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Independent Contractor or Employee? Getting It Right When Classifying Workers

Improperly classifying workers exposes an employer to significant fines and penalties. Andrea Murdock discusses various tests employers should use in determining whether to treat workers as independent contractors or employees.

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Roll out the orange barrels – it's construction season again in Wisconsin.

Construction contractors expanding their workforce by hiring seasonal workers may be tempted to classify their workers as independent contractors, rather than employees, to avoid paying unemployment insurance taxes and worker's compensation premiums.

But misclassification exposes employers to fines, interest, and other penalties.

Misclassification of workers is not an isolated problem for Wisconsin's construction employers. Over the past three years, the Department of Workforce Development conducted 1,963 investigations that found 5,841 workers misclassified and underreported gross wages of almost \$70 million.¹

In 2018 alone, the Unemployment Insurance Division auditors conducted 2,459 audits, and found 8,677 misclassified workers, leading to recoupment of more than \$1.5 million in unemployment insurance taxes, interest, and penalties.²

The New Joint Enforcement Task Force

In recognition of the serious impact of worker misclassification, Governor Tony Evers announced [Executive Order 20](#) in April 2019, creating the Joint Enforcement Task Force on Worker Misclassification.

The Task Force will involve collaborative investigation and enforcement efforts by the Department of Workforce Development, Department of Revenue, Commissioner of Insurance, Department of Justice, and other relevant agencies.

The goal of the task force is multifaceted:

1. to make sure that workers receive the compensation and benefits they deserve;

2. to even the playing field for employers who are being underbid by employers who misclassify workers as independent contractors to gain an unlawful competitive advantage; and
3. to reduce the millions of dollars of losses to the state government due to underpayment of wages, unemployment insurance, worker's compensation insurance, and payroll taxes.

How to Correctly Classify Workers

Correctly classifying workers is an important step for all employers. The collaborative efforts of the Task Force likely will increase the risk of repercussions for employers.



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Getting it right is important. But where to start?

The first step is understanding that a worker may not be deemed an independent contractor across the board for all purposes. The various Wisconsin agencies use their own independent contractor tests. So, for example, a worker may be considered an independent contractor for unemployment purposes, but not for worker's compensation purposes. Employers need to look at each test carefully when deciding how to classify their workers.

The second step is carefully applying the tests. The following provides an overview on the various tests Wisconsin employers may need to apply when classifying their workers.

Independent Contractors and Wisconsin Worker's Compensation

To be properly classified as an independent contractor for purposes of worker's compensation, a worker must meet and maintain each of the requirements of a nine-part test set forth in the Worker's Compensation Act, [Wis. Stat. section 102.07\(8\)](#).

Specifically, the worker must:

- maintain a separate business with their own office, equipment, and materials;
- have a Federal EIN or have filed business or self-employment income tax returns with the IRS based on work or service in the prior year;
- operate under specific contracts or work for specific amounts of money and control the means and methods of performing the work;
- be responsible for operating expenses under the contracts;
- be responsible for satisfactory performance of the contract work;
- be paid for contracted work on a commission, per job, or competitive bid basis;
- be subject to profit or loss in performing the contract work;
- have recurring business liabilities and obligations; and
- be in a position to succeed or fail depending on the relationship of business income to expenses.

Not satisfying even one of the above requirements means that, for worker's compensation purposes, the worker is an employee, not an independent contractor.

Independent Contractors and Wisconsin Unemployment Insurance

The independent contractor test for Wisconsin unemployment insurance is somewhat more complicated than it is for Worker's Compensation determinations, as different tests apply to different types of employers.

First, determine which category of employer applies:

- general private employers;
- state and local government employers;
- nonprofit employers;
- trucking employers;
- logging employers; or
- Indian tribal government employers

For purposes of this article, we'll focus on general private employers and Indian tribal government employers, which share tests. Be aware, however, that there are similar but different tests for the other categories of

employers.

For general private employers and Indian tribal government employers, if the worker performs services for pay, then there is a presumption that the worker is an employee. The presumption can be overcome by showing evidence that satisfies the two-part independent contractor test set forth in [Wis. Stat. section 108.02\(12\)\(bm\)](#).

Part one of the test looks at the employer's control or direction. If the worker is under the control or direction of the employer, then the worker is an employee. The factors to be considered in determining control or direction include whether:

- the worker has to follow the employer's instructions as to how to perform the services;
- the employer trains the worker to perform the services;
- the worker has to personally perform the services;
- the worker has to perform the services at particular times or in a particular order; and
- the worker has to report to the employer on a regular basis.

Based on these factors, if the worker is considered to be under an employer's control or direction, then the worker is considered to be an employee. End of analysis.

If, however, the worker is free of the control or direction of the employer, then the worker *may* be an independent contractor if they can *also* satisfy the "six of nine conditions" test. To wit, the worker has to meet six of the following nine conditions to be considered an independent contractor:

- The worker advertises or holds himself or herself out as being in business.
- The worker maintains their own office or performs most of their work in a location of their choosing, and uses their own equipment or materials in performing the services. If an employer dictates the worker's specific work location or provides equipment or material for the worker's use in performing the work, then this condition is not satisfied.
- The worker has multiple contracts with one or more employers to perform services.
- The worker incurs the main expenses for services they provide under the contract.
- The worker has to redo unsatisfactory work for no cost or is subject to a penalty for unsatisfactory work.
- The worker's services do not directly relate to the employer and are substantially different from the employer's business.
- The worker may realize a profit or suffer a loss under their contracts with employers.
- The worker has recurring business liabilities or obligations. This includes costs a worker would incur even when not performing work for the employer, such as office rent, liability insurance premiums, or license renewal fees.
- The worker is not economically dependent upon any one particular employer. If the worker performs services for one employer and then moves on to provide services for another employer, that would tend to satisfy this condition and lean toward independent contractor status. If, on the other hand, the worker performs most of its work for one employer, this would be evidence that the worker is an employee.

