



EMPOWERING INDEPENDENT
CONTRACTORS:

Why Americans need the freedom to work for themselves

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KEY FINDINGS

1

THE PROBLEM:
THIRTY-ONE STATES HAVE UNNECESSARY
BARRIERS FOR FREELANCE WORKERS



2

THE RESULT:
WORKERS AND BUSINESSES ARE BEING
HELD BACK



3

THE SOLUTION:
GIVE WORKERS THE FREEDOM TO WORK
FOR THEMSELVES



4

THE IMPACT:
FEWER BARRIERS FOR BUSINESSES AND
WORKERS



5

THE BENEFITS:
MORE OPPORTUNITY FOR WELFARE
ENROLLEES, INDIVIDUALS WITH DISABILITIES,
RURAL WORKERS, SENIORS, AND RETIREES



BOTTOM LINE:
WORKERS SHOULD BE FREE TO WORK FOR THEMSELVES.

What is an independent contractor?

Independent contractors are a critical part of the American economy. Also known as freelance workers or independent entrepreneurs, independent contractors typically have more flexibility than traditional employees. They can choose when and where they work, who they work for, and how much they charge for their work. These workers are able to freelance (or contract) with multiple clients rather than being tied down in a traditional employer-employee relationship.

Freelancers are comprised of rural and urban workers, disabled and able-bodied workers, single and stay-at-home parents, seniors, and retirees. They can be found in nearly all industries and professions including as doctors, graphic designers, construction workers, home health care providers, and farmers, among others.

Both large and small businesses are embracing the freelancing economy because it allows them to find outside perspectives and expertise, not just those in nearby communities.

CORINA'S STORY

As the mother of young daughters, having flexible work hours and the ability to work from anywhere gives Corina a chance to support her family doing what she loves, while modeling what hard work looks like for her children. An independent graphic designer, Corina is able to set her own hours, fulfill her clients' needs, and still be at all of her daughters' sporting events. Independent contracting has made Corina, and so many others, financially independent even though she is geographically dependent.

Even though far too many states have barriers in place for these hard-working Americans, independent contracting continues to grow.¹ Today, one in five jobs in America is held by a worker under contract, and within a decade, freelance workers could make up half of the U.S. workforce.²

In May 2017, there were over 10 million independent contractors who earned most of their income from freelance work.³ Millions more earn supplemental income as independent contractors. Studies estimate that up to 30 percent of the American workforce is freelancing for at least some of their income.⁴⁻⁵

But unfortunately, heavy-handed government rules are holding them back.



AN INDEPENDENT GRAPHIC DESIGNER, CORINA IS ABLE TO SET HER OWN HOURS, FULFILL HER CLIENTS' NEEDS, AND STILL BE AT ALL OF HER DAUGHTER'S SPORTING EVENTS.

The problem: Thirty-one states have unnecessary barriers to entrepreneurship

While most laws governing work relationships come from the federal government, 31 states use overly-strict and burdensome worker-classification tests that make it harder for individuals to work for themselves and for businesses to contract with them.

These states assume that all workers are employees and must be treated as such unless the contracting business can prove otherwise under some form of an “ABC” test.

Most common form of ABC test:⁶

an individual shall be deemed to be an employee irrespective of whether the common law relationship of master and servant exists, unless and until it is shown to the satisfaction of the state’s unemployment administrator that:

(A) such individual has been and will continue to be free from control and direction in connection with the performance of such service, both under his contract for the performance of service and in fact; and

(B) such service is performed either outside the usual course of the business for which the service is performed or is performed outside of all the places of business of the enterprise for which the service is performed; and

(C) such individual is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed.

If a business fails to prove any part of an AB or ABC test, the worker must be classified as an employee instead of an independent contractor, creating problems for workers and businesses because of the variety of interpretations that can be applied.



