



Employee or Independent Contractor?

Deanna Swisher

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If you have someone work for you, then you, the employer, need to determine whether you have hired an “independent contractor” or an “employee.” “Classification” is the term employment lawyers use to sort out whether the worker is an employee or an independent contractor. Classification has very important legal and financial implications for you, the business or business owner.

If the worker is an employee, then the employer must withhold income taxes and pay one-half of FICA tax, federal and state unemployment taxes, maintain workers’ compensation insurance and make numerous filings during the course of the year. In contrast, an independent contractor takes care of their own taxes, while the business owner reports payments made to the contractor via a 1099. As a result of these differences, small businesses are inclined to hire “independent contractors” as though it is simply an option that allows them to avoid paperwork, tax withholding and expense.

However, if a governmental agency finds that you have “misclassified” an employee as an independent contractor, you will be in a very difficult, expensive position. Governmental agencies, to include the IRS and U.S. Department of Labor (“DOL”), Michigan’s Unemployment Agency and Department of Treasury may cooperate and share information. So, if one agency questions your classification, that agency may work with other agencies to maximize recovery of money that is payable to these government entities.

But how will they know? Even if you have obtained the worker’s signature on a well-drafted independent contractor agreement, what is likely to happen if they stop receiving work from you? Will they file a claim for unemployment compensation? If they get hurt “on the job” would they seek workers’ compensation? Either of these occurrences will subject your classification to rigorous scrutiny.

In 2015, the DOL was faced with numerous complaints from workers who were asserting that they had been misclassified as independent contractors. In response, DOL Administrator David Weil issued

AUTHORS/ CONTRIBUTORS

Deanna Swisher

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Administrator's Interpretation, No. 2015-1, noting that a worker who is improperly classified does not receive workplace protections (i.e. minimum wage, overtime compensation, unemployment insurance, and workers' compensation) and the government sees lower tax revenues. Administrator Weil clearly signaled that the DOL would rein in misclassification, based upon a very expansive view of the employment relationship which caused most workers to be employees.

The current DOL Administration has "withdrawn" its 2015 Interpretation, while communicating that this withdrawal does *not* change the legal responsibilities of employers under the Fair Labor Standards Act or the Migrant Seasonal Agricultural Worker Protection Act. To comply with these responsibilities, in the absence of further guidance from the DOL, classification determinations require greater analysis.

Recent court decisions, to include *Benion v LeCom, Inc.*, 336 F.Supp 3rd 829, 838 (ED Mich 2018), effectively return the classification determination to the long standing "economic-reality test." This six factor test causes courts to consider: permanency of the relationship; degree of skill; the worker's investment in "tools;" the worker's opportunity for profit or loss; degree of control over the work; and whether the service rendered is an integral part of the employer's business. Generally, an independent contractor will have a variable or impermanent working relationship, moving to a new relationship as work is offered to them, where an employee usually works for one employer in a manner that is continuous and indefinite.

An independent contractor is more likely to have gained relevant skill through education, apprenticeship or prior experience, where an employee is more likely to be trained by the employer. An independent contractor is more likely to have made a "capital investment" in the tools or equipment needed to perform services, where an employee is more likely to use tools provided by the employer. An independent contractor has the opportunity for greater profit based upon their management and skill, where an employee earns more by taking on more hours or additional tasks. An independent contractor is likely to decide how and when they work, where an employee is likely to perform tasks when and how the employer directs. Lastly, the more integral the services are to the business, the more likely it is that the worker is an employee.

If you have any questions regarding the differences between employees and independent contractors, or need a hand in making the important classification decision, please contact Deanna Swisher at 517.371.8136 or at dswisher@fosterswift.com.

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