

## INDEPENDENT CONTRACTOR V. EMPLOYEE SUMMARY FOR THE CONSTRUCTION INDUSTRY IN MINNESOTA

Guidelines used to classify independent contractors:

### A. Workers Compensation

#### Minnesota Statutes Chapter 176.

A person shall not be deemed a contractor or subcontractor where:

- (a) the person performs work upon another premises, with the other's tools or appliances, and under the other's direction; or
- (b) the person does what is commonly called "piece work;" or,
- (c) in any way the system of employment merely provides a method of fixing the worker's wages<sup>i</sup>.

If a worker is injured and the worker is determined by an administrative law judge to be an employee for workers compensation purposes and the employer does not have workers compensation insurance coverage for that employee, the employer is liable to the state for the workers compensation paid out of the pool to the employee plus 65% additional as a penalty. This amount due also becomes a lien to the state on all assets owned by the employer<sup>ii</sup>.

#### Non-statutory guidelines.

Non-statutory guidelines used to classify independent contractors exist on two levels – by administrative rule and case law.

In the case of administrative rule, Minnesota's Department of Labor and Industry in Minnesota Rules Chapter 5224<sup>iii</sup> lists distinguishing criteria for thirty-four specific occupational areas in order to classify workers as either independent contractors or employees. In occupational areas not specified by Chapter 5224 or where the definitional criteria for either independent contractor or employee are not met, general criteria are used to determine whether an agent is an independent contractor or employee.

These general criteria<sup>iv</sup> include:

- the degree of control the principal exerts over the manner and method of the contracted work (principal's control indicates employee status);
- the incidence of control over the agent's assistants (principal's control indicates employee status, agent's control indicates independent contractor status);
- requirement and frequency of reports from the agent to the principal regarding the method of job performance (reports indicate employee status);
- location of contracted work (non-necessary requirement of work performance on principal's business property indicates employee status);
- level of control regarding who is to perform contracted work (principal's control

- indicates employee status, agent's control indicates independent contractor status);
- the existence of a continuing relationship between principal and agent (relationship indicates employee status);
- requirement of set working hours (indicates employee status);
- provision of work-related training provided by principal to agent (training indicates employee status);
- existence of control over amount of work time devoted by agent to principal (principal control indicates employee status);
- degree of limitation by principal on agent's freedom to perform simultaneous contracts (limitation indicates employee status);
- incidence of provision of tools and materials required for completion of contracted work (principal provision indicates employee status);
- incidence of expenses related to completion of contracted work (principal's responsibility indicates employee status).

Other factors<sup>v</sup> to be considered are:

- the existence of a principal's right to discharge an agent at short notice, without cause or because of agent's failure to comply with specified rules or methods (principal's right indicates employee status);
- the agent's availability to the public (restrictions on availability indicate employee status, availability indicates independent contractor status);
- whether compensation is job based or time based (job based indicates independent contractor status, time based indicates employee status);
- existence of profit loss risk or profit gain on agent not principal (principal risk indicates employee status, agent risk indicates independent contractor status);
- existence of termination power over agent by principal (principal's power indicates employee status);
- incidence of investment in tools and materials required for performing contracted services (principal's investment indicates employee status, agent's investment indicates independent contractor status);
- incidence of responsibility for liability arising from performance of contracted work (principal's responsibility indicates employee status, agent's responsibility indicates independent contractor status);
- and whether the services contracted are fundamental to the principal's business (fundamental services indicate employee status).

Should the status of an agent be disputed or otherwise brought before judicial review, two precedential worker's compensation cases have set out five factors to be considered in classifying an agent as an employee or independent contractor<sup>vi</sup>. These five factors are: the right to control the means and manner of performance; the mode of payment; incidence of investment in tools and materials required for performing contracted services; the control of the premises where the work is performed; and the existence of a principal's right to discharge an agent. Further, a 1993 Minnesota Supreme Court ruling emphasized that employment status is determined legally and not by the label given it by the parties involved<sup>vii</sup>.

