

MINUTES OF THE SENATE COMMERCE COMMITTEE

The meeting was called to order by Chairperson Susan Wagle at 8:30 a.m. on March 10, 2011, in Room 548-S of the Capitol.

All members were present.

Senator Emler – excused
Senator Holland - excused

Committee staff present:

Ms. Margaret Cianciarulo, Committee Assistant
Mr. Ken Wilke, Office of the Revisor of Statutes
Mr. Reed Holwegner, Kansas Legislative Research Department
Ms. Dorothy Noblitt, Kansas Legislative Research Department

Conferees appearing before the Committee:

Mr. Karl Hansen, Chief Counsel, Department of Labor
Mr. Eric Stafford, Senior Director of Government Affairs, Association of General Contractors
Mr. Luke Bell, Vice President of Government Affairs, Kansas Association of Realtors

Others attending:

See attached list.

Handout of Approval of Committee Minutes

Upon calling the meeting to order, the Minutes of January 13, 19, 27 and February 8 and 9, 2011 were distributed to the Committee. Chairperson Wagle asked that they call her Committee Assistant with their comments and if none are received on or before March 15, the above Minutes would stand approved. She stated going forward, the remaining Minutes would be emailed to each of the members where they can request changes through her assistant.

Hearing on Substitute for HB2135 – an act concerning certain employees; relating to misclassification of employees to avoid tax withholding contributions and reporting requirements.

The Chair said the next order of business was a hearing on **Substitute for HB2135** and called on Mr. Ken Wilke, Office of the Revisor of Statutes, to explain the bill which included:

In 2006, the legislature made misclassification of employees a crime and the original version of this bill basically undid what the legislature did in 2006. The problem is, if you have someone who has an employee but labeled as an independent contractor, that change of label can lead to tax fraud since you would not end up paying UI tax and others. At the current time, the issue of determining whether an employee is classified or not, could occur by either the Secretary of Labor (SOL) or the Secretary of Revenue (SOR) depending on which tax area you are looking at. In **HB2135**, the House changed the procedure so that the SOL has the sole responsibility of whether the employee is truly an employee or an independent contract.

New Sec. 1 provides that the SOL is the only one that makes determinations of whether a worker is classified or misclassified. This section sets forth a process whereby, if the SOR comes up with this question, he or she refers the issue to SOL for investigation and determination. The determination has to be accepted by the SOR.

New Sec. 2 imposes on the SOL the test for making this determination, by looking at the totality of circumstances, and how much control do you assert over this employee. For instance, do you provide the equipment, determine when they work, and several other factors that can be taken into consideration. Subsection (a) tells how the SOL determines if the business has classified their workers and has a reasonable basis for how they have done, based on a judicial decision, a review or ruling from IRS, or the DOL validating the classification. In the absence of this, you have a situation in the Subsection (b), beginning on page 3, line 9, setting forth eight factors that have to be considered by the secretary in making the determination.

CONTINUATION SHEET

The minutes of the Senate Commerce Committee at 8:30 a.m. on March 10, 2011, in Room 548-S of the Capitol.

Page 8, lines 25 and 26, is a cross reference to the section of the unemployment compensation act where this is going to be done with reference to K.S.A. 33-703(i)(3)(D) which starts at the bottom of page 9. The stricken language, which is the key to the bill, starts at the bottom of page 9, line 43 and lines 1-6 on page 10, and comprises the old test as in current law. This stricken language is being replaced by the material we discussed in New Sec. 1 and New Section 2. The new language after this test helps codify this result.

On page 24, Section 4, lines 30-43 and at the top of page 25, lines 1-8, the old reference for the penalty pursuant to tax statutes has been taken out and inserting a new set of penalties based on the tax penalty that would be determined under K.S.A. 79-3228. The first violation is a civil penalty. On the second violation, the person would be subject to a civil penalty and if convicted, that person would be guilty of a Class C nonperson misdemeanor. If there is a third or subsequent violation, the individual would again have a civil penalty against them with a tax due and on conviction, that person would be guilty of a security level 10 nonperson felony.

