Longitudinal Employer - Household Dynamics

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Employment that is not covered by state unemployment insurance laws

Date	:	January 2002
Prepared by	:	David W. Stevens
Contact	:	Ronald Prevost (Ronald.C.Prevost@census.gov)
		U.S. Census Bureau, LEHD Program
		FB 2138-3
		4700 Silver Hill Rd.
		Suitland, MD 20233 USA

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EMPLOYMENT THAT IS NOT COVERED BY STATE UNEMPLOYMENT INSURANCE LAWS

David W. Stevens
"dstevens@ubmail.ubalt.edu"

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INTRODUCTION

The Longitudinal Employer-Household Dynamics (LEHD) Program at the Census Bureau links data sources to estimate worker and job flows. The LEHD Program includes an Employment Dynamics Estimates (EDE) Project.

A basic goal of the EDE Project is to prepare and release accurate estimates of worker accession and separation flows and gross job creation and destruction flows. To achieve this goal, the LEHD research team has forged partnerships with other federal entities and state employment security agencies.

This paper focuses on the worker flows component of the more inclusive EDE Project. The EDE Project is using employment information received from states that have signed a memorandum of understanding permitting authorized statistical use of confidential state administrative records.

EDE Project researchers are linking two longitudinal files of state administrative records:

1. Unemployment insurance (UI) wage records; and

2. ES-202 records.

Each state UI law defines criteria that determine who is required to submit a quarterly UI contribution and employment report to the state employment security agency, and which workers are to be included in this report.

This paper describes the employment coverage of the UI wage records that are used by EDE Project researchers to prepare estimates of worker accessions and separations. Only the first two of three bundled questions are answered here:

1. What do EDE Project researchers need to know about the definition of covered employment in state UI law that might affect how they prepare worker flow estimates?

2. What components of overall worker flows are of particular concern?

3. How should EDE Project researchers respond to this potential threat to the integrity of some worker flow estimates?

TWO PERSPECTIVES ON COVERAGE

The *BLS Handbook of Methods*[1] describes state ES-202 reporting coverage:

> UI coverage is broad and basically comparable from State to State. In 1994, UI and UCFE [unemployment compensation for federal employees] covered over 112 million jobs, or over 96 percent of total wage and salary civilian jobs. Covered workers received $3.0 trillion in pay, or 92.5 percent of the wage and salary component of national income.

The *Handbook* statement is tempered by a statistic from a supplement to the February 2001 Current Population Survey.[2] The survey found an estimated 8.6 million independent contractors (6.4 percent of total employment). State unemployment insurance laws do not define independent contractors as covered, unless elective coverage is provided for and acted upon.

CONTENT

Section II covers basic issues that emerged in responding to the two questions posed—is there an employment coverage problem; and, if so, is the problem concentrated in particular segments of overall worker flows? Section III offers examples of how the federal and state unemployment insurance laws define exceptions from covered employment. Section IV examines the independent contractor issue, and estimates the level of independent contractor employment. Section V summarizes the counsel offered to EDE project researchers.

II

DEFINING COVERED EMPLOYMENT

Today's state unemployment insurance laws reflect more than 60 years of unemployment insurance legislation. Federal unemployment insurance legislation has molded, but not controlled the evolution of state unemployment insurance laws.

U.S.C. Title 26, Subtitle C, Chapter 23, is the Federal Unemployment Tax Act (FUTA), first enacted in 1938. Section 3306(a) of this Act defines *employer*; Section 3306(b) defines *wages*; Section 3306(c) defines *employment*; and Section 3306(c)(1) through (20) defines exceptions to covered employment. These exceptions are covered in Section III.

The FUTA gives the federal government fiscal leverage over state legislative behavior. Covered employment definitions in state unemployment insurance laws that comply with FUTA stipulations qualify those states to receive a credit against their FUTA tax liability.

Each state unemployment insurance law contains employment coverage and exception from coverage language that reflects the unique history of interest group dynamics in the state. Employers have a financial interest in limited coverage because this lowers their unemployment insurance tax liability. Workers who are vulnerable to involuntary separation from employment seek an inclusive definition of covered employment, and try to defeat attempts to except currently covered employment. Examples of the results of this interplay appear in Section III.

LIMITED STATE INTEREST IN EMPLOYMENT THAT IS NOT COVERED

EDE Project researchers cannot turn to state unemployment insurance laws to find an enumeration of non-covered employment. The state laws define exceptions from coverage only when there has been a reason for doing so, usually a legislative response to interest group advocacy. Otherwise, non-covered employment is an undefined residual--any employment that is not defined as covered.

Managers of state unemployment insurance programs have little motivation to be interested in employment that is not defined as covered in the state unemployment insurance law. Their basic responsibility is to ensure accurate reporting of covered employment. Interest in a particular type of non-covered employment might emerge in advocacy for broadening the definition of covered employment for equity of treatment or fiscal reasons.

NON-COVERAGE VERSUS FAILURE TO REPORT

The previous paragraph contains the sentence "their basic responsibility is to ensure accurate reporting of covered employment." Employer failure to accurately report covered employment, whether intentional or not, jeopardizes the integrity of worker accession and separation flow estimates. EDE Project researchers should be aware of the sources and magnitude of these reporting glitches, but this is not a coverage issue.

