

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 2357-02
Bill No.: HCS for HB 1137
Subject: Labor and Management; Employees-Employers
Type: Original
Date: April 3, 2019

Bill Summary: This proposal modifies provisions relating to the misclassification of workers.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
General Revenue	\$0 or (Unknown)	\$0 or (Unknown)	\$0 or (Unknown)
Total Estimated Net Effect on General Revenue	\$0 or (Unknown)	\$0 or (Unknown)	\$0 or (Unknown)

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
Various State Funds	\$0 or (Unknown)	\$0 or (Unknown)	\$0 or (Unknown)
Total Estimated Net Effect on <u>Other</u> State Funds	\$0 or (Unknown)	\$0 or (Unknown)	\$0 or (Unknown)

Numbers within parentheses: () indicate costs or losses.

This fiscal note contains 8 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
Unemployment Compensation Administration Fund (0948)	\$0 or (\$40,000,000)	\$0 or (\$40,000,000)	\$0 or (\$40,000,000)
Job Development and Training Fund (0155)	\$0 or (\$12,000,000)	\$0 or (\$12,000,000)	\$0 or (\$12,000,000)
Total Estimated Net Effect on <u>All</u> Federal Funds	\$0 or (\$52,000,000)	\$0 or (\$52,000,000)	\$0 or (\$52,000,000)

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
Total Estimated Net Effect on FTE	0	0	0

☒ Estimated Net Effect (expenditures or reduced revenues) expected to exceed \$100,000 in any of the three fiscal years after implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
Local Government	\$0 or (Unknown)	\$0 or (Unknown)	\$0 or (Unknown)

FISCAL ANALYSIS

ASSUMPTION

§§285.500 and 285.517 - Misclassification of workers

Officials from the **Department of Labor and Industrial Relations (DOLIR)** state:

The bill adds a new section 285.517, that provides the definition of an independent contractor.

Review of this bill has identified an issue that may affect certification of Missouri's unemployment insurance (UI) program.

The federal and state governments are jointly responsible for administering the unemployment insurance (UI) system. State laws must meet certain federal requirements for the state agency to receive the administrative grants needed to operate its UI program and for employers to qualify for certain tax credits.

Each year, on October 31, the Secretary of Labor certifies the state unemployment insurance programs that conform and comply substantially with federal law. (26 U.S.C. § 3304.) If, and only if, a state's unemployment insurance program is certified to be in conformity with Federal requirements, employers within the state are eligible to receive a credit against their Federal Unemployment Tax Act (FUTA) taxes. (26 U.S.C. § 3302.)

Non-conformity with federal law will jeopardize the certification of Missouri's UI program. If the program fails to be certified, Missouri would lose approximately \$40 million in federal funds the state receives each year to administer the UI program. Additionally, Missouri would lose the approximately \$12 million in federal funds each year the Department of Economic Development, Division of Workforce Development uses for Wagner-Peyser reemployment services.

The Federal Unemployment Tax Act (FUTA) imposes a 6.0% payroll tax on employers. Most employers never actually pay the total 6.0% due to credits they receive for the payment of state unemployment taxes and for paying reduced rates under an approved experience rating plan. FUTA allows employers tax credits up to a maximum of 5.4% against the FUTA payroll tax if the state UI law is approved by the Secretary of Labor. However, if this bill causes Missouri's program to be out of compliance or out of conformity, Missouri employers could pay the full 6.0%, or approximately an additional \$1.014 billion per year.

ASSUMPTION (continued)

This bill may raise an issue with federal law since section 285.517 indicates that workers shall be considered independent contractors and not employees of the company if certain conditions are met.

The designation of independent contractor status for services performed for a company that may include entities required to be covered under 3304(a)(6)(A), FUTA, may raise a conformity issue.

In the event that the service of the individual is provided to an entity for which coverage is not required, no conformity issue would be raised. However, if the IRS determines that an employer-employee relationship exists using the common law test, the company, as the employer, would be liable for the full FUTA tax of 6.0% without the benefit of any credit as no state contributions would have been paid with respect to the services.

Section 3304(a)(6)(A), FUTA, requires, as a condition of certification of the unemployment compensation (UC) program that UC be payable based on certain services that are not subject to FUTA tax. Services performed for state and local government entities and Indian Tribes (Section 3306(c)(7), FUTA) and certain nonprofit organizations (Section 3306(c)(8), FUTA) must be covered under the UC system if an employer/employee relationship exists.

Section 3306(I), FUTA, references the definition of an employee in Section 3121(d) of the Internal Revenue Code (IRC) of 1986. Section 3121(d)(2), IRC, specifies that employee means "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee."

Regulations implementing Section 3306(I), FUTA, are found at 26 C.F.R. 31.3306(i)-1. These regulations specify that an individual is an employee if the relationship between the individual and the person for whom services are performed has the legal relationship of employer and employee:

"Generally such a relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the results to be accomplished by the work but also as to the details and means by which that result is accomplished."

