

MINUTES OF THE HOUSE COMMERCE AND LABOR COMMITTEE

The meeting was called to order by Chairman Don Dahl at 9:00 A.M. on February 21, 2005 in Room 241-N of the Capitol.

All members were present.

Committee staff present:

Jerry Ann Donaldson, Kansas Legislative Research Department
Norm Furse, Office of Revisor of Statutes
Renaë Jefferies, Office of Revisor of Statutes
June Evans, Committee Secretary

Conferees appearing before the committee:

Representative Tom Holland
Representative Anthony Brown
Paul Rodriguez, Contractor
Ken Hayes, Cornerstone Construction Company, Lawrence
Melinda Lewis, El Centrol
Secretary Joan Wagon, Internal Revenue Service

Others attending:

See attached list.

The Chairman opened the hearing on **HB 2372 - Misclassifying employees as independent contractors to avoid withholding income tax; Class A nonperson misdemeanor, investigations by Department of Revenue and Labor.**

Staff gave a briefing on **HB 2372.**

Representative Tom Holland testified in support of **HB 2372.** The intentions in introducing this legislation are three-fold: 1) to protect honest Kansas small businesses who are having to compete on an unlevel playing field, 2) to protect Kansas workers from suffering continued wage erosion and exploitation, and 3) to stop the resulting loss of income tax collections to the state of Kansas.

1099 (or independent contractor) misclassification occurs when an employer purposefully treats a worker as an independent contractor instead of an employee. This allows the employer to avoid paying social security, workers compensation, unemployment insurance, liability insurance, and both overtime and time-off wages.

The Internal Revenue Service (IRS) has for several years provided a twenty-question test to assist employers in determining whether a laborer should be treated as an employee or independent contractor.

Misclassification puts those businesses that play by the rules at a distinct disadvantage; the responsible employer may end up paying 20% or more in employee-related costs versus the unscrupulous contractor. **HB 2372** provides the Kansas Department of Revenue with a number of tools for investigating and prosecuting those employers who knowingly violate the law under this act (Attachment 1).

Representative Anthony Brown, a proponent to **HB 2372,** testified stating improper and/or misclassification of employees as "independent contractor," which is illegal under federal tax law, costs the United States Treasury and the Kansas Treasury potentially billions of dollars annually. According to some studies, more than half of the nine million people who file as independent contractors are currently misclassified at a loss of some \$20 billion a year to the federal government. This revenue loss stems from the loss of legally-mandated tax payments, Social Security contributions, etc. that employers must pay for employees, but not for independent contractors (who, in theory, are supposed to pay such taxes themselves). There is an uneven playing field. Honest employers who follow the law find themselves at a competitive disadvantage against unscrupulous business owners who falsely label their employees as independent contractors (Attachment 2).

Paul Rodriguez, President of Rodriguez Mechanical Contractors, Inc., Kansas City, Kansas, testified as a proponent to **HB 2372.** Rodriguez Mechanical has been in the plumbing business for twenty-eight years,

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licensed in both Kansas and Missouri. The 70 people currently employed are comprised of administrative staff, plumbers, laborers, and operating engineers.

Prior to September 11, 2001, it was reported that our firm was the largest employer of union plumbers in the region. Our firm went from 143 plumbers to a low of 35. The past two years the employment is up to 70. Current competition utilizes a workforce that does not always reside in Kansas permanently and is willing to work for less, with no benefits and in some cases does not pay taxes (Attachment 3).

Ken Hayes, Cornerstone Construction, testified as a proponent to **HB 2372**, stating the bill deals with the deliberate misclassification and abuse of the 1099 independent contractor status. We deal with the issue of competitors and our own sub-contractors using labor that is not classified correctly. The use of 1099 labor instead of employing people directly means in short that an employer does not have to cover social security benefits, workers compensation withholding, health insurance, unemployment insurance, overtime wages and any other benefit at the federal, state, or germane to the employers. This puts a contractor that obeys the law at a serious disadvantage due to the costs of legally employing a person versus the practice of "spinning off" an employee to 1099 status. On average an employee costs 33 to 40% due to the withholding taxes and programs associated with them than a 1099 independent contractor which incurs no extra costs to salary (Attachment 4).

Melinda K. Lewis, Director of Policy Advocacy and Research, El Centro, Inc., testified as a proponent to **HB 2372**. This is a serious issue of the misclassification of workers as independent contractors and which has significant implications for our state's revenue outlook as well as for workers rights. This bill is not about those individuals who work as legitimate independent contractors; who set the terms of their own work and compensation and organize their work product in a way that makes sense for them and those with whom they do business. Clearly there is no interest in hindering their operation.

