

# Independent Contractor? *or employee?*



## WHAT YOU NEED TO KNOW ABOUT HIRING INDEPENDENT CONTRACTORS

### What is Worker Misclassification?

Worker misclassification happens when employers improperly classify workers as “independent contractors” instead of “employees.”

Worker misclassification is illegal, and the practice often leads to employers avoiding required workers’ compensation insurance, unemployment coverage, or other employer-paid taxes and withholdings.

At first glance, it might be hard to tell the difference between an employee and an independent contractor.

But if your business hires independent contractors for jobs or projects, **it is critical that you understand your legal obligations concerning employment-related taxes, insurance, and labor law compliance.**

There are serious consequences for misclassifying workers as independent contractors when

they are legally considered employees. **Make sure you know how the law applies to your business.**

This brochure was developed by the Joint Enforcement Task Force on Employee Misclassification to provide employers with information on state laws that regulate the hiring and employment of independent contractors. It is not intended to substitute for laws or formal interpretations.

# contents/background

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## What is Worker Misclassification?

Worker misclassification happens when employers improperly classify workers as “independent contractors” instead of “employees.”

## Why Does it Matter?

Whether a worker you hire is employee or an independent contractor affects the taxes and withholdings your business pays, your liability for workers compensation and unemployment insurance coverage, and applicability of labor laws. State and federal laws determine which workers can be defined as independent contractors. Misclassifying an employee as an independent contractor is illegal.

### Worker Misclassification is a Growing Problem

The number of employers misclassifying workers is increasing. In 2009, 17 percent of Maine employers audited had misclassified workers, up from 11 percent in 2002.

# costs of misclassification

## How Worker Misclassification Affects You

Misclassification has a serious impact on misclassified employees, law-abiding businesses and the general public.

**Harms Businesses** - Employers that misclassify workers place law-abiding businesses at a competitive disadvantage by artificially reducing their costs. In addition to losing business, employers who properly classify employees subsidize misclassifying businesses by paying higher workers' compensation premiums and unemployment insurance taxes.

**Harms Workers** - Misclassified workers may lose out on state and federal employment protections, including Unemployment Insurance, minimum wage and overtime, Family and Medical Leave, and Occupational Safety and Health regulations. Misclassified workers may not be covered by Workers' Compensation Insurance and may miss out on employer-provided benefits like health insurance, retirement plans and vacation and sick leave.

**Shifts Costs on All of Us** - When a misclassified worker injured on the job needs medical care but is not covered by workers' compensation or health insurance, hospitals and doctors recoup these uninsured expenses by increasing the cost of care, resulting in higher health care costs, higher health insurance premiums, and higher taxes for all.

Misclassified employees who become unemployed or injured and do not receive unemployment or workers' compensation create a greater demand for public assistance, which increases taxes. Finally, taxes that misclassifying employers owe, but do not pay, must be made up by law-abiding employers.

# employee or independent?

State and federal laws determine whether or not you can hire a worker as an independent contractor. Although each employment situation may be unique, and each government agency may apply slightly different standards, all such standards look at the amount of direction and control the business has on the worker, whether that control is exercised or not.

## Who is an Employee?

Workers performing services for an employer that controls the work to be done and how it will be done are typically considered to be employees under Maine law.



## Who is an Independent Contractor?

Workers who are classified as independent contractors are in business for themselves and retain the right to control how they work.

Independent contractors have an independent trade or profession and offer services to the public. They are generally hired to accomplish tasks determined by the employer, but they retain the right to control how and when they will do the work, subject to a completion schedule and completion standards.

## Laws Defining Employees and Independent Contractors

Pursuant to state law, the Maine Department of Labor and Maine Workers' Compensation Board presume a worker you hire is an employee unless you can demonstrate the worker meets the legal standard for being an independent contractor. Standards vary by agency and additional information is included further in this booklet.

### **More Information on Standards Used by Agencies to Determine Independent Contractor Status**

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# understanding the differences

## Characteristics of Employees and Independent Contractors

This list is merely intended to provide a general comparison of the characteristics that tend to make a worker an employee or an independent contractor.