III

AN INTRODUCTION TO DEFINITIONS

EDE Project researchers need to understand some of the nuances of statutory definitions found in state unemployment insurance laws. Five state unemployment insurance laws are drawn upon to provide examples of key definitions. These will help EDE Project researchers to understand the employment coverage issue. The states chosen for this purpose were the first to deliver state administrative records to the LEHD Program.

1. California Unemployment Insurance Code, Sections 601-832.

2. Florida Statutes, Title XXXI, Chapter 443.036.

3. Illinois Compiled Statutes, Employment, Unemployment Insurance Act, 820 ILCS 405, Sections 201-247.

4. Maryland Unemployment Insurance Law, Subtitle 1, Section 8-101.

5. Texas Government Code, Title 4, Subtitle A, Chapter 201, Subchapters B-H.

The examples begin with the definition of employer. This has been a source of confusion and misunderstanding for many previous users of UI wage records and ES-202 data.

EMPLOYER

The Unemployment Insurance Law of Maryland, 8-101(o), defines employer as a person or government entity who employs at least one individual within the State.

A reviser's annotation note in the Maryland statute explains that

> the term *employer* is substituted for *employing unit* as the defined term because *employer* is universally recognized as a person who employs. The Employment Article Review Committee believed that use of the usual definition of *employer* would result in less confusion about whether a provision applies universally to *one who employs* or specifically to an employer who is required to pay contributions, i.e., under the revised title, an *employing unit*.

EMPLOYING UNIT

The Maryland law, 8-101(p), defines employing unit as

> (1) an employer that has at least one employee engaged in covered employment for at least part of a day; (2) an employer that has elected to become subject to this title under 9-203 of this title; or (3) an employer that is not otherwise subject to this title but that: (i) within the current or preceding calendar year, is liable for any federal tax against which credit may be taken for contributions required to be paid into a State unemployment fund; or (ii) as a condition for approval for full credit of contributions against the tax imposed by the Federal Unemployment Tax Act, is required by that Act to be an employing unit.

A NEED FOR CAUTION

The Maryland definition of employing unit does not align with the Texas definition of employing unit. The Texas Unemployment Compensation Act, 201.011(11), defines employing unit as a person who has employed an individual to perform services for the person in this state. The Texas definition of employing unit aligns with the Maryland definition of employer.

State unemployment insurance law definitions are not uniform. Care must be exercised in the interpretation of each term on a state-specific basis.

Some, but not all employers are employing units for state unemployment insurance program reporting purposes. Some, but not necessarily all services provided in the employ of an employing unit are defined as covered employment. Individuals providing identical services, but in the employ of different employers, may not be treated the same for reporting purposes.

EXCEPTIONS FROM COVERED EMPLOYMENT

Earlier, it was noted that federal unemployment insurance legislation molds, but does not control state unemployment insurance laws. The federal definition of exceptions to employment coverage illustrates this point.

The federal “hammer” is the criteria that determine eligibility for a credit against the FUTA tax. States are required to enact conforming legislation, or face a loss of employer eligibility for this credit.

Here, the federal exceptions to covered employment are covered first. Then, examples of state exceptions are provided. Together, these are intended to help EDE Project researchers understand the scope and diversity of exceptions to covered employment, as these will affect their estimates of worker accession and separation flows.

FEDERAL EXCEPTIONS

The Federal Unemployment Tax Act, Section 3306(c), defines employment to include

> any service, of whatever nature, performed after 1954 by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed in connection with such vessel or aircraft when outside the United States, and (B) any service, of whatever nature, performed after 1971 outside the United States (except in a contiguous country with which the United States has an agreement relating to unemployment compensation) by a citizen of the United States as an employee of an American employer (as defined in subsection (j)(3)), **except** [20 exceptions follow].

1. Agricultural labor (as defined in subsection (k)) **unless** [criteria omitted here].

   The words except and unless appear in bold font to make an important point about the relationship between the FUTA and state unemployment insurance laws. The FUTA definition of employment is quite inclusive until the 20 exceptions, which begin with agricultural labor, are considered.

   Each exception has to be read carefully, because some, like the agricultural labor exception, include the qualifier unless. When the words except and unless are paired, the scope of the exception is reduced by the criteria following the qualifier unless. This means that each of the 20 exceptions applies for FUTA purposes, unless explicit criteria are satisfied, which then removes affected employment from the exception; that is, the employment is covered.

2. Domestic service

   in a private home, local college club, or local chapter of a college fraternity or sorority unless performed for a person who paid cash remuneration of $1,000 or more to individuals employed in such domestic service in any calendar quarter in the calendar year or the preceding calendar year.

Florida Statutes, Title XXXI, Chapter 443.036(21)(g), elaborates on the federal definition of covered domestic service employment.

The term 'employment' includes domestic service after December 31, 1977, performed by maids, cooks, maintenance workers, chauffeurs, social secretaries, caretakers, private yacht crews, butlers, and houseparents, in a private home, local college club, or local chapter of a college fraternity or sorority performed for a person who paid cash remuneration of $1,000 or more after December 31, 1977, in any calendar quarter in the current calendar year or the preceding calendar year to individuals employed in such domestic service.

3. Service not in the course of the employer's trade or business performed in any calendar quarter by an employee unless the cash remuneration paid for such service is $50 or more and such service is performed by an individual who is regularly paid by such employer to perform such service.

4. Service performed on or in connection with a vessel or aircraft not an American vessel or American aircraft, if the employee is employed on and in connection with such vessel or aircraft when outside the United States.

