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## For Your Information<sup>®</sup>

### **DOL's new worker classification rules: Do you know who your employees are?**

On January 10, the DOL's Wage and Hour Division issued a final rule for determining whether a worker is classified as an employee or an independent contractor for purposes of the Fair Labor Standards Act. The new rule replaces more business-friendly regulations with a revised economic realities test that tips the scales toward finding employee status.

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#### Background

Independent contractors — unlike employees — are not entitled to wage protections the Fair Labor Standards Act (FLSA) provides (e.g., minimum wage and overtime pay requirements). While the FLSA broadly defines the terms “employer” and “employee,” it does not define the term “independent contractor.”

In September 2020, the DOL proposed — for the first time — a rule to clarify when workers are employees or are independent contractors in business for themselves under the FLSA. Aiming to simplify worker classification, the agency proposed a five-factor “economic reality” test for determining employee status. The analysis elevated two “core factors” — the nature and degree of the worker’s control over the work, and the worker’s opportunity for profit or loss based on initiative or investment — as most probative of proper classification and gave the other factors less weight. (See our [September 29, 2020 FYI](#).)

In the final days of the Trump administration, the DOL issued an independent contractor final [rule](#) that adopted the proposed test effective March 8, 2021. Upon taking office, the Biden administration first delayed the effective date and then withdrew the rule altogether. Following legal challenge, a Federal district court vacated those actions and reinstated the 2021 rule retroactively to March 2021. (See our [May 19, 2021 FYI](#).)

In October 2022, the DOL commenced rule-making to rescind and replace the 2021 independent contractor rule “to be more consistent with judicial precedent and the Act’s text and purpose.” For analyzing when workers would be considered independent contractors, the DOL proposed a six-factor “economic realities” test with a primary focus on whether the workers are dependent on the employer for work or are in business for themselves. On January 10, the DOL issued a final rule that largely mirrors the proposed rule. The final rule is slated to replace the 2021 rule effective March 11.

## Independent contractor final rule

The final rule adopts a multifactor economic realities test and returns to the pre-2021 totality-of-the-circumstances approach to determining whether a worker is properly classified as an employee or as an independent contractor. Classification under the final rule depends on “whether the worker is economically dependent on the potential employer for work.” According to the DOL, this approach is “more consistent with the FLSA as interpreted by longstanding judicial precedent” and will reduce the risk of misclassification while providing “greater consistency” for businesses that engage with individuals who are in business for themselves.

**Buck comment.** DOL FAQs make clear that the final rule applies only to the FLSA and would not affect worker classification under other federal, state or local laws that use different standards to classify employees, such as the Internal Revenue Code and the National Labor Relations Act. Neither would it impact state or local wage and hour laws that do not follow the FLSA for determining employee status, such as California’s “ABC” test for classifying workers.

### Six-factor test

The final rule implements a six-factor test for worker classification and provides detailed guidance on how the following factors should be applied to analyze employee or independent contractor status under the FLSA: (1) the opportunity for profit or loss depending on managerial skills; (2) investments by the worker and the employer; (3) degree of permanence of the work relationship; (4) nature and degree of control; (5) extent to which the work performed is an integral part of the employer’s business; and (6) specialized skill and initiative.

Unlike the 2021 rule that focused on the exercise of control over the worker and the worker’s opportunity for profit and loss, the final rule provides that no one factor may determine worker status. Rather, all six factors have equal weight and additional factors may be considered if they “are relevant to the overall question of economic dependence.”

**Buck comment.** The final rule is expected to make it more difficult for employers generally to classify workers as independent contractors. However, companies that rely heavily on subcontracting, services agreements, or so-called gig workers as part of their business model may face greater misclassification risk.

While the final rule closely tracks the proposed rule, it includes important clarifications and refinements with respect to several of the factors to be used in analyzing worker classification,

including profit and loss, relative investments, the nature and degree of control, specialized skill, and tools and equipment.

### **Profit and loss**

Under the proposed rule, a worker does not have an entrepreneurial opportunity for profit or loss when they can earn more money just by working more hours or taking more jobs. The final rule clarifies that a worker's decision to earn more by working more when paid a fixed rate per hour or per job generally does not reflect the exercise of managerial skill indicating independent contractor status.

### **Investments**

The final rule clarifies that the Department will compare the relative — rather than the absolute — investments by the worker and the potential employer to determine whether the worker is making “similar types of investments” that “suggest the worker is operating independently.”

### **Control**

Unlike the proposed rule, the final rule allows businesses to take steps to comply with legal requirements without affecting the worker's classification. But measures that go beyond legal compliance such as quality control or customer service standards may indicate control and affect the classification analysis.

### **Specialized skill**

The final rule clarifies that specialized skill alone does not indicate that the worker is an independent contractor. What is relevant is whether the worker uses specialized skill “in connection with business-like initiative.”

### **Tools and equipment**

The final rule clarifies that a potential employer's requirement that a worker buy tools and equipment to perform a specific job does not indicate independent contractor status.

## **In closing**

The DOL's new independent contractor rule aims to reduce the risk of worker misclassification. Businesses should review the new rule carefully, evaluate their classification practices, and identify any changes that may be needed. Legal challenges have been filed but, unless the courts act, the final rule will take effect on March 11.

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