

# SAFETY NEWSLETTER

SELF INSURED WORKER'S COMPENSATION FUND MEMBERS

September 2020

## Independent Contractor or Employee?

Outlining a MCWCF members WC exposure if appropriate forms are not obtained

Dear [MCWCF] Member:

Generally speaking, the Michigan Workers' Disability Act only protects employees. A self-employed person, or the owner of a business that is a sole proprietorship, may not be considered an employee, and is therefore not subject to the Michigan Workers' Disability Compensation Act (hereinafter referred to as "Act"). Simply stated, the Act does not provide coverage or benefits to such independent contractors.

Unfortunately, the means for determining whether a particular worker is an employee versus an independent contractor is complicated. Moreover, where your relationship with the worker is properly considered an independent contractual arrangement, employees of that independent contractor may still be able to collect workers' compensation benefits from you, as the principal contractor, under certain circumstances.

### A. Who Is Properly Considered an Independent Contractor Versus an Employee

The factors for determining whether a particular individual is an employee, as opposed to an independent contractor, changed as of January 1, 2013. For employment on or after that date, certain amendments to the Act passed in 2011 (but effective on January 1, 2013), require the use of a standard derived from an old IRS Revenue Ruling. See IRS Rev Rule 87-41. (A copy of that IRS Revenue Ruling is attached hereto). Essentially, the IRS used common law rules to identify 20 factors to determine whether an employee-employer relationship exists. The 20-factor test is based primarily on three principal considerations that are set forth within an explanatory letter issued by the Office of the General Counsel for the IRS:

Because of the difficulty in applying the 20-factor test and because business trends have changed over the years, the [IRS] has recently begun using a new approach with respect to worker classification. Rather than listing items of evidence under the 20 factors, the approach now is to group the items of evidence into the following three main categories: behavioral control, financial control, and the relationship of the parties. See Memorandum from Office of Chief Counsel, Internal Revenue Service, SCA 1998-037, at 3 (December 4, 1998).

The fact that a MCWCF member simply designates or labels an individual as an independent contractor is not particularly relevant to the issue. The mere fact that payments made to the worker are reflected on a Form 1099, as opposed to a W-2, is not dis-positive. It is the economic reality of the relationship, and the amount of behavioral and financial control, and the true relationship of the parties that will dictate whether an individual is properly considered an independent contractor, or properly considered an employee.

Unfortunately, the test for making the determination is even further complicated by the fact that the Act still provides that, as a starting point, an employee is:

Every person performing service in the course of the trade, business, profession, or occupation of an employer at the time of an injury, if the person in relation to this service [1] does not maintain a separate business, [2] does not hold himself or herself out to and render service to the public, [3] and is not an employer subject to this Act. See MCL 418.161(1)(n).

The Act and Michigan courts have made it clear that this is the starting point for making the determination, and the aforementioned 20-factor test set forth in the attached IRS Revenue Ruling, is to be used in conjunction with, and not in place, of this statutory language.

Application of the 20-factor test, along with the statutory language above, results in a very broad definition of "employment." Essentially, every person who does not maintain a separate business or does not hold himself out to and renders service to the public or is not an employer subject to the Workers' Compensation Act will probably be considered an employee so long as application of the 20-factor test does not establish otherwise.



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## B. Even If A MCWCF member Hires a Worker Who Is An

### **Independent Contractor Under the Afore-Described Tests, if that Worker has Employees of His or Her Own, and One of Those Employees is Injured, The MCWCF member May Have Liability for Workers' Compensation Benefits.**

According to Section 171 of the Act, a principal, also known as the contractor, that hires an independent contractor that is either uninsured or too small to be covered by the Michigan Workers' Disability Compensation Act, may become a "statutory" or "shoot through" employer if an employee of that independent contractor is injured while performing the principal's work. See MCL 418.171. Where the independent contractor is actually a corporate entity, a limited liability company, or even a partnership, an owner of that corporation, limited liability company, or partnership, may be, under certain circumstances, considered an employee of the independent contractor -- and thereby entitled to benefits from the principal, or contractor, pursuant to a "statutory" or "shoot through" theory of liability.