5. Service performed by an individual in the employ of his son, daughter, or spouse, and service performed by a child under the age of 21 in the employ of his father or mother.

   The conforming language in Florida Statutes, Title XXXI, Chapter 443.036(21)(n)(4) updates the Federal language to recognize the frequency of remarriage.

   Service performed by an individual in the employ of his or her son, daughter, or spouse, including step relationships, and service performed by a child, or stepchild, under the age of 21 in the employ of his or her father or mother, or stepfather or stepmother.

6. Service performed in the employ of the United States Government or of an instrumentality of the United States.

7. Service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing.

   This exception from FUTA tax liability applies "to the extent that the instrumentality is, with respect to such service, immune under the Constitution of the United States from the tax imposed by section 3301."

The states, in turn, have defined most services performed in the employ of a state, or a political subdivision thereof, or an instrumentality of any one or more of these, as covered employment for state tax purposes. However, certain services remain excepted from a particular state's definition of covered employment. For example, the Texas Unemployment Compensation Act, 201.063(a)(1), excepts from covered employment:

[Employment] (A) as an elected official; (B) as a member of a legislative body; (C) as a member of the judiciary; (D) as a temporary employee in case of fire, storm, snow, earthquake, flood, or similar emergency; or (E) in a position that is designated under law as a major nontenured policy-making or advisory position or a policy-making or advisory position that ordinarily does not require more than eight hours of service each week.

8. Service performed in the employ of a religious, charitable, educational, or other organization described in section 501(c)(3) that is exempt from income tax under section 501(a).

   The Unemployment Insurance Law of Maryland, 8-208(a), is typical of how the states have treated religious, charitable, and educational institutions for state unemployment insurance tax purposes:

   Except as otherwise provided in this subtitle, employment is covered employment if the employment is: (1) performed for a charitable, educational, religious, or other organization; and (2) excluded from the definition of 'employment' in the Federal Unemployment Tax Act soley by 3306(c)(8) of the Act.

   (b) Exception--Church or religious organization. Employment is not covered employment if the employment is performed for: (1) a church or an association or convention of churches; or (2) an organization that is: (i) operated primarily for religious purposes; and (ii) controlled, operated, principally supported, or supervised by a church or an association or convention of churches.

   (c) Same--Minister or member of religious order. Employment is not covered employment if the employment is performed by: (1) a commissioned, licensed, or ordained minister of a church in the exercise of the ministry; or (2) a member of a religious order in the exercise of duties required by the order.

   (d) Same--Tax exempt organizations. During any calendar quarter in which the compensation is less than $50, the employment is not covered employment if it is performed for an organization that is exempt from income tax under [applicable IRS codes].

So, while the Federal Unemployment Tax Act, Section 3306(c)(8), excepts religious, charitable, educational or other organizations that are exempt from Federal income taxes, Maryland law excepts only employment performed for a church or an association or convention of churches. Religious schools are not excepted because they have been ruled to be operated primarily for other than religious purposes. Each of the other four state laws examined differs from the Maryland language, but the basic effect on coverage of religious, charitable and educational organizations is similar.

9. Service performed by an individual as an employee or employee representative as defined in section 1 of the Railroad Unemployment Insurance Act (45 U.S.C. 351). The Railroad Unemployment Insurance Act parallels the Federal Unemployment Tax Act. The employment covered in each is mutually exclusive of the other.

   The Railroad Unemployment Insurance Act, Section 351, states that, except when used in amending the provisions of other Acts,--(a) The term 'employer' means any carrier (as defined in subsection (b) of this section), and any company which is directly or indirectly owned or controlled by one or more such carriers or under common control therewith, and which operates any equipment or facility or performs any service (except trucking service, casual service, and the casual operation of equipment or facilities) in connection with the transportation of passengers or property by railroad, or the receipt, delivery, elevation, transfer in transit, refrigeration or icing, storage, or handling of property transported by railroad, and any receiver, trustee, or other individual or body, judicial or otherwise, when in the possession of the property or operating all or any part of the business of such employer: Provided, however, That the term 'employer' shall not include any street, interurban, or suburban electric railway, unless such railway is operating as a part of a general steam-railroad system of transportation, but shall not exclude any part of the general steam-railroad system of transportation now or hereafter operated by any other motive power.

   The term 'employer' shall also include railroad associations, traffic associations, tariff bureaus, demurrage bureaus, weighing and inspection bureaus, collection agencies, and other associations, bureaus, agencies or organizations controlled and maintained wholly or principally by two or more employers as hereinbefore defined and engaged in the performance of services in connection with or incidental to railroad transportation; and railway labor organizations, national in scope, which have been organized in accordance with the provisions of the Railway Labor Act, and their State and National legislative committees and their general committees and their insurance departments and their local lodges and divisions.

The term 'employer' shall not include any company by reason of its being engaged in the mining of coal, the supplying of coal to an employer where delivery is not beyond the mine tipple, and the operation of equipment or facilities therefor, or in any of such activities.

(b) The term 'carrier' means a railroad subject to the jurisdiction of the Surface Transportation Board under part A of subtitle IV of title 49.

(c) The term 'company' means corporations, associations, and joint-stock companies.

(d) The term 'employee' (except when used in phrases establishing a different meaning) means any individual who is or has been (i) in the service of one or more employers for compensation, or (ii) an employee representative.

