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HOW THE DOL'S RULE CHANGES THE STANDARD FOR CLASSIFYING INDEPENDENT CONTRACTORS

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The US Department of Labor ("DOL") has modified the standard for classifying independent contractors in response to recent trends. This change will take effect March 14.

Over the past decade the DOL has put significant investigative resources behind investigating organizations with independent contractors. Unlike hourly employees, independent contractors do not receive minimum wages or overtime, which has historically led to some organizations, either accidentally or intentionally, improperly identifying certain categories of workers as independent contractors. This conduct caused the DOL to not only closely investigate such relationships, but to also err on the side of finding that certain workers categorized as independent contractors were, in fact, employees, and therefore entitled to back wages.

The DOL's modified standard analyzes whether an "independent contactor," "self-employed" or "freelancer" is truly independent, or not economically dependent on an employer for work, but what does this mean? The standard applies a totality-of-the-circumstances analysis of the economic realities test, which looks at six factors for determining whether a worker is an independent contractor or employee. Each factor does not have a predetermined weight and is considered in view of the economic reality of the whole activity.

What are the Six Factors?

1. Opportunity for Profit or Loss Depending on Managerial Skill

Does the worker exercise managerial skill in the manner in which the work is performed that will affect the worker's economic success or failure in performance of the project?

Employee – if the worker has no opportunity for a profit or loss, then this factor will lean toward finding the worker is an employee.

Independent Contractor – if the worker can accept and decline jobs; makes decisions to hire others, purchase materials and equipment and/or rent space; or engages in marketing and advertising efforts to expand their work, then this factor will lean toward finding the worker is an independent contractor.

2. Investments by the Worker and the Potential Employer

Are investments made by the worker capital or entrepreneurial in nature?

Employee – if the worker's investments relate to tools and equipment to perform specific jobs, this is not evidence of a capital investment, and this factor will lean toward finding the worker is an employee.

For example, a graphic designer who works for a firm that provides software, a computer and office space, and occasionally uses the worker's preferred drafting tools for certain jobs, will indicate employee status.

Independent Contractor – if the worker's investments support an independent business or function to increase the worker's ability to do different types of or more work, reduces costs or extends market research, then this factor will lean toward finding the worker is an independent contractor.

For example, in comparison, when a graphic designer purchases the worker's own software, computer, and drafting tools and invest in marketing services, then those actions will indicate independent contractor status.

3. Degree of Permanence of the Work Relationship

Is the nature of the work relationship indefinite in duration or continuous?

Employee – if the worker's relationship is continuous or regularly occurring for fixed periods of work, then this factor will lean toward finding the worker is an employee.

Independent contractor – if the worker's relationship is definite in duration, non-exclusive, project-based or sporadic, then this factor will lean toward finding the worker is an independent contractor.

What if the worker is seasonal or temporary? If the temporary nature of the work is unique to the business, i.e. a retail worker around the holidays, then the worker will still likely be an employee. If the temporary nature is based on the worker's own independent initiative, then the worker will likely be an independent contractor.

4. Nature and Degree of Control

- Does the employer exercise control over the worker's schedule?
- Does the employer supervise the performance of the worker's work?

- Does the employer set the price or rate of the worker's services?
- Does the employer limit the worker's ability to work for others or place demands on the worker's time that prevents the worker from working for others?

Employee – if an employer sets the employee's work schedule, prohibits workers from working outside of the employer[MB1] supervises the workers with consistent check-ins, then this factor will lean toward a finding the worker is an employee.

Independent Contractor – if a worker has the ability to choose when and how often the worker works, to set prices for the worker's services, provide services without direction or supervision from the employer and can provide similar services at competitors of the employer, then this factor will lean toward a finding the worker is an independent contractor.

5. Extent to Which the Work Performed is an Integral Part of the Potential Employer's Business

Is the worker's work critical, necessary or central to the employer's principal business?

Employee – if the worker is involved in making the product or providing the service that is integral to an employer's business, then this factor will lean toward finding the worker is an employee.

Independent Contractor – if the worker has an independent business that would exist with or without the employer, then this factor will lean toward finding the worker is an independent contractor.

6. Skill and Initiative

Does the worker use specialized skills to perform the work and do those skills allow the worker to initiate a working relationship independently?

Employee – if a worker does not bring specialized skills and depends on the employer for training to perform the work, then this factor will lean toward finding the worker is an employee.

Independent contractor – if a worker brings specialized skills to the work relationship and those skills allow the worker to independently contribute to the employer's business, then this factor will lean toward finding the worker is an independent contractor.

In sum, economic dependence is the ultimate inquiry, meaning that a worker is an independent contractor as opposed to an employee if the worker is, as a matter of economic reality, in business for themself. These factors are tools or guides to conduct the totality-of-the-circumstances analysis to determine economic dependence. Additional factors may also be considered if they are relevant to the overall question of economic dependence.

What this means for Employers:

The FLSA generally requires covered employers to:

- **Overtime**. Employers must pay nonexempt employees at least the federal minimum wage for all hours worked and at least one and one-half times the employee's regular rate of pay for every hour worked over 40 in a workweek.
- **Maintenance of Employee Records and Anti-Retaliation.** The Act also requires covered employers to maintain certain records regarding employees and prohibits retaliation against employees who are discharged or discriminated against after, for example, filing a complaint regarding their pay.

These protections do not apply to independent contractors, so an employer wants to make sure that its workers are properly classified so it is appropriately abiding by the FLSA's protections.

Related Practices

Labor and Employment

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