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DOL Says Most Workers Are Employees

Yesterday, the DOL's Wage and Hour Division issued guidance on classifying workers as employees or independent contractors under the Fair Labor Standards Act. Applying an economic realities test, the Administrator's Interpretation takes an expansive view of who is an employee. Employers that utilize independent contractors will want to review the economic realities of their working relationships and worker classifications in light of this guidance.

Background

The Fair Labor Standards Act (FLSA), enforced by the DOL's Wage and Hour Division (WHD), establishes minimum pay standards for public and private sector employers. Employees covered by the FLSA must be paid at least the federal minimum wage and, in most cases, overtime at time and one-half of the employee's regular rate of pay for all hours worked in excess of 40 in any workweek. Because the FLSA's minimum wage and overtime provisions apply only to workers who are "employees," they do not extend to "independent contractors." In addition to wages, other benefits and protections — such as coverage under employee benefit plans, family and medical leave, unemployment insurance and safe workplaces — similarly depend on the existence of an employment relationship.

Worker classification — or employee misclassification — continues to fuel lawsuits under the FLSA and state laws. As the use of independent contractors and other non-traditional arrangements (including interns) has grown in the 21st century "on-demand" economy, employee misclassification has been a growing concern for both the federal and state governments. The WHD is working with the IRS and has entered into information sharing and\or coordinated enforcement agreements with more than 20 states to address worker misclassification.

The Administrator's Interpretation

On July 15, the WHD issued Administrator's Interpretation No. 2015-1 — "The Application of the Fair Labor Standards Act's 'Suffer or Permit' Standard in the Identification of Employees Who Are Misclassified as Independent Contractors." The interpretation discusses FLSA definitions and the scope of employment relationships covered by that law.

> **Comment.** Because the federal Family and Medical Leave Act (FMLA) adopts the FLSA's definition of "employee" (any individual employed by an employer), the guidance has potential implications for leave administration as well.

Economic Reality Factors

The FLSA generally defines "employ" as including "to suffer or permit to work." This broad definition of employment covers work that the employer directs or allows to take place. Over the years, courts have held that an employer suffers or permits an individual to work if, as a matter of economic reality, the individual is dependent on the employer's business. While there is no bright-line test, the guidance discusses how businesses should evaluate employee or independent contractor status using a multi-factor economic realities test.

Whether a worker is an employee for purposes of the FLSA hinges on the economic relationship between the business and the worker. In analyzing that relationship, the WHD will typically consider the following six factors:

- The extent to which the work performed is an integral part of the employers' business
- The worker's opportunity for profit or loss, depending on his or her managerial skill
- The extent of the relative investments of the employer and the worker
- Whether the work performed requires special skills and initiative
- The permanency of the relationship
- The degree of control exercised or retained by the employer

In analyzing whether a worker is an employee or an independent contractor, no one factor will be determinative. Rather, the factors are considered in their totality. Essentially, the status determination hinges on whether the worker is in business for him or herself or is economically dependent on the employer.

> **Comment.** Tests for determining employee status vary. The IRS, for example, employs a common law control test and considers about 20 factors that focus on the employer's control over the worker rather than the broader economic realities. Importantly, the IRS test is used to determine employee status for purposes of the Affordable Care Act.

Determining Whether a Worker is an Independent Businessperson or Economically Dependent on the Employer

The guidance discusses each of the six factors that WHD will use to determine employee status and provides examples to illustrate how the factors would be applied in making that determination.

1. Is the Work an Integral Part of the Employer's Business? A worker is more likely to be economically dependent on the employer if the work he or she performs is integral to the employer's business. Work can be integral to a business even if it is just one component of the business and/or is the same as or interchangeable with many others' work. Recognizing the role telework and flexible work schedules now play, the guidance makes clear that work may be integral regardless of where it is performed.

   Example: Work performed by carpenters is an integral part of a construction company's business to frame residential homes. In contrast, work performed by a software developer that creates programs to assist the company in job scheduling and tracking bids and material orders is not integral to the business.

2. Does the Worker's Managerial Skill Affect the Worker's Opportunity for Profit or Loss? Whether a worker is in business for him or herself largely depends on whether the worker has not only the potential to make a profit but also to experience a loss based on his or her managerial skill — in the current job or in the future. Neither an individual's ability to increase earnings by working more hours nor the amount of work available from the employer factor into the analysis.

