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EMPLOYEE MISCLASSIFICATION
(as of 3/17/2017)

Employee misclassification is an illegal but widespread practice of business owners in Maine and indeed throughout the country. It occurs when employers incorrectly classify their workers as independent contractors rather than treating them as employees. One reason employers do this is to save money. By classifying a worker as an independent contractor, the employer does not pay a whole host of otherwise required expenses, including FICA taxes (i.e. Medicare and Social Security), federal and state unemployment insurance premiums, and worker's compensation insurance premiums. Recently, the Department of Labor and Maine Revenue have stepped up their enforcement efforts, and businesses who misclassify their workforce face stiff penalties.

Even if you disregard the risk of getting caught, it's important to understand that misclassification has damaging consequences on the economic environment. It artificially raises the unemployment and worker's compensation insurance rates for those businesses who correctly classify their workers – less employers paying into the system means higher premiums. It undermines federal and state tax collection efforts. Furthermore, it denies workers the various employment benefits to which they're entitled under the law (e.g. minimum wage and overtime benefits, worker's compensation and unemployment, medical insurance, vacation, holiday pay, retirement contributions, family and medical leave). The purpose of this memo is to clarify the federal and Maine rules in this area and to provide guidance to business-owner clients seeking to comply with the law.

The Federal "Economic Realities" Test

The federal test is *whether the worker is economically dependent on the employer or in business for him or herself*. The courts have developed several factors, none of which is singularly determinative and all of which should be considered in totality, to assist in this inquiry:

- The extent to which the work performed is an *integral part of the employer's business*;
- The *worker's opportunity for profit or loss* depending on his or her managerial skill;
- The extent of the *relative investments* of the employer and the worker;
- Whether the work performed requires *special skills* and initiative;
- The *permanency* of the relationship;
- The *degree of control* exercised or retained by the employer.

An independent contractor agreement which merely labels the worker as an independent contractor is *not* relevant to the inquiry. Rather, the economic realities of the employment relationship are the relevant facts used in the determination.

***REMEMBER: MOST WORKERS ARE CONSIDERED EMPLOYEES UNDER THE FEDERAL GUIDELINES.**

Workers who believe they have been misclassified may file a complaint with the Department of Labor. The consequences of employee misclassification depend on whether the IRS determines the misclassification was intentional or unintentional. Even unintentional misclassifications are severe: percentage penalties on failure to withhold the appropriate income and FICA taxes plus interest, and a separate “failure to pay taxes” penalty. Intentional or fraudulent misclassification results in additional fines, and the business owner can be held personally liable. To avoid all of this, business owners should strive to properly classify all workers in their employ. If there is any ambiguity, we suggest filing a Form SS-8 for a formal determination of worker status by the IRS.

Maine’s Employment Standard

The Bureau of Labor Standards enforces Maine’s employment standard as stated by statute and summarized as follows:

Services performed for compensation are considered to be employment unless:

- 1) the worker is ***free from the essential direction and control of the employer***, both under the worker’s contract of service and in fact; and
- 2) the worker ***meets all of the below criteria***; and
 - The worker has the essential right to control the means and progress of the work except as to final results;
 - The worker is customarily engaged in an independently established trade, occupation, profession or business;
 - The worker has the opportunity for profit and loss as a result of the services being performed for the employer;
 - The worker hires and pays the worker’s assistants, if any, and, to the extent such assistants are employees, supervises the details of the assistants' work; and
 - The worker makes the worker’s services available to some client or customer community even if the worker’s right to do so is voluntarily not exercised or is temporarily restricted.
- 3) the worker ***meets three (3) of the below criteria***.
 - The worker has a substantive investment in the facilities, tools, instruments, materials, and knowledge used by the worker to complete the work;
 - The worker is not required to work exclusively for the employer;
 - The worker is responsible for satisfactory completion of the work and may be held contractually responsible for failure to complete the work;
 - The parties have a contract that defines the relationship and gives contractual rights in the event the contract is terminated by the employer prior to completion of the work;
 - Payment to the worker is based on factors directly related to the work performed and not solely on the amount of time expended by the worker;
 - The work is outside the usual course of the business for which the service is performed; or

- The worker has been determined to be an independent contractor by the federal Internal Revenue Service (i.e. an SS-8 determination).

In Maine, workers may report suspected misclassification anonymously by calling a tip line or filling out an online form. Like the federal regime, Maine law imposes harsh penalties on employers who misclassify their workers, including penalties ranging from \$2,000 to \$10,000, accrued interest on back taxes, back unemployment insurance taxes, and the risk of costly lawsuits in the event a misclassified worker is injured on the job. We advise our clients who operate businesses in Maine to pay particularly close attention to the flowchart prepared by the Maine Department of Labor.¹ Again if there is any ambiguity as to worker status, we encourage clients to file an application for predetermination of independent contractor status² with the Workers' Compensation Board. Although it is not conclusive, the application if granted does establish a rebuttable presumption that the individual in question is an independent contractor.

Special Note Regarding Self-Employed Fishermen³

Certain fishermen who work on a fishing boat are considered to be self-employed for purposes of federal employment and self-employment taxes. A fisherman is considered self-employed if he meets all of the following conditions:

- 1) He receives a share of the catch or a share of the proceeds from the sale of the catch.
- 2) His share depends on the amount of the catch.
- 3) He receives his share from a boat (or from each boat in the case of a fishing operation involving more than one boat) with an operating crew that is normally made up of fewer than 10 individuals. This requirement is considered to be met if the average number of crew members on trips the boat made during the last 4 calendar quarters was less than 10.
- 4) He does not get any money from his work (other than his share of the catch or of the proceeds from the sale of the catch), unless the pay meets all of the following conditions.
 - a. He does not get more than \$100 per trip
 - b. He is paid only if there is some minimum catch.
 - c. He is paid solely for additional duties (such as for services performed as mate, engineer, or cook) for which additional cash payments are traditional in the fishing industry.

¹ http://www.maine.gov/labor/misclass/how_to_determine_independent_contractor_status.shtml

² <https://www1.maine.gov/wcb/forms/WCB-266.pdf>

³ <https://www.irs.gov/businesses/small-businesses-self-employed/self-employed-fishermen>