10. (A) Service performed in any calendar quarter in the employ of any organization exempt from income tax under section 501(a) or under section 521, if the remuneration for such services is less than $50, or (B) service performed in the employ of a school, college, or university, if such service is performed (I) by a student who is enrolled and is regularly attending classes at such school, college, or university, or (ii) by the spouse of such a student, if such spouse is advised.

    The full definition of this exception from covered employment is long. The essence of the definition is that employment of a student or a student's spouse that is considered to be financial aid allowing the student to attend a school, college, or university is excepted from coverage, as is employment that is required as part of a regular work-study curriculum.

    The California Unemployment Insurance Code, Section 633, adopts the FUTA student and spouse exception criteria, but also excepts services performed as an intermittent or adjunct instructor at a post-secondary educational institution, if the intermittent or adjunct instructor and the employing unit enter into a written contract with specified provisions

11. Service performed in the employ of a foreign government (including service as a consular or other officer or employee or a non-diplomatic representative).

12. Service performed in the employ of an instrumentality wholly owned by a foreign government.

13. Service performed as a student nurse in the employ of a hospital or a nurses' training school by an individual who is enrolled and is regularly attending classes in a nurses' training school. The school must be chartered or approved pursuant to State law. Service performed by an intern in the employ of a hospital by an individual who has completed a 4 years' course in a medical school chartered or approved pursuant to State law is also excepted from coverage.

14. Service performed by an individual for a person as an insurance agent or as an insurance solicitor, if all such service performed by such individual for such person is performed for remuneration soley by way of commission.

15. (A) Service performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution; (B) service performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers.

16. Service performed in the employ of an international organization.

17. Service performed by an individual in (or as an officer or member of the crew of a vessel while it is engaged in) the catching, taking, harvesting, cultivating, or farming of any kind of fish, shellfish, crustacea, sponges, seaweeds, or other aquatic forms of animal and vegetable life (including service performed by any such individual as an ordinary incident to any such activity**),** except—

    (A) service performed in connection with the catching or taking of salmon or halibut, for commercial purposes, and

    (B) service performed on or in connection with a vessel of more than 10 net tons.

    These are additonal examples of exceptions to a stated exception—those engaged in catching fish other than salmon and halibut, and in vessels weighing 10 net tons or less, are not covered, but those engaged in catching salmon or halibut, and those on vessels weighing more then 10 net tons, are covered.

18. Service described in section 3121(b)(20).

19. Service which is performed by a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J), or (M) of section 101(a)(15) of the Immigration and Nationality Act, as amended.

The Immigration and Nationality Act, Section 101(a)(15), states that the term 'immigrant' means every alien except an alien who is within one of the following classes of nonimmigrant aliens:

(F) an alien having a residence in a foreign country which he has no intention of abandoning, who is a bona fide student qualified to pursue a full course of study and who seeks to enter the United States temporarily and soley for the purpose of pursuing such a course of study.

(J) an alien having a residence in a foreign country which he has no intention of abandoning who is a bona fide student, scholar, trainee, teacher, professor, research assistant, specialist, or leader in a field of specialized knowledge or skill, or other person of similar description, who is coming temporarily to the United States…for the purpose of teaching, instructing or lecturing, studying, observing, conducting research, consulting.

(M) an alien having a residence in a foreign country which has no intention of abandoning who seeks to enter the United States temporarily and soley for the purpose of pursuing a full course of study at an established vocational or other recognized nonacademic institution.

Subparagraphs (F) and (M) do not permit a nonimmigrant alien to work, so except for speculation about illegal employment these are not pertinent here. However, subparagraph (J) defines temporary teaching, instructing or lecturing, conducting research, and consulting services performed by nonimmigrant aliens, which are exempted from the FUTA definition of covered employment in 3306(c)(20) above.

20. Services performed by a full time student (as defined in subsection (q)) in the employ of an organized camp.

This completes a brief description of the 20 exceptions to covered employment that appear in the Federal Unemployment Tax Act, Section 3306(c)(1) through (20).

Attention turns next to examples of state exceptions from covered employment. These examples do not include all exceptions in each of the five states. The examples were chosen to highlight the diversity of exceptions that appear in state unemployment insurance laws.

EXAMPLES OF EXCEPTIONS THAT APPEAR IN STATE LAWS

California

- Section 650. 'Employment' does not include services performed as a real estate, mineral, oil and gas, or cemetery broker or as a real estate, cemetery or direct sales salesperson, or a yacht broker or salesman, by an individual if all of the following conditions are met: (a) The individual is licensed… (b) Substantially all of the remuneration (whether or not paid in cash) for the services performed by that individual is directly related to sales or other output (including the performance of the services) rather than to the number of hours worked by that individual. (c) The services performed by the individual are performed pursuant to a written contract between that individual and the person for whom the services are performed and the contract provides that the individual will not be treated as an employee with respect to those services for state tax purposes.

- Section 651. 'Employment' does not include services performed by an individual as a golf caddy in caddying or carrying a golf player's clubs.

- Section 654. 'Employment' does not include service performed by a free-lance jockey or exercise boy who is regularly licensed by the California Horse Racing Board.

- Section 656. 'Employment' does not include professional services performed by a consultant working as an independent contractor. For the purpose of this section, there shall be a rebuttable presumption that services provided by an individual engaged in work requiring specialized knowledge and skills attained through completion of recognized courses of instruction or experience are rendered as an independent contractor. These services shall be limited to those provided by attorneys, physicians, dentists, engineers, architects, accountants, chiropractors, and the various types of physical, chemical, natural, and biological scientists.

