



Testimony on HB 1781 – Independent Contractors
House Labor and Industry Committee
April 16, 2018

Good afternoon, Chairman Kauffman and members of the committee. The National Federation of Independent Business (NFIB) is Pennsylvania's leading small-business organization, representing 14,000 small and independent businesses in the Commonwealth and 350,000 nationwide. NFIB members represent virtually every sector in Pennsylvania's economy.

Nearly 98 percent of businesses employ 100 or fewer workers. These businesses create two out of every three new jobs and are responsible for half of the private sector workforce.

Thank you for the opportunity to comment on HB 1781 today. NFIB represents businesses on all sides of the independent contractor relationship, and one of the great headaches for small businesses in Pennsylvania is trying to figure out how to properly define this relationship.

Research shows about one-in-four individuals who start a small business previously were unemployed or not in the labor force. Many others start a business to supplement their family income. Still other small-business owners just don't want to work for someone else.

It's important to protect the ability of individuals to start and run businesses as independent contractors and to clearly define the meaning of this in Pennsylvania law. The independent contractor relationship has significant tax, legal, and financial implications for the contractor and the employing entity. The lack of clarity in the area of the law governing independent contractor relationships causes confusion, contractual complications, and problems for the workers' compensation system.

HB 1781 would permit independent contractors to register with the Department of Labor and Industry to clarify their status as an independent contractor, rather than an employee, for the purpose of workers' compensation, in the case where both parties agree that no employer-employee relationship exists. The bill also would allow the independent contractor to cancel the registration at any time and provide penalties for businesses that attempt to require the agreement as a condition of hiring.

NFIB supports efforts to further clarify the independent contractor relationship so that both the contractor and employing entity have a better understanding of their obligations under the law. Doing so in the area of workers' compensation will reduce the likelihood that law-abiding small businesses would be forced into costly legal actions to prove legitimate business relationships.

We believe that this change to the law will provide some clarity to businesses for the purpose of workers' compensation. Unfortunately, even if it is signed in good faith by both parties, an affidavit may be disregarded entirely if challenged in a workers' compensation case. Or, it may be viewed as just one factor in a multi-prong balancing test in the determination of whether an individual should be considered an independent contractor or an employee.

In workers' compensation cases, judges often look at many factors to determine the nature of the relationship between an employing entity and an individual whose relationship with the business is in dispute. One NFIB member was hit with penalties for failing to pay insurance on workers who held themselves out to be in business for themselves, had their own tools, set their own hours, and carried their own liability insurance. But the judge found that, because they showed up to perform the contracted jobs at her place of business, they were employees. The balance test led the judge to give a greater weight to one factor, while giving less weight to other factors that cut in favor of viewing the relationship as an independent contractor.

It is not clear that an affidavit and registration, as provided in HB 1781, would be sufficient a rule or add enough weight to the balancing test for a judge to find in favor of an independent contractor relationship.

NFIB would suggest a number of additional ways that the law may be clarified to ensure a more balanced approach to determining that a worker or business has held themselves out to the world as in business for themselves and should be viewed as an independent contractor.

Examples include: how much control or management over the contracted work the employing entity has; whether projects are finite in duration and can be rejected by a contractor; whether the contractor has chosen to incorporate or has an employer identification number; and whether the contractor has other clients or accounts.

Of course, one of the challenges with the treatment of independent contractors under law is that they are treated differently by different agencies. For example, the U.S. Department of Labor employs the "economic realities" test, whereas the IRS employs a different (20-prong) test. The best solution would apply not just to workers' compensation, but to all situations in labor and tax law in Pennsylvania.

Arizona recently enacted a law clarifying independent contractor relationships and allowing contractors and the employing entity to establish their shared intent by use of a declaration. The declaration creates a rebuttable presumption in any labor dispute that an independent contractor relationship exists between the two entities. The compliant declaration requires that the contractor expressly acknowledge very specific terms, and the presumption may only be overcome if the independent contractor shows that the employing entity acted in a manner inconsistent with the declaration. Some of the criteria in the declaration are similar to those suggested above. I've attached a summary of Arizona's Declaration of Independent Business Status Law for your review.

Thank you for the opportunity to testify today on this important issue. We would be happy to take questions.

Arizona Enacts New Law Aimed at Clarifying the Independent Contractor Relationship

A determination that an individual is an employee rather than an independent contractor can have significant legal, tax and other financial implications for the employing entity. Nonetheless, employing entities often inadvertently misclassify workers as independent contractors, exposing themselves to significant wage and tax liability. To help clarify the relationship between employing units and workers and reduce the risk of exposure from misclassification, Arizona has enacted a new law, known as the Declaration of Independent Business Status law (DIBS). The new law, approved as House Bill 2114, amends existing Arizona employment law by adding A.R.S. §§ 23-1601 and 23-1602 to Title 23 of the Arizona Revised Statutes. DIBS became effective on August 6, 2016.

