

Increase tools to collect UI taxes owed from employers who illegally call their workers “independent contractors”



What is it?

Unemployment insurance taxes are paid by employers for the benefit of their “employees.” Some employers misclassify employees as independent contractors in order to avoid many kinds of legal obligations, including the obligation to pay UI taxes for these workers. Misclassification of workers is a major drain on the unemployment compensation system. Some states have taken steps to ensure that they are identifying and penalizing those employers who would cheat the system. These state efforts include interagency task forces, targeted audits, and cross-matching tax and employment data.



Key arguments in favor

Employers frequently call workers independent contractors when they are in fact employees. According to a major Labor Department study, between 10 and 30 percent of all employers were found to misclassify some of their workers as independent contractors. State audits for 2003 found errors due to misclassification of one or more employees in 44 percent of cases audited; nearly all of these errors resulted in underreporting of wages rather than over-reporting. These types of errors represent a tremendous loss of revenue to UI trust funds. The latest state reports indicate \$436 million in wages that went unreported by employers just from the very small percentage (less than 2 percent) of the cases audited.

When employers cheat, workers suffer. When a worker is misclassified as an independent contractor, and no UI earnings are reported for that worker, he or she might be denied UI benefits due to insufficient work history or might receive UI benefits based on other employment, but in a smaller amount. A Department of Labor study estimated that 80,000 workers a year are denied unemployment benefits as a direct result of employer misclassification. In addition, DOL estimates that workers were underpaid \$1.3 billion in 2002 (about 3.2 percent of all UI benefits paid) due to misclassification as independent contractors.



Key arguments against and responses to them

Opponents say: States already go after employers who cheat.

Response: In 2002, nearly half the states reporting (20 states) failed the Labor Department’s standards for quality operation of their UI tax collection systems.

Opponents say: This isn’t a new or increasing problem.

Response: On the contrary, misclassification of workers is a growing problem. State audits report that the number of workers misclassified as independent contractors has increased by 42 percent in the past year.



Which states do it?

Joint agency task forces. California was the first state to create a joint agency task force to focus on misclassification of workers as independent contractors. The California task force collected \$74 million in unpaid wages in 2002 and \$10 million in payroll tax assessments.

Cross-matching with 1099 data. Fourteen states use IRS 1099 data to identify employers for audit purposes and share this data with other states. Other states perform data cross-matching with other agencies within the state.

Targeted audits. Federal law provides for a process for targeting industries with a high volume of misclassified workers. States should develop these processes and devote resources to increased targeted audits. Audit selection criteria should include employers with high turnover, sudden growth, or decrease in employment as well as focus on certain types of industries.



Model legislation

Joint agency task force

California's law creating a task force on the Underground Economy provides a good model and is available through <http://www.leginfo.ca.gov>. CAL. UNEMP. INS. CODE § 329

1099 Cross-Matching

California's law on 1099 cross-matching provides a good model and is available through <http://www.leginfo.ca.gov>. CAL. UNEMP. INS. CODE § 1088.8

Penalties

In addition to any other penalties imposed by law, if any tax deficiency assessment is made is due to an intent to evade the provisions of this law, the department shall assign to the employer, and to any contribution tax preparer found to be promoting the evasion of such provisions, the maximum tax rate provided for by law for the current rate year and the three rate years immediately following. If the employer's business is already at such highest rate for any year, or if the amount of increase in the person's rate would be less than 2 percent for such year, then a penalty rate of contributions of 2 percent of taxable wages shall be added to the assigned tax rate for such year.

Based on DOL Model Anti-SUTA dumping legislation.

Washington

(b) If an employer knowingly misrepresents to the employment security department the amount of his or her payroll upon which contributions under this title are based, the employer shall be liable to the state for up to ten times the amount of the difference in contributions paid, if any, and the amount the employer should have paid and for the reasonable expenses of auditing his or her books and collecting such sums. Such liability may be enforced in the name of the department. WASH. REV. CODE § 50.12.220

References

U.S. DEPT OF LABOR, ETA HANDBOOK 407, FIELD AUDIT FUNCTION, Part V, § 3677-3693, Appendix A, available at <http://www.ows.doleta.gov>.

U.S. DEPT OF LABOR, UI INFORMATION BULLETIN NO. 05-04 (May 2004), available at <http://workforsecurity.doleta.gov>.

NATIONAL EMPLOYMENT LAW PROJECT, THE WHOLE TRUTH: EMPLOYER FRAUD AND ERROR IN THE UI SYSTEM (Dec. 2003), available at: <http://www.nelp.org>.