

Issue: Employee Misclassification in Virginia

## Employee Misclassification in Virginia

### The Problem

Worker misclassification is the practice of falsely labeling employees as independent contractors. It is a flagrant violation of workers' rights and protections in Virginia and across the country and robs the state and federal government of much-needed revenue. While employers are responsible for paying taxes on their employees, including federal income taxes, Social Security and Medicare taxes, and unemployment taxes, this is not the case for independent contractors, who are self-employed and receive a 1099-MISC form instead of a W-2.<sup>1</sup> Below is a list of important distinctions between employees and independent contractors.

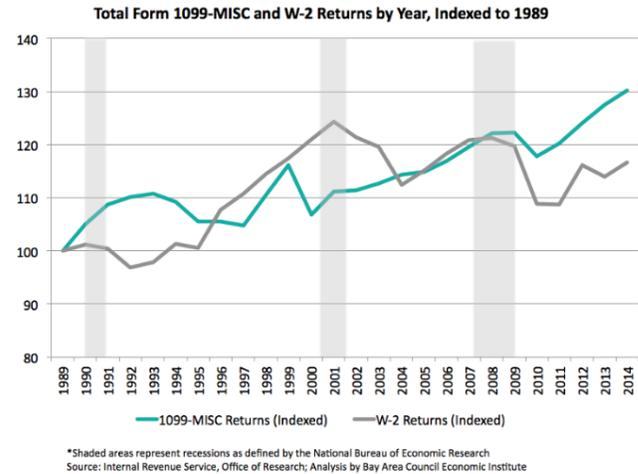
<b>Employee / Intern</b>	<b>Independent Contractor</b>
<ul style="list-style-type: none"><li>Works exclusively for the company</li></ul>	<ul style="list-style-type: none"><li>May work for other companies</li></ul>
<ul style="list-style-type: none"><li>Company provides tools</li></ul>	<ul style="list-style-type: none"><li>Worker provides tools</li></ul>
<ul style="list-style-type: none"><li>Company controls duties</li></ul>	<ul style="list-style-type: none"><li>Worker decides how the task is completed</li></ul>
<ul style="list-style-type: none"><li>Company sets working hours</li></ul>	<ul style="list-style-type: none"><li>Worker sets own working hours</li></ul>
<ul style="list-style-type: none"><li>Worker must perform services</li></ul>	<ul style="list-style-type: none"><li>Worker may hire someone else to complete the job</li></ul>
<ul style="list-style-type: none"><li>Worker has pension / group benefits</li></ul>	<ul style="list-style-type: none"><li>Worker does not get benefits</li></ul>
<ul style="list-style-type: none"><li>Worker gets paid vacation</li></ul>	<ul style="list-style-type: none"><li>Worker gets no paid vacation, and has no restrictions on time off.</li></ul>
<ul style="list-style-type: none"><li>Company pays expenses</li></ul>	<ul style="list-style-type: none"><li>Worker pays own expenses</li></ul>
<ul style="list-style-type: none"><li>Worker is paid salary or hourly wage</li></ul>	<ul style="list-style-type: none"><li>Worker is paid by the job on a predetermined basis</li></ul>

Source: <https://www.lawgives.com/guide/53fbac07777773bfa000000/Workplace+Hiring>

In addition to avoiding mandatory payroll taxes, employers circumvent an entire legal system to which traditional employees are subject because the vast majority of employment and labor laws do not apply to the self-employed.<sup>2</sup> Moreover, employers are not liable for sexual harassment or discrimination lawsuits by independent contractors.<sup>3</sup> The host of exemptions that misclassification affords to employers help explain its high prevalence in Virginia and across the nation.

## The Extent of Misclassification

In 2010, the Virginia Employment Commission conducted an audit of just one percent of employers, and identified 5,639 workers who were misclassified that year.<sup>4</sup> The National Employment Law Project then extrapolated from the audit data to estimate that 214,000 workers across the state may be misclassified.<sup>5</sup> Data from the Internal Revenue Service (IRS) indicates that the number of independent contractors in the U.S. rose by 12 percent between 2000 and 2012. This growth in independent contracting is reflected in the increasing rate of FORM 1099-MISC returns seen in the attached graphic.



Examining the frequency of misclassification in various sectors of Virginia’s economy is critical to addressing the root cause of the issue. The Joint Legislative Audit and Review Commission found that the Administrative and Support and Waste Management and Remediation Services sector had the highest percentage of employees who were misclassified.<sup>6</sup> Misclassification was also pervasive in the construction and real estate industry, along with the Accommodation and Food Services sector.<sup>7</sup> From an employer’s perspective in construction, classifying one employee as an independent contractor could reduce payroll costs by nearly 26 percent.<sup>8</sup> Compensation premiums in the construction field are particularly high given the dangerous nature of construction jobs.<sup>9</sup> Hence, the incentive to misclassify workers is stronger in industries where it yields more profit.

