Employee Misclassification Harms All Oregonians

Employee misclassification, a form of payroll fraud, is a serious problem in Oregon. Misclassification occurs when an employer wrongly labels a worker an “independent contractor” rather than an “employee” or pays a person “off the books.” This practice harms workers, undercuts law-abiding businesses and deprives the state of revenue used to support services that Oregonians rely on and value.

In short, misclassification harms all Oregonians.

Misclassification Is Not a Rare Occurrence

Some employers cut costs by cheating the payroll tax system, a type of fraud called misclassification. While misclassification can happen inadvertently, often it is the result of employers intentionally labeling workers independent contractors or simply paying them “off the books,” even though the workers function as employees.

National and state studies indicate that a significant number of employers misclassify their workers. According to a survey of state studies, “moderate” estimates of the share of employers engaging in misclassification range from between 13 to 24 percent.[1] A 2000 study conducted for the U.S. Department of Labor estimated that the share of employers misclassifying workers in nine states (not including Oregon) ranged from 10 to 30 percent.[2] A 2007 study of certain industries in New York State estimated that 10.3 percent of the workers in those industries are misclassified each year.[3]

Audits by Oregon state officials confirm that misclassification occurs in Oregon. The Interagency Compliance Network (ICN), created by the legislature in 2009 to improve compliance with Oregon’s tax and employment laws, developed a database of employers deemed “high-risk” for misclassification based on certain criteria, indicating the possibility of misclassification. That database contained the names of 16,867 businesses. From that list, ICN identified 118 businesses to evaluate further and audited 14 employers. Those 14 audits revealed 1,265 misclassified workers.[4]

Misclassification Harms Workers, Honest Businesses and All Oregonians

Misclassification has many victims. It harms the employees misclassified, it undercuts law-abiding businesses and it deprives the state of tax revenue — thereby harming all Oregonians.

Workers suffer. Independent contractors lack certain protections afforded by law: unemployment insurance, workers’ compensation insurance, minimum and prevailing wages, overtime pay, health and safety protections, family and medical leave, the federal right to act collectively to improve working conditions, and employment civil rights. Thus, employees wrongly treated as independent contractors have a harder time claiming rights and benefits that come with a job. When wrongly classified as independent contractors, misclassified employees assume full responsibility for Social Security and Medicare taxes, rather than the employer paying half. Finally, the misclassified employee can’t access benefits that the employer may provide other employees, such as health insurance.

Honest businesses suffer. By skirting their legal obligations, cheating employers undercut law-abiding competitors. ICN estimates that for every $100 in payroll costs, Oregon employers who misclassify employees save nearly $5 in state unemployment insurance, workers' compensation insurance premiums and transit taxes.[5] But there is more. Looking at national data, the Internal Revenue Service calculates that misclassification saves an employer, on average, about $3,700 in employment taxes (Social Security, Medicare and federal unemployment) on a worker earning about $43,000 a year.[6] This puts honest employers at a competitive disadvantage in paying their employees properly.

All Oregonians suffer. The state of Oregon loses revenue when employers misclassify their employees. As noted above, misclassification undermines collection of unemployment insurance, workers' compensation and transit taxes. In addition, the state loses income tax revenue — nearly all of which goes to fund schools, public safety and programs that protect the vulnerable. ICN explains that there are too many variables to allow an accurate estimate of how much the state loses in income tax revenue as a result of misclassification.[7] It's clear, though, that in various ways misclassification harms all Oregonians.

Conclusion

The form of payroll fraud known as employee misclassification harms workers and undercuts law-abiding businesses. And by depriving the state of tax revenue, it ends up harming all Oregonians.

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Endnotes

[1] Sturgeon, James I. and Michael P. Kelsay, *Summary Findings Regarding he Economic Costs of Employee Misclassification in the State of Indiana Department of Economics*, University of Missouri, Kansas City September 16, 2010, p. 2, available at http://ibew725.org/ImageUploads/File/Misclassification/Summary_--_UMKC_Report_on_Employee_Misclassification.pdf.

[2] States included in the study were California, Colorado, Connecticut, Maryland, Minnesota, Nebraska, New Jersey, Wisconsin and Washington. De Silva, Lalith et al., *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs*, Planmatics, Inc., prepared for U.S. Department of Labor, Employment and Training Division, February 2000, p. iii, available at http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf.

[3] Industries examined include construction; manufacturing; wholesale and retail trade; transportation and warehousing; information; finance and insurance; real estate; professional, scientific, and technical services; administrative and support and waste management and remediation services; health care and social assistance; arts, entertainment, and recreation; other industries. Donahue, Linda H. et. al., *The Cost of Worker Misclassification In New York State*, Cornell University ILR School, February 2007, p. 5, available at http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1009&context=reports.

[4] Interagency Compliance Network's Second Report to the Oregon Legislature, March 2013, p. 6.

[5] Interagency Compliance Network's Second Report to the Oregon Legislature, March 2013, p.8.

[6] Treasury Inspector General for Tax Administration, *Employers Do Not Always Follow Internal Revenue Service Worker Determination Rules*, June 14, 2013, p. 2, available at http://www.treasury.gov/tigta/auditreports/2013reports/201330058fr.pdf.

[7] Interagency Compliance Network's Second Report to the Oregon Legislature, March 2013, p. 9.