



# Members Brief

An informational brief prepared by the LSC staff for members and staff of the Ohio General Assembly

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## Employee Misclassification

Employee misclassification refers to when an employer misidentifies a worker as an independent contractor instead of an employee. This distinction is important because employees, and not independent contractors, have protections under state and federal employment laws, including minimum wage and overtime pay protections, as well as unemployment and workers’ compensation coverage. In turn, an employer that misclassifies a worker as an independent contractor does not pay employment-related taxes or pay other costs for that worker, thus lowering the employer’s costs. An employer that misclassifies a worker may be subject to state or federal civil or criminal penalties.

Different tests are used to determine a worker’s employment status depending on the law at issue. While the tests vary, generally the determination is based on how much direction or control an employer has over the worker performing the services. It is possible that a worker may be an employee under one law and an independent contractor under another law.

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### Employee misclassification

Employee misclassification refers to when an employer misidentifies a worker as an independent contractor instead of an employee. An independent contractor generally is a worker who undertakes a specific project but who is left free to do the assigned work and choose the

method for accomplishing it.<sup>1</sup> Independent contractors pay their own income and self-employment taxes.<sup>2</sup> An employer generally does not withhold or pay taxes on payments to independent contractors.<sup>3</sup>

In contrast, an employer generally must withhold and pay employment taxes on an employee's wages, pay for unemployment and workers' compensation coverage, and pay at least the minimum wage and pay overtime compensation if an employee works more than a specified number of hours in a week. Thus, if an employer misclassifies a worker, the employer avoids those payments, and the worker may lack statutory protections and coverage. In addition, an employer that is found to have misclassified an employee may incur civil or criminal penalties under state or federal law.

### **Employee determination**

Courts and administrative agencies apply different tests to determine a worker's employment status for purposes of state and federal employment laws. These tests stem from various statutes, administrative rules, agency interpretations, and court cases. While the tests vary, the determination generally is based on the extent to which an employer retains the right to direct and control the worker performing the services. Because different tests are used under various laws, it is possible for a worker to be considered an employee under one law and an independent contractor under another law.

### **Statutory coverage**

Generally, a law's "employee" definition describes the type of workers covered by the law, and the applicable employee classification test determines whether an employment relationship exists for purposes of that law. For example, under the federal Fair Labor Standards Act<sup>4</sup> (FLSA), which governs minimum wage and overtime pay, an "employee" includes "any individual employed by an employer." It excludes from the definition of employee specified individuals, such as certain legislative branch employees.<sup>5</sup> Thus, the applicable employment test, known as the economic reality test, determines whether an employment relationship exists for FLSA purposes with respect to a worker not excluded from the FLSA's definition of employee.

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<sup>1</sup> *Black's Law Dictionary* (11<sup>th</sup> Ed. 2019).

<sup>2</sup> See page 3 of [IRS Publication 334 \(2021\) \(PDF\)](#), which may be accessed by conducting a keyword "Publication 334" search on the Internal Revenue Service (IRS) website: [irs.gov](https://www.irs.gov).

<sup>3</sup> See page 7 of [IRS Publication 15-A \(2022\) \(PDF\)](#), which may be accessed by conducting a keyword "Publication 15-A" search on the IRS website: [irs.gov](https://www.irs.gov).

<sup>4</sup> 29 United States Code (U.S.C.) 201, *et seq.*

<sup>5</sup> 29 U.S.C. 203(e).

## Employee classification tests

The various employee classification tests applicable to state and federal income tax laws, the FLSA, and Ohio's Workers' Compensation Law,<sup>6</sup> Unemployment Compensation Law,<sup>7</sup> Overtime Law, and Minimum Wage Law<sup>8</sup> are described below. Most tests share similar factors that indicate a worker's employee or independent contractor status.

