

ISSUES FOR EMPLOYERS*

WHO IS AN EMPLOYEE?

IN GENERAL

Many laws affecting the worker/employment relationship will require the business owner to first determine whether an individual who performs services for the business is an “employee” for purposes of the particular law. **Business owners who use “independent contractors” may think they do not have employees and, therefore, employment laws do not apply to them. An individual’s status as an independent contractor, however, is not determined by agreement or by what he or she is called; the individual’s status is determined by what he or she does.**

The relationship between the business and the individual may be that of:

- A common law employee.
- A statutory employee.
- An independent contractor.

If the individual is a common law employee, the business by law must obtain workers’ compensation coverage, withhold FICA (Social Security and Medicare) and income taxes, pay the employer’s share of the FICA tax and pay federal and state unemployment taxes. Fair labor standards laws, occupational safety and health requirements and a variety of other federal and state laws also may apply.

If the individual is a statutory employee, the business does not withhold federal or state income tax. The employer should consult with an attorney or other competent tax advisor with respect to withholding Social Security and Medicare taxes and paying unemployment tax. Fair labor standards laws will probably apply.

An independent contractor is himself or herself a sole proprietor of a business, and not an employee of the firm who contracts with them. The tax requirements for sole proprietorships are discussed in the “Choosing the Form of Business Organization – Tax and Non-Tax Considerations” section of the Small Business Assistance Office publication, *A Guide To Starting A Business In Minnesota*.

*A comprehensive discussion of employment issues is provided in the publication, *An Employer’s Guide to Employment Law Issues in Minnesota*. The publication is available without charge from the Minnesota Small Business Assistance Office.

The question of whether a worker is an independent contractor or an employee may be determined by common law rules (definitions fashioned by the courts based on specific cases) or by statute. A person may be an employee for certain purposes but not for others. If a question arises, the employer is strongly urged to seek professional advice.

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COMMON LAW EMPLOYEES

Under common law rules, courts balance a number of factors to determine whether an employer-employee relationship exists. The employer's right to control the manner and means of performing the work is the most important factor distinguishing an employer-employee relationship. It does not matter that the employer gives the employee substantial discretion and freedom to act, so long as the employer has the legal right to control both the method and result of the service.

Some of the other factors examined by the courts in determining whether an employment relationship exists include:

- **Mode of payment.** Workers who are paid on a regular basis, e.g., hourly or bi-weekly, are more likely to be considered employees than are persons who are paid a fixed amount for a specific service, regardless of the amount of time taken to complete the task. Withholding for taxes and providing fringe benefits such as medical insurance are considered typical of an employer-employee relationship.
- **Materials and tools.** A person who furnishes his or her own materials and tools and equipment and has a significant investment in the tools and equipment used in connection with providing the service is less likely to be considered an employee than is a person who uses tools and materials furnished by the hiring entity.
- **Control of the premises.** An employer-employee relationship is more likely to be found where the hiring entity owns or controls the premises where the work is performed. Premises controlled by the service provider or by a third person are considered more characteristic of an independent contractor relationship.
- **Right of discharge.** The ability of the hiring entity to terminate or discharge the worker and/or the ability of the worker to leave before the task is completed without becoming liable for nonperformance under the contract or agreement also are factors examined in determining whether an employment relationship exists.

It is important to note, however, that none of the above factors, standing alone, will determine whether an employment relationship exists. The most important factor is the hiring entity's right to control the manner and means of completing the work. Doubtful situations generally are resolved by examining the facts of the specific case in light of all relevant factors.

If an employment relationship exists, the legal requirements placed on employers will apply regardless of what the parties call the worker, regardless of how payments are measured or made, and regardless of whether the person works part time or full time, unless a statutory exception applies to the situation.

