

Category: VA Economy

Worker Misclassification in Virginia

Introduction

Workers in America have less power now than decades ago, and they have less clout than their counterparts in other wealthy industrial nations. One way workers in the U.S. are taken advantage of is by being inaccurately labeled as independent contractors instead of as employees. The default classification for workers is to be employees; only if specific criteria are met can a worker be an independent contractor. Misclassified workers are generally paid less and lose many worker protections.

Worker misclassification has been a problem in Virginia for many years. The Virginia legislature is assisted in evaluating state programs and agencies by a watchdog entity called the Joint Legislative Audit and Review Commission (JLARC).¹ A JLARC report from 2012 concluded that worker misclassification is prevalent throughout the Commonwealth.² That report recommended making employee misclassification illegal. Progress on deterring this practice finally started with the 2020 legislative session—because Democrats controlled both chambers.

Consequences of Employee Misclassification

Loss of Workplace Protections

One consequence of employee misclassification is the loss of state and federal legal protections for workers because the vast majority of employment and labor laws do not apply to the self-employed.³ Employers are not legally required to provide independent contractors with a minimum wage or compensation for overtime hours. In addition, employers are responsible for paying half of an employee's Social Security and Medicare taxes, while independent contractors must pay their entire share of payroll taxes.

A constellation of lost benefits comes into play when an independent contractor is injured on the job. Contract workers are not protected by occupational safety standards nor are they eligible for employer-sponsored health coverage.⁴ They also cannot receive workers' compensation because their employer has not contributed to this fund. If independent contractors suffer from work-related injuries, they are forced to shoulder both lost income and medical costs. For all these reasons, employers who misclassify have less incentive to make the workplace safe and often circumvent OSHA requirements.⁵

Contract workers are also ineligible for family and medical leave and for employer pension plans.⁶ They are not subject to safeguards against workplace discrimination. Independent workers are not eligible for unemployment benefits should they lose their jobs as their employers have not contributed to this fund. Additionally, workers lose the right to join a union when designated as independent contractors, making it more challenging for them to negotiate for improved conditions or better pay.⁷

Unfair Competition

Employers who properly classify their workers are undercut by their competitors who misclassify. In the event of competitive bidding, those who do not play by the rules have a substantial advantage over law-abiding employers. Governor Northam's Taskforce on Worker Misclassification and Payroll Fraud states that employers can save up to 40% of their labor overhead by misclassifying workers.⁸ Clearly, such unscrupulous practices stifle competition in Virginia and hurt responsible businesses.

Loss of Revenue

Sometimes, misclassified workers are paid completely under-the-table, which makes it easier for employers to avoid paying the minimum wage and overtime. In turn, that leads to state and federal governments losing tax revenue.⁹ For information about Wage Theft, please see the Local Majority paper "*Wage Theft in Virginia*."

Governments also lose revenue when Social Security, Medicare, unemployment insurance and worker's compensation taxes are not paid. The Economic Policy Institute (EPI) has reported that states incur additional costs in providing services to uninsured workers.¹⁰ The 2012 JLARC report on worker misclassification estimated that about \$28 million per year was lost in taxes.¹¹

The Extent of Misclassification

Because misclassification is fraud, and because of insufficient auditing capability of regulators, it is very difficult to estimate its extent. However, the 2012 JLARC report cited earlier estimates that there could be 40,000 employers in Virginia who misclassify and as many as 214,000 affected workers.¹²

Misclassification tends to be most prevalent in industries with lower wages and higher numbers of immigrant workers. There is also a stronger incentive to misclassify workers in industries where this practice yields more profit, such as in construction. Worker's compensation premiums in the construction industry are particularly high because of the dangerous nature of these jobs.¹³

Other industries where this illegal practice is widespread are trucking, restaurants, hotels, janitorial services, nail salons, car wash operations, home health care industries, and even in activity related to staging a concert.^{14, 15} Businesses that employ workers in the sharing economy, such as ride services, are also coming under scrutiny for their classification of workers as contractors.

Tests to Determine Worker Status

The federal government and each state decide how to distinguish between an employee and a contractor. Because multiple laws pertain to misclassification and multiple agencies have oversight of the laws, it can be very complicated to determine if a worker is an employee or contractor. Virginia was no exception, with four different state agencies dealing with misclassification issues.

