



Flexible and Portable Benefits for Independent Workers: State Policy Guide

Liya Palagashvili and Jonathan Wolfson

October 2024

Today more than one-third of Americans earn income through independent contracting, freelancing, or gig (temporary and on-demand) work.¹ For some, independent work provides supplemental income to help meet financial needs, while for others, it provides the only opportunity to enter the workforce. Independent workers are diverse, spanning a wide range of industries, skill levels, and educational backgrounds. They include freelance creatives, knowledge-work professionals, contractors, self-employed service providers, merchants or sellers, and entrepreneurs.

The growth of this nontraditional workforce is creating policy challenges because many independent workers do not have access to standard employment-based benefits, such as health insurance and retirement savings plans. Policymakers and regulators are debating how to best address the issue. Some state and federal proposals, such as California's Assembly Bill 5 and the Department of Labor's most recent independent contractor rule, aim to reclassify workers as employees. Far from delivering their intended results, these reclassification policies tend to harm independent workers,² the vast majority of whom prefer to keep their nontraditional work arrangements rather than be forced to switch to traditional employment.³

Most independent workers would appreciate and gain from flexible or portable benefits—benefits that are not tied to a particular job or employer but travel with the worker. In this policy brief, we outline seven comprehensive state reforms that will increase access to such benefits for independent workers without imposing large costs on contracting companies, including small businesses.

The seven key state policy recommendations below aim to legalize the flow of benefits to independent workers, increase opportunities for flexible benefits and savings, and improve access to healthcare benefits:

1. Stipulate that no state agency can use the presence of benefits to determine whether a worker is an independent contractor or an employee.

2. Allow workers to register as independent workers, and ensure that state regulators treat registered independent workers accordingly.
3. Adopt federally created Section 125 cafeteria plans for independent workers and exempt the contributions to these flexible benefits accounts from state income taxation.
4. Adopt federally created universal savings accounts (USAs) and exempt them from state-level capital gains taxes and state income taxation.
5. Clarify that any individuals can join together for any reason (as long as they are residents of that particular state) for the purposes of forming their own group risk pools to buy insurance.
6. Allow independent contractors to buy into a company's insurance plan as if they were employees without it triggering an employment classification criterion.
7. Establish that any payments made by independent contractors or hiring parties toward purchasing health insurance products are not subject to state income taxes.

REMOVING BARRIERS TO BENEFITS FOR INDEPENDENT WORKERS

Recommendation 1: Stipulate that no state agency can use the presence of benefits to determine whether a worker is an independent contractor or an employee.

The current regulatory framework in the United States restricts and thus discourages organizations from providing benefits to independent contractors. When a company provides benefits other than compensation to an independent contractor, there is a risk that the worker will be reclassified as an employee, which would result in the company incurring higher costs and misclassification fees or penalties. Additionally, the company and the worker would face steep hurdles to keep the relationship contractual, as desired.

State policymakers can legalize independent contractors' access to benefits by removing classification barriers and by explicitly stating that no state agency can use the presence of benefits to determine whether a worker is an independent contractor or an employee.⁴ This would allow companies to voluntarily provide a "menu" of benefits, based on the companies' resources, and give independent workers more opportunities to receive benefits.

States are already taking more interest in flexible approaches to benefits to address the needs of the growing independent workforce. In 2023, Utah became the first state to legalize access to benefits for independent contractors by removing classification barriers, explicitly stating that no agency in the state can use the presence of benefits to determine whether a worker is an independent contractor or employee.⁵ This legal change paved the way for Stride and Target's Shipt, a delivery company, to create the first voluntary benefits contribution program. The program allows independent workers to receive health coverage, paid time off, long-term savings, and other benefits typically extended to traditional employees.

Recommendation 2: Allow independent workers to register as such, and ensure that state regulators treat registered independent workers accordingly.

Many businesses that contract with legitimate independent workers are concerned that regulators might misconstrue the nature of their business relationship. State agencies such as workers' compensation commissions, unemployment and labor departments, and tax authorities might scrutinize whether an independent contractor has been "misclassified." If they reach that conclusion, the contracting business could face penalties, additional expenses, and legal action. To avoid such a scenario, states should offer workers the option to formally register their independent status. Such registration would provide businesses with confidence that if the state investigates, it will confirm the workers' independent classification. With this assurance, hiring parties will be more likely to provide benefits to independent workers without fearing repercussions.

Workers who have a limited liability company (LLC)—and thereby are registered as an official business entity—should be eligible to obtain this optional self-certification. Workers who have not registered as an LLC should also be permitted to obtain this self-certification if they meet one of the following criteria: have a household income greater than the poverty threshold, are under the age of 26, or are eligible for social security. These alternative criteria help protect vulnerable members of the population.

