=2365](http://www.pepperlaw.com/publications_article.aspx?ArticleKey=2365).

46. Independent contractors’ earnings are reported to the IRS on a Form 1099 basis, while employees report their earnings using a Form W-2.

47. See Reibstein, Petkun & Rudolph, *supra* note 46.

48. UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 36, at 32-38.

49. David R. Fuller & Jerry E. Holmes, *The Employment Tax National Research Project—Ripple or IRS Tsunami?*, SOCIETY FOR HUMAN RESOURCE MANAGEMENT, (Feb. 2, 2010)

Third, the Obama Administration's proposed budget for the 2011 fiscal year authorized \$25 million to the DOL to target employee classification by hiring ninety additional investigators and ten additional lawyers to "eliminate incentives in law for employers to misclassify their employees."<sup>50</sup>

In addition to national scrutiny, several states have also taken steps to enact stricter penalties and private rights of action for worker misclassification.<sup>51</sup> To date, more than a dozen states have created misclassification task forces.<sup>52</sup> In the past three years, eleven states have passed laws either limiting the permissible uses of independent contractors or increasing penalties for misclassification.<sup>53</sup> Overall, twenty-one states have targeted worker misclassification in some fashion.<sup>54</sup> "In addition, at least eighteen state legislatures have proposed bills intended to limit the use of independent contractors or make misclassification more costly."<sup>55</sup>

### III. ARGUMENTS FOR GREATER SCRUTINY

Independent contractors do not have a right to unionize,<sup>56</sup> are exempt from minimum wage and overtime protections,<sup>57</sup> occupational safety laws,<sup>58</sup> and most discrimination safeguards,<sup>59</sup> and typically do not receive health and pension benefits

<http://www.shrm.org/LegalIssues/FederalResources/Pages/NationalResearchProject.aspx>; Reibstein, Petkun & Rudolph, *supra* note 46.

50. U.S. DEP'T OF LABOR, FY 2011, CONGRESSIONAL BUDGET JUSTIFICATION, WAGE AND HOUR DIVISION 23 (2011); U.S. DEP'T OF LABOR, FY 2011 DEPARTMENT OF LABOR, BUDGET IN BRIEF 44 (2011).

51. *See, e.g.*, NEB. REV. STAT. § 48-2907 (2012) (made effective in 2010, providing for fines of \$500 per each misclassified individual for the first offense, and \$5,000 per each misclassified individual for each subsequent offense); N.J. STAT. ANN. § 34:20-5 (West 2013) (made effective in 2007, providing for fines between a hundred and a thousand dollars for each individual offense, and prison time between ten and 90 days; each week in any day of which an employee is misclassified and each employee so misclassified constituting a separate offense); 820 ILL. COMP. STAT. ANN. 185 / 60 (West 2012) (made effective in 2008, creating a private right of action to file suit in state court, and providing for \$500 in compensatory damages for each violation and attorney's fees and costs).

52. Those states include: Connecticut, Iowa, Maryland, Massachusetts, Michigan, Minnesota, New Hampshire, New York, Oregon, Rhode Island, Tennessee, Utah, Vermont and Washington. *See* Reibstein, Petkun & Rudolph *supra* note 46, at n.7; Reibstein, Petkun & Rudolph, PEPPER HAMILTON, LLP, *Independent Contractor Compliance*, <http://independentcontractorcompliance.com/legal-resources/state-ic-laws-and-selected-bills/> (last visited Jan. 26, 2013) for a complete list of state and federal independent contractor laws and bills.

53. These states include: California, Connecticut, Florida, Kansas, Maine, Nebraska, New York, Pennsylvania, Utah, Vermont and Wisconsin. *See* Reibstein, Petkun & Rudolph, *supra* note 46, at 2.

54. Reibstein, Petkun & Rudolph, *supra* note 46, at 2.

55. *Id.* *See* Reibstein, Petkun & Rudolph, *supra* note 46, at n.9.

56. National Labor Relations Act, 29 U.S.C. § 152(3) (2013) (expressly excluding independent contractors from the protections and provisions of the Act, including the right to join and form unions).

57. Fair Labor Standards Act, 29 U.S.C. § 203(e) (2013) (merely defining an "employee" as any individual employed by an employer); *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 728-30 (1947) (discussing the distinctions between "employee" and "independent contractor" under the FLSA).

58. The Occupational Safety and Health Act (OSHA), 29 U.S.C. § 654(a), requires employers only to provide safe workplaces for "employees."

59. For example, the protections granted by Title VII only apply to individuals in an employment relationship. However, 42 U.S.C. § 1981 does protect independent contractors from race and some national origin discrimination in the making and enforcement of contracts. *See, e.g.*, *Brown v. J. Kaz, Inc.*, 581 F.3d 175 (3d Cir. 2009).



that employees receive.<sup>60</sup> Some experts believe that “[I]ax enforcement by revenue and workforce agencies has contributed greatly to the misclassification of employees as [independent contractors].”<sup>61</sup> Proponents of increased scrutiny on employer practices highlight the need for greater penalties as an incentive for businesses to comply with existing regulations. Many underlying statutes like the FLSA merely require employers to pay what was originally owed had the worker properly been classified as an employee (e.g. minimum wage or overtime).<sup>62</sup> Thus, it is more cost beneficial for employers to misclassify and simply receive a “slap on the wrist” if they eventually get caught. In addition, the statute of limitations on existing regulations limit the amount of damages that workers can receive.<sup>63</sup> It is argued that greater protection for workers is required because violating wage/hour laws by misclassifying is so easy and cost-beneficial. Increased penalties might deter business from making a conscious decision to misclassify. Proponents of increased enforcement argue that employers need incentives to comply with existing wage/hour laws and tax regulations and disincentives to “cheat,” ensuring that they correctly classify employees.

#### IV. ARGUMENTS AGAINST GREATER SCRUTINY

On the other hand, employers deny that misclassification is deliberate, arguing that the laws are unclear about how to correctly classify a worker. Federal regulations have different definitions for what constitutes an “employee.” For example, a worker could theoretically be categorized as an independent contractor for tax purposes but as an employee for wage and hour laws.<sup>64</sup> Some officials further argue that attempting to raise tax revenue is not an appropriate rationale for reclassifying workers.<sup>65</sup> Moreover, the consequences to businesses that are highly reliant on independent contractors (e.g. the construction industry) are immeasurable. Possible

60. For example, the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1002, only applies to “employees.”

61. Reibstein, Petkun & Rudolph, *supra* note 46, at 3.

62. In addition to requiring employers to pay what was originally owed, employees are entitled to liquidated damages (plus interest) unless the employer can prove it acted in good faith under the FLSA.