The regulations go on to point out that "it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if [the employer] has the right to do so." Concerning independent contractors, the regulations are not permissive; if an employer-employee relationship exists, "it is of no consequence that the employee is designated

ASSUMPTION (continued)

as a partner, coadventurer, agent, independent contractor, or the like." Thus, the basic determinant of whether or not service is performed by an independent contractor is the right of direction and control, whether or not it is exercised.

While this bill does not amend the Missouri UI law, the provisions in the bill that an independent contractor relationship exists may preclude the Division of Employment Security from applying the common law of agency right to control test for determination of an employment relationship as provided in Section 288.034.5, RSMo. Missouri UI law must contain a test for an employment relationship at least as strict as the test used by the IRS. The classification of an independent contractor relationship in this bill could result in the exclusion of coverage under the Missouri UI law. Certain individuals could be classified as independent contractors regardless of the outcome of a determination on employment using the common law of agency right to control test. As a result, their services would not be covered under Section 3304(a)(6)(A), FUTA. In the event that there is the right of direction and control of the services performed by the individual, and the employer is a company that is a state and local governmental entity, certain nonprofit organizations, and Indian tribes, the services must be covered under UI law, or a conformity issue could be raised.

Oversight does not have any information to the contrary. Therefore, Oversight will reflect the estimates provided by DOLIR and a zero to unknown cost to the state and local political subdivisions to reflect the potential increase to 6.0% to employers for the payroll tax if the Unemployment Compensation Program is found to be out of compliance or out of conformity by the Secretary of Labor.

Officials from the **Department of Transportation**, the **Office of Administration** and the **City of Kansas City** each assume the proposal will have no fiscal impact on their organization.

In response to a previous version, officials at the **Department of Conservation** and **St. Louis County** each assumed no fiscal impact to their respective agencies from this proposal.

Oversight only reflects the responses that we have received from state agencies and political subdivisions; however, other cities and counties were requested to respond to this proposed legislation but did not. For a general listing of political subdivisions included in our database, please refer to www.legislativeoversight.mo.gov.

<u>FISCAL IMPACT - State Government</u>	FY 2020 (10 Mo.)	FY 2021	FY 2022
GENERAL REVENUE FUND (0101)			
<u>Cost</u> - potential to pay full 6% payroll tax	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>
VARIOUS STATE FUNDS			
<u>Cost</u> - potential to pay full 6% payroll tax	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>
ESTIMATED NET EFFECT ON VARIOUS STATE FUNDS	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>
UNEMPLOYMENT COMPENSATION ADMINISTRATION FUND (0948)			
<u>Loss</u> - DOLIR If UI program fails to be certified	\$0 or <u>(\$40,000,000)</u>	\$0 or <u>(\$40,000,000)</u>	\$0 or <u>(\$40,000,000)</u>
ESTIMATED NET EFFECT ON UNEMPLOYMENT COMPENSATION ADMINISTRATION FUND	\$0 or <u>(\$40,000,000)</u>	\$0 or <u>(\$40,000,000)</u>	\$0 or <u>(\$40,000,000)</u>

<u>FISCAL IMPACT - State Government</u> (continued)	FY 2020 (10 Mo.)	FY 2021	FY 2022
JOB DEVELOPMENT AND TRAINING FUND (0155)			

<u>Loss</u> - DED - If found to be out of compliance - Wagner-Peyser reemployment services	\$0 or <u>(\$12,000,000)</u>	\$0 or <u>(\$12,000,000)</u>	\$0 or <u>(\$12,000,000)</u>
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ESTIMATED NET EFFECT ON JOB DEVELOPMENT AND TRAINING FUND	\$0 or <u>(\$12,000,000)</u>	\$0 or <u>(\$12,000,000)</u>	\$0 or <u>(\$12,000,000)</u>
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<u>FISCAL IMPACT - Local Government</u>	FY 2020 (10 Mo.)	FY 2021	FY 2022
POLITICAL SUBDIVISIONS			

<u>Cost</u> - potential to pay full 6% payroll tax	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>
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ESTIMATED NET EFFECT ON POLITICAL SUBDIVISIONS	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>	\$0 or <u>(Unknown)</u>
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FISCAL IMPACT - Small Business

There are over 156,000 small businesses (less than 50 employees) covered under Missouri's unemployment insurance system. Because Missouri's UI program is certified in conformity with Federal UI laws, most employers never actually pay the total 6.0% in FUTA taxes due to the credits they receive for the payment of state unemployment taxes and for paying reduced rates under an approved experience rating plan. However, this bill could cause Missouri employers to pay the full 6.0%.

FISCAL DESCRIPTION

This bill establishes the criteria of a worker to be considered as an independent contractor. It states that independent contractors shall have a written contract that states the person is an independent contractor, not an employee, and that the person is responsible for all costs, fees, and taxes as an independent contractor. In addition, the person must have the right to control the manner and means by which the work is accomplished, and satisfies at least three out of nine listed requirements of an independent contractor.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Department of Labor and Industrial Relations
Department of Transportation
Office of Administration
Missouri Department of Conservation
City of Kansas City
St. Louis County



Kyle Rieman
Director
April 3, 2019

Ross Strobe
Assistant Director
April 3, 2019