Subsection (c) allows violations to be prosecuted by the Attorney General or County or District Attorney in the county where this occurred. Civil penalties go to the State Treasury and those are in addition to any other penalties prescribed by law.

The last set of amendments that you need to be aware of he said, are on page 27 and 28. In lines 24 through 33, this is the existing piece that is in the law and taken out and replaced with what you see on lines 34 through 43, and lines 1 through 14 at the top of page. Basically this amends the DOR statute to allow for transfer of information without violating any revenue law statutes to the SOL or the Secretary's designee for the purpose of making these determinations. On page 28, lines 8-12, impose confidentiality requirements on the SOL and the Secretary's designee, and on lines 13-15 it allows both the SOL and the SOR to adopt rules and regulations necessary to affect the provisions of this particular paragraph.

The Chair recognized Senator Longbine who asked Mr. Wilke regarding page 10, regarding real estate agents and insurance agents, if the broker or manager requires the independent contractors go through continuing education, sales training, prospecting activities, or whatever the broker deemed necessary to help that individual be successful, does this language make them an employee? (Whether an employee is an independent contractor or a true employee hinges on how much control the supervisor exercises over that person. Not sure it would make them an employee, regarding continuing education.) On page 10, for real estate agents, if the broker requires a contractor to go into continuing education, does this make the person an employee? (Determined by how much supervisor control has over employee, but do not think so.)

The Chair then recognized the first of three proponents Mr. Karl Hansen, Chief Counsel, Department of Labor, who stated the bill:

- 1.) Primarily brings greater uniformity for the examination of work classification between federal and state standards.
- 2.) Streamlines the process and eliminates layers of bureaucracy with which employers may have to deal with by creating a "one touch" examination process by which only one state agency shall seek to investigate the employer for the same matter, yet provide for the proper assessment and collection of all taxes, interest and penalties due any affected state agency. If Revenue should be the first agency with whom the employer has contact in this regard, Revenue shall be the point of contact throughout and disseminate information to KDOL accordingly, and visa versa. This way, the employer has one point of contact and has only to produce the same information one time, rather than dealing with multiple agencies over the same issue.
- 3.) Previously, had no escalation of penalties for repeat offenders, however, this bill enhances the penalty scheme for these offenders.
- 4.) Brings forth principles more effective of the modern workplace as the decade old landscape when the current laws were conceived.

CONTINUATION SHEET

The minutes of the Senate Commerce Committee at 8:30 a.m. on March 10, 2011, in Room 548-S of the Capitol.

Finally, Mr. Hansen said that for federal UI conformity reasons, a clarifying amendment is required prior to passage of this bill and they have submitted the appropriate language to the Revisor for the Committee's consideration. A copy of his testimony is (Attachment 1) attached and incorporated into the Minutes as referenced.

The next proponent to come before the Committee was Mr. Eric Stafford, Senior Director of Government Affairs, The Kansas Chamber of Commerce, who stated the bill amends the statutory provision of the division under the Department of Labor specifically tasked with investigating alleged claims of misclassification of employees. As introduced, the bill simply eliminates the enforcement provisions included in K.S.A. 79-3234 and is significantly different from the original version. He went on to say The Kansas Chamber opposes the new division as they did when it was created in 2006 as numerous laws are in place for companies who intentionally fail to withhold or pay taxes for employees which he has listed on page 2 of his testimony.

He stated they questioned the perceived nature of the problem versus reality, but during testimony we heard the impact of how many millions of dollars the state is missing out on because of misclassification of employees. He mentioned a report submitted from UMKC back in 2006 that said that Kansas was missing out on \$40M a year in unpaid taxes. The reality is, since this division was created in 2006, between 2006-2008 the department collected \$548K in unpaid taxes, not quite the \$40M. Also, this \$548K does not break out those who intentionally misclassify or unintentionally misclassify.

The final change made by the House they would like to address provides the state the ability to go after businesses who knowingly violate laws by misclassifying employees and close their doors only to reopen under a new business in an effort to avoid penalties of misclassifying employees. A copy of his testimony is (Attachment 2) attached and incorporated into the Minutes as referenced.

