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BILL ANALYSIS



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Senate Bill 645 (Substitute S-1)
Sponsor: Senator Mike Kowall
Committee: Commerce

Date Completed: 9-27-16

CONTENT

The bill would create the "Employee Classification Act" to prohibit an employer or an agent of an employer from misclassifying an employee in a report required under State law. If the misclassification resulted in a lessening or avoidance of a legal obligation to the employee, another individual, or the State, the employer or agent would be subject to the sanctions provided in the statute under which the report was required.

"Misclassify" would mean to fail to properly identify an individual as performing services in employment in an employer-employee relationship with an employer. An employer-employee relationship would be determined using the 20-factor test announced by the Internal Revenue Service in Revenue Ruling 87-41, 1987-1 C.B. 296.

BACKGROUND

For Federal employment tax purposes, the existence of an employer-employee relationship is determined based on common law rules that examine whether the person for whom services are performed has the right to direct and control the individual performing the services. The analysis focuses on whether the person for whom services are provided controls the result to be accomplished as well as the means by which it is accomplished. An employer need not actually control the manner in which the services are provided to satisfy the employee-employer test. Instead, an employer-employee relationship will be found to exist if the employer has the right to control the manner in which services are provided, regardless how the arrangement is designated.

Revenue Ruling 87-41, issued by the Internal Revenue Service in 1987, identifies 20 factors derived from previous Internal Revenue Rulings and case law that help to differentiate whether an arrangement is an employer-employee or independent contractor relationship. None of the factors provided in Revenue Ruling 87-41 is controlling, and their importance in a given situation depends on the facts and circumstances of the relationship and occupation of the parties involved. The factors are described below:

- Instructions: An individual who must comply with another's instructions about the location, time, and manner of the work is more likely an employee.
- Training: An employer-employee relationship is indicated when the person for whom services are provided indicates that the services are to be performed in a particular way, and requires an inexperienced worker to learn that method.
- Integration: Direction and control are usually present when the worker's services are integrated in the business operations.
- Services Rendered Personally: Interest in whether the services are provided personally usually indicates a degree of control over the method and result of the work.

- Hiring, Supervising, and Paying Assistants: This factor analyzes whether the person for whom services are provided or the worker hires, supervises, and pays assistants.
- Continuing Relationship: A continuing relationship, even if irregular, between the worker and person for whom services are provided generally indicates an employer-employee relationship.
- Set Hours of Work: When hours of work are set by the person for whom services are provided indicates control, and an employer-employee relationship.
- Full Time Required: An independent contractor is generally free to work when he or she chooses; a worker required to commit full-time to the business of the person for whom services are provided is restricted from other gainful employment.
- Doing Work on Employer's Premises: If the person for whom services are provided requires the services to be performed on the premises, or otherwise controls the location where services are provided, the relationship is more likely to be one of employer-employee.
- Order or Sequence Set: If the worker is not free to follow his or her own pattern of providing the service, or the person for whom services are provided has the right to set the pattern of work, then control is demonstrated.
- Oral or Written Report: Oral or written reporting requirements demonstrate a degree of control in how the services are performed.
- Payment by Hour, Week, or Month: Payment by job or straight commission generally indicates an independent contractor relationship; payment by hour, week, or month usually demonstrates an employer-employee relationship.
- Payment of Business or Travel Expenses: Where a person for whom services are provided pays for the worker's business or travel expenses and regulates the person's business activities, the worker is typically an employee.
- Furnishing of Tools and Materials: The furnishing of tools, material, or other equipment to a worker tends to show an employee-employer relationship.
- Significant Investment: A lack of investment in facilities demonstrates dependence on the person for whom services are provided, which indicates an employee-employer relationship.
- Realization of Profit and Loss: A worker who can realize a profit or risk a loss as a result of his or her services (and not simply a failure to receive payment) is generally an independent contractor.
- Working for More Than One Firm at a Time: If a worker performs more than trivial services for more than one firm, this generally indicates that the worker is an independent contractor.
- Making Services Available to General Public: If a worker makes his or her services available to the general public on a consistent basis, he or she is likely to be an independent contractor.
- Right to Discharge: If a person's or firm's right to discharge a worker generally secures his or her obedience, that relationship is likely to be one of an employee-employer.
- Right to Terminate: The right of a worker to terminate his or her relationship with the person for whom services are provided without liability generally indicates an employee-employer relationship.

Legislative Analyst: Jeff Mann

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Josh Sefton

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.