Optional self-certification would not interfere with a state's existing worker classification test. Businesses would still be required to comply with each state's worker classification determinations. The optional self-certification process would serve as an additional measure that independent workers could undertake to provide assurance of their status. This would allow businesses to offer benefits to independent workers without risking that regulators might misconstrue those benefits as evidence of an employee–employer relationship.

CREATING OPPORTUNITIES FOR FLEXIBLE BENEFITS AND SAVINGS

Recommendation 3: Adopt federally created Section 125 cafeteria plans for independent workers and exempt the contributions to these flexible benefits accounts from state income taxation.

Employees generally have access to federal Section 125 cafeteria plans, which allow employees and employers to make pre-tax contributions to a variety of employee benefits. Therefore, company contributions and employee contributions are shielded from an employee's federal income and payroll taxes. These contributions can be used to pay for health insurance premiums, purchase disability insurance, and pay for parking, or they can be deposited into retirement, health, or flexible savings accounts. This tax advantage does not currently exist for self-employed workers.⁶

Through a nationwide survey, Massachusetts Institute of Technology economist Jonathan Gruber found that Uber drivers highly valued these types of flexible benefits accounts.⁷ To this end, if federal policymakers allow independent workers to create a cafeteria plan similar to what employees are able to do under Section 125 of the tax code, states could adopt a similar policy.

In such a scenario, independent workers would contribute income to their flexible benefits accounts, and these contributions would be shielded from state income taxation. Independent workers could use these flexible benefits accounts to make eligible purchases in a Section 125 cafeteria plan (e.g. retirement savings, life and disability insurance, dependent care expenses).

Additionally, any amount that a contracting organization contributes to the independent worker's flexible benefits account should not count as income for the employee's state income obligations. It should be clarified that contributions from hiring parties to a flexible benefits account could not be used as a factor in determining a worker's classification status.

Recommendation 4: Adopt federally created universal savings accounts (USAs) and exempt them from state-level capital gains taxes and state income taxation.

Independent workers have limited access to employer-sponsored retirement benefits and traditional savings platforms. Current retirement vehicles—such as 401(k)s and IRAs—are poorly suited for the diverse needs of independent workers, and many independent workers are discouraged from using them, fearing the complex penalties for misusing funds.

Federal USAs would offer a flexible, clear, and nondistortionary solution for independent workers to save for their own priorities.⁸ The key advantage of USAs would be that, unlike traditional retirement accounts, USAs would allow tax-free withdrawals at any time for any purpose without penalties or usage restrictions. USAs therefore would encourage greater savings while also offering the freedom to withdraw those savings as needed, before or after retirement.

While USAs should be created at the federal level, state policymakers could also unilaterally adopt a similar policy. States could lead by creating USAs that are exempt from state-level capital gains taxes and ensuring that if the accounts are adopted at the federal level, they are also exempt from state income taxation. Policymakers should clarify that companies' contributions to an independent contractor's USA cannot be used as evidence of an employer–employee relationship, again protecting the worker's independent classification.

IMPROVING ACCESS TO HEALTHCARE BENEFITS

Health insurance coverage is often a significant concern for independent contractors. While some contractors are able to access health insurance through a full-time job, a spouse's plan, or a government program, many are not so fortunate.⁹ Self-employed workers are more likely to be uninsured

than employees of companies. Reforms should aim to remedy this critical issue by making health-care benefits more accessible and affordable for independent workers.

Recommendation 5: Establish that any individuals within a state can join together for any reason to form their own group risk pools to buy insurance.

Allowing independent workers to band together in larger risk pools may help to reduce the cost of health insurance. Although there is some uncertainty regarding how federal enforcement will impact state laws on this issue, states should move forward nonetheless to establish this infrastructure to help with access to healthcare benefits at the state level.

Recommendation 6: Allow independent contractors to buy into a company's insurance plan as if they were employees without it triggering a change in employment classification.

Allowing interested independent contractors to buy into companies' insurance plans is another pathway for independent workers to be part of a larger risk pool that could lower the price of their health insurance. Any such policy should include language that allows workers to retain their independent contractor status even if they buy into a company's insurance plan. These state reforms would involve insurance policies regulated by the state (small group and individual plans) but not the Employee Retirement Income Security Act (ERISA) plans (large employer plans).

Recommendation 7: Establish that any payments by independent contractors or hiring parties toward health insurance products will not be subject to state income taxes.

If a hiring party subsidizes an independent contractor's health insurance products, that subsidy should not be taxed as income at the state level. It should be clarified that if hiring parties subsidize health insurance products for independent contractors, this too cannot be used as a factor for determining whether or not the worker is an employee or independent contractor.

CONCLUSION

To better meet the needs of the growing independent workforce, policymakers can reform existing laws to help independent workers access flexible benefits. Embracing innovative reforms to unleash flexible benefits will help both workers and employers seize more opportunities in this evolving economy.