  For the purposes of this section, the rebuttable presumption shall not apply to an individual who enters into a contract agreement with the recipient of the professional services which establishes an employer-employee relationship.

Florida

- 443.036(21)(n)(18). Service performed by an individual for a person as a barber, if all such service performed by such individual for such person is performed for remuneration soley by way of commission.

- 443.036(21)(n)(20). Service performed by a speech therapist, occupational therapist, or physical therapist who is nonsalaried and working pursuant to a written contract with a home health agency as defined in s. 400.462.

- 443.036(21)(n)(23). Service performed by an individual for remuneration for a private, for-profit delivery or messenger service, if the individual: [criteria omitted here].

Illinois

- 820 ILCS 405/212.1(a). The term 'employment' shall not include services performed by an individual as an operator of a truck, truck-tractor, or tractor, provided the person or entity to which the individual is contracted for service shows that the individual: [criteria omitted here].

- 820 ILCS 405/220(B). The term 'employment' shall not include service in the employ of this State or any of its instrumentalities: ...(6) Directly for the Illinois State Fair during its active duration (including the week immediately preceding and the week immediately following the Fair).

- 820 ILCS 405/226. The term 'employment' shall not include services performed in connection with the illegal recording or making of bets or wagers or the selling of pools upon any contest or race, or in connection with the playing of or betting on any game of chance involving the losing or winning of money or any other thing of value; or in connection with the illegal operation of any lottery whether by dice, lot, numbers, game, hazard, or other gambling device.

Maryland

- 8-206(a). Work is not covered employment when performed by a licensed barber or licensed cosmetologist who leases a chair or booth from a holder of a barbershop permit, a beauty salon permit, or an owner-manager permit who operates a barbershop or beauty salon, if [criteria omitted here].

- 8-206(e). Work is not covered employment when performed by a taxicab driver who uses a taxicab or taxicab equipment of a taxicab business that is carried on by the holder of a taxicab permit if [criteria omitted here].

  Taxicab driver is a particularly good example of sub-state differences in the importance of a particular exemption from covered employment. This exception may be of little importance statewide, but of substantial interest in one or more cities in a state.

Texas

- 201.077. In this subtitle, 'employment' does not include service performed for a private for-profit person by an individual as a landman if: (1) the individual is engaged primarily in negotiating for the acquisition or divestiture of mineral rights or negotiating business agreements that provide for the exploration for or development of minerals; (2) substantially all remuneration, paid in cash or otherwise, for the performance of the service is directly related to the completion by the individual of the specific, contracted-for tasks, rather than to the number of hours worked by the individual; and (3) the service performed by the individual is performed under a written contract between the individual and the person for whom the service is performed that provides that the individual is to be treated as an independent contractor and not as an employee with respect to the service provided under the contract.

THE IMPORTANCE OF EXCEPTIONS FOR EDE PROJECT RESEARCH

This section has presented and commented on excerpts from the Federal Unemployment Tax Act, the Railroad Unemployment Insurance Act, and five state unemployment insurance laws. The intent has been to alert EDE Project researchers to the diversity of exceptions to employment coverage, despite the *BLS Handbook of Methods* statement that "UI coverage is broad and basically comparable from State to State."

Another question remains unexamined up to this point: Does exception to coverage, and interstate diversity of exceptions, matter in the use of state UI wage records to estimate worker accession and separation flows? One affirmative answer follows in Section IV.

IV

INDEPENDENT CONTRACTORS[3]

The relevance of independent contractors, who are excepted from covered employment in state unemployment insurance reporting, was introduced on page one of this paper. The Contingent and Alternative Employment Arrangements supplement to the February 2001 Current Population Survey identified an estimated 8.6 million independent contractors who are not defined as covered employment in state unemployment insurance laws.

Another recent press release[4] heightens the urgency of being alert to the possible effect of independent contractor employment dynamics on worker accession and separation flow estimates.

> The IRS acknowledged that corporate downsizing has lead to an explosion of displaced workers becoming business consultants or contractors…But the agency is concerned that companies are hiring back these very same workers—some with a minimal break in company service—in order to lower their costs in payroll and employee benefits.

DEFINITIONS OF INDEPENDENT CONTRACTOR

The authors of a recent study of independent contractor employment issues[5] reviewed each of the 50 state definitions of employee and independent contractor, concluding that

> there are no universal rules or ways to apply each state's definition of employee to specific situations because unemployment insurance violations are within the state realm, not the federal realm. In the absence of clearly defined standards for employee status and employer liability, administrative agency officials, administrative law judges, and the state courts must settle disputes. Ultimately, the state determines which individuals are employees and which are independent contractors.

States determine who is an employee and who is an independent contractor using one or more of three methods.

A Common Law Test

The Unemployment Insurance Law of Maryland, 8-201, states that

> except as otherwise provided in this subtitle, employment is covered employment if: (1) regardless of whether the employment is based on the common law relation of master and servant, the employment is performed: (i) for wages; or (ii) under a contract of hire that is written or express or implied; and (2) the employment is performed in accordance with 8-202 of this subtitle.

The reviser's note for this section of the annotated Unemployment Insurance Law of Maryland states that

> services performed are presumed to be employment under this title, regardless of whether or not there is a common law relationship of master and servant between the employer and employee, until it is shown by the employer, who has the burden of so showing, that a person rendering such service comes within the exceptions enumerated. The burden is upon the employer to show that the parties concerned fall within the tests enumerated.