### **INDEPENDENT CONTRACTOR**

- Free from direction and control
- Has necessary skills and training to complete job
- Has a business location
- Performs services for multiple customers
- Sets own hours
- Determines own price for contracted services
- Not eligible for employee benefits
- Provides equipment and tools used to complete job
- Supplies materials needed to do job
- Personally liable for errors and/or accidents
- Files self-employment taxes
- Has right to hire and fire workers
- Must legally complete each contract

### **EMPLOYEE**

- Means and manner of work are (or can be) controlled by employer
- May be trained by employer to perform job
- May work at employer's business location
- Works for one employer, may serve that employer's customers
- Hours set by employer
- Accepts wage, salary, or commission determined by the employer
- Employer may provide and control equipment and tools
- Employer may purchase materials and supplies
- Employer liable for employee errors and/or accidents
- Is hired and can be fired by employer
- May quit working for an employer at any time

# tax / insurance implications

## Payroll Taxes / Withholdings

Employers are required to withhold and match Medicare and Social Security taxes, and withhold federal and state income taxes for any worker considered under the law to be an employee. If you don't, you face penalties and interest charges from Maine Revenue Services and the Internal Revenue Services. You can only make 1099 payments if that worker meets the legal definition of an independent contractor in state and federal tax law.

For more information see pages 11-12.

## Workers Compensation

State law requires employers to carry workers' compensation insurance coverage on all employees.

When in doubt, you can file an application with the Maine Workers' Compensation Board for a predetermination of independent contractor status.

If an employee is injured on the job and you do not have appropriate workers' compensation insurance, you may face state penalties as well as a civil lawsuit from the injured worker or their family. For more information, see pages 7-8.

### **What if I Have a Written Contract?**

Even if you have a contract declaring the worker to be an independent contractor, that worker may still be considered an employee if you retain the right to control what will be done and how it will be done.

## Unemployment Insurance

If the job performed by a worker for your business is considered "covered employment" in state unemployment law, then your business is required to pay unemployment insurance premiums on that worker. If a worker you misclassify as an independent contractor files for unemployment benefits, the worker may be eligible for unemployment and you will be liable for paying back unemployment taxes and penalties on that individual and other misclassified workers. For more information, see pages 9-10.



# labor laws

If the Maine Department of Labor considers the worker to be an employee for the purposes of unemployment coverage, then that worker will also be covered by any applicable labor laws. Those include, but are not limited to:

- Minimum Wage
- Overtime Pay
- Family and Medical Leave
- Rest Breaks
- Severance Pay
- Discrimination and Harassment Laws
- Labor Posters in the Workplace
- Workplace Safety Regulations

If you are found to be misclassifying workers, you may be responsible for paying any back wages and overtime owed to workers, plus penalties. You are also putting yourself at risk from civil lawsuits related to labor law violations.

## Protection for Whistleblowers

It is against the law (26 MRSA § 831-840) for an employer to fire or threaten any employee or misclassified independent contractor who reports misclassification or any other law violation at your work site.



## For More Information on Labor Laws

The Maine Department of Labor can provide you with information on labor laws that pertain to your business. Visit [www.maine.gov/labor/labor\\_laws](http://www.maine.gov/labor/labor_laws) or call 207-623-7900.

# workers' compensation

## Non-construction Occupations

The Maine Workers' Compensation Board looks at several factors when determining whether a worker is an employee or an independent contractor. In occupations other than construction, the factors considered include:

1. Whether or not a contract exists for the person to perform a certain piece or kind of work at a fixed price;
2. Whether or not the person employs assistants with the right to supervise their activities;
3. Whether or not the person has an obligation to furnish any necessary tools, supplies and materials;
4. Whether or not the person has the right to control the progress of the work, except as to final results;
5. Whether or not the work is part of the regular business of the employer;
6. Whether or not the person's business or occupation is typically of an independent nature;
7. The amount of time for which the person is employed; and
8. The method of payment, whether by time or by the job.

### For More Information

Contact the Maine Workers'  
Compensation Board  
(207) 287-7071 or  
[www.maine.gov/wcb](http://www.maine.gov/wcb)

In applying these factors the Board may not give any particular factor a greater weight than any other factor; nor may the existence or absence of any one factor be decisive. The Board considers the totality of the relationship in determining whether an employer exercises essential control or superintendence of the worker.