THIRTY-ONE STATES
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For example, in a recent California Supreme Court ruling, the court said that a plumber temporarily hired by a store to repair a leak or an electrician to install a line would be an independent contractor. A seamstress, however, who works at home to make dresses for a clothing manufacturer from cloth and patterns supplied by the company or a cake decorator who works on a regular basis on custom-designed cakes would be an employee.⁷

This type of uncertainty and confusion creates unnecessary barriers for employers who want to engage freelancers and, worse yet, discriminates against many independent workers.

The result: Workers and businesses are being held back

Because lawsuits challenging independent contractor classification have become common and costly for businesses, ABC tests almost certainly deter the use of such workers in many states.⁸

There is no standard definition at either the state or federal level of what it means to be an “independent contractor.”⁹ Instead, various laws at both levels define what it means to be an employee, which creates worker classification problems for businesses and freelancers.¹⁰ Specifically, so-called “worker misclassification” subjects businesses to a plethora of potential liability, including unpaid wages and benefits, unpaid payroll taxes, and penalties.¹¹⁻¹²

Even if the worker agrees to the arrangement and wants to be classified as an independent contractor, the tests cannot be avoided. The applicable statutory rights cannot be waived. Also, receiving a 1099-MISC does not guarantee that a worker is properly classified as an independent contractor, nor does establishing a limited liability corporation (LLC) or filing for an employee identification number (EIN).¹³

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Businesses may avoid working with these independent entrepreneurs and expanding into states with ABC tests because of the legal complexity and million-dollar issues that they risk facing. For example, Instacart, a same-day grocery delivery service company, settled for \$4.6 million in a class action worker misclassification lawsuit.¹⁴ This risk deters growth, specifically for smaller businesses who don't have the capital to afford this.

States have done themselves a disservice by creating a muddled legal framework for working with independent contractors. Thankfully, there is a simple fix.



STATES ADOPTING THE
IRS 20-FACTOR TEST
WILL ALLOW BUSINESSES TO
WORK WITH INDEPENDENT
CONTRACTORS BASED ON
THEIR BUSINESS NEEDS AND
INDEPENDENT WORKERS
WILL BE ABLE TO SEEK OUT
WORK AS THEY SEE FIT.

The solution: Give workers the freedom to work for themselves

States are free to adopt their own statutory definitions of how to define an employee for workers' compensation and unemployment insurance purposes. They should use this freedom to make independent work as easy as possible.

To do this, states should update their laws to match the predominant federal independent contractor standard by adopting the IRS 20-factor test and eliminating their alternative test.¹⁵ This would make it easier for businesses to engage independent workers, making it easier for workers to work for themselves.

Thankfully, nineteen states have already implemented either the IRS common law test or use another less restrictive test.

The 20-factor test embraces the reality that the economy is more complex than just two or three subjective questions. That is why, under the 20-factor standard, no single factor determines an employee-employer relationship. Instead, the factors focus on who controls what work is done and how it is completed, creating a more objective standard and the most flexibility for both independent contractors and businesses.

By using the 20-factor test, businesses will be able to work with independent contractors based solely on their business needs without unnecessary exposure to legal risks. Likewise, independent workers will be able to seek out work as they see fit.

The impact: Fewer barriers for businesses and workers

Finding work should not be made more complicated by government rules and regulations or courts. While it is nearly impossible to calculate how many more independent contractors would result from this reform, it is clear that these complicated definitions and tests for worker classification are nothing more than barriers to work.

Empowering Independent Contractors would help businesses by reducing complexity, reducing risk, and making it easier for businesses to work directly with freelancers. This reform would also assist workers by making work more accessible and giving individuals the freedom to contract with businesses as they see fit.

Under this new landscape, instead of worrying about government agencies and bureaucrats, businesses and workers can get back to what makes sense—creating products and services that Americans need and want and creating jobs for individuals who want to be in the workforce.

The benefits: More opportunity for individuals with disabilities, welfare enrollees, rural workers, seniors and retirees

Simplifying independent work rules will have many benefits for states. Specifically, promoting independent work will reduce barriers for five key groups of Americans: individuals with disabilities, those stuck on welfare, rural workers, seniors, and retirees.