The California Unemployment Insurance Code, 606.5(a), states that

> whether an individual or entity is the employer of specific employees shall be determined under common law rules applicable in determining the employer-employee relationship, except as provided in subdivisions (b) and (c).

Subdivisions (b) and (c) of the California Unemployment Insurance Code, 606.5, describe criteria for defining an employment relationship involving a temporary services employer and a leasing employer.[6]

Florida Statutes, Title XXXI, 443.036(21)(a)(1)(b), states that

> any individual, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. However, when a company, hereafter referred to as 'client', which would otherwise be designated as an employing unit has contracted with an employee leasing company to supply it with workers, those workers shall be considered employees of the employee leasing company.

These employment circumstances are not a coverage issue. However, EDE Project researchers should be aware that a common employee cost-containment motive affects management decisions about use of independent contractors, temporary service employers and leasing employers. Sequential, or concurrent, use of a mix of these employer-employee relationships will affect whether, and how, worker transition events are recorded.

The ABC Test

The ABC refers to three criteria, each of which must be met to except services provided from covered employment.

1. Criterion A is that the person performing the service must be free from contractual and *de facto* control of the performance of the service by the recipient of such service.

2. Criterion B is that the service is either outside the normal business activities of the recipient of the services or performed off the premises of the recipient of the services.

3. Criterion C is that the service provided is customarily engaged in as an independent trade, occupation, profession, or business by the person performing the service.

The IRS Test

IRS Revenue Ruling 87-41 describes a 20 common law factors test that is used to determine if a person is an employee or an independent contractor.[7]

The Texas Government Code, Section 201.041, states that

> in this subtitle, 'employment' means a service, including service in interstate commerce, performed by an individual for wages or under an express or implied contract of hire, unless it is shown to the satisfaction of the commission that the individual's performance of the service has been and will continue to be free from control or direction under the contract and in fact.

STATE LAW DYNAMICS

The authors of the recent study of independent contractor employment issues, as these affect state unemployment insurance programs, conclude that

> contributing to the differences in approach to [independent contractor] classification is the fact that the criteria and their relative importance are constantly under review by the courts. The laws in the individual states dealing with UI vary and, in the main, reflect the states' social and economic philosophy. These laws are then shaped and clarified by the judicial process established in that state. The end result can highlight the perceived differences, reinforcing the critics' claim of inconsistency. It should be pointed out that although the state legislatures are empowered to bring the differing [independent contractor] criteria into uniformity, there is no evidence in the recent past that this is their inclination.[8]

This serves as another warning that EDE Project researchers must remain alert to future changes in state unemployment insurance laws, as these might affect the coverage of state administrative records. The Census Bureau research team's state partners are well informed about these changes.

Unemployment insurance reform is expected to be addressed by the 107th Congress, Second Session, which begins this month. One of the proposed reforms is a change in the base period definition, which determines whether a claimant satisfies the previous employment criterion for unemployment insurance benefit eligibility. Today, most states define the base period to be the first four of the five quarters prior to the filing date of the claim. A proposed change would include employment in the most recent quarter in the eligibility determination process. Enactment of this provision in federal legislation would then require conforming action by state legislatures. This, in turn, could result in a change in employer hiring practices and use of independent contractors.

REGULATION INCENTIVES

Another potentially important consideration for the EDE Project researchers is an employment size class issue.[9] By hiring independent contractors, an employer's employment size class can be held below the threshold number of employees that triggers a need to comply with state and federal regulations.

AFFIRMATIVE ACTION AND OTHER RECRUITMENT COST INCENTIVES

Some employers are alleged to designate selected new hires as independent contractors with an intention to then convert some to employee status based on observed performance criteria. This behavior will affect the timing and incidence of accession and separation estimates calculated from state UI wage records.

WORKERS' COMPENSATION BENEFIT INCENTIVES

Employers of some providers of high-risk services, such as roofers, construction workers and bicycle couriers, are alleged to engage these service providers as independent contractors, but then convert them to employees if they are injured on the job, so they can collect Workers' Compensation benefits. This practice, too, could affect the timing and incidence of worker accession and separation estimates.

TAX BURDEN INCENTIVES

Some employers are alleged to give work to employees to take home. Instead of paying overtime for take-home work, the employer categorizes the employee as an independent contractor and pays by the piece for work done in the home. Family members 'help' and never show up on company books as employees or independent contractors.

The California Unemployment Insurance Code, Section 606, states that

> each individual employed to perform or to assist in performing the work of any individual employed by an employing unit shall be deemed to be employed by that employing unit for all the purposes of this division, whether or not he was hired or paid directly by the employing unit if the employing unit had actual or constructive knowledge of the work.

The Illinois Compiled Statutes, 820 ILCS 405/213, provides that

> each individual performing services for, or assisting in performing the work of, any person in the employment of an employing unit shall be deemed to be employed by such employing unit for all the purposes of this Act, whether such services were procured or were paid for directly by such employing unit or by such person, provided the employing unit had actual or constructive knowledge of the work.

The California and Illinois definitions clearly define take-home work as covered employment. This means that the employer practice of assigning take-home work, described above, is an accuracy of reporting, or compliance, issue, not a coverage issue. Of course, from an EDE Project researcher's perspective, this distinction may not matter—worker accession and separation events occur but do not appear in the state UI wage records relied upon to calculate worker flow estimates.

