CHALLENGES FACING CONTINGENT WORKERS & WHY IT MATTERS FOR YOUNG WORKERS

YOUNG YI INVINCIBLES

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Summary:

This brief expands on Financial Health of Young America, Young Invincibles' research measuring the financial decline of Millennials through the lens of education, student debt, and diversity, characteristics that make this generation unique. This brief explores the contingent workforce, a sector disproportionately made up of young adults, illustrating their challenges compared to regular employees. While more research is needed, particularly on young adults' perspectives, we hope by laying out how federal, state, and voluntary policies impact different types of workers, and by engaging a thought experiment for a possible framework for reform, policymakers can create a system that's fair to the most vulnerable workers.

Independent contractors, particularly those without employees and not within an incorporated business (referred to as contingent workers in this brief), tend to experience higher tax burdens and fewer social protections and benefits than traditional employees. This brief attempts to show why examining this sector is important for young adults, and to more clearly illustrate the distinctions between contractors and employees. This brief also presents ideas to grant new protections for workers contractors, but still allow for the flexibility and creativity alternative work can provide for contract workers.

Some protections given to regular employees could be extended to contract workers through a shared burden model, where customers or the contracting agent share the burden with the contractor. Also, simplifying the self-employment tax process could assist contingent workers when navigating their tax liability. This is a complex issue involving federal, state, and voluntary benefits, and this brief offers only a few ideas, and will not detail every step of reform.

Background:

Workers earning income are generally classified into two categories; employees and independent contractors. The Internal Revenue Service provides guidance on how to distinguish the two. They define an independent contractor as having full control over how and what will be done in order to provide the contracting agent with their request.[1] And while they also provide a test to ensure proper classification, 10 to 30 percent of U.S. employers misclassify their workers, resulting in loss of benefits and income to the worker.[2]

Furthermore, researchers, economists, and government entities lack consensus about the difference between contractor and regular employment work. As a result, there is disagreement about the size and growth of the contingent workers: estimates range from 5 percent to 35 percent of the labor force. [3]

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[1]"Internal Revenue Service," last modified July 7, 2017, https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-defined

[2]National Employment Law Project (NELP), Indepdenent Contractor Missclassification Imposes Huge Costs On Workers And Federal And State Treasuries (July: 2015), acessed June 29, 2017, http://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-on-workers-and-federal-and-state-treasuries/

[3] U.S. Government Accountability Office (GAO), Contingent Workforce: Size, Characteristics, Earnings, and Benefits (Washington, DC: 2015), accessed June 29, 2017, http://www.gao.gov/assets/670/669899.pdf & Elaine Profeld, "Freelances Now Make Up to 35% Of U.S. Workforce," Forbes, October 6, 2016, accessed July 5, 2017, https://www.forbes.com/sites/elainepofeldt/2016/10/06/new-survey-freelance-economy-shows-rapid-growth/#454ca69d7c3f

Although, researchers cannot agree on an exact definition, in this brief we define "contingent workers" as independent contractors, including on-demand and gig workers, who are not incorporated and do not have any employees. With this definition, we attempt to better understand contingent workers' challenges and explore a possible framework to protect them from financial instability and expand their economic opportunity.

What is clear is that contingent workers face lower wages, fewer benefits, and a larger tax liability. A Government Accountability Office's recent report shows contingent workers earn less than standard workers on an hourly, weekly, and annual basis. They are also more likely to report living in poverty and receive more public assistance than standard workers.[4] Furthermore, they are two-thirds less likely than standard workers to have a work-provided retirement plan.[5] Independent contractors also struggle with paying and even being aware of the self-employment tax, a liability split with employers in traditional employment.[6]

Contingent workers also tend to be young.[7] The twenty-three million Millennial on-demand workers make up the majority of the sector, according to one estimate.[8] They are also more likely to earn income on online labor platforms and capital platforms-people who market goods or rent assets (Airbnb, amazon,

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[4] U.S. Government Accountability Office (GAO), Contingent Workforce: Size, Characteristics, Earnings, and Benefits (Washington, DC: 2015), accessed June 29, 2017, http://www.gao.gov/assets/670/669899.pdf.

[5] U.S. Government Accountability Office (GAO), Contingent Workforce: Size Characteristics, Earnings, and Benefits (Washington, DC: 2015), accessed June 29, 2017, http://www.gao.gov/assets/670/669899.pdf. Pg. 6.

