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PAYROLL FRAUD: TARGETING BAD ACTORS HURTING WORKERS AND BUSINESSES

HEARING

BEFORE THE

SUBCOMMITTEE ON EMPLOYMENT AND WORKPLACE SAFETY

OF THE

COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS

UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING PAYROLL FRAUD

NOVEMBER 12, 2013

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TUESDAY, NOVEMBER 12, 2013

PAYROLL FRAUD: TARGETING BAD ACTORS HURTING WORKERS AND BUSINESSES

TUESDAY, NOVEMBER 12, 2013

U.S. SENATE,
SUBCOMMITTEE ON EMPLOYMENT AND WORKPLACE SAFETY,
COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:30 p.m. in room SD–430, Dirksen Senate Office Building, Hon. Robert Casey, chairman of the subcommittee, presiding.

Present: Senators Casey, Franken, and Isakson.

OPENING STATEMENT OF SENATOR CASEY

Senator CASEY. The hearing will come to order.

Thank you, very much for being here this afternoon. I want to thank Senator Isakson, our Ranking Member, and our witnesses for being here.

This is a subcommittee hearing this morning, which is a subcommittee of the Health, Education, Labor, and Pensions committee. This subcommittee work is critically important. We are grateful that people would be here to hear the testimony.

I wanted to provide an opening statement and then I will turn to our Ranking Member for his statement or comments, following that I will introduce the witnesses, and after that we will take witness testimony.

Payroll fraud is a problem that is cheating workers, employers, and taxpayers through the loss of worker protections, the loss of business due to an uneven playing field, and the loss of revenue. When an employee is wrongly classified as an independent contractor, that worker loses vital rights like payroll protections, workers' compensation, unemployment compensation, and other basic safeguards.

The vast majority of employers that follow the rules are placed at a significant disadvantage when competing against a business that is breaking the law and not paying employment taxes; lower costs for those breaking the rules means less business for those who follow the rules. This also places downward pressure on wages paid to workers and leads to other problems as well. Taxpayers are also shortchanged through the loss of revenue by Federal and State Governments.

Independent contractors serve a valuable role in our economy, and there is no intent on my part—nor anyone advocating the legislation we will talk about today—to use an overly broad brush to

point fingers at companies that are following the law or pointing fingers at law abiding independent contractors.

While there are employers that mistakenly identify an employee as an independent contractor, there is no doubt that intentional misclassification is a widespread occurrence and a problem that must be addressed.

A June 2013 Treasury Department Inspector General for Tax Administration report stated, in part,

> "The misclassification of employees as independent contractors is a nationwide issue affecting millions of workers that continues to grow and contribute to the tax gap,"

so said the Inspector General for the Treasury.

Employees wrongly classified as independent contractors do not enjoy the same worker protections. A 2009 GAO report cites the example of,

> "A construction worker who fell three stories, was severely injured, and incurred hospital expenses of over $10,000 related to the injury. Because the worker was misclassified as an independent contractor, his employer did not provide workers' compensation coverage for the employee,"

according to the GAO.

While some progress has been made at the Federal and State level to combat payroll fraud, much more needs to be done; more tools and more enforcement are needed to stop the intentional misclassification of workers. That is why I intend to introduce legislation to hold accountable employers and to give greater scrutiny to employees and their families.

With my colleagues, Chairman Tom Harkin, chairman of the Health, Education, Labor, and Pensions committee, and Senator Sherrod Brown of Ohio, I will be introducing the Payroll Fraud Prevention Act of 2013, which will protect workers from being misclassified as independent contractors, thereby ensuring access to safeguards like fair labor standards, health and safety protections, and unemployment and workers' compensation benefits. The Act would also prohibit employers from using misclassification to avoid paying their fair share of taxes.

This is not a new problem, as I mentioned before. In 1984, the Internal Revenue Service found that 3.4 million employees were misclassified as independent contractors. At that time, this cost taxpayers $1.6 billion in income taxes, unemployment taxes, Social Security taxes, and Medicare taxes. That is 19 years ago.

That report 19 years ago found that 15 percent of employers had misclassified employees. A new review is being undertaken. Unfortunately, we will not see the results of that new review for some time.

In 2009, a Treasury Inspector General's report on misclassification acknowledged the lack of comprehensive new information while saying that the lost revenue would be, "Markedly higher than the $1.6 billion," of course, referring then to the 1984 IRS report.

Why would an employer intentionally commit payroll fraud? I think that is an important question to ask. A June report, again

by the Inspector General at Treasury, summarizes the reason as follows.

> "The IRS estimates that employers misclassify millions of workers as independent contractors instead of employees. The misclassifications allow employers to avoid paying a significant amount of money in employment taxes, which adversely affects employees and tax administration. . . . On average, an employer can save approximately $3,710 per worker per year in employment taxes on an annual average salary of $43,007 in income paid per employee when the employer misclassifies a worker as an independent contractor."

That is all quoted from the Inspector General.

There is a clear financial incentive for bad actors—not all, we are talking about bad actors here—but there is an incentive for those actors to defraud taxpayers. This has a clear impact on Federal and State taxpayers and obviously on the so-called tax gap.

I am also a member, as Senator Isakson is, of the Finance Committee, but we will not spend much time on the tax issue today. I will note that my friend and former Health, Education, Labor, and Pensions committee member, Senator Brown, intends to introduce legislation dealing with the tax issue that I will support and cosponsor.

Finally, an aspect of the financial incentive for fraud that we will discuss is the impact on the overwhelming number of businesses that play by the rules and do the right thing. Put simply, law abiding businesses are put at a disadvantage when they bid against an unscrupulous operation that is paying $3,710 less per employee per year in employment taxes. So I look forward to a productive process here at the hearing to target the bad actors who are hurting workers and hurting businesses.

I would also like to add for the record, I will introduce for the record a report entitled, "Campaign for Quality Construction." It is a report dated today and this statement will be admitted as part of the record.

[The information referred to may be found in additional material.]

Senator CASEY. Now, I will turn to our Ranking Member, Senator Isakson.

STATEMENT OF SENATOR ISAKSON

Senator ISAKSON. Thank you, Senator Casey.

This is an important subject, and I am delighted to have the chance to participate in the hearing with you.

I want to compliment you on the differentiation between intentional and unintentional in your opening remarks and in your closing paragraph, to talk about the people that play by the rules because there are rules in the IRS tax code, the labor laws of the United States of America that clearly identify what is a legal, independent contractor by designation, and we all know what they are. We are focusing on the people who are intentionally disobeying those laws and those standards, not the people who are willfully obeying by those laws.

I was one of them. I ran a company for 22 years that had 800 independent contractors and 200 employees. Almost every one of my independent contractors was a second career or a divorced woman, because there were very few job opportunities for them. In that career, I had a real estate brokerage company.

By working as an independent contractor, they had flexible hours so they could pick up their kids from school. They could be sure dinner was prepared. They could work some days and not work other days. They could not do things you would have to do if you were working for an employer and were an employee status. So I want to point out there are meaningful jobs that provide jobs to people in need of those jobs, where the independent contractor status fits the situation and the circumstance.

Ironically, our witness for the minority, Mr. MacKrell and I, had not met until about an hour and a half ago. So this is not a preplanned plug, but when I was asking him about his business, which is specialized delivery by truck and a delivery service and the last mile delivery service, if you will. Last Christmas, I ordered my wife's Christmas present from a company in New Jersey. It was delivered to my house by a last mile trucking delivery system who, on his truck, had everything from my wife's present to probably a hundred other wives' presents, and other things that were on the truck, delivering each one individually; something that somebody for an employer never could have afforded to do from New Jersey to Atlanta.

So there are perfectly good, legitimate reasons for independent contractor status to exist, and perfectly good companies who are around, obeying by those laws and producing employment and opportunities for American workers. I think it is clear that we understand the difference between intentional and unintentional, those playing by the rules and those who are not.

To make that point, I have letters to introduce for the record of support for the independent contractor status from the following organizations: the National Association of Home Builders; James Mark, the president of Private Care Association of America; Zane Kerby, the president and CEO of American Society of Travel Agents; the American Trucking Association; and Russell Hollrah, the executive director of the Coalition to Promote Independent Entrepreneurs.

[The information referred to may be found in additional material.]

Senator ISAKSON. And with that, I will look forward to the testimony from our witnesses and appreciate the opportunity to co-chair this with you today.

Senator CASEY. Thank you, Senator Isakson. What I will do is provide an overview of the backgrounds of our witnesses. They will not be complete, but they will be given introduction for each and then Mr. Anderson, we will start with you, and we will go from my left to right.

First of all, Matthew Anderson, who is joining us today from the State of Michigan, we are grateful you are here, has his own experience of being injured on the job and the real and lasting impact misclassification can have on a family. Mr. Anderson, we are grate-

ful you are here today, and we will start with you in a couple of moments.

Daniel Odom is chief operating officer of Odom Construction in Tennessee and has firsthand experience as a victim of unfair competition. Odom Construction is primarily an interior systems contractor. In good times, Mr. Odom has about 200 employees and has bid and performed construction work in a number of States. Mr. Odom, we thank you for being here.

Cathy Ruckelshaus, from the National Employment Law Project, NELP, is also here to discuss the impact of payroll fraud. She joined NELP in 1995 after working for the Employment Law Center in San Francisco. For over 20 years, she has litigated and advocated for policy reforms promoting the workplace rights of immigrant and nonstandard workers, enforcement of wage and hour in workplace laws, and antidiscrimination in family and medical leave laws. We are grateful that Cathy is here. She testified in 2010 as well.

Finally, we will hear from Chris MacKrell, president and COO of Custom Courier Solutions based in Rochester, NY who, I understand, has an office in my hometown of Scranton. We appreciate that. Senator Isakson also mentioned the discussion you had today.

Custom Courier Solutions is a full service transportation organization based in Sarasota Springs, NY. It provides a full range of logistic services to the less than 24-hour delivery market.

So we will start with you, Mr. Anderson, and then we will go to Mr. Odom and others.

Thank you very much.

STATEMENT OF MATTHEW ANDERSON, RESIDENTIAL CONSTRUCTION TRIM INSTALLER, IRA TOWNSHIP, MI

Mr. ANDERSON. Chairman Casey, Ranking Member Isakson, and members of the subcommittee, my name is Matthew Anderson. I am a resident of St. Clair County in the State of Michigan where I live with my wife and two wonderful children. Thank you for this opportunity to speak with you today about how payroll fraud has harmed my family and thousands of other families across this country.

Currently, I am an estimator for a construction company, but previously, I was a working carpenter. I made cabinets, installed interior trim, lay crown molding. My employer was Rush Construction Services, Incorporated. Rush had a contract with the carpenter's union and they paid me an hourly wage, health, and pension benefits. There was training and daily instructions. I was supplied with building materials, power tools, and other construction equipment. When I made mistakes or did not meet production quotas, I got a tongue-lashing.

Rush deducted income taxes. They paid employment taxes and they paid unemployment contributions. They paid time and a half for overtime and they provided me with workers' compensation protection. In other words, I and my fellow workers were employees. That is how it was for 6 years, but things changed for the worse.

We were told the recession cut into Rush's bottom line and they were having problems competing to get jobs. Mr. Marty Steudle was the owner of Rush. Mr. Dave Marracco was his right hand

man. They told us they wanted to switchover to another company they jointly owned, Dave and Marty, Incorporated, DMI.

We were given a choice, work for DMI as independent contractors or do not work at all. My fellow workers and I had families to support. We saw how bad the economy was, so we went along with it.

Mr. Steudle and Mr. Marracco directed us to register as DBA's, Doing Business As persons. I passed these instructions onto my wife, and she did the registration. I was never incorporated. I never had a business card. I never operated a business. Still, the simple DBA registration would come back to haunt me because DMI knew what they were doing.

DMI's official address was Mr. Marracco's house. The actual business office was still Rush's. I worked for DMI for 2½ years. There was training, daily instructions. I was supplied with building materials, power tools, and other construction materials. When I made mistakes or did not meet production quotas, I received a tongue lashing. So I was still treated the same as before, but instead of being an employee and receiving a W–2 at the end of the year, I received a 1099 form. There were no more deductions from my pay. I paid my portion of employment taxes and I paid DMI's as well. There were no more health and pension benefits, and we did not get time and a half for overtime.

Then on February 9, 2011 my life changed forever. My left hand slipped into a table saw, severing my ring finger and severely damaging three others. I was rushed to the hospital for emergency surgery for them to try to save my hand. While I was at the hospital, I was told that my medical bills would not be covered because I was an independent contractor.

My medical treatment was long and painful. So far, I have had eight surgeries and still need one more. The damage was so bad, they had to take bones from my wrist and hip, and the doctors also needed to take bones from a cadaver to do the reconstruction. During this time, I could not work and my medical bills piled up. And in a short time, they were in the range of $100,000. That is more than I and my wife make in an entire year.

I filed a workman's compensation claim. DMI claimed I was an independent contractor and they refused to pay. I was pressured to settle with DMI and their insurance carrier. In the end, my family and I were left with our credit ruined and still owe $25,000 in medical bills.

This has been a nightmare for my family. A few years ago, my family and I felt secure. We were a middle-class family paying our bills, playing by the rules, and living a comfortable life. Now, we live paycheck to paycheck just to make ends meet. I struggle to hold onto a job and I struggle to pay my medical bills. In the meantime, DMI continues to bid, and get work, and make money.

I work now as an estimator and I see firsthand how companies like DMI, who force their employees to become independent contractors, then they underbid law-abiding companies who pay their taxes and protect their workers.

I am here today to tell my story about what happened to my family so it does not happen to any other families.

I respectfully urge you to end this unfair practice that has harmed my family and thousands of other families across this country.

Thank you.

[The prepared statement of Mr. Anderson follows:]

PREPARED STATEMENT OF MATTHEW ANDERSON

Chairman Casey, Ranking Member Isakson and members of the subcommittee, my name is Matthew Anderson. I am a resident of St. Clair County in the State of Michigan, where I live with my wife and two wonderful young children. Thank you for the opportunity to speak with you today about how payroll fraud has harmed my family and thousands of families across the country.

Currently, I am an estimator for a construction company. Previously, before my injury, I was a working carpenter. I made cabinets, and installed interior trim like crown molding.

My employer was Rush Construction Services, Inc. Rush had a contract with the carpenters union, and they paid me an hourly wage with health and pension benefits. There was training and daily instructions. I was supplied with building materials, power tools and other construction equipment. When I made mistakes or didn't meet production quotas, I got a tongue-lashing. Rush deducted income taxes. They paid employment taxes and unemployment contributions. They paid time-and-a-half for overtime and provided workers' compensation protection. In other words, I and my fellow workers were employees. That is how it was for 6 years.

But things changed for the worse. We were told the recession cut into Rush's bottom line and they were having problems competing for jobs. Mr. Marty Steele was the owner of Rush and Mr. Dave Marracco was his right hand man. They told us they wanted to switch over to another company they jointly owned, called Dave & Marty, Inc. (DMI). We were given a choice: work for DMI as independent contractors or don't work at all. My fellow workers and I had families to support. We saw how bad the economy was, so we went along with it. Mr. Steudle and Mr. Marracco directed us to register as D/B/A's (doing-business-as persons). I passed the instructions on to my wife and she did the registration. I was never incorporated. I never had a business card or operated a business. Still that simple D/B/A registration would come back to haunt me. DMI knew what they were doing.

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On February 9, 2011, my life changed forever. My left hand slipped into a table saw blade, severing one finger and severely injuring three others.

I was rushed to the hospital for surgery to save my hand. I was told that the bills would not be covered by workers' compensation insurance because I was an independent contractor. My medical treatment was long and painful. I've had eight surgeries and I need one more. The damage was so bad that bones had to be taken from my hip. The doctors also needed to take bones from a cadaver for reconstruction.

I couldn't work and medical bills piled up. In a short time, we owed in the range of $100,000. That's more than my wife and I make in an entire year. I filed a workers' compensation claim. DMI claimed I was an independent contractor and refused to pay. I was pressured to settle with DMI and their insurance carrier. In the end, my family and I were left with our credit ruined and $25,000 in bills to pay.

This has been a nightmare for my family. A few years ago, my family and I felt secure. We were a middle-class family paying our bills, playing by the rules and living a comfortable life. Now we live paycheck to paycheck to make ends meet. I struggle to hold down a job. I struggle to repay my medical bills. In the meantime, DMI continues to bid and get work and make money. I work now as an estimator so I see first-hand how companies like DMI force workers to become independent contractors, then underbid law abiding companies that pay taxes and protect their workers.

I'm here today to tell my story so what happened to me and my family doesn't happen to anyone else. I respectfully urge you to end this unfair practice that has harmed my family and thousands of others across the country.

Thank you.

Senator CASEY. Thank you, Mr. Anderson. Appreciate your testimony.

Mr. Odom.

STATEMENT OF DANIEL ODOM, CHIEF OPERATING OFFICER AND VICE PRESIDENT, ODOM CONSTRUCTION SYSTEMS, KNOXVILLE, TN

Mr. ODOM. Chairman Casey, Ranking Member Isakson, and subcommittee members, my name is Daniel Odom, and I am the chief operations officer and vice president of Odom Construction Systems. I welcome the opportunity to talk to you today about how payroll fraud or misclassification is undercutting my company and crippling the construction industry. It is with great passion that I am testifying here today against this practice.

Odom Construction is a family owned and run company purchased by my father in 1982. We are primarily an interior systems contractor, meaning we do carpentry, drywall, plastering, and acoustical ceilings. We also do masonry and we do some prefabrication of walls and trusses as well.

Almost everything we do is self-performed. We are based in Knoxville, TN and we have offices in Kentucky and Austin, TX. We have a couple hundred employees and in the last year, we worked on projects in Tennessee, Virginia, Kentucky, Georgia, Alabama, Texas, Michigan, Louisiana, and Florida. So we have seen payroll fraud in a lot of places.

Payroll fraud happens when an employee is called an independent contractor and is sent a 1099 form. Also, employees are paid off the books, something that is extremely common in the construction industry.

In our business, it is not too hard to figure out who is an employee. When you supply building materials, tools, and equipment, training and daily instruction, and set hours of work, you have an employee. Still, people misclassify their workers because benefits can be worth the risk.

Payroll fraud is a hammer used to underbid law abiding employers by avoiding taxes, workers' compensation premiums, and overtime. It allows our competition to bid their labor costs 20 to 30 percent lower than those of us that play by the rules. In construction, the value of labor can be 50 percent of a total project. So the cheaters compete at a level that no law abiding contractor can reasonably touch even by better buyout of materials, or training, or productivity. Also, even when caught, the cheaters often prosper. Let me give you an example.

