



Business Protection Plan

WHAT IS THE DIFFERENCE BETWEEN EMPLOYEES AND INDEPENDENT CONTRACTORS AND WHY DO YOU CARE?

Do you understand the difference between independent contractors and employees? Does your business have extra cash for taxes, penalties and fines lying around? If not, keep reading. Although many businesses believe that they should be free to contract with independent contractors as it desires without government intervention, mislabeling an individual as an independent contractor can have serious unintended legal and monetary consequences.

How do you tell if an individual is an employee or an independent contractor?

Merely designating a person as an independent contractor is not sufficient to prove that a person is, in fact, an independent contractor. The determination of whether a worker is an independent contractor is a mixed question of law and fact. As such, the overall relationship of the parties and the totality of the circumstances giving rise to the relationship must be taken into consideration. Generally, in Minnesota, the determination of whether an individual is an employee or an independent contractor is based on the consideration of five factors: (1) the right to control the means and manner of performance; (2) the mode of payment; (3) the furnishing of material or tools; (4) the control of the premises where the work is done; and (5) the right of the employer to discharge.

The most important of these five factors is the right to control the means and manner of performance. The existence of the right of control may be inferred from a combination of factors that usually varies according to the circumstances of each case. Essentially, if an individual must follow a business' instructions regarding things like the "when, where and how" work is accomplished, the individual is likely to be classified an employee. However, if the individual hired is in charge of when, where and how their own work is completed, the individual can usually be classified as an independent contractor.

The following factors are often considered in determining whether or not the "control" factor has been met:

1. authority over assistants;
2. compliance with instructions;
3. existence of oral or written reports;

4. the place that the work is performed;
5. personal performance of the worker;
6. existence of a continuing relationship between the worker and the employer;
7. right of the employer to discharge the worker;
8. who sets the hours of work;
9. training;
10. amount of time dedicated to the work;
11. who provides tools and materials;
12. whether or not expense reimbursement is provided and by whom; and
13. which party is responsible for satisfying requirements of regulatory and licensing agencies.

By example, if an employer conducts trainings for workers, sets the hours of work for workers, provides tools and materials to the worker, generates reports based upon the work performed, provides specific instructions relative to the work performed, and ensures compliance with regulatory and licensing requirements relative to said workers, it is likely that said workers will be treated as employees, even if the employer designates the workers as an independent contractor.

Why do you care about this?

The problem is that misclassifying an individual as an independent contractor rather than an employee can have significant monetary consequences on a business, resulting in fines and penalties in the form of double tax and social security withholdings or even monetary fines up to \$5,000.00. In order to avoid these penalties and fines, businesses can request a determination from the IRS or the State of Minnesota as to whether an individual is an employee or an independent contractor.

Another potentially prickly area where employers may unwittingly become exposed is unemployment. A worker's right to receive unemployment benefits is determined by statute and accompanying administrative regulations. A prerequisite to qualifying for said benefits is actual employment. As such, independent contractors do not qualify for unemployment benefits. However, as we have discussed above, it is quite easy to inadvertently treat an independent contractor as an employee. If a worker misclassified as an independent contractor is terminated and is able to successfully claim and receive unemployment benefits, an employer runs the risk of having its unemployment insurance premiums increased.

Worker's compensation is yet another area where employers can succumb to the pitfalls of worker misclassification. Generally speaking, in Minnesota, the workers' compensation act requires employers to carry compensation insurance for employees. Worker's compensation insurance is not required for independent contractors. If an employer fails to obtain the proper compensation insurance, the act gives affected employees the option to sue the employer. In addition, the Department of Labor and Industry may also assess penalties against employers that fail to carry the required compensation insurance. As such, if it is determined that an independent contractor is actually an employee, an employer can face serious consequences if the employer has failed to procure adequate worker's compensation insurance coverage.

In addition to tax consequences and civil fines, misclassification of workers can have other unintended results. Under common law, an employer can be held vicariously liable for certain actions of its employees, if said actions are conducted by employees within the scope of the employee's employment. On the contrary, the general rule relative to independent contractors is that an employer is not liable harm to another caused by an independent contractor's acts or omissions. There are, of course, exceptions to the general rule regarding independent contractor liability, but the point is that businesses may be inadvertently exposing themselves to unnecessary and unanticipated vicarious liability by treating their independent contractors too much like employees. By failing to be mindful of the employee vs. independent contractor distinctions, employers by surprisingly find themselves liable for negligent acts performed by workers who they considered independent contractors but that the law actually deems to be employees.

What does this mean for your business?

It is important for all businesses, both large and small, to avoid the incurrence of unnecessary and avoidable expenses. Time and money are valuable, and employers do not want to waste their time or resources dealing with issues arising out of misclassification of employees and/or independent contractors. It is important to be aware of the distinctions and to make informed decisions when designating workers in order to avoid the common pitfalls outlined above.

To review your Business Protection Plan and to get any other questions you may have answered, contact our office at (763) 389-0178 to schedule a meeting or send us an email by clicking here.



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