ALERTS

US Department of Labor Issues Final Rule on Independent Contractor Classification

March 15, 2024

On Jan. 10, 2024, the US Department of Labor ("DOL") published its final rule on employee or independent contractor classification under the Fair Labor Standards Act ("FLSA") for purposes of minimum wage and overtime. The final rule became effective March 11, 2024.

The final rule formally rescinds the prior more-business-friendly independent contractor rule published by the DOL weeks before the end of the Trump Administration in 2021. The DOL and the courts have historically applied a test, the ultimate inquiry being whether, as a matter of economic reality, the worker is economically dependent on the employer for work, or is self-employed. The final rule returns to the pre-2021 totality-of-the-circumstances analysis of economic realities when classifying worker status under the FLSA. The final rule provides that a worker who is economically dependent on an employer is not an independent contractor. Economic dependance is determined through a flexible, multifactor totality-of-the-circumstances analysis, considering the following factors:

1. *Nature and degree of control.* This factor considers an employer's degree of control over the performance of work and the economic aspects of the working relationship. A higher level of employer control over the performance of the work, including whether the employer sets the worker's schedule, supervises performance or places restrictions on outside work, weighs in favor of employee status.

2. *Opportunity for profit or loss depending on managerial skill.* This factor considers whether the worker uses managerial skills that impacts the worker's ability for profit or loss. Relevant considerations include whether the worker can determine or meaningfully negotiate their pay, whether the worker has discretion in declining or choosing certain jobs and whether the worker can make business decisions such as creating their own marketing, hiring, procurement or renting space. Lack of opportunity for profit and loss indicates employee status.

3. *Investments by the worker and the potential employer.* This factor considers whether investments made by a worker are entrepreneurial in nature. Investments by a worker that serve a business-like function and increase a worker's ability to do different types of work and extend market reach indicate independent contractor status.

4. *Degree of permanence of the work relationship.* This factor weighs in favor of employee status when the work relationship is indefinite in duration, continuous and is exclusive of work for other employers. Work relationships that are fixed in duration, non-exclusive, project-based or sporadic weigh in favor of independent contractor status.

5. *Extent to which the work performed is an integral part of the potential employer's business.* This factor considers whether the function a worker performs is an integral part of an employer's business. A worker whose function is critical, necessary or central to the business weighs in favor of employee status.

6. *Skill and initiative.* This factor considers whether a worker uses specialized skills in performing work and whether those skills contribute to a business-like initiative. Whether or not a worker has specialized skills is not indicative of status. Rather, the worker's use of specialized skills in connection with a business-like initiative indicates independent contractor status.

The factors do not carry a predetermined weight and no one factor is dispositive. Additional factors that may indicate a worker is in business for themself, rather than being economically dependent on an employer, may be relevant to determining worker status.

While the final rule is already subject to multiple legal challenges, employers should analyze their independent contractors to ensure proper classification. The final rule will only apply to interpretation of worker

status under the FLSA, and does not affect other federal laws, or state specific laws and tests for independent contractor classification. For example, the IRS has its own test. State laws may be more stringent and should be reviewed for individuals working in those states and possibly others. For example, California and New Jersey utilize the "ABC test" which provides that individual workers are presumed to be employees, unless the employer can demonstrate (A) the work is done without the direction and control of the employer, (B) the work is performed outside the usual course of the employer's business and (C) the work is done by someone who has their own independent business or trade doing that kind of work. This analysis should take into account the key consideration promulgated by the final rule, as well as other federal and state tests for whether a worker is properly classified.

If an independent contractor is properly classified, employers also should ensure compliance with applicable state and local laws that are being enacted to protect gig workers. For example, New York City's Freelance Isn't Free Act, discussed here, and the New York State Freelance Isn't Free Act, which is effective May 20, 2024.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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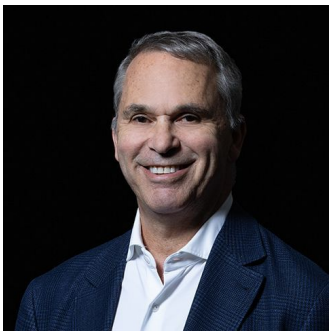

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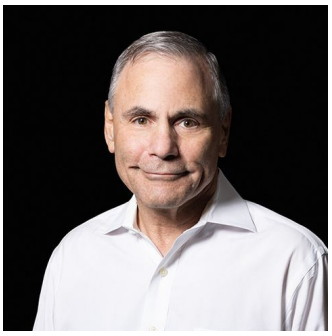

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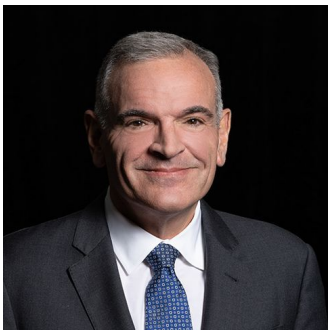

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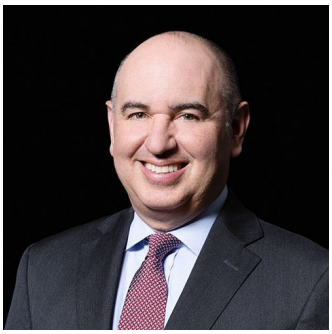

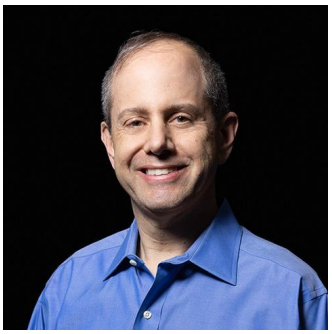

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