## Predeterminations

You may apply to have the Workers' Compensation Board make a Predetermination of Independent Contractor Status. To request a Predetermination, call: (207) 287-7071



# workers' compensation

## Independent Contractors in Construction

Effective January 1, 2010 any worker\* on a Maine construction site is considered an employee unless the worker meets every one of the following factors:

1. Possesses a valid employer identification or social security number or enters into a written contract requiring compliance with this statute;
2. Has control and discretion over the means and manner of performance of the construction work or services;
3. Has control over the time when the work is performed within the project schedule;
4. Hires and pays assistants (if any,) and supervises the details of the assistants' work;
5. Holds himself or herself out as self-employed;
6. Has ongoing construction business liabilities or obligations;
7. Succeeds or fails in the construction business based on whether business revenue exceeds expenditures;
8. Receives compensation for construction work or services that is not determined unilaterally by the company that retained him or her;
9. Is primarily responsible for the expenses related to the construction work performed;
10. Is contractually responsible for satisfactory completion of the construction work and accountable for the failure to provide such work;
11. Supplies the principal tools and instruments used in the work; and
12. Is able to work for other firms and not exclusively for the company that hired him or her.

\*This requirement does not apply to an owner/lessor and operator of heavy equipment exceeding 7,000 pounds.

# unemployment and labor laws

For purposes of Unemployment Insurance and labor law coverage, Maine Employment Security Law defines employment as “...any service performed for wages or under any contract of hire, written or oral, expressed or implied.” The definition contains a three-part test [Title 26, Section 1043], commonly referred to as the “ABC Test”.

In order to classify a worker as an independent contractor, you must be able to demonstrate that the worker meets each part of the ABC Test. If the worker fails to meet **even one section** of the ABC Test, the worker is an employee.

## For More Information

Contact the Maine  
Department of Labor at  
(207) 621-5120 or  
[www.maine.gov/labor](http://www.maine.gov/labor)

**Part A: Control or Direction - *The individual performing the service has been, and will continue to be, free from control or direction over the performance of the service, both under the contract of service and in fact.***

This part of the “ABC Test” requires the employer to show proof it does not, nor does it have the right to, control or direct the worker. Some examples of control are when the employer sets prices and wages, sets work performance standards, determines the terms of employment contracts, provides a place for the worker to perform the services, reserves the right to instruct, discipline or discharge workers, exercises control over price of products, or furnishes leads.

**Part B: Usual Course of Business/ Places of Business - *The service is either outside the usual course of the business for which the service is performed, or the service is performed outside of all the places of business of the enterprise for which the service is performed.***

# unemployment and labor laws

This part of the “ABC Test” contains two provisions: 1.) usual course of business; and 2.) place of business. The employer needs only to meet one of these two provisions.

The Maine Department of Labor interprets “place of business” to mean any place where the employer operates or conducts its business. This is not limited to its office, shop or plant, but includes the business territory within which the employer operates.

## **Part C: Independently Established Business - *The individual is customarily engaged in an independently established trade, occupation, profession or business.***

This part of the “ABC Test” requires proof that the worker has an independently established trade, occupation, profession or business. The Maine Department of Labor interprets that to mean the worker’s business stands alone, independent of services performed on a particular job. Such a worker must make it known to potential customers that he or she is available to perform service and that his or her business is established to the extent that it can operate without hindrance from any source. Another indicator of an established business is when the worker can experience either a profit or a loss from the business operations. Note that such services performed must be in connection with the independently established business to pass this part of the “ABC Test.” For example, a person in business as a carpenter would be an employee when performing services other than carpentry.

## **What is Usual Course of Business?**

Usual course of business means the type of work customarily done by the employer. For example, it would be in the usual course of business for a landscaping company to hire a worker for mowing. However, it may not be considered in the usual course of business if that landscaper hires a contractor, or subcontracts someone to create a website or marketing materials.

# employment taxes

Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not typically have to withhold or pay any taxes on payments to independent contractors.

Maine Revenue Services and the Internal Revenue Services each use Common Law Rules to determine if a worker is an independent contractor. The Common Law Rules provide evidence of the degree of control and independence of the worker and fall into three categories.

**1.) Behavioral - *Does the company control or have the right to control what the worker does and how the worker does his or her job?*** Behavioral factors include the type of instructions given, degree of instruction, evaluation systems, training and types of instructions.

**2.) Financial - *Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)*** Financial controls show whether or not the business has the right to control the economic aspects of the worker's job.