We frequently find ourselves in competition with a contractor, some say, uses payroll fraud tactics through brokers that supply labor. The Tennessee Department of Labor collected over $61,000 in unpaid unemployment contributions and interest from that contractor for three or more projects spanning many years. Some of those projects were publicly financed.

One of those projects, a new student housing for a secondary education institution in Tennessee, our bid was close to $1 million.

The usual markup for a bid of profit and overhead to cover office salaries and expenses is around 15 percent. When you consider markup on that one job at $150,000 the $61,000 delinquency payment collected by the Tennessee Department of Labor for multiple projects was less than half the markup for just this one project alone.

The payment was essentially just a fine that took a small bite out of an overall profit margin. It was just the cost of doing business and arguably well worth the risk. There were no limits placed on this contractor bidding future public work. We have competed against them many times ever since and, in most cases, they beat us.

Many States have begun the hard work of eliminating payroll fraud from the construction industry. Tennessee, for instance, enacted new laws this year with business support to fight back against workers' compensation premium fraud. But it will take sensible comprehensive action by the Federal Government to put this issue to bed for a number of reasons.

Not all States understand the issue, some do understand and they have enacted new laws, but effective enforcement is still uneven. The Federal Government can look at the various State laws, find out what is working and what is not, make enforcement plans and pass legislation that is enforceable across all States.

One of the worst offenders we know is based out of Georgia, but regularly prices work in Tennessee and elsewhere. It uses labor brokers that are sometimes based out of Florida who, in the end, there are three States involved on a single project for just this one contractor.

Interstate regulation is a Federal function, and it applies to this problem. U.S. Attorneys could help by prosecuting egregious cross border offenders. Also, the Federal Government already has E-Verify in place and it, too, can be part of a sensible solution.

The bad news for us is that violating the law has become an established business plan. Today, the profitability of breaking the law, fueled by reduced opportunities due to the recession, creates the danger of phasing out law abiding businesses until there is nothing left but the bad operators. This has also resulted in tradesmen leaving the industry en masse to seek employment in safer industries with wages that have not been beaten into the ground by the criminal operators. We cannot let that continue.

Payroll fraud is shutting down a whole industry of contractors that believe in building middle-class jobs and making a reasonable profit by doing things the right way. Businesses like ours deserve your protection.

Thank you.

[The prepared statement of Mr. Odom follows:]

PREPARED STATEMENT OF DANIEL ODOM

INTRODUCTION

Thank you for the opportunity to testify before this committee. My name is Daniel Odom, and I am the chief operations officer and vice president of Odom Construction Systems Inc. We are based in Knoxville, TN, and we have offices in Lexington, KY, Nashville, TN, Kingsport, TN, and most recently in Austin, TX. We have hundreds of employees throughout our work area which consists of the entire southeast and, in certain circumstances, other areas of the country. In the last year, we have

completed projects in Tennessee, Virginia, Kentucky, Georgia, Alabama, Texas, and Michigan. We are currently involved in those States plus Louisiana and Florida, and are actively pursuing work in other areas.

I would like to deal with the payroll fraud, or misclassification issue. Payroll fraud happens when a worker is an employee and is called an independent contractor and sent a 1099 form. It also happens when employees are paid off the books, something that is extremely common in the construction industry. Payroll fraud has stolen jobs from our company and employees and is crippling the construction industry. Our company's regional experience, as well as lengthy history, allows us to have a comprehensive perspective on how payroll fraud threatens companies like ours that provide decent middle-class jobs by doing business in a fair, honest, and legitimate way.

COMPANY AND PERSONAL HISTORY

The parent company of Odom Construction, Gilbert Plastering and Painting, started in Knoxville in 1883. In 1982, it was purchased and incorporated as Odom Construction Systems by my father Bill Odom. It has been operating in Tennessee, and expanding into the areas noted above, ever since. A now third-generation family business, my brother William Odom (CEO), and Melinda Sands (CFO) also have spent their entire working lives in this business.

Odom Construction is a specialty contractor focusing on interior systems trades (carpentry, drywall, plastering, acoustical ceilings, etc.) as well as masonry. We also have a very technology-driven prefabrication operation for walls and trusses. Almost everything we do is self-performed.

Odom Construction, like many family businesses, has as its roots, strong values and high business ethics. We believe in treating our employees well, compensating them fairly for the tremendous work they do on our behalf, and caring for their well-being and that of their families. As such, we have employees that have been with our company for their entire careers, several spanning 25 years-plus. Seeing the well-being of those families jeopardized by fraudulent business practices is the primary reason I am here today.

We have existed as 100 percent open shop, and 100 percent union shop in our past, and we currently exist as a hybrid operation. Many of our carpenters are represented by the Carpenters' Union. Other trades are open shop. Payroll fraud does not affect only union or only non-union aspects of our business. It is crippling to all our field personnel, and by association, their families as well, regardless of their affiliation with any labor or trade organizations.

Personally, I have grown up in this business. As did my brother, I started working summers during school as the lowest man on the totem pole, cleaning up as a general laborer. I worked up through the plasterer's trade as I completed my degree at the University of Tennessee, Knoxville.

My experiences in the office began shortly after I graduated in 1997, and I have worked as an assistant estimator, estimator, project manager, vice president, chief operations officer, and I am also now the president of OCS Steel, our prefabrication division. As such, I believe my experience is varied and fairly extensive in this industry that I love, and it is with great passion that I testify to try and protect it.

THE PROBLEM OF PAYROLL FRAUD

The payroll fraud problem has been documented and testified to before, but it has gotten pervasively worse as a function of the severe recession our country faced. As I am sure you are aware, the construction industry was profoundly affected by the recession. To make matters worse, the construction industry was also being decimated from within by the problem of payroll fraud.

At its most basic definition, payroll fraud is a method used to misclassify workers, construction trades people in this case, as independent subcontractors or off-the-books employees for the sole purpose of underbidding law-abiding employers by avoiding paying employment taxes, withholding tax, workers' compensation premiums and overtime. When deployed, this method allows our competition to show up on bid day with a cost basis for their labor that is 20 percent–30 percent lower than those of us that play by the rules. In our line of work, the value of labor on a total project can be 50 percent of the project value, and so these methods allow those companies to compete at a level that no law-abiding contractor can reasonably touch.

Moreover; in our business it is not too hard to figure out who is an employee. When you supply building materials, tools, equipment, training and daily instruction and set hours of work, you have an employee. The notion that the problem is

mostly negligence or confusion does not wash. Much of the abuse we see is intentional.

HOW PAYROLL FRAUD HURTS LAW-ABIDING COMPANIES

Payroll fraud destroys companies like ours because the savings a company can achieve by using illegal tactics is so significant that we cannot overcome it by legal means. While we have a huge, best in class, focus on training and productivity in our organization, there comes a point where you reach the limit to the efficiencies you can reasonably expect to achieve. We also cannot erase this gap through better buyout of our materials. Materials in construction are predominantly commodity-based goods, and within certain variances, we all pay essentially the same prices for the products we use. We cannot overcome payroll fraud even by more Draconian methods of slashing the hourly wages of field employees. It is difficult enough to staff projects with wages having been beaten down as much as they have been in the last 5 years without having to do so at rates we haven't seen since the 1990s. Even at those rates, to which our markets have been pushed as a direct result of payroll fraud, we still wouldn't be on a level playing field.

AN EXAMPLE OF PAYROLL FRAUD IN THE REAL WORLD

We frequently find ourselves in competition with a contractor that some say uses payroll fraud tactics through brokers that supply its labor. The Tennessee Department of Labor collected over $61,000 in unpaid unemployment contributions and interest from that contractor for three or more projects spanning many years. Some of those projects were publicly financed.

One of those projects, new student housing for a secondary education institution, we priced close to $1,000,000. Allowable profit margins and overhead for office salaries and expenses are pretty well-defined in our industry, and 15 percent is a reasonable total markup. If you consider the total markup of that job at $150,000, the $61,000 delinquency payment for three or more projects was less than half for just one.

The payment was a fine that, for all practical purposes, took a small bite out of an overall profit margin. It was essentially just a cost of doing business and arguably well worth the risk. There were no limits placed on this contractor against bidding future publicly funded work, as we have competed against them many times ever since. In most cases they beat us, and they beat others that price the work with all taxes and premiums included in their proposals.

HOW THE FEDERAL GOVERNMENT CAN HELP

Many of the parameters for successfully eliminating payroll fraud from the construction industry are in place, but I feel it will take comprehensive, yet sensible, action by the Federal Government to put this issue to bed for a couple of reasons.

Several States, including now my home State of Tennessee, have made attempts at addressing this issue on their own. While it is very encouraging that a State like Tennessee has listened to the issue and enacted some positive legislation to try and proactively address the issue, what we find regionally is that not all States understand it, and the ones that do are enacting legislation with varying focus and levels of enforcement. The end result is the offenders scurry from State to State, manipulating the system in increasingly sophisticated ways, and then concentrating in other less-savvy States until they decimate the local construction economies, and then moving on only to repeat the cycle.

The Federal Government can look at the various State plans, and find out what is working and what is not working to create a plan that is enforceable across all States.

Second, this is an issue that crosses State borders. One of the worst offenders against which we compete is based out of Georgia, but regularly prices work in Tennessee and other States in the region. Since those types of companies are using labor brokers that are sometimes based out of Florida or other regional States, there could be three States involved on a single project. As such, no single State is able to fully take charge of a prosecution across State lines. Interstate regulation is a primary function of the Federal Government, and certainly applies to this problem. Additional focus by U.S. attorneys would certainly help here by prosecuting egregious cross-border violators.

Last, the Federal Government already has functional systems in place that could be part of a sensible comprehensive treatment of this issue. One example is E-Verify. Our company has been E-Verify compliant for years, and while it is actually very easy to use, reliable, and accurate, it is also probably the easiest Federal system to circumvent in our industry. The project I noted above was an E-Verify

project. We see notorious operators in our industry function without interruption on publicly funded projects (including projects with ARRA funding) simply because there is no enforcement of this provision. However, the system is in place, and with intelligent modifications to the implementation of it, could be used as an effective tool.

CONCLUSION

I noted in the introduction that this devastating issue has gotten worse during the recession. Back in the 1990s when the entire labor broker payroll-fraud phenomena really hit the Southeast, the bad apples gained a poor reputation within the industry. In many cases, when general contractors would receive bids from the questionable contractors, and those prices looked artificially low, they would toss those bids into the trash, because the risk just wasn't worth it. However, as opportunities dried up, and there wasn't always 10 other jobs that could be bid if you lost the last one, suddenly the generals starting using those numbers out of fear that, if they didn't, the guy across the street would, and there just wasn't that much else out there to bid.

What that means now is that the prevalence of those players in the market, coupled with reduced opportunity overall due to recession, is phasing out law-abiding businesses like ours until there won't be anything left but the bad operators. If we wait until that happens, then when action comes, it will be too late. Trades people are leaving our industry in mass to seek employment in other safer industries with wages that haven't been beaten into the ground by the criminal operators. This is not going to be a light switch we can turn back on and fix once the workforce disappears. Without action, construction stands to go the way of many elements of manufacturing in our country's history. Yet, this time, it is not being sent overseas. It is happening right under our noses on our soil, and it is hurting workers and their families, as well as shutting down a whole industry of contractors that believe in building middle-class jobs and who are just trying to do things the right way and make a reasonable profit to support their own families.

Senator CASEY. Thank you very much, Mr. Odom.

Ms. Ruckelshaus.

STATEMENT OF CATHERINE K. RUCKELSHAUS, LEGAL CO-DIRECTOR, NATIONAL EMPLOYMENT LAW PROJECT, NEW YORK, NY

Ms. RUCKELSHAUS. Thank you, Chairman Casey, Ranking Member Isakson, and members of the subcommittee.

I appreciate the opportunity to testify today on the important subject of payroll fraud. I am Cathy Ruckelshaus and I am general counsel of the National Employment Law Project, NELP. We are a nonprofit that promotes good jobs, access and opportunities for work.

It has been a little over 3 years since I appeared before the HELP committee to talk about independent contractor misclassification, and I am disheartened to say that the problems have exacerbated despite some State activity to combat the problems, and the problems call for Federal leadership and activity.

At NELP and in my practice, we see low-wage workers in our economy's growth sectors being forced to sign contracts saying they are an independent contractor as a condition of getting a job. We also see employers changing the status of their workers from employee into independent contractor without any change in the underlying relationships at work. We also see employers call their workers "franchisees," of one in the janitorial industry and we see workers being paid off the books. All of these practices, unfortunately, have been on the rise, especially in this period of high unemployment when workers are willing to take a job under almost any circumstance.

These janitors, homecare workers, construction workers, cable installers, and even restaurant servers are not running their own business by any definition. They want to work and they, too often, accept whatever arrangement gets them a job. And these same occupations with high payroll fraud suffer from high violations of other workplace laws, so it means these jobs are not paying well and they suffer high rates of health and safety violations, among other things.

As Senator Casey mentioned, this hurts not only the workers, but it also hurts law abiding employers and it hurts our Government's coffers, and I will talk about that in a little bit. Today, I am just going to briefly describe payroll fraud and its impacts. It is the impact on State and Federal Government coffers and on law abiding employers, and then I will talk a little bit at the end about why I think the Payroll Fraud Protection Act is an important first step to combat this problem.

As Senator Isakson mentioned, every day employers legitimately contract with other independent businesses typically to perform jobs that the contractor performs for a variety of customers. These routine practices are not the subject of payroll fraud reforms. Genuine independent contractors constitute a small proportion of the American workforce because, by definition, an independent contractor is in business for him or herself.

What is happening today is that companies have become increasingly emboldened in the ways they seek to skirt basic labor standards, insurance, and tax laws that apply to employers. We have heard about some of the practices today.

The problem of workers being required to sign boiler-plate contracts attesting to their independent contractor status is especially galling even when the functional relationships do not reflect true independence.

These practices are called payroll fraud because they are intentional and they are aimed at evading the law. Legitimate business-to-business transactions are not payroll fraud because true independent contractors bring a specialized skill. They typically invest a capital in their business against which they can earn a profit. And they can pass on increased costs to their customers as any business does, like higher gas prices or an increase in the cost of safety equipment. So companies orchestrate these relationships to avoid labor and employment protections, and because they can underbid competitors, as we have heard.

So how prevalent is this? In my testimony, I detail that it is quite prevalent. The 2000 U.S. Department of Labor study that is being updated found that up to 30 percent of employers that misclassify their workers state studies have shown percentages as high as 47 percent of employers. It rises during periods of high unemployment.

The cost to the States and the Federal Government are literally in the billions of dollars. They are staggering and it is typically unemployment insurance, workers' compensation, income tax, and payroll taxes.

There has been State activity across a wide variety of States: Delaware, Maryland, Minnesota, Nebraska, New Mexico, New York, Pennsylvania, Wisconsin have construction-specific laws.

Over 20 States have established task force to study the problem. The interesting thing is that these State task force and the U.S. Department of Labor report that most of the complaints that come in to them come from competitors; not from workers, but from competitors like Mr. Odom's business.

So we need Federal leadership and reform. The Department of Labor's task force has established some important first steps. The Payroll Fraud Prevention Act that Senator Casey mentioned would provide important transparency for workers and employers about the status of workers and would enable workers to question that status if they think it is incorrect.

In addition, there is a Fair Playing Field Act that was introduced by Senator Kerry that would fix the tax code. I realize that is not the topic of this panel, but that would have a huge impact on narrowing the safe harbor that is currently enabling hundreds of thousands of businesses to take advantage of misclassifying their workers, and then never having to repair or correct the mistake. This is causing, again, billions of dollars of unpaid revenues for the Government.

I appreciate the opportunity to testify today. I am happy to answer your questions in the intervening period.

Thank you.

[The prepared statement of Ms. Ruckelshaus follows:]

PREPARED STATEMENT OF CATHERINE K. RUCKELSHAUS

Senator Casey and members of the subcommittee, thank you for this opportunity to testify today on the important subject of payroll fraud and its impacts on workers and their families, law abiding employers, and the broader economy.

My name is Cathy Ruckelshaus, and I am a general counsel of the National Employment Law Project (NELP), a non-profit organization that promotes policies and programs that create good jobs, strengthen upward mobility, enforce hard-won worker rights, and help unemployed workers regain their economic footing through improved benefits and services. It has been a little over 3 years since I appeared before the HELP Committee to talk about independent contractor misclassification,[1] and I am disheartened to say that the problems have exacerbated despite some State activity to combat the problems, and call for Federal leadership and action.

At NELP, we see low-wage workers in our economy's growth sectors being forced to sign contracts saying they are "independent contractors" as a condition of getting a job; we see employers changing employees into independent contractors, franchisees, or other non-employee labels to cut costs, and we see workers being paid off the books completely, with no reporting or withholding of the basic payroll taxes or insurance. Janitors, home care workers, construction laborers and drywallers, cable installers, delivery persons, and even restaurant servers—these are the workers we see who are called non-employees by their employers. They are not running their own businesses by any definition. They want to work and they too often accept whatever arrangement gets them a job. These same occupations with high rates of independent contractor misclassification are among the jobs with the highest numbers of workplace violations.[2]

This hurts the workers, who lose out on labor and employment protections including workers compensation, unemployment insurance, fair pay, and health and safety safeguards. They also bear a tax burden that their employers are supposed to incur. It hurts law-abiding employers who treat their workers as employees but who cannot compete with those who perpetrate fraud. This has resulted in a race to the bottom and rewards cheaters. This affects the quality of what should be middle-class jobs that could stimulate our economy.

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[1] *See*, Testimony of Catherine Ruckelshaus before Senate HELP Committee, June 2010,

[2] *See*, National Employment Law Project, *Holding the Wage floor, http://www.help.senate.gov/imo/media/doc/Ruckelshaus.pdf. http://nelp.3cdn.net/95b39fc0a12a8d8a34__iwm6bhbv2.pdf.*

My testimony will update what I presented in 2010, describing independent contractor misclassification and its impacts on workers, on State and Federal Government coffers, and on law-abiding employers. I will describe the recent downturn in State legislative activity on this important issue, and conclude with comments on Federal efforts to address the problem, including the Payroll Fraud Protection Act.

I. WHAT IS INDEPENDENT CONTRACTOR MISCLASSIFICATION, OR PAYROLL FRAUD?

Companies looking to cut payroll costs to compete for work have become increasingly emboldened in the ways they seek to skirt basic labor standards, insurance and tax laws that apply to employers. They call employees "independent contractors," even when the worker is not running his own business; they require employees to form a limited liability corporation or franchise company-of-one as a condition of getting a job, and they pay workers off the books, without any payroll treatment at all. These workers are sometimes required to sign boilerplate contracts attesting to independent contractor status even where the functional relationships do not reflect true independence.

