

What is Virginia Doing About Misclassification of Workers?

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The Charlotte Observer calls it an “abuse of workers”.¹ The New York Times refers to it as “wage theft”.² Governor Terry McAuliffe pulls no punches when he classifies it as “payroll fraud”.³ And the Virginia Joint Legislative Audit and Review Commission (JLARC) concludes that it leaves employers who play by the rules “unable to compete.”⁴

What is Worker Misclassification?

Misclassification occurs when an employer improperly classifies an employee as an independent contractor.

Why is Misclassification So Harmful?

While employees are afforded many protections and benefits by the federal government and the Commonwealth of Virginia, individuals designated as independent contractors are excluded for the most part.

Worker misclassification is a destructive practice—whether intended or accidental—and costs Virginia’s taxpayers, employees and employers tens and perhaps hundreds of millions of dollars annually.

It also denies essential employment protections and benefits to hundreds of thousands of Virginia workers in such areas as⁵:

- occupational safety and health protections
- unemployment benefits
- workers’ compensation
- minimum wage and overtime
- health insurance
- retirement benefits, including Social Security
- family and medical leave
- protections from discrimination (e.g., Americans With Disabilities Act (ADA), Age Discrimination in Employment Act (ADEA))

“Employers who misclassify can save significantly in payroll costs. Studies in other states reported that these savings can range from ten to 40 percent. As an example, a Virginia employer in the construction industry could save an estimated 26 percent of payroll costs by classifying an average-wage construction worker as an independent contractor instead of an employee. In industries where competitive bidding occurs, misclassifying employers may be able to underbid their competitors due to their lower payroll costs, leaving employers who properly classify unable to compete. Employers who properly classify their workers may also face higher costs when unemployment tax and workers’ compensation insurance rates are adjusted upwards to cover costs incurred by misclassified workers.”⁶

What is the Extent of the Problem in Virginia?

In 2012, the Joint Legislative Audit and Review Commission (JLARC) reported that:

“A Virginia Employment Commission (VEC) audit of one percent of Virginia employers found 5,639 workers were misclassified in 2010. Based on findings in other states, Virginia could have on the order of 40,000 misclassifying employers and 214,000 misclassified workers.”

Misclassification is only thought to be more widespread and costly now than when JLARC first studied the issue three years ago.

Commissioner of Labor and Industry, C. Ray Davenport:
“Misclassification stifles competition and directly harms honest Virginia companies by allowing unscrupulous employers to undercut their bids on construction projects and in other procurement scenarios.”

Which Virginia Industries are Most Impacted?

The JLARC Study reported on the frequency of misclassification in Virginia industries based on Virginia Employment Commission audits conducted in 2010:

Administrative and Support and Waste Management and Remediation Services Industry Has Highest Proportion of Misclassifying Employers (2010)

Industry ^a	% of Audited Employers Found to Be Misclassifying Within Industry	Number of Misclassifying Employers
Administrative and Support and Waste Management and Remediation Services	40	58
Construction	33	242
Accommodation and Food Services	27	20
Real Estate and Rental and Leasing	27	11
Transportation and Warehousing	26	16
“All Other” Industries ^b	24	51
Health Care and Social Assistance	24	30
Retail Trade	23	55
Wholesale Trade	22	23
Other Services (except Public Administration)	19	42
Professional, Scientific, and Technical Services	19	31
TOTAL	27%	579^c

^aNorth American Industry Classification System (NAICS) code descriptions.

^bIncludes Educational Services; Public Administration; Manufacturing; Finance and Insurance; Information; Arts, Entertainment, and Recreation; Management of Companies and Enterprises; Utilities; Agriculture, Forestry, Fishing and Hunting; and Mining, Quarrying, and Oil and Gas Extraction.

^cNAICS industry codes were missing for five misclassifying employers, so total is less than the total number of misclassifying employers (584).

Source: JLARC staff analysis of 2010 audit data from the Virginia Employment Commission.

What is the Government’s Response?

Misclassification of workers has garnered considerable attention over the last several years from the federal government and state governments, including Virginia.

The U. S. Department of Labor’s Wage and Hour Division has a Misclassification Initiative which has established multi-jurisdictional Memorandums of Understandings (MOU) with twenty-one states with varying political constituencies from Texas to New Hampshire and Florida to Hawaii.⁷

A number of states, such as our neighbors to the north in Maryland, have identified misclassification of workers as not only a very harmful practice to workers and businesses, but as a significant cost center in the state’s budget. In 2009, Maryland adopted a statute to prevent misclassification in the construction and landscaping industries.⁸ An in-depth study conducted in Indiana found that lost state revenues resulting from misclassification was conservatively estimated to be 246.2 million dollars per year.⁹ A similar study in Illinois put the figure at 300.6 million dollars per year.¹⁰ Other states that have enacted laws include Colorado, Illinois, Massachusetts, Pennsylvania, New Jersey and New Mexico and New York.

In response to the 2012 Report of the Joint Legislative Audit and Review Commission (JLARC), which identified and defined the problem of worker misclassification in Virginia, Governor

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Terry McAuliffe issued Executive Order 24 on August 14, 2014, entitled “Establishing an Inter-Agency Task Force on Worker Misclassification and Payroll Fraud”: The misclassification of employees as “independent contractors” undermines businesses that follow the law, deprives the Commonwealth of millions of dollars in tax revenues, and prevents workers from receiving legal protections and benefits.”

