

Independent Contractor or Employee?  
The status of workers in the construction  
and landscaping industries in the  
State of Maryland  
By: Kathleen S. Sibbald  
October 2011

The lack of a specific statutory definition of what constitutes an independent contractor or an employee is a long standing source of frustration for many individuals and businesses throughout the country. Individuals and businesses have been forced to rely upon a common law analysis of the relationship to determine the status of workers. To make matters worse, a lack of uniformity in the application of the common law analysis by local jurisdictions, state governments and various federal agencies further clouds the issue.

Historically, the test to determine a worker's status under the common law has been one of direction and control. If a person or business exercises a sufficient degree of direction and control over a worker or group of workers to establish an employment relationship, the worker or workers are deemed to be employees of the person or business for whom the services are performed.

However, the degree of direction and control necessary to establish an employment relationship varies based on the nature of the industry and the nature of the occupation. For instance, an individual who is highly skilled and highly trained (i.e. professional workers such as doctors, lawyers, computer programmers or technicians, etc.) may require very little supervision, training, direction and control, and may have the ability to exercise his or her own judgment in making work related decisions and still be properly classified as an employee. Other highly skilled and highly trained workers may properly be classified as independent contractors (i.e. plumbers, electricians, various tradesmen, etc.). Accordingly, one must look at the "big picture" in analyzing any given relationship to determine if an independent contractor or an employment relationship exists.

## **Federal Law**

Section 3121(d)(2) of the Internal Revenue Code reads, in pertinent part, that "for purposes of this chapter, the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee." In determining whether a worker is an independent contractor or an employee under the common law for Federal employment tax purposes, including Federal Income Tax Withholding (FITW), the Federal Insurance Contribution Act (FICA), and the Federal Unemployment Tax Act (FUTA), the Internal Revenue Service (IRS) looks at three different categories: behavioral control, financial control and relationship type.<sup>1</sup>

---

<sup>1</sup> <http://www.irs.gov/businesses/small/article/0,,id=99921,00.html>

## Behavioral Control

In examining the behavioral control that a business exercises over a worker, an employee is someone who is generally subject to the business's instructions about when, where and how to do the work. The more detailed the instructions provided by the business, and the greater the degree of control exercised by the business, generally indicates that an employment relationship exists. However, the amount of instruction and, therefore, the degree of control, varies among different jobs. Some employees, by virtue of their knowledge or skill level, may require very little or no instruction. The key element to consider is whether the business retains the right to control the details of the worker's performance, regardless of whether it exercises that right, or whether the business has given up that right.

Another behavioral factor to consider is whether or not the business trains the worker on how to do the job. If the business wants the work performed in a particular method or manner and trains the worker in this particular method or manner, this is a strong indication that the worker is an employee. Periodic or on-going training about procedures and methods is an even stronger indication that an employment relationship exists. Independent contractors, on the other hand, use their own methods or procedures to complete the tasks.

If a business uses an evaluation system that measures the details of how the work is performed, it indicates that the business has a vested interest in how the work is performed and, therefore, exercises a sufficient degree of behavioral control over the worker to establish an employment relationship. In contrast, if a business merely evaluates the end results and is not concerned about the methods or procedures used to achieve the end result, the worker is generally an independent contractor.

## Financial Control

Financial control refers to facts that show whether or not the business has the right to control the economic aspects of the worker's job. There are five categories of financial control that must be examined in determining a worker's status:

1. Whether the worker has a significant investment in the tools and equipment that he uses in performing services for another party;
2. Whether the worker incurs fixed, on-going costs regardless of whether work is currently being performed and whether the worker is reimbursed for expenses he incurs;
3. Whether the worker has the opportunity to make a profit or loss as a result of the services he performs;
4. Whether the worker is free to seek out other business opportunities and does so by advertising, maintaining a visible business location, or holding himself out as being available to work in the relevant market; and,
5. Whether the worker is guaranteed a regular wage amount for an hourly, weekly or other time period or whether the worker is paid by a flat fee for a job.

## Relationship Type

The type of relationship that exists between the parties must also be examined to determine whether an independent contractor or an employment relationship exists. In evaluating this relationship, there are several factors to consider. The first is whether a written contract exists between the parties. However, a contract that specifically refers to the worker as either an employee or an independent contractor is not valid unless other facts support that type of relationship.

Another factor to consider is whether the business provides the worker with any type of benefits normally provided to employees such as insurance, pension plans, paid vacations, sick days and disability insurance. Independent contractors are not entitled to participate in employee benefit plans, but a lack of benefits in and of themselves, does not mean that a worker is an independent contractor, since in most cases, there are no requirements that businesses provide employees with such benefits.

The permanency of the relationship is another factor to consider. If a worker is hired to work on either a full-time or part-time basis, with the expectation that the relationship will continue indefinitely, the worker is generally classified as an employee. An independent contractor, on the other hand, is generally hired on a job-by-job basis or for a specific time period to complete a specific project with no stated or otherwise implied promise that he will be offered work on a continuous or on-going basis.