These practices are increasingly being called "payroll fraud" because they are intentional and aimed at evading the law. Legitimate business-to-business transactions are not payroll fraud, because true independent contractors have a specialized skill and have invested in a business that enables them to earn a profit.[3]

Companies do this to avoid having to report and pay FICA and FUTA taxes, evade labor organizing, skirt baseline labor standards like minimum wage and overtime, discrimination protections, health and safety and workers compensation, and unemployment insurance.[4] And they construct these arrangements because they can under-bid competitors in labor-intensive sectors by saving as much as 30 percent of payroll and related costs.

A. Misclassification persists in labor-intensive and lower-wage jobs.

The most recent Government Accountability Office (GAO) report on employment arrangements states in 2009 that,

> "[t]he 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."[5]

A 2000 study commissioned by the U.S. Department of Labor found that up to 30 percent of firms misclassify their employees as independent contractors.[6] In January 2013, the U.S. Department of Labor sought comments on a planned classification survey of workers, which should update these earlier studies with much-needed more recent information.[7]

Many States have studied the problem and find high rates of misclassification, especially in construction, where as many as 47 percent of employers were found to have misclassified their employees.[8]

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[3] *See, Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification,* GAO–06–656 (July 2006), at p. 43.

[4] *See, Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification,* GAO–06–656 (July 2006), at p. 25.

[5] *See, Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification,* GAO–06–656 (July 2006), at p. 43.

[6] Lalith de Silva, *et al.*, "Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs" i–iv, *prepared for* U.S. Department of Labor, Employment and Training Division by Planmatics, Inc. (Feb. 2000), *available at http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf.*

[7] Proposed Information Collection Request (ICR) for the Worker Classification Survey; Comment Request *http://www.gpo.gov/fdsys/pkg/FR-2013–01-911/html/2013-900389.htm.*

[8] *See* Fiscal Policy Institute, "New York State Workers Compensation: How Big is the Shortfall?" (January 2007); Michael Kelsay, James Sturgeon, Kelly Pinkham, "The Economic Costs of Employee Misclassification in the State of Illinois" (Dept of Economics: University of Missouri-Kansas City: December 2006); Sturgeon and Kelsay, "The Economic Costs of Employee Misclassification in the State of Indiana," Department of Economics, University of Missouri-Kansas City (2010); Peter Fisher, et al, "Nonstandard Jobs, Substandard Benefits", Iowa Policy Project (July 2005); Francois Carre, J.W. McCormack, "The Social and Economic Cost of Employee Misclassification in Construction (Labor and Worklife Program, Harvard Law School and Harvard School of Public Health: December 2004); State of New Jersey, Commission of Investigation, "Contract Labor: The Making of an Underground Economy" (September 1997); Canak and Adams, "Misclassified Construction Employees in Tennessee" (2010).

Most of these studies do not capture the so-called "underground economy," where workers are paid off-the-books, sometimes in cash.[9] These workers are *de facto* misclassified independent contractors, because the employers do not withhold and report taxes or comply with other basic workplace rules. Many of these jobs are filled by immigrant and lower-wage workers.[10]

Payroll fraud is persistently common in jobs where the workers are not truly running their own independent businesses: construction,[11] day labor,[12] janitorial and building services,[13] home health care,[14] agriculture,[15] poultry and meat processing,[16] high-tech,[17] delivery,[18] trucking,[19] home-based work,[20] and the public[21] sectors.

Press accounts and queries coming into the NELP offices indicate that employer payroll fraud and related practices rise during periods of high unemployment, where workers will take a job under nearly any circumstance. When job opportunities are scarce, workers face increased pressure to acquiesce to independent contractor arrangements. An Ohio worker who agreed in 2010 to be labeled an independent contractor as a condition of getting a job building housing for the homeless under a Federal grant explained, "I went along with it because I felt my back was up against the wall. I have a family. My fiance was in school. I'm the only bread winner."[22]

Permitting employers in these jobs to get away with skirting basic labor and tax requirements will have a significant and long-term effect on the nature of jobs and our economy.

II. FEDERAL AND STATE GOVERNMENTS LOSE BILLIONS

Federal and State governments suffer hefty loss of revenues due to independent contractor misclassification, in the form of unpaid and uncollectible income taxes, payroll taxes, and unemployment insurance and workers' compensation premiums.

A. Losses to Federal Revenues

As detailed in my 2010 testimony, several government studies document the extent to which misclassification drains Federal revenues:

- A 1994 study by Coopers and Lybrand estimated the Federal Government would lose $3.3 billion in revenues in 1996 due to independent contractor misclassification, and $34.7 billion in the period from 1996 to 2004.[23]

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[9] Bear Stearns in 2005 estimated that the United States is losing $35 billion annually due to off-the-books employment. Justich and Ng, "The Underground Labor Force is Rising to the Surface," at p. 3, Bearns Stearns Asset Management (2005).

[10] Francois Carre, J.W. McCormack, "The Social and Economic Cost of Employee Misclassification in Construction (Labor and Worklife Program, Harvard Law School and Harvard School of Public Health: December 2004), at p. 8.

[11] Workers Defense Project, "Building Austin, Building Injustice: Working Conditions in Austin's Construction Industry" (2009); Francois Carre, J.W. McCormack, *et al.*, "The Social and Economic Cost of Employee Misclassification in Construction" 2, Labor & Worklife Program, Harvard Law School and Harvard School of Public Health, Dec. 2004, *available at http://www.faircontracting.org/NAFCnewsite/prevailingwage/pdf/Work__Misclass__Stud__1.pdf*.

[12] Abel Valenzuela and Nik Theodore, *On the Corner: Day Labor in the United States* (January 2006).

[13] *See Bulaj* v. *Wilmette Real Estate and Management Co., LLC*, 2010 WL 4237851 (N.D.Ill.2010); *Coverall North America, Inc. vs. Commissioner of the Division of Unemployment Assistance*, SJC–09682, 447 Mass. 852 (2006); *Vega* v. *Contract Cleaning Maintenance*, 10 Wage & Hour Cases 2d (BNA) 274 (N.D. IL 2004).

[14] *See Crouch* v. *Guardian Angel Nursing, Inc.*, 2009 WL 3737887 (M.D.Tenn.2009); *Bonnette* v. *Cal. Health & Welfare Agcy.*, 704 F.2d 1465 (9th Cir. 1983).

[15] *Sec'y of Labor* v. *Lauritzen*, 835 F.2d 1529 (7th Cir. 1988).

[16] *Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification*, GAO–06–656 (July 2006), at p. 30.

[17] *Vizcaino* v. *Microsoft Corp.*, 97 F.3d 1187 (9th Cir. 1996).

[18] *Ansoumana, et al* v. *Gristedes, et al*, 255 F.Supp.2d 184 (S.D.N.Y. 2003).

[19] *See* Smith, Bensman, Marvy, "The Big Rig: Poverty, Pollution and the Misclassification of Truck Drivers at America's Ports," (2010), *http://nelp.3cdn.net/000beaf922628dfea1__cum6b0fab.pdf*; Steven Greenhouse, *The New York Times*, *Clearing the Air at American Ports, http://www.nytimes.com/2010/02/26/business/26ports.html*.

[20] *Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification*, GAO–06–656 (July 2006), at p. 31.

[21] Phillip Mattera, "Your Tax Dollars at Work . . . Offshore," Good Jobs First (July 2004) *http://www.goodjobsfirst.org/publications/Offshoring__release.cfm*.

[22] *http://www.bloomberg.com/news/2013-10-18/states-clamping-down-on-workers-mislabeled-as-contractors.html*.

[23] Coopers & Lybrand, *Projection of the Loss in Federal Tax Revenues Due to Misclassification of Workers*, Prepared for the Coalition for Fair Worker Classification (1994).

• A 2000 study commissioned by the U.S. Department of Labor (DOL)—the "Planmatics" study—found that misclassification exacts an enormous toll: misclassifying just 1 percent of workers as independent contractors would cost unemployment insurance (UI) trust funds $198 million annually.[24]

• A 2009 report by the Government Accountability Office (GAO) estimated independent contractor misclassification cost Federal revenues $2.72 billion in 2006.[25]

• A 2010 study by the Congressional Research Service estimated that a proposed modification to the IRS's "Safe harbor" rules, which currently allow employers significant leeway to treat workers as independent contractors for employment tax purposes and would yield $8.71 billion for fiscal years 2012–21.[26]

B. Losses to State Revenues

The 2010 testimony I provided enumerated the various State task force studies showing staggering losses in the billions of dollars to State workers' compensation, unemployment insurance, and income tax revenues.[27] Updates to the State and Federal costs reports show continued and damaging drains on public funds. Recent results from State task force reports include:

• A 2013 bill in the California legislature finds that an estimated $9 billion of corporate, personal, and sales and use taxes goes uncollected in California each year, with unreported and underreported economic activity responsible for the vast majority of that total. In 2012 California's Employment Development Department's (EDD) Tax Branch conducted 4,290 audits and investigations, resulting in assessments totaling $230.6 million, and identifying 89,063 unreported employees. EDD's Compliance Development Operations which concentrates on the underground economy, conducted 2,600 joint inspections, identified 13,226 previously unreported employees, assessed $36 million in payroll tax assessments and assessed over $9 million on fraud cases in 2012.[28]

• The New York Joint Enforcement Task Force on Employee Misclassification said in February 2013 that since its inception in 2007, it has identified over 88,700 instances of employee misclassification and discovered over $1.4 billion in unreported wages and conducted 142 joint sweeps. In 2012, the JETF identified over 20,200 cases of employee misclassification; discovered over $282.5 million in unreported wages; and assessed over $9.7 million in unemployment insurance taxes.[29]

• In 2012, Massachusetts' Joint Task Force on the Underground Economy and Employee Misclassification recovered over $15.4 million through its enforcement efforts: the Department of Unemployment Assistance recovered $13 million in unpaid employer contributions to the UI Trust Fund; the Department of Revenue recovered $328,000 in unpaid taxes; and the Attorney General's Office brought in $593,400 in

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[24] Lalith De Silva, *et al., Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs*, Planmatics, Inc., Prepared for the U.S. Department of Labor Employment and Training Administration (2000), available at *http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf*.

[25] U.S. General Accounting Office, *Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention* (August 2009), available at *http://www.gao.gov/products/GAO-09-717*. See also, Treasury Inspector General for Tax Administration, *While Actions Have Been Taken to Address Worker Misclassification, and Agency-Wide Employment Tax Program and Better Data are Needed* (February 4, 2009), available at *http://www.treas.gov/tigta/auditreports/2009reports/200930035fr.pdf* (explaining that "Preliminary analysis of fiscal year 2006 operational and program data found that underreporting attributable to misclassified workers is likely to be markedly higher than the $1.6 billion estimate from 1984.")

[26] A 2010 study by the Congressional Research Service built on earlier national studies to compare the costs and benefits of improved classification if President Obama's proposed modification of Section 530 of the Revenue Act of 1978 were passed. The modification would permit the IRS to prospectively reclassify workers who are misclassified. The U.S. Treasury estimated that the proposal would yield $8.71 billion for the period of fiscal year 2012 through 2021. The CRS study acknowledged, however, that the work needed to reduce misclassification "would impose significant costs." James M. Bickley, *Tax Gap: Misclassification of Employees as Independent Contractors*, Congressional Research Service (March 10, 2011), available at *http://op.bna.com/dlrcases.nsf/id/vros-8euvqa/$File/taxgap.pdf*.

[27] *See,* Testimony of Catherine Ruckelshaus before Senate HELP Committee, June 2010, at pp. 7–8; *http://www.help.senate.gov/imo/media/doc/Ruckelshaus.pdf*.; Leberstein, "Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries," National Employment Law Project (2012); *http://nelp.3cdn.net/0693974b8e20a9213e_g8m6bhyfx.pdf*.

[28] California Employment Development Department, *Annual Report: Fraud Deterrence and Detection Activities*, report to the California Legislature (June 2013), available at *http://www.edd.ca.gov/about_edd/pdf/Fraud_Deterrence_and_Detection_Report13.pdf*.

[29] *Annual Report of the Joint Enforcement Task Force on Employee Misclassification*, (February 1, 2013), available at *http://www.labor.ny.gov/agencyinfo/PDFs/Misclassification-Task-Force-Report-2-1-2013.pdf*.

restitution, penalties, and fines related to violations of the State's wage and hour and independent contractor laws. Based on the review and investigation of all JTF referrals in 2012, the Department of Industrial Accidents issued 15 stop-work orders for lack of workers' compensation coverage.[30]

III. STATE AND FEDERAL POLICY REFORMS

A. State reforms

State legislation seeking to combat independent contractor abuses has dwindled since the initial spate of laws were passed in the mid- to late-2000s, with much of the more recent activity pertaining to small provisions allowing discretionary penalties or weakening previously enacted laws.[31]

The State reforms fall into a few general categories, and with one possible exception, are not comprehensive laws applying to all sectors. Some themes that emerge from an analysis of State laws are:

- Laws that create a presumption of "employee" or "employer" status for those performing or receiving labor or services for a fee. State UI and other laws that use the so-called "ABC" test are an example of these laws; they create a presumption of employee status and require employers to overcome this presumption by showing that: (a) an individual is free from control or direction over performance of the work, both under contract and in fact; (b) the service provided is outside the usual course of the business for it is performed; and (c) an individual is customarily engaged in an independently established trade, occupation or business. This "ABC" test for non-employee status is the most objective and the most difficult for employers to manipulate.[32]
- Construction industry-specific laws that apply the standard across multiple State workplace laws to determine the status of construction workers.[33]
- Laws creating a study commission or task force to coordinate audits and enforcement.[34]

The State reforms, including the State task forces and executive branch activity, are an important first step and have brought real results to the State treasuries. There is however a continued need for Federal leadership and oversight, as nearly half of the States have no payroll fraud provisions in place, and because the practices continue largely unabated in many sectors.

B. Federal Reforms

To date, no Federal legislation has been enacted to address this growing problem. The U.S. Department of Labor has launched a multi-agency task force to combat payroll fraud, which is an important step.

Department of Labor Employee Misclassification Initiative: The Department of Labor's multi-agency initiative to strengthen and coordinate Federal and State efforts to identify and deter employee misclassification was launched in 2010.[35] In its Strategic Plan, the Department described Wage & Hour Division investigations in industries with the most substantial independent contractor abuses, and training for investigators on the detection of misclassified workers; targeted efforts to recoup unpaid payroll taxes due to misclassification, including a pilot pro-

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[30] Massachusetts Department of Labor, *Joint Task Force on the Underground Economy and Employee Misclassification 2012 Annual Report* (August 2013), available at *http://www.mass.gov/lwd/eolwd/jtf/annual-report-2012.pdf*.

[31] For State legislative round-ups of leading independent contractor legislation, *see* National Employment Law Project, "NELP Summary of Independent Contractor Reforms: New State and Federal Activity," November 2011, *http://nelp.3cdn.net/85f5ca6bd2b8fa5120__9qm6i2an7.pdf*. Earlier year round-ups are cited in the 2011 report footnotes.

[32] Twenty-four States have this definition in their unemployment insurance law Alaska, Arkansas, California, Connecticut, Delaware, Florida, Hawaii, Illinois, Indiana, Louisiana, Massachusetts, Maryland, Nebraska, New Hampshire, New Jersey, New Mexico, Nevada, Oklahoma, Rhode Island, Tennessee, Virginia, Vermont, Washington, and West Virginia. Another eight States use a test that includes part "C" in combination with other factors (Colorado, Georgia, Idaho, Minnesota, Oregon, Pennsylvania, South Dakota, and Utah). This is also the law in over 10 States' workers' compensation acts: AZ, CA, CO, CT, DE, HI, NH, ND, WI, WA. Massachusetts' minimum wage act and its wage payment law use the ABC test as well. *http://www.mass.gov/legis/laws/mgl/149-148b.htm*.

[33] E.g., DE, IL, MD, MN, NB, NM, NY, PA, WI.

[34] For a recent summary of State task forces and their results, see National Employment Law Project, "Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries," National Employment Law Project (2012); *http://nelp.3cdn.net/0693974b8e20a9213e__g8m6bhyfx.pdf*.

[35] The DOL has signed Memoranda of Understanding with 13 States and is undertaking targeted enforcement in collaboration with other agencies to combat the worst abuses; *see http://www.dol.gov/whd/workers/misclassification/*.

gram to reward States with the most success at detecting and prosecuting employers that misclassify; coordination with the States on enforcement litigation against multistate employers that routinely abuse independent contractor status; training for Occupational Safety and Health inspectors on misclassification issues; and legislative changes requiring proper classification, providing penalties for misclassification, and restoring protections for employees who have been improperly classified.[36]

The Internal Revenue Service has also launched its **Voluntary Worker Classification Settlement Program**, which enables employers to resolve past worker misclassification problems by voluntarily reclassifying their workers prospectively and making a minimal payment covering past payroll tax obligations.[37] To be eligible, the employer must have (1) consistently treated the workers in the past as nonemployees; (2) filed all required Forms 1099 for the workers for the previous 3 years; and (3) not currently be under audit by the IRS, the Department of Labor or a State agency concerning the classification of these workers. Employers accepted into the program will pay an amount equaling just over 1 percent of the wages paid to the reclassified workers for the past year.

The Payroll Fraud Prevention Act[38] was introduced in April 2011 by Senator Brown, and would amend the recordkeeping requirements of the Fair Labor Standards Act (FLSA) to require employers to notify all employees and non-employees who perform services for remuneration of their status, would establish a presumption that an individual is an employee under the FLSA if the employer violates the notice requirements; and would provide for the imposition of civil penalties. The bill would also amend the Social Security Act to require State unemployment insurance programs to implement investigative procedures and establish penalties for misclassification; would require the Department of Labor (DOL) to measure State performance in this independent contractor misclassification enforcement when conducting unemployment compensation tax audits; would require information-sharing within the DOL regarding possible independent contractor abuses under the FLSA, and authorize the sharing of such information with the IRS; and would require that targeted audits conducted by the Wage & Hour Division include industries with frequent incidence of employee misclassification.

This law, if enacted, would provide important transparency for workers and their employers, and enable workers to question their designated employment status if the notification appeared incorrect or was confusing.