### Economic reality test

As noted above, for FLSA purposes, as well as Ohio laws governing minimum wage and overtime pay, the "economic reality" of the relationship between a worker and employer is examined to determine whether an employment relationship exists. The focus of this test is on whether the worker is economically dependent on the employer. The test generally includes six factors that are listed to the right, though no one single factor is determinative.<sup>9</sup>

#### Economic Reality Test Factors

- The employer's degree of control over the worker.
- The worker's opportunity for profit or loss.
- The worker's investment in the business.
- The amount of skill required for the work.
- The permanence of the working relationship.
- The extent to which the work is an integral part of the employer's business.

### Internal Revenue Service common law test

The Internal Revenue Service (IRS) uses an 11-factor "common law test" to determine a worker's employment status for federal income tax and federal unemployment tax purposes.<sup>10</sup> Ohio also follows this test for state income tax purposes.<sup>11</sup> In applying the test, the IRS considers evidence regarding the degree of control or independence of a worker. Facts that provide evidence fall under three categories: (1) behavioral control, (2) financial control, and (3) relationship of the parties.<sup>12</sup>

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<sup>6</sup> R.C. Chapters 4121, 4123, 4127, and 4131.

<sup>7</sup> R.C. Chapter 4141.

<sup>8</sup> Ohio Constitution, Article II, Section 34a; R.C. Chapter 4111.

<sup>9</sup> 29 Code of Federal Regulations 795.105 and Ohio Const., art. II, sec. 34a and *Ellington v. City of E. Cleveland*, 689 F.3d 549, 555-557 (6<sup>th</sup> Cir. 2012), citing *Donovan v. Brandel*, 736 F.2d 1114 (6<sup>th</sup> Cir. 1984).

<sup>10</sup> 26 U.S.C. 3121(d) and 3306(i).

<sup>11</sup> R.C. 5747.01 and 1976 Ohio Atty.Gen.Ops. 76-040, at 2-140.

<sup>12</sup> See page 7 of [IRS Publication 15-A \(2022\) \(PDF\)](#), which may be accessed by conducting a keyword "Publication 15-A" search on the IRS website: [irs.gov](https://www.irs.gov).

The **behavioral control** category determines whether the business has a right to direct and control how a worker does the task for which the worker is hired.

#### Behavioral Control Factors

- Instructions the business gives to the worker.
- Training the business gives to the worker.

The **financial control** category determines whether the business has a right to control the business aspects of the worker's job.

#### Financial Control Factors

- The extent to which the worker has unreimbursed business expenses.
- The extent of the worker's investment.
- The extent to which the worker makes the worker's services available to the relevant market.
- How the business pays the worker.
- The extent to which the worker can realize a profit or loss.

The **relationship of the parties** is determined by considering the four factors listed below.

#### Relationship of the Parties

- A written contract exists describing the relationship the parties intended to create.
- Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.
- Whether the relationship is permanent.
- The extent to which services performed by the worker are a key aspect of the company's regular business.

## Direction and control test

Under Ohio's Unemployment Compensation Law, an employment relationship generally exists unless it is shown to the satisfaction of the Director of Job and Family Services, who administers the Law, that the individual performing the services has been and will continue to be free from direction or control over that service, both under contract and in fact. An employment relationship exists when the Director determines that:

- The employer has the right to direct or control the performance of those services; and
- The worker receives remuneration for services performed.

In determining how much direction and control an employer has over a worker, the Director considers 20 factors that are similar to the IRS common law test. The presence of a factor indicates some degree of direction or control. For workers not in the construction industry, each factor's degree of importance varies depending on the occupation and the factual context in which the services are performed.

For the construction industry, if at least ten of the 20 factors are met, the worker is considered an employee for unemployment purposes. Ohio's Workers' Compensation Law uses a similar 20-factor test for construction; if at least ten factors are met, the worker is considered an employee.<sup>13</sup> The 20 factors are listed below.