## **B. Construction Workers – Unemployment Compensation**

### **Minnesota Statutes Chapter 268 and 181.**

Beginning in 1996, a worker in the construction industry was required to satisfy a 9-Point checklist or be subject to determination by the State of Minnesota as an employee for purposes of collection of unemployment tax due<sup>viii</sup>. That 9-Point checklist is attached to this summary (**Appendix A**).

If the State of Minnesota determines that an employee was misclassified as an independent contractor and unemployment taxes have not been paid by the employer on the employee, the employer is liable to the state for the unemployment tax due plus costs of enforcement, collection and interest<sup>ix</sup>. This amount due also becomes a lien to the state on all assets owned by the employer<sup>x</sup>.

### **Non-statutory guidelines.**

Non-statutory guidelines used to classify independent contractors exist on two levels – by administrative rule and case law. In the case of administrative rule, Minnesota's Department of Employment and Economic Development in Minnesota Rules Chapter 3315<sup>xi</sup> identifies five factors to consider whether to classify a worker as an employee or an independent contractor. Those factors are<sup>xii</sup>:

- Right of the worker to control the means and manner of performance;
- Right to discharge the worker without incurring liability;
- The mode of payment;
- Who furnishes the materials and tools; and
- The control over the premises where the work is performed.

## **C. Construction Workers – Subcontractor Exemption**

As of January 2009, the employee-employer relationship was redefined.<sup>xiii</sup> This definition applies to those who perform public or private sector commercial or residential building construction or improvement services.<sup>xiv</sup> This does not include those who manufacture, supply, or sell materials or those who provide landscaping services.<sup>xv</sup> An individual is considered to be an employee if the individual performs services for another that are in the course of that person's trade, business, profession, or occupation.<sup>xvi</sup>

The exemption to the employee classification is considered by the Minnesota Department of Labor and Industry ("DOLI"). For an individual to be considered an independent contractor, one

needs to be registered as such with DOLI and is required to meet the 9- point criteria set out in **(Appendix A)**.<sup>xvii</sup>

This law was replaced August 1, 2012 and only applies for the time period prior to August 1, 2012.

From that replacement law, as of September 15, 2012, anyone who performs construction services must register with DOLI prior to performing services.<sup>xviii</sup> Registration must be done electronically and forms to become registered can be found on DOLI's website at: <https://secure.doli.state.mn.us/license/intro.aspx>. There are a few miscellaneous exceptions to the registration requirement.<sup>xix</sup> However generally, all contractors must be registered with DOLI or hold a current license. If one fails to register or contracts with an unregistered person, the penalty for non-compliance is \$2,000, but the penalty may be forgiven if the person registers within 30 days of the date of the penalty.<sup>xx</sup> This registration requirement applies regardless of whether the contractor was an individual or in an entity form. If a contractor is not registered or meets one of the registration exceptions, that contractor is by law an employee of the party hiring them<sup>xxi</sup>.

#### **D. Federal Tax Guidelines Used to Classify Independent Contractors.**

The Internal Revenue Service, as cited in its Publication 15-A (Rev. 2012)<sup>xxii</sup>, considers three categories when considering whether an individual is an employee or an independent contractor. The old test consisted of twenty factors and used a "burdens and benefits" approach in its determining the classification of an agent as an independent contractor or employee. These factors, while no longer the official test, remain helpful as a guide in ascertaining where the burden of various contract-related expenses lie and to whom the benefit of gains from the contracted activity accrue. The twenty factors and description are listed in an attachment to this summary **(Appendix B)**.

Currently, to determine whether an individual is an employee or an independent contractor, the relationship between the two parties is evaluated for behavioral control, financial control, and the type of relationship of the parties.

If an employee is wrongfully classified as an independent contractor, the employer may be held liable to the Internal Revenue Service for the entire employer portion and a percentage of the employee portion of the unpaid payroll taxes attributable to the employee's wages<sup>xxiii</sup>.

#### **Terms of Use for this Summary Guide**

This information is being provided as general educational materials by Acumen Legal Advisors, PLLC. It is not specific legal advice to you and does not create an attorney-client relationship. We encourage you to obtain competent legal advice from an attorney in determining how you will be affected by Minnesota and federal employment law.