The Chair recognized the final proponent, Mr. Luke Bell, Vice President of Government Affairs, Kansas Association of Realtors who stated **HB2135** would impose new protections on the exchange of confidential taxpayer information between the Kansas Department of Labor and the Kansas Department of Revenue and would provide greater protections for the ability of individuals to act as independent contractors. They believe the state should protect the confidentiality of taxpayer information and should not attempt to discourage individuals from acting as independent contractors in the marketplace. A copy of his testimony is (Attachment 3) attached and incorporated into the Minutes as referenced.

Written opponent testimonies have been offered from Mr. Bruce Tunnell, Executive Vice President, AFL-CIO and Mr. Joe Hudson, Business Agent/Organizer Carpenters' District Council of St. Louis and Vicinity and also representing members in Kansas and Missouri. Copies of their testimonies are (Attachment 4) attached and incorporated into the Minutes as referenced.

The Chair recognized Mr. Andy Sanchez, Executive Secretary Treasurer, Kansas AFL-CIO and asked if he would like to comment to the Committee on behalf of Mr. Tunnell's written testimony? He said, the AFL-CIO opposes the bill and as the Committee listens to the testimony you hear "make it less strict," he feels it weakens the law so they are going backwards here and as far as trying to get in line with the Federal government, he would like for us to be out in front to find these people that are actually skirting the law. Lastly, he does stand by Mr. Tunnell's written testimony.

The Chair thanked the conferees and asked Mr. Hansen, how many states take care of this in the DOL instead of their DOR? (Does not know for sure, but imagines it is a bifurcated situation like what Kansas had previously, where each was going their own way. When we drafted this particular language, Revenue actually requested the DOL release the finding and renders that to the DOR.) Do you know if DOL was doing it before 2007, or was it totally DOR? (He does not know.) The Chair said we need to answer that question.

The Chair believes The Kansas Chamber testified they actually saved \$540K last year, however, in Mr. Sanchez's testimony he stated DOL discovered more than \$10.8M in previously unreported wages and could be as much as \$40M, so she said we need to figure out exactly what is going on. Mr. Hansen stated, at the end of November, 2010, according to their statistics, there were 293 employers affecting 1,826 workers the DOL discovered during their investigation, which resulted in \$195K in UI tax. The Chair

CONTINUATION SHEET

The minutes of the Senate Commerce Committee at 8:30 a.m. on March 10, 2011, in Room 548-S of the Capitol.

asked, does Revenue work on the income tax side? (On the Revenue side, including the 293 and their 226, they have a total of 566 employers they found evaded withholding tax and \$10M of the wages they turned up, was subject to employee tax.) If you are talking about a "one-stop-shop" with this new bill, why wouldn't this be in Revenue? (DOR requested bill and part of it was for consistency sake.) The Chair stated she understood but the 1099's, the W2's and corporate taxes are all going to Revenue and the only thing going to the DOL is unemployment. (The DOL is doing some leg work for the DOR but at the same time, there should only be one answer and feels this best placed in the DOL because they have dealt with so many variances of employment issues and more familiar with ins and outs of the work place.) The Chair said, the DOL does not have the federal records, however, her big question is, did this bill first pass in 2006, is when the DOL was put in charge?

The Chair asked for questions or comments from the Committee which came from:

1.) Senator Olsen asked Mr. Hansen if he or Research could provide the other 12 of the 20 federal steps since he had already given the Committee 8 and also provide the old rules as well? (Yes.)

2.) In the beginning of Mr. Hansen's testimony he said the intent of the bill was, be on the same page as the federal government level requirement, but her understanding, the current law is working well. Could he comment on this?

3.) To Mr. Bell and Mr. Stafford, Senator Longbine said he was still not comfortable regarding the scenario he had asked Mr. Wilke, whether this bill could be interpreted to make realtors and insurance agents employees, as they are traditionally contracted employees? (Referring to Subsection (i)(4)(Q) which pertains to qualified real estate agents.)

