

INDEPENDENT CONTRACTOR EXEMPTION LAW FAQ SHEET

Q: What is the Independent Contractor Exemption Law and why should I care about it?

A: In 2007, Minnesota passed a law requiring that all individual/non-entity construction subcontractors performing certain trade work in Minnesota obtain an Exemption Certificate from the Minnesota Department of Labor and Industry (DLI). Although enforcement was delayed because the proposed regulations were not timely put in place, enforcement begins on January 1, 2009. For non-compliant subcontractors and the persons hiring them after January 1, 2009, the non-compliant subcontractor will convert by law to an employee of the person hiring them. Penalties for each violation are \$5,000 to the non-compliant subcontractor and \$5,000 to the person hiring them. For licensed contractors, non-compliance will also be a license violation. Reclassification to employee status also raises issues of unpaid unemployment compensation, unpaid FICA, associated penalties and interest, and increased premiums for general liability insurance and workers' compensation insurance for the person hiring the non-compliant subcontractor.

Q: What if my subcontractors are corporations, limited liability companies or partnerships?

A: The Independent Contractor Exemption Law only applies to individuals/non-entity subcontractors; therefore, entity subcontractors or subcontractors that convert to entity form by January 1, 2009 are exempt from the requirements of this law.

Q: What types of work does the Independent Contractor Exemption Law apply to?

A: The law applies to commercial and/or residential work performed by all subcontractors performing public or private building construction or improvement services. It specifically does not include landscaping services unless such services are part of the construction/improvement contract. It also arguably does not apply to other types of subcontractors, such as sales and production that do not perform trade work identified above; however, because the identification of what trades are governed by this law has become more ambiguous by the 2008 amendment to the law, we recommend our construction clients have all of their construction related subcontractors become compliant or switch to entity form.

Q: What information should I obtain from my subcontractors to determine whether they are compliant with the Independent Contractor Exemption Law or are exempt from its application?

This information is being provided as general educational materials by C. Alden Pearson, P.A. It is not specific legal advice to you and does not create an attorney-client relationship. We encourage you to obtain competent legal advice from an attorney in determining how you will be affected by the Independent Contractor Exemption Law.

A: For entity subcontractors, we recommend our clients annually obtain a Certificate of Good Standing issued by the Minnesota Secretary of State for their entity. You can access that information by going to www.sos.state.mn.us/home/index.asp?page=3. Either you can obtain that information or have your subcontractor provide it to you. You may even want to make it a requirement that your subcontractor provide it in your subcontractor agreement with them. That ensures that the entity is presently in existence (status has not lapsed or been dissolved). For partnerships, a Certificate of Good Standing may not be available. In that instance, we recommend our clients obtain a copy of the partnership's IRS Form SS-4 showing the business as a partnership and a copy of the IRS issued letter establishing the business as a partnership for tax purposes. We recommend our clients make all payments to the entity only – do not make payment to individuals or payees other than the entity or risk violating the Independent Contractor Exemption Law. We also recommend our clients obtain and keep on file a completed W-9 form identifying the entity and its federal employer identification number. Form W-9 can be obtained from the IRS at www.irs.gov/pub/irs-pdf/fw9.pdf.

For individual/non-entity subcontractors (sole proprietorships), we recommend our clients annually obtain a copy of their Independent Contractor Exemption Certificate (ICEC) issued by DLI. From January 1, 2009, unless an ICEC has been obtained from a subcontractor, we recommend our clients not hire them or they must convert the subcontractor to employee status and pay them on a W-2 basis. Be aware that some individuals operate under an assumed name or DBA but are not actually entities such as corporations or limited liability companies. Some individuals also misuse the Inc or LLC identifications in their company name when they are not actually a corporation or limited liability company. Again, to verify entities use the procedures identified above.

Q: Are there any tax withholding requirements relating to subcontractors I should know about?

A: Yes. Sole proprietor subcontractors in the building trades in Minnesota are subject to a 2% Minnesota income tax backup withholding beginning in 2009 for all amounts in excess of \$600 in a given year. This backup withholding must be done by the party paying the subcontractor. This requirement does not apply to entity form subcontractors.

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