

SESSION OF 2011

**SUPPLEMENTAL NOTE ON  
SUBSTITUTE FOR HOUSE BILL NO. 2135**

As Amended by Senate Committee of the Whole

**Brief\***

Sub. for HB 2135, as amended, would revise the procedures used to determine if employees have been misclassified as independent contractors.

The bill would revise employment security law regarding the process used to determine the misclassification of employees, the communication of confidential taxpayer information between the Departments of Revenue and Labor, and penalties for repeated violations of employee misclassification.

The Secretary of the Department of Labor, or the Secretary's designee, would have the responsibility to make all determinations regarding the classification of a worker as being an employee or an independent contractor. If the Department of Revenue would have reason to believe that a business misclassified an individual, the Department of Revenue would request the Department of Labor to make a determination of the individual's status. The Department of Revenue would be authorized to submit all relevant payroll and withholding tax information to the Department of Labor, which would be required to abide by the same levels of confidentiality that is required statutorily of the Department of Revenue. If the Department of Labor would need additional information regarding the business in question, the Department of Revenue would be required to provide it.

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\*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

The Labor Secretary would be required to determine an individual's status based upon the totality of circumstances, exercising strict impartiality in the determination process. A business would be deemed to have made a valid classification if the business had made a reasonable reliance based upon:

- A judicial decision;
- A ruling from the Internal Revenue Service (IRS), the Department of Revenue, or the Department of Labor;
- An audit performed by the IRS, the Department of Revenue, or the Department of Labor; or
- Work Classifications that customarily are used by the industry in which the business operates.

The business would need to demonstrate that it has acted consistently in its employment practices and tax reporting. If the Labor Secretary could not ascertain a reasonable basis, then eight factors contained in the following questions would be considered:

- Must the individual comply with specific instructions from the business regarding when, where, and how to perform the service;
- Are the activities of the individual integrated into the ongoing operations of the business;
- If needed to accomplish the desired end result, does the individual have the responsibility to hire, supervise, and pay assistants;
- Must the individual work exclusively for the business in question;

- Is payment by the business to the individual for services contingent on completion of established benchmarks or tasks;
- Does the individual provide significant tools, materials, or other equipment used in the accomplishment of the desired end result;
- Is the individual responsible for any expenses incurred in the performance of services; and
- Can the individual suffer a loss in the course of performing services?

Once the Labor Secretary had determined an employee's classification, the Department of Revenue would accept the determination. The Department of Revenue could request the Department of Labor to provide the information that was used to make the determination. If so, the Department of Revenue would maintain the same level of confidentiality that is required statutorily of the Department of Labor. If it would be determined that an employee was misclassified, then the two departments would notify the business that additional UI contributions and income withholding taxes were due.

Before a UI penalty or interest could be charged, the Labor Secretary would have the discretion to consider the appropriateness to the business. If a reasonable basis for the classification exists, the Labor Secretary would be prohibited from imposing penalties, interest, or the recovery of back taxes owed to the Employment Security Fund. The Labor Secretary would be required to educate businesses on the classification of employees. The Secretaries of Revenue and Labor would be granted rule and regulation making authority to implement the Act.

The current statutory UI definition for "employment" would be revised by deleting the "two-prong" requirement. In

order for an individual to be considered an independent contractor, that person's work must be: (1) free from the business's control and (2) performed outside the usual course of the business's operations. The new text would state that an individual would be considered an employee if the business would retain the right to control the end result and the means by which the end result would be accomplished.

Penalty provisions would be revised to provide for a second and subsequent violations. For a second violation, a person who misclassifies an individual would be subject to the civil penalty that currently is specified in statute and would become subject to a class C nonperson misdemeanor. For subsequent violations, the person would be subject to the civil penalty and class A nonperson misdemeanor.

The bill would require the Secretary of the Department of Labor to make an annual report to the Senate Committee on Commerce and the House Committee on Commerce and Economic Development. The report would provide information regarding the number of employee misclassifications, investigations, and money collected in the preceding calendar year.

## **Background**

HB 2135, as introduced, would have repealed the authority for the Department of Revenue to share taxpayer information with the Department of Labor for purposes of determining the classification of employees. The inter-departmental sharing of information was authorized in 2006.

Proponents included the Kansas Chamber, the Kansas Association of Realtors, and a private attorney. Proponents stated concern over the sharing of confidential taxpayer information. Proponents also stated concern regarding meritless investigations that were initiated by the allegations of competitors. The current "two-prong" employment test can be difficult to meet.

Opponents included the Carpenters' Union, Kansas AFL-CIO, and a former Secretary of Revenue. Opponents were concerned that the inability for the two departments to share information could lead to the misclassification of more employees. This, in turn, could lead to decreased revenues to the State General Fund and the UI Security Fund.

The Departments of Revenue and Labor provided neutral testimony during the House Committee hearing. In 2010, the Department of Labor determined the misclassification of 1,826 workers, recovering more than \$195,000 owed to the UI Security Fund. Approximately \$10 million in wages was subject to withholding taxes.

The House Committee on Commerce and Economic Development adopted a substitute bill that would:

- Clarify the exchange of taxpayer information between the two departments;
- Assign to the Department of Labor the responsibility to determine employee classification and require the Department of Revenue to abide by the determination;
- Revise the Department of Labor's method to determine classification; and
- Provide for additional penalty provisions.

The Senate Committee on Commerce amended the bill to:

- Clarify that a business's reasonable basis for an employee's classification is subject to the Act; and
- Clarify when penalties, interest, and back taxes would not be imposed upon employers.

The Senate Committee of the Whole amended the bill to:

- Reduce the penalty for third and subsequent violations, from a severity level 10, nonperson felony to a class A, nonperson misdemeanor; and
- Require misclassification information to be reported annually to the Senate Commerce Committee and the House Commerce and Economic Development Committee.

According to the fiscal note prepared by the Division of the Budget, in consultation with the Departments of Revenue and Labor, the original bill would have a negative but unknown impact on the State General Fund. The Department of Revenue stated that approximately \$300,000 has been collected annually in withholding tax collections due to audits that involved information exchanged between the two Departments.