



Prevent the Misclassification of Employees as Independent Contractors

Issue Background:

Employee misclassification occurs when an employer improperly classifies a worker as an “independent contractor” who should be classified as an employee. If a worker is misclassified as an independent contractor the action produces significant tax consequences for both the worker and the service recipient. When employers incorrectly classify workers as independent contractors rather than full-time employees for the purpose of avoiding the payment of the required taxes and benefits, it is a form of payroll fraud and tax evasion. Classifying workers as independent contractors excludes them from coverage under laws designed to protect them. Consequently, these employees are not provided benefits, including employer social security contributions, health care, and worker’s compensation. In a competitive-bid industry like construction, misclassifying provides an unfair competitive advantage for those who take advantage of current loopholes that must be closed.

Key Points:

- *Allowing the Wrongful Misclassification of Workers Threatens to Degrade the Quality of Workforce Standards.* All NECA contractors offer a generous and comprehensive benefits package, which features worker compensation, over-time, healthcare, and retirement benefits to those who are classified correctly as employees.
- *Compliant Employers Are Forced To Compete In The Marketplace Against Unlawful Employers Who Cut Their Labor and Administrative Costs.* Employers who misclassify their workers reap substantial savings and gain unfair competitive marketplace advantages by avoiding payment of Social Security and Medicare taxes, federal and state unemployment insurance taxes, and workers’ compensation premiums. Furthermore, misclassification results in lost revenue for the Treasury and in the Social Security, Medicare, and Unemployment Insurance Trust Funds.
- *Misclassifying Workers As Independent Contractors Excludes Them From Coverage Under Laws Designed to Protect Them.* Unfortunately, it may be in the interest of some unscrupulous employers to deliberately misclassify a worker as an independent contractor to avoid the burden associated with these protective laws. Such protections include the Fair Labor Standards Act, which provides minimum wage, overtime pay, and child labor protections. Additional laws designed to protect employees include the Family Medical Leave Act, Occupational Safety and Health Act, and the National Labor Relations Act. Misclassified workers may also lose access to employer provided benefits such as health insurance coverage and pensions.
- *Misclassification Costs the Government and the American Taxpayer Substantial Tax Revenues.* Income earned by independent contractors is not subject to withholding requirements and has led to cases of uncollected Social Security taxes, unemployment insurance taxes, and income taxes. The Government Accountability Office studied a series of IRS audits and uncovered \$751 million in uncollected tax assessments from 483,000 misclassified workers.

NECA Position:

NECA urges Congress to pass legislation that will prevent employers from knowingly misclassifying employees as independent contractors through the following means:

- Require the Department of Treasury and the IRS to publish guidance on classification for both income and employment taxes.
- Repeal the safe harbor provision in the tax code and replace it with an Internal Revenue Code (IRC) provision providing a safe harbor applicable to both federal income and employment taxes, which allows the taxpayer to establish a reasonable basis for the classification. In making the classification determination, the IRS should be authorized to consider industry practices.
- Lift the moratorium on the IRS's ability to issue regulations addressing worker classification.
- Issue new guidance clarifying the employment status of individuals for employment tax purposes.
- Require employers who contract independent contractors to notify those independent contractors of their labor and employment status.
- Shield employers from tax liability for past misclassification, without retroactive penalties.
- Permit workers to petition the United States Tax Court to review the IRS's classification determinations.
- Direct the Department of Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.
- Require the Secretary of the Treasury to issue reports on worker misclassification.
- Require the IRS and the Department of Labor to conduct targeted public awareness campaigns to inform workers of the comparative rights afforded to employees and independent contractors, the tax consequences associated with each classification, and the opportunity to enter into voluntary income tax withholding agreements.