63. A 2-year statute of limitations applies to the recovery of back pay, except in the case of a willful violation, in which case a 3-year statute applies under the FLSA. Fair Labor Standards Act, *supra* note 58, at § 255. Therefore, unless the violations are willful, back wages may only be recovered within two years of when the violations occurred; the statute of limitations on employer liability for unpaid employment taxes is typically three years. *See e.g.*, Internal Revenue Manual, Exhibit 4.23.9-1 Instructions for Determining Civil Penalty Statute of Limitations, [http://www.irs.gov/irm/part4/irm\\_04-023-009.html#d0e1138](http://www.irs.gov/irm/part4/irm_04-023-009.html#d0e1138) (last visited Feb. 16, 2013) (citing IRC 6721, 6722, 6679, 6682, 6694(a), 6695, 6702).

64. The IRS Code, 26 U.S.C. § 3401(c), defines an employee as “an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term “employee” also includes an officer of a corporation,” *id.*, while the Fair Labor Standards Act does not provide an explicit definition of “employee” and merely excludes volunteers, 29 U.S.C. § 203(e).

65. Randel K. Johnson, senior vice president of the United States Chamber of Commerce has stated, “[t]he goal of raising money is not a proper rationale for reclassifying who falls on what side of the line . . . The laws are unclear in this area, and legitimate clarification is one thing. But if it’s a way to justify enforcing very unclear laws against employers who can have a legitimate disagreement with the Labor Department or I.R.S., then we’re concerned.” *See*, Greenhouse, *supra* note 5.

penalties include liability for unpaid federal, state, and local income tax withholdings and Social Security and Medicare contributions, unpaid workers' compensation and unemployment insurance premiums, and unpaid work-related expenses and overtime compensation – even for a mistaken, unintentional incidence of misclassification. These potential liabilities (plus interest and penalties for non-compliance) can be devastating for businesses that make substantial use of independent contractors. Employee benefit plans are also a potential source of costly liabilities to employers that misclassify. *Vizcaino v. Microsoft Corp.* is a prime example of how expensive re-characterization of worker status can be to companies, even when the misclassification is unintentional.<sup>66</sup> In addition to a substantial payment to the IRS, Microsoft paid \$97 million to settle the case, plus millions more in legal fees for the workers' class action lawyers.<sup>67</sup>

## V. WHAT DO THE WORKERS THINK?

Some argue that many workers do not know when they are being misclassified and oftentimes do not know the difference between an “employee” and an “independent contractor.” George Grody, who has been working as a construction worker for twenty-five years, however, was clear on the distinction between independent contractor and employee. He articulated that the employer takes care of “pretty much everything” for employees, while independent contractors are “left on their own.” Pointing to the issues of taxes as the most significant difference between the classifications, “when you’re an independent contractor, you’re responsible for making sure all of your own taxes [*sic*], but if you’re an employee, the company pretty much takes care of that for you,” said Grody.<sup>68</sup> As a member of a union, Grody said he was certain that he was an employee and that his employer took care of everything, from pension plans to healthcare and taxes. If Grody is representative of most construction workers, it would seem that workers are fairly knowledgeable about the issue.

## VI. WHY DOES IT MATTER?

Two simple words: tax revenue. Companies that classify workers as independent contractors rather than as employees do not withhold income taxes from workers' paychecks. Furthermore, several studies have indicated that misclassified independent contractors do not report 30% of their income.<sup>69</sup> This means that in theory,

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66. In 1989 and 1990, the IRS had reclassified certain Microsoft “freelancers” to “employees.” Afterward, the employees sought fringe benefits provided to all other Microsoft employees. The Ninth Circuit nullified waivers of benefit provisions signed by the workers when they were hired, and concluded that the agreements were not controlling because they assumed that the workers were independent contractors, construing ambiguity in the benefit plan against Microsoft. See *Vizcaino v. Microsoft Corp.*, 97 F.3d 1187 (9th Cir. 1996).

67. See *Vizcaino v. Microsoft Corp.*, 142 F. Supp. 2d 1299 (W.D. Wash. 2001) *aff'd*, 290 F.3d 1043 (9th Cir. 2002) (approving a \$27,127,800 percentage-based award of attorneys' fees, which was 28% of the \$96.885 million 1996 settlement fund).

68. Interview with George Grody, Worksite Supervisor, Skanska, in Notre Dame, In. (Jan. 17, 2013).

69. Greenhouse, *supra* note 5.

both federal and local governments lose income tax revenue when workers are classified as independent contractors rather than employees. Employers also avoid paying Social Security, Medicare and unemployment insurance taxes when they label a worker as an independent contractor.

One of the most significant reasons behind the recent efforts against worker classification is the need to increase tax revenue in a recessive economy. The IRS estimated a loss of \$1.6 billion in tax revenue from misclassification in 1984.<sup>70</sup> Coupled with the apparent increase in worker misclassification and inflation, the estimated loss in tax revenue is expected to be substantially more today. Greater scrutiny of worker classification has the potential to raise a significant portion of revenue. Therefore, in light of the country's desperate need to increase government income, it is no coincidence that the Obama Administration has made misclassification a priority. In fact, as a senator, President Obama supported proposed legislation amending the IRS Code to implement proper procedures for employee/independent contractor classification in September 2007, soon after the housing market crash.<sup>71</sup> Furthermore, making sure that workers receive the wages, benefits, and protections to which they are entitled is undoubtedly a very important motivating factor in ensuring proper worker classification. Given the current economic state, however, trying to regain lost tax revenue seems to be an especially large motivating factor behind the recent push for increased scrutiny on misclassification.

#### A. Federal Taxation Considerations

Federal tax law requires employers to withhold income taxes to pay the employer share of Social Security, Medicare, and federal unemployment taxes. The IRS uses the common law "control test" to determine the employee/independent contractor classification.<sup>72</sup> In 1996, the IRS promulgated three categories of control used to facilitate classification: (1) behavioral control; (2) financial control; and (3) how the parties perceive the relationship.<sup>73</sup>

"In theory, the IRS should receive roughly the same amount in revenue regardless of how a worker is classified."<sup>74</sup> Independent contractors are required to pay a self-employment tax, made up of Social Security and Medicare taxes.<sup>75</sup> The self-

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70. UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE-, *supra* note 36, at 1.

71. *See infra* notes 88-90 and accompanying text. The "Independent Contractor Proper Classification Act of 2007" was introduced on September 12, 2007, and the housing market crash caused credit markets to freeze in the summer of 2007.