CLOSING THE IRS SAFE HARBOR—FAIR PLAYING FIELD ACT

Under current law, an employer who is found by the IRS to have misclassified its workers as independent contractors can have all employment tax obligations waived. This "Safe harbor", at Section 530 of the Internal Revenue Act of 1978, 26 U.S.C. § 7436, also prevents the IRS from requiring the employer to reclassify the workers as employees in the future. Among other factors, to get the safe harbor, a business can assert its belief that a significant segment of its industry treated workers as independent contractors, thereby perpetuating industry-wide noncompliance with the law.

This loophole prevents the IRS from collecting back payroll taxes and even issuing regulations or guidance clarifying the agency's analysis of independent contractor practices for purposes of payroll taxes, and has thus been a major bar to effective enforcement against independent contractor abuses. To close this loophole, Senator Kerry introduced the Fair Playing Field Act of 2012 (S. 2145). This bill would amend the Internal Revenue Code to modify the rules giving employers a "safe harbor" when they misclassify employees, and would permit the IRS to issue guidance on the subject. This change is vital to serious reform seeking to combat independent contractor abuses. Without this monetary and tax incentive for employers to fix the problem, it will continue unabated.

In addition, the Congress should support more Federal criminal prosecutions for egregious violators of Federal criminal laws, including the failure to report currency transactions, mail and wire fraud, and tax fraud. The IRS could extend 1099 transaction reporting requirements to any payments made to incorporated businesses; this would help the IRS track down the companies who received those payments but did not pay taxes. And finally, comprehensive immigration reform would enable more immigrants to come forward and inquire about and protect their rights.

Senator CASEY. Thanks very much.

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[36] See *http://www.dol.gov/__sec/media/congress/20100310__appropriations.htm*.
[37] See *http://www.irs.gov/newsroom/article/0,id=246203,00.html*.
[38] *https://www.govtrack.us/congress/bills/112/s770*.

Mr. MacKrell.

STATEMENT OF CHRIS MacKRELL, PRESIDENT AND CHIEF OPERATING OFFICER, CUSTOM COURIER SOLUTIONS, ROCHESTER, NY

Mr. MACKRELL. Chairman Casey, Ranking Member Isakson, and the committee, I want to thank you both for affording me the opportunity to appear here today. I provided the committee with a written testament of both my business and our industry, but I wanted to share with the committee this afternoon my personal perspective, the important role independent contractors play in the economy.

After graduating college in 1982, I found myself ready to start my career, but as you may recall, the country struggled with tough economic times, not dissimilar to what the country is going through today. In my search for a job, I was presented with an opportunity to start my career as an independent contractor working for a small courier company in up-state New York. Over the next 3 years, I operated as an I.C. learning the skills necessary to succeed in the same-day delivery business.

After 23 years working in the industry, I found myself, once again, with the opportunity to operate my own small business. So in 2006 with a partner, I started Custom Courier Solutions. CCS's first business opportunity was to operate as an independent contractor for a much larger courier company. For the first 6 months, revenue from that single customer was what kept CCS alive. As time passed, we developed our own customer base and as they say in Saratoga Springs, NY, we were off to the races.

Based on my experience gained as an I.C., we have built our company. Our projected revenue is expected to exceed $22 million in 2013. We support a $6 million annual payroll. More importantly, our company created over $13 million in annual revenue for the independent contractors that work for our organization.

CCS now operates in the northeast. We have offices in Fairless Hills in Scranton, PA. We provide last mile solutions for the medical and pharmaceutical industry, critical parts, industrial and auto supplies, banking, retail, and home delivery.

CCS relies on the I.C. business model to meet our customer needs. Our 200-plus contractors and our 156 traditional employees work together to support the needs of our 150-plus customers. We have accomplished this despite one of the Nation's toughest economic environments in decades.

Congress must not hinder the entrepreneurial spirit and recognize the great potential and opportunity being an I.C. can provide. Like Popaul Mukuralinda of Rochester, NY, a 30-year-old recent immigrant from Africa who, in 2011, started providing services to CCS with a single van. Today, Popaul has a fleet of three vehicles, is operating his own small business, and is living the American Dream. His story and my story are not unique.

CCS is a member of the Customized Logistics and Delivery Association, the CLDA. Our Associations focus on the last mile of the world's supply chain. My testimony today is submitted on behalf of CLDA's 425 members.

As an industry with a long history of reliance on an I.C. for our mutual success, we are keenly aware of the need to properly classify individuals. CLDA members are urged to file industry best practices, as well as guidance from both Federal and State agencies to determine classification. We take these decisions seriously.

At CCS, we ask every potential I.C. to complete a questionnaire that details their rights, expectations of being an I.C., including those questions related to the requirements that they file both State and Federal taxes. When we engage an I.C., we execute a written contract. We issue them 1099 forms for all services provided. We require them to provide us with proof of insurance for both themselves and their vehicles.

Previous legislation has focused on the rights of the misclassified worker, but has never extended to the rights of the individuals who choose to operate as independent contractors like Don Wulf, a 70-year-old retiree from Rochester, NY who has been an I.C. since 1995. As Don says,

> "I get to set my own schedule, work when I want, and meet the needs of my individual needs and the energy levels that allow me to work."

Or Cathy Woods, a 52-year-old mother from Scranton, PA who has been an I.C. for us little over a year; as Cathy says,

> "I have finally found a way to contribute to my family's financial well-being while at the same time not having to give up the ability to participate in my family's activities."

In closing, I would like to ask as you consider legislation, you look at the full picture and include considerations for those who choose to be independent contractors. Tens of thousands of people every day choose to operate as an independent contractor in pursuit of the American Dream. The right to do so must also be protected.

Chairman Casey, Ranking Member Isakson, I thank you for your time and consideration.

[The prepared statement of Mr. MacKrell follows:]

PREPARED STATEMENT OF CHRIS MACKRELL

Chairman Casey and Ranking Member Isakson, I appreciate this opportunity to provide testimony to the committee on the need for proper classification of individuals as independent contractors or employees. I share your concern over businesses that intentionally misclassify employees as independent contractors. With that said, I want you to have the full picture. I would like to share how my industry, the customized logistics and delivery industry, relies upon independent contractors to respond to our customers' needs. I also want to voice our concerns with legislation introduced in the House and Senate in past Congresses addressing the misclassification of employees as independent contractors.

I am the president and COO of Custom Courier Solutions, which is a customized logistics and delivery company based in New York with operations throughout the Mid-Atlantic and Northeast. We have offices in Fairless Hills and Scranton, PA, along with seven locations in up-state New York and one location each in Maryland and Virginia. Our company has been providing business services to our customers for more than 7 years. Throughout that time, Custom Courier Solutions has relied heavily on independent contractors to meet our customers' needs. Custom Courier Solutions employs approximately 156 individuals and utilizes the services of about 225 independent contractors to make deliveries.

Custom Courier Solutions is a long-standing member of the Customized Logistics and Delivery Association (CLDA) and its predecessor organization, which is the nonprofit association of the messenger courier industry. My testimony today is sub-

mitted on behalf of CDLA's 425 members, who represent our industry and have serious concerns about this critical issue.

The same-day customized logistics and delivery industry is an integral part of the American economy, providing transportation of packages, medical supplies, bulk materials and documents among businesses and corporations in the United States and beyond. What distinguishes our companies from other components in the delivery supply chain is our emphasis on less than 24 hour, just-in-time delivery of packages in response to customer demand.

Customized logistics and delivery businesses are small businesses that have a long history of positive influence in their communities. Firms typically employ about 25 individuals, who receive good salaries and benefits, and utilize up to three times that many independent owner-operator drivers annually. There are more than 5,000 small businesses that make up the multibillion-dollar same-day delivery industry.

Our owner-operators pick up and deliver important business documents or packages that need to be sent or received quickly either locally, regionally or nationally. They also deliver items that the customer is unwilling to entrust to other means of delivery because they are either time-sensitive or require specialized individual handling, including machine parts, medical supplies, blood and organs for transplant.

While there are many industries that use our CLDA members' services, certain industries critically depend on couriers for expedited same-day or less than 24 hours delivery on a daily basis. Biomedical labs and analysis centers use couriers to retrieve and deliver samples for testing and evaluation. The manufacturing industry relies on customized logistics and delivery services to distribute parts to keep their plants operating smoothly. Financial institutions use members of our industry to transfer multiple documents every day between branch processing centers and the Federal Reserve. Law firms rely on us to deliver confidential documents on very strict deadlines and use couriers to ensure rapid delivery. Pharmaceutical distributors utilize use our members as a critical part of their ability to deliver medications to pharmacies, hospitals and nursing homes daily. And pharmacies rely on customized logistic and delivery professionals to deliver medications to the homebound. These are just a few examples of our primary customer markets—each CLDA member company, depending on its expertise and regional needs, has a unique customer and market profile.

Due to the critical need for flexibility and speed, these packages cannot be slotted into the existing delivery times for next-day or 2-day delivery offered by the Postal Service and the large overnight delivery companies. They must be delivered according to the customer's schedule and specifications. Organs must be delivered in a certain timetable to be viable for transplantation. Medical specimens must be delivered for testing within a specific timeframe if results are to be useful and available quickly. And legal documents are often prepared and delivered to the client or judge on unforgiving deadlines.

For these types of goods, customized logistics and delivery services are the only form of delivery that does not jeopardize the item delivered or the business involved. Independent contractors are a key part of our ability to make this happen. They are crucial to meeting customer demands for flexible scheduling and to ensure that a delivery professional will always be available for a customer's specific needs.

The business model for the customized logistics and delivery industry is particularly reliant on independent contractors, who are engaged to perform a variety of deliveries. The nature of the industry, with its on-demand, often unscheduled delivery model, requires a varying number of courier drivers on any given day and time of day to complete a set service. The business model is also supported by numerous dedicated employee resources in a variety of executive, clerical and administrative functions.

To meet those needs, our members contract with competent, ambitious and responsible individuals on an "as needed" basis to service their community every day. These independent contractors (whom we refer to as owner-operators) pick up and deliver letters, important business documents or packages that need to be sent or received quickly within a local area. Because these items are transported according to the customer's own timetable and often these shipments are time sensitive, the owner-operator business model allows courier companies to staff each day of work appropriately.

In our industry, independent contractors contribute to a healthy competition in many respects. Independent contractors bid for work from courier companies and by so doing set the price paid for their work. It is common in our industry for individuals to start out as an independent contractor providing services to courier companies and over time develop their own courier company and compete with the company to which they formerly provided services. In fact, I have had many inde-

pendent contractors expand their own firms to support both the service they provided to CCS as well as offer their service to the general business community and are now competitors of Custom Courier Solutions.

In many instances, independent contractor owner-operator drivers can make significantly more money offering their services competitively to multiple businesses rather than receiving work from just one company. We have independent contractors who have made a good living and have provided services to our company dating back to 2006. *It is this entrepreneurial spirit and opportunity that helps drive our industry and our country.*

Many independent contractors in our industry enjoy the flexibility of their situations. Accepting or rejecting work based on their desire and ability to work as they wish is very attractive to many independent contractors. There are many examples of independent contractors telling companies that they will not work on certain days or will not accept dispatch after certain hours or refusing a job because they don't want to drive a long distance or short distances. The bottom line here is that they like having control over the work they perform when and if they want it.

The use of independent contractors by our industry is not a recent trend or a new phenomenon. Independent contractors have been an integral part of our industry since our early beginnings dating back well over a hundred years. Our industry has evolved as the economy has changed, but the need for independent contractors has remained a constant.

There is a concern over businesses that intentionally misclassify employees as independent contractors. As an industry reliant upon independent contractors for our mutual success, we are keenly aware of the need to properly classify individuals. CLDA urges all of its members to use industry best practices in making determinations on this matter. Our member companies make the determination about whether an individual is an independent contractor or an employee based upon guidance from Federal, State and private sources. We take these decisions seriously.

Here's how our company does things: When engaging with an independent contractor, Custom Courier Solutions executes a written contract with the independent contractors. We ask that every potential independent contractor complete a questionnaire that details the rights and expectation of being an independent contractor. Included in the survey is the requirement that they file both State and Federal tax forms. We submit 1099 forms for all the services that our independent contractors preform. We also require that they provide proof of the proper insurance for themselves and their vehicle.

Our industry has great concerns over the legislation that has been introduced in the Senate and House of Representatives in previous Congresses on classification of independent contractors. Legislation to eliminate the safe harbor found in Section 530 of the Internal Revenue Code in particular is very troubling to our industry. The intention of these bills may be to curtail intentional misclassification by those companies or even industries. However, the reality is that these bills will affect all companies using independent contractors, including those that apply rigorous standards compliant with Federal, State and local regulations.

We have two broad concerns with legislation introduced in previous Congresses to amend the Fair Labor Standards Act. In the past, legislation has created additional mandates and requirements on all businesses using independent contractors. These new requirements, in a vacuum, may not seem to some as too onerous. Unfortunately, we don't operate our businesses in a vacuum. These changes must be considered in the context of existing and new mandates being imposed on our businesses.

Second, we have a concern about the employees' rights Web site called for in previous legislation. We believe this proposed legislation does not recognize the rights of an individual to be an independent contractor or the benefits of being an independent contractor. Independent contractors often have much greater economic opportunity than employees, as well as the freedom to work when they want and where they want.

The majority of the legislation introduced over the last few years has focused on the rights of a misclassified worker, but it has never extended to the right of an individual who chooses to operate as an independent contractor.

We would urge this committee to proceed cautiously with this issue. Our industry has seen the successful use of industry guidance as a way to ensure proper compliance. In the State of Minnesota, our industry with the help of CLDA was able to pass a State law providing such guidance with the support of organized labor and the trucking industry. We also urge the committee to review the New York State Department of Labor (NYSDOL) Guidelines for the Messenger Courier Industry (a copy is attached). As part of the team that worked with the NYSDOL to design these guidelines, we can act as template for successful guidance throughout the

country. We would recommend Congress consider this approach as an alternative to the changes in law.

The customized logistics and delivery industry is a critical part of the national and global supply chain. People in our industry are saving lives daily and improving the health and well-being of our citizens. The most important deliveries—including financial transactions, critical machine parts, lab reports and lifesaving medications—are performed by independent contractors working for more than 5,000 small courier companies. For more than 100 years, our industry has been served by a business model that is a great example of the American Dream. Our independent contractors work hard, follows the rules and provide efficient, flexible services that cannot be duplicated. We recommend that any future legislation consider how it will impact our industry and its essential core component: the independent contractor.

Senator CASEY. Thank you, Mr. MacKrell.

We are going to go in a different order. I am going to switch questioning order with Senator Franken. He will go ahead of me.

Senator Franken.

STATEMENT OF SENATOR FRANKEN

Senator FRANKEN. Thank you, Mr. Chairman.

Thank you for this very important hearing. Thank you, all of you, for your testimony.

I was just struck, Mr. Anderson with Mr. MacKrell's description of independent contractors that work with his business, and his describing them as entrepreneurial, and having insurance for their vehicles, and that kind of thing.

You were, in your testimony, you did exactly the same thing; right? And nothing changed other than you being told that either you would have to accept being an independent contractor or, quote, "Don't work at all."

Mr. ANDERSON. Correct.

Senator FRANKEN. I think that is a big difference. I mean, does anyone acknowledge that there is not a difference there? OK. And Mr. Odom testified to the fact that he is competing with companies that do exactly that.

Mr. Odom, you testified that it would serve, OK, you get caught. It is kind of the cost of doing business. You get a little bit of a fine that does not reflect anything near the advantage that you get from doing this practice, which is unethical and illegal.

Was there any indication, Mr. Anderson, that your employer thought that what they were doing was against the law or do you believe that the employer was at all concerned about facing penalties?

Mr. ANDERSON. I do not believe they were afraid of facing the penalties. Like Mr. Odom said, it is part of the cost. They are willing to take that risk.

Senator FRANKEN. OK. I think it is important.

Ms. Ruckelshaus, you talked about during a recession, this practice becomes a widely used practice and employees are under a lot of pressure.

And Mr. Odom, I have to say, I commend you for sticking with your ethical way of doing business during the very difficult times.

But this is very common now, Ms. Ruckelshaus. You said you testified a few years ago and now it is more common.

Can you tell us a little bit about what happens in a recession and also, can you draw a distinction here between legitimate uses of independent contractors, I do not know much about your business,

Mr. MacKrell. I understand what it is. It is making those deliveries on the same day like an organ, my goodness, an organ transplant delivery or something like that.

But there is a distinction here, a very clear distinction in my mind. Is there not?

Ms. RUCKELSHAUS. Yes, it is and I think the question really is: is the person running a business or not; running his or her own business? And if you think about what that means, it means you have a specialized skill. You invest some capital. You can decide what you are going to do, how you are going to do it. You are not integrated into somebody else's business, and doing their bidding, and doing construction work or janitorial work.

The workers we see, the low-income workers, under no definition are they running their own business. I mean, restaurant servers, it is hard to imagine how they could be called independent contractors and they are.

So in a recession and when the unemployment rate is high, as we have seen in the last several years, it is exacerbated and we have gotten a lot more calls. We have been involved in a lot more enforcement actions around the country because the workers have no bargaining power. They will take a job because they need a job. So if they are told that the arrangement is changing on paper, they do not have much of a choice. They take it because they need the job.

Senator FRANKEN. Mr. Odom, you do work in several States and that there have been efforts by States, including Minnesota, to get a handle on this. But what is—to both of you—the importance of Federal legislation to address this?

Mr. ODOM. In our experience, the importance of the Federal involvement here as opposed to State level is because you have, as I mentioned in my testimony, multiple; a contractor can be touching several different States within a given a project. He can be domiciled in Georgia, installing a project in Tennessee, with labor brokers that are sending labor out of Florida. So there is some issue of jurisdiction there that having clear cut enforcement across at the Federal level would help.

Ms. RUCKELSHAUS. There is also a patchwork of State laws. Less than half have enacted laws that pertain in any way to independent contractor abuses, and most of them pertain only to construction because that is the poster child of where the problems lie.

Senator FRANKEN. Right.

Ms. RUCKELSHAUS. It is very patchwork, and then enforcement, as Senator Casey mentioned earlier, is very spotty because of lack of resources. So it is not enough.

We need Federal oversight and leadership to really get a handle on the problem.

Senator FRANKEN. My time is up, Mr. Chairman, but I want to thank all of the witnesses for their testimony.

Thank you, Mr. Chairman.

Senator CASEY. Thank you Senator Franken.

Senator Isakson.

Senator ISAKSON. Thank you, Mr. Chairman, and thanks to all the witnesses.

Ms. Ruckelshaus, you made a reference in your closing statement to the safe harbor in the IRS code. Is that the 10-point test to establish whether or not an independent contractor is truly independent or not?