El Centro, Inc. first became aware of the problem of misclassification of employees as independent contractors in the process of helping immigrant workers file their taxes. It was clear from their description of their work environment that they were employees of the landscaping company. Where they worked they were told what time to get to work, they drove in a company truck to jobs, used their employers' tools, were told how much they would be paid per hour, wore uniforms identifying them as part of the company, and were threatened of dismissal if they took a sick day. However, at tax time, they did not receive a W-2 and it was discovered that they had signed a 1099 form identifying them as an independent contractor. For tax purposes, this meant that no taxes had been withheld or paid on their behalf, so they owed a significant liability. Since then many more cases of misclassification have become evident, i.e., workers who are injured on the job who have difficulty filing a workers' compensation claim because they are not considered employees, those paid much less than minimum wage because the employer pretends that they are not really employees, and employees logging more than 80 hours per week without overtime because they are not entitled to the protections that normally accompany employment.

HB 2372 first and foremost recognizes this abusive practice and denounces it. It sets up penalties for those found misclassifying their employees and thereby creates a deterrent that we hope would end such activity (Attachment 5).

Joan Wagon, Secretary, Kansas Department of Revenue, stated the Department has the responsibility to collect taxes and fees. It is of great concern if employers skirt the rules and do not report wages in accordance with the Fair Labor Standards Act. Since the Department only has the authority to pursue civil actions to enforce the collection of taxes, this bill gives the Department new powers.

Section 2. of the bill creates a hot line so that persons and businesses that wish to report this unfair labor practice can call into one place. Revenue and Labor would work together to design a method of investigating all reports received through this tip line. Another feature of this section is the creation of an Assistant Attorney General position in cooperation with the Department of Revenue to investigate such crimes. This position should be allowed to investigate tips and prosecute employers who commit these crimes.

Section 3. allows the Department to share confidential income tax information with the Department of Labor,

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but only for purposes of investigating misclassification of employees. There have been many anecdotal reports of employers trying to avoid the payroll taxes by treating their employees as independent contractors. Not only does this create an unfair advantage, particularly for those businesses that use a competitive bid process such as in the construction industry, but it also deprives workers of important coverage if they are injured, laid off, or retire (Attachment 6).

The Chairman closed the hearing on **HB 2372**.

The Chairman asked the Sub-Committee Chair of **HB 2142 - Workers compensation; date of accident, employer's maximum liability for disability compensation, attorney fees** to give the Sub-Committee Report to the Committee.

Representative Kevin Yoder stated the Subcommittee carried out its charge by asking the opposing parties to meet and confer, and come up with a resolution regarding the contents of **HB 2142**. As a result, the Subcommittee offers a compromise that does the following:

Deletes sections two and three from the bill; and
Focuses on a single issue, i.e., the date of accident as embodied in Substitute for **HB 2142**.

“In cases where the accident occurs as a result of a series of events, repetitive use, cumulative traumas or microtraumas, the date of accident shall be the date the authorized physician takes the employee off work due to the condition or restricts the employee from performing the work which is the cause of the condition. In the event the worker is not taken off work or restricted as above described, then the date of injury shall be the earliest of the following dates: (1) the date upon which the employee gives written notice to the employer of the injury; or (2) the date the condition is diagnosed as worker related, provided such fact is communicated in writing to the injured worker. In cases where none of the above criteria are met, then the date of accident shall be determined by the administrative law judge based on all the evidence and circumstances; and in no event shall the date of accident be the date of, or the day before the regular hearing. Nothing in this subsection shall be construed to preclude a worker's right to make a claim for aggravation of injuries under the workers compensation act” (Attachment 7).

Representative Ruff moved and Representative Grange seconded to accept the compromise Substitute for **HB 2142**. The motion carried.

Representative Jack moved and Representative Pauls seconded on page 4, sub (d) (2) line 11, change “worker” to “work”. The motion carried.

Representative Ruff moved and Representative Grant seconded to move Substitute **HB 2142** out favorably as amended. The motion carried.

Staff rebriefed the committee on **HB 2299**, stating the membership on the advisory panel increases the membership from 7 to 8 by adding physical therapists to the panel.

Representative Huntington moved and Representative Jack seconded to amend **HB 2299** and add “occupational therapists” and increase the panel to 9. (R. E. “Tuck” Duncan requested amendment.) The motion carried.

Representative Sharp stated the scope of these therapists is very broad and there is duplicate service, so she doesn't feel they should be included.

Representative Jack said this panel helps set the fee schedule, not policy, and so he believes it would be helpful to include all of them.

Representative Sharp requested to be recorded as voting “NO”.

Representative Grant moved and Representative Swenson seconded to move **HB 2299** out of committee

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favorably as amended. The motion carried.

The meeting adjourned at 10:25 a.m. The next meeting will be called by the Chairman.