In some cases, an employment relationship may exist between the employee and more than one employer, creating a situation of joint employment. A common example of this is when businesses obtain employees on contract from a temporary employment agency. It is important for employers to know that when they are in a situation of joint employment, both employers are jointly responsible to ensure that the employee is paid in accordance with the federal Fair Labor Standards Act as described in the Labor Standards section of this chapter. Note also that the Equal Employment Opportunity Commission (EEOC) has issued guidance on the application of Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act (ADEA), the Americans with Disabilities Act (ADA) and the Equal Pay Act (EPA) to individuals placed in job assignments by temporary employment agencies and other staffing firms (the EEOC refers to such individuals as “contingent workers”). In that Guidance, the EEOC states that either the staffing firm or the client (i.e. the business to which the contingent workers have been supplied), or both, may properly be considered an employer. If either or both has “control” over the contingent worker’s work, that party will be an employer under Title VII, the ADA, the ADEA, and the EPA. Also, even if either lacks such “control”, it will be considered an employer of that contingent worker, if it has enough other employees so as to be subject to those laws.

STATUTORY EMPLOYEES

Even if a worker is not an employee under common law rules, he or she may be considered an employee for certain statutory purposes, such as FICA (Social Security and Medicare) tax, federal and state unemployment insurance taxes, workers’ compensation, Fair Labor Standards Act compliance, occupational safety and health requirements, and other statutory programs. Likewise, a federal or state statute may exempt certain employers or employees from its application.

Because both federal and state statutes define employees covered by their respective laws, both sources must be consulted before concluding a legal requirement is not applicable to a specific situation. Special rules apply to certain occupations, such as salespersons, and to special situations such as family owned businesses that employ family members.

The definition of “employee” often involves a legal determination. For this reason, particularly in unclear cases, it is important to consult an attorney before concluding an individual is not an employee.

INDEPENDENT CONTRACTORS

Persons who follow an independent trade, business or profession in which they offer their services to the general public usually are considered independent contractors and not employees. However, whether such persons are employees or independent contractors depends on the law and facts applicable to each case. For example, Minnesota law considers nonresidents who perform personal or professional services in Minnesota to be employees for certain purposes, such as income tax withholding. This is true even though under federal law they would be considered self-employed independent contractors. Similarly, certain individuals such as direct sellers and real estate agents are by statute considered independent contractors for federal tax purposes if certain conditions are met.

In general, the individual will be considered an independent contractor if the business entity obtaining the person's services has the legal right to control the result of the work but does not have the legal right to control the manner and means of accomplishing the result.

Independent contractors offer their services to the public through the exercise of an independent business enterprise. An independent contractor is responsible for making his or her own estimated tax payments and paying self employment (Social Security and Medicare) tax. The business that obtains the independent contractor's services generally is not required to obtain workers' compensation insurance, withhold taxes or pay employment taxes on behalf of the independent contractor. Independent contractors generally do not receive benefits such as paid holidays, health insurance or sick pay from the business that obtains their services.

INDEPENDENT CONTRACTORS IN THE CONSTRUCTION INDUSTRY

Minn. Stat. § 181.723, requires individuals (not corporations, LLCs or partnerships) who work as independent contractors in public or private commercial or residential building construction to obtain from the Minnesota Department of Labor and Industry an Independent Contractor Exemption Certificate (ICEC). For purposes of state's workers compensation, unemployment insurance, wage and hour, and occupational safety and health laws, individuals doing building construction work without an ICEC will be employees of the contractor for whom they are working.

To obtain an ICEC, individuals must complete and submit an application that establishes that they meet the conditions required to operate as an independent contractor. To operate as independent contractors, individuals must be able to meet the conditions set out in the new law's nine-factor test.