THE CONCENTRATION OF INDEPENDENT CONTRACTOR USE

The authors of the comprehensive study of independent contractor issues, as these affect state unemployment insurance programs, asked state employment security agency audit department staff members in 14 cooperating states to list the industries where they frequently encounter misclassification of independent contractors. California, Florida, Maryland and Texas audit staff responses are included in the published findings.

- California—Services, landscaping, construction, manufacturing.
- Florida—Trucking, construction, home health.
- Maryland—Construction, cleaning services, home health, trucking, catering, cable and carpet installers, hygienists referred to dentists, secretaries to attorneys.
- Texas—Eating and drinking establishments, trucking, warehousing, oil & gas industry, real estate, farm labor, non-residential building construction, special trade contractors, employment agencies, and general automotive repair shops.

SUMMARY

Today's legal, regulatory and economic environment is motivating a growing number of employers to define some service providers as independent contractors. What does this mean for EDE project researchers? Employer opportunities to legally define some service providers as independent contractors are limited and concentrated in sectors that can be identified and isolated in the estimation of worker accession and separation flows.

AN ESTIMATE OF INDEPENDENT CONTRACTOR EMPLOYMENT

Up to this point, the basic theme has been that employment coverage in state employment security agency administrative records is inclusive overall, but certain exceptions remain of concern as a threat to the integrity of EDE project worker accession and separation estimates. Having made the case that a problem exists, attention turns to the calculation of an estimate of independent contractor employment in three industry sectors (construction, retail trade, and services) and five states (CA, FL, IL, MD and TX).

CURRENT POPULATION SURVEY DATA

The May 24, 2001, Bureau of Labor Statistics *News Release*, which includes findings from the Contingent and Alternative Employment Arrangements supplement to the February 2001 Current Population Survey, distributes an estimated 8.6 million independent contractors using the Standard Industrial Classification one-digit division level.

Seventy-three percent of the estimated 8.6 million independent contractors in February 2001 were affiliated with three industries—44 percent in Services; 20 percent in Construction; and 9 percent in Retail Trade. These percentages were used to estimate state-specific independent contractor employment in these industries.

The employment figures found in Table 8 of the May 24, 2001 Bureau of Labor Statistics *News Release* were used to calculate the number of independent contractors included in the 8.6 million independent contractor estimate.

The employment figures for independent contractors, on-call workers, temporary help agency workers, workers provided by contract firms, and workers in traditional arrangements were calculated and summed for each of the three industries.

Estimates of Independent contractors as a percentage of each industry-specific summed employment number were derived, using the published *News Release* report that independent contractors composed 19.7 percent of February 2001 construction employment; 3.4 percent of retail trade employment; and 7.6 percent of employment in services.

CURRENT EMPLOYMENT STATISTICS SURVEY DATA

Three additional steps were taken to arrive at state-specific estimates of independent contractor employment in the construction, retail trade, and services industries. Seasonally adjusted non-farm 16+ Current Employment Statistics (CES) establishment survey data for February 2001[10] for each of the five states were used as the starting point for estimating state-specific independent contractor employment in construction, retail trade, and services.

The Bureau of Labor Statistics reported that 12 percent of self-identified independent contractors had described themselves as wage and salary workers in the main February 2001 Current Population Survey instrument.[11] This percentage figure was used in a two-step sequence to derive an estimate of the number of independent contractors not included in the state-specific CES estimates of employment in each of the three industries.

The result from this series of calculations appears on the next page. I estimate that almost 1.5 million independent contractors were employed in the construction, retail trade, and services sectors of the CA, FL, IL, MD and TX economies in February 2001, but not included in the CES employment estimates for these state-specific sectors for the same month.

The 1.5 million figure amounts to two-thirds of total independent contractor employment in these states omitted from the CES employment estimates, ranging from a low of 60 percent in Illinois to a high of 72 percent in Florida and Maryland. Most of this interstate difference is traceable to a lower percentage of total employment in Illinois being in the services sector.

The 1.5 million independent contractors who are assumed to be omitted from the CES employment estimates for these states and industries is a conservative, and perhaps fragile, estimate of workers who do not appear in the state UI wage records being used by the EDE Project researchers.

AN ESTIMATE OF
INDEPENDENT CONTRACTOR EMPLOYMENT
FOR FIVE STATES AND THREE INDUSTRIES
(FEBRUARY 2001)
(000's)

	CA	FL	IL	MD	TX
Construction					
Total Employment	762	398	281	161	575
Estimate of all IC's	150	80	56	32	115
Wage & Salary IC's	18	10	7	4	14
Omitted IC's	132	70	49	28	101
Retail Trade					
Total Employment	2,499	1,392	1,003	444	1,723
Estimate of all IC's	85	46	33	15	57
Wage & Salary IC's	10	6	4	2	7
Omitted IC's	75	40	29	13	50
Services					
Total Employment	4,720	2,736	1,883	874	2,798
Estimate of all IC's	359	205	141	66	210
Wage & Salary IC's	43	25	17	8	25
Omitted IC's	316	180	124	58	185

Sources: Current Population Survey Supplement, February 2001
Current Employment Survey, February 2001

The independent contractor employment estimate, and the separation of independent contractor employment into wage and salary versus self-employed components, is based on the Current Population Survey of households. The state-specific industry employment data that were then used are collected through the Current Employment Statistics survey of establishments.

