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### Proposed DOL rule clarifies FLSA's independent contractor test

On September 25, the DOL issued a proposed rule to clarify when a worker is an employee covered by the Fair Labor Standards Act or an independent contractor. Adopting an “economic reality” test that focuses on two core factors, the proposal would simplify worker classification under federal wage law.

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#### Background

Unlike employees, independent contractors (including many gig economy workers) are not entitled to minimum wage or overtime pay under the Fair Labor Standards Act (FLSA). Because the federal wage law does not clearly define who is an “employee,” courts have applied divergent standards using different tests in deciding whether an employer-employee relationship exists.

#### Proposed rule

On September 25, the DOL proposed — for the first time — a rule to clarify when a worker is an employee or independent contractor under the FLSA. Rather than the common law “right to control” test used by the IRS, the DOL adopted an “economic reality” test to determine worker status under federal wage law. It aims to simplify worker classification by sharpening the inquiry into an individual’s economic dependence through five distinct factors — two “core factors” and three “guidepost” factors.

**Buck comment.** Because the DOL’s proposed rule applies only in the context of the FLSA, it would not affect worker classifications under other federal (e.g., IRS, NLRB, or OSHAct) or state laws, such as California’s AB 5 that requires using the three-part “ABC” test to determine employee vs. independent contractor status under its Labor Code.

#### Economic reality test

Under the proposed economic reality test, the DOL would consider whether a worker is in business for themselves or is economically dependent on another entity for work. The DOL’s proposed

framework focuses on two core factors in determining whether workers are independent contractors or are FLSA-covered employees eligible for federal minimum wage and overtime protections:

- The nature and degree of the worker’s control over the work
- The worker’s opportunity for profit or loss based on initiative or investment

While these two are the primary and most probative factors in determining an individual’s degree of economic dependence, three other factors may serve as additional guideposts. However, they are not as significant and would be entitled to less weight than the core factors.

### Core factors

Under the proposed rule, the first core factor — the nature and degree of the individual’s control over the work — would weigh in favor of an independent contractor relationship to the extent that the worker exercises substantial control over key aspects of performing the work (such as setting their own work schedule, choosing assignments, working with little or no supervision, and being able to work for others, including a potential employer’s competitors). Conversely, that factor would indicate employee status to the extent that the potential employer exercises substantial control over key aspects of the work, including requiring that the individual work for it exclusively.

Further, the proposed rule clarifies that requiring an individual to comply with specific legal obligations or satisfy other contract terms (such as compliance with health and safety standards) would not make employee status more or less likely under the FLSA. Nor would a requirement to carry insurance, meet agreed-on deadlines or quality control standards, or satisfy other similar terms that are typical of contractual relationships between businesses tip the scales toward employee status. Rather, the parties’ actual practice would be more relevant in assessing the level of control than what may be contractually or theoretically possible.

The second core factor — the worker’s opportunity for profit or loss based on initiative or investment — would weigh in favor of an independent contractor relationship if the worker has an opportunity for profit or loss either through the exercise of personal initiative (including managerial skill or business acumen) or managing investments or capital expenditures on, for example, helpers, equipment, or materials.

According to the DOL, if the combined weight of these two core factors — control and opportunity for profit or loss — point toward the same classification, they are substantially likely to outweigh the other factors. If not, the DOL would then look to three “guidepost” factors.

### Other factors

Three “guidepost” factors that may be considered in the worker classification analysis but would be given less weight than the core factors are:

- The amount of skill required for the work

- The degree of permanence of the working relationship between the worker and the potential employer
- Whether the work is part of an integrated unit of production

Notably, the first of these factors focuses on the amount of skill required rather than on aspects of control. Because the ability to work for others is taken into account as part of the control factor, the second factor looks to the duration rather than the exclusivity of the relationship between the worker and employer when evaluating the permanence factor. When the working relationship is by design definite in duration or sporadic, the permanence factor would weigh in favor of an independent contractor relationship. Conversely, a working relationship that is indefinite in duration or continuous would suggest employee status.

Finally, the proposal would change the “integral” factor to the “integrated unit” factor, shifting the focus from the extent to which the services rendered are a central or integral part of the principal business to whether the work “is a component of a potential employer’s integrated production process, whether for goods or services.” This factor weighs in favor of employee status where a worker depends on the overall process to perform work duties. As the DOL clarifies, the “overall production process need not be a physical assembly line, but it must be an integrated process that requires the coordinated function of interdependent subparts working towards a specific unified purpose.” Examples may include a programmer who works on a software development team or an individual who works closely with employees and performs identical or closely interrelated tasks, such as providing office cleaning services as part of a team of employees.

## In closing

Public comments are due on or before October 26 as the DOL moves toward finalizing the rule before year end. If finalized, the proposed rule would provide greater clarity in applying economic reality factors when determining employee or independent contractor status under the FLSA. While it focuses on economic dependence, businesses should be mindful that states and federal agencies may use different tests and make sure to analyze their relationships with workers and service providers under all applicable laws.

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