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DOL Clarifies Definition of ‘Independent Contractor’ Under the FLSA

On July 15, 2015, the U.S. Department of Labor (DOL) released an Administrator’s Interpretation to provide guidance to employers on properly classifying workers as employees or independent contractors. According to the memo, *most* workers qualify as employees under the Fair Labor Standards Act (FLSA) and are entitled to workplace protections such as minimum wage, overtime pay, unemployment insurance and workers’ compensation.

The goal of the memo, according to the DOL’s Wage and Hour Division administrator, is to encourage "proactive compliance" and provide "fair notice" of the department’s intent to bolster enforcement of the FLSA.

A Matter of Definition

Under the FLSA, "employ" is defined as "to suffer or permit to work." To support the far-reaching intended coverage of the FLSA’s workplace protections, the DOL said, the term "employ" is given broad application and the FLSA is liberally construed.

The key inquiry in classifying workers is "whether a worker is economically dependent on the employer or is truly in business for him or herself." The degree of economic dependence is determined by six primary factors of the "economic realities" test. The DOL memo includes a summary of how courts have analyzed these factors and how they are applied in practice:

1. Whether the work is "integral" to the employer’s business. While no one factor is dispositive, courts have considered this factor to be "compelling." Even where the work performed is only one component of the business, consists of the same work performed by others, or is not performed on the employer’s premises, courts have found the work “integral,” indicating an

employee-employer relationship.

2. Whether a worker's "managerial skill" affects the opportunity for profit or loss. Managerial skills indicating independence include decisions related to operating a business, such as hiring, purchasing supplies and equipment, making capital investments, advertising, renting space to conduct business and managing schedules.
3. Comparison of the "relative investment" of the worker compared to the employer and related risk of loss. Investments in efforts to increase business capacity, reduce cost and expand operations to new markets suggest the worker is an independent contractor, while investments only in tools and equipment generally do not.
4. Whether a worker utilizes business skills, judgment and initiative. The use of such skills points to independent contractor status. However, special or technical skills alone are not determinative. This inquiry focuses on skills needed to run independent business operations.
5. Duration of the relationship between the worker and employer. A longer or indefinite relationship supports status as an employee. Conversely, where a worker performs on a project basis, does not continuously work for the employer, works for other employers, or does not rely on the employer as his or her primary source of income, the facts suggest independent contractor status.
6. Nature and degree of the employer's control. Notably, this "control test" is considered among the other five factors (and any other factors a court deems relevant to the situation at issue) and is not dispositive. To warrant classification as an independent contractor, the worker must *actually* exert control over the work, and any theoretical exercise of control is not part of the inquiry.

Finally, labeling a worker as an independent contractor is not determinative. Similarly, employers that label workers as "owners," "partners" or "members of a limited liability company" will not avoid scrutiny. The DOL will apply the economic realities test to determine proper classification.

What This Means to You

In light of the DOL's announcement that the default rule is to classify workers as employees, employers should carefully review the classification of workers who are labeled anything other than employees and apply the economic realities test to ensure compliance.

The proper classification of workers directly impacts employers' labor costs. Because the Family Medical Leave Act also adopts the FLSA's definition of "employ," the proper classification of workers has additional financial implications for employers.

Improper classification of a worker also can lead to penalties under the Affordable Care Act when an employer fails to accurately account for the number of its employees or fails to offer affordable health coverage to full-time employees. With respect to employee benefit plans other than health plans, the guidance makes it even more important to have proper language in plan documents excluding individuals whom the employer classifies as non-employees, regardless of any determination by government agency or court.

Looking ahead, the DOL has noted that its next initiative is to tackle retaliation for reporting misclassification. As a result, employers should review their policies and procedures to ensure that proper reporting mechanisms and anti-retaliation provisions are in place and that employees are properly trained.

The release of the DOL's interpretive memo comes two weeks after issuance of a proposed rule that would broaden federal overtime pay regulations and increase the minimum salary threshold for "white collar" exemption. The timing sends a message to employers that the DOL is vigorously working to reshape and enforce the provisions of the FLSA.