72. 26 U.S.C. § 3121(d)(2). *See also* IRS.gov, *supra* note 35 (discussing the definition of a common law employee).

73. *Independent Contractor or Employee? Training Manual*, U.S. DEP'T OF THE TREASURY, 2-7 (Oct. 30, 1996).

74. Bruntz, *supra* note 1, at 344.

75. *Self-Employment Tax (Social Security and Medicare Taxes)*, INTERNAL REVENUE SERVICE, available at:

[http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Self-Employment-Tax-\(Social-Security-and-Medicare-Taxes\)](http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Self-Employment-Tax-(Social-Security-and-Medicare-Taxes)) (last visited Feb. 18, 2013).

employment tax for 2013 is 15.3%.<sup>76</sup> The 2013 Social Security and Medicare tax rate is 7.65% for employees, and 7.65% for employers, adding up to a total of 15.3%.<sup>77</sup> Therefore, irrespective of how the relationship is classified, the IRS imposes the same tax rate (15.3%).<sup>78</sup> So why has the IRS made continued efforts to police misclassification?<sup>79</sup> Because it is much harder to recoup lost revenue from independent contractors than it is to monitor employers who withhold taxes from regular employees.<sup>80</sup>

Reclassification is one negative consequence that employers face if they get caught misclassifying a worker as an independent contractor for IRS purposes.<sup>81</sup> After a negative audit, the IRS can retroactively reclassify an independent contractor as an employee, making the employer liable for some or all of the income and Social Security taxes that should have been withheld and for matching Federal Insurance Contribution Act (“FICA”) and Federal Unemployment Tax Act (“FUTA”) taxes.<sup>82</sup> The employer may also lose their qualified status for employee benefit and pension plans as well as the associated expense deductions for these plans.<sup>83</sup> Section 3509 of the Internal Revenue Code (“IRC”) specifies an employer’s liability when it unintentionally misclassifies a worker.<sup>84</sup> Section 3403 imposes a variety of taxes on the employer if it intentionally disregards requirements to deduct and pay employment taxes, including liability for the payment of withholding the tax, whether or not the Social Security and federal unemployment taxes were actually withheld.<sup>85</sup> Additionally, the employer may be liable for a penalty equal to the total amount of the tax evaded, not collected, or not accounted for and paid over under Section 6672 of the IRC.<sup>86</sup>

The problem of worker misclassification for taxation purposes has garnered federal legislative attention since 2007.<sup>87</sup> Several Democratic senators, including then-Senator Barack Obama, introduced the “Independent Contractor Proper Classification Act of 2007.”<sup>88</sup> The bill would have amended the Revenue Act of 1978<sup>89</sup> to provide procedures for the proper classification of employees and independent contractors and sought to eliminate the “industry practice” defense to misclassifica-

76. See *Social Security and Medicare tax rates; maximum taxable earnings*, SOCIAL SECURITY ADMINISTRATION, [http://ssa-custhelp.ssa.gov/app/answers/detail/a\\_id/240/~/2012-social-security-tax-rate-and-maximum-taxable-earnings](http://ssa-custhelp.ssa.gov/app/answers/detail/a_id/240/~/2012-social-security-tax-rate-and-maximum-taxable-earnings) (last visited Feb. 18, 2013).

77. *Id.*

78. *Id.*

79. Sarah E. Needleman & Emily Maltby, *Price of Reclassifying Workers*, WALL STREET JOURNAL (Sept. 26, 2011), <http://online.wsj.com/article/SB10001424053111903791504576588811797594764.html>.

80. Bruntz, *supra* note 1, at 344.

81. *Id.*, at 343.

82. *Id.*; *Ssee also* *Avis Rent A Car Sys., Inc. v. U.S. United States*, 503 F.2d 423 (2d Cir. 1974).

83. *Id.*; Howard B. Soloman & Michael Schlisinger, *Section 1706: Where It Came from and Where It Is Going?*, 66 TAXES TAXES 50, 55 (1988).

84. I.R.C. Internal Revenue Code § 3509(c) (1990), codified at, 26 U.S.C. § 3509(c) (1998).

85. I.R.C. § 3403 (1990), codified at *Id.*, at 26 U.S.C. § 3404 (1998); Bruntz, *supra* note 1, at 344.

86. I.R.C. § 6672 (1990), codified at Internal Revenue Code, 26 U.S.C. 26 U.S.C. § 6672 (1998).

87. Bran Noonan, *The Campaign Against Employee Misclassification*, 82 N.Y. ST. B.J. 42, 44 (Oct. 2010).

88. *Id.*; *Ssee also* Pub. L. 95–600 (HR 13511), PL 95–600, NOVEMBER 6, 1978, 92 Stat 2763 (1978).

89. Pub. L. 95–600 (HR 13511), PL 95–600, NOVEMBER 6, 1978, 92 Stat 2763 (1978).

tion.<sup>90</sup> The proposed legislation did not provide a definition of “employee” and was never passed.<sup>91</sup> Two years later, the Taxpayer Responsibility, Accountability and Consistency Act of 2009 (“TRAC”) was proposed in the House.<sup>92</sup> It was aimed at amending the IRS Code of 1986,<sup>93</sup> and adopted the “usual common law test” to determine worker status.<sup>94</sup> TRAC proposed to eliminate the “safe harbor” provision of Section 530 of the Revenue Act of 1978, and presumed that a classification of “independent contractor” is valid so long as the employer had a reasonable basis for it,<sup>95</sup> requiring: (1) reasonable reliance on a written determination or a concluded examination that the worker is not an employee; and (2) the employer has not treated any other individual holding a substantially similar position as an employee for employment taxes.<sup>96</sup> Under the bill, an employer would have had the burden to prove, by a preponderance of the evidence, that it was reasonable to classify a worker as an independent contractor.<sup>97</sup> TRAC also provided remedial measures that allowed any individual to petition the DOL for a determination of worker status for employment tax purposes and granted the right to a civil appeal if the individual was not determined to be an “employee.”<sup>98</sup> Upon a finding that an individual had been misclassified, that individual was to be eligible for the refund of self-employment taxes.<sup>99</sup> TRAC was never passed.<sup>100</sup>

### B. Federal Wage and Hour Laws

Although the FLSA provides for minimum wages and overtime payments for “employees,” it does not offer a specific definition of an “employee,” nor does it point to a particular body of law for guidance.<sup>101</sup> It simply offers a circular definition: “any individual employed by an employer.”<sup>102</sup> Given this lack of clarity, courts

90. Independent Contractor Proper Classification Act of 2007, S. 2044, 110<sup>th</sup> Cong. (2007). *See also* GOVTRACK.US, “S. 2044 (110<sup>th</sup>)” *Independent Contractor Proper Classification Act of 2007*, GOVTRACK.US, )”<http://www.govtrack.us/congress/bills/110/s2044> (last visited May 16, 2013).

