

Testimony of:

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before the

Pennsylvania General Assembly
Committee on Labor Relations
Robert E. Belfanti, Jr., Chair

Re: HB 2400 Employee Misclassification Prevention Act

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Ridley High School

The failure of construction industry employers to properly classify workers as employees is a priority concern of the United Brotherhood of Carpenters. I am therefore pleased to submit this testimony on the issue and offer our support of HB 2400 Employee Misclassification Prevention Act. My comments will focus on how the practice has been affecting the construction industry and how other states have begun to address it.

The problem of employees being misclassification as 1099 subcontractors or the off-the-books payment of construction workers is not isolated to the Commonwealth of Pennsylvania. It is a problem we are seeing throughout the United States. We polled our affiliate councils and 88 percent of them said misclassification fraud is a serious problem. In a competitive industry like ours, it is not difficult to see why it has become alarming. Construction employers who violate the law gain an unfair bidding advantage over their law abiding competition by unlawfully evading employment taxes, overtime pay and workers compensation premiums. That creates an uneven playing field where honest employers have difficulty competing for jobs. Also, it is not isolated to small remodeling projects. We see misclassification fraud in many types of construction-large and small, commercial and residential, public and private.

Along the way, those contractors, depending upon the schemes they use, can violate a variety of federal and state labor, tax and other laws including: workers' compensation premium fraud, insurance fraud, mail fraud, conspiracy, racketeering and money laundering.

There are some that say that misclassification is not intentional, that it occurs out of confusion over the various definitions of employment in state and federal law. But it is difficult to imagine hundreds of independent contractors building schools, bridges, sky scrapers and power plants. In the countless number of cases we have investigated, what we continue to find is intentional misclassification to gain an illegitimate competitive advantage. We have seen cases in Florida, for instance, where contractors conspire with check cashing stores and others to pay employees cash through shell corporations.¹ That is not confusion-it is fraud as a business plan.

Enforcement agencies, we find, do what they can with the resources and tools that the law provides. It is clear by the magnitude of the problem that more needs to be done. Our problems, though, cannot be placed at the door steps of enforcement agencies. There are too many people in the construction industry today who are either willfully ignorant or co-conspirators. Misclassification fraud is our worst kept secret.

We have recognized that contractors who violate the law to gain a competitive advantage not only harm industry standards-they also harm the greater community. Local, state and federal governments are cheated out of tax revenue. Insurance companies lose workers compensation premiums and pass along their losses to other employers. Workers are exploited, the hiring of undocumented immigrants is facilitated and important legal protections that have been the law of the land for close to a hundred years are lost.

We are not alone in recognizing the problem of misclassification fraud. (Attached is a summary of numerous state and national studies of its scope and cost.²) Recent studies done in Illinois, Maine, Massachusetts and Minnesota have found that 14 to 24 percent of construction employers misclassify their workers.³ A 1984 IRS study says 19.8 percent of construction workers are misclassified. According to an Illinois study, fraud in the construction industry costs the state \$54.6 million in state income taxes, unemployment taxes and workers compensation premiums.⁴ You should note that these studies offer conservative estimates, because they do not quantify off-the books payments--paying workers unreported compensation.⁵ Other studies, though, have done that. A California study of workers compensation premiums identified \$100 billion dollars of

¹*West Palm Beach Man Convicted in Multi-Million Dollar Federal Payroll Evasion Case*, Press Release, US Attorney's Office, Southern District of Florida (November 21, 2007).

² These studies can be found at: http://www.carpenters.org/misclassification/key_studies.html

³ *The Social & Economic Cost of Employee Misclassification in Construction*, Construction Policy Research Center, Labor & Worklife Program, Harvard Law School & Harvard School of Public Health, by Bernhard and Herrick, p. 1 (December 2004) (Massachusetts Study), *The Social & Economic Cost of Employee Misclassification in the Maine Construction Industry*, Construction Policy Research Center, Labor & Worklife Program, Harvard Law School & Harvard School of Public Health, by Bernhard and Herrick, pp. 1-2 (April 2005) (Maine Study), *The Cost of Worker Misclassification in New York State*, Cornell Univ., ILR School, by Donahue, p. 2 (February 2007), *Economic Costs of Employee Misclassification in the State of Illinois*, Dep. Of Economics, Univ. Missouri-Kansas City, by Kelsay, Sturgeon and Pinkham, pp. 4, 5 and 15 (December 2006) (Illinois Study) and *Misclassification of Employees as Independent Contractors*, Office of the Legislative Auditor, State of Minnesota, pp 15 and 18 (November 2007).

⁴ Illinois Study, p. 6-8.

