



# Statement of Associated Builders and Contractors

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Testimony of Rich Shavell, CPA

House Education and Labor Committee

Subcommittee on Workforce Protections  
Chairwoman Lynn Woolsey and Ranking Member Joe Wilson

Hearing on "Providing Fairness to Workers Who Have Been Misclassified as  
Independent Contractors"

March 27, 2007

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## The Voice of the Merit Shop

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Good morning Madam Chair and honorable members of this subcommittee. My name is Rich Shavell and I am President of Shavell & Company, P.A. We are an accounting and consulting firm that specializes in construction with offices in Florida. I serve as Chair of the Tax Advisory Group for The Associated Builders and Contractors, Inc. (ABC).

ABC is a national trade association representing more than 24,000 merit shop contractors, subcontractors, materials suppliers, and related firms from across the country and from all specialties in the construction industry. Our diverse membership is bound by a shared commitment to the merit shop philosophy in the construction industry. This philosophy is based on the principles of full and open competition unfettered by the government, nondiscrimination based on labor affiliation, and the award of construction contracts to the lowest responsible bidder through open and competitive bidding. It is an honor to be their voice before you today.

ABC appreciates the opportunity to address the Committee on the issue of independent contractors.

While Congressional action may be necessary to clarify the entire independent contractor regime, we caution this Committee and Congress to carefully consider the impact of any such action to ensure that good-honest hard working businesses and their workers are not overrun with increased and costly regulatory requirements.

I intend to address three topics:

- ❑ First, ABC supports a level playing field for all businesses and ABC supports efforts to ensure that workers who are misclassified receive appropriate relief;
- ❑ Secondly, Independent Contractors are integral to our industry and our country's dynamic economy; and
- ❑ Lastly, what potential resolutions are available to address worker misclassification.

### **1. All Parties Desire a Level Playing Field**

While the construction industry provides significant opportunities for independent contractors, all parties must function under a confusing framework of rules that inadequately address the classification of workers as either employees or independent contractors. Initially, it is critical to distinguish between *wrongful* classification and misclassification. In construction, *wrongful* classification by a competitor can result in a competitive disadvantage to other contractors. Contrast this with misclassification, which can easily occur because current law and rules are extremely complex.<sup>1</sup>

Those companies not paying employee taxes or worker' compensation by *wrongful* classification can undercut the competition by offering lower bids. ABC in no way condones intentional misclassification by businesses that shirk their duties to society and their workers. We endorse a level playing field for all businesses and workers. For those

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<sup>1</sup> Consider that the instructions for the three pages Form SS-8 (Rev. 11-2006), Determination of Worker Status for Purposes of Federal Employment Taxes and Income Withholding, that the IRS requires to secure a determination letter on the status of a worker, reflects 22 hours for recordkeeping and two hours to complete.

workers who are faced with improper misclassification we believe they should be accorded every opportunity to have their financial situation corrected. Also employment agencies that do not properly pay workers should face severe enforcement.

Under current tax law, taxpayers use a 20-factor common law test that can be controversial and cumbersome because it is so subjective, leading to disputes between the IRS and businesses. Even if misclassification is unintentional the ramifications can be dramatic to both the worker and business owner in the form of back taxes, interest, applicable penalties, and even the possible disqualification of retirement plans.

Adding further confusion is that in addition to the IRS methodology for determining status a business owner may confront other methodologies for differing purposes.<sup>2</sup> For example, the Common Law “Right to Control” test which is often used by courts to determine employee status in various types of cases, including employment discrimination and benefit cases, tax cases, and tort liability cases. And, the Department of Labor uses a model of analysis known as the “economic realities test” to determine coverage under, and compliance with, the minimum wage and overtime requirements of the Fair Labor Standards Act. Further many states have similar but not identical methods for state purposes.