[6] Bruckner Caroline, "The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy," (Washington, DC: 2016), accessed July 10, 2017, http://www.american.edu/kogod/news/upload/shortchanged-caroline-bruckner-kogod-au.pdf

[7] U.S. Government Accountability Office (GAO), Contingent Workforce: Size Characteristics, Earnings, and Benefits (Washington, DC: 2015), accessed June 29, 2017, pg 5, http://www.gao.gov/assets/670/669899.pdf.

[8] Aspen Institute, What Do On-Demand Economy Workers Want? We Asked Them," (January: 2016), accessed June 14, 2017, https://www.aspeninstitute.org/blog-posts/time-magazine-gig-economy-future-of-work-aspen-institute/

ebay)-than the national average.[9] Young adults are also more likely to believe responsibility falls on the on-demand app or ensure quality and resolve problems in service.[10] For these reasons, we believe young people are particularly impacted by this sector and we should look to improve their benefits and work experience.

Difference Between Employees and Contractor (and a Framework for Reform):

Contingent workers face numerous challenges; primarily they are excluded from many safety net programs and pay a substantially high-income tax. In contrast, a traditional employee has the legal guarantee of various benefits, such as shared responsibility for FICA taxes,[11] worker's compensation,[12] and unemployment insurance. Additionally, some employers offer benefits such as paid leave and retirement savings plans. In order to protect the contingent workforce, we should consider improving their legal and voluntary benefits by providing similar protections and simplifying the tax process provided to a traditional employee.

In the chart, we present some of the typical benefit liabilities for regular employment, contingent work, and our potential reforms to contingent work. For the purpose of this brief, we focus on FICA taxes, workers' compensation, retirement, and paid leave.[13] For every $100 earned, we identify, on average, how much each entity covers for the benefits shown. As shown, the current relationship between an independent contractor and their contracting agent provides no social safety net protections and greater tax liabilities on the worker.

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[9]JP Morgan Chase & CO. Institute, Paychecks, Paydays, and the Online Platform Economy, (February: 2016) accessed July 5, 2017, pg 22, https://www.jpmorganchase.com/corporate/institute/document/jpmc-institute-volatility-2-report.pdf

[10]Pew Research Center (PEW), Shared Collaborative and On Demand: The New Digital Economy, (Washington, DC: 2016), accessed July 5, 2017, http://www.pewinternet.org/2016/05/19/the-new-digital-economy/

[11] FICA refers to Federal Insurance Contributions Act, and generally refers to the 15.2 percent tax on wages earned to fund Medicare and Social Security.

[12] All states except Texas manage Worker's Compensation and coverage and benefits vary by state.

[13] We recognize other benefits might be considered, but focus on the four identified for simplicity's sake.

Table 1. Benefit Liabilities as percent of $100 earned								
		Regular Employment		Contingent Work		Potential Reforms to Contingent Work		
		Employer	Employee	Contracting Agent	Independent Contractor	Contracting Agent	Independent Contractor
Legally Required benefits	Worker's Compensation	**$1.95**	**$0.00**	**$0.00**	**$0.00**	**$1.95**	**$0.00**
	State Unemployment Insurance	**$0.66**	**$0.00**	**$0.00**	**$0.00**	**$0.00**	**$0.00**
	Social Security	**$6.20**	**$6.20**	**$0.00**	**$12.40**	**$3.10**	**$9.30**
	Medicare	**$1.45**	**$1.45**	**$0.00**	**$2.90**	**$0.73**	**$2.18**
Voluntary Benefits	Paid Leave	**$10.33**	**NA**	**$0.00**	**$0.00**	**$0.00**	**$0.4**
	Retirement (Defined Contribution)	**$2.86**	**NA**	**$0.00**	**$0.00**	**$0.00**	**$3.00**

Young Invincibles' analysis of Bureau Of Labor Statistics- Employer Costs for Employee Compensation for the Regions-March 2017 & Internal Revenue Service.The default employee contribution for Secure Choice models is set at 3 percent. Paid leave is set at a 0.2 percent employee contribution rate by Senator Gillibrand's FAMILY Act.

In this section, we discuss the basic benefit types we think should be considered to improve the financial security of independent contractors. As we introduce each benefit, we also demonstrate how contingent workers are either at a disadvantage or can directly benefit from some of our suggestions.

A. **The Federal Insurance Contributions Act** This social security and Medicare payroll tax is divided between employer and employee. The social security tax rate or the amount withheld from the employee is 6.2 percent and employer contributes 6.2 percent, for a 12.4 percent total.[14] The Medicare tax rate is 1.45 percent for both the employee and employer resulting in a 2.9 percent contribution.[15] Two challenges arise for the self employed: 1) they are responsible for the full 15.3 percent, in the form of the self-employment tax[16] and 2) do not have the advantage of having their wages withheld and face a more complicated and tax situation.

