



2010 Annual Meeting Richmond, VA

Russell Hollrah

**Coalition to Preserve Independent Contractor Status
Hollrah Leyden LLC
Washington, D.C.**

Overview

- **Time to Re-Calibrate Enforcement Intensity**
- **Congress Continues to Ramp Up Intensity**
- **Market Has Reacted**
- **Context**
- **Coalition Supports Compliance**

Time to Re-Calibrate the Enforcement Intensity on Worker Classification

- Independent contractors and their clients are experiencing an unprecedented coordinated enforcement effort by the federal and state government agencies.
- U.S Department of Labor stepped up its auditing of companies
- The Internal Revenue Service:
 - 6,000 National Research Program employment-tax audits
 - Regular employment-tax audits
 - Responding to an overwhelming increase in Forms SS-8
 - due in part to the new Form 8919.

The Congress continues to intensify the attack at the federal level

- *Employee Misclassification Prevention Act, S. 3254 and H.R. 5107*
 - Proposes changes to the Fair Labor Standards Act that would increase the regulatory risks of doing business with independent contractors to an excessively high level.

The Congress continues to intensify the attack at the federal level

- The FLSA already is punitive
 - A company that fails to pay minimum wage or overtime can be liable for actual damages plus liquidated damages plus attorneys' fees.
 - The *Employee Misclassification Prevention Act* would make those sanctions even more onerous when worker misclassification is involved, by
 - Increasing the double damages to treble damages and
 - Adding to that a penalty of up to \$1,100 or \$5,000 per misclassified worker.

The Congress continues to intensify the attack at the federal level

- The *Employee Misclassification Prevention Act* would elevate the offense of worker misclassification to a higher magnitude than the *criminal* predicate acts that form the basis for civil penalties under the Racketeer Influenced and Corrupt Organizations Act ("RICO")
 - Imposes only treble damages plus attorneys' fees.
 - Congress intended RICO's civil remedies to help eradicate organized crime...

The Congress continues to intensify the attack at the federal level

- The *Employee Misclassification Prevention Act* also would require a company to maintain a record of an “accurate classification of the status” of each IC with whom it does business, and to provide a specified notice to each such IC
 - For each IC for whom the foregoing requirements are not satisfied, the individual is presumed an employee
 - The presumption can be rebutted only by “clear and convincing” evidence of the individual’s IC status
 - A trap for the unwary....

The Congress continues to intensify the attack at the federal level

- The *Taxpayer Responsibility, Accountability and Consistency Act of 2009*, S. 2882 and H.R. 3408
- Would repeal the federal safe-harbor provision enacted as Section 530 of the Revenue Act of 1978
 - Section 530 provides essential federal employment-tax certainty to companies that do business with large numbers of independent contractors
 - Section 530 is no “loophole”

The Congress continues to intensify the attack at the federal level

- Businesses need the *prospective* certainty that Section 530 provides:
 - to know that the business model is viable
 - to justify capital investments that require several years to become profitable
 - to justify leasing office space for multiple years
 - to obtain essential outside capital to fund their operations
 - to ultimately sell the business at a fair price

The Congress continues to intensify the attack at the federal level

- Ironically, the *Taxpayer Responsibility, Accountability and Consistency Act of 2009* would repeal a safe harbor that only covers companies that comply with Form 1099 reporting requirements
 - IRS's own data show a 97% tax compliance rate for recipients of Forms 1099
- The bill completely misses the independent contractors who operate in the cash economy and for whom IRS data show a lower tax compliance rate
- In an effort ostensibly aimed at addressing the tax gap, the bill targets the currently compliant and completely misses the noncompliant

States also have stepped up the intensity

- Federal agencies have coordinated their enforcement efforts with state agencies through their joint **Questionable Employment Tax Practices** (“QETP”) program
- States have independently intensified their crackdown on independent contractors by enacting new laws that impose draconian penalties on companies found to have misclassified workers as independent contractors.
 - Nebraska recently joined other states, such as Maryland, to impose a fine of **up to \$5,000 per misclassified worker**
- Not surprisingly, the market has reacted to these enforcement efforts...

The market has reacted

- Entrepreneurial start-up activity plummeted in the first half of 2010
- Falling to the lowest rate in more than two decades

(survey released on July 19, 2010, by global outplacement and executive coaching firm Challenger, Gray & Christmas, Inc.)

The market has reacted

According to a press release announcing the results...

