



Indiana Unemployment Insurance Misclassified Worker Frequently Asked Questions (FAQs) September 3, 2019

To view a recording of the Misclassified Worker webinar, [follow this link](#).

1. Why is correctly classifying workers as either independent contractors or employees so important?

Unemployment taxes paid by employers go into the Unemployment Insurance (UI) trust fund. This money is then used to pay UI benefits. Misclassification of workers has a negative impact on the UI trust fund, as it results in employers' not paying, or underpaying, UI taxes. Employers failing to pay the correct amount in UI taxes can lead to an insolvent, or empty, trust fund. In a recession or economic downturn many unemployed individuals need assistance, so it is important that the trust fund has enough money to pay benefits. If the trust fund becomes insolvent, then the State of Indiana must take a loan from the federal government, which will accrue interest. This interest would have to be paid for with higher tax rates on employers. Therefore, if some employers fail to pay their fair share, then all employers end up paying more.

If an employer is found to have misclassified a worker, then the employer must pay the taxes owed to the trust fund, plus interest in the amount of 1% per month for all quarters where the worker was misclassified. Additionally, a statutory penalty of 50% of the total amount of the unpaid taxes is assessed if the employer is found to have intentionally misclassified the worker.

Also, misclassifying workers can result in workers believing they are ineligible for UI payments when they are actually eligible for them and are in need of temporary assistance. Having to investigate and correct an employer's misclassification of the worker can result in unnecessary delays to the worker receiving UI payments.

2. How does Indiana law differ from federal law regarding the criteria for classifying a worker as independent contractors for unemployment insurance purposes?

Each state administers a separate UI program, adhering to broad guidelines established by federal law. IC 22-4-8-1 establishes what is known as the 1-2-3 test (also known as the "ABC" Test). This test is used to evaluate the services being performed within our jurisdiction. The test is similar to the common law rules used by the IRS for revenue reporting purposes. However, the test used by the IRS does not specifically address parts 2 and 3 of Indiana's 1-2-3 test. See the IRS website for more information about IRS requirements (www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-defined).

3. Why is issuing a 1099 or a W-9 not sufficient proof that the worker is an independent contractor?

To be classified as an independent contractor, workers must meet all three parts of Indiana's 1-2-3 test. The fact that an employer issued a 1099 or a W-9 for that worker may be considered as part of the analysis, but is not conclusive for this test.

4. What is the 1-2-3 test?

To be considered an independent contractor, all three criteria of the 1-2-3 test must be satisfied. See IC 22-4-8-1.

For a worker to be an independent contractor:

1. The individual must be free from direction and control; AND
2. The work performed must be outside the usual course of the employer's business; AND
3. The individual must be engaged in their own independently established trade, occupation, profession, or verifiable business of the same nature as that involved in the service performed.

5. What constitutes "direction and control"?

The purpose of part 1 of the test is to determine whether the worker is operating free from the control or direction of the employer. When determining whether an individual is free from direction and control, the following types of information are considered:

- Does the employer set the hours the individual will work?
- Does the employer specify the rate of pay?
- If the payment is based upon the job, does the employer reimburse the individual for expenses?
- Does the employer direct the way in which the work is performed?
- Is the individual evaluated or monitored by the employer?
- Is the individual required to comply with instructions concerning how to perform the services?
- Does the individual receive training from the employer with respect to the services performed?
- Is the individual required to personally perform the services?
- Is the individual required to perform the services at a certain place and time?
- Is there a dress policy?
- Does the individual bid for and get paid by each job?

For example, Smith owns a retail business and needs general repair work done on the property of the business. Smith enters into an agreement with Jones to complete the work. Smith leaves Jones alone to do the work. Smith and Jones agree to a deadline for the work to be completed, but Jones determines how to complete the work. There is no set schedule from Smith for Jones' work, and Smith does not instruct or guide Jones on how to complete the work in progress. In this case, the work meets part 1 of the 1-2-3 test.

6. What constitutes outside the usual course of the employer's business?

The "usual course of business" could be any business activity regularly or continually performed, no matter the scale. This is highly dependent upon the operations of each individual business. And, a business may have more than one course of business.

The individual cannot be performing a service that is normally done by this business. The services being performed by the individual are also not currently being or recently performed by an employee of the business. The individual does work that none of the business's employees do. Even if a worker functions independently, and "freelances" for other companies in addition to providing services for a business, if what that person does is part of the business's ordinary operations, then this worker is likely not an independent contractor.

Generally, the services are of a professional or technical nature, functionally distinct from all services being performed by the business. Often, the individual performs all services at their own facility.