Chairperson Wagle asked Mr. Reed Holwegner, Office of the Revisor of Statutes, if he could provide the answer by email to all Committee members on when did we start putting this mechanism into the DOL? She asked, last year did the DOL recoup \$195K in unemployment taxes because they had the bill? (Yes.) Senator Lynn asked if this bill passed, they would no longer need FTE's to perform the functions? (No.)

Adjournment

As there were no further questions or discussions, the meeting was adjourned. The time was 9:30 a.m.

The next meeting is scheduled for March 15, 2011.



**Testimony of Karl Hansen
Chief Counsel**

**Sub. HB 2135
Senate Committee on Commerce**

March 9, 2011

Madam Chairman, members of the Committee, I come before you on behalf of the Department of Labor in reference to Sub. HB 2135 regarding provisions related to the misclassification of workers.

The primary purpose of the bill is to bring greater uniformity for the examination of worker classification between federal and state standards. The federal analysis being the benchmark as the more generally accepted standard practice. The bill also seeks to draw equity in the application of classification standards, recognizing the difficulty of compliance in this area and adding greater opportunities for education in conjunction with enforcement. Finally, the bill streamlines the process and eliminates layers of bureaucracy with which employers may have to deal by creating a "one touch" examination process by which only one state agency shall seek to investigate the employer for the same matter, yet provide for the proper assessment and collection of all taxes, interest and penalties due any affected state agency.

The bill employs a summary of the Internal Revenue Service (IRS) audit guideline twenty factor test, and also employs limited safe harbors for employers similar in nature to those codified in federal tax law. These methods recognize that proper classification is not a "one size fits all" exercise, unlike current Kansas law. In fact, there have been occurrences of employers receiving dueling determinations from the IRS and from Kansas authorities. By allowing flexibility and shifting some of the burden to the state to make a more comprehensive inquiry of the facts in its determination, the proper classification of workers can be achieved viewing each industry and occupation on its own merits.

While more flexible than current state law, the bill actually provides for stronger and more accurate enforcement. The bill clarifies with specificity cooperation between the Department of Labor and the Department of Revenue. Despite previous efforts in this regard, there remained a "silo" mentality between the bureaucracies with each pointing to one loophole or another in statute to hide behind. This bill shatters the bureaucratic walls and fosters a direct line of cooperation. The result is better information sharing and a lessened burden on employers who may be subject to investigation, not by lessening the employer's compliance obligations, but rather

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Attachment 1*

creating a "one stop" audit investigation for all agencies involved. If Revenue should be the first agency with whom the employer has contact in this regard, then Revenue shall be the point of contact throughout and disseminate information to KDOL accordingly, and *visa versa*. This way, the employer has one point of contact and has only to produce the same information one time, rather than dealing with multiple agencies over the same issue.

Finally, the bill enhances the penalty scheme for repeat offenders. Previously, while measures were in place to escalate penalties for those entities that continued to improperly classify workers, there lacked an enforcement tool to deal with those principles who would set up multiple entities over time and engage in misclassification. For example, Bad Guy sets up company A, gets caught, pays a penalty, and at some point thereafter shuts down. Bad Guy then sets up company B and does it again. Under our current scheme these each would be first time offenses, even though the same decision maker was purposefully at fault. Under 2135, the violation at company B would be counted as a second offense with an escalated penalty.

The modern workplace is far different than the decades old landscape when the current laws were conceived. The difficulty when examining a business-worker relationship is that no one job is necessarily the same, as no one industry is necessarily the same. Add to the mix the modern practices of outsourcing, the use of on-site temporary services, and workers performing duties from home, the equation gets ever more complex.

This legislation brings forth principles more reflective of the modern workplace. And, by shattering the bureaucratic paranoia between enforcement agencies, the legislation brings forth economies of scale that not only make government more efficient, but makes Kansas a better place for our employers to do business.

Additionally, Madam Chairman it has come to our attention that for federal UI conformity reasons, a clarifying amendment is required prior to passage of this bill. We have submitted the appropriate language to the revisor for the committee's consideration.

Thank you.