If at least six of the nine conditions are *not* met, then the worker is considered an employee of a general private employer or Indian tribal government.

See [Wis. Stat. section 108.02\(12\)\(c\)](#) for the tests specific to other types of employers.

Independent Contractors and Wisconsin Wage and Hour Laws

Employees have protections under wage and hour laws, while independent contractors do not. The test here is not statutory, but instead comes from common law.

The Bureau of Labor Standards uses a six-part "economic realities" test to determine if the worker is an independent contractor. The factors to be considered are:

1. The degree of control exercised by the employer. This is the most important of the six parts. Questions to consider may include who sets the schedule and hours of work, whether the worker is supervised, whether the worker is required to attend work meetings, whether the worker performs services for others, and whether the worker receives bonuses or other fringe benefits from the employer.
2. The worker's opportunity for profit or loss based upon their managerial skills. If a worker can realize a profit or a loss depending on how they perform their services, they are typically an independent contractor.
3. The worker's investment in equipment or employment of helpers. If the worker uses their own equipment and hires others to help with the work, they are typically an independent contractor.

4. The degree of special skill required for the work. Workers who have special skills learned through education and experience (e.g., electricians, plumbers) are more likely to be independent contractors than other workers performing more routine work that requires little training.
5. The degree of permanence in the relationship between the parties. Questions to consider may include how long the worker's job has lasted, whether there is any method to terminate the relationship between the employer and worker, whether the relationship is open-ended, and whether the worker's contract is subject to periodic review.
6. Whether the services constitute an integral part of the employer's business. The worker's services must be substantially different from the employer's business for the worker to be an independent contractor. If the worker's services are merely an extension of the employer's business, this factor is not satisfied.

There is no threshold of factors that needs to be met for this test. In other words, a worker need not satisfy all conditions or even a majority of the conditions to be classified an independent contractor. Rather, it is the totality of the circumstances that matters, no matter what the parties call the relationship.

Independent Contractors and Wisconsin Civil Rights

Under the Wisconsin Fair Employment Act, employers may not unfairly discriminate in employment based on age, race, creed, color, disability, marital status, sex, national origin, ancestry, sexual orientation, arrest record, conviction record, military service, use or nonuse of lawful products off-premises during nonworking hours, or declining to participate in meetings or communications about religious or political matters.³

The Act's statutes defining "employee" and "employer" are limited, leaving it to the courts to define these terms.⁴

The Civil Rights Bureau applies a hybrid right of control/economic realities test that looks at the employer's right to control as the most important factor, but also considers eleven other factors when determining if a worker is an employee or an independent contractor.⁵

Specifically, these factors are:

- Whether the work is directed by a supervisor or is performed by the worker without supervision. Supervised work tends to show an employment relationship.
- The degree of special skill required for the work. Workers who have special skills and who exercise initiative in their work are more likely to be independent contractors.
- Whether the worker provides the place of work and materials needed for the services.
- How long the worker has worked with the employer. Longer relationships or those of undefined length tend to be employment relationships.
- How the worker is paid, whether by time or by the job. Workers who are paid by the hour or by a regular salary tend to be employees. Workers who are paid by the job tend to be independent contractors.
- How the work relationship is terminated. If there is a contract with consequences for termination, that tends to show an independent contractor relationship. If there is an ending date for the relationship after completion of the work, that tends to show an independent contractor relationship. If the relationship is open-ended, that tends to show an employment relationship.
- Whether vacation time or other leave is provided. Vacation time or other leave is a benefit typically provided to employees, not independent contractors.
- Whether the services constitute an integral part of the employer's business. The worker's services must be substantially different from the employer's business for the worker to be an independent contractor.
- Whether the worker earns retirement benefits. Retirement benefits are typically provided to employees, while independent contractors are responsible for planning and providing for their own retirement.
- Whether the employer pays Social Security taxes. If the employer pays Social Security taxes for the worker, that shows that the worker is an employee.
- What the parties intended when they entered into their relationship. An agreement between the worker and the employer to provide services as an employee or as an independent contractor are evidence of the type of relationship intended. However, the intent of the parties alone cannot waive protections provided under the Act.

Here, as in other tests, no one factor is determinative, and the totality of the circumstances must be considered.

For additional information and a step-by-step, interactive guide to help employers classify their workers, visit the State of Wisconsin Department of Workforce Development's [Worker Classification website](#).

Don't miss the Construction and Public Contract Section's lunchtime CLE seminar on managing construction accidents, "Dealing with Disaster," in Milwaukee on Wednesday, May 22, 2019. It is offered as a live presentation and a live webcast. For more information, see wisbar.org/sa7617.

This article was originally published on the State Bar of Wisconsin's [Construction and Public Contract Law Section Blog](#). Visit the [State Bar sections](#) or the [Construction and Public Contract Law Section](#) web pages to learn more about the benefits of section membership.

Endnotes

¹ Executive Order 20, April 15, 2019.

² "Governor Evers Signs Executive Order Creating Joint Task Force on Payroll Fraud and Worker Misclassification," State of Wisconsin Department of Workforce Development, April 15, 2019.

³ Wis. Stat. § 111.321

⁴ See Wis. Stat. § 111.32(5), (6)

⁵ See *Moore v. LIRC*, 175 Wis. 2d 561, 569, 499 N.W.2d 289 (Ct. App. 1993)