HELPING INDIVIDUALS WITH DISABILITIES

Employment rates for the disabled are already significantly lower than those of non-disabled workers.¹⁶ The good news is that many individuals with disabilities create opportunities for themselves through entrepreneurship. According to the United States Census Bureau, individuals with disabilities are almost twice as likely to be self-employed as the general population—14.7 percent compared to eight percent.¹⁷

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Allowing individuals to satisfy these education requirements through on-the-job training in apprenticeships would help young workers, boost incomes, and reduce government dependency.

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SIMPLIFYING INDEPENDENT WORK RULES WILL BENEFIT:



INDIVIDUALS WITH
DISABILITIES



SENIORS AND
RETIREES



RURAL
WORKERS



INDIVIDUALS
TRAPPED ON
WELFARE

Technological advances have created new opportunities for businesses to use freelance workers rather than in-house employees. This trend provides workers—especially those with disabilities or smaller work limitations—the opportunity to choose work that works best for them.¹⁸

HELPING THOSE TRAPPED ON WELFARE

One benefit of empowering independent contractors is creating more work opportunities for those trapped on welfare. Growth in freelance workers alone accounted for nearly 30 percent of all jobs added between 2010 and 2014, when the national economy was still grappling with high unemployment rates following the Great Recession.¹⁹ Rather than turning to welfare as their only option, Americans were able to turn to independent work.

By increasing opportunities for independent entrepreneurs and businesses to find or create work, policymakers can make it even easier for Americans trapped on welfare to return to the workforce.

HELPING RURAL WORKERS

By empowering independent contractors, rural workers would no longer be kept at a disadvantage to those workers living in larger cities and urban hubs.

Rural independent contractors would be able to seek out work anywhere and keep living in their smaller communities. Workers living in rural areas with limited job markets can more easily find work in the freelance economy and better maximize their potential earnings.

HELPING SENIORS AND RETIREES

According to the U.S. Small Business Administration, more seniors are choosing to stay in the workforce and, in many cases, work for themselves in the later years of their lives.²⁰ Seniors who are not financially able to retire but cannot remain in the workforce full-time can, in the freelance economy, continue working on their own terms. Retirees who lost their jobs or some of their retirement savings during the Great Recession could also more easily find work. Reducing barriers to work will help seniors and retirees find opportunities that fit their schedules and abilities.

Bottom line: Workers should be free to work for themselves

The modern workforce is changing. Technology is increasingly making it easier for people of all education, skill, and income levels to work as independent contractors.²¹

Embracing the freelance economy will help individuals with disabilities, welfare enrollees, rural workers, seniors and retirees find work that works best for them, which means healthier people, families, and communities.²² By empowering independent contractors, states can empower these Americans with more opportunities and, simultaneously, boost their economies.

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APPENDIX 1: STATE TESTS GOVERNING UNEMPLOYMENT INSURANCE AND WORKERS' COMPENSATION

STATE	UNEMPLOYMENT INSURANCE	WORKERS' COMPENSATION
Alabama	✓	✓
Alaska	✗	✓
Arizona	✓	✓
Arkansas	✗	✓
California	✓	✓
Colorado	✗	✓
Connecticut	✗	✓
Delaware	✗	✓
Florida	✓	✓
Georgia	✗	✓
Hawaii	✗	✓
Idaho	✗	✓
Illinois	✗	✗
Indiana	✗	✓
Iowa	✓	✓
Kansas	✓	✓
Kentucky	✓	✓
Louisiana	✗	✗
Maine	✗	✗
Maryland	✗	✓
Massachusetts	✗	✗
Michigan	✓	✓
Minnesota	✓	✓
Mississippi	✓	✓
Missouri	✓	✓