- An average of **3.7%** of “job seekers” opted to start their own business in the first half of 2010
 - **3.4%** in the first quarter and **3.9%** in the second quarter
 - down from **7.6%** percent -- first half of 2009
 - down from **9.6%** -- average for last two quarters of 2009
 - **lowest two-quarter average** recorded, since tracking began in 1986
- To provide a context: the **highest two-quarter average**: the first half of 1989, when **21.5%** of job seekers started businesses

The market has reacted

Bureau of Labor Statistics data paint a similar picture

- Seasonally adjusted the number of self-employed have fallen to **8.89 million** as of June 2010
- Down from **8.95 million** in May 2010
- Down from a peak of **9.77 million** in June 2007
- Slight uptick in self-employment in the second half of 2009, peaking at **9.14 million in December**, but the numbers have since followed a relatively consistent downward trend

The market has reacted

- Massachusetts –
- Experiencing IC flight
 - Widely reported story of the freelance writer who moved from Massachusetts to New Hampshire to keep her business alive
- Companies refusing to do business with Massachusetts-based ICs

The market has reacted

Clients of independent contractors have begun to react

- Recent article by former Labor Secretary Robert Reich commented on the proliferation of **third-party firms** that function as “employer of record” for ICs
 - Keep a portion of IC’s fees
 - Leads to increased costs to clients and decreased fees to ICs
 - These firms add no value other than reduce regulatory risk

The market has reacted – what ICs have to say about 3rd party firms

- Many years ago, I worked as an independent contractor in the software industry and had to deal with Section 1706. At the time, my issue with 1706 had nothing to do with taxes being withheld from my pay. Rather, **I disliked 1706 because it forced me to go through an agency (i.e., "middle man") in order to be able to work for my client.**

In many cases, your pay as an independent contractor is substantially reduced because the agency is motivated to make its "cut" as high as possible. As far as I know, the agency carries out payroll processing and provides liability insurance and that's about it. In some instances, the agency may find work for its employees, but that was never the case for me. I found work through my own contacts and then had to contact an agency because of the 1706 requirements.

The market has reacted

- I've worked as a **contract software developer** since 1992. Most of the time, I have to work via staffing agencies, since the majority of companies don't want to even try to navigate the vague federal laws regarding independent contractor status.
- ...Personally, I work as a contractor so *I* can be in control of my work life and not some company for whom I happen to work. I don't need another "nanny" organization to take care of me. I get paid quite well for what I do and pay the appropriate taxes, so I'm in no way exploiting or being exploited by being a freelancer. Laws like this simply deny freelancers the ability to work the way they choose.

The market has reacted

Unintended consequence of forced employee status –

- Loss of intellectual property rights of creative ICs – when forced into employment arrangements
- “Most of us are independent contractors and we want to be because once you’re classified as an employee you don’t own any rights to your intellectual property,” she says, “whether you’re a visual artist, a dancer, an engineer, videogamer”

The market has reacted

- I've been an independent software developer for more than a decade. The first time I heard of this [Massachusetts] law was in wrapping up negotiations with a new potential client (which happens to be the largest company working in the particular software niche I specialize in.) We were all set to finish the deal when one of their lawyers notices, “oh, wait, you live in Massachusetts? Sorry, we can't work with you.” And that was the end of that.

The market has reacted

- The government is very close to – if it has not already passed – the *tipping point* on worker classification
- Unless it relents, it could do substantial damage to the entrepreneurial sector of our economy
- Could take many years to repair, assuming the damage could be repaired

The market has reacted

- It is somewhat ironic that one industry that seems always to be targeted is construction.
- A book *Power of Productivity*, written by Bill Lewis based on his research while at McKinsey Global compares the efficiency of different industries on a country by country basis.
- At a speech, Mr. Lewis discussed construction, noting that it is an industry in which the U.S. is far away the most efficient in the world.
- The reason cited is the high degree of subcontracting that occurs in U.S construction, which is much higher than in the rest of the world.
- It would be a sad outcome if the government's crackdown on worker classification in the construction industry resulted in the U.S. construction industry becoming less efficient and less competitive

Context

Worker Misclassification Swept Up by Other Issues

- Environment
 - *E.g.*, California Ports
- Immigration
 - *E.g.*, cash payments “under the table”
- Tax Compliance
 - *E.g.*, Form 1099 recipients / one-sided revenue estimates
- Organized labor
 - *E.g.*, NLRA coverage / competition
- level playing field...

Support Compliance

- We support federal and state efforts to remedy misclassification
- Urge that government agencies begin to temper the intensity of their enforcement efforts
- Target the truly bad actors while easing up on the companies that admittedly might be in the gray area but when the facts are examined with objectivity, they weigh heavily toward legitimate independent-contractor relationships

Abraham Lincoln

“The man who labored for another last year, this year labors for himself, and next year he will hire others to labor for him.”

Questions?



Russell Hollrah
**Coalition to Preserve
Independent Contractor Status**
Hollrah Leyden LLC
1850 K Street, N.W.
Washington, D.C.
(202) 659-0878
rhollrah@hollrahllc.com
rhollrah@iccoalition.org