The only sure way to prevent the possibility of such "statutory" or "shoot through" exposure for workers' compensation benefits is by requiring that the independent contractor, who intends to use employees of his/her own to perform your work, have a certificate of valid workers' compensation insurance covering its employees. In the event that the worker is the sole owner of such a corporate entity or LLC, then a valid Form BWC 337, excluding that individual from coverage under the Act, will suffice.

#### **Conclusion:**

The issue of who is, and who is not, an employee is a complicated one. As noted above, there is a tendency for the Workers' Compensation Agency to determine that a worker is an employee, as opposed to an independent contractor. Simply calling someone an independent contractor, or having him/her sign an agreement that designates him/her as an independent contractor, or paying him on a 1099 as opposed to a W-2, will provide little to no protection from liability for workers' compensation benefits. Any worker who does not maintain a separate business and who does not hold himself or herself out to and render service to the public and who is not an employer subject to the Michigan Workers' Disability Compensation Act, will be able to establish a prima facie case of an employment relationship -- unless application of the 20-factor test clearly dictates otherwise. If an individual is labeled an independent contractor, but is ultimately determined to be an employee, this will create an unintended exposure for workers' disability compensation benefits.

Moreover, there still may be some unintended exposure for workers' disability compensation benefits if an employee of your independent contractor is injured while performing your work. This is why it is essential for you to ensure that each of your independent contractors which has one or more employees provide you with either a certificate of workers' disability compensation insurance, or a properly filed, valid BWC 337 -- Exclusion of Liability -- for any worker who will be performing work activities for you.

Thus, it is required you have every putative independent contractor complete the attached CompOne Form. If you fail to do so, and/or if you fail to obtain the independent contractor BWC Form 337 and/or valid certificate of workers' compensation insurance, and if your MCWCF incurs liability to such a worker or his/her employees for workers' compensation benefits, your MCWCF shall be entitled to indemnification from you for all such benefits paid.

#### **Bullet Points Review:**

- All subcontractors to complete ICS Form before starting work
- Valid for attached and on website
- ICS Forms fully completed. If additional information requested please provide. ICS Form is not valid unless all requested documentation is received
- Employment contracts are not valid substitute for a ICS Form
- All ICS Forms and certificates of insurance need to be submitted to CompOne Administrators within the time-line given by the audit firm hired by the MCWCF
- All audit questions should go to the audit contact at CompOne
- Without the proper documentation, you will be paying additional premium and exposing the fund to potential losses
- The fund bears all exposure for potential losses for subcontractors without proper documentation.
- The "shoot through" language, in the WC Act, states if the subcontractor doesn't hold coverage that the larger employer (in our case, the member) may be held accountable to cover costs





MCWCF Member:

Policy Year:

TO BE COMPLETED BY THE INDEPENDENT CONTRACTOR

Subcontractor Name: \_\_\_\_\_

Doing Business as (DBA): \_\_\_\_\_

1. I operate as:  Sole Proprietor  Partnership  Corporation  Limited Liability Company

Note: If indicating Partnership, Corporation, or Limited Liability Company, a Certificate of Workers' Compensation insurance or a properly filed BWC 337 form must be submitted.

2. The type of work I performed can be described as: \_\_\_\_\_

3. I hire employees or casual laborers to complete work for the named policyholder:

- Yes You must attach a certificate of Workers Compensation Insurance
 No Form 1040 schedule C may be provided as verification

4. I hire subcontractors or casual laborers to complete work for the named policy holder:  Yes  No

5. I have General Liability and/or Professional Liability Coverage:  Yes  No

6. To validate my standing as an independent contractor, I state that I do not exclusively depend upon the payments of the named policyholder and have worked for the following general contractors or clients during the past twelve months.

Table with 3 columns: Name, City, Phone. Rows 1, 2, 3.

I acknowledge that as a sole proprietor, I am by law not covered by or subject to the Workers' Disability Compensation Act.

I certify the above represent a true and complete statement of my status as an Independent Contractor. I understand a company representative may verify that statement at any time. If requested, I agree to provide documentation to verify my status as a sole proprietor.

Signed \_\_\_\_\_ Date: \_\_\_\_\_
(Independent Contractor)

Phone Number: \_\_\_\_\_ Email Address: \_\_\_\_\_ (Required)

This form is utilized as a test of the above individual's independent status. By completing this form, it does not automatically remove the above individual's exposure from the audit of the policy period in question. Additional information may be required. If independent status is proven, the exposure will not be charged.