One idea, is to ease the monetary burden and simplify the process. In such a structure, the contractor and contracting agent could share the responsibility to make FICA tax contributions. Rather than split the tax between contracting agent and independent contractor evenly like regular employment, a 25/75 split could be a good compromise, where the contracting agent pays 25 percent of the 15.3 percent tax rate and the independent contractor will pay 75 percent of their 15.3 percent tax rate. This shifts some burden away from the contractor through a shared liability and also ensures a portion of the Medicare and Social Security tax is paid with each transaction or job.

B. Worker's Compensation This insurance program covers medical bills and wages for employees and their families due to injury in the workplace and it is important contingent workers receive this benefit. However, worker's compensation is not federally mandated and is left up to states to administer. In all fifty states, with the exception of Texas, private sector employers are mandated to provide worker's compensation insurance to traditional workers. The employers are subjected to finance the program entirely with the exception of three states, where the employee

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[14]"Internal Revenue Service," last modified 2017, https://www.irs.gov/publications/p15/ar02.html#en_US_2017_publink1000202428

[15] Ibid.

[16]Ibid.

contributes a small percentage.[17] The average employer contribution to worker's compensation for a regular employment, is roughly two cents per $100 paid.

Contingent workers currently do not receive this benefit, despite being at a higher risk for injuries. Taxi drivers and chauffeurs are five times more likely than standard workers to be killed on the job.[18] The Occupational Safety and Health Administration found factors such as working in unsafe areas and late night hours, increase homicide rates for taxi drivers are due to their work environment.[19] Online on-demand platform work (e.g., Uber, Lyft) also includes these factors. The transportation work is not the only sector that has affected individuals' health and well-being. Other jobs like domestic work, delivery, and home and repair and improvement prove to be hazardous as well. A national study found that 38 percent domestic workers suffer from wrist, shoulder, elbow, or hip pain in previous months and 29 percent of housecleaners experienced skin irritation.[20]

As visible in the table, independent contractors are not covered for worker's compensation due to their self-employed status. We suggest a framework that would require the contracting agent provide worker's compensation and match the average given to traditional employees, due to the various risk factors mentioned.

C. **Retirement** A retirement account is available to traditional employees if their employer offers it. Even if the employer does not match employee

[17] National Academy of Social Insurance (NASI), Worker's Compensation: Benefits, Coverage, and Costs, (Washington, DC: 2016), accessed July 4, 2017, https://www.nasi.org/sites/default/files/research/NASI_Workers_Comp_Report_2016.pdf
[18] National Employment Law Project (NELP), On Demand Workers Should Be Covered By Workers Compensation, (New York: 2016), accessed June 23, 2017, http://www.nelp.org/publication/on-demand-workers-should-be-covered-by-workers-compensation/
[19] Ibid.
[20] Ibid.

contributions, the traditional employee still benefits from pre-tax contributions conveniently diverted from their paycheck. The independent contractor is largely denied this opportunity. And contingent workers are not taking the necessary steps to invest in their retirement, which will hinder their financial security for the future.[21] Although, there are non-employer-sponsored retirement plans, less than 14 percent of all individuals contribute to an Individual Retirement Account in a given year.[22]

More states are experimenting and implementing portable retirement savings plans for employees who are not offered a plan by their employer. While these "Secure Choice" programs increase retirement security for a standard worker, there is no option for the contingent worker. They do not have access to participate in the the automatic payroll program or employer matching programs.[23]

States could adopt the Secure Choice model of a state facilitated retirement plan and include independent contractors. The state secure choice programs default employee contribution rate begins at 3 percent, while the average employer-provided retirement contribution is about three cents per dollar as seen in the table. We have included the 3 percent contribution rate in the table, similar to Secure Choice plan's' contribution rate, in the potential reforms column. This could be withheld from workers' payments, perhaps through online credit card transactions, in hopes to simplify and increase retirement savings.

D. **Paid Leave** This voluntary benefit grants a traditional employee earned income when they take time off for family and medical reasons. In states where this is not a required benefit, individuals are burdened to choose

[21] Brookings, Retirement Plans For Contingent Workers: Issues and Options, (Septemeber: 2016), accessed July 10, 2017, https://www.brookings.edu/wp-content/uploads/2016/09/rsp923paper1-1.pdf
[22] Ibid.
[23] "California State Treasurer," last modified 2016, http://www.treasurer.ca.gov/scib/employees.asp

between being paid or taking care of their loved ones. This is largely a voluntary employer-provided benefit and it leaves the contingent worker without an option to participate.

