DOL releases new proposed independent contractor rule

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On September 22, 2020, the US Department of Labor (DOL) unveiled a new proposed rule that would, if finalized, codify and clarify the appropriate test for determining whether a worker should be classified as an employee or independent contractor under the Fair Labor Standards Act (FLSA). The FLSA is a federal law that requires covered employers to pay nonexempt employees at least the federal minimum wage for every hour worked, overtime for every hour worked over 40 in a workweek, and to keep certain records about its employees. A worker who is an independent contractor is not an "employee" under the FLSA.

Below we summarize the new proposed rule and provide organizations three key takeaways as the DOL opens the rule to public comment.

Summary of proposed rule

The FLSA does not define "independent contractor," but it does define "employer" as "any person acting directly or indirectly in the interest of an employer in relation to an employee," 29 U.S.C. 203(d), "employee" as any "individual employed by an employer," *id*. at 203(e), and "employ" as "includ[ing] to suffer or permit to work," *id*. at 203(g). For years, courts and the DOL have interpreted the phrase "suffer or permit" as requiring an evaluation of the worker's economic dependence on the putative employer using a multifactor test commonly referred to as the "economic reality" test. Under the economic reality test, no factor is dispositive and the ultimate inquiry is whether the worker is dependent on a particular organization for work (and is thus an employee) or is in business for him or herself (and is thus an independent contractor).

The DOL has never promulgated a generally applicable regulation addressing the economic reality test. Instead, over the years, the test has been cited and explained in different ways by a patchwork of subregulatory guidance and court decisions. This history, according to the DOL, has produced a test that is unclear, unwieldy, and ultimately unhelpful to the regulated community. The DOL's new proposed rule seeks to clarify the economic reality test and codify its application in regulation. To that end, the DOL proposes that the economic reality test be comprised of five factors, the first two of which are "core" and "highly probative" to the inquiry: (1) the nature and degree of the individual's control over the work (core factor); (2) the opportunity for profit or loss (core factor); (3) the skill required to perform the work; (4) the permanence of the working relationship; and (5) whether the services provided are an integral part of the business. If the first two factors are indicative of a particular outcome, the DOL states it is highly likely those factors would outweigh the other factors. The DOL also states that the actual experience of the worker, and not just what the putative employer says the worker does, will be an important consideration.

Key takeaways

Public Comment / Fast-Track. The DOL has put the proposed rule on a fast-track, which means it may be finalized

by January. Once published on the Federal Register, which is expected to happen in the coming weeks, stakeholders will have 30 days to comment on the proposed rule. This leaves the DOL two months to process the comments and finalize the regulation.

Impact on State Wage/Hour Rules. Some states, such as California, have laws that place more stringent limitations on who may qualify as independent contractors. Because the FLSA does not preclude states and localities from establishing broader wage and hour protections than those under the FLSA, workers in some states may be unaffected by this proposed rule.

Multiple Standards for Employment Status. As noted above, some states have more stringent standards for determining employment status under state wage/hour laws. Adding to the complication and challenge for employers, other laws that make distinctions between employees and non-employees may use different tests and emphasize different factors. For example, the IRS uses a test that is different from (although partially overlapping) the proposed DOL framework to determine employment status for purposes of income tax withholding and payroll taxes. Other laws and government agencies at the state and federal level (such as workers compensation and unemployment benefits laws) can use similar but distinct standards. Thus, the designation of an individual worker as an independent contractor can be a determination with a variety of legal consequences under a variety of different laws.

Audit. This new proposed rule and changing developments at the state level can cause confusion as to the appropriate test for employers. Organizations with multi-state operations are particularly vulnerable to the changing legal and regulatory landscape. Employers should consider auditing their existing independent contractor population to ensure alignment with all applicable laws and regulations. Misclassification claims can result in hefty penalties and damages if proven.

To learn more about the DOL's proposed rule, or for assistance navigating the complicated patchwork of independent contractor rules at the state and federal level, please reach out to one of the key contacts listed here or any member of the Dentons Employment & Labor team.

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