New Year, New Independent Contractor Test

What the U.S. Department of Labor's Final Rule Means for Worker Classification in 2024 & Beyond

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On January 10, 2024, the U.S. Department of Labor (DOL) unveiled its latest rule on the classification of workers as employees or independent contractors under the Fair Labor Standards Act (FLSA), marking a shift from the 2021 Independent Contractor Rule (ICR). The final rule is effective beginning March 11, 2024, and aims to mitigate the potential misclassification of employees as independent contractors while establishing a consistent framework for businesses engaging with self-employed individuals.

Key Distinctions from the 2021 Rule: Under the Trump administration, the 2021 ICR consisted of a tiered test which identified five economic reality factors, two of which were designated as "core factors" to guide the independent contractor inquiry. These core factors included: (1) the nature and degree of control over the work; and (2) the opportunity for profit and loss. The 2021 ICR also listed three other factors that could be considered in the analysis, including:

- The amount of skill required for the work;
- The degree of permanence of the working relationship between the individual; and
- The potential employer and whether the work is part of an integrated unit of production.

While bearing resemblances to the 2021 ICR, the final rule introduces several important changes. Notably, it broadens its applicability to workers across various industries and reverts to a totality-of-the-circumstances economic reality test which encompasses six factors instead of the previous five. These factors include:

(1) Opportunity for Profit or Loss Depending on Managerial Skill: This factor considers a worker's ability to earn profits or incur losses through their own independent efforts. Facts that suggest independent contractor status include a worker's ability to negotiate their own pay, decide to accept or decline work assignments, hire their own workers, purchase their own work equipment, or advertise and market their own services.

(2) Investments by the Worker and the Potential Employer: This factor examines whether the worker makes capital or entrepreneurial investments in their own work and compares the worker's investments to the company's investments in its business to determine whether the worker is making similar types of investments in their work. If the worker is making similar investments to the company, this suggests that the worker is operating as an independent contractor.

(3) Degree of Permanence of the Work Relationship: This factor examines the nature and duration of the work arrangement, including whether the work is sporadic or project-oriented with a predetermined end date. It also considers whether the worker may decide to take on multiple different jobs. If so, this suggests that the worker is an independent contractor.

(4) Nature and Degree of Control: This factor examines the company's control over various aspects of the work relationship, including hiring, firing, scheduling, pay rates, supervision, discipline, and the ability to preclude the worker from working for others. Greater control supports an employee classification. The DOL clarifies that actions taken by a company solely for compliance with laws and regulations do not indicate an employment relationship. However, if these actions extend beyond mere compliance with specific laws or regulations, this can impact the overall analysis.

(5) Extent to Which the Work Performed is an Integral Part of the Potential Employer's Business: This factor assesses whether the work performed by the worker is "critical, necessary, or central" to the company's principal business, which, if so, would suggest employee classification. The DOL emphasizes that the importance of this factor lies not in whether the worker themself is integral to the business, but rather in the significance of the work they undertake in relation to the overall operations of the company.

(6) Skill and Initiative: This factor considers whether the worker uses specialized skills, business planning, and independent efforts to perform the work and support or grow a business. The mere possession of specialized skills does not automatically classify a worker as an independent contractor. However, if the worker employs specialized skills in conjunction with entrepreneurial initiative, it indicates independent contractor status.

Importantly, no single factor carries predetermined weight, and additional considerations may prove relevant to discern whether a worker operates in business for themselves (i.e., as an independent contractor) or is economically reliant on the employer (i.e., as an employee under the FLSA).

Interaction with Other Laws: It's crucial to recognize that the final rule exclusively revises the DOL's interpretation under the FLSA and does not alter worker classification under other federal, state, or local laws. Laws such as the Internal Revenue Code and the National Labor Relations Act possess distinct statutory language and legal precedents governing employee-independent contractor differentiations overseen by separate federal agencies. Similarly, state wage and hour laws, including those utilizing an "ABC" test like California, remain unaffected.

Practically speaking, it will be harder for a worker to qualify as an independent contractor under the new test as compared to the 2021 ICR. Accordingly, employers should consider auditing their independent contractor relationships to confirm that their documentation and how those relationships operate in practice minimize the risk of worker misclassification claims.

For those wanting more information on this and other employment law issues, please consider attending Barran Liebman LLP's seminar "Navigating Hot Topics in Wage & Hour Law: Tip Pooling, Joint-Employer Status & Overtime" on March 20, 2024.

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