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<sup>2</sup> There are many non-federal income factors that may be relevant to independent contractor vs. employee status: Workers compensation benefits; Federal and state civil rights laws; Fair Labor Standards Act; National Labor Relations Act; Occupational Safety and Health Act; Americans with Disabilities Act; and State income/unemployment taxes

## **Independent Contractors are Integral to the Construction Industry**

Independent contractors are often the perfect answer to a pressing need for special skills and experience needed on short-term projects. The flexibility an independent contractor provides to a small, fledging operation as well as larger enterprises creates numerous advantages for all parties involved. The independent contractor has freedom to choose his or her work schedule, while the small business owner maintains the flexibility to adjust work demands with current business activity, and the consumer enjoys the benefit of a reasonably priced, quality product. Lawful utilization of independent contractors provides a good source of labor for projects where the contractor does not need to exercise the type of control that would necessitate the hiring of an employee.<sup>3</sup>

### **Potential Resolutions**

Four resolutions are commonly discussed:

1. Increase Reporting Requirements - Within the context of ‘The Federal Tax Gap’ it has been proposed to Congress that increased information reporting may provide part of the solution<sup>4</sup>. IRS statistics indicate that when reporting requirements such as Forms 1099 are required, compliance increases from

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<sup>3</sup> Many ABC members started their own businesses by initially working as an independent contractor. It is not unusual for these individuals to work as employees during regular hours and as independent contractors during off-hours and weekends. There is no better way to become established as a small business than to begin as an independent contractor. Because of the cyclical nature of the industry, many businesses cannot afford to keep certain specialized trade craftspeople as employees. Sometimes, skilled craftspeople are needed several times throughout the year, but not enough to warrant full-time or even part-time employment. Having to place two or three extra employees on the payroll just to finish a short-term project places a significant and unnecessary burden on companies.

<sup>4</sup> *The Causes and Solutions to the Federal Tax Gap: Hearing Before the Senate Committee on the Budget, 109th Cong.* (2006) written statement of Nina E. Olson, National Taxpayer Advocate available at: <http://budget.senate.gov/repUBLICAN/hearingarchive/testimonies/2006/NinaOlsenTestimony.pdf>.

approximately 57% to 96%.<sup>5</sup> Eliminating the exemption from 1099 reporting for corporations would facilitate elevated reporting for independent contractors. By approaching the issue this way, less emphasis is placed on unclear classification rules while emphasis is shifted to the relatively clear laws of filing annual information returns.

2. Elevate Enforcement - IRS indicates that for every dollar invested in enforcement four dollars in increased revenue to Treasury is returned. Further, the Commissioner of the IRS has stated, "This 4:1 return on investment does not consider the indirect effect of increased enforcement activities in deterring taxpayers who are considering engaging in non-compliant behavior."<sup>6</sup> Departments of Labor - both Federal and the States - can also elevate enforcement on this issue.
3. Clarify and simplify the 20-factor subjective test and educate businesses and workers<sup>7</sup>.
4. Eliminate availability of independent contractor status.

ABC supports the three initial listed with the understanding that we remain concerned that any action taken by Congress should be measured against the impact on good-honest hard working businesses and their workers to ensure they are not overrun with increased and costly regulatory requirements.

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<sup>5</sup> *IRS Updates Tax Gap Estimates*, IR-2006-28 (Feb. 14, 2006).

<sup>6</sup> Written testimony of Commissioner of Internal Revenue Service, Mark Everson, before The Senate Committee on the Budget (Feb. 14, 2007)

<sup>7</sup> ABC previously testified on July 26, 1995 before the House Small Business Committee in support of increased education and clarification of the 20-factor independent contractor test.

However, the mechanics of eliminating independent contractors from our economy is wrought with technical problems that are not clearly explained by constituencies who have concerns with the legal availability of independent contractors. These technical issues may be the reason you don't hear the IRS constructively discussing the option of eliminating independent contractor status.

Further, this would not be a viable alternative in the construction industry. Consider one fundamental concern for the contractor who is properly functioning as an independent contractor: Cash flow would be impaired for the independent contractor who exceeds FICA limits since each "employer" would withhold up to the limit.<sup>8</sup> For significant technical and practical reasons, ABC cannot advocate that independent contractor status is eliminated and no credible consideration can be given to such option.

I thank you for the opportunity to testify today on behalf of ABC. I look forward to your questions.

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<sup>8</sup> The end result will be increased construction costs. Also consider: a). It would force the independent contractor to adopt a massive record keeping structure that they may not be equipped to handle. At times the independent contractor may be the employer when performing small projects, then switch to an "employee" status when working as a sub. The resulting tax payment requirements would be difficult to monitor; b). Monitoring the unemployment rates in some states would be very difficult and rules would have to be established to help determine which "employer" would be responsible for the unemployed worker; c) Companies in some states may be forced to take on additional exposure in the area of workers compensation for which they may not be familiar and for which duplicative or exorbitant safety program costs may be the result; d) The new "employer" would have to take on all of the financial risks of a project rather than mitigating some of that risk by using the independent contractor for a lump sum job. Bidding jobs would thereby become more complex.