Tests that determine if a worker is an independent contractor or an employee ask questions pertaining to who controls the activities of the workers, where the work is performed, and how work hours are set. But there were a multitude of other criteria—and three difference tests—used in Virginia. See the Appendix, which shows the details of different tests, and the circumstances under which each is applied. This table was taken from the 2012 JLARC misclassification document.¹⁶

For additional details, please refer to page three of the JLARC document in the section titled "Multiple Tests May Determine Whether a Worker is an Employee."

Workers get Additional Protections from Democrats

Prior to 2020, when Republicans controlled both chambers in the Virginia Assembly, there was very little action to rein in this illegal practice. In 2014, then-Governor Terry McAuliffe signed an executive order that established an interagency task force to examine employee misclassification and payroll fraud.¹⁷ In the House, in 2018, Del. Jennifer Boysko (D) introduced HB 1106, which authorized the Attorney General, upon obtaining probable cause, to investigate wrongful employee misclassification and to file court complaints to recover lost wages and other benefits.¹⁸ That bill died in a Republican-led subcommittee.

When Democrats took control of the state legislature in January 2020, several laws were passed to protect workers against misclassification:

HB 984 enables a worker to bring a civil suit against an employer who knowingly misclassified the worker.¹⁹ Additionally, this legislation creates the presumption that a worker is an employee, unless the IRS guidelines for an independent contractor are met. (Karrie Delaney (D) was the prime sponsor.)

HB 1199 protects workers from retaliation should the worker file a worker misclassification complaint against an employer.²⁰ (Kathy Tran (D) was the prime sponsor.)

HB 1407 establishes penalties against employers who misclassify.²¹ With passage of this bill, the IRS "twenty factor" test is now being explicitly used. (The chief sponsor was Democrat Jeion Ward.)

Penalties for misclassification went into effect on January 1, 2021. For a first offence, the penalty can be as high as \$1,000 for each misclassified worker. The maximum fine for a second offense is \$2,500 per worker, and for a third offense, the penalty can be up to \$5,000.²² In certain egregious cases, an employer can be prevented from being awarded a contract from public entities.

With this newly enacted legislation, Virginia is explicitly using the rules specified by the IRS²³ to determine whether a worker is an employee or contractor.^{24, 25} The general IRS criteria is "that an individual is an independent contractor if the payer has the right to control or direct only the result of the work, not *what* will be done and *how* it will be done."²⁶ In a nutshell, workers are now assumed to be employees unless proven otherwise.

The Virginia Employment Commission describes the distinction as in the box below.²⁷

Generally speaking, a **worker is an employee** if his or her employer:

- Furnishes tools, materials, and equipment needed to do the work;
- Sets the hours of work;
- Withholds payroll federal and state income taxes and Social Security taxes;
- Receives direction and training from the employer about how to do the work; and
- Is paid by the hour, week, or month instead of being paid at the completion of a job.

Compliance and Enforcement

To enforce labor laws, the state must have methods for finding employers who are thwarting the laws.

Investigations are often instigated because of complaints not just from workers but also from unions and worker centers. Industries that generate the most complaints aren't necessarily those where the practice is most widespread, making it challenging to find businesses engaging in misclassification. More pro-active approaches include on-site audits and auditing of unemployment insurance claims.²⁸ Unfortunately, states are often constrained by limited resources.

Cross-agency coordination has been useful in identifying employers who break labor laws.

Among the recommendations in a comprehensive study done by the Labor and Worklife Program at Harvard Law School are that:²⁹

- liability in cases of multiple sub-contractors should go up several levels to the general contractor,
- individuals, and not just businesses, should be liable.

Conclusion

Worker misclassification is a widespread problem that harms workers, compliant businesses and the revenue streams of government. Thanks to the more worker-friendly Democratic-controlled General Assembly, Virginia workers now have more protections against unscrupulous employers.

Appendix–Worker Status Tests from 2012 JLARC report

Table 1: Status of Worker as Employee May Be Determined by Different Tests for Different Purposes