STATE	UNEMPLOYMENT INSURANCE	WORKERS' COMPENSATION
Montana	×	×
Nebraska	×	✓
Nevada	×	✓
New Hampshire	×	×
New Jersey	×	✓
New Mexico	×	✓
New York	✓	✓
North Carolina	✓	✓
North Dakota	✓	✓
Ohio	✓	✓
Oklahoma	×	✓
Oregon	×	✓
Pennsylvania	×	✓
Rhode Island	✓	✓
South Carolina	✓	✓
South Dakota	×	×
Tennessee	×	✓
Texas	✓	✓
Utah	×	✓
Vermont	×	✓
Virginia	✓	✓
Washington	×	×
West Virginia	×	✓
Wisconsin	×	×
Wyoming	×	×
COMMON LAW TESTS	19	40
AB/ABC TESTS	31	10

APPENDIX 2: IRS 20-FACTOR TEST

In 1987, based on an examination of cases and rulings, the Internal Revenue Service (IRS) developed a list of 20 factors that may be examined in determining whether an employer-employee relationship exists. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed; factors other than the listed 20 factors may also be relevant.

The 20 factors identified by the IRS are as follows:

1. **Instructions:** If the person for whom the services are performed has the right to require compliance with instructions, this indicates employee status.
2. **Training:** Worker training (e.g., by requiring attendance at training sessions) indicates that the person for whom services are performed wants the services performed in a particular manner (which indicates employee status).
3. **Integration:** Integration of the worker's services into the business operations of the person for whom services are performed is an indication of employee status.
4. **Services rendered personally:** If the services are required to be performed personally, this is an indication that the person for whom services are performed is interested in the methods used to accomplish the work (which indicates employee status).
5. **Hiring, supervision, and paying assistants:** If the person for whom services are performed hires, supervises or pays assistants, this generally indicates employee status. However, if the worker hires and supervises others under a contract pursuant to which the worker agrees to provide material and labor and is only responsible for the result, this indicates independent contractor status.
6. **Continuing relationship:** A continuing relationship between the worker and the person for whom the services are performed indicates employee status.
7. **Set hours of work:** The establishment of set hours for the worker indicates employee status.
8. **Full time required:** If the worker must devote substantially full time to the business of the person for whom services are performed, this indicates employee status. An independent contractor is free to work when and for whom he or she chooses.
9. **Doing work on employer's premises:** If the work is performed on the premises of the person for whom the services are performed, this indicates employee status, especially if the work could be done elsewhere.
10. **Order or sequence test:** If a worker must perform services in the order or sequence set by the person for whom services are performed, that shows the worker is not free to follow his or her own pattern of work, and indicates employee status.
11. **Oral or written reports:** A requirement that the worker submit regular reports indicates employee status.
12. **Payment by the hour, week, or month:** Payment by the hour, week, or month generally points to employment status; payment by the job or a commission indicates independent contractor status.
13. **Payment of business and/or traveling expenses:** If the person for whom the services are performed pays expenses, this indicates employee status. An employer, to control expenses, generally retains the right to direct the worker.
14. **Furnishing tools and materials:** The provision of significant tools and materials to the worker indicates employee status.
15. **Significant investment:** Investment in facilities used by the worker indicates independent contractor status.
16. **Realization of profit or loss:** A worker who can realize a profit or suffer a loss as a result of the services (in addition to profit or loss ordinarily realized by employees) is generally an independent contractor.
17. **Working for more than one firm at a time:** If a worker performs more than de minimis services for multiple firms at the same time, that generally indicates independent contractor status.

- 18. **Making service available to the general public:** If a worker makes his or her services available to the public on a regular and consistent basis, that indicates independent contractor status.
- 19. **Right to discharge:** The right to discharge a worker is a factor indicating that the worker is an employee.
- 20. **Right to terminate:** If a worker has the right to terminate the relationship with the person for whom services are performed at any time he or she wishes without incurring liability, that indicates employee status.

More recently, the IRS has identified three categories of evidence that may be relevant in determining whether the requisite control exists under the common-law test and has grouped illustrative factors under these three categories: (1) behavioral control; (2) financial control; and (3) relationship of the parties. The IRS emphasizes that factors in addition to the 20 factors identified in 1987 may be relevant, that the weight of the factors may vary based on the circumstances, that relevant factors may change over time, and that all facts must be examined.

Source: Internal Revenue Service

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