APPENDIX

FAQs: Flexible and Portable Benefits for Independent Workers, State Policy Guide

1. Do flexible and portable benefits reforms increase the chances of misclassification?

No, businesses are still required to follow their state's worker classification tests—whether that is the common-law, ABC, or another test. This means that if regulators find that a business is misclassifying independent contractors as employees, that business is still in violation of state laws. The proposed portable benefits reforms should have no impact on that determination. Legalizing access to benefits for independent contractors means that legitimate and properly classified independent contractors will be able to receive benefits from hiring parties.
2. Does state self-certification amend existing worker classification tests?

No, the optional self-certification does not alter a state's worker classification test. Businesses are still required to properly classify workers as either employees or independent contractors according to their state's laws. This is an optional self-certification that independent workers can obtain in addition to meeting the state's existing worker classification test. The self-certification is meant to help protect legitimate, properly classified independent workers by allowing them to register with the state as an independent business entity.
3. What criteria should be used to obtain state self-certification as an independent worker?

Workers who have an LLC, and are thereby registered as an official business entity, would be eligible to obtain this optional self-certification. Workers who have not registered as an LLC could also obtain this self-certification if they meet one of the following criteria: have a household income greater than the poverty threshold, are under the age of 26, or are eligible for social security. These alternative criteria would help protect vulnerable members of the population.
4. What is the difference between typical retirement savings accounts and flexible universal savings accounts?

The key advantage of USAs is that unlike existing types of retirement accounts, USAs allow tax-free withdrawals at any time for any purpose without penalties and have no restrictions on how the savings are used, whether for retirement, paid time off, emergencies, creating a business, or something else.
5. If states allow independent workers to band together for the purposes of forming a risk pool to buy insurance, does this violate federal ERISA laws?

Generally, ERISA governs large-group market plans that move across state lines, and states should be able to establish their own rules regarding insurance within the state. However, there is uncertainty regarding how federal enforcement will impact state laws on this issue. Nevertheless, states could move forward to establish a more effective infrastructure for access to healthcare benefits at the state level.

ABOUT THE AUTHORS

Liya Palagashvili is a senior research fellow and director of the Labor Policy Project at the Mercatus Center at George Mason University. Her research focuses on labor regulations, the gig economy, and the changing nature of work. Before joining the Mercatus Center, Palagashvili was a professor of economics at State University of New York–Purchase and a Visiting Scholar at King’s College London. She earned her PhD in economics at George Mason University.

Jonathan Wolfson is the chief legal officer and policy director at the Cicero Institute. He also oversees the Cicero Law & Policy Fellows program. Before joining Cicero, Wolfson led the Policy Office at the US Department of Labor where he managed deregulatory efforts and oversaw the DOL’s internal policy development think tank. Wolfson received an AB in Economics from Washington University in St. Louis and a JD from the University of Virginia School of Law, where he was an Olin Law and Economics Fellow and won the John M. Olin Prize for best original law and economics research.

NOTES

1. About 10 to 29 percent of US workers engage in independent work as their primary source of income, and up to 39 percent use it as a supplementary source of income. To get a better sense of this range, see table 1 in Liya Palagashvili, *Understanding Nontraditional Work Arrangements and the Policy Landscape for Self-Employed and Gig Workers* (American Enterprise Institute, July 3, 2023).
2. Liya Palagashvili et al., “Assessing the Impact of Worker Reclassification: Employment Outcomes Post-California AB5,” (Mercatus Working Paper, Mercatus Center at George Mason University, January 31, 2024).
3. Bureau of Labor Statistics, “Contingent and Alternative Employment Arrangements—May 2017,” news release no. USDL-18-0942, June 7, 2018.
4. Liya Palagashvili, “Flexible Benefits for a Flexible Workforce: Unleashing Portable Benefits Solutions for Independent Workers and the Gig Economy” (Mercatus Policy Brief, Mercatus Center at George Mason University, February 3, 2023).
5. Liya Palagashvili and Caden Rosenbaum, “Findings and Recommendations of the Utah Flexible Benefits Working Group,” *Libertas Institute*, February 21, 2024.
6. Self-employed workers can contribute to a tax-deferred retirement account and can deduct health insurance premiums from their federal income tax obligations, but not from their self-employment taxes (equivalent to payroll taxes for employees).
7. Jonathan Gruber, “Designing Benefits for Platform Workers” (NBER Working Paper No. 29746, National Bureau of Economic Research, February 2022).
8. Adam N. Michel, “Universal Savings Accounts: A Flexible Financial Tool to Support the Gig Economy” (Policy Paper 2020.007, The Center for Growth and Opportunity, July 2020).
9. For example, Jonathan Gruber’s survey found that 77 percent of Uber drivers have health insurance (compared to 89 percent for workers nationally), and among that group, 52 percent receive their insurance either through their primary employer or through a family member’s employer. See Jonathan Gruber, “Designing Benefits for Platform Workers.”