   Example: A worker who provides cleaning services to corporate clients through a cleaning company, and does not independently schedule assignments, solicit additional work from clients, advertise, or try to reduce costs would be an employee. In contrast, a worker who exercises managerial skill in providing those services (such as producing advertising, negotiating contracts, deciding which jobs to perform and when necessary, hiring helpers and recruiting new clients) would likely be an independent contractor.

Proposed Overtime Changes

The guidance comes on the heels of the DOL's proposed expansion of the FLSA's overtime requirement to an estimated 5 million more employees. On June 30, the DOL unveiled proposed regulations that would significantly expand eligibility for overtime pay by more than doubling the salary threshold for the FLSA's so-called "white-collar" exemptions. (See our **June 30, 2015** *FYI Alert*.)

3. How Does the Worker's Relative Investment Compare to the Employer's Investment? To support an independent contractor classification, the worker should make more than a relatively minor investment — and undertake some risk — in support of the business (and not just a job). The guidance notes that a worker's investment in tools and equipment, for example, must be significant in nature and size relative to the employer's investment in the overall business — and not simply for the purpose of performing specific work for the employer — to support a finding that the worker is an independent businessperson.

   Example: A worker providing cleaning services for a cleaning company that provides her with insurance, a vehicle to use, and equipment and supplies would be an employee even though she signed a contract stating she is an independent contractor and receives a Form 1099-MISC rather than a W-2 each year. In contrast, a worker providing cleaning services who sometimes works for a cleaning company but uses her own commercial vehicle, material, and equipment, and hires helpers to perform larger jobs would likely be an independent contractor.

4. Does the Work Performed Require Special Skill and Initiative? The worker's business skills, judgment and initiative — rather than technical skills — factor heavily in the determination of independent contractor status. The fact that workers use technical or specialized skills in performing their jobs does not necessarily indicate that they are in business for themselves.

   Example: A highly skilled carpenter who provides services for a construction firm is likely an employee where the carpenter makes no independent judgments on the job site other than those involving his particular tasks and simply provides skilled labor. In contrast, a highly skilled carpenter who provides a specialized service for various construction companies (such as made-to-order cabinets) may be an independent contractor if he markets his services, determines when and the quantity of materials to order and decides which orders to fill.

5. Is the Relationship between the Worker and Employer Permanent or Indefinite? Although a worker is likely an employee if the worker's relationship with the employer is either permanent or indefinite, independent contractor status cannot be presumed if the relationship is neither permanent nor indefinite. Rather, the guidance cautions, the reason for the lack of permanence or indefiniteness should be carefully reviewed to determine whether it indicates that the worker is running an independent business.

   Example: An editor who works for a publishing house edits the publisher's books in accordance with its specifications, using its software. In contrast, an editor who works with and markets her services to different publishing houses, negotiates different rates, and decides which jobs to accept would likely be an independent contractor.

6. What is the Nature and Degree of the Employer's Control? As with the factors discussed above, the extent to which the worker is economically dependent on the employer or is an independent businessperson depends on the how much control the worker has — and exercises — over meaningful aspects of the work. As the guidance makes clear, a relatively flexible working arrangement or schedule — increasingly commonplace due to technological advances — does not make a worker an independent contractor. The guidance cautions that classifications cannot be determined on the basis of the control factor, and confirms that the FLSA covers workers who are economically dependent on the employer even if the employer does not exercise the requisite control.

   Example: A registered nurse who provides skilled nursing care in nursing homes is listed with a registry to be matched with clients. The registry interviewed the nurse and provided certain training. The registry sends the nurse a weekly listing of potential clients, and sets wage ranges and hour restrictions. The nurse must inform the registry if she is hired by a client and if she will miss any scheduled work. Because of the degree of control exercised by the registry, the nurse is likely an employee. In contrast, the nurse is likely to be an independent contractor if she is free to call and work for as many clients as she wishes, negotiates her own wage rate and sets her own schedule.

Other Implications of Misclassification

Businesses are not required to withhold taxes for independent contractors. Misclassifying employees as independent contractors results in lower tax revenues, as well as reduced employer contributions to Social Security, Medicare, state unemployment insurance and workers' compensation funds.

Employers face potential liability for misclassified workers who, if properly classified as employees, might be entitled to benefits under employer-sponsored benefit programs. Changes to workers' status could also have ACA implications and impact various nondiscrimination tests.

In Closing

The WHD concludes that most workers are employees under the FLSA's broad definition of employment. In light of the agency's expansive view and continued focus on employee misclassification, employers that utilize independent contractors should review the economic realities of their working relationships to ensure that they have properly characterized them.

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