91. GOVTRACK.US, “S. 2044 (110<sup>th</sup>)” *Independent Contractor Proper Classification Act of 2007*, GOVTRACK.US, )”<http://www.govtrack.us/congress/bills/110/s2044> (last visited May 16, 2013).

92. Noonan, *supra* note 84884, at 45.; *See also* Taxpayer Responsibility, Accountability, and Consistency Act of 2009, H.R. 3408, 111<sup>th</sup> Cong. (2009).

93. I.R.C. § 3501-3510 (1986), codified at 26 U.S.C. Internal Revenue Code, *supra* note 85, at § 3501-3510 (1986).

94. Noonan, *supra* note 84884, at 45.

95. Taxpayer Responsibility, Accountability, and Consistency Act of 2009, H.R. 3408, 111<sup>th</sup> Cong. § 3 (2009).

96. *Id.*, (the determination of “substantially similar position” was to be made by the Secretary of Labor in a manner consistent with the Fair Labor Standards Act of 1938).

97. *Id.*

98. *Id.*

99. *Id.*

100. GOVTRACK.US, “H.R. 3408 (111<sup>th</sup> Cong.)” *Taxpayer Responsibility, Accountability, and Consistency Act of 2009*, GOVTRACK.US, *available at*: <http://www.govtrack.us/congress/bills/111/hr3408> (last visited May 16, 2013).

101. Fair Labor Standards Act, *supra* note 58, at 29 U.S.C. § 203, .; *See also* Noonan, *supra* note 884, at 46.

102. Fair Labor Standards Act, *supra* note 58, at 29 U.S.C. § 203(e)(1).

have tended to define “employee” broadly.<sup>103</sup> When determining the employee/independent contractor dichotomy under the FLSA, courts have applied the “economic realities” test developed in *Silk*.<sup>104</sup> The economic realities test looks at “whether, as a matter of economic reality, the workers depend upon someone else’s business for the opportunity to render service or are in business for themselves.”<sup>105</sup>

In 2008, the “Employee Misclassification Prevention Act” (“EMPA”)<sup>106</sup> was introduced in the U.S. House of Representatives.<sup>107</sup> The bill was intended “to amend the [FLSA],” and, more specifically, “to require employers to keep records of non-employees who perform labor or services for remuneration.”<sup>108</sup> The EMPA was intended to require employers to keep records of non-employees who perform labor or services for remuneration and to provide a special penalty for employers who misclassify employees as non-employees.<sup>109</sup> The EMPA did not contain “an explicit classification test,” and was never enacted.<sup>110</sup> In April of 2010, Senator Sherrod Brown (D-OH) re-introduced the EMPA in the Senate.<sup>111</sup> However, the bill never passed the Committee stage.<sup>112</sup> In October of 2011, Representative Lynn Woosley (D-CA) re-introduced the bill in the House.<sup>113</sup> Currently, the EMPA has a 4% chance of getting passed the Committee stage, and a 1% chance of being enacted.<sup>114</sup> Passage of the EMPA would affect all businesses because it would impose upon all companies a recordkeeping and notice requirement, and would make misclassification a federal labor law violation for the first time in history. It would also subject businesses to substantial penalties for noncompliance with the proposed law.

103. See, e.g., *Nationwide Mutual Ins. Company v. Darden*, 503 U.S. 318, 326 (1992) (applying the standard set in *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947) and stretching to the meaning of “employee” to cover some parties who might not qualify as such under a strict application of traditional agency law principles); *Brock v. Superior Care Inc.*, 840 F.2d 1054 (2d Cir. 1988) (refusing to perform a mechanic application of the economic realities test and using the totality of the circumstances to hold that nurses were employees under the FLSA).

104. *United States v. Silk*, 331 U.S. 704, 713-719 (1947); see also Noonan, *supra* note 88, at 46 (discussing the Supreme Court’s adoption of the economic realities test in *Silk* in order to expand the societal goals of the FLSA); *Goldberg v. Whitaker House Coop., Inc.*, 366 U.S. 28, 33 (1961) (holding that the economic realities test, rather than technical concepts test, is to be applied in a FLSA case).

105. *Superior Care*, 840 F.2d at 1059.

106. H.R. 6111, 110th Cong. (2008).

107. Noonan, *supra* note 88, at 44; see also Employee Misclassification Prevention Act, H.R. 6111, 110th Cong. (2008).

108. H.R. 6111.

109. *Id.*

110. Noonan, *supra* note 88, at 45; see also H.R. 6111 (110<sup>th</sup>): *Employee Misclassification Prevention Act*, GOVTRACK US, <http://www.govtrack.us/congress/bills/110/hr6111> (last visited May 16, 2013).

111. See Employee Misclassification Prevention Act, S. 3254, 111th Cong. (2010).

112. S. 3254 (111<sup>th</sup>): *Employee Misclassification Prevention Act*, GOVTRACK US, <http://www.govtrack.us/congress/bills/111/s3254> (last visited May 16, 2013).

113. Employee Misclassification Prevention Act, H.R. 3178, 112th Cong. (2011); see also H.R. 3178 (112<sup>th</sup>): *Employee Misclassification Prevention Act*, GOVTRACK.US, <http://www.govtrack.us/congress/bills/112/hr3178> (last visited May 16, 2013).

114. GOVTRACK.US, “H.R. 3178 (112<sup>th</sup> Cong)” <http://www.govtrack.us/congress/bills/112/hr3178>, (last visited May 16, 2013).

### C. Labor Issues

Labor unions have been a significant driving factor behind the effort to increase reclassification and investigate instances of misclassification. Unions have been urging government regulators to prosecute businesses suspected of misclassifying workers, and have been lobbying for legislation that would limit the use of independent contractors by businesses at both the state and federal level.<sup>115</sup> Because the NLRA only covers “employees,”<sup>116</sup> unions have much to gain if workers are classified as employees, and much to lose if they are categorized as independent contractors. Passing state and federal legislation targeted at reclassifying employees and placing harsher penalties upon employers for misclassification would induce employers to classify workers as employees, thus exposing more workers to union organizing. Employers that misclassify workers as independent contractors arguably receive a competitive advantage over employers who classify workers properly and must bargain with unions for fair labor standards. By labeling workers as independent contractors, companies are able to avoid unionization, as well as escape various tax requirements. This means that a company who misclassifies has more freedom to offer their product or services at a discounted rate because they do not have to offer minimum wage, overtime, health care benefits, pension benefits, union bargaining, etc. In other words, employers are incentivized to misclassify their workers because it allows them to avoid unions, and, ultimately, because it saves money.