Test	Application	
IRS 20-Factor Test Worker is an employee if he/she... Complies with employer's instructions Requires training to do the work Has work integrated into employer's operations Is required to perform the services personally Has continuing relationship with employer Performs work within set hours Devotes most of time to work for employer Must perform services in order or sequence set by employer Must perform work on employer's premises Must submit reports May be discharged by employer Has the right to terminate the relationship Is paid by the hour, week, or month (rather than by job or commission) Has business or traveling expenses paid by employer	Worker is an independent contractor if he/she... Furnishes tools, materials, and equipment Has significant investment in facilities needed to do the work Can make a profit or suffer a loss as a result of performing the services Can work for more than one firm at a time Makes his/her services available to general public Hires, supervises, and pays assistants	To establish conformance with federal tax law
Economic Reality Test Worker is an employee depending on relationship to alleged employer as determined by ... Degree of control exercised by employer; Extent of relative investments of worker and employer; Degree to which employer determines worker's opportunity for profit and loss Skill and initiative required in performing the job Permanency of the relationship		To enforce Fair Labor Standards Act by U.S. Department of Labor and Virginia labor laws by DOLI
Seven-Factor Test Worker is an employee depending on... Who the worker considers his/her employer Who pays worker's wages Who has responsibility to control the worker Who has power to control the worker Whether alleged employer has power to fire, hire, or modify worker's employment conditions Whether worker's ability to increase his/her income depends on efficiency rather than initiative, judgment, and foresight How worker's wages are established		To enforce Virginia safety and health laws

Note: DOLI, Virginia Department of Labor and Industry
 Source: JLARC staff analysis of IRS, Employer's Supplemental Tax Guide, 2012; U.S. v Silk, 331 US 704 (1947); S&S Diving Company, 8 OSHC 2041 (1980), and DOLI staff.

¹ <http://jlarc.virginia.gov/about.asp>

² <http://jlarc.virginia.gov/pdfs/reports/Rpt427.pdf>

³ <https://www.dol.gov/whd/workers/Misclassification/misclassification-facts.pdf>

⁴ <https://www.nelp.org/wp-content/uploads/Policy-Brief-Independent-Contractor-vs-Employee.pdf>

⁵ https://www.osha.gov/sites/default/files/inequality_michaels_june2015.pdf

⁶ <https://www.nelp.org/wp-content/uploads/Policy-Brief-Independent-Contractor-vs-Employee.pdf>

⁷ https://dpeaflcio.org/programs-publications/issue-fact-sheets/misclassification-of-employees-as-independent-contractors/#_edn29

⁸ https://www.jacksonlewis.com/sites/default/files/docs/VirginiaFinal_Worker-Misclassification-Report.pdf

⁹ <https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-workers-federal-state-treasuries-update-october-2020/>

¹⁰ <https://www.epi.org/publication/independent-contractor-misclassification/>

¹¹ <http://jlarc.virginia.gov/pdfs/reports/Rpt427.pdf> page v

¹² https://www.jacksonlewis.com/sites/default/files/docs/VirginiaFinal_Worker-Misclassification-Report.pdf

¹³ <https://www.epi.org/publication/independent-contractor-misclassification/>

¹⁴ <https://lwp.law.harvard.edu/files/lwp/files/misclassification.pdf>

¹⁵ <https://www.epi.org/publication/independent-contractor-misclassification/>

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[https://www.dpor.virginia.gov/sites/default/files/Virginia%20Fine%20Housing/JLARC_Employee%20Misclassification%20Report%20\(2012\).pdf](https://www.dpor.virginia.gov/sites/default/files/Virginia%20Fine%20Housing/JLARC_Employee%20Misclassification%20Report%20(2012).pdf)

¹⁷ <https://www.natlawreview.com/article/virginia-governor-signs-executive-order-establishing-joint-task-force-worker-misclas>

¹⁸ <https://lis.virginia.gov/cgi-bin/legp604.exe?181+ful+HB1106>

¹⁹ <https://lis.virginia.gov/cgi-bin/legp604.exe?201+sum+HB984>

²⁰ <https://lis.virginia.gov/cgi-bin/legp604.exe?201+sum+HB1199>

²¹ <https://lis.virginia.gov/cgi-bin/legp604.exe?201+sum+HB1407>

²² <https://law.lis.virginia.gov/vacodefull/title58.1/chapter19/>

²³ <https://www.irs.gov/newsroom/understanding-employee-vs-contractor-designation>

²⁴ https://www.governor.virginia.gov/media/governorvirginiagov/governor-of-virginia/pdf/Final_Worker-Misclassification-Report.pdf page 6.

²⁵ <https://acatimes.com/employee-misclassification-laws-add-headache-to-employer-aca-compliance/>

²⁶ <https://www.irs.gov/newsroom/understanding-employee-vs-contractor-designation>

²⁷ <https://www.vec.virginia.gov/employers/employee-or-independent-contractor>

²⁸ Illegal Labor Practices in the Philadelphia Regional Construction Industry: An Assessment and Action Plan.

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<https://www.keystoneresearch.org/sites/default/files/KRC%20Illegal%20Labor%20Con%20Final.pdf>

²⁹ <https://lwp.law.harvard.edu/files/lwp/files/misclassification.pdf>