**APPENDIX A****Minn. Stat. Section 181.723 Subd. 4 Independent contractor**

A worker doing commercial or residential building construction or improvement, in the public or private sector, performing services in the course of the trade, business, profession, or occupation of the employer, is considered an employee and not an "independent contractor" unless the worker meets all the following conditions:

- (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 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 obligations; and
- (9) the success or failure of the independent contractor's business depends on the relationship of business receipts to expenditures.

**APPENDIX B****IRS 20-factor Test to Determine Employee or Independent Contractor Status**

The IRS has a 20-factor test to use as a guide in determining whether a worker is an employee or an independent contractor. (This test is also incorporated into Form SS-8.) These factors help ascertain whether sufficient control is present to establish an employer-employee relationship. These factors are:

1. A worker required to comply with others' instructions on when, where, and how to work is usually an employee.
2. Training a worker indicates that services are to be performed in a particular method.
3. Integration of a worker's services into the business operations indicates control.
4. Services to be rendered personally indicates control.
5. The right to hire, supervise, and pay assistants show control.
6. A continuing relationship indicates an employment relationship.
7. Set hours of work for the worker indicates control.
8. Full-time work indicates control. An independent contractor is free to work when and for whom he chooses.
9. Work performed on a business's premises suggests control.
10. Requiring work be performed in a set order indicates control.
11. A requirement that the worker submit regular or written reports indicates control.
12. Payment by the hour, week, or month indicates an employment relationship.
13. Payment of business expenses indicates an employment relationship.
14. Furnishing of tools and equipment indicates an employment relationship.
15. Investment by the worker in facilities indicates an independent contractor.
16. The ability to realize a profit or loss from services indicates an independent contractor.
17. Working for more than one firm at a time indicates an independent contractor.
18. Services available to the general public on a regular and consistent basis indicates an independent contractor.
19. The right to discharge a worker indicates an employment relationship.
20. The worker's right to terminate his relationship without liability indicates an employment relationship.

## Endnotes

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- <sup>i</sup> Minn. Stat. §176.205, Subd. 3 (2012).
- <sup>ii</sup> Minn. Stat. §176.183, Subd. 2 (2012).
- <sup>iii</sup> <https://www.revisor.leg.state.mn.us/arule/5224/>
- <sup>iv</sup> Minn. Rules 5224.0320 and 5224.0330 (2008).
- <sup>v</sup> Minn. Rules 5224.0340 (2008).
- <sup>vi</sup> *Guhlke v. Roberts Truck Lines*, 268 Minn. 141, 128 N.W. 2d 737 (1964); and *Kahn v. State of Minnesota*, 289 N.W. 2d 737 (1980).
- <sup>vii</sup> *Hunger v. Crawford Door Sales* (No. C1-93-220)
- <sup>viii</sup> Minn. Stat. §268.035, Subd. 9a (2012).
- <sup>ix</sup> Minn. Stat. §268.057 (2012).
- <sup>x</sup> Minn. Stat. §268.058 (2012).
- <sup>xi</sup> <https://www.revisor.leg.state.mn.us/arule/3315/>
- <sup>xii</sup> Minn. Rules 3315.0555, Subp. 1 (A), (B) (2008).
- <sup>xiii</sup> Minn. Stat. §181.723 Subd. 3(2012).
- <sup>xiv</sup> Minn. Stat. §181.723 Subd. 2(2012).
- <sup>xv</sup> *Id.*
- <sup>xvi</sup> Minn. Stat. §181.723 Subd. 3(2012).
- <sup>xvii</sup> Minn. Stat. §181.723 Subd. 4(2012).
- <sup>xviii</sup> Minn. Stat. §181.723 Subd. 4 (b) (2012).
- <sup>xix</sup> Minn. Stat. §181.723 Subd. 4 (c)(1)-(8) (2012).
- <sup>xx</sup> Minn. Stat. §181.723 Subd. 8a (2012).
- <sup>xxi</sup> Minn. Stat. §181.723 Subd. 3 (2012).
- <sup>xxii</sup> <http://www.irs.gov/pub/irs-prior/p15a--2012.pdf>
- <sup>xxiii</sup> I.R.C. Section 3509