### D. Class Actions

Plaintiffs’ class action attorneys have also targeted companies that use independent contractors. Most notably, FedEx Ground and FedEx Home Delivery have been battling multiple, nationwide class action suits since 2006.<sup>117</sup> These suits allege that FedEx has misclassified drivers as independent contractors rather than as employees for purposes of state and federal employee benefit and labor laws.<sup>118</sup> The drivers claim damages for unpaid medical and pension benefits, unpaid overtime and reimbursement of employee expenses.<sup>119</sup> Similar lawsuits have been filed

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115. Reibstein, Petkun & Rudolph, *supra* note 50.

116. 29 U.S.C. § 152(3) (expressly excluding independent contractors from the protections and provisions of the Act).

117. *See, e.g., Estrada v. FedEx Ground Package Sys., Inc.*, 64 Cal. Rptr. 3d 327, 335-337 (2007) (holding that drivers were employees in a class action for reimbursement of work related expenses); *In re FedEx Ground Package Sys., Inc., Emp’t Practices Litig.*, 662 F. Supp. 2d 1069, 1080-83 (N.D. Ind. 2009), *order clarified sub nom. In re FedEx Ground Package Sys., Inc. Emp’t Practices Litig.*, No. 3:05-MD-527 RM, 2010 WL 597988 (N.D. Ind. Feb. 17, 2010) (holding that certification of collective action under the Fair Labor Standards Act (“FLSA”) was not appropriate); *In re FedEx Ground Package Sys., Inc.*, 722 F. Supp. 2d 1033, 1052 (N.D. Ind. 2010) (granting FedEx’s motion for partial summary judgment on plaintiffs’ ERISA claims for failure to exhaust administrative remedies); *Craig v. FedEx Ground Package Sys., Inc.*, 686 F.3d 423 (7th Cir. 2012) (certifying questions as to the interpretation of “employee” under the Kansas Wage Payment Act).

118. *See Estrada v. FedEx Ground Package Sys., Inc.*, 64 Cal. Rptr. 3d 327, 331, 337 (2007).

119. *Estrada v. FedEx Ground Package Sys., Inc.*, 64 Cal. Rptr. 3d 327, 330 (work related expenses); *In re FedEx Ground Package Sys., Inc., Emp’t Practices Litig.*, 662 F. Supp. 2d 1069, 1080 (N.D. Ind. 2009) (unpaid overtime); *In re FedEx Ground Package Sys., Inc.*, 722 F. Supp. 2d 1033, 1038 (N.D. Ind. 2010) (unpaid medical and pension benefits); *Craig v. FedEx Ground Package Sys., Inc.*, 686 F.3d 423, 425 (7th Cir. 2012) (unpaid overtime and reimbursement of employee expenses).

against companies in other industries.<sup>120</sup> Plaintiffs' class action attorneys have made pursuing employers for misclassification a "part of their business model."<sup>121</sup> In fact, 2010 brought a 50% increase in class actions brought by "independent contractors."<sup>122</sup>

## VII. THE ILLINOIS EMPLOYEE CLASSIFICATION ACT

The Illinois Employee Classification Act ("ECA")<sup>123</sup> became effective on January 1, 2008.<sup>124</sup> The purpose of the ECA is "to address the practice of misclassifying employees as independent contractors"<sup>125</sup> in the construction industry.<sup>126</sup> The ECA explicitly addresses the use of misclassification "to avoid payroll taxes, unemployment insurance contributions, workers' compensation premiums and minimum wage and overtime payments," because misclassification "puts contractors that comply with tax and employment laws at a competitive disadvantage."<sup>127</sup> The ECA applies to all public and private "construction" work performed within the State of Illinois on or after January 1, 2008.<sup>128</sup> Under the ECA, an employer must meet a three-part test in order to correctly classify a worker as an independent contractor.<sup>129</sup>

120. For selected benefit cases, see, for example, *Vizcaino v. U.S. Dist. Court for W. Dist. of Washington*, 173 F.3d 713 (9th Cir.), *opinion amended on denial of reh'g sub nom.* In re *Vizcaino*, 184 F.3d 1070 (9th Cir. 1999); *Romero v. Allstate Ins. Co.*, 344 F. App'x 785 (3d Cir. 2009); *Martin v. Pub. Serv. Elec. & Gas Co., Inc.*, 271 F. App'x 258 (3d Cir. 2008); *Berger v. AXA Network LLC*, 459 F.3d 804 (7th Cir. 2006); *Belluardo v. Cox Enterprises, Inc.*, 157 Fed. App'x 823 (6th Cir. 2005); *Flanagan v. Allstate Ins. Co.*, 580 F. Supp. 2d 663 (N.D. Ill. 2008); *Thompson v. Linvatec Corp.*, No. 06-cv-0404, 2008 U.S. Dist. LEXIS 13959 (N.D.N.Y. Feb. 25, 2008). For selected wage payment cases, see, for example,

*Labrie v. UPS Supply Chain Solutions, Inc.*, 2009 U.S. Dist. LEXIS 25210 (N.D. Cal. Mar. 18, 2009)

; *Chaves v. King Arthur's Lounge, Inc.*, No. 07-2505, 2009 Mass. Super. LEXIS 298 (Mass. Super. Ct. July 30, 2009).

121. Reibstein, Petkun & Rudolph, *supra* note 50.

122. Richard Hackman, *Independent Contractor Misclassification and the Rise in Class Actions*, EMP. L. UPDATE (Barley Snyder LLC, Lancaster, P.A.), Aug. 2011, at 5, available at [http://www.barley.com/publications/article.cfm?Article\\_ID=481](http://www.barley.com/publications/article.cfm?Article_ID=481).

123. 820 ILL. COMP. STAT. 185/1-999 (2008).

124. *Id.* § 999.

125. *Id.* § 3.

126. *See id.* § 5. It is important to note that the ECA only applies within the construction industry. *See id.* "Construction" is defined broadly as:

[A]ny constructing, altering, reconstructing, repairing, rehabilitating, refinishing, refurbishing, remodeling, remediating, renovating, custom fabricating, maintenance, landscaping, improving, wrecking, painting, decorating, demolishing, and adding to or subtracting from any building, structure, highway, roadway, street, bridge, alley, sewer, ditch, sewage disposal plant, water works, parking facility, railroad, excavation or other structure, project, development, real property or improvement, or to do any part thereof, whether or not the performance of the work herein described involves the addition to, or fabrication into, any structure, project, development, real property or improvement herein described of any material or article of merchandise. Construction shall also include moving construction related materials on the job site to or from the job site.