Industry <sup>a</sup>	% of Audited Employers Found to Be Misclassifying Within Industry	Number of Misclassifying Employers
Administrative and Support and Waste Management and Remediation Services	40	58
Construction	33	242
Accommodation and Food Services	27	20
Real Estate and Rental and Leasing	27	11
Transportation and Warehousing	26	16
"All Other" Industries <sup>b</sup>	24	51
Health Care and Social Assistance	24	30
Retail Trade	23	55
Wholesale Trade	22	23
Other Services (except Public Administration)	19	42
Professional, Scientific, and Technical Services	19	31
<b>TOTAL</b>	<b>27%</b>	<b>579<sup>c</sup></b>

Source: JLARC staff analysis of 2010 audit data from the Virginia Employment Commission

## Absence of Legal Penalties for Misclassification

Employers who misclassify their workers are rarely caught. Despite the rampant culture of misclassification in Virginia, the state has failed to strengthen laws to distinguish between employees and independent contractors or to institute stiffer penalties for businesses that misclassify their workers. In fact, the only significant stride Virginia has made to combat misclassification was in 2014, when then-Governor Terry McAuliffe signed an executive order that established an interagency task force to examine employee misclassification and payroll fraud.<sup>10</sup> Since then, little to no action has been taken. In 2018, Del. Jennifer Boysko (D) introduced HB 1106, authorizing the Attorney General, upon obtaining probable cause, to investigate wrongful employee misclassification and file court complaints to recover lost wages and other benefits.<sup>11</sup> Unfortunately, this bill died in a Republican-led subcommittee. On the federal level, a loophole in the Revenue Act of 1978 grants immunity from paying income taxes to the IRS to employers with a “reasonable” explanation for misclassification.<sup>12</sup> The resulting lack of state and national government policies allows employers to skirt labor law compliance requirements without fear of punishment.

## Consequences of Employee Misclassification

### Loss of Workplace Protections

The main consequence of employee misclassification is the loss of state and federal legal protections for workers. Such protections include occupational safety, unemployment insurance, workers' compensation, minimum wage and overtime pay, employer-sponsored health coverage and pension plans, family and medical leave, as well as safeguards against discrimination based on disability or age.<sup>13</sup> Additionally, workers lose the right to join a union once they are designated as independent contractors, making it more challenging for them to form a united front against their employers.<sup>14</sup> Since employers are not legally required to provide independent contractors with a minimum wage or to compensate them for overtime hours, workers often end up underpaid.<sup>15</sup> Furthermore, if independent contractors suffer from work-related injury, they are forced to shoulder huge lost income and medical costs without the support of employer-sponsored insurance.<sup>16</sup>

### Stifled Competition

Employers who properly classify their workers are undercut by their counterparts who misclassify. In the event of competitive bidding, those who do not play by the rules have a substantial advantage over law-abiding employers. A collaborative report by the Center for Construction Policy Research and the Labor and Worklife Program of Harvard Law School found that employers can reduce labor costs by 20 to 40 percent through misclassification.<sup>17</sup> Thus, an unlevel playing field stifles competition in Virginia and hurts responsible actors.

### Loss of Tax Revenue

Worker misclassification decreases state and federal tax revenue. As employers bypass tax contributions by labeling their workers as independent contractors, state and local governments are deprived of much-needed tax revenue. The Government Accountability Office estimates that the federal government alone lost \$2.72 billion in various taxes in 2006 due to misclassification.<sup>18</sup> Within Virginia, that number is approximately \$28 million each year.<sup>19</sup> Not only are treasury funds depleted, but social insurance systems lose funding as well. For instance, Pennsylvania's state unemployment insurance fund is shorted \$200 million annually due to misclassification.<sup>20</sup> With fewer financial resources, the quality and scope of these public services declines.

It is long past time that corporations are held accountable for worker misclassification. Absent the leadership and will in Washington to enforce the law, it is up to states to pass legislation that protects not only a growing sector of the economy, but also a vital revenue stream the state is foregoing as it turns a blind eye to the problem. Even periodic enforcement would go a long way in deterring this pervasive problem that worsens every year.

---

<sup>1</sup> <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Defined>

<sup>2</sup> <https://www.dol.gov/whd/workers/Misclassification/misclassification-facts.pdf>

<sup>3</sup> <https://wdr.doleta.gov/owsdrr/00-5/00-5.pdf>

<sup>4</sup> [http://www.dpor.virginia.gov/uploadedFiles/MainSite/Content/Licensees/JLARC\\_Employee%20Misclassification%20Report%20\(2012\).pdf](http://www.dpor.virginia.gov/uploadedFiles/MainSite/Content/Licensees/JLARC_Employee%20Misclassification%20Report%20(2012).pdf)

<sup>5</sup> Ibid

<sup>6</sup> <https://www.osha.gov/dcsp/osp/vamisclassification.pdf>

<sup>7</sup> Ibid

<sup>8</sup> See note 4

<sup>9</sup> <https://www.epi.org/publication/independent-contractor-misclassification/>

---

<sup>10</sup> See note 6

<sup>11</sup> <https://lis.virginia.gov/cgi-bin/legp604.exe?181+ful+HB1106>

<sup>12</sup> <http://www.gpo.gov/fdsys/pkg/CHRG-110hrg43758/html/CHRG-110hrg43758.htm>

<sup>13</sup> See note 6

<sup>14</sup> [https://dpeaflcio.org/programs-publications/issue-fact-sheets/misclassification-of-employees-as-independent-contractors/#\\_edn29](https://dpeaflcio.org/programs-publications/issue-fact-sheets/misclassification-of-employees-as-independent-contractors/#_edn29)

<sup>15</sup> See note 9

<sup>16</sup> [https://www.osha.gov/Publications/inequality\\_michaels\\_june2015.pdf](https://www.osha.gov/Publications/inequality_michaels_june2015.pdf)

<sup>17</sup> <https://www.nelp.org/wp-content/uploads/Independent-Contractor-Costs.pdf>

<sup>18</sup> <http://www.gao.gov/products/GAO-09-717>

<sup>19</sup> [www2.timesdispatch.com/news/2012/jun/12/tdmet01-misclassified-workers-cost-va-millions-jla-ar-1980895/](http://www2.timesdispatch.com/news/2012/jun/12/tdmet01-misclassified-workers-cost-va-millions-jla-ar-1980895/)

<sup>20</sup> [http://nelp.3cdn.net/0693974b8e20a9213e\\_g8m6bhyfx.pdf](http://nelp.3cdn.net/0693974b8e20a9213e_g8m6bhyfx.pdf)