



Senator Charles J. Colgan, Chair
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Review of Employee Misclassification in Virginia

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BACKGROUND

Worker misclassification occurs when an employer improperly classifies a worker as an independent contractor instead of as an employee. This can happen when the employer or worker does not understand the legal distinctions between employees and independent contractors, or when an employer wishes to avoid paying certain taxes and benefits on behalf of workers. Employees have taxes withheld from their paychecks and have legal protections such as the minimum wage law, unemployment benefits, and workers' compensation insurance. Independent contractors are generally responsible for paying all of their own taxes and benefits, and are often not eligible for these and other legal protections.

Some employers in Virginia are concerned about the unfair competitive advantage gained by other employers who misclassify workers. Misclassifying employers can lower their costs by up to 40 percent. Several other states, the IRS, and the U.S. Government Accountability Office have found that misclassification can impact government revenues as well as employers and workers.

KEY FINDINGS

Our review of employee misclassification in Virginia found that:

- Employers who properly classify workers pay higher payroll costs and may be less competitive in their respective industries. Misclassified workers are often denied certain legal rights and benefits.
- A Virginia Employment Commission (VEC) audit of one percent of Virginia employers found 5,639 workers were misclassified in 2010. Based on estimates in other states, Virginia could have on the order of 40,000 misclassifying employers and 214,000 misclassified workers.
- Worker misclassification lowers Virginia's state income tax collections, leading to estimated foregone revenues on the order of \$1 million for workers identified during VEC audits and \$28 million in total based on other states' findings in 2010.
- A comprehensive approach to the problem of employee misclassification would include strategies to prevent misclassification before it happens, find it when it occurs, and penalize employers who misclassify.

SUMMARY OF RECOMMENDATIONS

- The Governor should establish a task force on employee misclassification consisting of VEC, the Virginia Workers' Compensation Commission, the Department of Labor and Industry, and the Department of Taxation. The agencies should work together to (1) develop a clear definition of "employee"; (2) develop procedures to share the information they gather about misclassification; and (3) produce educational materials for workers, employers, and citizens about what misclassification is, what its consequences are, and how to report it.
- Misclassification of employees should be made illegal in Virginia, and employers who misclassify workers should be penalized financially. If misclassifying employers are working on state contracts, they should be issued a stop work order and possibly disbarred from bidding on future state or local contracts for a specified period of time.