*Id.* This definition greatly expands the traditional definition of construction.

127. Andrew J. Martone & Mindy K. Mahn, *A Plain-English Guide to the Illinois Employee Classification Act*, BHLM CLIENT BULLETIN (Bobroff, Hesse, Lindmark & Martone, P.C., Saint Louis, M.O.) Dec. 7, 2009, at 1, available at [http://www.bobroffhesse.com/library/pdfs/Guide\\_Illinois\\_ECA\\_120709.pdf](http://www.bobroffhesse.com/library/pdfs/Guide_Illinois_ECA_120709.pdf).

128. *Id.* 820 ILL. COMP. STAT. 185/5 (2008).

129. *Id.* at 2.



Often referred to as the “ABC” test, an employer must prove that the worker is (A) “free from control or direction” of the employer; (B) “the service[s] performed by the individual [are] outside the usual course of services performed by the contractor”; and (C) “the individual is engaged in an independently established trade, occupation, profession or business.”<sup>130</sup> The ECA also allows a legitimate sole proprietor or partnership to be properly labeled as an independent contractor. The ECA establishes a twelve-part test in order for an employer to label a worker as a sole proprietor or partnership.<sup>131</sup>

In determining whether direction or control exists, the Illinois Department of Labor will consider the following factors:

- (1) Is the individual eligible for a pension, health insurance, bonuses, paid vacation, or sick pay?
- (2) Does the contractor carry Workers’ Compensation insurance and pay Unemployment Insurance taxes on the individual?
- (3) Does the contractor deduct Social Security taxes from the individual’s compensation and report the worker’s income to the IRS?
- (4) Does the contractor furnish the individual with transportation, samples, business cards, or an expense account?
- (5) Does the contractor require the individual to turn down work from other contractors or assign or limit the territory in which the individual performs services?
- (6) Does the contractor set the price and credit terms for the product or the services being performed by the individual?
- (7) Does the contractor require attendance at meetings or provide training?
- (8) Does the contractor have the right to set rules and regulations?
- (9) Does the contractor require the individual to perform services a specific number of hours per day or per week?
- (10) Does the contractor issue assignments, schedule work or set quotas with time requirements?
- (11) Does the contractor require the individual to follow a routine, order or sequence set by the contractor in performing the services?
- (12) Does the contractor engage the individual with the expectation that the relationship will continue indefinitely, rather than for a specific project or period of time?<sup>132</sup>

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130. 820 ILL. COMP. STAT. 185/10(b) (2008).

131. *Id.* § 10(c). The twelve factors include: (1) being “free from direction or control”; (2) “the sole proprietorship or partnership is not subject to cancellation”; (3) “the sole proprietorship or partnership has a substantial investment of capital” in the entity “beyond ordinary tools and equipment”; (4) “the sole proprietorship or partnership owns the capital goods and gains the profits and bears the losses of the sole proprietorship or partnership”; (5) “its services [are] available to the general public”; (6) its services are on the Federal Income Tax Schedule; (7) “the sole proprietorship or partnership performs services . . . under the sole proprietorship’s or partnership’s name”; (8) if a license is required for the services, the sole proprietorship or partnership pays for it; (9) “the sole proprietorship or partnership furnishes the tools and [necessary] equipment”; (10) “the sole proprietorship or partnership hires its own employees without contractor approval”; (11) “the contractor does not represent the sole proprietorship or partnership as an employee”; and (12) “the sole proprietorship or partnership has the right to perform similar services for others on whatever basis” it chooses. *Id.*

132. Martone & Mahn, *supra* note 129, at 2-3.

The ABC test and the twelve-part sole proprietorship or partnership test are also used in other state employee classification statutes,<sup>133</sup> and do not particularly add much substance to existing classification law.<sup>134</sup> The real bite to the ECA comes with the creation of a private right of action.<sup>135</sup> Any interested party, or person aggrieved by a violation of the ECA has the right to file suit in circuit court.<sup>136</sup> This includes third parties, unions, and workers who believe they have been misclassified as independent contractors. In order to facilitate the coordination of information, if a violation is determined, the Illinois DOL must inform the Illinois Department of Revenue, the Illinois Department of Employment Security, the Workers' Compensation Committee, and the Comptroller.<sup>137</sup> Remedies for a violation of the ECA include: (1) the amount of any wages, salary, employment benefits, or other compensation denied or lost, plus an equal amount in liquidated damages; (2) compensatory damages and an amount up to \$500 for each violation of the ECA; (3) all legal or equitable relief appropriate in the case of unlawful retaliation; and (4) attorney's fees and costs.<sup>138</sup> In effect, businesses that are found to be in violation of ECA are faced with enormous fines and penalties – even for a non-willful violation.

#### A. "ECA" Case Law

Since its passage in 2008, there have been roughly four substantive cases regarding the ECA. Two of which have discussed the constitutionality of the ECA. In *Bartlow v. Shannon*,<sup>139</sup> plaintiffs, who engaged in the roofing, siding and window business, sought a temporary restraining order against the Illinois DOL's directors and Illinois Attorney General seeking declaratory and injunctive relief challenging enforcement of the ECA.<sup>140</sup> Plaintiffs argued that the ECA was facially unconstitutional and unenforceable.<sup>141</sup> The Fifth District Appellate Court held that (1) the Department's powers under the ECA were merely investigatory and thus the ECA was not facially unconstitutional; (2) the ECA was not unconstitutionally vague or unlawful delegation of legislative power; (3) the ECA was supported by legitimate state interest; and (4) the fact that the ECA applied only to construction industry did

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133. See, e.g., The New York Construction Industry Fair Play Act, N.Y. LAB. LAW § 861-c (McKinney 2010).

134. The ABC test draws its roots from unemployment insurance laws. See Robert Wood, *Defining Employees and Independent Contractors: Don't Try This at Home!* AMERICAN BAR ASSOCIATION: BUSINESS LAW TODAY (May/June 2008), <http://apps.americanbar.org/buslaw/blt/2008-05-06/wood.shtml>. Although the twelve-part test for sole proprietors and partnerships was newly created by labor organizations specially for the ECA, the twelve considerations listed reflect existing case law discussing factors such as right to control, economic realities, wages versus payment for services, tax considerations, etc. that have always been used when determining worker classification. See *supra* notes 7-35 and accompanying text.

