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## Workers' Compensation - Who Is An Employee

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Workers' compensation is compulsory in every state except Texas and New Jersey. But New Jersey with all its provisos is essentially compulsory; and even Texas' coverage is compulsory for some contractor classifications. Although requirements vary by state, each state statute mandates that "employers" with a specified number of "employees" provide workers' compensation benefits either through the purchase of a workers' compensation policy, as a qualified self-insurer or out of pocket.

Most states require any entity with one employee or more to provide workers' compensation benefits; only 13 states allow the employer more than one employee before protection is required (these thresholds range between three and five employees). Sounds simple, except that this calculation is complicated by each state's definition of "employee;" the definition hinges on how the person is engaged to do the work **and** the employer's legal structure.

### "Employee?"

"Employee" is generally defined as a person hired to perform certain services or tasks for particular wages or salary under the control of another (the employer); or a worker hired to perform a specific job usual and customary to the employer's business operation in exchange for money or other remuneration. "Independent contractors" (defined later) generally do not fall within the definition of an "employee" unless statute requires classification as an employee or the individual is titled an independent contractor for tax purposes but is actually an employee under workers' compensation definitions.

Two disparate views regarding the difference between an "employee" and an "independent contractor" exist, one applied by the IRS

and a broader view enforced by the insurance industry and industrial/labor commissions country-wide. Workers' compensation-defined "employees" encompass more than just hourly or salaried workers; they can include what some incorrectly deem to be independent contractors (paid without withholding - a 1099). Certain tests are applied to differentiate between a "legal" employee and a true independent contractor for workers' compensation purposes. "Test" questions include:

- Does the employer/contracting party control the individual's ways and means (i.e., does the employer tell the contractor when to show up, how to do the job, and when to leave or is the contractor free to come and go as he or she pleases);
- Are the tools and materials supplied by the employer/contracting party;
- Does the "independent contractor" work for anyone else or does he contract solely with the employer; or
- Does the "independent contractor" carry his/her own insurance?

Generally the level of control is the deciding factor when classifying a worker as an employee or an independent contractor. The higher the degree of control over the worker, the more likely he will be considered an employee rather than an independent contractor. If the employer: 1) sets the hours and methods of doing the job; 2) supplies the tools and materials; and/or 3) is the sole source of income for the contractor the higher the likelihood that the worker is an employee not an independent contractor.

This is only a representative sample of the questions that may be applied in determining employee or independent contractor status; and not all the tests have to affirmatively indicate status as an employee only a preponderance of evidence is required. Statutes step in at times and assign a worker "employee" status even when they might qualify as a true independent contractor.

Likewise, general contractors may find themselves responsible for injury to de jure employees who work directly for an uninsured subcontractor. In most states employees of uninsured subcontractors are statutorily defined as employees of the general contractor.

### **Legal Structure and Workers' Compensation**

Sole proprietorships, partnerships, LLC's, and corporations do not define "employee" or calculate the number of employees using the same methods. And most states do not differentiate between a full-time or part-time employee. Legal structure and statute dictate who is an employee and ultimately the number of employees (for statutory counting purposes).

#### ***Sole Proprietorships and Partnerships***

Sole proprietors and partners are most often exempted from the workers compensation law and do not count toward the total number of employees. In jurisdictions subscribing to this statutory precept, a three-member partnership with one other worker has, by such statute, only one employee. States that exclude sole proprietors and partners from the definition of "employee" allow these individuals to subject themselves to the law and the benefits if desired.

There are a few states that do not exempt partners from the definition of "employee" requiring coverage unless a specific rejection notice is filed. There are even a few states that require sole proprietors to be classified as an employee if there are other employees on

staff. These few states that consider sole proprietors and partners to be employees allow these individual to exclude themselves from coverage.

### ***Corporate Officers***

Conversely, corporate officers, whether compensated or not, are commonly subject to the workers compensation law and are included in the calculation of the total number of employees. Although most state statutes allow these corporate officers to exclude themselves from coverage, they are still included in the total calculation of employees regardless of their coverage status. Variations to this rule apply to not-for-profit corporations.

A corporation with three officers and one employee by statute has four employees even if the officers exclude themselves from coverage.

### ***Limited Liability Companies***

Limited liability companies (LLCs) are unique entities designed to combine some of the tax benefits of a partnership with some of the legal protections afforded corporations. Each jurisdiction dictates whether the members and managers of an LLC are treated as partners not subject to the workers compensation statute or as corporate officers and subject to the law. Members are simply the owners of the LLC and may or may not participate in the day-to-day management of the company. Members involved in the management maintain a dual role as a member and a manager.

### **Natural vs. Legal Persons**

Differences among legal structures determine who is considered the "employer" and ultimately who is an "employee." An employer is always a person, either a natural person or a legal person.

- **Natural person:** A flesh and blood human being. In workers compensation the employer is a natural person(s) in sole proprietorships and partnerships. Managers and members of an LLC are viewed as natural persons in a majority of states making these persons the employers.
- **Legal person** (a.k.a. juridical person): A legal fiction, a "person" created by statute and born with the filing of articles of incorporation. These legal persons are given the right to own property, sue and be sued. Corporations are legal persons. Several states consider LLC's a legal person making the managers and members employees.

"Employers" are not required to be covered by workers' compensation, but statute requires employers to provide workers' compensation benefits for their "employees." Thus, the sole proprietor as the "natural person" employer is excluded from the count; but the corporate officer is included as an employee because he/she works for the corporation, a "legal person."

### **Following**

General contractor relationships and statutorily created employer-employee relationships will be the initial focus of the next

commentary. Additionally, the next commentary will discuss contractually requiring lower tier contractors to provide workers compensation. This contractual requirement is not to be confused with contractual risk transfer, which will be the topic of a future article.

*(Some information for this commentary sourced from "Knowing and Managing Your Workers' Compensation Risk for Employees, Independent Contractors and Subcontractors" by Christopher J. Boggs published in the Fall 2006 edition (Volume 16 No. 1) of The Journal of Workers Compensation published by Standard Publishing Corp., Boston, MA. [www.spcpub.com](http://www.spcpub.com).)*

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