**TESTIMONY OF PAUL JOHNSON  
P.J. NICE CONSTRUCTION**

**ON BEHALF OF  
ASSOCIATED BUILDERS AND CONTRACTORS**

**BEFORE THE  
HOUSE SMALL BUSINESS COMMITTEE  
SUBCOMMITTEE ON TAX AND FINANCE**

**JULY 26, 1995**

Good morning Madam Chairman and honorable members of the Subcommittee. My name is Paul Johnson, and I am the owner of P.J. Nice Construction, located in Maryland. I appreciate the opportunity to appear before you today to discuss the simplification of the independent contractor designation. This issue is extremely important to the open shop construction industry, and I am pleased to speak on behalf of Associated Builders and Contractors as well as my own company.

Associated Builders and Contractors is a national trade association representing approximately 18,000 contractors and related firms in 81 chapters across the country. ABC's diverse membership is bound by a shared commitment to the free enterprise system and the merit shop philosophy of awarding construction contracts to the lowest responsible bidder, through open and competitive bidding. With 80 percent of the construction workforce choosing to work open shop, it is an honor to be their voice before you today.

In the small business world and in construction in general, independent contractors are



often the perfect answer to a pressing need for special skills and know how for certain projects. The flexibility provided by an independent contractors provides numerous advantages for the business owner as well as for the independent contractor. It is imperative that businesses be able to make sound economic decisions about the classification of individuals as employees or independent contractors.

Because of the importance of independent contractors to the construction industry, clarification of the standards that determine independent contractor status is critical. The current 20-factor, common law test is unwieldy. Because of the uncertainties surrounding it, it can lead to litigation and potentially to back tax penalties that can be devastating. Not only are the financial implications very serious for a small business like mine, but it is also very upsetting to discover that a sound business decision made in good faith one day, is a costly violation of the law the next day.

Independent contractors in the construction industry make significant investments in their own businesses. These investments include tools of the trade, vehicles, consumables, and specialized equipment. But the most important, and often most costly investment made by independent contractors in the construction industry is insurance. In order for an independent contractor to do business with my firm, they must demonstrate that they have sufficient insurance coverage. Other investments may included travel from job to job as well as any special clothing or personal protective equipment. Finally, independent contractors in certain crafts must have earned certificates pre-qualifying them to work with certain materials or to certain standards.

The nature of construction contracting necessitates commitments from independent contractors to complete certain tasks within certain time periods. The only way a general contractor, such as myself, can estimate a job accurately for time and cost is to make sure that all independent contractors I contract with have an acute awareness of their schedules and the overall time line of the project. The contracts that I use for my independent contractors make them liable for early termination. In cases where the contracts are task, rather than time, oriented, the independent contractor would be liable for damages for defective work.

The independent contractors I contract with also contract with other general contractors. Understandably, construction work cannot be simultaneously performed at more than one site. However, it the nature of a project that tasks must be performed in a certain order, leaving down time between independent contractor performances. Independent contractors often take advantage of these intervals to perform services for others. This is an ideal situation for all involved.

Despite these factors, which so clearly indicate proper designation of independent contractor status, the construction industry is repeatedly plagued by IRS audits and reclassifications. The IRS generally examines worker classification some time after the taxpayer has made its determination of the worker's classification and after the taxpayer has filed its returns. Thus, reclassification by the IRS can result in severe penalties. Because the current system is unwieldy and unpredictable for the contractors involved, the ideal solution seems to be Congressional clarification of independent contractor status.

H.R. 1972, introduced by Congressman Christensen and cosponsored by Congressman Kim, both of whom addressed this subcommittee earlier today, addresses the problems faced by the construction industry. H.R.1972 has been endorsed by Associated Builders and Contractors as well as many other organizations advocating the proper utilization of independent contractors. This bill clears up the fog surrounding the 20-factor test and replaces it with a clear-cut option for businesses.

I cannot understate the value to our nation of strong relationships between small businesses and independent contractors. Independent contractors are not only useful for businesses like mine, they are also the seeds of new small businesses.

I thank you for your subcommittee's attention to this important matter. On behalf of Associated Builders and Contractors, I offer any assistance we can give you to resolve this issue.

This concludes my prepared testimony. I believe that, as someone who actually uses independent contractors on a regular basis, my greatest use to you may be to make myself available to answer any questions you may have.