135. 820 ILL. COMP. STAT. 185/60 (2008).

136. *Id.*

137. *Id.* at § 75.

138. *Id.* at § 60.

139. 974 N.E.2d 937 (Ill. App. 5<sup>th</sup> Dist. 2012), *reh'g denied* (Sept. 20, 2012), *appeal granted* (Jan. 30, 2013).

140. *Id.* at 941.

141. *Id.*

not make act an equal protection or special legislation violation.<sup>142</sup> Similar to *Bartlow*, in *World Painting Co., LLC v. Costigan*,<sup>143</sup> plaintiff, a contracting firm, brought an action against the Illinois Director of Labor and the Illinois Attorney General challenging the constitutionality of the ECA.<sup>144</sup> Plaintiff argued that the ECA was facially unconstitutional because it violated due process for not providing adequate notice.<sup>145</sup> In other words, plaintiff alleged that by not granting an opportunity to be heard prior to the imposition of penalties, the Illinois DOL was violating the Constitution. Reversing the trial court's order for preliminary injunction barring the Director and Attorney General from enforcing the ECA, the Fourth District Appellate Court held in favor for the Illinois DOL, reasoning that because the Illinois DOL was forbidden from making any adjudicatory findings of plaintiff's liability, due process was not implicated by their investigation.<sup>146</sup>

*Chicago Regional Council of Carpenters v. Sciamanna, Inc.*,<sup>147</sup> discussed the issue of individual officer liability under the ECA. The Northern District Court of Illinois held that "[b]y its clear and unambiguous text, the Illinois ECA does not provide for personal liability against a corporate officer or director."<sup>148</sup> *Perez v. Comcast*<sup>149</sup> discussed the scope of the definition of "construction" under the ECA. Plaintiffs, workers who performed cable installations and repairs for the cable company Comcast, alleged misclassification under the ECA.<sup>150</sup> Defendant Comcast argued that plaintiffs only performed residential cable services, and failed to properly allege that they were engaged in construction.<sup>151</sup> The Northern District Court of Illinois held that, "the statutory language is clear and points to a broad interpretation of the statute," and that the Illinois Department of Labor, "which is charged with the ECA's enforcement, has taken the position that the 'term 'construction' is broadly defined.'"<sup>152</sup>

### B. "ECA" Statistics

Since the passage of ECA, a total of 235 complaints have been filed with the Illinois DOL.<sup>153</sup> 146 of those complaints were currently open under investigation as of June 2011, with 19 cases under direction of the Illinois Attorney General for

142. *Id.* at 937-38.

143. 967 N.E.2d 485 (Ill. App. 4<sup>th</sup> Dist. 2012).

144. *Id.* at 487.

145. *Id.*

146. *Id.* at 491.

147. *Chi. Reg'l Council of Carpenters v. Joseph J. Sciamanna, Inc.*, 2008 U.S. Dist. LEXIS 85983 (N.D. Ill. Oct. 23, 2008).

148. *Id.* at \*6; see also 820 ILL. COMP. STAT. 185/60(a).

149. 2011 U.S. Dist. LEXIS 126401 (N.D. Ill. Nov. 1, 2011).

150. *Id.* at \*1-\*2.

151. *Id.* at \*4.

152. *Id.* at \*5; see also 820 ILL. COMP. STAT. 180/5.

153. Sean Stott, Dir. of Governmental Affairs, Laborers' Int'l Union of N. Am. – Midwest Region, Illinois' Employee Classification Act, Presentation at the National Foundation for Unemployment Compensation & Workers' Compensation: National UI Issues Conference (June 30, 2011), available at [http://www.uwcstrategy.org/Conferences/pdfs/EmployeeClassificationAct\\_Stott.aspx](http://www.uwcstrategy.org/Conferences/pdfs/EmployeeClassificationAct_Stott.aspx).

subpoena enforcement.<sup>154</sup> Complaints were dismissed if the incidences of misclassification pre-dated the passage of the ECA, if the incidences were not construction related, or if there was insufficient evidence to pursue action.<sup>155</sup> Of the 146 open investigations, the Illinois DOL found thirty-two ECA violations.<sup>156</sup> Pursuant to the information sharing provision of the ECA, six contractors found to have violated the Act were referred to other agencies.<sup>157</sup> Misclassification was found statewide, primarily in the “basic craft” industry – masonry, drywall hanging, and roofing.<sup>158</sup> Violations in the mechanical trades were rare.<sup>159</sup>

### *C. Why the “ECA” is Unfair and Unnecessary*

The penalty provisions are “crippling” and can “destroy a business,” said Jeffrey Risch, Chair of the Illinois Chamber of Commerce’s Employment Law & Litigation Committee.<sup>160</sup> The possible penalties are “so significant that a business will usually go bankrupt or close down if the [Illinois] DOL or a court wanted to pursue or allow the maximum penalties.”<sup>161</sup> Furthermore, the ECA applies not only to public projects, but also to purely private ones. This means that an individual homeowner who hires a carpenter to do remodeling work on their own home could potentially face ECA penalties if she fails to prove that the worker met the ABC test. Although it would be highly unlikely for the Illinois DOL to pursue an action against an individual homeowner, the ECA provides for a private cause of action which allows a disgruntled worker to initiate a lawsuit for unpaid wages, unemployment, overtime, etc.

Additionally, numerous existing federal and state laws protect misclassified workers. From workers’ compensation, unemployment, the FLSA, tax laws to tort laws, misclassified workers already have an avenue to obtain unpaid wages and benefits. Employers are also subject to fines and penalties under these existing regulations. Therefore, the ECA is merely superfluous legislation. As Risch stated, “[t]he construction industry did not need its own definition, standards and remedies.”<sup>162</sup> Relatedly, the definition of construction under the ECA is so broad that it covers virtually any and all fields. “Planting daisies in a pot to put out for simple decoration triggers the law. . . [and] the scope of work will continue to expand,”

154. *Id.*

155. *Id.*

156. *Id.* The Illinois DOL found that 183 individual workers were misclassified, with 6,665 separate violations (per person/per day), and \$8.5 million in potential penalties - \$820,000 penalties pending and \$62,000 received to date (in 2011). *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

160. Interview with Jeffrey Risch, Chair, Ill. Chamber of Commerce, Emp’t Law and Litig. Comm.. (Oct. 26, 2012). Jeffrey Risch is also the Chief Labor Law Counsel for the Associated Builders & Contractors of Illinois. *Id.* He works closely with the Midwest Truckers Association and was heavily involved in providing input and commentary in the rulemaking process of the ECA with the Illinois Department of Labor. *Id.* Risch helped to create the “carve out” exceptions for bona fide corporations and limited liability companies. *Id.*

161. *Id.*

162. *Id.*

said Risch.<sup>163</sup> Moreover, the twelve-part test is unworkable; it is merely a “creation of labor unions. . .that is virtually impossible for contractors in the construction industry to meet,” explains Risch.<sup>164</sup> Overall, the ECA is an unnecessary statute. It simply creates an additional avenue for individuals to receive remedial benefits of misclassification, in conjunction to the well-functioning methods that already exist.