**Testimony before Senate Commerce Committee
HB 2135 – Misclassification
Presented by Eric Stafford, Senior Director of Government Affairs**



Thursday, March 10, 2011

Madam Chair and members of the Committee:

We appreciate the opportunity to provide testimony in support of House Bill 2135 which amends the statutory provision of the division under Department of Labor specifically tasked with investigating alleged claims of misclassification of employees. HB 2135 as introduced simply eliminated the enforcement provisions included in 79-3234. The bill as it stands today is significantly different than the original version.

In 2006, the Kansas legislature passed HB 2772 which created this new division in the department of labor. The Chamber opposed this legislation with concerns over the perceived problem of misclassification versus the reality of the problem in our state.

The Kansas Chamber also voiced concerns about the need to create a division to investigate claims of misclassification as numerous laws are in place for companies who intentionally fail to withhold or pay taxes for employees (see page 2). Now, as then, we believe that intentionally fraudulent classification of an employee should be penalized. However, current law allows anonymous claims to be filed whether or not there is merit to the claim, automatically opening an investigation into the company's business practices. Proponents of the 2006 legislation assured committee members that meritless investigations would not occur. The Chamber supports efforts by the state to investigate legitimate claims of misclassification if reasonable suspicion exists.

Changes made by the House satisfies these concerns and establishes more clear guidelines to help make the determination as to whether a company is intentionally misclassifying employees as independent contractors. Essentially, companies will no longer be guilty until proven innocent as they are under today's law.

The House also made changes to specify what information can be shared between the department of revenue and department of labor, ensuring information relating to one's business remains confidential. The final change made by the House we would like to address provides the state the ability to go after businesses who knowingly violate laws by misclassifying employees and close their doors only to reopen under a new business in an effort to avoid penalties of misclassifying employees. This fix is an attempt to address the fly by night companies who blatantly violate the law and repeatedly "shut down" only to open up under a new business name.

I would like to thank the committee for the opportunity to speak in support of House Bill 2135 and I would be happy to answer any questions.

The Kansas Chamber, with headquarters in Topeka, is the leading statewide pro-business advocacy group moving Kansas towards becoming the best state in America to do business. The Chamber represents small, medium and large employers all across Kansas.



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Attachment 2*

Summary of Existing Penalties for Failure to Pay or Withhold Taxes (Department of Revenue)

- The statute establishing penalties for failure to pay income taxes is 79-3228. In this statute, if one without intent to evade, fails to file a return but voluntarily files a correct return or pay tax due within 6 months, there is a 10% fine of the unpaid balance plus interest.
- If one fails to file a return within 6 months, in addition to the unpaid amount, there is a 25% penalty, plus interest added.
- If any taxpayer who has failed to file a return or has filed an incorrect return, and after notice from the director refuses or neglects within 20 days to file a proper return, the face a penalty of 50% of the unpaid balance plus interest.
- Any person who with fraudulent intent fails to pay any tax shall be assessed a penalty equal to the amount of the unpaid balance plus interest. Such person shall also be guilty of a misdemeanor and if convicted, faces a maximum fine of \$1,000 or imprisonment not less than 30 days and no more than one year.
- Any person who willfully signs a fraudulent return shall be guilty of a felony and upon conviction face imprisonment for no more than 5 years.
- A similar statute is in place for withholding tax with the same penalties found in 79-3228.

Department of Labor Provisions

- Penalties currently in place for the Department of Labor to enforce are found in 44-717 and 44-719.
 - 44-717 covers collection of employer payments, penalties and interest for past due payments. The penalty for each month or fraction of a month for the calendar quarter which they failed to pay is equal to .05% of the total wages paid by the employer during the quarter, except no penalty shall be less than \$25 or more than \$200.
 - Statute 44-719 establishes a penalty equal to 100% of the unpaid taxes if the employer willfully fails to pay contributions.



