



**MISCLASSIFYING EMPLOYEES AS
SUBCONTRACTORS:
A COSTLY MISTAKE THAT JUST GOT
EASIER TO MAKE**

David C. Pierson, Esq.

MISCLASSIFYING EMPLOYEES AS SUBCONTRACTORS: A COSTLY MISTAKE THAT JUST GOT EASIER TO MAKE

David C. Pierson, Esq.

The construction industry has a long tradition of subcontracting work to other companies and individuals but this tradition is not always consistent with the laws distinguishing independent contractors from employees. The changes to the Workers Compensation Act that take effect on January 1, 2010 will make it easier to distinguish between employees and subcontractors but the changes will make it more difficult to classify workers as subcontractors. The effect of the changes will be to expand the number of workers who must be covered by workers compensation insurance coverage.

Misclassifying a worker who meets the legal definition of an “employee” under the Workers Compensation Act as a subcontractor or independent contractor can have serious consequences.

Contractors who misclassify workers can face substantial audit premiums from their workers compensation insurers. The failure to provide workers compensation insurance can result in civil penalties up to \$10,000.00 or 108% of the premiums avoided, whichever is larger, and is a Class D crime punishable by up to one year in prison. The State may also revoke the license of a Contractor who is in a licensed trade. Finally, Contractors who do not provide workers compensation insurance can face a civil suit from an injured worker that would otherwise be barred by its immunity under the workers compensation laws, one the Contractor’s liability insurer may not cover.

Beginning on January 1, 2010, every worker on a construction site is automatically considered to be an employee of the contractor for whom he or she works (the “hiring agent) unless he or she meets the definition of a “Construction Subcontractor.”

A Construction Subcontractor is a worker who:

1. Possesses or has applied for a federal employer identification number or social security number or has agreed in writing to carry out the responsibilities imposed on employers under this chapter;
2. Has control and discretion over the means and manner of performance of the construction work, in that the result of the work, rather than the means or manner by which the work is performed, is the primary element bargained for by the hiring agent;

eatonpeabody.com

3. Has control over the time when the work is performed and the time of performance is not dictated by the hiring agent. Nothing in this paragraph prohibits the hiring agent from reaching an agreement with the person as to a completion schedule, range of work hours and maximum number of work hours to be provided by the person;
4. Hires and pays the person's assistants, if any, and, to the extent such assistants are employees, supervises the details of the assistants' work;
5. Purports to be in business for that person's self;
6. Has continuing or recurring construction business liabilities or obligations;
7. For whom success or failure of the person's construction business depends on the relationship of business receipts to expenditures;
8. Receives compensation for construction work or services performed and remuneration is not determined unilaterally by the hiring agent;
9. Is responsible for the main expenses related to the service or construction work performed; however, nothing in this paragraph prohibits the hiring agent from providing the supplies or materials necessary to perform the work;
10. Is responsible for satisfactory completion of the work and may be held contractually responsible for failure to complete the work;
11. Supplies the principal tools and instruments used in the work, except that the hiring agent may furnish tools or instruments that are unique to the hiring agent's special requirements or are located on the hiring agent's premises; and
12. Is not required to work exclusively for the hiring agent.

To qualify as a Construction Subcontractor, the worker must meet all twelve requirements. The old definition of an independent contractor was more flexible and more workers could qualify as subcontractors. It relied on eight factors, but no one factor was necessary or determinative.

Any worker who does not meet the definition of a Construction Subcontractor is an Employee and the person who hires that worker must provide workers compensation insurance covering the worker, with three exceptions.

Under the new law, all workers must be covered by workers compensation insurance unless the worker is: (1) a Construction Subcontractor, (2) the owner-operator of construction equipment that weighs more than 7,000 pounds, or (3) has an approved waiver of coverage. Everyone else is an employee who must be covered by workers compensation insurance.

Workers and small businesses that want to be treated as Construction Subcontractors can apply for and

eatonpeabody.com

receive a pre-determination certificate from the Workers Compensation Board. The Board will be preparing new application forms, but they are not ready yet. The changes in the law will render any prior pre-determination certificates invalid. There are penalties of up to \$1,000.00 for individuals and up to \$10,000.00 for business entities who submit fraudulent or intentionally misleading information to the Workers Compensation Board that leads to the misclassification of a worker.

The owner-operator exception permits owners of equipment such as dump trucks and excavation equipment to hire out as independent contractors. This exception is limited to the owner-operator using the equipment or truck to perform work on the construction site or deliver materials to the construction site. It doesn't cover a worker such as a carpenter with a 7,000 pound gross vehicle who brings materials to the construction site and then does carpentry work on the site.

Sole proprietors, working members of a partnership or a limited liability company and persons who owned more than 20% of the stock of a corporation can still waive workers compensation coverage for themselves and their parents, spouses, domestic partners and children. Contractors should obtain a copy of a waiver of coverage that has been approved by the Workers Compensation Board for any Construction Subcontractor who claims it is not required to have workers compensation insurance under that waiver.

Insurers are encouraged to report misclassified workers to the Department of Labor.

The amendments to the Workers Compensation Act encourage insurers to report misclassified workers to the State Tax Assessor and immunizes the insurers who make the report. A report to the Board could trigger a tax audit and the State can require that the employer pay back withholding taxes and unemployment taxes. If the employer is a corporation or limited liability company, the State can hold the officers of the corporation or company members personally liable for any unpaid payroll taxes.

Even if an individual worker is a Construction Subcontractor, he or she may be an employee for purposes of the Unemployment Tax Laws.

The unemployment law uses the so-called ABC test. Unlike the situation under the workers compensation law, a company must prove that the worker:

- A. Is free from control or direction in performing the services;
- B. The work is either outside the regular course of the company's business or not performed at any of the company's places of business; and
- C. The individual is engaged in an independently established trade, occupation or business.

It is very difficult for construction companies to prove that the work is done outside of one of the contractor's places of business, because each construction site is usually considered to be one of the

eatonpeabody.com

Contractor's places of business. Further, if the Contractor uses an individual Construction Subcontractor to do work that it performs with its own employees at times, the work will generally be considered to be in the course of the Contractor's own business. Therefore, it is very difficult to qualify an individual worker as an independent contractor under the unemployment taxation laws.

Contractors are required to report independent contractors to the Department of Labor under the "dead beat dad" law.

The Legislature recently amended the "dead beat dads" law to expand the reporting requirements related to independent contractors who are individuals. If a Contractor anticipates that the amount to be paid to the individual will exceed \$2,500.00, the Contractor must file a report with the Department of Labor within seven days of signing a contract or the commencing work. This requirement applies even if the worker qualifies as a Construction Subcontractor. In addition to using the report for purposes of collecting past due child support, the Department of Labor may share the reports with the State Tax Assessor and Workers Compensation Board.

Given the risks involved, anyone planning to hire individual workers as subcontractors should carefully consider the situation and, before making any decision, seek the advice of their attorney.

eatonpeabody.com