Ms. RUCKELSHAUS. No. I was referring, Senator, to the safe harbor at section 530 of the Internal Revenue Act. It is at 26 U.S.C. §7436 and that describes what, under the Internal Revenue Code which, again, is a 20-factor test. That may be what you are referring to.

But it prohibits, that safe harbor, prohibits the IRS from issuing any guidance on the subject at all for payroll fraud. It also permits employers to evade any kind of liability for any back problems. So if the IRS says, "You are misclassifying your employees and you need to change it," there is no ability to collect penalties or any damages there. And an employer can get the safe harbor if it says that, "Most of the other employers in my business do this"—have this practice.

Senator ISAKSON. Excuse me for cutting you off, but the time will be short.

The reason I mention this is my recollection, the company I ran was covered by that safe harbor, and it defined the definition and the parameters by which you could comply with the Federal law, and IRS was the enforcement agent in terms of that. And that is true today that a company can be challenged by anybody to be in violation of that section and it can be tested under the IRS codes. Is that not correct?

Ms. RUCKELSHAUS. That is correct, sir.

Senator ISAKSON. How often does that happen?

Ms. RUCKELSHAUS. That is a good question. There is very little data on how often that happens. It is typically competitors who come in and complain because workers are not protected if they come to complain to the IRS. So I do not have data on how often that happens.

Senator ISAKSON. My point is that when you refer to doing away with the safe harbor, amending the safe harbor, you are talking about the provisions that allow people to operate as independent contractors legitimately.

Ms. RUCKELSHAUS. No, that is not what would happen. The proposed law that Senator Kerry had introduced would have narrowed the ability for employers to claim the safe harbor and would have permitted the IRS to issue guidance, to give guidance to employers around the country.

Senator ISAKSON. Which is my point; we have got to tread very carefully on going from where we are with a clear definition to a narrowing of that definition which might, by intent or the unintentional consequences of depriving a lot of people of work that is legitimate that they are doing. That is the reason I wanted to bring that up.

Mr. MacKrell, thank you very much for being here. You talked about workers enjoying the flexibility that comes with an independent contractor status.

Can you expand on that, particularly what would happen to these workers if that flexibility went away?

Mr. MACKRELL. In our situation, and like many people who work in our industry, the independent contractors that work for us have chosen this style of life, this way to earn a living because they need a flexible, variable schedule. They want to work when they want to work. They do not want to be told when to come to work, what time they need to be at work, whether they work, what rates they need to charge.

So if we were forced to move into an employee type of basis, I believe that we would probably lose probably 60 to 70 percent of our workforce. They move on to other things. They would, by the very nature of the services that they provide to us, they are looking for flexibility and the ability to operate their own business.

Senator ISAKSON. Do you know, out of curiosity, how many of your contractors might actually be multiple contractors for different businesses? I mean, not just in the delivery business, but in other types of professions?

Mr. MACKRELL. All I can really speak about is, obviously, in our delivery business, I would say about 35 to 40 percent of our I.C.'s provide services to other similar transportation companies.

Senator ISAKSON. Any other second career-type businesses other than transportation?

Mr. MACKRELL. Not that I can chime in on.

Senator ISAKSON. Not that you know.

Mr. MACKRELL. No.

Senator ISAKSON. Mr. Odom, I am sorry you had difficulty with a Georgia company. I was paying close attention in your testimony. I would only suggest they passed a pretty strong law in Georgia with regard to labor brokers' verification of employment and legality in the United States and in Georgia. So I would urge you to take a look at that. Those violations probably took place in the State of Tennessee, so Georgia law might not be applicable, but Georgia has really tried to address that problem in terms of labor brokers and that type of labor. But I am sorry you had the problem with Georgians coming across the line into Tennessee and competing with you.

Mr. Anderson, thank you for your willingness to come and testify. It is incidents like what happened to you that are important to all of us. I think it is very important we provide a way to see to it that people's rights are protected. That when somebody is injured unduly, like you are, because somebody made a voluntary shift for convenience for their sake, but certainly inconvenience for yours, that we pay close attention to that. So thank you for your testimony and for being here today.

Thank you, Mr. Chairman.

Senator CASEY. Thank you, Senator Isakson.

I wanted to start, Mr. Odom, with a couple of questions for you, but just by way of preface, this is a place and this is an institution, the Senate and the House, the Congress overall, where you often have conflict by way of policy or otherwise between employers and employees on issues. Sometimes taxpayers feel that their concerns are not being heard.

I have to say that there are very few areas of policy or maybe in this case a problem that we are trying to rectify or deal with where, if we get this right, we will have benefited all three. Right?

Employees and workers will be better off, companies and employers will be better off, and certainly taxpayers will. So that is pretty rare and I just mention that by way of preface.

Mr. Odom, I want to ask you about when you are competing against firms that are engaged in misclassification, and again I will say for the record, these are the ones who are violating the rules, violating the law. Not all employers and, frankly not even most, but we have to recognize that there is a problem here.

But when you are competing against those that are not playing by the rules, those competitors—it is almost hard to call them competitors when they have a 20 percent head start, or whatever the exact percentage is, if we could ascertain that—what types of projects are you talking about? What is the common scenario in your work?

Mr. ODOM. We primarily focus our efforts in the commercial industry. So we do a lot of assisted living type facilities, multifamily housing. We do a lot of public work—new buildings on school campuses, university campuses, and hospitals as well. We do that kind of work, so your larger scale commercial is where we focus most of our efforts.

Senator CASEY. And can you walk us through the process? I think everyone in the room by now understands the basic problem, but can you walk us through either a specific experience or a common set of facts in terms of how you confront this problem?

Mr. ODOM. Where we see it is on the results on bid day is where it is first obvious.

Oftentimes you will have a group of prices of people such as ourselves that are on a level playing field that are trying to do things the right way. We will be a percentage or two apart from each other on bid day, and then you will have a separate group of pricing down below that, 10, 15, 20 percent also grouped together. It is pretty obvious if you are looking in our scopes of work that we price. That is where we see it.

And then we get onto projects as well, where we are performing a certain scope of work and then additional scopes of work are being performed by companies that are handling their business in that way. And so, we see it on the ground level as well.

Senator CASEY. And in terms of your direct experience, the differential between the bids between you and, say, a firm that is not playing by the rules, can be in that range of 10 to 30 percent. Is that accurate?

Mr. ODOM. Yes.

Senator CASEY. I want to also ask you, as well, about Senator Isakson's mention of this concept of labor brokers. Can you tell us what you know about that and what that means?

Mr. ODOM. The labor broker is sort of an intermediary that an offending contractor will use to go and seek out a collection of guys that can be brought in under the 1099.

So if I am contractor wanting to operate in that way, I would approach XYZ Labor, which operates as a business and say, "I need 25 carpenters next Monday." And then he assembles those carpenters and sends them to the jobsite.

Senator CASEY. And that is a rather new player in this or has that been part of the dynamic for a while?

Mr. ODOM. It has been part of the dynamic for a while; it just seems to be more prevalent because there are fewer opportunities.

In the past when the economy was really hopping in construction, you miss one, you lose one to these type of operators on bid day, you go and bid the next 25 that are on your bid schedule because there are so many opportunities. Now, the opportunities are much fewer, so it is a lot more noticeable. Whether it is more prevalent, I am unsure, but it has always been there. It has been there since I have been in the office, which would be mid-1990s in our neck of the woods.

Senator CASEY. I will come back to you on a couple of other things, but Ms. Ruckelshaus, I wanted to ask you about the State efforts here. Obviously, I know often in this town when there is a problem, some people think the solution is always a Federal law, and I understand the concerns about that. I know people are being very polite in the room; some probably want to stand up and shout and say, "Yes."

But there are some problems that we have to deal with in a more comprehensive way across the Nation because of, as you describe it, I think, a patchwork sometimes does not work. That will be an area of debate and we can debate that. I think there are good intentions on both sides of that.

But to the extent that there is activity, and there has been a substantial amount of activity at the State level, I guess now both Tennessee and Texas have enacted laws targeting this classification. But what I wanted to ask you is, is action at the State level sufficient, even if you had more of it? Let us say for purposes of argument, they had more of it and they were in the area of reform that you would advocate.

Where do you see it now? How do you compare what could be done or is being done at the State level with what should be done federally if you believe that there should be Federal action?

Ms. RUCKELSHAUS. Yes. My office has been tracking the State legislation since it really started to pick up around 2005, and there was an up-tick and quite a bit of activity. Since last year, it has begun to dwindle; 2011, 2012, the activity has dipped and there has been more defensive actions by businesses who want to cheat and who think the laws are not good.

We have actually been engaged in a lot of fight back and some of the laws have been weakened, the new ones that were passed have been weakened. Most of them continue to only cover construction, and while that is a big sector that has the problems, there are a lot of other sectors, like the ones I mentioned, that are not covered at all by these laws.

It is very incomplete and because the task forces and commissions often lack resources, the ebbs and flows of the enforcement are very striking. So, it is my opinion that we do need Federal leadership on this.

Senator CASEY. I will come back to you, because I am overtime. I want to get back to Senator Isakson.

Senator ISAKSON. Mr. Odom, everybody at your construction company is an employee of the company?

Mr. ODOM. Yes, sir.

Senator ISAKSON. When you bid a job of, say, dormitory project or a multifamily project, everybody that contributes to the construction of that project is an employee?

Mr. ODOM. Yes, for our scope of work. Yes, sir.

Senator ISAKSON. Say what that means.

Mr. ODOM. Well, we are going in—when we price a dormitory, we are pricing the framing, the drywall, acoustical ceiling, plastering, the scopes that pertain to our company. We do not do plumbing, electrical work, other scopes of work that would be bid by other subcontractors. But everything that is in our scope of work to perform is performed by an employee.

Senator ISAKSON. And that inures itself to my point: most of those subcontractors would more likely to be independent contractors rather than employees, correct?

Mr. ODOM. I am not sure; of the other subcontractors?

Senator ISAKSON. Yes, of the ones that you refer to that you do not cover their scope of business.

Mr. ODOM. That would——

Senator ISAKSON. And my point—that is not a trick question. I am not trying to pose a trick question.

But my point is there are an awful lot of people who are in independent contractor status like Mr. MacKrell who may deliver a specialized fixture to one of those projects, an electrician that you hired to put in there who is going to install, he is an independent contractor delivering the specialty fixture. And the electrician is an independent contractor who bid the part of the job that you do not do. That is my point I am making.

Mr. ODOM. Yes, sir. That would be true.

Senator ISAKSON. Because there are an awful lot of small—the National Association of Home Builders said 75 percent of homebuilders, or was it 75, 85 percent of homebuilders built 25 or fewer homes and 75 percent built 10 or fewer homes. So there are a lot of small operators that operate as contractors that contract with independent contractors and puts them together, end up building their end product. Is that not correct?

Mr. ODOM. Yes.

Senator ISAKSON. And that would be, you would not want to do away with that, would you?

Mr. ODOM. No, no.

Senator ISAKSON. What you want to make sure is that the master contractor that performs the services you provide, which is the main structural service in terms of construction, is competing with you on a level playing field. Is that right?

Mr. ODOM. Correct.

Senator ISAKSON. OK. Mr. MacKrell, tell me a little bit more about your typical independent contractor. Do you have a typical one or are they across the board?

Mr. MACKRELL. Our typical independent contractor would be somebody who has come to us either through word of mouth, advertising that we have, or just because they have been working in the industry. They offer their services to us.

We give them a scope of work that they review. They submit pricing to us. We come to an agreement. We sign a contract. We

exchange, obviously, insurance and other information, and they begin to provide services to us.

Senator ISAKSON. Could you tell me approximately—and I realize this would be an estimate—what percentage of truckers in the United States of America operate as independent contractors?

Mr. MACKRELL. I really would not have the ability, in our industry as it relates to truckers, but in our industry, there is an estimated 5,000 courier companies in the United States. Our industry surveys show that 85 percent of those companies use some form of independent contractors to operate their business.

Senator ISAKSON. And that is from primarily the last mile service?

Mr. MACKRELL. Last mile delivery services, yes.

Senator ISAKSON. Which the big company really cannot meet with the same standards that they have to meet; is that correct?

Mr. MACKRELL. Correct, yes.

Senator ISAKSON. OK. All right. That is an important, very important thing to understand that in this whole battle because of the fact that I ran a company that had independent contractors does not mean that I am on the other side of this issue. But I do think we have to have a balanced advocacy on behalf of America's needs.

One of the things we have acknowledged is that some of the unintended consequences of Government regulation or of the economy, one of the two or both in some cases, have forced people to do things we would rather they not do, like go to an independent contractor status, or go to a 30-hour workweek, or something like that.

We have to be conscious of what we are talking about when we talk about these very critical issues because nobody wants to sanction illegal, or unintentional, or just plain wrong practices on the part of workers or on the part of the companies on their workers, but we also want to make sure we protect the opportunity for workers to have jobs in America in a very challenging time.

Thank you, Mr. Chairman.

Senator CASEY. Thank you, Senator Isakson.

I wanted, Ms. Ruckelshaus, to get back to a question which I do not think you have an answer for, maybe you do, but I doubt it because I have not seen an overall number. But it is a question of how many businesses we are talking about here.

I was struck by what Mr. MacKrell said in the pertinent part of his testimony. Toward the end, he talked about the CLDA urging all of its members to use industry best practices in making determinations about independent contractor status and all of that. That is what we want to see more of, obviously, and we appreciate that they are doing that. But you probably cannot answer the question about the number of businesses that are engaged in this or even maybe a ballpark figure.

But you did in your testimony, and I am looking at your testimony, you had it broken down into two sections of loss of revenue. You had a Federal revenue section and you had a State revenue section. I just wonder if you could just walk through some of that to the extent that we have data, even though I always believe data that is important, numbers are relevant, but I think stories like Mr. Anderson's and others are more compelling because they tell

us about what happened to one person, one family, one employer, one community.

But walk through some of the more significant Federal revenue losses here.

Ms. RUCKELSHAUS. Yes, and as you mentioned earlier, Senator, the data is old and there is a U.S. Department of Labor survey that is being undertaken right now which should update, at least, in terms of the magnitude of the problem.

The General Accountability Office in 2009 estimated that these independent contractor abuses cost Federal revenues $2.72 billion in just 1 year in 2006. The Congressional Research Service estimated that a modification to the IRS safe harbor rule would save $8.7 billion from 2012 to 2021. So that is mostly on the income side, the income tax side.

Senator CASEY. So that would be like a 9-year number, roughly?

Ms. RUCKELSHAUS. Right, that is a 9-year number, $8.7 billion.

The State losses are typically calculated using unemployment insurance losses and workers' compensation; those are the sources of data that the States use.

California is the most recent one. In 2013, it estimated that there was a $236 million loss just in 1 year in California to its unemployment revenues. New York found $1.4 billion in losses and Massachusetts found a combination of unemployment insurance, $15.4 million in 1 year loss and $13 million in unreported earning. So adding up, it is quite a magnitude.

The Federal estimates vary a lot and depend on which data set the agency is looking at.

Senator CASEY. Appreciate that.

Mr. Anderson, I did not have a chance to ask you a question or two about your own situation, but I was struck by, in your testimony, the reference you made to, I picked up on that phrase "tongue lashing," meaning, this is the way I interpreted it; see if this makes sense to you. That when you are an employee there is, to use a term of art so to speak, there is a degree of control that someone has, as an employer, over an employee, and can direct them, and can obviously give them a tongue lashing when they are not doing good work.

Whether it was that aspect of your relationship with your employer and then however you described the next entity that you were working with, whether it was tongue lashing or other aspects of your relationship that did not change very much from one status to the other. Is that correct?

Mr. ANDERSON. Correct. It did not change at all.

Senator CASEY. The only thing that really changed in your case—and that was kind of a leading question, but it is important to validate it—the only thing that changed is that you had a lot less protection and therefore later had to pay a very severe price for not having those protections. Is that fair?

Mr. ANDERSON. Yes, sir.

Senator CASEY. I wanted to ask you as well from your own experience. I take it from your testimony, you obviously did not ask to be an independent contractor. You felt almost compelled to because of your own circumstances and because the employer in that circumstance was not giving you much of a choice. Is that correct?

Mr. ANDERSON. Correct.

Senator CASEY. I realize this is not the norm, but it does happen, that is why your story is so important. You felt that you had to do that in order to keep your job and have income for your family.

Mr. ANDERSON. That is the way they put it to us.

Senator CASEY. And I wanted to kind of project out from your own story. You have obviously done all kinds of good work and carpentry being a big part of that. If someone came up to you today, a young person even younger than yourself, came up to you today and said, "I am thinking about a similar career." What advice would you give them in terms of this aspect of your work?

Mr. ANDERSON. I would tell them under no circumstances do something like that; put themselves in a vulnerable position like I put myself and my family.

Senator CASEY. Senator Isakson, do you have any more?

Senator ISAKSON. Only that I appreciate the witnesses' testimony today and look forward to working with you, Chairman Casey and others, to see to it that we make sure that the people who are doing the wrong thing the wrong way for the wrong reasons are held accountable. But that we do not throw out those people that are doing it playing by the rules and contributing to the great development of the United States of America and our economy. And thank you for calling the hearing.

Senator CASEY. I want to thank Senator Isakson also for bringing his own personal experience as someone who has lived in the real world of business, not just the world of Congress.

I will just put a note, a little commercial here for the Payroll Fraud Prevention Act. I do not have a chance to do this very often with a captive audience, so I will do it, but I will not read the whole summary. But as you read through even a summary of this legislation I think it is, in a word, not just necessary or essential but really, in a word, reasonable.

To break it down into kind of sections or subject areas, part of this, and in some ways I almost cannot believe that we do not have an existing prohibition on misclassifying workers. But there are obviously aspects to this where if an employer were to misclassify a worker that would be a violation of the Fair Labor Standards Act.

If there is any kind of, what I might call intimidation, but really any efforts to discharge someone or discriminate against them based upon their opposition to any practice concerning their own classification that would be a violation of the law. I wish that were in place now. It does not seem to make sense that it is not a violation presently. So there are penalties for this kind of activity and sanctions, civil penalties and others, and that is obvious and I know that gives some people real concern, but I think it is essential, and again reasonable.

But a lot of this, as well, if you look at the legislation, is about basic, fundamental recordkeeping. You ought to have to tell the employee and others that basic information about classification. It is not asking too much to say someone is either an employee or an independent contractor. The employer should have to provide that information.

I believe that one measure of accountability is not just that kind of disclosure and that kind of information to an employee, a work-

er, but also that those kinds of actions should be subject to audit, certainly, at the State level or otherwise.