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To: Senate Commerce Committee

Date: March 10, 2011

Subject: **HB 2135** -- Protecting the Confidentiality of Taxpayer Information and the Ability of Professionals to Work as Independent Contractors

Chairperson Wagle and members of the Senate Commerce Committee, thank you for the opportunity to provide testimony on behalf of the Kansas Association of REALTORS® in support of **HB 2135**. Through the comments expressed herein, it is our hope to provide additional legal and public policy context to the discussion on this issue.

KAR is the state's largest professional trade association, representing nearly 8,000 members involved in both residential and commercial real estate and advocating on behalf of the state's 700,000 home owners. REALTORS® serve an important role in the state's economy and are dedicated to working with our elected officials to create better communities by supporting economic development, a high quality of life, and providing affordable housing opportunities, while protecting the rights of private property owners.

Among other things, **HB 2135** would impose new protections on the exchange of confidential taxpayer information between the Kansas Department of Revenue and the Kansas Department of Labor and would provide greater protections for the ability of individuals to act as independent contractors. In summary, we wholeheartedly believe that the state should protect the confidentiality of taxpayer information and should not attempt to discourage individuals from acting as independent contractors in the marketplace.

Unfortunately, it is very common during the legislative process to witness discussions where negative dispersions are cast on independent contractor relationships and unproven allegations are made that employers encourage the formation of improper independent contractor relationships. In many cases, these comments allege that employers force employees to become independent contractors in order to avoid the payment of various fees and taxes.

In the real estate industry, it is extremely common (if not customary) for real estate salespersons to be associated with supervising real estate brokers as independent contractors. As independent contractors, real estate salespersons enjoy a greater degree of flexibility, freedom and control over their individual businesses than employees in a traditional employer-employee setting.

REALTORS® absolutely believe that the state should enact no statutes or regulations that would discourage individuals from choosing to become independent contractors to take advantage of these benefits. By supporting this legislation, we believe that the Kansas Legislature will ensure that the state protects confidential taxpayer information and that no attempt is made to discourage individuals from acting as independent contractors in the marketplace.

For all the foregoing reasons, we would urge the Senate Commerce Committee to strongly support the provisions of **HB 2135**. I would be happy to stand for questions at the appropriate time.

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Attachment 3*

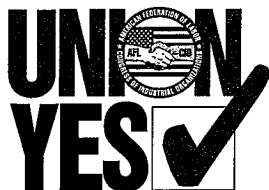
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Testimony IN OPPOSITION TO HB 2135 MARCH 10, 2011

By **Bruce Tunnell, Executive Vice President, Kansas AFL-CIO**

Chairperson and committee members, thank you for reading my testimony. I am asking you to please reject HB 2135 which makes violating the law attractive and easier.

The current law which HB 2135 is attempting to "gut" was a compromise attempt to level the competitive field for all employers. The vast majority of all Kansas employers are honest tax paying individuals and groups. But, there are those who employ illegal workers and workers they misclassify as contract labor all in an attempt to circumvent paying the proper taxes on these individuals. Each day thousands of illegal workers enter the United States and some are employed in Kansas under very questionable circumstances.

The current law allows the Department of Labor and the Department of Revenue to work together to determine if an employer is violating current law. Why in this time of great State financial challenges would you as lawmakers want to make it easier for a small group of employers to not pay their fair share of taxes? Would it be to give that small group a competitive edge over all the law abiding employers or would it be to allow illegal workers to replace tax-paying Kansas workers; thus, allowing a few scrupulous employers to make more money by not paying State taxes, social security taxes, unemployment taxes and workers compensation taxes.

Calendar year 2008 the KDOL investigated misclassification of workers issues involving 263 employers affecting 2193 workers. Through these investigations, the agency discovered more than \$10.8 million in previously unreported wages and could be as much as \$40 million in payroll taxes. These investigations resulted in determinations of over \$204,000 in UI tax debt. In 2010 the KDOL found over 1800 employees misclassified which resulted in finding more than \$5.4 million in unreported wages. As a result, close to \$1 million was collected in owed taxes.

Under this bill employers will again have little incentive to properly report wages or withhold taxes from employees. This will harm law-abiding business, workers, and the State.


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Please ask yourselves, do I want to help employ illegal workers? Do I want to advantage the employers who break the laws of this State? Do I, in this time of need for State resources, want to create more ways for the few to not meet their responsibilities?