States have begun to pass paid leave measures, while Congress is debating providing the benefit. These portable plans could allow independent contractors to pay into the enacted systems. In the recently introduced FAMILY Act by Senator Gillibrand (D-NY) includes the self-employed and would provide them with a 0.4 percent contribution of paid wages.[24] For our experimental framework, we incorporate this rate.

Implementation & Looking Ahead:

Implementing these federal, state, and voluntary benefits will require a system that captures transactions between the contracting agent and contractor. The challenge stems in part from the lack of an intermediary that can document the relationship between the customer and contractor. In regular forms of employment, the intermediary between an employer and employee's wages is set up through a payroll system and human resources staff. These systems make it feasible for the employer to capture FICA taxes, fund retirement contributions, and provide other voluntary payroll deductions.

However, there is opportunity to partner with electronic and mobile payment services to extend deductions and contributions for benefits to independent contractors. Although this model excludes cash and check payments, there is evidence that consumers prefer to use credit cards and debit cards over cash, and mobile payments are projected to grow.[25] Companies like Square and Intuit could potentially assist in incorporating various benefits we consider for contingent

[24] FAMILY ACT, S.337,115th Cong. (as introduced by Senate, Feb. 7, 2017), https://www.congress.gov/bill/115th-congress/senate-bill/337/text

[25] Total System Services, Inc.(TSYS), 2016 U.S. Consumer Payment Study, (October: 2016), accessed July 24, 2017, http://www.tsys.com/Assets/TSYS/downloads/rs_2016-us-consumer-payment-study.pdf

workers. The details of this partnership will need to be further researched and discussed.

Another way contingent workers could receive the potential benefits mentioned is by collectively organizing and negotiating with their contracting agent. However, independent contractors do not have the right to organize. They are excluded from the National Labor Relations Act which restricts them from improving their working conditions or negotiating for better wages and benefits.[26] Cities such as Seattle, have provided a framework for contractors to collectively bargain, due to the lack of federal protection.[27] The inclusion of independent contractors to the National Labor Relations Act could provide workers with the right to come together and bargain.

These factors limit contingent workers ability to gain benefits and ultimately their financial security. Yet, there are many other issues challenging today's young adults to build assets, including regular W-2 employees:

- **Wages:** The decline of wages has stifled the ability of Millennials to achieve a reasonable standard of living.[28] Young Invincibles supports an increase to the federal minimum wage to help young adults build assets both short-term and long-term.

- **Health Care**: Over 8 million young adults have gained health insurance through the Affordable Care Act's insurance marketplaces, expansion of Medicaid, and the ability to stay on their parent's plan.[29] Without medical

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[26] Nayantara Mehta,"On-demand workers'right to organize: Seattle, 1, Uber 0," Quartz, January 7, 2016, accessed July 6, 2017, https://qz.com/587099/on-demand-workers-right-to-organize-seattle-1-uber-0/

[27] Daniel Beekman, "Seattle First U.S. City to Give Uber, Other Contract Drivers Power to Unionize," The Seattle Times, December 14, 2015, accessed August 3, 2017, http://www.seattletimes.com/seattle-news/politics/unions-for-taxi-uber-drivers-seattle-council-votes-today/

[28] Young Invincibles (YI), The Financial Health of Young America, (January: 2017), accessed August 3, 2017, http://younginvincibles.org/wp-content/uploads/2017/04/FHYA-Final2017-1-1.pdf

[29] "Young Invincibles," accessed August 2, 2017, http://younginvincibles.org/issues/health-care/

coverage, young adults are exposed to additional risk of accumulating medical debt.[30] Now that young people are covered we should continue to protect and improve the Affordable Care Act.

- **Retirement**: Regular employees also struggle saving for retirement, due to the lack of access to an employer-sponsored plans.[31] There are potential federal and state facilitated retirement options for workers. States should adopt programs on the Secure Choice model, because it gives access to workers without a employer-sponsored plan. The administration should also restore the federal retirement account program, MyRA, to give workers another opportunity to save.[32]

[30] "Young Invincibles," accessed August 2, 2017, http://younginvincibles.org/reports-briefs/health-coverage-gap-young-texans/

[31] The PEW Charitable Trusts, Employer-Sponsored Retirement Plan Access. Uptake, and Savings, (September: 2016), accessed August 1, 2017, http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/09/employer-sponsored-retirement-plan-access-uptake-and-savings

[32] Tara Siegel Bernard, "Treasury Ends Obama-Era Retirement SAvings Plan", The New York TImes, July 28, 2017, https://www.nytimes.com/2017/07/28/business/treasury-retirement-myra-obama.html?_r=0.