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DOL Proposes Rule to Distinguish Independent Contractors from Employees Under FLSA

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The Department of Labor (DOL) announced a proposed rule last week that will change the way in which "independent contractors" are distinguished from employees under the Fair Labor Standards Act (FLSA). The rule comes in response to calls from trade organizations and others seeking clarification on the issue after recent court decisions reached different results under the existing test, including several high-profile cases in the 'gig' economy sector.

The new test will continue to focus on the "economic reality" of the relationship between the worker and employer – to determine whether the worker is truly in business for himself or is economically dependent on the employer for work – but attempts a more linear approach aimed toward more consistent results. Under the proposed rule, new provisions would be added to DOL regulatory guidance, explaining that:

Two "core factors" will largely determine whether an individual is an economically dependent employee or economically independent contractor:

1. The nature and degree of the worker's control over the work. For example, to the extent a worker sets his own schedule, chooses his own assignments, works with little or no supervision, and is able to work for others, including competitors, he is more likely to be considered an independent contractor.

2. The worker's opportunity for profit or loss based on initiative and/or investment. To the extent a worker's initiative (such as managerial skill, business acumen or judgment) and/or management of his investment and expenses in the relationship affect his financial gain as a result of the relationship, he is more likely to be considered an independent contractor.

Three other factors may serve as guideposts in the analysis, though they are "less probative and afforded less weight" than the core factors:

1. Skill required. This factor weighs in favor of classification as an independent contractor to the extent the work at issue requires specialized training or skill that the potential employer does not provide.

2. Degree of permanence. This factor weighs in favor of classification as an independent contractor to the extent the work is more definite in duration or sporadic (as opposed to being indefinite or continuous).

3. Integration into employer process. This factor weighs in favor of an individual being an independent contractor to the extent his work is segregable from the employer's process in producing goods or providing services.

While these additional factors may be helpful in some instances, the regulations expressly state that they "are highly unlikely, either individually or collectively, to outweigh the combined weight of the two core factors."

The actual practice of the parties involved – on behalf of both the worker and the employer – is more persuasive than what is contractually required or possible.

Notably, this rule would only change the DOL's interpretation of independent contractors for wage and hour purposes, such as minimum wage requirements, overtime, and the maintenance of employee records. Interpretations by other agencies at the state and federal level are not affected. For example, the Internal Revenue Service has long used, and will continue to use, its own test in distinguishing employees from independent contractors for employer tax withholding and related purposes. The proposed rule will similarly have no effect on the classification of independent contractors under various state laws, including workers' compensation statutes, unemployment benefits, and, in some states (such as California), state wage and hour requirements.

The DOL has fast-tracked the implementation of this rule, which is expected to happen sometime prior to January 20, 2021. It will first be published in the Federal Register in the coming weeks, triggering a 30-day comment period during which the public can provide comments on all aspects of the proposed rule at regulations.gov. The DOL will then have approximately two months to finalize the regulations based on comments received.

In anticipation of the rule change, employers should consider auditing their current classifications with respect to independent contractors, particularly in light of the trend by states to codify their own definition and corresponding tests. Misclassification could result in claims on an individual or class

basis with potentially severe consequences, particularly for employers operating in multiple states and/or those with a large population of contracted workers.

Contact us

If you have questions regarding the Department of Labor's proposed rule, contact Erik Eisenmann or your Husch Blackwell attorney.