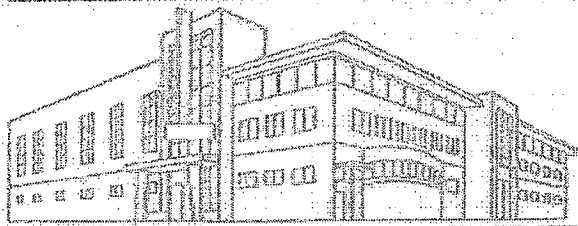
Please Reject HB 2135

Thank you,

A handwritten signature in cursive script, appearing to read "Bawa Tinnell".

Affiliated with The United
Brotherhood of Carpenters
and Joiners of America

Carpenters' District Council of Greater Saint Louis and Vicinity



Carpenters' Building

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Carpenters' Testimony on Sub. HB 2135 An Act relating to misclassification of employees

Chairwoman Wagle and members of the Committee,

Thank you for the opportunity to submit this testimony on behalf of the Carpenters' District Council of St. Louis and Vicinity representing members in Kansas and Missouri. The bill before you today is a step backward in dealing with the problem of employee misclassification in the State of Kansas. When House Bill 2135 was originally released, it gutted key elements of the 2006 misclassification law by eliminating tax penalties for employers who knowingly and intentionally misclassify workers and by barring the Secretary of Revenue from providing taxpayer information to the Department of Labor so KDOL could investigate whether the employers are in compliance with State reporting requirements.

We were initially pleased when the bill was modified and replaced with this substitute bill. The provision allowing for the disclosure of taxpayer information to KDOL was reinstated. The tax penalties were also reinstated, and new criminal penalties were included for second- and third-time offenders.

But in taking a closer look at the new version, it is clear the bill creates new loopholes that will render the investigative and penalty provisions virtually meaningless.

Under the new version, the Department of Labor has sole authority and responsibility for determining whether an employer has classified its workers correctly. The Department of Revenue must accept KDOL's determination and is barred from conducting its own investigation. We believe that both the Department of Labor and the Department of

Revenue should have the authority to conduct their own, independent investigations. Each agency is uniquely suited to uncover incidents of misclassification. And if the goal here is to truly root out situations where workers have been wrongly classified, narrowing the scope of the State's investigative powers would run afoul of that goal.

Even more troubling about the new version of this bill is that it narrows the scope of its application, allowing many employers to simply avoid enforcement altogether. New Section 2 of the bill says that if an employer establishes a "reasonable basis" for making a classification, then the classification will be considered valid. The bill makes it very easy for an employer to establish such a "reasonable basis." For example, if an employer has been audited by the IRS, Department of Revenue, or Department of Labor, and no misclassification expressly noted by auditor, then the way the employer has been classifying employees has a "reasonable basis"—regardless of whether employee classification was a focus of the audit. In addition, if an employer relies on how workers are customarily classified by a significant segment of its industry, that is also considered a "reasonable basis." This is a license to cheat for contractors in industries like residential construction, where misclassification of workers runs rampant! This bill essentially says to employers: "Hey, if your competitors are misclassifying their workers, then it's okay for you to do the same." In fact, the more employers there are who misclassify, the more justification other employers have to do the same. If employers get wise to this loophole, this bill could eventually bankrupt the state!

And if the employer doesn't escape scrutiny under those tests, the bill says the Department of Labor has to consider eight separate factors in determining whether the employer had a reasonable basis for making the classification. We're pleased the penalties have been beefed up in this new version, but when the law seems designed to justify the way businesses are currently classifying their employees, those penalties mean nothing. During this time when all states are trying to take steps to ensure economic recovery, we need to do what we can to keep Kansas business-friendly. Dealing with the problem of worker misclassification is one means of ensuring a fair playing field and making Kansas a place where workers are protected.

