EMPLOYEE MISCLASSIFICATION

Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention

Why GAO Did This Study

When employers improperly classify workers as independent contractors instead of employees, those workers do not receive protections and benefits to which they are entitled, and the employers may fail to pay some taxes they would otherwise be required to pay. The Department of Labor (DOL) and Internal Revenue Service (IRS) are to ensure that employers comply with several labor and tax laws related to worker classification. GAO was asked to examine the extent of misclassification; actions DOL and IRS have taken to address misclassification, including the extent to which they collaborate with each other, states, and other agencies; and options that could help address misclassification. To meet its objectives, GAO reviewed DOL, IRS, and other studies on misclassification and DOL and IRS policies and activities related to classification; interviewed officials from these agencies as well as other stakeholders; analyzed data from DOL investigations involving misclassification; and surveyed states.

What GAO Recommends

This report includes various recommendations to DOL and IRS to enhance enforcement of proper worker classification, improve outreach to workers about classification, and improve interagency coordination in addressing misclassification. In commenting on a draft of this report, DOL and IRS generally agreed with our recommendations.

View GAO-09-717 or key components.
For more information, contact Andrew Sherrill at (202) 512-7215 or sherrilla@gao.gov.

What GAO Found

The national extent of employee misclassification is unknown; however, earlier and more recent, though not as comprehensive, studies suggest that it could be a significant problem with adverse consequences. For example, for tax year 1984, IRS estimated that U.S. employers misclassified a total of 3.4 million employees, resulting in an estimated revenue loss of $1.6 billion (in 1984 dollars). DOL commissioned a study in 2000 that found that 10 percent to 30 percent of firms audited in 9 states misclassified at least some employees.

Although employee misclassification itself is not a violation of law, it is often associated with labor and tax law violations. DOL's detection of misclassification generally results from its investigations of alleged violations of federal labor law, particularly complaints involving nonpayment of overtime or minimum wages. Although outreach to workers could help reduce the incidence of misclassification, DOL's work in this area is limited, and the agency rarely uses penalties in cases of misclassification.

IRS enforces worker classification compliance primarily through examinations of employers but also offers settlements through which eligible employers under examination can reduce taxes they might owe if they maintain proper classification of their workers in the future. IRS provides general information on classification through its publications and fact sheets available on its Web site and targets outreach efforts to tax and payroll professionals, but generally not to workers. IRS faces challenges with these compliance efforts because of resource constraints and limits that the tax law places on IRS's classification enforcement and education activities.

DOL and IRS typically do not exchange the information they collect on misclassification, in part because of certain restrictions in the tax code on IRS's ability to share tax information with federal agencies. Also, DOL agencies do not share information internally on misclassification. Few states collaborate with DOL to address misclassification, however, IRS and 34 states share information on misclassification-related audits, as permitted under the tax code. Generally, IRS and states have found collaboration to be helpful, although some states believe information sharing practices could be improved. Some states have reported successful collaboration among their own agencies, including through task forces or joint interagency initiatives to detect misclassification. Although these initiatives are relatively recent, state officials told us that they have been effective in uncovering misclassification.

GAO identified various options that could help address the misclassification of employees as independent contractors. Stakeholders GAO surveyed, including labor and employer groups, did not unanimously support or oppose any of these options. However, some options received more support, including enhancing coordination between federal and state agencies, expanding outreach to workers on classification, and allowing employers to voluntarily enter IRS's settlement program.

United States Government Accountability Office