An ICEC permits individuals to work as independent contractors. Certificate holders, however, may work as either independent contractors or as employees. Whether a certificate holder is working as an employee or an independent contractor will depend on the conditions of the particular work relationship. To be an independent contractor, in addition to having the ICEC, the conditions of the work relationship must also meet the nine-factor test:

1. maintains a separate business with the independent contractor's own office, equipment, materials, and other facilities;
2. holds or has applied for a federal employer identification number or has filed business or self-employment income tax returns with the federal Internal Revenue Service based on that work or service in the previous year;
3. operates under contracts to perform specific services or work for specific amounts of money and under which the independent contractor controls the means of performing the services or work;
4. incurs the main expenses related to the service or work that the independent contractor performs under contract;
5. is responsible for the satisfactory completion of work or services that the independent contractor contracts to perform and is liable for a failure to complete the work or service;

6. receives compensation for work or service performed under a contract on a commission or per-job or competitive bid basis and not on any other basis;
7. may realize a profit or suffer a loss under contracts to perform work or service;
8. has continuing or recurring business liabilities; or
9. the success or failure of the independent contractor's business depends on the relationship of business receipts to expenditures.

Applications for the ICEC are available from the Minnesota Department of Labor and Industry at www.dli.mn.gov/CCLD/ICEC.asp. The application and renewal fee for the certificate is \$165. Independent contractors will be required to renew their certificate every two years.

Contractors are obligated to verify that the workers with whom they enter into agreements as independent contractors have a current exemption certificate. Contractors are required to maintain a copy of these certificates for five years. The DLI will maintain a list of certificate holders on its website, and certificates for those individuals will be available for download.

Contractors who employ individuals who do not have an ICEC will face penalties if they do not provide workers' compensation and unemployment insurance to these individuals, and do not properly withhold state and federal taxes from their employee's pay.

INDEPENDENT CONTRACTORS IN THE TRUCKING AND MESSENGER/COURIER INDUSTRIES

Minn. Stat. § 176.043, lays out the criteria for when an operator in the trucking and messenger/courier industry is considered an employee or an independent contractor. There are seven factors that must all be present for a worker to be considered an independent contractor. Some of the factors include when the individual:

- owns the equipment or holds it under a bona fide lease agreement;
- is responsible for the equipment's maintenance;
- pays for the operating costs;
- substantially controls the means and manner of the service performance; and
- enters into a written contract specifying that the relationship is one of an independent contractor and not that of an employee.

FURTHER INFORMATION

In addition to consulting a professional advisor, more detailed information on "Who is an Employee" for various purposes may be obtained from the following sources, at the addresses and telephone numbers listed in the Resource Directory section of the Small Business Assistance Office publication, *A Guide To Starting A Business In Minnesota*. See also the section of the *Guide* titled "Checklist for Hiring an Employee."

- **Federal income, withholding and FICA (Social Security and Medicare) tax:** *Publication 15 – Circular E, Employer's Tax Guide; Publication 15A, Employer's Supplemental Tax Guide;*

and Publication 1779 – Employee or Independent Contractor. The IRS also has a Virtual Small Business Tax Workshop, an online resource for business owners who are not sure if they have employees or independent contractors. See www.irsvideos.gov/virtualworkshop/.

- **Minnesota income tax:** *Minnesota Income Tax Withholding Instructions and Tax Tables*, available from the Minnesota Department of Revenue or on its website at www.taxes.state.mn.us
- **Workers' Compensation:** Information on the Minnesota Worker's Compensation System is available from the Minnesota Department of Labor and Industry. The Department of Labor and Industry has adopted rules addressing the conditions under which workers will be considered employees or independent contractors for workers' compensation purposes. These rules can be found at *Minnesota Rules* Chapter 5224. *Minnesota Rules* is available at law libraries and many public libraries. A general information sheet on independent contractor/employee questions is available from the Department of Labor and Industry's Legal Services Unit, many public libraries, and on the Department's website at www.doli.state.mn.us/WorkComp.asp.
- **Federal Fair Labor Standards Act:** U.S. Department of Labor, Employment Standards Administration. Fact Sheet #13, Employment Relationship Under the Fair Labor Standards Act, at www.dol.gov/ESA.
- **Minnesota Fair Labor Standards Act:** Minnesota Department of Labor and Industry, Labor Standards Division.
- **Human Rights:** Minnesota Department of Human Rights.