Worker misclassification occurs when workers who should properly be classified as employees are instead classified as independent contractors. Misclassification wrongfully deprives the State of Kansas of payroll and withholding taxes that are required to be paid by employers on their employees—tax revenue the State can ill-afford to forego as it struggles to fund its budget. The deliberate misclassification of employees to avoid payment of taxes unfairly disadvantages the overwhelming majority of Kansas employers who obey the laws and pay their taxes.

The Department of Labor found more than 1800 workers were misclassified in Kansas in 2010, alone and some \$10 million in wages was subject to withholding taxes. And this isn't a new problem. In 1983, the General Accounting Office estimated the Federal Government lost \$1.6 billion in tax revenue due to employee misclassification.

So why do businesses misclassify workers? The harsh reality is that *businesses have an economic incentive to misclassify*. Think about it. Businesses that misclassify employees as independent contractors have significantly lower overhead than law-abiding businesses. If a business employs independent contractors, that business does not have to pay unemployment insurance contributions, workers compensation premiums, or social security tax on those independent contractors. These "add-on" costs make hiring an employee 26-30% more expensive than hiring an independent contractor. Those businesses also don't have to offer independent contractors any sort of health insurance benefits.

Worker misclassification is not a victimless crime. A myriad of harms stem from misclassification. These harms include harm to law-abiding businesses, harm to the misclassified workers, and harm to the State.

Solid, law-abiding businesses which properly classify employees and offer health benefits to those employees are at a competitive disadvantage when competing directly against companies which wrongfully classify their employees as independent contractors. The problem is particularly noticeable and rampant in industries like the construction industry, where companies bid for jobs. There can never be a fair and competitive bid process when companies that misclassify can bid for work without having to account for normal payroll costs. The misclassifying company will always have the lower bid and will be able to take work away from the law-abiding company. The result is that the "good" companies receive fewer jobs, employ fewer workers, and may eventually be driven out of business.

Not only does misclassification harm law-abiding businesses, it also harms the misclassified workers themselves. When employees are not properly classified, costs that should be borne by the employer (such as unemployment insurance, social security tax, and workers compensation insurance) are illegally shifted to the individual worker. If the individual worker pays out of pocket for these costs, the worker has less money available for basic living expenses. As a result, many workers do not make contributions to the unemployment, social security or workers compensation systems and are left with little to no safety net in the event of layoff or on the job injury.

Employees misclassified as independent contractors additionally lack the benefit of company-provided benefits such as health insurance and a retirement plan or 401(k). Many are either unable to qualify for individual health insurance or unable to afford the premium

for individual health insurance. With no health insurance, and no retirement savings, these workers are stuck in a grim situation from which there is no escape. They work every day praying to avoid injury and cannot see a time when retirement could be possible. If one of these workers is injured on the job and disabled, the cost for supporting that worker and his family falls back on the state public assistance programs.

This is but one impact of worker misclassification borne by the State. State finances regularly fall victim to employee misclassification. The University of Missouri-Kansas City conducted a study on the economic costs of misclassification in the state of Illinois. The study found that *during every year from 2001 through 2004, the state lost \$39.2 million in unemployment taxes due to worker misclassification. During 2005, this number grew to \$53.7 million. The state only managed to recover approximately 2% of the unpaid amount.* Of the unpaid unemployment insurance amounts in 2005, \$2.5 million was the result of misclassification in the construction sector.

States also collect less income tax from independent contractors. According to the IRS, *workers classified as independent contractors report only 68% of their income (as opposed to employees, who report 99% of income).* As such, *when a worker is misclassified, the state collects taxes on 31% less income than the worker actually earns.*

Worker misclassification takes a heavy toll on law abiding companies, misclassified workers, and the State of Kansas. The enactment of the misclassification law in 2006 was a positive step toward dealing with this problem. This new bill would appear to impose tougher enforcement on offenders, but it actually narrows the scope of application, giving employers a laundry list of ways to justify how they are doing business. Keep the penalties and close the loopholes. Kansas can't afford to lose the revenue or its status as a leader in business and economic development.

Respectfully,

A handwritten signature in black ink, appearing to read "Joe Hudson", with a stylized flourish at the end.

Joe Hudson

Business Agent / Organizer

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