In addition to the inequitable penalty provisions and redundant nature of the ECA, practical concerns inhibit the proper enforcement of the ECA. As of 2011, budget issues within the Illinois DOL plagued adequate enforcement of the Act. The twelve employees who were investigating and enforcing complaints for 102 counties, were also tasked with enforcing the Prevailing Wage Act<sup>165</sup> and the Worker Adjustment and Retraining Notification Act (“WARN”).<sup>166</sup> A need for additional staff has yet to be satisfied.<sup>167</sup> Lastly, the time intensive nature of such investigations and the lack of worker cooperation often impede easy enforcement of the ECA.<sup>168</sup>

#### D. *Why Other States Should not Enact Similar Laws*

There is no need for states to pass legislation concerning worker misclassification like the ECA. Individuals can choose from a host of existing opportunities to receive unpaid wages, overtime, benefits, etc. States can also enforce present laws to curb misclassification abuse. Moreover, the U.S. government has already addressed the issue and has made a collaborative effort to tackle the problem in both a regulatory and legislative manner. Although federal bills like EMPA and TRAC have failed to pass through Congress, the increase in task forces and the DOL’s “Misclassification Initiative” achieve the same goals as the ECA. “[T]he law is in a complete state of disarray with regard to the definition of employee.”<sup>169</sup> There exists a strong need for uniformity among states, agencies, and regulations. Large companies that operate in multiple states should not have to worry that their “independent contractors” in one state should be classified as an “employee” in a different state. Federal laws should address worker misclassification on a uniform basis.

Furthermore, companies that have made good faith efforts to classify workers are subject to exorbitant fines and penalties under laws like the ECA. Often times, figuring out whether or not a worker is an employee versus an independent contractor is a difficult thing to do. Even the GAO has stated, “the tests used to determine

163. *Id.*

164. *Id.*

165. 820 ILL. COMP. STAT. 130/1-12.

166. 29 U.S.C. § 2101-2109 (1988).

167. Budget limitations halted the scheduled hiring of five additional investigators, one additional attorney, and one clerical staff member. See Sean Stott, *supra* note 148,.

168. Sean Stott, Director of Governmental Affairs for the Laborers’ International Union of North America (Midwest Region), has stated that ECA enforcement requires in-person interviews that take up much of the Illinois DOL’s time and effort; and that worker cooperation is often lacking within the process. Both of these factors contribute to difficulties with enforcing the ECA. See *id.*

169. Mitchell H. Rubinstein, *Employees, Employers, and Quasi-Employers: An Analysis of Employees and Employers Who Operate in the Borderland Between an Employer-and-Employee Relationship*, 14 U. PA. J. BUS. L. 605, 606 (2012).

whether a worker is an independent contractor or an employee are complex, subjective, and differ from law to law.”<sup>170</sup> Therefore, having extreme penalty provisions that provide for fines for each misclassified individual, for everyday they are misclassified are disproportionate to the alleged wrongdoing when employers make a good faith, mistaken judgment. If states wish to pass similar legislation, honest errors in misclassification should not be made a violation.

Lastly, to try and regulate the use of independent contractors within the construction industry alone is bad policy. It is unfair for states to enact laws specifically targeting construction companies. Misclassification occurs in a multitude of other trades. From healthcare to high tech industries; truck drivers, janitors, and even lawyers are misclassified.<sup>171</sup> In fact, a landmark study of workplace violations discovered that minimum wage violations were relatively low in the residential construction industry.<sup>172</sup> Although misclassification is arguably more frequent within the construction industry, if the goal is to ensure that workers are getting the wages they deserve and that the government is receiving the taxes it should, merely targeting the construction companies seems to fall short.

## VIII. CONCLUSION

With the recent increase in scrutiny on worker misclassification, it will be interesting to see whether or not Congress will ever pass a bill like TRAC or EMPA. In light of these bills never making it past the Committee stage, it seems that the DOL and IRS have taken matters into their own hands by implementing task forces and agreeing to coordinate and share information for better enforcement. Therefore, despite the lack of national legislation, federal administrative efforts to promote proper worker classification have adequately addressed the issue of worker classification. Thus, it is unnecessary for states to pass statutory remedies like the ECA that attempt to tackle an issue that is currently being resolved at the federal level. Besides the fact that laws like the ECA are redundant, they are also unfair in that they target the construction industry when misclassification occurs throughout a wide range of different businesses. In conclusion, even though defining the relationship between “employees” and “independent contractors” has been defined as “one of the most troublesome and important issues facing businesses today,”<sup>173</sup> reg-

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170. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO REPORT 06-656, EMPLOYMENT ARRANGEMENTS: IMPROVED OUTREACH COULD HELP ENSURE PROPER WORKER CLASSIFICATION 25 (2006), available at <http://www.gao.gov/new.items/d06656.pdf>.

171. Steven Greenhouse, *Investigating Mislabeling of Workers*, N.Y. TIMES (June 9, 2007), [http://www.nytimes.com/2007/06/09/nyregion/09contractor.html?\\_r=0](http://www.nytimes.com/2007/06/09/nyregion/09contractor.html?_r=0).

172. ANNETTE BERNHARDT ET AL., BROKEN LAWS, UNPROTECTED WORKERS: VIOLATIONS OF EMPLOYMENT AND LABOR LAWS IN AMERICA'S CITIES 2-6 (2008) ((discussing a “landmark study of 4,387 workers in low-wage industries in the three largest cities – Chicago, Los Angeles, and New York City.” The study found that employer violations “varied significantly by industry.” For example, “minimum wage violation rates were most common in apparel and textile manufacturing, personal and repair services, and in private households (all of which had violation rates of 40% or more).” Employer violations “were substantially lower in residential construction, social assistance and education, and home health care” (all of which had violation rates of 12-13%). Additionally, “industries such as restaurants, retail and grocery stores, and warehousing fell into the middle range” (with the frequency of minimum wage violations around 20-25%).

173. Bruntz, *supra* note 1.

ulatory agencies have made substantial, successful efforts at tackling misclassification, making states' involvement unnecessary.