

Department of Legislative Services
Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

House Bill 649
Economic Matters

(Delegate Carr, *et al.*)

Labor and Employment - Independent Contractor - Definition

This bill specifies that an independent contractor is a person who is not an employee for the purposes of the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act, based on the application of the 20 factors set forth by the Internal Revenue Service.

Fiscal Summary

State Effect: None. The change is technical in nature and does not directly affect governmental finances.

Local Effect: None. The change does not affect local government finances.

Small Business Effect: Potential minimal.

Analysis

Bill Summary: In order to determine whether a worker is an employee under the common law rules, the Internal Revenue Service (IRS) has identified 20 factors that may indicate whether the employer can exercise enough control to establish an employer-employee relationship. These factors are based on the circumstances that the courts have identified and relied upon to decide whether an employment relationship exists. Not all the factors must be present to find an employer-employee relationship, but the factors are guides to use to assess whether an individual is an employee or an independent contractor. The 20 factors include:

- *Instructions:* An employee must comply with instructions about when, where, and how to work. The control factor is present if the employer has the right to require compliance with the instructions;
- *Training:* An employee receives ongoing training from, or at the direction of, the employer. Independent contractors use their own methods and receive no training from the purchasers of their services;
- *Integration:* An employee's services are integrated into the business operations because the services are important to the business. This shows that the worker is subject to direction and control of the employer;
- *Services rendered personally:* If the services must be rendered personally, the employer is presumably interested in the methods used to accomplish the work as well as the end results. An employee often does not have the ability to assign their work to other employees; an independent contractor may assign the work to others;
- *Hiring, supervising, and paying assistants:* If an employer hires, supervises, and pays assistants, the worker is generally categorized as an employee. An independent contractor hires, supervises, and pays assistants under a contract that requires him or her to provide materials and labor and to be responsible only for the result;
- *Continuing relationship:* A continuing relationship between the worker and the employer indicates that an employer-employee relationship exists. The IRS has found that a continuing relationship may exist where work is performed at frequently recurring intervals, even if the intervals are irregular;
- *Set hours of work:* A worker who has set hours of work established by an employer is generally an employee. An independent contractor sets his or her own schedule;
- *Full time required:* An employee normally works full time for an employer. An independent contractor is free to work when and for whom he or she chooses;
- *Work done on premises:* Work performed on the premises of the employer for whom the services are performed suggests employer control, and therefore, the worker may be an employee. An independent contractor may perform the work wherever he or she desires as long as the contract requirements are performed;
- *Order or sequence set:* A worker who must perform services in the order or sequence set by an employer is generally an employee. An independent contractor performs the work in whatever order or sequence he or she desires;
- *Oral or written reports:* A requirement that the worker submit regular or written reports to the employer indicates a degree of control by the employer;
- *Payments by hour, week, or month:* Payments by the hour, week, or month generally indicate an employer-employee relationship;

- *Payment of expenses:* If the employer ordinarily pays the worker's business and/or travel expenses, the worker is ordinarily an employee;
- *Furnishing of tools and materials:* If the employer furnishes significant tools, materials, and other equipment, the worker is generally an employee;
- *Significant investment:* If a worker has a significant investment in the facilities where the worker performs services, the worker may be an independent contractor;
- *Profit or loss:* If the worker can make a profit or suffer a loss, the worker may be an independent contractor. Employees are typically paid for their time and labor and have no liability for business expenses;
- *Working for more than one firm at a time:* If a worker performs services for a multiple of unrelated firms at the same time, the worker may be an independent contractor;
- *Making services available to the general public:* If a worker makes his or her services available to the general public on a regular and consistent basis, the worker may be an independent contractor;
- *Right to discharge:* The employer's right to discharge a worker is a factor indicating that the worker is an employee; and
- *Right to terminate:* If the worker can quit work at any time without incurring liability, the worker is generally an employee.

Current Law: In order to determine the proper classification of an individual, the State uses a measure termed the "ABC" test, a simplified version of the IRS's 20 factors. An independent contractor must meet each of the three standards of this measure. **Exhibit 1** summarizes the test and its components.

Employers who are found to have misclassified employees must comply with unemployment insurance and workers' compensation requirements. However, the State has no established penalties for misclassification.

All employers in Maryland are required to provide workers' compensation coverage for their employees, but not for independent contractors. An employer, or its insurer, is required to compensate covered employees upon a determination that an accidental personal injury suffered by an employee was the result of his or her employment.

Employers are further required to meet federal and State unemployment insurance requirements for their employees. All private business employers and nonprofit organizations employing one or more persons are subject to Maryland Unemployment Insurance Law, with employer contributions generally based on taxable wages for covered employment.

Exhibit 1
The “ABC” Test

<u>Standard</u>	<u>Criteria</u>
A. Direction and Control	Employer does not train the independent contractor, set his or her work hours, or provide direct orders.
B. Outside Usual Course of Business	Service performed by an independent contractor is not integrated into the employer’s operation and is unrelated to employer’s business.
C. Independently Established	Independent contractor has liability and workers’ compensation insurance, a place of business, and a financial investment in his or her enterprise.

Source: Department of Labor, Licensing, and Regulation

Background: When a company hires an employee, it is responsible for paying half of that employee’s Social Security and Medicare taxes, as well as premiums for workers’ compensation and unemployment insurance coverage. Employers also typically withhold federal, state, and local income taxes. An employee is responsible for half of his or her Social Security and Medicare taxes, as well as any state and federal income tax in excess of the amounts withheld by the employer.

By contrast, an independent contractor pays all of his or her Social Security and Medicare taxes and has no income taxes withheld but is still responsible for paying them in full. Independent contractors are not covered by workers’ compensation or unemployment insurance, nor do they receive overtime compensation or benefits such as health insurance. They are treated by the law as temporary, freelance workers and are comparable to self-employed individuals.

A May 2007 report by the U.S. Government Accountability Office found that in 2005 there were 10.3 million independent contractors working nationwide in industries that include construction, cleaning and janitorial services, food service, landscaping, and agriculture. Independent contractors in these industries often work on a contingent basis to provide extra coverage to an employer on a temporary or part-time basis. Independent contractors do not generally have access to employer-based health insurance coverage

and pension programs and are not covered by workers' compensation and unemployment insurance. Other protections, such as employee safety requirements, minimum wage and overtime compensation, and anti-discrimination protections, are generally unavailable to these contractors.

Additional Information

Prior Introductions: None.

Cross File: SB 1006 (Senator Garagiola) – Rules.

Information Source(s): Kent, Montgomery and Worcester counties; cities of Baltimore and Havre de Grace; Board of Public Works; Department of General Services; Human Relations Commission; Injured Workers' Insurance Fund; Comptroller's Office; Department of Labor, Licensing, and Regulation; Subsequent Injury Fund; Maryland Department of Transportation; Uninsured Employers' Fund; University System of Maryland; Workers' Compensation Commission; Internal Revenue Service; Department of Legislative Services

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