So I think when you go through this whether it is by way of disclosure and providing basic information, whether it is the prohibitions and the sanctions which I believe should be in the law already, but are not; so we have to enact laws to do that. But I think it is reasonable and in light of the problem here, and again whether it is from the employees' and the workers' perspective, whether it is from the perspective of most of the folks doing this work, meaning the companies, the businesses, the employers from their own vantage point. They are in need of this kind of help because they are doing the right thing and they are being underbid because someone else is cheating and violating the law.

And then last, but not least obviously, are taxpayers. They are being ripped off every day of the week. They are paying their taxes and someone else is not, and we are all the worse for it especially at a time when we have such fiscal challenges and tight budgets.

So whether it is the employer, the employee, the employer, or the taxpayer, I think it is important we pass legislation like the Payroll Fraud Prevention Act. I appreciate the opportunity to provide that commercial.

Senator Isakson has been great to work with on a whole range of issues. I am grateful he is here with us today and to be as our Ranking Member to be with us at this hearing.

I want to thank all of our witnesses for being here, for taking the time to develop your testimony, to bring your own personal experiences to bear on this issue, and we are certainly grateful.

The record will remain open for 10 days to receive any additional comments.

With that, the Subcommittee on Employment and Workplace Safety hearing is adjourned. Thank you.

[Additional material follows.]

ADDITIONAL MATERIAL

PREPARED STATEMENT OF THE AMERICAN TRUCKING ASSOCIATIONS, INC.

Chairman Casey, Ranking Member Isakson, and members of the panel, American Trucking Associations, Inc. ("ATA") submits this statement in response to the subcommittee's hearing on the issue of worker misclassification. ATA is the national association of the trucking industry. Through a federation of 50 affiliated State trucking associations and industry-related conferences and councils, ATA represents more than 37,000 members covering every type of motor carrier in the United States. The trucking industry is the backbone of the Nation's economy with nearly 7 million Americans working in trucking-related jobs. Given the critical role that independent contractors ("ICs", also referred to as owner-operators in the trucking industry) play in enabling the Nation's trucking companies to deliver goods to the public at large, ATA is pleased to offer its perspective on the classification of workers.

INTRODUCTION

The growing importance of independent contracting as an engine of economic growth—particularly among small businesses—is widely recognized.[1] The trucking industry, with its long history of independent contracting, underscores the point. For decades, independent owner-operators—who drive vehicles in which they maintain an ownership interest, or employ others to drive them—have been widely used by trucking companies to meet fluctuations in demand, provide needed equipment at considerable cost savings, and address longstanding shortages of operators. In addition, a number of trucking companies have structured their business models around the use of independent contractors, recognizing that the experience, maturity, energy, and initiative of the independent owner-operator can be harnessed to the mutual benefit of trucking companies and contractors alike. ICs share the motor carrier's incentives to meet customer demand safely and efficiently and increase revenues and profits. By successfully and skillfully managing operations, an IC grows his or her own business—whether by productively performing services him or herself, or by hiring employees to provide additional services—and, at the same time, contributes to the success of the trucking company.[2]

Recently, there have been increased efforts at the Federal and State level to legislatively impose conditions making it difficult to predictably and reliably structure independent contractor relationships. These efforts, which range from repeal of the section 530 safe harbor rules to presumptions of employment, are based on mistaken, paternalistic notions that will only serve to reduce economic growth, stifle small business entrepreneurialism, and increase consumer costs—all with an uncertain impact on overall tax revenues. ATA will briefly demonstrate why these efforts are misguided and unfounded. No doubt, there are instances where workers may be subject to excessive control of methods and means of performance and thus improperly classified as ICs. However, devising ever-more complicated classification tests and imposing presumptions that detract from predictability of status and therefore stifle use of ICs is not the answer.

ICS IN THE TRUCKING INDUSTRY CHOOSE TO BE ENTREPRENEURS

One widespread misconception is that ICs in the trucking industry would prefer to be employees but instead have IC status forced upon them. The results of a recent survey of ICs deemed to be representative of IC drivers in the trucking industry in general[3] suggest otherwise. When asked how easy it would be to be hired as an employee driver, 67 percent said it would be "very easy" and another 13 percent said it would be "easy."[4] Those who indicated it would not be easy attributed the difficulty to safety concerns over their driving record (e.g., previous accidents or violations). This data reflecting the IC's free choice mirror data across all industries, indicating the vast majority of independent workers affirmatively chose that path,

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[1] Steven Cohen and William B. Eimicke, *Independent Contracting Policy Management and Analysis* (Aug. 2013) (hereafter "Columbia Study"), 8.

[2] *See, e.g.*, Philip J. Romero, *The Economic Benefits of Preserving Independent Contracting* (Sept. 2011), 30.

[3] Steven L. Johnson, *Relative Advantages and Disadvantages of Independent Contractor Status: A Survey of Owner-Operators' Opinions and Rationale*, (January 2012) (hereafter "Univ. of Arkansas Study") at 4.

[4] Id. at 17.

with "[o]nly 1 in 7 report[ing] that the decision to work independently was due to factors beyond their control." [5]

ICs in the trucking industry elect and prefer this type of arrangement, because they like independence, freedom, and control of their own destiny.[6] Again, the trucking industry reflects the population at large. Several studies have found that ICs prefer independent arrangements to employee arrangements and that ICs have a higher sense of job satisfaction than employees.[7] Additionally, research indicates self-employment is a springboard for entrepreneurship and small business creation.[8]

ICS IN THE TRUCKING INDUSTRY PAY THEIR TAXES

The belief that classification of workers creates a tax gap motivates legislative efforts to reclassify ICs as employees. The notion of a tax gap is based on the premise that employers subject to withholding taxes on wages paid to an employee are more likely to submit those taxes than ICs are to submit tax payments voluntarily. The facts cast doubt on the premise. Of the IC drivers surveyed, 94 percent said they engaged a tax preparer to prepare their returns while an additional 3 percent said they use tax software.[9] These numbers suggest a high level of tax compliance among IC drivers and, in conjunction with IRS research that estimated that 99 percent of income is reported on a W–2 (employee) compared to 96 to 97 percent on a Form 1099–MISC (IC),[10] means that reclassification of ICs would have little impact on the purported tax gap.

ICS CAN AND DO FARE WELL RELATIVE TO EMPLOYEE DRIVERS

One more common misconception is that IC drivers cannot do as well financially as employee drivers. Like any small business, the numbers vary as there is ample opportunity for profit or even loss depending on individual business practices. However, it is common for IC drivers to earn more than similarly situated employee drivers. As one industry expert recently put it, "the average owner-operator fares better than company driver counterparts," with a net income of $51,912 compared to "about $40,000 per year for the same amount of work" by an employee driver.[11] Similarly, the Bureau of Labor Statistics puts the average annual wage for commercially licensed driver at just over $40,000 [12] while a trade group for IC drivers calculated annual average net income for its members to be $50,000.[13]

CONCLUSION

As ATA has noted, the foundation for the pursuit of further legislative efforts to address alleged misclassification of employees as ICs is very weak at best. The limited potential for collection of additional tax revenues could be far outweighed by negative impacts on small business job creation, economic growth and higher costs for consumers. Instead, a simplification of the many confusing tests for determining a worker's status to focus on control over methods and means of performance would encourage greater compliance and allow authorities to focus investigation and audit resources on the small percentage that may be deliberately cheating the system. Some of the most recognized trucking company names today, such as Schneider National, C.R. England, Werner Enterprises and J.B. Hunt, started off as single truck owner-operators. We need to ensure we do not, through legislation, snuff out the opportunity for today's ICs to become the next generation of recognized trucking company names.

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[5] MBO Partners, *The State of Independence in America: Third Annual Independent Workforce Report*, Sept. 2013, at 6.

[6] Univ. of Arkansas Study at 54.

[7] Jeffrey A. Eisenach, *The Role of Independent Contractors in the U.S. Economy*, (December 2010) (hereafter "Navigant Study") at 33–4.

[8] Navigant Study at 35, citing Robert W. Fairlie, "Self-Employment, Entrepreneurship and the NLSY79," Monthly Labor Review (February 2005) 40–7.

[9] Univ. of Arkansas Study, at 29.

[10] Navigant Study, at 40–1.

[11] Rip Watson, *Owner-Operators Make Modes Income, Freight-Rate Gains, Industry Expert Says*, Transport Topics, Sept. 23, 2013, at 12.

[12] Bureau of Labor Statistics, *Occupational Employment and Wages*, May 2012 at *http://www.bls.gov/oes/current/oes533032.htm* (last visited November 7, 2013).

[13] Owner-Operator Independent Drivers Association, *Owner-Operator Independent Drivers Profile 2012* at *http://www.ooida.com/OOIDA%20Foundation/RecentResearch/OOIDP.asp* (last visited November 7, 2013).

PREPARED STATEMENT OF THE CAMPAIGN FOR QUALITY CONSTRUCTION*

The *Campaign for Quality Construction (CQC)* is comprised of the six leading construction specialty trade associations, which together represent industries comprised of more than 27,000 contractor firms that perform mechanical, electrical, sheet metal, plumbing, air conditioning, steel erection, trowel trades, painting, glazing, flooring and related work.

The CQC is actively involved at all levels of public policy to ensure that construction owners and taxpayers receive full value for their construction dollar and **urges the Congress to take strong action on behalf of taxpayers and legally compliant employers who are at a competitive disadvantage because they cannot compete with bad actor employers who commit payroll fraud and otherwise engage in various schemes to evade tax and employment law by misclassifying their employees.**

Independent contractors play a vital role in our economy but too many employers are able to game the system and evade labor, employment, and tax laws by taking advantage of the many loopholes in current law. Employee misclassification schemes in construction have nothing to do with career enhancement or individual entrepreneurship, but rather everything to do with unfair low-wage competition.

Federal laws and policies should be reformed to favor law abiding companies. Stronger employment and tax laws at the State and Federal level with more effective enforcement should be enacted to eliminate the current competitive advantages for those who abuse the system to line their own pockets at the expense of their competitors, of the government and the taxpayer and of workers.

PAYROLL FRAUD, EMPLOYMENT MISCLASSIFICATION SCHEMES HIGHLY PREVALENT IN CONSTRUCTION

Unfair and abusive employment practices are widely acknowledged by public policy experts to be epidemic in the construction industry. Construction projects are temporary by nature, engage multiple levels of contractors and subcontractors, and employ a highly mobile workforce, all of which combine to make the industry especially vulnerable to abuse. Ever-evolving schemes give unscrupulous employers a huge advantage in a highly competitive, head-to-head bid industry.

As early as 1984, an Internal Revenue Service study found overall, 15 percent of employers misclassified their employees, *but the rate was 19.8 percent in construction*. A U.S. Department of Labor Employment and Training Administration study reported $198 million tax loss annually due to misclassification. That study noted that the construction industry was a major offender. A 2005 study conducted in Maine reported that 14 percent of construction employers misclassified workers while in other industries it was 11 percent. In Massachusetts, a 2004 study showed that misclassification in construction was calculated to be at 24 percent, higher than all other industries by 6 percent. Significantly, in 2008, a Michigan study showed 26 percent of construction employers misclassifying their workers. The same study showed that construction employers engaged in payroll fraud through other schemes more frequently than other employers. State studies and task forces repeatedly show illegal employment practices to be significant in the construction industry.

MISCLASSIFICATION/CLASSIFICATION SCHEMES: A CALCULATED BUSINESS DECISION

Businesses that avoid properly classifying workers as employees do not have to pay unemployment insurance taxes, workers' compensation premiums, or the employee's portion of Social Security and Medicare taxes. Additionally, they do not pay or withhold payroll taxes on behalf of their employees. It is estimated that busi-

*The Campaign for Quality Construction (CQC) is an employer-based construction coalition representing approximately 27,000 employers. It is comprised of the leading specialty contracting firms in the Nation and include the Finishing Contractors Association International (FCA), the International Council of Employers of Bricklayers and Allied Craftworkers (ICE), the Mechanical Contractors Association of America (MCAA), the National Electrical Contractors Association (NECA), the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA), and The Association of Union Constructors (TAUC). These groups represent more than 25 percent of the total building construction industry volume in this country and employ approximately 500,000 skilled workers. Specialty contractors hold a market share of more than 60 percent of non-residential building construction. Our members employ highly trained and highly skilled workers who are well-compensated in wages, health and pension benefits—core components of a strong and sustainable workforce.

The employers who comprise the CQC are leading members of Taxpaying Employers Against Misclassification (TEAM). Union and non-union employers in diverse industries have banded together, to focus on payroll fraud and employee misclassification schemes. Membership and information can be viewed at *www.nomisclassification.com*.

nesses can save at least 30 percent in labor costs by using misclassification schemes, but in the end they are simply committing payroll fraud.

Legally compliant employers abide by Federal and State labor laws, including the Fair Labor Standards Act. They abide by minimum wage and overtime laws, and are more likely to provide benefits such as vacation and sick leave, health care coverage and retirement.

CQC employers maintain high wage and benefit standards. They embrace a system that includes training, health and welfare benefits, pension benefits, and career advancement training as a way to ensure an adequate supply of highly skilled trade persons who are compensated and classified correctly as employees. Trending misclassification schemes threaten to degrade the quality of high workforce standards in the vitally important construction industry.

As further evidence that employers are deliberately trying to avoid tax and employment law, one can see how business owners are stretching the law in creative ways. No longer do firms simply misclassify employees as independent contractors. Firms in construction and other industries use labor brokers, form LLCs so that employees become owners filing not a 1099 but a K1, establish sophisticated check cashing schemes, and require workers to purchase a shell franchise.

While CQC contractors adhere to ethical employment relationships and practices, they are increasingly forced to compete in the private and public market against unlawful, unethical companies that deliberately engage in payroll fraud to gain an unfair competitive advantage.

MISCLASSIFICATION AND FRAUD COST ALL LEVELS OF GOVERNMENT NEEDED REVENUE

The Federal Government has budget deficits and has an increasing responsibility to collect owed revenue. Addressing payroll fraud is not about increasing taxes, it is about increasing compliance. It is not a union versus non-union issue; it is about going after the bad actors. It is estimated that independent contractors under-report their income by about 30 percent. Those workers paid off-the-books are unlikely to report their income at all.

Paul Alexander, Strauss Engineering, Stafford, TX, wrote in a letter to the Governor of Texas when the Texas State Legislature was considering legislation to address the problem in the construction industry,

> "They break the law to underbid law abiding contractors like me, and to add insult to injury, I am subsidizing those who are gaming the system with impunity."

Mr. Alexander's point is that the lawful business owner pays a double penalty through lost economic opportunity and then again as a taxpayer because higher taxes and premiums are levied to make up for the dollars lost to the government and the community.

Government and academic studies estimate that the Federal Government loses at least $3.5 billion annually on average. State studies show a much higher figure. These serious budget issues cannot be ignored. Texas loses $35 million each year in unemployment taxes alone as a result of improper classification. Maryland estimated it was losing $20 million or more in unemployment taxes due to misclassification. Ohio did a comprehensive study and found it was losing $35 million a year in unemployment taxes, $103 million a year in workers' compensation premiums, and $223 million in lost State (not including Federal) income tax revenue.

SOLUTIONS: STATES ALONE CANNOT CHANGE THE TREND; THE FEDERAL GOVERNMENT MUST ACT

The Federal Government and the States need the most effective tools possible to go after the bad players. Business owners who commit payroll tax fraud rely on lax State and Federal enforcement to cheat the government and taxpayers and that ultimately disadvantages lawful contractors.

Some 37 States have addressed the problem at some level. A large percentage of the State laws passed deal directly with the construction industry. But it is not enough; States alone cannot fully address this problem. It should be noted this is a problem growing in scope and tactics. It is a growing problem in janitorial services, trucking and language interpretive services. Employers are resorting to creative schemes to avoid paying Federal Social Security and Medicare and unemployment taxes, while also avoiding overtime pay, State unemployment taxes, and workers' compensation premiums.

CQC supports many of the recommendations in an August 2009 Government Accountability (GAO) report on ensuring detection and prevention of misclassification. Studies show an epidemic rise of worker misclassification with some reports stating

as many as 30 percent of businesses are engaging in payroll fraud. Others suggest it could be higher when new schemes are included.

The CQC also supports the U.S. Department of Labor cracking down on misclassification in combination with other Labor Department actions. However, the IRS needs to do more and Congress must act, both to un-handcuff the IRS and to strengthen the Department of Labor in its efforts on this issue.

The CQC has supported legislation in successive Congresses to deal with the issue. It supports and recommends the following changes to IRS and employment law:

- Amend or eliminate section 530 safe harbor provisions of the IRS code to create a new statutory standard with more realistic standards for deeming a worker to be a non-employee and to end the moratorium on allowing the IRS to close loopholes and provide guidance.
  - **Eliminate the ability of employers to rely on industry practice as a basis for claiming safe harbor. It defies common sense to say that if enough employers in an industry cheat, it should be deemed legitimate.**
  - Allow IRS to prospectively reclassify workers while guaranteeing no retroactive assessments would be allowed.
  - Allow IRS to issue regulations or revenue rulings on employee/independent contractor status.
  - Create administrative procedures to allow workers to petition Treasury for a determination of employment status.
  - Prohibit employer retaliation against an individual petitioning for review of employment status.
- Narrow the circumstances under which the Secretary of Treasury may reduce the penalties for failure to deduct and withhold income taxes or the employee's share of FICA taxes.
- Require affirmative notifications by those who contract with independent contractors, including written statements to each independent contractor of their Federal tax obligations and the loss of labor and employment protections, and their right to seek a status determination from the IRS. Failure to comply in a timely manner would be subject to penalties.
- Require annual reports from the Secretary of Treasury and the Secretary of Labor on worker classification schemes and to identify and track complaints and enforcement actions.
- Maintain current list of employee "exclusions" to assure true independent contractors are not adversely affected by new legislation.

Finally, The CQC promotes immigration reform that supports lawful employers and solves the problem of undocumented workers in order to level the playing field for companies that abide by the law. The CQC also supports a fair and efficient worker verification system such as E-Verify and would support a new law requiring businesses E-Verify individuals contracted as independent contractors. However, reform should not impose vicarious liability on contractors by separate employers or lower tier contracting parties. CQC cautions Congress against authorizing a new expanded guest worker program for skilled trades and additionally supports strict controls in the program to avoid guest workers admitted for low-skilled classifications from migrating to construction. Additionally, CQC supports flexibility in Administration programs to deal with skilled workforce shortages in the future.

As the problem grows in construction and other industries, it is time for Congress to join States and take action to eliminate loopholes and schemes that currently enable firms to use a business model that eliminates the employer-employee relationship. Without action, responsible firms will be priced out of the market place. We urge you to consider these sorely needed reforms.