A respondent in the Current Population Survey may be classified as a wage and salary employee based on answers given to questions in the main questionnaire, but then classified as an independent contractor based on answers given to questions in the supplement to the main questionnaire. Twelve percent of the respondents in the February 2001 survey were classified in this way.

Each Current Population Survey respondent can have no more than one type of employment affiliation in a reference month. A respondent's answers have no predictable relationship to how a Current Employment Statistics respondent (an employer) might categorize them. Furthermore, the CES counts jobs, not people.

Meanwhile, a Current Population Survey respondent's employer, or employers, may, or may not treat them as covered for state unemployment insurance reporting purposes. Again, there is no predictable relationship between CES reporting and whether a worker is treated as covered for state unemployment insurance reporting purposes.

If all the independent contractors classified as wage and salary employees in the Current Population Survey results are treated by their employers as non-covered for state unemployment insurance reporting purposes, then the 1.5 million estimate should be increased by 200,000.

This section provides EDE Project researchers with a quantitative sense of the importance of independent contractor employment that is excepted from coverage in the state UI wage records that are being used to estimate worker accession and separation flows. Nearly three-fourths of the potential threat to the accuracy of worker flow estimates appears to be concentrated in three sectors—construction, retail trade, and services.

V

CONCLUSIONS

Overall, as the *BLS Handbook of Methods* states, employment coverage in state employment security agency administrative records is "broad and basically comparable from state to state."[12] However, exceptions to the statutory definition of covered employment appear in each state unemployment insurance law. Many of these exceptions are common, but over time interest group dynamics have resulted in additional state-specific exceptions to the definition of covered employment.

State law changes are infrequent, so EDE Project researchers should not be alarmed about such amendments as a source of recurring discontinuities in data series. Having said this, the researchers should be vigilant for future changes that might require adaptive responses.

The independent contractor issue is another matter—it does have immediate implications for some uses of worker flow estimates. This paper does not advise EDE Project researchers how to respond to knowing that independent contractors are not included in the state UI wage records that are being used to estimate worker flows.

The state partners in the EDE Project share an interest with their Census Bureau colleagues in the development of methods to investigate when and how independent contractor accession and separation flows should be calculated. These methods can then be applied, with appropriate refinements, to other employment that is excepted from coverage in state UI wage records.

A caution mentioned earlier is repeated here:

> Some, but not all employers are employing units for state unemployment insurance reporting purposes. Some, but not necessarily all services provided in the employ of an employing unit are defined as covered employment. Individuals providing identical services, but in the employ of different employers, may not be treated the same for reporting purposes.

The content of this paper should protect EDE Project researchers from making a common, but avoidable mistake. It is not possible to compile two lists of occupations—one describing employment that is covered by state unemployment insurance law and another that describes occupations that are not covered by these laws. No occupational descriptor is found in a state UI wage record (except in Alaska.) But, even if such a descriptor was included in a state UI wage record, occupation is not a stand-alone criterion for determining whether employment is treated as covered by a state unemployment insurance law.

REFERENCES

[1] U.S. Department of Labor (1997), *BLS Handbook of Methods*, Bulletin 2490, p. 42. UI refers to employment covered by state unemployment compensation laws, while UCFE refers to employment covered by the unemployment compensation for federal employees program.
[2] Bureau of Labor Statistics, *Contingent and Alternative Employment Arrangements, February 2001*, News Release 01-153, May 24, 2001.
[3] See: Lalith de Silva, Adrian Millett, Dominic Rotondi and William Sullivan, *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs*, Planmatics, Inc., February 2000, 99 pp. + appendices (released as U.S. Department of Labor Occasional Paper 2000-5, Office of Employment Security, Employment and Training Administration (http://www.ttrc.doleta.gov/awsdrr/)).
[4] NetCompliance, Inc., "Corporate Downsizing Causes IRS to Look at Role of Business Consultants," June 22, 2001 (http://www.netcompliance.com).
[5] de Silva *et al*., *op cit*, p. 14.
[6] EDE Project researchers are encouraged to read Susan N. Houseman, Arne L. Kalleberg and George A. Erickcek, *The Role of Temporary Help Employment in Tight Labor Markets*, Staff Working Paper No. 01-73, Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 45 pp. While not an employment coverage issue *per se*, the same cost containment forces that motivate the employer behavior described in this Staff Working Paper influence employer use of independent contractors.
[7] The IRS 20 common law factors can be found at http://www.contingentlaw.com/IRS20.htm.
[8] de Silva *et al*., *op cit*, p. 24.
[9] This example, and those that follow, are described in *Ibid*.
[10] Found at http://data.bls.gov/cgi-bin/surveymost?sa.
[11] The *Technical Note* to the May 24, 2001 *News Release* reports that "about 88 percent of independent contractors were identified as self-employed in the main questionnaire, while 12 percent were identified as wage and salary workers. Conversely, about half of the self-employed were identified as independent contractors." This *Technical Note* is available at http://www.bls.gov/new.release/conemp.tn.htm.
[12] This observation in the *BLS Handbook of Methods* refers to ES-202 data coverage. The core of ES-202 employment counts is covered employment reported by employers who are required to submit quarterly reports in compliance with a state unemployment insurance law. However, the ES-202 employment counts include additional sources of information, such as federal employee information obtained from the Office of Personnel Management, and are based on average employment in a representative week of a reference month, not on a count of all covered employment during the month.