The new law allows Arizona employing units and independent contractors to establish their shared intent for the status of their relationship from its inception by permitting employing units to require their independent contractors to execute declarations affirming that their relationship with the business is as an independent contractor and not as an employee. The effect of the declaration is to create a rebuttable presumption that an independent contractor relationship exists between the independent contractor and the employing unit. If a dispute later arises, the presumption may be overcome by the independent contractor showing that the employing unit did not act in a manner "substantially consistent with the declaration."

A compliant declaration must be signed and dated by the independent contractor and requires that he or she expressly acknowledge that the following terms apply to the contractor, the contractor's employees and the contractor's own independent contractors:

1. The contractor operates its own independent business separate from the contracting party and is providing services to the employing unit as an independent contractor.
2. The contractor is not an employee of the contracting party and services provided to the contracting party do not provide the contractor a right to unemployment benefits or any other right arising from an employment relationship.
3. The contractor is independently liable for all taxes owed on payment received from the contracting party, and the contracting party will not withhold taxes from payments to the contractor.
4. The contractor is independently responsible for procuring and maintaining any registration, license or other authorization necessary to render the contracted services.

Additionally, the declaration requires the contractor to acknowledge at least six of the following:

1. That the contractor is not insured under the contracting party's health insurance coverage or workers' compensation insurance coverage.
2. That the contracting party does not restrict the contractor's ability to perform services for or through other parties and the contractor is authorized to accept work from and perform work for other businesses and individuals besides the contracting party.
3. That the contractor has the right to accept or decline requests for services by or through the contracting party.
4. That the contracting party expects that the contractor provides services for other parties.
5. That the contractor is not economically dependent on the services performed for or in connection with the contracting party.
6. That the contracting party does not dictate the performance, methods or process the contractor uses to perform services.
7. That the contracting party has the right to impose quality standards or a deadline for completion of services performed, or both, but the contractor is authorized to determine the days worked and the time periods of work.
8. That the contractor will be paid by or through the contracting party based on the work the contractor is contracted to perform, and that the contracting party is not providing the contractor with a regular salary or any minimum, regular payment.
9. That the contractor is responsible for providing and maintaining all tools and equipment required to perform the services performed.
10. That the contractor is responsible for all expenses incurred by the contractor in performing the services.

Finally, A.R.S. § 23-1602 sets forth that "any supervision or control exercised by an employing unit to comply with any state or federal statute, rule or code, including licensing, professional, or ethical requirements may not be considered" when determining whether an independent contractor or employment status exists.

Even after the enactment of DIBS, employing units and independent contractors need not execute the aforementioned declarations; their use is entirely optional. The statute specifically makes clear that the failure of a party to execute a DIBS-compliant declaration "does not create any presumptions [regarding the existence – or lack – of an employment or independent contractor relationship,] and is not admissible to deny the existence of an independent contractor relationship."

Proponents of the law maintain that it encourages employers and independent contractors to clearly define the nature of their relationship from the outset of the working relationship. But even if employing units opt not to take advantage of DIBS declarations to outline the nature of their independent contractor relationships, the requirements set by the new law for a compliant declaration are useful guidelines for Arizona businesses to assess whether their relationship with workers is that of an employer or merely a contracting party.

The DIBS law does have some notable exceptions. A compliant DIBS declaration does not have the same effect or serve as a substitute for similar agreements executed by independent contractors pursuant to A.R.S. § 23-902(D) under Arizona's workers' compensation scheme. Section 23-902 agreements allow independent contractors to acknowledge that they are not entitled to workers' compensation coverage under the contracting party's policy. Therefore, employing units currently making use of Section 23-902 agreements to clarify their workers' compensation responsibilities should continue to do so independent of securing DIBS declarations. The DIBS process also exempts those individuals licensed by the Registrar of Contractors, unless they are contracting with an independent contractor. Furthermore, the execution of a DIBS declaration does not affect any investigatory or enforcement authority related to the determination of the independent contractor or employment status of any relationship as provided by Title 23 of the Arizona Revised Statutes or under federal law.

DIBS declarations should not be used as a substitute for measured consideration of the relationship between a worker and employing unit. The execution of a DIBS declaration provides only a rebuttable presumption, not a conclusive determination, that the working relationship is an independent contractor relationship. Employers with questions regarding the classification of their workers are advised to consult with counsel, not only to ensure compliance with the DIBS statute under Arizona state law, but also to determine whether their working relationships with purported independent contractors satisfy federal independent-contractor tests used by the US Department of Labor, Internal Revenue Service and National Labor Relations Board, among other agencies.

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