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## Study to shed light on “gray economy” of misclassified workers

BY MICKY BACA

For decades, unscrupulous construction contractors, as well as employers in other industries, have circumvented workers' compensation, unemployment insurance and other mandated payroll expenses by misclassifying workers as independent contractors. Now researchers at Harvard University are conducting a study to find out how widespread such practices are and how much it is costing in lost state and federal revenue, worker hardships and unfair competition to legitimate businesses.

While the results are expected to have significance for those on all sides of the construction labor market, the study has added incentive to monitor the outcome after a recent state Superior Court ruling empowered a misclassified worker of a subcontractor to sue the general contractor for damages if the worker is injured.

The study is taking place as construction union officials contend misclassification of workers is on the rise. The state's Attorney General's office has vowed to make prosecution of misclassification a priority in the coming months as it clarifies regulations.

### How it works

Here's an illustration of how misclassification works: Drywall subcontractor X has been hired to work on a project. It has workers report to the job at a prescribed time and supplies them with tools, materials and doesn't list the workers as employees. Instead, it deems them “independent contractors,” who, among other things, are responsible for their own workers' compensation, unemployment insurance, social security and other workers' benefits.

With no deductions and an opportunity to under-report income, the workers may get more money in the short term but lose out on overtime, health insurance and unemployment benefits if they are laid off. Company X, in turn, saves 20 to 30 percent in payroll expenses it would have incurred if it paid the “independent” workers like regular employees.

So goes the “gray economy” of misclassifying workers in the construction industry, an illegal practice that regulators admit is tough to quantify, even tougher to enforce and could have far-reaching ramifications for workers and the construction industry overall.

### Offloading private problems to the public purse

The study is being done by the Construction Policy Research Center, a research and public policy group of the Harvard School of Public Health, the Harvard Law School's Labor and Worklife Program, and the executive director of the Labor and Worklife Program. The issue of misclassifying workers was brought to attention by the various groups, Bernard says, including the Boston-based N.E. Regional Council of Carpenters, which has long practiced as a growing problem in the region.

*From six percent to 20-25 percent of employers misclassify workers, depending on the state and the income level of the worker, according to a study by Françoise Carre of the McCormack School, UMass-Boston.*

While misclassification is a major concern of unions because it undermines their organization of workers, the practice hurts those on all sides of the construction labor world. "It's an interesting situation, where work is harmed and the government is harmed," she says. "A number of individuals and institutions are taking a big bite out of the pie by offloading the cost of their failure to comply onto everybody else."

When companies don't pay their share of workers comp, Bernard notes, other companies must pick up the tab. Companies that become disillusioned with being classified as subcontractors have difficulty changing back to being classified as employees because they could be liable for back taxes, she says. And if an uninsured worker is injured, the cost is transferred to the public purse. Bernard says. What's more, other subcontractors bidding on the same work as those who misclassify workers are at a decided pricing disadvantage, she says.

General contractors, under which unscrupulous subcontractors may work, also have a stake in the misclassification issue that got even higher with the recent court ruling, notes James Grosso, legal council for the Associated General Contractors of Massachusetts Labor Relations Division. Not only are they potentially liable for illegal actions on their job sites, but they are also required to pay worker comp benefits to workers (misclassified or not) of subcontractors when a worker is injured on their job site and the sub has no workers comp insurance. The Sept. 14, 2004 ruling extended the liability of general contractors' potential liability in such cases even further when it determined that an uninsured masonry worker is entitled to sue Burlington-based general contractor Fred Salvucci Corp. for damages even though Salvucci provided comp benefits for Larson's injuries on the job. Larson was a worker for Methuen-based subcontractor Giannelli. Giannelli did not provide workers comp insurance for him, according to the suit.

In a traditional employee relationship, Grosso says, when an employer provides workers comp insurance, the employer cannot be sued by the worker for damages. While Larson was not listed as a misclassified worker in the lawsuit, the ruling certainly ups general contractors' exposure in misclassification cases.

### **A reliable source**

Grosso says misclassification of workers isn't a top concern of AGCM but it is a concern. He says he thinks it is a good idea to quantify just how big a problem the practice is. Grosso says he is confident that a study by Harvard will be balanced. He says he would be "suspicious" of such a study if it were done by a less reputable organization linked to labor unions.

The misclassification issue is a key focus of the N.E. Regional Council of Carpenters, which sees it as a problem in the construction labor market and seeks to publicize alleged violations by contractors. Stephen Joyce, head of the union's labor management program, says the practice is "rampant" and isn't just a threat to the union but also to companies and taxpayers. Some contend, however, the union uses the issue in its effort to discredit contractors committed to using union labor.

One contractor dogged by the carpenters union for allegedly using questionable subcontractors because he has not agreed to sign a contract with the union, is Worcester-based Cutler Associates Inc. Cutler CEO says that, while he is not familiar with the Harvard study, he thinks it would be helpful if the issue of misclassification could be clarified.

Mulligan says there's a lot of confusion about who can be classified as an independent contractor. "The problem is that it is so unclear," he says, noting that state and federal guidelines vary. "If there were more clarity, more companies trying to do it right," he adds.

His company, he says, does the right thing, has never had a claim against it for misclassification and has never had any problems with subcontractors on its work sites. He says some subcontractors his company uses have been cited by

*“It’s real, real easy to fall into the trap,” says William Philbrick of Greenberg, Rosenblatt, Kull & Bitsoli. can realize from misclassifying workers as independent subcontractors can be up to 30-3 percent.*

### **This could happen to you**

Bill Philbrick, director of tax and business valuation services at Worcester-based accounting firm Greent Bitsoli, agrees that the distinction between who is a valid independent contractor and an employee is a c which companies need to be careful. In some cases, he says, a company may have crossed the line bet as an employee instead of a subcontractor and not even realize it.

For example, he notes, a general contractor who has long done business with a particular subcontracto other jobs may not realized that, if the relationship changes to the point where that subcontractor only dc general contractor and begins to take direction from them, they have become an employee.

Straying into misclassifying workers can have tremendous financial repercussions for companies, Philb hires a worker as a subcontractor and has other employees who have tax-exempt pension and benefit the IRS to have misclassified that one subcontractor, the IRS could declare the benefits program in offered to all employees. In such a case, he says, the IRS could revoke the tax-exemption status of all o Such a ruling could bankrupt a company, according to Philbrick.

Philbrick cautions that when it comes to independent contractors, companies should seek professional : easy to fall into the trap,” he says. On the other hand, Philbrick says, the savings companies can enjoy f workers as independent subcontractors are substantial, as much as 30-35 percent. “Let me put it this wa he says.

*“The problem from my view is that it is so unclear,” says Frederick Mulligan, CEO of Cutler Associates, federal guidelines for classifying employees. “If there were more clarity, it would benefit the companies :*

### **In a nutshell**

- Worker misclassification, which researchers and union officials speculate is on the rise in the region, is companies can save between 20 and 30 percent on labor costs by listing employees as “independent cc as employees.
- But treating an independent contractor in the same manner as employees can have significant financi: as loss of tax benefits for pension plans and, in the case of a recent state Superior Court ruling, allowing to sue the general contractor for damages if the worker is injured on the job site.
- A Harvard study is seeking to establish patterns of subcontracting practices in New England to enable estimate how much misclassification may be occurring. Researchers are using unemployment insurance have access to information on specific companies or individuals. The study is expected to be finished ne
- The state Attorney General’s office says new laws have clarified misclassification and that the office expects to prosecute more violators.