Direction and Control Factors	
<ul style="list-style-type: none"> <li>▪ The worker must comply with the employer's instructions regarding when, where, and how to perform the services.</li> <li>▪ The employer requires particular training for the worker.</li> <li>▪ Services performed by the worker are part of the employer's regular business.</li> <li>▪ The employer requires that services be provided by a particular worker.</li> <li>▪ The employer hires, supervises, or pays the worker's wages.</li> <li>▪ A continuing relationship exists between the employer and the worker that contemplates continuing or recurring work, even if not full time.</li> <li>▪ The employer requires the worker to perform services during set hours.</li> <li>▪ The employer requires the worker to be devoted full time to the employer's business.</li> <li>▪ The employer requires the worker to perform services on the employer's premises.</li> <li>▪ The employer requires the worker to follow the order of work set by the employer.</li> </ul>	<ul style="list-style-type: none"> <li>▪ The employer requires the worker to make oral or written progress reports.</li> <li>▪ The employer pays the worker on a regular basis, such as hourly, weekly, or monthly.</li> <li>▪ The employer pays expenses for the worker.</li> <li>▪ The employer furnishes tools, instrumentalities, and other materials for the worker's use.</li> <li>▪ The worker has not invested in the facilities used to perform services.</li> <li>▪ The worker does not realize a profit or suffer a loss from performing the services.</li> <li>▪ The worker is not performing services for a number of persons at the same time.</li> <li>▪ The worker does not make the services performed available to the general public.</li> <li>▪ The employer has a right to discharge the worker.</li> <li>▪ The worker can end the worker's relationship with the employer without incurring liability under an employment contract or agreement.</li> </ul>

### **Right to control test**

To determine a worker's employment status under Ohio's Workers' Compensation Law, as well as other Ohio employment laws that do not use another employment test, the Ohio Supreme Court has concluded the primary test is that:

<sup>13</sup> R.C. 4123.01 and 4141.01(B)(1) and (2)(k) and Ohio Administrative Code 4141-3-05.

[I]f the employer reserves the right to control the manner or means of doing the work, the relationship is that of master and servant, while if the manner or means is left to the operative who is responsible to the employer for the result only, an independent contractor relationship exists.<sup>14</sup>

Courts determine who has the right to control on a case-by-case basis by examining certain factors, including the following:

Right to Control Factors <sup>15</sup>	
<ul style="list-style-type: none"> <li>▪ Who controls the details and quality of the work;</li> <li>▪ Who controls the hours worked;</li> <li>▪ The type of business;</li> <li>▪ The length of employment;</li> </ul>	<ul style="list-style-type: none"> <li>▪ Who selects the materials, tools, and personnel used;</li> <li>▪ Who selects the routes traveled;</li> <li>▪ The method of payment;</li> <li>▪ Any pertinent agreements or contracts.</li> </ul>

### Motor carrier exemptions from coverage

Under Ohio law, if an individual operates a vehicle in performing services for a motor carrier transporting property and meets specified factors, the individual is exempt from coverage under Ohio's Workers' Compensation Law, Unemployment Compensation Law, Overtime Law, and Minimum Wage Law.<sup>16</sup>

### ABC test

Some states use the "ABC test" or a variation of it for their employment relationship test. Under the ABC test, a worker is considered an employee unless the worker meets the three factors listed to the right, in which case the worker is considered an independent contractor.<sup>17</sup>

#### ABC Test Factors

- The worker is free from direction and control over the performance of the work.
- The worker performs the service outside the usual course of business or outside of all places of business of the enterprise for which it is performed.
- The worker is customarily engaged in an independent trade, occupation, profession, or business.

<sup>14</sup> *Gillum v. Industrial Comm.*, 141 Ohio St. 373, 374 (1943); see also *Bostic v. Connor*, 37 Ohio St.3d 144 (1988) and *Hartings v. Nat'l Mut. Ins. Co.*, 2014-Ohio-1794 (3<sup>rd</sup> Dist.), ¶ 55.

<sup>15</sup> *Bostic* at 146, citing Restatement of the Law 2d, Agency, Section 220 (1958).

<sup>16</sup> R.C. 4111.03, 4111.14, 4121.01, 4123.01, and 4141.01.

<sup>17</sup> See, e.g., 820 Ill. Comp. Stat. 405/212.