



Written Testimony of Deputy Secretary Jennifer L. Berrier

Department of Labor & Industry

Before the House Labor & Industry Committee

April 29, 2019

Good afternoon Chairman Cox, Chairman Harkins, Representative Galloway and members of the House Labor & Industry Committee. I am grateful for the opportunity to participate in this hearing to discuss House Bill 716. The Department of Labor & Industry (L&I) is on the forefront of combatting the harmful practice of employee misclassification and appreciates the General Assembly's initiatives to provide additional resources and tools.

As you may know, misclassification occurs when employers wrongfully classify employees as independent contractors for financial gain. By purposefully misclassifying their employees, businesses not only dodge their responsibility to pay federal, state, and local employment taxes, but also avoid providing fair wages, health benefits, and retirement benefits to those employees. As a result of misclassification, the commonwealth and local municipalities lose out on much-needed revenue and hard-working employees and their families may be robbed of adequate income, benefits, and the assurance that they can access safety net programs should they become injured on the job or experience a layoff.

Unlawful employers who misclassify employees as independent contractors have an unfair advantage over law-abiding employers. These employers are not paying mandatory payroll taxes such as Social Security, Medicare, and unemployment insurance. They are also not paying workers' compensation premiums, health insurance, or overtime pay. With this unfair advantage, law-abiding employers are more easily underbid by dishonest firms, making it more difficult for good, honest businesses to be successful and thrive in the Commonwealth. It is crucial for us to protect and reward employers who follow the rules and pay their fair share.

L&I is affected by employee misclassification in three distinct practice areas: Unemployment Compensation, Workers' Compensation, and the Construction Workplace Misclassification Act, otherwise known as Act 72. For Unemployment Compensation, misclassification is typically discovered through two avenues. The first is when a worker files for unemployment insurance benefits with L&I when a working relationship is terminated. The second is when the Office of Unemployment Compensation Tax Services (UC Tax Services) performs a routine audit of an employer. In both instances, when an employer is found to have misclassified employees as independent contractors, the employer is required to pay the retroactive contribution into the fund along with interest and penalties. Nonpayment, while it could result in a lien against the employer's personal property, undoubtedly impacts the benefits trust fund.

The Center for Workforce Information and Analysis, within L&I, reviewed a variety of sources in an attempt to understand the extent of employee misclassification in Pennsylvania. Utilizing federal and

nationwide data, it estimated that 15% of Pennsylvania employers may misclassify their employees as independent contractors. Based on the number of workers reportable to the unemployment compensation system, this may equate to 275,000 workers. Moreover, under this scenario, the amount of tax revenue lost under the unemployment compensation system alone may be \$103 million annually.

For workers' compensation, misclassification is discovered when a worker is injured while performing tasks for a business. In that instance, the worker files a claim with the Bureau of Workers' Compensation and the misclassification is discovered during the hearing process. A judge from the Workers' Compensation Office of Adjudication (WCOA) will issue a determination finding that the worker is an employee entitled to compensation for the injury. Workers in this situation are often forced to rely on the Commonwealth's Uninsured Employers Guaranty Fund—a fund that is currently coping with significant insolvency.

According to information L&I has gathered, the top industries misclassifying employees as independent contractors are construction, trucking, domestic services, food services, and administrative services. In 2010, the General Assembly recognized the significant problem of misclassification in the construction industry, and attempted to curb this harmful practice through the passage of Act 72. The act sought to prohibit misclassification by establishing specific criteria that narrowly defines which workers within the construction industry can be counted as independent contractors. The act granted L&I investigatory powers for complaints of violations, and it set forth administrative penalties for L&I's enforcement and criminal penalties for local District Attorneys' and Attorney General's Office's enforcement.

Under Act 72, L&I actively works to identify alleged violations in three primary ways. First, the Bureau of Labor Law Compliance (BLLC) accepts complaints from aggrieved workers and conducts investigations. Second is through cooperation of an internal task force. L&I currently maintains an internal taskforce with UC Tax Services, WCOA, and BLLC, with plans to extend the intra-agency task force to the State Workers' Insurance Fund and the Bureau of Internal Audits. As a usual course of business, UC Tax Services performs audits of many Pennsylvania businesses throughout the year, including audits of construction firms. These audits may reveal whether employers have misclassified employees as independent contractors. Pursuant to departmental policy, UC Tax Services then refers its findings to BLLC, which in turn issues fines for Act 72 violations. Similarly, WCOA flags and reports misclassified employees discovered through workers' compensation disputes to BLLC. Lastly, BLLC identifies Act 72 violations through construction worksite visits. During visits, investigators interview workers on the construction site, review payroll information as appropriate, and distribute educational materials on labor laws to construction workers.

I should also note that this year, the department joined the Joint Task Force on Construction Industry Fraud in Pittsburgh. The task force was created by Pittsburgh City Council in January as a tool to identify construction employers who commit wage violations that result in tax fraud. In addition to the department, the task force includes a number of city officials and the Pittsburgh Regional Building and Construction Trades Council.

Since Governor Wolf took office, the department has stepped up its efforts to detect and prevent misclassification under Act 72. Measuring from 2015, the department has fined over 700 contractors and collected over \$1.5 million in penalties. In 2018 alone, BLLC collected nearly \$567,000 in fines from more than 200 contractors, a 57% uptick from the previous year. Investigators also conducted over 400 on-site investigations of construction sites last year, which represents a 71% increase in productivity over the prior year.

Additionally, under our task force, UC Tax Services identified more than \$36 million in under-reported wages in 2018, and found nearly 1,800 misclassified employees in the construction industry. It is important to point out that while Act 72 is limited to the construction industry, our UC Tax Services offices can pursue unpaid unemployment compensation taxes and impose penalties against employers in any industry who fail to comply with the requirements of the Unemployment Compensation Act. Across all industries, 2018 audits by UC Tax Services discovered over 22,000 unreported employees that generated nearly \$7.2 million in additional unemployment compensation contributions.

While we should certainly acknowledge these successes, there remain significant barriers to curbing all instances of misclassification. Despite L&I's efforts to break down silos within the department and maximize its resources, the issue is so prevalent that a larger net is needed, especially when addressing vulnerable workers who participate in the underground economy. We want to ensure that low-skilled workers with barriers to employment are not exploited because of their desire to work. However, these workers may have a disincentive to report violations. In many cases, workers may be unwilling to jeopardize their ability to earn income to support themselves or their families. Unfortunately, L&I typically hears from these misclassified workers only when an employer withholds pay or when they attempt to file for workers' compensation or unemployment compensation benefits.

For these reasons, L&I is grateful for the introduction of a number of bills by House members that would attack this issue head-on and provide us with additional resources and tools, like House Bill 716, so we can improve our ability to investigate and impose meaningful penalties. The department remains committed to protecting all law-abiding employers and workers in Pennsylvania.

Thank you for the opportunity to testify today. I'm happy to answer any questions you may have.