

## Employee or Independent Contractor – Proper Worker Classification

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Hiring a worker, giving them an IRS Form 1099, and having them sign an Independent Contractor Agreement does not automatically make that worker a legitimate subcontractor/independent contractor. Unfortunately, it is not completely the business owner's decision whether a worker should be classified as an employee, and when they should be classified as an independent contractor.



Each state can create additional rules and regulations pertaining to worker classification, so check with your state labor department for clarification. Generally, the federal government guidelines provide enough clarity to determine proper worker classification.

The IRS looks at the degree of control a company exercises over the worker. The more control, the more likely the worker will be classified as an employee. The first type of control the IRS considers is behavioral control. Does the company control where, when, and how a worker performs their work? If so, the worker looks more like an employee. The IRS also looks at the financial control between a company and the worker. Is the worker paid hourly? Do they purchase their own tools and equipment? Can the worker realize a profit or loss independently of the specific amount of time spent on a job? A worker who is paid hourly, and is provided with tools and materials to perform work, appears to be an employee instead of an independent contractor. Finally, the IRS looks at the overall relationship between a worker and the company. Are employee benefits provided in any form, such as insurance, vacation pay, retirement benefits, etc.? If so it looks like an employer/employee relationship.

The IRS is just one of the federal government agencies that looks at worker classification. The Department of Labor (DOL) also considers multiple factors when determining whether a worker is properly classified. While the DOL takes more factors into account, many of them intersect and overlap with what the IRS looks at. First, the DOL looks at the extent to which the work performed is an integral part of the employer's business. If the work performed by a worker is integral to the employer's business, it is more likely that the worker is economically dependent on the employer and less likely that the worker is in business for himself or herself.

Second, the DOL considers whether the worker's managerial skills affect his or her opportunity for profit and loss. Does the worker supervise their own workers/employees? Do they purchase their own equipment? If the worker can control profit and loss by managing their affairs, then they appear more like an independent contractor.

Next, the DOL will review the relative investments in facilities and equipment by the worker and the employer. The worker must make some investment compared to the employer's investment (and bear some risk for a loss) in order for there to be an indication that he/she is an independent contractor.

The DOL also considers the worker's skill and initiative. Both employees and independent contractors may be skilled workers, however the more unique a skill-set the worker has, the more they appear to be an independent contractor. Additionally, if the worker contracts with other businesses and companies, it can indicate independent contractor status,

Another factor is how permanent is the relationship between the worker and the company. Permanency or indefiniteness in the worker's relationship with the employer suggests that the worker is an employee, as opposed to an independent contractor.

Finally, the DOL also considers the nature and degree of control by the employer, just like the IRS factors discussed above. The analysis is similar to that of the IRS and focuses on the level of control exercised by the company over the worker.

On their own, none of the factors above conclusively show an employment or independent contractor relationship. The overall situation must be reviewed to determine how a worker should be classified. Often a company's underlying motive for a classification gives away what the true classification should be. If a worker is classified as an independent contractor for the purpose of reducing taxes, or reducing the amount of overtime paid out, the worker may properly be classified as an employee. But if the worker is used only occasionally, for convenience to the purposes, and for a unique service for which they provide their own tools and equipment, then perhaps they are a true independent contractor.

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