PREPARED STATEMENT OF THE COALITION TO PROMOTE INDEPENDENT ENTREPRENEURS

The Coalition to Promote Independent Entrepreneurs (the "Coalition") appreciates the opportunity to submit testimony concerning the important issue of independent contractors and the economic effect of companies doing business with them. The Coalition consists of industry associations, businesses and independent contractors that share a common interest in preserving the legal status accorded independent contractors, and in the creation of economic opportunities for all individuals, whether they offer their services as independent contractors or employees.

The Coalition absolutely supports the proper classification of workers, and the proper and timely compliance by independent contractors with their Federal, State

and local tax reporting and payment obligations. Moreover, it supports government policies aimed at enhancing these objectives, provided that such policies do not undermine the rights of independent contractors and their clients to do business with each other, or the economic opportunities created by the legitimate use of independent contractors.

I. INDIVIDUALS BENEFIT FROM THE ABILITY TO BE SELF-EMPLOYED

Individuals choose self-employment for a variety of different reasons that are very personal to them. Examples include:

- To be one's own boss;
- To be able to work with a wide variety of different clients and thereby maintain a high level of professional technical expertise;
- As a bridge between the loss of a job and the next job;
- To maximize control over one's financial destiny;
- To ensure that the individual reaps the financial rewards of his or her hard work;
- To earn more money than would be possible by working as an employee, e.g., as a commissioned sales representative or as a consultant;
- To generate supplemental income to fund a family vacation;
- To generate additional income to save for retirement;
- To be able to work from home and meet family obligations; and
- To be able to work a flexible, seasonal or sporadic schedule.

Individuals highly value the freedom to achieve these objectives by working as an independent contractor. Surveys of independent contractors consistently report a high degree of satisfaction with their self-employed status.[1]

II. COMPANIES BENEFIT FROM HAVING ACCESS TO SELF-EMPLOYED INDIVIDUALS

Companies also benefit from the ability to do business with independent contractors. For example, if a company has a short-term need for a specific type of service that the company's personnel does not possess, the ability to engage independent contractors who possess that skill and are able to promptly commence work on the project can be of immense value to the company.

Similarly, for a company that engages individuals to perform services away from its premises and has found it impractical to supervise or monitor their performance, a business model that has proven effective is for the company to contract with dedicated entrepreneurial independent contractors who will self-manage their own performance and consistently perform at a high level in order to grow their own business and retain and attract clients.

In some cases, the decision whether to do business with independent contractors is based on a philosophical viewpoint. An example is sales. Some companies operate with an employee sales force, while other direct competitors contract with independent-contractor sales professionals. This decision commonly turns on whether (i) the company believes it knows best how to sell and that the best strategy for maximizing sales results is for the company to train an employee sales force; or (ii) the company believes the best strategy for maximizing sales results is to contract with independent-contractor sales professionals and unleash their entrepreneurial zeal and creativity.

All of these examples illustrate a decision to do business with independent contractors that is driven by a desire to maximize performance and achieve legitimate business objectives.

III. SELF-EMPLOYMENT IS NOT ANTI-COMPETITIVE

The contention that a company doing business with independent contractors enjoys an unfair competitive advantage relative to a different business that chooses to perform such work with its own employees creates a very slippery slope. A fundamental defect with this type of contention is that there is no discernible limiting principle, as a similar argument could be made with respect to any business decision that could create a disparity in terms of cost or efficiency. For example, should a startup family-owned business that pays its family members relatively low salaries and provides them no benefits beyond what the law requires be prohibited from competing against a publicly held corporation that pays its employees generous sala-

[1] See, Jeffrey A. Eisenach, *The Role of Independent Contractors in the U.S. Economy*, at p. 37 (December 2010), Navigant Economics, *http://www.navigantеconomics.com/docs/Role%20of%20Independent%20Contractors%20December%202010%20Final.pdf* (the "Navigant Economics Study") (citing multiple studies for this proposition).

ries plus a wide array of employee benefits? Should a company be prohibited from implementing a new technology that will enable it to perform more efficiently when its competitor chooses not to?

Moreover, such a contention is woefully inequitable to the independent contractor who is seeking to do business with company clients. If an individual decides to work as a self-employed individual, there is nothing anticompetitive or otherwise inappropriate about the individual doing so—or about a company engaging the individual to perform a project or accomplish an objective. A government policy that impedes a company's ability to do business with legitimate independent contractors is highly inequitable to enterprising and entrepreneurial independent contractors.

IV. NO NEW BURDENS SHOULD BE IMPOSED ON COMPANIES THAT DO BUSINESS WITH SELF-EMPLOYED

While the Coalition certainly does not in any way support or condone "payroll fraud," it nonetheless believes it critically important to keep the payroll-fraud issue completely separate from the "competitive" issue associated with one company operating a business model that is more efficient or cost-effective than a competitor. Conflating the two can lead to economically harmful policy prescriptions.

In this regard, the Coalition would oppose the imposition of any additional administrative or regulatory burdens on companies that do business with legitimate independent contractors. The current legal and regulatory environment governing worker classification already has had a disruptive impact on these relationships.

During the past several years, certain companies that traditionally operated on an independent-contractor model have changed their model, terminated the independent contractors and offered them employment—due principally if not entirely to the current legal and regulatory environment. The best interests of the economy are not served when companies change their business model in the direction of a less efficient one, solely to reduce their legal and regulatory risks.[2]

The adverse impact of the current legal and regulatory environment is also corroborated by government data. The number of self-employed individuals, as reported monthly by the Bureau of Labor Statistics, has been gradually declining over the past several years. The following is a graph illustrating the number of "self-employed workers, unincorporated," as reported each month in *The Employment Situation*, Table A–8, commencing June 2009, *http://www.bls.gov/schedule/archives/empsit_nr.htm*. The "y" axis represents the number of "self-employed workers, unincorporated," in millions.

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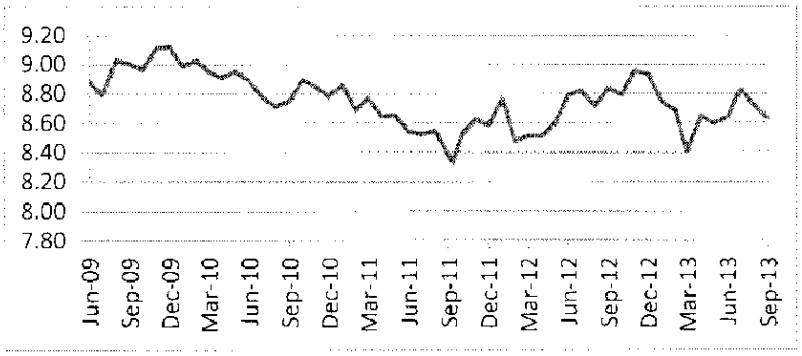
[2] The Navigant Economics Study found that curtailing independent contracting would:

- *Reduce job creation and small business formation.* Independent contractors start businesses and create jobs. Of the 10.3 million independent contractors in the most recent Bureau of Labor Statistics survey, nearly 2.4 million had one or more paid employees, with the vast majority employing five or fewer workers.
- *Reduce competition and increase prices.* By reducing the importance of economies of scale, independent contracting allows small businesses to compete with larger ones, increasing competition and lowering prices for consumers.
- *Create sector specific disruptions.* Independent contracting is a primary business model in a number of important industries, including construction, emergency medicine, financial advice, timber harvesting and transportation. Limitations on independent contracting could create serious economic disruptions in these and other industries.
- *Produce a less flexible and dynamic workforce.* Independent contracting allows both firms and workers to respond to changes in the economy, reducing "structural" unemployment. Empirical studies show independent contracting facilitates workers' re-entry into the workforce after being laid off.

Navigant Economics Study at p. ii.



The foregoing graph reveals that not since February 2010 has the number of self-employed unincorporated workers exceeded nine million. Moreover, the graph illustrates a disturbing downward trend of self-employment.

V. CONCLUSION

The Coalition respectfully urges that the Congress not impose any additional administrative or regulatory burdens on companies that do business with self-employed individuals. We believe the current regulatory and legal environment for these relationships is more than adequate to discourage worker misclassification, as the environment has had the unfortunate impact of causing companies to eschew even legitimate independent-contractor relationships due to legal and regulatory concerns. Such an outcome only exacerbates the financial pressures for those legitimate self-employed individuals who are seeking client opportunities to expand their operations and support their families in these difficult economic times.

PREPARED STATEMENT OF FOREST RESOURCES ASSOCIATION, INC.,
DEB HAWKINSON, PRESIDENT

The **Forest Resources Association** is a 79-year-old trade association representing all components of the U.S. wood supply chain, which provides forest-based raw materials to primary forest products manufacturers such as pulp and paper mills, lumber and other building product mills, and bio-energy plants. FRA members include forest landowners; logging contractors and other wood suppliers; forest product trucking businesses, wood- and forest-biomass consuming mills; as well as businesses providing products and services in support of the wood supply chain.

Forest products manufacturing is the seventh largest industrial sector in the United States, contributing to economic growth and community development in rural and remote communities where other job generators have much less access.

In contrast to most other countries with large forest products industries, U.S. wood supply systems are substantially de-integrated, and contracting among their various components is crucial to their operation. The reasons lie in the historical configuration of our diverse forest resource, the many different types and sizes of landownerships, and our country's tradition of enabling and fostering entrepreneurship at the local level.

The remote working conditions under which timber is harvested in the United States create great challenges for supervision. Vesting independent personnel with personal entrepreneurial goals and profit opportunities relieves the service recipient—who needs timber delivered or a forest improvement contract executed—of the expenses and time of supervision, while imposing on him or her the lighter and less intrusive task of contract administration. With today's emphasis on excellence in environmental compliance, giving a responsible entrepreneur, qualified with appropriate education and certification, a measurable stake in project outcome can be more practical than threading a supervisory chain from the headquarters of a major corporation to the forest operation, itself.

Independent contracting is essential to this supply chain's working flexibly within market realities. Policies which raise uncertainties about these relationships or call into question the ability of a contractor to make independent business decisions

cloud the contractor's planning horizon, obstruct his or her access to credit, and make business investments difficult.

In summary, clarity in Independent Contractor status determinations is very important to the forest products supply chain:

- Entrepreneurship in logging and wood supply creates value and quality;
- Uncertainty in status determinations impedes small businesses' planning and credit access;
- Current policy already discourages illicit "underground" operators, within both IRS and Department of Labor jurisdictions;
- Additional regulatory requirements will add costs and administrative burdens, impeding small business recovery.

PREPARED STATEMENT OF THE HOME CARE ASSOCIATION OF AMERICA[1]

MISCLASSIFICATION OF WORKERS

POSITION

The Home Care Association of America (HCAOA) supports efforts to clarify and fully enforce existing worker classification laws. Many in-home, non-medical companion care workers should be classified as employees, because how, where and when they perform their duties is controlled by the person or entity who sets up the assignment.

HCAOA asks that you support legislative and regulatory efforts to enhance appropriate worker classification.

BACKGROUND

Current law requires that workers be treated as employees when the nature, time and place, and method of performing the work are under the control of the entity or person for whom the work is done. This is the 20-point common law control test.

However, agencies that refer workers, seniors and their families who employ them, and the workers themselves all too frequently either do not know or misinterpret these rules. This results in a misclassification of these workers as independent contractors.

A misclassified private-pay home care worker loses important employee protections when this misclassification occurs. These include:

- Worker compensation.
- Unemployment insurance.
- The employer-paid share of payroll (Social Security/Medicare) taxes.
- As of 2014, when health reform rules take effect, employer-provided (and paid) health insurance.

Seniors, individuals with disabilities and their families are also harmed by this worker misclassification because they may find themselves liable for back taxes and penalties when their situation is discovered and remedied.

Federal and State Governments lose much-needed tax revenue when misclassified workers—usually through ignorance rather than conscious decisions to ignore the law—fail to pay their appropriate level of income and payroll taxes.

Compliant employee-based private-pay home care companies face a severe competitive imbalance because their competitors—who are often not complying with current law and thus incurring the employee protection expenses associated with current law—can and do offer lower cost private-pay home care services.

If you would like more information on this matter or have questions please contact Patrick Cooney at *Patrick@Federalgrp.com* or by calling (202) 347–0034 x101. You may also contact Michael Eastman at *meastman@ntll.com* or by calling (202) 629–5625.

PREPARED STATEMENT OF PRIVATE CARE ASSOCIATION, INC., JAMES MARK, PRESIDENT

The Private Care Association ("PCA"), since 1977, has been the voice of private duty home care. PCA's membership is made up of home care registries that refer self-employed caregivers to provide assistance with activities of daily living such as

[1] The Home Care Association of America (HCAOA) is the Nation's first association for providers of private-pay home care. HCAOA was founded on the principle that quality private duty home care has one model of care and that model is to employ, train, monitor and supervise caregivers, create a plan of care for the client and work toward a safe and secure environment for the person at home.

bathing, dressing, lifting/transferring, continence care, feeding/meal preparation, companion care, homemaker services and nursing services in the client's home. The consumer-directed model of care is based on the idea of consumer choice in home care options and gives consumers the right to make decisions and direct the care needed. The principal advantages of consumer-directed care are that it costs less to the consumer, the caregivers typically earn more, it allows consumers to individually select caregivers, it provides greater continuity in caregiver relationships, and it supports caregiver entrepreneurship.

The title of this hearing suggests that it is focused on circumstances where the decision to provide services as an employee or as an independent contractor is made by the service recipient and not by the worker who provides the services, in that a service recipient that misclassifies workers is a "bad actor." The home-care industry does not operate in that manner.

I. THE HOME-CARE INDUSTRY

In the home-care industry, the individual caregivers who provide the care decide whether to work as employees or as independent contractors. They have far more opportunities to work as employees than to work as independent contractors. Examples of opportunities for employment include:

- Hospitals;
- Nursing homes;
- Assisted living centers;
- Skilled nursing facilities;
- Group homes;
- Home health agencies; and
- Employee-based home care agencies.

By contrast, the opportunities available to caregivers to work as independent contractors are more limited. They can offer their services on Craigslist and similar Web sites, market their services through other informal marketing channels, or offer their services through caregiver registries.

It follows that caregivers who work as independent contractors in the home-care industry have made an affirmative decision to do so. They represent a self-selecting cohort of caregivers who choose to work in this capacity.

There are many reasons why caregivers will make this choice. The independent-contractor option offers caregivers the flexibility to determine *when* they will work, which enables them to (i) supplement other full-time work, (ii) balance family needs with work, and (iii) enjoy the freedom to take time off at any time without explanation or justification. The independent-contractor option also empowers caregivers to select their own clients, determine where they will work, and set their own pay rate. In fact, these caregivers typically earn more than their colleagues who work as employees, in terms of both per-hour and take-home pay. The level of enjoyment of work is also an important factor. Under the independent-contractor option, a caregiver has only one client to keep satisfied, namely, the care recipient. This contrasts with those who work for an employee-based agency, where the caregiver needs to keep satisfied both the client and the agency; and those who work in an institutional setting where one caregiver can be expected to keep satisfied a large number of care recipients.

Among those caregivers who choose to work as independent contractors, there are compelling reasons why they would choose to offer their services through a caregiver registry. Fundamentally, a registry enables a caregiver to devote work hours to performing compensable client services, rather than marketing. In addition, a caregiver registry offers access to a wide variety of client opportunities, which creates a greater potential that a caregiver will be able to find a client opportunity that matches the caregiver's work availability. Finally, an important factor to caregivers is that many of their potential clients feel more comfortable obtaining a caregiver through a caregiver registry—because a caregiver registry will refer to clients only caregivers who have passed a rigorous background-check and credential-verification protocol.

Consumers who need care have many options as well. They could move to a facility, obtain care from an employee-based home care agency, or obtain a caregiver on their own. The principal value that a caregiver registry offers a consumer is that a registry provides a critically important safety component by virtue of its background-check and credential-verification protocol. Furthermore, consumers who wish to self-manage their home care can avoid the third-party interference in their home-care relationship that results when an employee-based agency is involved. For example, while an agency can re-assign a caregiver from one client to a different client, a registry cannot.

Finally, for clients whose finances are being handled by an out-of-town relative or an institution, a caregiver registry can facilitate the delivery of client payments to the caregivers. Registries commonly accomplish this by establishing an escrow account for the purpose of receiving and disbursing third-party payments to caregivers. For clients who have long-term care insurance, a registry also can facilitate the insurer's approval and payment of the benefits to which the care recipient is entitled.

II. CAREGIVER REGISTRIES ARE NOT "BAD ACTORS"

Caregiver registries have been operating since at least the 1940s, when they were regulated by the State of Florida under the Private Employment Agency regulatory law.[1] These entities perform an important function for the home-care market, by creating a virtual marketplace through which buyers (consumers) and sellers (caregivers) of home-care services can find each other. In this regard, caregiver registries facilitate consumer choice by creating a marketplace where consumers can shop for a caregiver that best meets their individual needs, as opposed to having to find a caregiver on their own.

Caregiver registries also provide a vitally important consumer-safety function by only referring to clients those caregivers who have passed a rigorous background-screening and credential-verification protocol.

In cases where clients utilize a caregiver registry's escrow account to disburse client payments to caregivers, the caregiver registry reports the payments on Forms 1099, and thereby enhances tax compliance by the caregivers,[2] inasmuch as the individual consumers, themselves, generally have no Form 1099 reporting obligations with respect to the payments they make to caregivers because they are not engaged in a trade or business.[3]

Finally, caregiver registries are not *providers* of home-care services, they do not set the rate of pay for caregivers, do not determine the hours a caregiver will work for a referred client, and do not determine any aspect of a home-care relationship that exists between a caregiver and a client. It follows that a caregiver registry does not function as an employer of a caregiver.

III. CAREGIVER REGISTRIES ARE NOT "HURTING WORKERS"

Because of the far more numerous employment options that are available to caregivers, caregiver registries only help caregivers, by providing those who affirmatively choose to work as independent contractors an avenue through which they can efficiently learn about client opportunities.

Caregivers need to affirmatively seek out caregiver registries, as there are fewer caregiver registries than other businesses that offer employment opportunities. Furthermore, a caregiver registry is inherently a passive business type, in that it can only inform caregivers about client opportunities; the caregiver in all cases will determine whether or not to pursue an opportunity.

IV. CAREGIVER REGISTRIES ARE NOT "HURTING BUSINESSES"

The principal competitors of caregiver registries are Internet options, such as Craigslist, and other informal channels through which consumers can find caregivers. While some employee-based agencies view caregiver registries as competitors, they are mistaken, as their true competitors in this context are the caregivers who choose to work as independent contractors and not as employees of agencies. A caregiver registry merely creates an efficient marketplace that facilitates a caregiver's ability to do this.

