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Proponent testimony in favor of passage of HB 523

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Misclassification of employees as independent contractors strips employees of their legal protections, deprives government on all levels of billions of tax dollars and undercuts employers who do the right thing. House Bill 523 would provide tools needed in Ohio to combat misclassification. It would clarify and give uniformity to the definition of ‘employee’ across Ohio laws and administrative rules, providing needed protection for employee and employer alike. We appreciate the opportunity today to write in support of House Bill 523.

Workers are considered employees when someone else controls how, where and when they perform their work. Independent contractors, by contrast, are in business for themselves. They obtain their own customers and work from a location of their choosing in a manner they control. Independent contractors pay their own payroll taxes – the contribution toward federal insurance like Medicaid and Social Security. Employers pay half of the payroll taxes of employees.

Regardless of the actual circumstances of control, employers have a financial incentive to classify employees as independent contractors. Outgoing Ohio Attorney General Richard Cordray estimates that there can be a financial differential between 20 and 30 percent between the cost of independent contractors and the cost of employees.¹ A 2000 study by the United States Department of Labor found that between 10 and 30 percent of employers in nine states studied misclassified workers.² Of 5300 companies audited by the Ohio Department of Job and Family Services (ODJFS) in 2005, 45 percent had findings of irregularities, many for worker misclassification. Officials of ODJFS estimate that Ohio’s unemployment insurance trust fund, currently \$2 billion dollars in debt to the federal government, is losing \$20 million dollars annually.³ While audit findings are common, however, ODJFS found the greatest number of misclassified workers concentrated in a small number of the firms, and concluded that the real problems are concentrated among a few.⁴ This highlights the need for better guidelines for all and better enforcement mechanisms to deal with a few, as proposed in HB 523.

¹ Steven Greenhouse, “US Cracks Down on ‘Contractors’ as Tax Dodge,” *The New York Times*, February 17, 2009 at <http://www.nytimes.com/2010/02/18/business/18workers.html>, accessed December 5, 2010.

² United States General Accounting Office, “Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention” August 10 2009 at <http://www.gao.gov/products/GAO-09-717>, accessed December 5, 2009.

³ Richard Cordray, Report of the Ohio Attorney General on the Economic Impact of Misclassified Workers for State and Local Governments in Ohio, February 18, 2009 at <http://www.ohioattorneygeneral.gov/getattachment/f2b2aa5b-de26-45a2-9631-2e0fd21cf9b5/Missclassification-Report.aspx>, accessed December 5, 2010.

⁴ Michelle Parks, “Federal, state officials take keener interest in employee classification, Workforce Management at <http://www.workforce.com/section/news/article/federal-state-governments-take-keener-interest-employee.php>, December 3, 2010.

Worker misclassification has a significant impact on government tax collections. National studies are dated, but illustrate a problem that dates back over the decades. For example, a 2009 report by the United States Treasury Inspector General for Tax Administration estimates the annual cost of misclassification nationally amounts to \$1.6 billion in payroll taxes and unemployment insurance taxes, although it acknowledges this figure is based on outdated (1984) data and believes the cost is actually far higher.⁵ The 2011 federal budget proposal for the Department of Labor includes \$25 million for enforcement in this area, with an anticipated yield of \$7 billion over 10 years.⁶ Here in Ohio, Attorney General Cordray estimates that Ohio could have 92,500 misclassified workers, which would cost the state up to \$20 million in payments for unemployment compensation, more than \$103 million in BWC premiums, and over \$36 million in forgone state income tax revenues.⁷ The impact on local government is also estimated to be significant: more than \$100 million in local income tax revenues to cities and villages in 2006, and an additional \$7.8 million to school districts with an income tax in 2008.⁸

The financial incentive to misclassify may be significant and the impact on government coffers high, but the real victim in misclassification is the misclassified individual. Misclassified workers are harmed financially and they lose the protection of unemployment insurance if laid off or workers compensation if hurt on the job. Although misclassification can cut across occupations and sectors, those who work in construction, trucking, home health care, dental, manufacturing, high-tech engineering and information technology may be particularly impacted⁹. This diverse list reveals that misclassification is a problem that cuts across educational and pay levels.

Employers deny deliberate intent in misclassification of workers as independent contractors. Grey areas in the law harbor ambiguity and interpretation. In Ohio, this ambiguity is caused in part by varying definitions of ‘employee’ in laws and administrative rules governing the payment of the minimum wage, the Bimonthly Pay Law, the Prevailing Wage Law, the Workers’ Compensation Law, the Unemployment Compensation Law, and the Income Tax Law. With passage of HB 523, Ohio would join more than two-dozen other states in fixing these problems of definition and enforcement.¹⁰ In so doing, our legislators would strengthen equity in the tax system and boost revenue collections in a year of extraordinary budget crisis.

House Bill 523 provides a uniform definition of ‘employee’ across laws and administrative rules. The definition of employee is pegged to the definition in the Fair Labor Standards Act. It creates a presumption of employee status, which is helpful for enforcement. The elements of the test of the employment relationship are strong. Provisions that guard workers who question their classification against retaliation are important protections.¹¹

⁵ Treasury Inspector General for Tax Administration, “While Actions Have Been Taken to Address Worker Misclassification, an Agency-Wide Employment Tax Program and Better Data Are Needed,” February 24, 2009, reference number 2009-30-035 at <http://www.treasury.gov/tigta/auditreports/2009reports/200930035fr.pdf>, accessed December 4, 2010. In that report, it is noted that the GAO subsequently updated to \$1.6 billion figure to \$2.72 billion in 2006 dollars.

⁶ Greenhouse, New York Times, See Footnote #1.

⁷ Cordray, See footnote #5.

⁸ Cordray, See footnote #5.

⁹ See Cordray (Footnote #5), Greenhouse (Footnote #1) and Parks (Footnote #4).

¹⁰ Cathy Ruckelshaus, Study of Independent Contractor Reforms, National Employment Law Project, July 2008 at http://nelpl.3cdn.net/ed7571b66f5e2cc263_fom6bn8pp.pdf, accessed December 5, 2010.

¹¹ Review of Ohio HB 523 by Cathy Ruckelshaus of the National Employment Law Project, March, 2010.

Current lack of clarity creates a financial incentive to structure work in a way that hurts workers, avoids taxes and undercuts employers who classify their employees properly. House Bill 523 would help correct the problem through clarification of laws and rules. The outcomes would benefit all affected. We urge the 128th General Assembly to pass this important legislation.