



IRS, States Crack Down on Independent Worker Abuse

Companies slash payrolls by calling workers independent contractors; costly to IRS and states

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NASHUA, N.H.

The Internal Revenue Service and 37 states are cracking down on companies that try to trim payroll costs by illegally classifying workers as independent contractors, rather than as full employees, The Associated Press has learned. The practice costs governments billions in lost revenue and can leave workers high and dry when they are hurt at work or are left jobless.

Many who have studied the problem believe it's worsened during the economic downturn, fueling even more aggressive recovery efforts by states.

"I think the economic downturn has had a serious impact ... has exacerbated the problem," said Vermont Rep. Warren Kitzmiller, who chaired a panel that recently reported on the issue. "Businesses are looking to trim costs in every way they can, and some are coming very close to shading the legal with the illegal on that question."

For a growing number of companies, including Target, FedEx Ground and Comcast, cutting costs means removing workers from the payroll or bringing on new workers — sometimes through intermediary companies — without making them full employees.

The Society for Human Resource Management, representing company personnel departments nationwide, said it surveyed members in October 2008 and found 12 percent of them were moving to use more independent contractors, contingent and temporary workers because of the recession.

By designating workers as "independent contractors," businesses can save as much as 30 percent of payroll — avoiding unemployment insurance and workers' compensation payments, as well as the employer's share of payroll withholding.

The practice also deprives states of sorely needed income as rising jobless rates strain their budgets. The nation's unemployment rate in January was 9.7 percent.

Typically, unless workers fight for and win a ruling that they should have been treated as full employees, they aren't able to collect workers' compensation for the injury or unemployment benefits when left jobless.

The federal Government Accountability Office estimated that employee misclassification resulted in the underpayment of an estimated \$2.72 billion in Social Security taxes, unemployment insurance taxes and income taxes in 2006, the last year for which figures are available.

The IRS said it would begin a three-year study of the issue this month. State crackdowns include:

— New York: A multi-agency team reported finding nearly 31,500 cases of employee misclassification and nearly \$390 million in unreported wages from Sept. 2007 and the end of 2009. It had ordered employers to pay more than \$28 million in past-due wages, taxes and penalties.

New York's numbers were up significantly. Its team found 12,300 misclassification cases in the 16 months ending in December 2008; by a year later it had found about 19,200 more.

— California: Orange County prosecutors said last year they would seek \$38 million from a couple for workers' compensation fraud for failing to pay premiums and submitting claims for 42 injured but uninsured workers at their construction companies.

— Florida: A 2008 statewide grand jury found some construction contractors conspired with check-cashing stores to fake payments to a bogus subcontractor, cash the checks themselves and pay workers cash, under the table.

— Ohio: The state's Bureau of Workers' Compensation ruled last year that a former state attorney general's top aide improperly classified all four employees at his Youngstown construction firm; on appeal only two were found misclassified. The state won't say how much he owes in restitution.

Matthew Capece, an officer with the United Brotherhood of Carpenters and Joiners of America, called the states' efforts encouraging.

"We're beginning to see the state and federal government fighting back and taking more interest," Capece said. But, "There's a lot of road left to travel to fix this."

Companies say using independent contractors helps them keep costs down and stay flexible in an increasingly tough and competitive economy.

"Some companies desire to focus on core business functions," said Kevin Hishta, an Atlanta-based lawyer who represents employers in labor relations matters. "They may feel they do not have the expertise to handle a particular function or that it would be more efficiently handled by others." He offered as an example "a carpet manufacturer who decides 'I really don't need to be in the installation business.'"

Experts say independent contractor abuse extends through a broad swath of industries: low-skilled makers of shipping pallets in California, home health providers — even dancers in some Massachusetts strip clubs. Several states said the practice is most prevalent in construction.

Some brand-name companies have been sued for alleged employee misclassification. FedEx Ground, a subsidiary of Memphis-based FedEx Corp., has been sued more than 45 times for classifying package delivery drivers as independent contractors. The company maintains its drivers are small-business owners, who can own multiple routes and expand their business as they wish. Court rulings have been split.

FedEx rival UPS is close to settling a California worker misclassification case, said a lawyer in the case.

Both cable television giant Comcast and Target have been sued for allegedly hiring intermediary companies that deny benefits to workers. Plaintiffs included janitors who worked in Target stores in Texas and cable TV installers in Massachusetts. Both Target and Comcast maintain the workers suing were never employees of theirs.

U.S. Labor Secretary Hilda Solis said some workers don't always know of their independent classification and perform hazardous work without any health and safety laws protecting them. They often discover their misclassification much later, she said.

New Hampshire construction worker Celso Mena, 59, a Panama native who became a U.S. citizen last year, fell from scaffolding at a school construction project in 2007 and shattered his ankle. From the hospital, he called the company that had hired him.

"They told me they weren't responsible for anything because I was their contract worker," Mena said through an interpreter at his home in Nashua.

In a state Labor Department hearing, the company argued that Mena voluntarily signed papers saying he would work as an independent contractor. Mena, whose English is poor, said he did not understand what he was signing and that it was not translated for him. The company, GMPB-Kal-Vin, and its attorney, Paul Kfoury Jr., did not return telephone calls seeking comment.

Mena eventually got nearly \$50,000 in a state-ordered settlement, but most of that went to medical bills, and he's been unable to work since the accident.

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