



Revised Independent Contractor Law

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Introduction

Effective as of July 19, 2004, the Massachusetts legislature amended Chapter 149, section 148B, known as the Independent Contractor Law. With these amendments, the Commonwealth has set strict rules for classifying workers as employees rather than independent contractors for purposes of workers' compensation, other state labor requirements and state income tax withholding. Stiff penalties, including penalties for individual officers, apply if a worker is improperly classified as an independent contractor. If not changed, the revised rules will pose operating problems, and additional costs, for employers.

For a full explanation, see Advisory 2004/2 issued by Attorney General Reilly (www.ago.state.ma.us – search for “Advisories”). A further 2004 law, the Act to Protect Tips and Wages of Certain Workers, increases penalties for violation of the Independent Contractor Law. See the Attorney General's Advisory 2004/3.

Background

Whether an individual is an employee or an independent contractor matters for a number of purposes:

- Withholding of federal and state income taxes
- Withholding, and employer payment, of Social Security (F.I.C.A.) taxes
- Unemployment taxes and benefits
- Workers' compensation payments and benefits
- Qualification for employer-provided benefits, such as health, life or disability insurance, paid leave and retirement plans
- Liability of an employer for acts of a worker

Rules as to how to classify a worker vary, depending on which federal or state statute may be involved and on legal principles reflected in court decisions over the years. A classic test is whether an employer has a right to control and direct an individual not only as to the results to be achieved but also the means and methods used. However, a number of other considerations come into play, depending on which aspect of the employment relationship is being considered. The IRS, for example, considers over 30 factors in making determinations of worker status for federal tax purposes. (See IRS Form SS-8 at www.irs.gov.)



How the New Law Works

The amendments in question were a part of an “Act Further Regulating Public Construction in the Commonwealth.” However, the Independent Contractor Law as revised is quite broad and is not restricted to the public construction field.

- Basic Rules. The Independent Contractor Law provides that for certain state purposes, an individual will be considered an employee unless three – all three – tests are satisfied:

- (1) the individual is free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact; *and*
- (2) the service is performed outside the usual course of the business of the employer; *and*
- (3) the individual is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed.

- Laws Affected. The Independent Contractor Law applies to state statutes dealing with wage and hour rules, minimum wage and overtime requirements, maintenance of records, income tax withholding (but see below) and workers’ compensation.

- Penalties and Liabilities. Employers that violate the law face debarment from public construction projects, criminal penalties and civil liability for damages. The president, the treasurer and other managers of an employer organization can be held personally liable for violations.

Analysis

- The Three Factors. The first factor quoted above, dealing with control and direction, is essentially a formulation of longstanding. Note that the worker’s contract and the worker’s actual activity must reflect freedom from control and direction. The second factor, requiring work outside the employer’s usual course of business, can easily spell trouble. In effect, an employer that engages individuals to perform work of the type normally performed by the employer must treat those individuals as employees, even though they would not pass traditional tests as to the employer’s control and direction. The third test, that a worker is customarily engaged in an independent trade, also may be difficult to meet in some cases. For example, an individual who regularly holds a job in one field and then works only for an employer on a contract basis would not be involved in an independent trade or business of the same nature as his or her work for the employer, as required by the statute.



- Federal vs. State. The Independent Contractor Law affects only certain state obligations. It has no bearing on federal rules, such as those relating to income tax withholding, Social Security taxes or requirements for various benefit plans that receive favorable tax treatment.

- State Income Tax Rules. The Massachusetts Department of Revenue has issued draft Technical Information Release 05-XX stating, in substance, that for purposes of state income tax withholding rules, the Department will not follow the new law, but instead will continue to follow established IRS tests as to independent contractors vs. employees. Go to www.dor.state.ma.us; then click to “Legal Library” and then “Technical Information Releases.”

- Unemployment Insurance. The test for unemployment insurance coverage is set forth in a separate statute (Chapter 151A, section 2). The three tests in that statute are essentially the same as in the Independent Contractor Law. However, the second test is more liberal. The difference has to do with off-site work, as shown in the italicized language:

Service is performed *either* outside the usual course of the business for which the service is performed *or is performed outside of all the places of business of the enterprise for which the service is performed....*

This language would matter, for example, in the case of individuals working in their own homes or offices.

- Employer Benefits. The Independent Contractor Law has no bearing on how an employer defines “employee,” or how federal benefit rules may define “employee,” for purposes of voluntarily provided employer benefits such as health, life or disability insurance, paid leave or retirement benefits.

- Employer’s Liability for Worker’s Acts. At common law, an employer may be held liable for acts of a worker that cause harm to others. These rules will not be affected by the Independent Contractor Law.

Practical Considerations

- Legislative Change. The Independent Contractor Law creates such problems for so many employers that legislative remedies will no doubt be proposed.

- Enforcement. While an employer could adopt a wait-and-see approach for the time being, the Attorney General has indicated that he will enforce the Independent Contractor Law vigorously. Even if the Attorney General should choose as an administrative matter not to enforce the law outside of the public construction area pending legislative action, misclassified workers could bring actions for civil damages. Also, workers’ compensation insurers may insist on charging premiums according to their interpretation of the Law.

- Split Treatment. An employer could treat some workers as employees for purposes of areas covered by the Law but not otherwise. In considering the treatment of workers who are presently independent contractors, an employer should review, and may well be able to comply with, state rules as to minimum wages, overtime pay and timely payment of wages. Beyond that, the problem areas would be with workers' compensation, and possibly with unemployment insurance under the separate, but similar, rules described above.

- With split treatment such as this, the employer would have to watch implementation, and draft its personnel policies, very carefully.

- Split treatment could heighten workers' sensitivity to the importance of other benefits that come with the status of employee.

- Broad Conformity. If, instead, an employer allows the Independent Contractor Law to control for all purposes, the employer could face considerable additional expense, especially for Social Security taxes and paid leave. Federal tax rules relating to qualification for certain benefits would have to be reviewed carefully.

- Cost Recovery for Human Services Providers. Human services providers that face additional costs due to the Independent Contractor Law may well be able to secure price relief from the Commonwealth under so-called unfunded mandate law in Chapter 7, Section 4A of the General Laws.

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