

Employee or Independent Contractor?

Oren D. Saltzman and Eric D. Disharoon

May 2, 2011

Posted in: MEQ



Oren Saltzman



Eric D. Disharoon

If employers incorrectly claim their workers are independent contractors, they could be liable for penalties and the payment of certain taxes and other contributions (plus interest).

Generally, employers are required to withhold employees' income taxes and pay Social Security and Medicare taxes and unemployment tax on all wages paid. Conversely, independent contractors are responsible for making their own withholding payments.

Federal Law

In determining whether a person is an employee or an independent contractor, the Internal Revenue Service (IRS) focuses on the degree of control that an employer may exert on a worker. The more control a boss has over a worker, the more likely it is that the worker should be classified as an employee.

Evidence of control falls into three categories: 1) Behavioral – Does the business have the right to control the worker? 2) Financial – Who controls the business aspect of the worker's job (e.g., how is the worker paid, are expenses reimbursable, who provides tools/supplies, etc.)? 3) Type of relationship – How do the worker and

business perceive their relationship to each other?

Behavioral control refers to facts that show whether there is a right to direct or control how the worker does the work. A worker is an employee when the business has the right to direct and control the worker. The business does not have to actually direct or control the way the work is done, as long as the business has the right to direct and control the work.

Financial control refers to facts that show whether the business has the right to control the economic aspects of the worker's job. Does the worker own his or her own tools/equipment? Is there a risk of economic loss to the worker in performing the service? Is the worker paid a guaranteed regular wage or a flat fee for the job?

The type of relationship refers to facts that show how the parties work together. Is there an independent contractor agreement or some other written contract? Does the worker receive employee type benefits (e.g., insurance, vacation pay, etc.)? Will the relationship continue indefinitely, rather than for a specific project or period? Is the work to be performed a key aspect of the business of the person for whom the work is performed?

Maryland Law

In Maryland, the degree of control a business may exert on a worker is still an important factor. However, the state considers additional factors when determining if a worker is misclassified.

An independent contractor is a person who is free from control and direction and who is engaged in an independent business or occupation of the same nature as that involved in the work. Furthermore, the work to be performed must be either: 1) outside of the usual course of business of the person for whom the work is performed; or 2) performed outside of any place of business of the person for whom the work is performed.

A person is deemed to be an employee unless he or she meets the definition of an independent contractor.

The freedom from control and direction element of the Maryland test is very similar to the "degree of control" element of the IRS test.

A person is engaged as an independent contractor if, among other things, that person has his or her own employees (or is free to hire helpers) and has created his or her own limited liability entity, such as a corporation.

Other indicators of an independent contractor include the ability to come and go from the job (as long as the job is completed properly and on schedule) and the ability to work (or seek) other similar jobs during the same period.

An example of the "work being performed being outside of the usual course of business of the person for whom the work is performed" element may include a painter being hired by a general contractor to paint a new house. The general contractor is hired to build the house and, although painting the house is one step in completing the house, it is outside of the scope of the general contractor's usual course of business.

Both the IRS and Maryland tests are subjective, and factors must be carefully weighed before determining whether workers are independent contractors or employees.

Oren Saltzman, Esq., is a member and Eric Disharoon, Esq., is an associate with the law firm of Adelberg, Rudow, Dorf & Hendler LLC. Saltzman focuses on commercial and corporate law, banking, estate planning and administration, bankruptcy workout, taxation and guardianship. Disharoon focuses on corporate, general business and employment law. They may be reached at 410-539-5195.