Whether the services performed by the worker are a key aspect of the business, is another factor to consider. If, for example, a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work, creating an employer-employee relationship. Services that are performed outside the scope of the business are generally performed by independent contractors.

## State Law

The State of Maryland (the State) enacted the Workplace Fraud Act (the "Act") in 2009 to provide the state with tools to crack down on workplace fraud, which involves employers who wrongly classify their employees as independent contractors or do not classify them at all.<sup>2</sup> This practice allows employers to cut payroll costs significantly, leaving workers unprotected by critical workplace protection laws and creating a competitive disadvantage for those employers who play by the rules. Workers who are misclassified as independent contractors are denied access to unemployment insurance, workers' compensation and other protections, and the taxpayers are deprived of millions of dollars to the Unemployment Insurance Trust fund and the State General Fund.

The Workplace Fraud Act adopted the ABC test, previously used in Maryland's Unemployment Insurance Law, to determine whether a worker in the construction or landscaping industries is an employee or an independent contractor. This is a three-pronged test, under which an employer-employee relationship is presumed unless the worker performing the services is an

---

<sup>2</sup> <http://www.dllr.state.md.us/workplace/>

exempt person (an individual who operates his own business and does not have any employees other than family members) or the employer demonstrates that:

- A. The individual is free from control and direction;
- B. The individual customarily is engaged in an independent business of the same nature; and,
- C. The work is outside the usual course of business of the employer or performed outside of any place of business of the employer. Work is “outside the usual course of business” if the individual performs the work off the employer’s premises; performs work that is not integrated into the employer’s operation; or performs work unrelated to the employer’s business.

The ABC test adopted by the State of Maryland does not differ significantly from the three-prong test adopted by the Internal Revenue Service in 1996. The key difference is that under the Workplace Fraud Act of 2009, an employment relationship is *presumed*, but only in the construction and landscaping industries, unless proven otherwise. This represents a significant flaw in the Maryland legislation. Neither an employment, nor an independent contractor relationship can be presumed in any case, or in any industry, absent specific legislation that *clearly* defines the status of specific workers under specific circumstances. The Act, as it is written, is vague and ambiguous and does **not** provide any clear statutory definitions of what constitutes an employment or an independent contractor relationship. Absent such legislation, the determination of whether a specific worker or a group of workers must continue to be based on an application of the common law analysis to the facts and circumstances in every case, regardless of the industry or occupation.

The State further erred in its enforcement provisions in cases involving individuals or businesses that “knowingly” misclassify workers. The Act defines “knowingly” as having actual knowledge, deliberate ignorance or reckless disregard for the truth. As evidence that the individual or business did not knowingly misclassify any worker, The State will consider whether the individual or business sought and obtained documentation from the worker or workers in question, showing the worker’s or workers’ reporting of business income and losses on his or her personal income tax return (evidenced by IRS form 1040, Schedule C); or a worker’s withholding of payroll taxes and payment of unemployment insurance and workers’ compensation premiums on behalf of all individuals working for him (evidenced by IRS form W-2). The fatal flaw here is that the State cannot require an individual or business to produce confidential tax records belonging to another individual or business, that the first individual or business would not, under normal circumstances, have access to. Nor would the second individual or business be under any obligation to provide its personal and confidential tax records to any other individual or business. An individual or business is only obligated to submit the appropriate tax records to the State or Federal agency having jurisdiction over the collection and assessment of such taxes.

Another factor that the State will consider as evidence that the individual or business did not knowingly misclassify workers, is whether the individual or business provided written notice to the worker or workers of their status as independent contractors and the implications thereof. The State has provided the form “Notice to Independent Contractors and Exempt Persons” which

the individual or business can provide to the worker or workers to satisfy this requirement. The flaw here is that under general contract law, two or more parties cannot enter into a contract to perform an act which is illegal and such contracts are illegal. If the legal relationship of employer-employee exists between the parties, the fact that they may have entered into an agreement stating that an independent contractor relationship exists, is not determinative of the workers' status. Conversely, a written agreement that an employment relationship exists if the facts prove otherwise, is also not determinative of the workers' status.

The only legitimate evidence that the State can consider in determining whether the individual or business knowingly misclassified a worker or workers, would be if the individual or business received a determination from the IRS (in the form of a private letter ruling or in the course of an audit or examination of the individual or business's operation) stating that the specific worker or group of workers in question were employees and not independent contractors. The issuance of 1099's or W-2's by the individual or business absent a determination by the IRS, is not determinative of the worker or workers' status, only evidence of what the individual or business believed the workers' status to be.

### **The Retail Flooring Industry in Maryland**

The State of Maryland has determined that the home improvement industry, falls under the broad umbrella of the construction industry, and therefore, the Workplace Fraud Act of 2009 is applicable to flooring retailers. Retailers engaged in the sale of carpet or hard surface flooring in the state of Maryland routinely engage independent contractors to install the products that they sell in their retail establishments. Because of the fluctuating nature of sales in the retail flooring business, it would not be economically feasible for the retailer to employ a staff of installers on a full-time basis. These workers are typically paid by the job (at a rate that has been negotiated between the retailer and the independent contractor), not by an hourly wage or set salary. Accordingly, if there is no work to be done, these workers do not get paid. Thus, the need to engage independent contractors on a job-by-job basis arises. In addition, these workers are not guaranteed any minimum amount of work or compensation and are not provided with any benefits that would typically be provided to employees such as health insurance, paid sick days, or paid vacation days.

