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U.S. Department of Labor Announces Final Rule for Classifying Workers as Independent Contractors Under the FLSA

By Lee Levin & John Waters

On January 7, 2021, the U.S. Department of Labor published its Final Rule ("Rule") for classifying workers as independent contractors under the Fair Labor Standards Act ("FLSA"), which Rule will take effect on March 8, 2021. The Rule provides a tool for employers to distinguish between independent contractors (which are not covered by the FLSA) and employees (which, unless an exemption applies, are covered by the FLSA's minimum wage, overtime pay and record-keeping requirements).

The Rule adopts an "economic reality" test to determine whether a worker is in business for herself or himself (in which case the worker would be classified as an independent contractor) or economically dependent on the employer (in which case the worker would be classified as an employee).

In order to apply the economic reality test, the Rule sets forth two "core factors" that are considered most probative of whether a worker is in business for herself or himself or economically dependent on their employer:

- **The nature and degree of control over the work**. For instance, does the worker have control over the key aspects of performing their services such as by establishing their own schedule, selecting their own projects and workers who assist in performing such services (who may be competitors of the employer). If worker has control over such key aspects of performance, then this factor weighs in favor of the worker being an independent contractor and, if the employer has control over the key aspects of performance, then this factor weighs in favor of the worker being an employee. In determining whether an employer controls a worker, requirements that the worker comply with applicable legal requirements, carry insurance, meet deadlines or quality control standards or other typical business terms between businesses (as opposed to employment relationships) do not constitute control that makes the worker more or less likely to be an employee.

- **The worker's opportunity for profit or loss based on initiative and/or investment**. For instance, if the worker invests in the business and bears the costs for equipment, workers and materials to perform their work, that weighs in favor of such worker being an independent contractor. If the employer bears such costs, it weighs in favor of the worker being an employee.

If the two core factors point to different classifications, then three additional factors are to be considered:

- **The amount of skill required for the work**. For example, if the worker has a specialized skill and does not depend on the employer for their training, this factor weighs in favor of the worker being an independent contractor.

- **The degree of permanence of the working relationship between the worker and the employer**. If the work duration is by design definite or sporadic (other than due to the seasonal nature of such work), then this factor weighs in favor of the worker being an independent contractor. If the work duration is by design indefinite or continuous, then this factor weighs in favor of the worker being an employee.

- **Whether the work is part of an integrated unit of production**. If the individual's work is a component of the employer's production process for a good or service, then this factor indicates the worker is an employee. If the individual's work is segregable from the employer's production process, then this factor weighs in favor of the worker being an independent contractor.

The Rule mentions that additional factors may be relevant in determining whether a worker is an independent contractor to the extent such additional factors show that the worker is in business for herself or himself, rather than economically dependent upon the employer.

The Rule also mentions that in applying the tests for worker classification, the actual practice of the worker and employer is more relevant than what may be contractually or theoretically possible. For example, an employer's authority to supervise and discipline a worker may not be relevant if it never exercises that authority.

Please be advised that the Rule applies to the Department of Labor's interpretation of the issue as it applies to the FLSA and that both state and federal agencies, such as the Internal Revenue Service, have their own interpretations of the issue of independent contractor versus employee.

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