DOL proposes to simplify worker classification test under FLSA

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In this article

A proposed Department of Labor (DOL) rule would simplify and clarify how to distinguish between employees and independent contractors under the Fair Labor Standards Act (FLSA). The proposal aims to ease compliance and reduce worker misclassification by making it easier for businesses to identify FLSA-covered employees. Comments on the proposal may be submitted until Oct. 26.

Proposed rule simplifies worker classification

The FLSA requires employers to pay nonexempt employees at least the federal minimum wage for every hour worked and overtime pay for every hour worked exceeding 40 in a workweek. The law also mandates that employers keep certain employee records. However, employers do not have these FLSA requirements for independent contractors because they are not “employees” under the statute.

While the FLSA defines the terms “employer” and “employee,” the law does not define “independent contractor.” The courts and the DOL over the years have developed a multifactor test to determine whether a worker is an employee or an independent contractor under the FLSA, but the test has proven “unclear and unwieldy,” creating uncertainty. The DOL proposed rule would establish the test for classifying workers under the FLSA, with the aim of simplifying and clarifying the analysis, thereby reducing the burden on businesses.

Economic reality test

The DOL and the courts have long taken the position that distinguishing between an employee and independent contractor requires evaluating the worker's economic dependence on a company. Independent contractors are workers who, as a matter of economic reality, are in business for themselves — unlike employees, who are economically dependent on their employers. The proposed rule would establish an economic reality test, using five factors to determine economic dependence:

- The nature and degree of the worker's control over the work (core factor)
- The worker's opportunity for profit or loss based on initiative and/or investment (core factor)
- The amount of skill required for the work
- The degree of permanence of the working relationship between the worker and the potential employer
- The extent to which the work is part of an integrated unit of production

The list is not exhaustive, and no single factor would be determinative, but the two core factors would carry greater weight in the analysis. The proposal also states that actual practices would have greater weight than what might be contractually or theoretically possible.

Employer implications

The proposed rule would relax the parameters for determining independent contractor status under the FLSA, so employers and business lobbies will likely welcome the new test. However, different standards may apply for identifying independent contractors under other laws, such as:

- **ERISA.** In *Nationwide Mutual Insurance Co. v. Darden* (503 U.S. 318 (1992)), the Supreme Court adopted a common-law test to evaluate whether certain workers are employees eligible for ERISA-covered benefit plans or independent contractors who may be excluded from those plans. This test focuses on the hiring party's right to control the means and manner of the work performed and considers factors similar to the new economic reality test, as well as others like the location of the work and the method of payment.
- **ACA.** The employer shared-responsibility requirements under the Affordable Care Act (ACA) use a similar common-law definition of an employee, but the Internal Revenue Service has provided a number of factors — focusing on behavioral control, financial control and the type of relationship between the parties — that employers may consider in making that determination.
- **Other laws.** Examples of other rights extended to employees but not contractors include leave protections under the Family and Medical Leave Act (FMLA), which uses the FLSA definition of

employee, and labor rights under the National Labor Relations Act, which uses a common-law definition of employee. In addition, some states, such as California and New Jersey, have set their own standards for determining whether an employment relationship exists.

For employees misclassified as independent contractors, companies will owe additional payroll taxes and might need to provide retroactive benefits. Misclassification of workers can have other unexpected consequences. For example, retirement plans sponsors might need to redo prior years' coverage tests to reflect newly classified employees, even if those employees aren't granted retroactive benefits.

Given the potential for litigation, the varying tests applied by other federal agencies and courts, and the divergent standards under some state laws, employers should continue to work with legal counsel to make worker determinations.

Related resources

Non-Mercer resources

- Proposed regulations (Federal Register, Sept. 25, 2020)
- Press release (DOL, Sept. 22, 2020)
- 2020 Ch. 38 (California Legislature, Sept. 4, 2020)

Mercer resources

- US: New Jersey enacts law to combat worker misclassification (March 18, 2020)
- US: Some independent contractors in California will become employees (Sept. 26, 2019)
- Independent contractor or employee? DOL, NLRB weigh marketplaces (May 16, 2019)
- US labor relations board reinstates traditional independent contractor standard (Feb. 1, 2019)