**3.) Type of Relationship - *Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?*** The factors, for the type of relationship between two parties, generally fall into the categories of: written contracts, employee benefits, permanency of the relationship, and services provided as key activity of the business.

# employment taxes

## How Common Law Rules Are Considered

With the Common Law Rules, each of the behavioral, financial and relationship factors are weighed to determine if the worker is an independent contractor. Each situation is unique and some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor.



There is no “magic” or set number of factors that “makes” the worker an employee or an independent contractor under the Common Law Rules, and no one factor stands alone in making this determination. Factors which are relevant in one situation may not be relevant in another.

In making the determination, it is important to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document each of the factors used in coming up with the determination.

## Predeterminations

IRS Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding* can be filed with the IRS to officially determine the worker’s status.

### **For More Information on Tax Issues**

Internal Revenue Services: - (802) 334-0252

[www.irs.gov](http://www.irs.gov)

Maine Revenue Services - (207) 626-8475 or TTY: 1-888-577-6690

[www.maine.gov/revenue](http://www.maine.gov/revenue)

# frequently asked questions

## **1. How can I find out how and when I have to pay taxes?**

Contact the Internal Revenue Service (IRS), Maine Revenue Services (MRS), and Maine Department of Labor, Bureau of Unemployment Compensation.

## **2. What kind of wage statement should I provide to workers?**

Employees receive a W-2 wage statement. Independent contractors receive a 1099-nonwage payment statement. If you're not sure which you provide, contact the IRS.

## **3. Should I have written contracts with independent contractors?**

Written contracts can show the intent of both parties before the beginning of their working relationship, but the contract could be invalid if the law does not consider the worker to be an independent contractor. The Workers' Compensation Board may require a written contract for determination of independent contractor status.



## **4. Can general contractors put people to work without putting them on the payroll?**

If the IRS determines the workers are independent contractors, they do not have to be on the payroll for income tax purposes. However, even if the IRS determines the workers are independent contractors, it is possible they would be employees for workers' compensation and unemployment purposes. To avoid paying back taxes, penalties and interest, you should contact each agency before workers start a job.



# frequently asked questions

**5. How do I find out if I need to purchase workers' compensation insurance?**

Contact the Workers' Compensation Board.

**6. I am a woodlot owner - do I need to purchase workers' compensation insurance for workers who are harvesting trees?**

A woodlot owner who gets a "Conclusive Predetermination" from the Workers' Compensation Board or contracts with a wood harvester who has an approved Certificate of Independent Status does not have to carry workers' compensation insurance for that harvester.



**7. How do harvesters obtain proof of independent contractor status?**

The harvester can apply to the Workers' Compensation Board for a Certificate of Independent Status to confirm independent contractor status.

**8. What agencies investigate wage or overtime issues for employees?**

The Maine Department of Labor and the U.S. Department of Labor Wage and Hour Division investigate complaints.

**9. What protection do independent contractors have if injured on the job?**

Contact the Workers' Compensation Board to learn about rights.

**10 . Can independent contractors get unemployment compensation?**

If a worker makes a claim for unemployment benefits, the Maine Department of Labor, Bureau of Unemployment Compensation will determine coverage.

## About the Worker Misclassification Task Force

On January 14, 2009, Governor Baldacci issued an Executive Order establishing a Joint Enforcement Task Force on Employee Misclassification. Misclassification occurs when an employer hires a worker and improperly classifies the person as an “independent contractor” rather than as an “employee”.

The Task Force is charged with examining the problem of employee misclassification, developing ways of improving communication and information sharing among task force and other public agencies, coordinating and strengthening enforcement mechanisms among state agencies and between the state and other jurisdictions, increasing public awareness of the illegality of and harms inflicted by misclassification, working cooperatively with affected groups to disseminate information and improve methods of identifying and reporting potential violations, and making recommendations for regulatory or statutory changes that would strengthen enforcement efforts.

## Report Worker Misclassification

It is against the law to misclassify workers as independent contractors. If you think an employer is misclassifying workers, please call the Worker Misclassification Tip Line at (207) 621-5120 or complete the online tip form at [www.maine.gov/labor/misclass](http://www.maine.gov/labor/misclass). All reporting will remain anonymous.

## For More Information

To learn more about worker misclassification, visit the Worker Misclassification Task Force at: [www.maine.gov/labor/misclass](http://www.maine.gov/labor/misclass).