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DOL Shakes Up Employee/Independent Contractor Distinction Again

On October 13, the Department of Labor (DOL) published a proposed rule changing the way employee or independent contractor status under the Fair Labor Standards Act (FLSA) is determined. The proposed rule would make it harder to classify a worker as an independent contractor instead of an employee. The classification of a worker as either an employee or an independent contractor is significant because the FLSA's minimum wage, overtime and recordkeeping obligations apply only to employees, not to independent contractors. The consequences of misclassifying employees as independent contractors can include liability for failure to pay minimum wage and overtime and possible criminal penalties, in addition to other penalties under state wage laws.

Previous Rule

The proposed rule would rescind the previous independent contractor rule, which was adopted in January 2021, near the end of the Trump administration. That rule uses a five-factor test to determine whether a worker is properly classified as an employee or an independent contractor, with two of those factors considered "core factors" that receive more weight than the others. The core factors are the nature and degree of the worker's control over the work and the worker's opportunity for profit or loss. The three other factors are the amount of skill required for the work, the degree of permanence of the working relationship between the individual and the potential employer, and whether the work is part of an integrated unit of production. If the two core factors point in the same direction, it is unlikely the other factors would outweigh them. With the change of administrations, the Biden administration initially stayed the enforcement of the January 2021 independent contractor rule, then withdrew it. A court later found the withdrawal to be ineffective under the Administrative Procedure Act and reinstated the rule. The new proposal would rescind and replace the January 2021 rule.

Proposed Rule

The proposed rule is generally in line with the standard that courts used to determine employee status under the FLSA before 2021. Under the proposed rule, determining whether a worker is an employee or an independent contractor under the FLSA would focus on the economic realities of the worker's relationship with the employer and whether the worker is economically dependent on the employer. A worker would be classified as an independent contractor rather than an employee if the worker is, as a matter of economic reality, in business for themself. Economic dependence does not focus on the amount of income earned or whether the worker has other income streams. Whether a worker is economically dependent on an employer is based on the totality of the circumstances. Relevant factors include:

- Whether the worker exercises managerial skill that affects the worker's economic success or failure in performing the work, such as whether the worker determines the pay for the work provided and whether the worker accepts or declines jobs. If a worker has no opportunity for profit or loss, this factor suggests that the worker is an employee.
- Whether any investments by the worker are capital or entrepreneurial in nature, for example, by increasing the worker's ability to do different types of or more work, reducing costs, or extending market reach. The worker's investments should support an independent business or serve a businesslike function in order for this factor to indicate independent contractor status.

- Whether the work relationship is indefinite in duration or continuous. This factor weighs in favor of the worker being an independent contractor when the work relationship is definite in duration, nonexclusive, project-based or sporadic.
- The employer's control over the performance of the work and the economic aspects of the working relationship. More control by the employer, such as setting the worker's schedule, supervising the performance of the work or explicitly limiting the worker's ability to work for others, suggests employee status, whereas more control by the worker suggests independent contractor status.
- Whether the work performed is an integral part of the employer's business. This factor weighs in favor of employee status when the work performed is critical, necessary or central to the employer's business.
- Whether the worker uses specialized skills to perform the work and whether those skills contribute to businesslike initiative. This factor indicates employee status where the worker does not use specialized skills or the worker depends on training by the employer to perform the work.

None of the above factors is dispositive, and none necessarily receives more weight than the others. Additional factors also may be relevant if they indicate whether the worker is in business for themself as opposed to being economically dependent on the employer for work. The DOL describes this multifactor economic reality test as offering a flexible, comprehensive and nuanced approach that can be adapted to disparate industries and occupations.

Bottom Line

The proposed rule's totality-of-the-circumstances test likely will make it more difficult for a worker to qualify as an independent contractor rather than an employee. Both under the current rule and under the proposed rule, if it becomes final, it is important for employers to examine all aspects of the relationship to make sure that workers are classified correctly. While the proposed rule is not yet final and may still change, employers may want to begin thinking about how it would affect their worker classifications. Employers should also remember that they must comply with any applicable state wage laws, which could impose additional penalties if they are violated. (For example, New Jersey's misclassification law is discussed here.) The DOL is soliciting comments regarding the proposed rule, which must be submitted on or before November 28. Comments may be submitted online or in writing to the Division of Regulations, Legislation and Interpretation, Wage and Hour Division, U.S. Department of Labor, Room S-3502, 200 Constitution Ave. NW, Washington, DC 20210.

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