⁵ Massachusetts Study, p. 1, Maine Study, p. 1, Illinois Study, p. 2.

underreporting-that would include misclassification, off the books payments and putting workers in cheaper-cost classification codes.⁶ As a result, employers in high risk industries, like construction, are paying up to eight times what they should be paying for workers compensation.⁷ A recent study by the Fiscal Policy Institute found that 50,000 of New York City's 200,000 construction workers are misclassified or paid off the books, costing up to \$557 million in lost state and federal taxes, workers compensation premiums and health-care cost shifting in 2008.⁸

States and federal agencies have been alarmed enough to take action. They have recognized that new law-enforcement tools are needed. The IRS has initiated an information sharing and joint unemployment tax auditing program with the states, following recognition that misclassification is part of the \$345 billion federal tax gap.⁹ In addition, misclassification in the construction industry has been identified as a 2008 enforcement priority by the US Department of Labor.¹⁰

Many states have recognized the lost revenue and harm caused by misclassification fraud. Since 2005 many states have addressed industry fraud in new law. In 2007 alone 35 bills in 19 states were introduced with 20 of those bills becoming law. New Jersey, Illinois and Minnesota passed comprehensive anti-fraud laws. Misclassification task forces have been initiated in California, New Jersey, New York, Michigan, Massachusetts and Utah. Connecticut, New York and New Jersey have joined Florida and Massachusetts in adopting stop work orders for non-compliant employers. New Mexico as well as New Jersey, Massachusetts, Florida, Illinois and Kansas specifically punish misclassification as a separate violation. Additional legislation clarifying or strengthening enforcement of existing laws has been passed in New Hampshire, Vermont and Washington.

The work done in New York has been particularly striking. The New York misclassification task force issued a report, and in just four months they found \$19.4 million in unreported wages, 2,078 misclassified workers, and they assessed \$1.4 million

⁶ *Up to One Fifth of California Payroll Not Reported*, WorkCompCentral, by Jim Sams (April 30, 2007), *Fraud in Workers' Compensation Payroll Reporting: How Much Employer Fraud Exists and How are Honest Employers Impacted*: Report for the Commission on Health and Safety and Workers' Compensation, by Frank Neuhauser and Colleen Donovan, University of California, Berkeley (August 2007), pp. 1-3 and 7-8.

⁷ *Ibid.*, pp. 1-3.

⁸ *Building Up New York, Tearing Down Job Quality: Taxpayer Impact of Worsening Employment Practices in New York City's Construction Industry*, Fiscal Policy Institute (New York City Construction) (December 2007), pp. 1 and 20-22.

⁹ This is the Questionable Employment Tax Practices program. See information at: <http://www.irs.gov/newsroom/article/0,,id=175457,00.html> and *IRS Entering Accords with States to Target Worker Misclassification for Examinations*, Daily Labor Report, Bureau of National Affairs, No. 94, p. A-4, Wednesday, May 16, 2007.

¹⁰ *Wage and Hour Collects a Record \$220 Million in Back Wages for Over 341,000 Employees in Fiscal Year 2007*, US Department of Labor, p. 5, available at: <http://www.carpenters.org/misclassification/ALL%20DOCUMENTS/DOL%20WHD%202007%20Statistics%20Fact%20Sheet-misclassification%20as%20IC%20a%202008%20focus.pdf>.

in taxes, penalties and interest.¹¹ If possible, it gets more shocking. They found 646 employees owed \$3 million in wages.¹² Clearly, we are not dealing with a small problem.

We are pleased that the Pennsylvania General Assembly is considering HB 2400. As in New Jersey, Illinois and Massachusetts the bill specifically prohibits the failure to properly classify a worker as an employee—that addresses both misclassification and paying employees unreported compensation. The bill provides for criminal and other penalties that increase for willful or repeated offenders. On tax-payer projects, offenders face debarment. Presumptions of employment are established in the bill as in New Jersey, Illinois, Massachusetts, New Hampshire and Minnesota. The bill also allows for private suits, and stop work orders that will encourage self policing by the industry.

If what we are seeking are new tools for law enforcement to battle misclassification, HB 2400 accomplishes that. We would expect that the additional revenue collected by the Act will surpass the cost of its application. That revenue is need in Pennsylvania. What is also needed is a level playing field that allows law-abiding employers and their employees to prosper. HB 2400 will help to make that happen, and we respectfully request the support of the Committee on Labor Relations.

Respectfully submitted,
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¹¹ *Report of the Joint Enforcement Task Force on Employee Misclassification to Eliot Spitzer, Governor State of New York* (February 1, 2008), pp. 3-4, and 11-12.

¹² *Ibid.*, pp. 4 and 12-13.