LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 79TH LEGISLATIVE REGULAR SESSION

April 12, 2005

TO: Honorable Allan Ritter, Chair, House Committee on Economic Development

FROM: John S. O'Brien, Deputy Director, Legislative Budget Board

IN RE: **HB3191** by Bailey (Relating to the reporting and misclassification of employees and independent contractors; providing administrative penalties.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for HB3191, As Introduced: an impact of $0 through the biennium ending August 31, 2007.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2006	$0
2007	$0
2008	$0
2009	$0
2010	$0

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue Gain/(Loss) from *UNEMPL COMP SP ADM ACCT* 165
2006	$8,136,623
2007	$8,136,623
2008	$8,136,623
2009	$8,136,623
2010	$8,136,623

Fiscal Analysis

The provisions of the bill amend the Labor Code by defining misclassification of an employee as an independent contractor, which means a service by an individual for remuneration, unless that employer can prove, to the satisfaction of the Texas Workforce Commission (TWC) that the individual’s performance has been and will continue to be free from control or direction.

The provisions also assess a penalty on employers that in bad faith misclassify their employees as independent contractors and stipulate the amount of a penalty to be over and above any tax or interest due on the wages. The penalty would be equal to the tax due on taxable wages or equal to three times the tax due on taxable wages if proven to be due to bad faith. Bad faith exists if at least one of the following occurs: after receiving a ruling from TWC or IRS that an employee is a misclassification, the employer fails to report wages and pay appropriate tax or if an employer exercises a high degree of direction and control over the individual's work in the normal course of business operations. The penalty would apply to each employee misclassification.

The provisions of the bill would assess a penalty based upon the additional tax due when a worker, previously classified by an employer as an independent contractor, is determined to be an employee. The penalty is based upon the additional amount of tax due and requires modifications to the employer tax accounting system and forms and processes used by the Tax and Labor Law Department.

The bill would take effect immediately if it receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If the bill does not receive the vote necessary for immediate effect, the bill would take effect September 1, 2005.

Methodology

According to TWC, in 2004 the TWC Tax Department audited over 8,000 employers. Of those audits 4,458 identified misclassified workers and would have resulted in assessment of the misclassified worker penalty. Assuming that each of these 4,458 employers had at least one misclassified worker that earned over $9,000 during the calendar year at an average tax rate of 1.74 percent, the additional 100 percent penalty would be $698,122.80 (4,458 times 9,000 times 1.74 percent).

According to TWC, each year the Tax Department conducts approximately 150,000 report due investigations. Using the Internal Revenue Service and Department of Labor's estimate of 15 percent of all employers underreporting their employees, the Tax Department calculates that 22,500 of the report due employers are misclassifying their workers. Assuming that each of these 22,500 employers had at least one misclassified worker that earned over $9,000 during the calendar year at an average tax rate of 1.74 percent, the additional 100 percent penalty would be $3,523,500 (22,500 timse 9,000 times 1.74 percent).

According to TWC, each year the Tax Department conducts approximately 25,000 block Unemployment Insurance (UI) claim investigations. The investigations take place when a business or organization does not properly report the wages of an employee. Assuming that each of these 25,000 employers had at least one misclassified worker that earned over $9,000 during the calendar year at an average tax rate of 1.74 percent, the additional 100 percent penalty would be $3,915,000 (25,000 times 9,000 times 1.74 percent)

The revenue estimated from misclassified worker penalty is $8,136,622.80 and would be a gain to the General Revenue Dedicated – Unemployment Compensation Special Administrative Account No. 165.

TWC estimates the additional examiner and supervisor time would be 6,062.1 hours. It is estimated that any additional costs associated with implementing the provisions of the bill could be absorbed within the agency's existing resources.

Local Government Impact

No fiscal implication to units of local government is anticipated.

Source Agencies: 320 Texas Workforce Commission

LBB Staff: JOB, JRO, MW, DE