The Secretary of Commerce and Trade is leading the Governor’s Task Force in its preparation of a report and recommendations on the issue. Other participating agencies are:

- Virginia Employment Commission (VEC)
- Workers’ Compensation Commission (VWCC)
- Department of Labor and Industry (DOLI)
- Department of Professional and Occupational Regulation (DPOR)
- Department of Taxation (TAX)
- State Corporation Commission Bureau of Insurance (SCC)

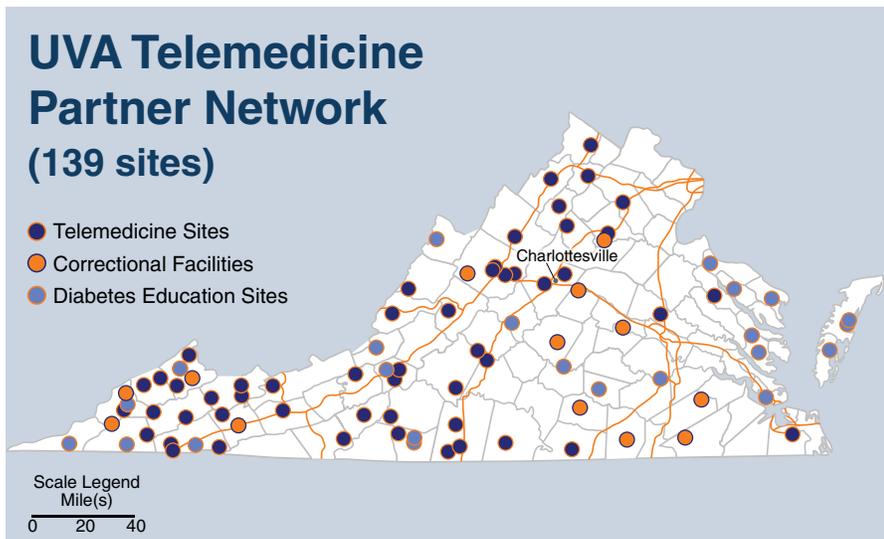
The Taskforce’s initial report was presented to Governor McAuliffe on December 1, 2014. It established a work plan with a timeline for researching and setting parameters for the implementation of a multi-agency pilot program by July 1, 2015. While some of the parameters are being finalized, the program will include employer outreach and education, the ability of agencies to better share data and information, and enhanced collection of data on the number and instances of employee misclassification. Results of the pilot program are to be reported by November 1, 2015.

What is One Agency Doing?

Commissioner of Labor and Industry C. Ray Davenport announced on June 2, 2015¹¹, the adoption of a new Virginia Occupational Safety and Health (VOSH) policy directed at preventing the misclassification of workers in VOSH cases:

“The Department today is committing itself to aggressively pursuing Governor McAuliffe’s initiative to root out the destructive practice of misclassification of workers in Virginia. Misclassification of workers as independent contractors constitutes payroll fraud, and denies hard-working Virginia employees of basic legal protections such as workers’ compensation, family and medical leave, and unemployment insurance. Misclassification also cheats those honest employers and contractors who properly classify employees, since employers who misclassify can undercut their bids due to lower operating costs.”

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New VOSH Policy¹²

The VOSH Program conducts thousands of safety and health inspections annually, and starting **July 1, 2015**, will take the following actions in worker misclassification cases:

- If VOSH penalties are proposed, penalty reductions for size and good faith will NOT be afforded to the employer.
- In construction inspections each contractor will be asked to provide its Department of Professional and Occupational Regulation (DPOR) contractor’s license AND proof of the DPOR license for any subcontractors.
- Make a referral to DPOR if a contractor has used an unlicensed subcontractor (DPOR sanctions may include fines, probationary terms, suspension or license revocation).
- For contracts under \$1,000, VOSH will make a referral to the Virginia Employment Commission (VEC) and/or the Virginia Workers’ Compensation Commission (VWCC) for potential audits of employment practices. Referrals may be made for contract values over \$1,000 as well.

The new policy and education and outreach materials can be found at: <http://www.doli.virginia.gov/>

¹NC’s \$467 million problem: Abuse of workers, failure to collect taxes”, Mandy Locke, David Raynor, Rick Rothacker and Franco Ordenez, Charlotte Observer, October 6, 2014.

²More Workers Are Claiming ‘Wage Theft’”, Stephen Greenhouse, New York Times, September 2, 2014

³Executive Order 24, “Establishing an Inter-Agency Task Force on Worker Misclassification and Payroll Fraud”, August 14, 2014.

⁴Review of Employee Misclassification in Virginia”, Senate Document No. 10, Joint Legislative Audit and Review Commission (JLARC), June, 2012, page 16.

⁵JLARC Report, pages 14-20

⁶JLARC Study, page iii

⁷<http://www.dol.gov/whd/workers/misclassification/>

⁸<http://www.dlir.state.md.us/workplace/>

⁹The Economic Costs of Employee Misclassification in the State of Indiana

¹⁰The Economic Costs of Employee Misclassification in the State of Illinois

¹¹DOLI Misclassification Public Service Announcement

¹²DOLI Policy Memorandum

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healthcare access, and the benefits of increasing coverage of both of these modalities is far reaching, beyond just healthcare. It will also support local economies, transportation networks, and day-to-day life of residents in Southwest Virginia. In addition, obstacles of funding, integrating with the Health Information Exchange (HIE), credentialing, licensing, and selecting appropriate clinical models present ongoing challenges that need to be addressed.

Ultimately, we are seeing the development of a network in Southwest Virginia centered on meeting the needs of veterans via mechanisms to increase access to services and efficiencies in how that access is increased. A cohesive transportation-telehealth system will help ensure high quality care and availability of services for veterans.

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