To the extent that employee-based agencies actually view caregiver registries as competitors and believe registries have an unfair competitive advantage, that viewpoint would be purely self-serving as it is premised on restricting consumer choice by forcing all consumers of home-care services into the one option that employee-

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[1] *Repeal of Nurse Registry Regulation?*, Staff of Florida H. Comm. on Health Care Licensing and Regulation, at p. 5 (Oct. 1999), *http://www.leg.State.fl.us/data/Publications/2000/House/reports/interim_reports/pdf/nurse.pdf*.

[2] Internal Revenue Service data indicate that the compliance rate for recipients of Forms 1099 is 97 percent. *E.g., TAX COMPLIANCE Opportunities Exist to Reduce the Tax Gap Using a Variety of Approaches*, GAO-06-1000T, at 11 (July 26, 2006) GAO, *Tax Gap: Making Significant Progress in Improving Tax Compliance Rests on Enhancing Current IRS Techniques and Adopting New Legislative Actions*, GAO-06-453T, at 17, (Feb. 15, 2006); GAO, *Tax Compliance: Reducing the Tax Gap Can Contribute to Fiscal Sustainability but Will Require a Variety of Strategies, GAO-05-527T, at 18 (Apr. 14, 2005).*

[3] Internal Revenue Code section 6041(a) imposes Form 1099 reporting duties only on "persons engaged in a trade or business."

based agencies have elected to offer them. If caregiver registries were eliminated, that would not reduce the ranks of independent-contractor caregivers, it would only cause the marketplace for freelance caregivers to operate less efficiently. Moreover, it would remove an important consumer-protection/caregiver-vetting service for consumers who wish to self-manage their own home care.

Academic studies have shown that the employee-based agency option is not the preferred option for all consumers; and that some consumers prefer a consumer-directed option—which caregiver registries facilitate.[4]

PCA supports consumer choice. We believe consumers should be given access to as many varied options as possible, so they have the opportunity to select the option that best meets their individual needs.

V. CAREGIVER REGISTRIES ARE CONCERNED ABOUT RECENT CHANGES TO THE FLSA

One issue that is of much concern to caregiver registries is the treatment of caregivers under the Fair Labor Standards Act ("FLSA"). Since 1974, home-care workers have been generally exempt from the FLSA's overtime and minimum-wage requirements, pursuant to what is commonly known as the companionship exemption.[5] This will soon change.

The U.S. Department of Labor recently issued final regulations[6] that, effective January 1, 2015, will materially change the companionship exemption so that it will apply only in exceptional circumstances. While the Preamble to these final regulations[7] contains an example that appears intended to clarify the circumstances in which a caregiver registry would not be considered a "third-party employer" of a caregiver, the conclusion given by the example is that under the stated facts the registry is "likely not" the employer of the caregiver. The example certainly is helpful, but it does not provide the degree of certainty that the industry needs.

The final regulations governing the FLSA's companionship exemption create a unique dilemma for caregiver registries, in that registries are potentially at risk for overtime or minimum-wages with respect to the caregivers they refer—by being deemed an employer or a joint employer for purposes of the FLSA; but they have no meaningful way to manage this risk. A caregiver registry does not control the number of hours a caregiver works for a client (or for two or more clients) or the amount the client will pay the caregiver for those hours.

PCA submits that for caregiver registries to be subjected to uncertainty with respect to their potential FLSA liabilities under these circumstances is inappropriate. For the reasons set forth above, caregiver registries provide consumers a safe option for gaining access to caregivers; registries are not intended to, and do not, function as an employer of the caregivers they refer. Consequently, caregiver registries seek clarifying guidance on how they can avoid employer and joint-employer status, for purposes of the FLSA, relative to the caregivers they refer to clients.

VI. CONCLUSION

Caregiver registries do not operate in an industry in which an individual's status, as an employee or independent contractor, is determined by the service recipient. For the reasons stated, caregivers in all cases make the unilateral decision on how they choose to work.

PCA submits that caregiver registries provide a vitally important role in facilitating the market for freelance home-care providers and in providing consumers with an opportunity to obtain an independent third-party verification of the background and credentials of the caregivers who care for them.

Caregiver registries are very concerned, however, about their potential legal risks under the DOL's final regulations governing home care. Consequently, PCA respectfully seeks additional clarification on how caregiver registries can operate their businesses with confidence that they will avoid any risk of being determined to be the employer or joint employer for purposes of the FLSA of the caregivers they refer to care recipients.

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[4] E.g., Benjamin, Mathias and Franke, *Comparing Consumer-directed and Agency Models for Providing Supportive Services at Home*, Vol. 35 Part II, *Health Services Research No. 1 Selected Papers From the Association for Health Services Research Annual Meeting* (April 2000) at 351, et seq.

[5] 29 U.S.C. § 213(a)(15).

[6] *Application of the Fair Labor Standards Act to Domestic Service*, 78 Fed. Reg. 60454 (Oct. 1, 2013) (to be codified at 29 CFR Part 552).

[7] Id. at pp. 60484 –485.

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)

The more than 140,000 members of the National Association of Home Builders (NAHB) appreciate the opportunity to present this statement to the U.S. Senate Committee on Health, Education, Labor, and Pensions Subcommittee on Employment and Workplace Safety as it considers the classification of employees and independent contractors. This issue is of great importance to the home building industry, which thrives on the efficiency and entrepreneurship that comes from both home builders and their trades being able to freely choose their form of business relationship.

NAHB's statement focuses on the economic considerations lending to the prevalence of the independent contractor business model in the residential construction industry. It further examines the motivations of both contractual parties in choosing this type of business relationship.

THE RESIDENTIAL CONSTRUCTION INDUSTRY AND ECONOMIES OF SCALE

Independent contractors are commonly engaged in the residential construction sector. With success and growth, many of these independent contractors become larger enterprises employing their own workers. Less understood, however, is the structure of the home building industry and the important business-related factors that necessitate the use of this business model in the construction of a home.

Intuitively, one understands that the construction of a home is a complex undertaking requiring a variety of labor, expertise, and skill to turn a design into a finished product. From laying the home's foundation, to framing the house and trusses, and installing complex plumbing and electricity systems, a home builder has an extensive and diverse set of projects to complete for the consumer in a set amount of time.

Consequently, home builders rely on myriad specialty trades to complete a finished home. The U.S. Census identifies some of these roles: construction supervisor, brick mason, carpenter, flooring contractor, cement worker, general laborer, pile driver, engineer, drywaller, electrician, glazier, insulation contractor, painter, paperhanger, pipe plumber, plaster contractor, rebar worker, roofer, metalworker, quality inspector, fencer, hazmat removal contractor, and septic and sewer specialist.

Importantly, the dominance of small business entities in the residential construction sector further illustrates the necessity of the independent contractor business model in the industry. In 2012, 85 percent of NAHB's builder members built 25 or fewer homes, and 75 percent built 10 or fewer.

Because the typical home builder may only construct a few homes annually, there is not sufficient internal demand to justify hiring an employee for the numerous specialized tasks required to complete a home project. For example, the total internal demand for an electrician may only be one-half of a position per year.

Economic theory dictates that firms employ labor in-house only when the costs of doing so are less than the cost of contracting with another firm. In general, labor costs are lower for businesses that specialize in a particular activity compared to a business that attempts to do all tasks in-house. Consequently, it may be more efficient to contract with a business consisting of dedicated specialists than housing a single specialized employee within the firm. This effect is also known as economies of scale and is likely to occur in industries associated with large fixed costs, low marginal costs and learning-by-doing, such as residential construction or the technology sector.

Accordingly, it makes more economic sense for a home builder to contract with an electrician who acts as an independent contractor rather than hire an employee. This contractor will likely own his or her own equipment, provide for his or her own training, and may have his or her own staff. Essentially, this contractual relationship is between two businesses—one hiring the other to perform a particular function the other cannot.

The economics of why there is a large share of independent contractors in the construction sector can also be seen in the data. The JOLTS data from the Bureau of Labor Statistics demonstrate hiring and separation rates can be 50 percent to 100 percent higher than other business sectors. These higher rates of both hiring and separations for the construction sector are consistent with a market that has high worker turnover due to seasonal and contract- or project-based labor needs. Such "lumpy" demand for workers results in high turnover as contracts are begun and completed, typically under weather constraints. Moreover, with respect to separations, the data indicate that while the categories for the rates of quits and other separations for construction are comparable with the rest of the economy, the layoffs/discharges separation rate is twice as high.

Overall, the JOLTS data for the construction sector reveal an industry with high rates of worker turnover. For such industries, independent contractor status makes a good deal of economic sense, as it provides the flexibility to link demand for workers with available supply. Also given the current weakness in economic growth, the economy needs more flexibility in this regard, not less.

BOTH CONTRACTUAL PARTIES BENEFIT FROM THE INDEPENDENT CONTRACTOR BUSINESS MODEL

Deciding whether to utilize independent contractors or hire employees is a question posed by a business when it decides how to operate. As discussed above, the independent contractor model is traditionally utilized in the home building industry due to the necessity of specialty trades and dominance of small business entities in the industry. This model also allows businesses to adjust their workforce based on demand, seasonal considerations, and other factors determined by a dynamic housing market.

Likewise, similar considerations are made by individuals in deciding whether he or she will seek entrepreneurship over a more traditional form of employment. Often is the case that an independent contractor will prefer this type of autonomous contractual relationship, which supports entrepreneurial activity, offers independence over one's own work hours, and control over his or her performance on the job.

Generally, self-employed individuals have exclusive ownership over their services, and because they are free to choose their own jobs and clients, the quantity and quality of their work is better correlated with the amount of money they make. In the construction industry, it is true that many independent contractors gain a foothold in the middle class by learning a specialty trade and growing their own business from the ground up.

CONCLUSION

The residential construction industry is dominated by small firms, in terms of count and homes built. A virtue of this large number of firms is competition, which is good for home buyers.

While NAHB appreciates the subcommittee's interest in the proper classification of employees and independent contractors, NAHB strongly supports maintaining the efficiency and flexibility of the marketplace by continuing to allow employers to classify their workers as independent contractors. At the same time, we support enforcement of present law to ensure a level playing field for small businesses.

Policies that would eliminate or raise the cost of engaging independent contractors would have the impact of increasing the minimum size of a home builder in order to have the scale required to place additional workers or subcontractors under full employee status. This increase in minimum firm size would in turn cause many small firms to cease to exist, thereby reducing competition and harming the demand side of the housing sector.

PREPARED STATEMENT OF THE SNACK FOOD ASSOCIATION

The Snack Food Association (SFA) is the international trade association of the snack food industry representing snack manufacturers and suppliers. SFA represents over 400 companies worldwide.

The core business of SFA member-companies is manufacturing and distributing convenience foods to thousands of retail outlets such as grocery and convenience stores. In support of these activities, these companies collectively employ or contract with tens of thousands of professional drivers and operate commercial vehicles in a wide range of private fleet operations.

SFA recognizes that abuses of independent contractor status may exist in certain industries. We also understand and support the need for proper employee/independent contractor classification. However, we also believe it is critically important for policymakers to recognize that many companies utilize independent contractors as a legal and appropriate means of doing business.

A number of snack food companies utilize self-employed contractors as a part of their direct store delivery systems. These independent drivers deliver product to retail locations, stack shelves and interact directly with customers, among other duties. This model helps meet customers' demands for flexible scheduling and other individual business needs. It has served as a successful one for our industry and for the small business entrepreneurs that provide these services.

These arrangements generate economic and other benefits for both the self-employed drivers and those companies that retain them by providing labor services in

situations where the traditional employee/employer relationship may not provide the best fit for the worker, the company, or both.

Paramount for many contract drivers is the desire to "be one's own boss" and to otherwise benefit from the independence associated with being self-employed. This spirit of entrepreneurship is a positive force for our industry and the economy as a whole.

Any legislation seeking to address "misclassification" of workers must not be so broadly crafted as to restrict or inhibit legitimate contracting practice. Doing so will result in higher unemployment, less formation of small businesses, a less dynamic workforce, and reduced economic vitality. For our industry, it would cause significant disruption for those companies that choose to utilize self-employed individuals as a part of their distribution business model.

SFA opposes efforts to place new disclosure or recordkeeping requirements on companies that utilize independent contractors. We further oppose any effort to amend or repeal the so-called "Section 530" protections in Federal law which provides a "safe harbor" against employment tax liability in cases where an employer has traditionally treated an individual as an independent contractor.

In sum, SFA believes the legitimate use of independent contractors has an essential and dynamic role for many of our member-companies and for the economy as a whole. We oppose changes in Federal law that would place new regulatory or administrative burdens on employment or contracting practices.

AMERICAN SOCIETY OF TRAVEL AGENTS,
ALEXANDRIA, VA 22314,
November 8, 2013.

Hon. ROBERT P. CASEY, JR., *Chairman,*
Subcommittee on Employment and Workplace Safety,
Senate Committee on Health, Education, Labor, and Pensions,
143 Hart Senate Office Building,
Washington, DC 20510.

Hon. JOHNNY ISAKSON, *Ranking Member,*
Subcommittee on Employment and Workplace Safety,
Senate Committee on Health, Education, Labor, and Pensions,
113 Hart Senate Office Building,
Washington, DC 20510.

DEAR SENATORS: I am writing to share the views of the American Society of Travel Agents (ASTA) on the issue of independent contractors in advance of the committee's November 12 worker classification hearing, and ask that this letter be included in the official hearing record.

By way of introduction, ASTA was established in 1931 and is the leading professional travel trade organization in the world. Its current membership consists of nearly 2,200 domestic travel agency firms—including 73 in Pennsylvania and 57 in Georgia—employing around 30,000 people. ASTA's members vary in size from the smallest home-based agent to large travel management companies such as American Express Travel to the prominent online agencies like Expedia, Orbitz, Priceline and Travelocity.

Like many other industries, travel agencies rely on the services of "independent contractors," which are defined by the Internal Revenue Service as "people such as doctors, lawyers, [and] accountants . . . who are in an independent trade, business, or profession in which they offer their services to the general public." [1] As the many travel agencies who have utilized an independent contractor (IC) arrangement can attest, it provides substantial benefits for both workers and agencies in situations where a traditional employment relationship is either impractical or uneconomical.

Travel agencies who use ICs are in good company. In 2010, 10.3 million workers, comprising 7.4 percent of the U.S. workforce, were classified as independent contractors by the U.S. Department of Labor (DOL), and another 4 million work in "alternative work arrangements" in which they may be legally classified as ICs.[2] Alternative workers accounted for approximately $626 billion in personal income, or

[1] "Independent Contractor Defined," last modified November 5, 2013, *http://www.irs.gov/Businesses/Small-Businesses-%26-Self-Employed/Independent-Contractor-Defined*.

[2] Bureau of Labor Statistics, Navigant Economics.

about one in every eight dollars earned in the United States.[3] For years, travel agencies across the country have utilized IC arrangements to run their businesses more efficiently. An estimated 61 percent of ASTA member agencies use at least one independent contractor, and the average ASTA member utilized eight ICs in 2012. According to the research firm PhoCusWright, an estimated 20,000 ICs work in the travel agency industry—equivalent to 20 percent of total industry employment.[4]

For an agency, using ICs allows for flexibility to bring people on to help out during a busy season, to pay for services based on output instead of timesheets, and to better manage their capital expenses. For a contractor, the arrangement provides benefits in terms of building the expertise and client base necessary for entrepreneurship and small business formation, but perhaps most of all fulfills the desire to "be your own boss."

Negative news articles on this issue give the impression that businesses are forcing their employees to become ICs against their will. The reality is quite the contrary—workers overwhelmingly prefer independent contractor relationships to salary/wage employment. According to the DOL, 82.3 percent of ICs prefer an independent work arrangement to being an employee, compared with only 9.1 percent who would prefer a traditional employment arrangement.[5] In the same vein, a 2009 Pew Research Center survey found that self-employed workers are "significantly more satisfied with their jobs than other workers," and that "they're . . . more likely to work because they want to and not because they need a paycheck."[6]

Another argument critics present is that independent contractors are more likely to underreport income than employees, leading to reduced tax revenues and thus increasing the so-called "tax gap." While tax evasion undoubtedly exists throughout the U.S. economy, there is no evidence that IC arrangements contribute disproportionately to the tax gap. In fact, the opposite is true. The Treasury Department looked at this in great detail several years ago and concluded that, provided income and expenses are properly reported, "independent contractors and their clients tend to pay *higher* levels of taxes, especially Social Security and Medicare taxes, than employees and employers" (emphasis added).[7]

At the end of the day, independent contracting provides a flexible way to conduct business when traditional employment arrangements don't make sense, allows for new entrants to move into the workforce, and is a key means toward small business development and new job creation. While there have been abuses, and the Federal Government is within its rights to ensure proper worker classification, we fear that cracking down too hard on the IC system will result in slower economic growth and lower consumer welfare overall.

ASTA's position is simple—the independent contracting system has proven its value to travel agencies' business operations and should remain a viable option. We will oppose proposals to undo longstanding protections for businesses that rely on the services of legitimate ICs, force them to fundamentally change the way they do business, and assume massive new tax and compliance expenses.

Thank you for considering ASTA's views on this critical issue. If you or your staff have any questions about this or any issue related to the travel industry or small business, please don't hesitate to contact me or Eben Peck, ASTA's VP of Government Affairs, at (703) 739–6842 or *epeck@asta.org*.

Yours Sincerely,

ZANE KERBY,
President and Chief Executive Officer.

[Whereupon, at 3:39 p.m., the hearing was adjourned.]

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[3] Navigant Economics calculations based on data from the Bureau of Labor Statistics and the Bureau of Economic Analysis. Note that these figures do not include earnings of those who engage in independent contracting as a "second job."

[4] Quinby, Douglas and Sullivan, Mary Pat. *The Once and Future Agent: PhoCusWright's Travel Agency Distribution Landscape 2009–2013*. PhoCusWright, Inc. March 2012.

[5] Bureau of Labor Statistics survey on Contingent and Alternative Work Arrangements, 2005.

[6] Rich Morin, *Job Satisfaction Among the Self-Employed* (Pew Research Center, September 2009) (available at *http://pewsocialtrends.org/pubs/743/job-satisfaction-highest-among-self-employed*).

[7] Department of the Treasury, *Taxation of Technical Services Personnel: Section 1706 of the Tax Reform Act of 1986, A Report to Congress* (March 1991) at 24–26.