These workers generally operate as independent businesses, offering their services to various retailers, other businesses and individuals. Many operate as sole proprietors, but some are organized as a partnerships or corporations. The independent contractors enter into verbal or written agreements with retailers or others to complete a specific job, at a specific location, and within a specific time frame. They set their own schedule, provide their own tools and transportation, determine what services they will or will not perform, obtain their own training and utilize their own methods and means to complete the services that they have contracted to perform. They receive no specific instructions from the retailer as to how the services are to be performed. The only method of evaluation by the retailer is whether or not the job is completed to the customer's satisfaction. If the customer is not satisfied, the independent contractor may be required to perform or pay for additional services, pay for additional materials to replace materials that were damaged by the independent contractor, or reimburse the customer for

damaged goods with no additional compensation from the retailer. Accordingly, the independent contractor assumes a risk of financial loss as a result of the services performed.

In the flooring installation industry, some independent contractors may perform the services under the terms of the contract themselves, while other independent contractors may hire other workers to assist them or perform services for the retailer on his or her behalf. In many cases, the retailer for whom the services are performed has no knowledge of whether the independent contractor performs the services by him or herself, whether he engages a helper to assist him or her, or whether other workers are engaged to perform the services on his or her behalf. In addition, if and when other workers are engaged by the independent contractor, the independent contractor provides the other workers with necessary training and instructions, and supervises the other workers in the performance of their services. The independent contractor also pays the other workers directly and determines the worker's rate of pay. Because the independent contractor has an obligation to pay the wages of the helpers or other workers, again the independent contractor assumes the financial risk of loss, should the amount the independent contractor receives under the terms of the agreement with the retailer be insufficient to cover the wages and related costs of the other workers.

As small business operators, these independent contractors may advertise simply by word of mouth or by direct contact with retailers, other business owners or individuals. They may or may not invest in print advertising such as business cards, fliers, direct mailings, etc., and they may or may not invest in a website or electronic advertising, as it may not be necessary for them to do so in order to obtain a sufficient amount of work. While an abundance of print or electronic advertising would provide evidence that the individual operates as an independent business, a lack of such advertising does not provide evidence that the individual is an employee.

As an independent contractor, the retailer assumes that the sole proprietor, partnership or corporation files the appropriate tax forms and pays the appropriate taxes on earnings and wages paid to other workers. However, the retailer, business or other party for whom the services are performed, has no enforcement authority and no obligation to insure that the independent contractor complies with local, State or Federal tax laws. Most likely, in cases of independent contractors who engage the services of other workers to assist them or perform services on their behalf, the independent contractor is the employer of the workers he or she hires. As an employer, the independent contractor would be required to file all appropriate local, State and Federal returns and would be required to withhold and pay appropriate local, State and Federal employment taxes from the worker's pay, reporting wages paid to the workers on Form W-2. A failure to comply with local, State or Federal tax laws on the part of the independent contractor does not make the independent contractor or other workers that he or she hires, employees of the retailer for local, State or Federal employment tax or other purposes, such as workers' compensation.

With regard to whether the services performed by the independent contractor are integral to the business of the retailer, the argument can be made that the retailer is engaged in the business of selling flooring, not in the business of installation flooring. Accordingly, the services performed by the independent contractor are not integral to the business of the retailer. In addition, none of the work performed by the independent contractors is performed at the

retailer's place of business or on the retailer's premises. Independent contractors generally report to the retailer's place of business (i.e. warehouse as opposed to retail location) to pick up the materials that have been purchased by the customer and delivered to the retailer's location. The materials, while temporarily in the possession of the retailer, are not the property of the retailer, but rather the property of the customer. All services performed by the independent contractor are performed at the customer's property.

## **Conclusion**

In determining whether installers in the retail flooring industry are employees of retailers or independent contractors, whether for Federal Employment Tax purposes or for State purposes, the common law analysis must be applied to the facts and circumstances in any given case. It is inappropriate, and in contradiction to the law, to presume that all installers in the retail flooring industry are employees of the retailer for whom services are performed simply for ease of tax collection. It is the obligation of the Federal government and the State to collect the appropriate amount of tax from the appropriate parties, not simply place the burden where collection is the easiest. Accordingly, installers should NEVER be presumed to be employees of a retailer, and in most cases, installers should not be considered employees of the retailers for whom the services are performed. In most cases, installers who contract directly with retailers are independent contractors and the workers they engage to assist them, or perform services for retailers on their behalf, are employees of the independent contractor. To treat all installers as employees of the retailers for whom they perform services, would signal death to many retailers in the flooring industry in Maryland, particularly to the smaller, privately owned businesses. Accordingly, it is absolutely imperative, that the law be applied appropriately to the facts and circumstances in each and every case, to reach a legally sound determination of a worker's status and subsequent liabilities.