In the case of Smith and Jones in the example above, Smith's business is a retail store selling clothes. The retail store does not perform general repair work as part of its business. As a result, the repair work that Jones performs is outside the usual course of Smith's business, and meets part 2 of the 1-2-3 test.

7. What constitutes an individual being engaged in their own verifiable business?

Either the individual must be their own independent business or the individual must be a commission-only sales agent.

For an individual to be operating their own trade or business, the business should be able to provide documentation that proves the individual is operating their own business, trade, occupation, or profession. The business should keep this documentation as part of its records. Documentation should be in the form of an invoice for the services (not a timecard), certificate of insurance for the independent business, or some similar documentation as discussed below.

For an individual to be considered a commission-only sales agent, the individual must be paid solely by commission and master of all of their own time and effort. A commission-only sales agent cannot be provided an office space, office supplies, sales materials, automobile, or travel expenses; nor may the individual be given instruction to do something for the business.

In the case of Smith and Jones in the examples above, Smith learned about Jones through a paid advertisement on a social media site. Jones regularly advertises general contract services on the internet and in the community where Jones operates. Jones is insured and invoices Smith for the repair services. The work Jones performs for Smith meets part 3 of the 1-2-3 test.

8. How can the existence of an established business be verified?

All information, circumstances, and documentation presented as evidence of an independently-established business must be weighed on its own merit. This is highly dependent upon the operations of each individual business and the evidence provided in support. Examples of such evidence include:

- A certificate of liability insurance for an individual performing roofing services for a contractor.
- A paid business listing for an individual who performs IT services.

The following items may provide supporting evidence, but are not conclusive, of an independently-established business:

- Business cards
- Invoices
- Letter-head
- Website or web advertisement
- Flyers

9. What about commissioned sales people?

Commission payments are not exempt by definition, except for commission-only licensed real estate agents and some insurance professionals (see IC 22-4-8-3(16)). The three criteria of the 1-2-3 test must still be satisfied for any other type of commissioned sales work. See IC 22-4-8-1(b)(3)(B).

10. What about certain drive away operations?

A driver is an independent contractor if:

the vehicle being driven by the driver is the commodity being delivered **AND** the driver has entered into an agreement with the party arranging for the transportation that specifies the driver is an independent contractor and not an employee. See IC 22-4-8-3.6,

11. What do I do if I realize I have been incorrectly classifying someone as an independent contractor?

Report the worker(s) immediately and adjust prior reports to include the worker(s) being misclassified back to the date the worker(s) began providing services.

12. What are the penalties for misclassifying individuals as independent contractors rather than employees?

If an employer is found to have misclassified a worker, then the employer must pay the taxes owed to the trust fund, plus interest in the amount of 1% per month for all quarters where the worker was misclassified. Additionally, a statutory penalty of 50% of the total amount of the unpaid taxes is assessed if the employer is found to have intentionally misclassified the worker.

13. What is casual labor?

A person (who is not an employee) who performs a service outside the usual course of a business, performs the service less than 24 times in a calendar quarter, and who was not considered employed for such services in the previous quarter is considered casual labor. Evidence must show what service was being performed by the individual and how many times the service was performed in each quarter. See IC 22-4-8-3(8).

14. The IRS does not require a 1099 for payments totaling less than \$600. Why do part-time workers have to be reported?

There is no exclusion in Indiana law for part-time workers. If the services provided by the individual meet the requirements to be wages, then it does not matter whether the work is full-time or part-time or whether the payment exceeds \$600.

15. In what quarter should I report employee wages?

Wages should be reported in the quarter they are paid.

16. What do I do if I suspect that a business is misclassifying workers?

Visit the DWD website at www.in.gov/dwd/2464.htm for instructions for reporting suspected worker misclassification and fraud by fax, mail, or online.

17. I own an internet job posting board and the workers do not have a written contract with the posting board, but appear to meet all of the other requirements of IC 22-6-1 for marketplace contractors. Can I consider them independent contractors?

No. There must be a written contract in place for IC 22-6-1 to apply.

18. Consumers needing services check my job posting board and then they can call the worker directly to negotiate about the service. Can we consider those workers independent contractors under the marketplace contractor provisions of IC 22-6-1?

No. For IC 22-6-1 to apply, the marketplace contractors cannot receive requests by phone, fax, or in person at a retail location. They can only receive requests via the business's web site or smartphone application.

19. We own a marketplace platform. We require our workers to work certain hours and the workers are not allowed to specify what hours they wish to work. Can we consider those individuals independent contractors?

No, for IC 22-6-1 to apply, the worker must be permitted to work any hours or schedule that the worker chooses. However, if the worker does specify hours they wish to work, the marketplace platform may require the contractor to work those hours.