

Testimony on Misclassification for Pennsylvania House Labor and Industry Committee June 11,  
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When employers misclassify employees as independent contractors, workers owe more in taxes than they otherwise would and get fewer benefits than they should. Here in Pennsylvania alone, according to the Pennsylvania Department of Labor and Industry Joint Task Force on Misclassification of Employees Final Report, issued in December 2022, at least 259,000 employees are misclassified annually. The same report found that, in a 2021-2022 period alone, misclassification resulted in \$91 million in lost revenue to the unemployment compensation trust fund. That is because when employers misclassify their workers, employers fail to withhold taxes, including unemployment taxes, and thus not only do the workers owe a greater burden but the revenue shortfall for federal, state, and local governments harms all of us. In the work we do in the Temple Law Low Income Taxpayer Clinic, we represent several taxpayers who are harmed at the individual level by misclassification.

Worker misclassification has a significantly burdensome financial impact for taxpayers, particularly low-income individuals. When employers misclassify their employees, it means that these workers will owe double the amount of Social Security and Medicare taxes than properly classified employees owe. Employers withhold 7.65% (6.2% for Social Security and 1.45% for Medicare) of employees' gross wages for Social Security and Medicare while employers pay the other 7.65% of a total 15.3% in taxes owed by both, out of their own coffers.

But when workers are misclassified, or when an individual is correctly classified as an independent contractor, they owe both sides of the Social Security and Medicare tax: the entire 15.3% -- the self-employment tax. Therefore, for example, an individual who makes roughly \$10,000 on a Form 1099-NEC (the income-reporting form on which so-called "non-employee compensation," for independent contractors or self-employed individuals, is reported) would owe approximately \$1,500 in self-employment taxes. If they were classified as an employee, on a Form W-2 with withholding, they would only owe \$765 (just the employee share) in Social Security and Medicare taxes.

At the state level, here in Pennsylvania, the fact that we have a flat 3.07% personal income tax means that though technically all workers owe the same tax no more how much they earn, employees get the benefit of these taxes usually being withheld from their pay. But when workers are misclassified, they end up owing the entire 3.07% tax after the fact and out of pocket. Because the personal state income tax is regressive, low-income taxpayers especially bear the brunt of misclassification.

Beyond the tax impacts, there is also the fact that misclassification means that workers are not guaranteed access to various benefits and rights that come with employment: minimum wage, overtime pay, unemployment compensation, the right to collectively bargain, workers'

compensation, and provisions of the Civil Rights Act, the Family Medical Leave Act, the Pregnant Workers Fairness Act, and various other safety net protections. Failure to report the misclassification income can also mean that the taxpayer does not get Social Security benefits credit for the income because without reporting the income and the Social Security tax owed on a tax return, the Social Security Administration does not place in the income in a worker's lifetime earnings record.

Throughout the last six years in which I have practiced in the low-income taxpayer controversy space, several of my misclassified clients have also been denied some of these very same important benefits. Often too, unfortunately, the case is that the misclassification is intentional in nature; we far too often see employers deliberately misclassify home health care workers, staffing agency workers, clerical staff, construction workers, and truck drivers, among workers in various industries, to avoid paying taxes and cut costs. Workers are then understandably hesitant to challenge their misclassification out of fear of retaliation, even if we inform them that we would be prepared to represent them in anti-retaliation suits.

However, even though it is not an anonymous process (employers would find out if you filed this form), there is path to challenging your misclassification for federal tax purposes – and at least one state agency (the Department of Labor and Industry in unemployment appeals) inquires about this form in their own investigations. A worker can file a Form SS-8 with the IRS to challenge their misclassification as an independent contractor (employers can file this form to inquire about the status of their workers too). The Form SS-8 is a five-page form that gives workers the opportunity to answer questions, based on the IRS' 20-factor test for determining employment (based on the common law definition of employment), regarding the level of control in the employee's job. Generally, under IRS and federal tax code definitions (that have been clarified in U.S. Tax Court case law), if the employer even had the right to control the employee's work, especially if they could control both the methods and means by which the work was done, the worker was likely an employee. There are various factors that the IRS asks about on the Form SS-8. These questions get to the level of control as these questions relate to whether the worker was assigned tasks, had a set schedule and rate of pay, what the level of supervision was, where the worker completed their assignments, and if they were required to attend meetings or compile reports, among other things.

Once the worker files the Form SS-8, the filing of the SS-8 gives the worker the right to list their misclassification income – and that includes if the worker was paid in cash, another form of misclassification – as “wages” on their return. The worker can then include a Form 8919, with their tax return, to account for just the employee share of Social Security and Medicare taxes. Therefore, a worker can ensure that they only pay the correct share of tax, a key pillar of the Taxpayer Bill of Rights. A worker need not wait for an SS-8 determination to report their income as employee wages on their return so long as they filed an SS-8 first. Ultimately, the SS-8 Unit will issue a ruling at least but if both the employer, who gets a blank copy to respond with their version of the facts, and the employee respond, the SS-8 Unit will issue a determination that compares both sides' responses and analyzes the law and facts to make a conclusion.

Misclassification is a serious problem that is particularly detrimental for low-income individuals. At its core, misclassification is a justice issue as it exposes the disparate bargaining power that allows for the dynamics that incentivize employer misconduct. This kind of wage theft, on the part of far too many employers, harms communities as misclassification exacerbates poverty. That is where institutions like ours come in to help remedy this problem to the extent we can. Through the work I have done at the Temple Law tax clinic and at Philadelphia Legal Assistance Low Income Taxpayer Clinic, I have filed dozens of SS-8s and consequently, taxpayers, who knew there was a problem and sought to address it, have saved themselves thousands of dollars. We will continue to curtail and address this problem of worker misclassification for the sake of our clients and their communities.