U.S. Dept. of Labor Finalizes Independent Contractor Regulation

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Introduction

- DOL rule creates six-factor “economic realities” test to determine independent contractor status under the FLSA.
- The new rule differs significantly from prior DOL guidance and its rule governing independent contractor relationships issued in 2021.

Introduction

The U.S. Department of Labor published a final rule on January 9, 2024, defining “independent contractor” under the Fair Labor Standards Act (FLSA). The final regulation rescinds a 2021 rule defining the same term. In place of the 2021 rule, this final rule adopts a six-factor test focused on the “economic reality” of the relationship between a potential employer and a worker. The test asks whether, as a matter of economic realities, the worker depends on the potential employer for continued employment or is operating an independent business.

Why does the definition of “independent contractor” matter?

The definition matters because it triggers coverage under federal wage-and-hour law. The FLSA sets federal rules for minimum wages and overtime. It also requires covered employers to keep certain records. But those standards and requirements apply only to “employees” and do not apply to independent contractors. The distinction between employees and independent contractors determines whether the FLSA applies or not.

Why is the Department publishing a new rule?

Until 2021, the Department had never defined “independent contractor” by regulation. Instead, it covered the topic through informal guidance. The Department published Fact Sheet 13, which laid out seven factors relevant to worker classification. It made clear, however, that these factors were only guidelines. What controlled were the circumstances of each relationship.

Why is the Department publishing a new rule?

Seeking to offer more clarity, the Department in 2020 proposed a new five-factor test. This test focused on two “core” factors: the principal’s right to control and the worker’s opportunity for profit or loss. If those factors pointed in the same direction, the analysis ended. But if they pointed in different directions or produced no clear result, the rule considered three “guidepost” factors: the relationship’s length or permanence, the worker’s special skills, and the work’s integration into the principal’s operations.

Why is the Department publishing a new rule?

In October 2022, the Department published a new proposed rule. The proposed rule offered to rescind the 2021 rule and, in its place, adopt a new six-factor test:

1. the worker's opportunity for profit or loss;
2. investments by the worker and potential employer;
3. the degree of permanence of the relationship;
4. the nature and degree of the potential employer's control over the work;
5. the extent to which the work is "integral" to the potential employer's business; and
6. the worker's skill or initiative.

Why is the Department publishing a new rule?

These factors were not exhaustive. That is, other factors might be relevant in a given case. But the proposed rule did not suggest what those factors might be. Instead, it took a "totality of the circumstances" approach.

What did the final rule change?

Now, the Department has published the final rule, which tracks the proposed rule closely. It uses the same six factors, but adjusts some of the details:

What did the final rule change?

- **Legal compliance.** Its most important change is to factor four, the "nature and degree of control." The proposed rule stated that when a potential employer exercises control to comply with other laws or regulations, that control still indicates that the worker is an employee. But the final rule changes course. It states that control necessary to comply with "specific" legal requirements does not necessarily indicate that the worker is an employee. Stated differently, businesses can take steps to comply with state, federal, tribal, or local laws without affecting the worker's classification. But the final rule also states that if a potential employer goes beyond specific legal requirements for its own convenience, this additional control will affect the analysis. Businesses who partner with independent contractors should therefore make sure that any control they exercise is necessary to comply with specific legal requirements.

What did the final rule change?

- **Relative investments.** The final rule also refines factor two, relative investments. The proposed rule suggested that the Department would compare the absolute investments by the worker and the potential employer. If the potential employer invested more than the worker, the worker was likely to be an employee. By contrast, the final rule clarifies that the Department will not compare the investments on a dollar-for-dollar basis. Nor will it consider the employer's absolute size. Instead, it will examine the relative investments to determine whether the worker is making "similar types of investments" that "suggest the worker is operating independently."

What did the final rule change?

- **Tools and equipment.** Similarly, the final rule changes the Department's approach to tools and equipment. The proposed rule stated that a worker is not an independent contractor simply because the worker pays for tools and equipment necessary to do a job. For example, if a worker buys a hardhat and handsaw, the investment in those tools does not make the worker an independent contractor. The final rule specifies that this limitation applies to costs "unilaterally imposed" by the potential employer. That is, if the potential employer requires the worker to buy the handsaw and hardhat, those costs do not make the worker more like an independent contractor. But presumably, tools the worker buys on the worker's own initiative may suggest independence.

What did the final rule change?

- **Earning more by working more.** The final rule also adjusts its approach to profit or loss. The proposed rule stated that a worker does not have an "entrepreneurial" opportunity for profit or loss when the worker can earn more money simply by working more hours or taking more jobs. The final rule clarifies that limitation. It states that the worker's ability to earn more by working more is not entrepreneurial opportunity "when [the worker] is paid a fixed rate per hour or per job." Presumably, then, when a worker is paid by another method, the ability to earn more by working more may suggest that the worker is independent.

What did the final rule change?

- **Specialized Skills.** Finally, the rule restricts the Department's approach to the final factor, specialized skill. It states that specialized skill alone does not indicate that the worker is an independent contractor. Both "employees and independent contractors may be specialized workers." What is relevant, then, is whether the worker uses specialized skill "in connection with business-like initiative."

What did the final rule change?

Besides these changes, the final rule tweaks the rule's language in small ways. For example, it changes the term "employer" to "potential employer." That change reflects that the analysis is supposed to reveal whether a person is an employer at all; calling the person an employer effectively prejudges the analysis. But otherwise, the rule closely tracks the proposed rule.

Questions?

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