COMPLIANCE OVERVIEW

FAQs - Final Rule: Employee or Independent Contractor Classification Under the FLSA

TOWNE BENEFITS

On Jan. 9, 2024, the U.S. Department of Labor (DOL) announced a final rule, effective March 11, 2024, revising the Department's guidance on how to analyze who is an employee or independent contractor under the Fair Labor Standards Act (FLSA). This final rule rescinds the Independent Contractor Status Under the Fair Labor Standards Act rule, which was published on Jan. 7, 2021, and replaces it with an analysis for determining employee or independent contractor status that is more consistent with the FLSA as interpreted by long-standing judicial precedent.

The misclassification of employees as independent contractors may deny workers minimum wage, overtime pay, and other protections. This final rule aims to reduce the risk of employees being misclassified as independent contractors while providing a consistent approach for businesses that engage with individuals who are in business for themselves.

Economic Realities Test Factors

The final rule applies the following six factors to analyze employee or independent contractor status under the FLSA:

- Opportunity for profit or loss depending on managerial skill;
- Investments by the worker and the potential employer;
- Degree of permanence of the work relationship;
- Nature and degree of control;
- Extent to which the work performed is an integral part of the potential employer's business; and
- Skill and initiative.

Important Dates

- Jan. 9, 2024 - The DOL released a final rule revising the agency's guidance on how to analyze who is an employee or independent contractor under FLSA.
- Mar. 11, 2024 - The final rule is effective on March 11, 2024.

General FAQS

1. What is the Employee or Independent Contractor Classification Under the Fair Labor Standards Act Final Rule?

This final rule, announced on January 9, 2024, revises the Department's guidance on how to analyze who is an employee or independent contractor under the Fair Labor Standards Act (FLSA). Specifically, the final rule rescinds the 2021 Independent Contractor Rule that was published on January 7, 2021, and replaces it with guidance for how to analyze employee or independent contractor classification that is more consistent with the FLSA as interpreted by long-standing judicial precedent. The Department believes that this final rule will reduce the risk of employees being misclassified as independent contractors while at the same time providing greater consistency for businesses that engage (or wish to engage) with individuals who are in business for themselves.

2. When is this rule effective?

This final rule is effective on March 11, 2024.

3. Why is the Department replacing the guidance it issued in the 2021 Independent Contractor Rule?

The Department believes that the 2021 Independent Contractor Rule does not fully comport with the text and purpose of the FLSA as interpreted by courts. Specifically, the 2021 Independent Contractor Rule includes provisions that are in tension with long-standing case law and the Department's prior guidance on independent contractor status, such as:

- Its designation of two "core factors"—control and opportunity for profit or loss—which are given greater predetermined weight in the analysis;
- Its consideration of a worker's investments and initiative only as part of the opportunity for profit or loss factor; and
- Its prohibition against considering whether the work performed is central or important to the potential employer's business.

These and other provisions in the 2021 Independent Contractor Rule narrowed the economic reality test by limiting the facts that may be considered as part of the test—facts that the Department believes are relevant in determining whether a worker is economically dependent on the employer for work (i.e., an employee under the FLSA) or is in business for themself (i.e., an independent contractor). The Department further believes that leaving the 2021 Independent Contractor Rule in place would have a confusing and disruptive effect on workers and businesses alike due to its departure from decades of case law describing and applying the multifactor economic reality test as a totality-of-the-circumstances test.

4. How will this final rule help workers and businesses understand their rights and responsibilities under the FLSA?

The final rule provides detailed guidance on employee or independent contractor status that is not only consistent with the FLSA and the decades of case law interpreting it, but more robust than the Department's earlier subregulatory guidance on the topic. The final rule's analysis may be applied to workers in any industry and will be easily accessible in the Code of Federal Regulations (CFR). For these reasons, the final rule will provide helpful guidance for workers and businesses alike.

5. Does this final rule adopt an "ABC" test?

No. The final rule does not adopt an "ABC" test, which permits an independent contractor relationship only if all three factors in a three-factor test are satisfied. Under the final rule, the Department will instead rely on the long-standing multifactor "economic reality" test used by courts to determine whether a worker is an employee or independent contractor. This test relies on the totality of the circumstances where no one factor is determinative.

6. Does this final rule affect the analysis for determining worker classification under other laws?

No. The final rule only revises the Department's interpretation under the FLSA. It has no effect on other laws—federal, state, or local—that use different standards for employee classification. For example, the Internal Revenue Code and the National Labor Relations Act have different statutory language and judicial precedents governing the distinction between employees and independent contractors, and those laws are interpreted and enforced by different federal agencies. Similarly, this rule has no effect on those state wage-and-hour laws that use an "ABC" test, such as California or New Jersey. The FLSA does not preempt any other laws that protect workers, so businesses must comply with all federal, state, and local laws that apply and ensure that they are meeting whichever standard provides workers with the greatest protection. See 29 U.S.C. 218.

Substance of the Final Rule

7. What analysis guides whether a worker is an employee or independent contractor under this final rule?

This final rule continues to affirm that a worker is not an independent contractor if they are, as a matter of economic reality, economically dependent on an employer for work. Consistent with judicial precedent and the Department's interpretive guidance prior to 2021, the final rule applies the following six factors to analyze employee or independent contractor status under the FLSA:

- Opportunity for profit or loss depending on managerial skill;
- Investments by the worker and the potential employer;
- Degree of permanence of the work relationship;
- Nature and degree of control;
- Extent to which the work performed is an integral part of the potential employer's business; and
- Skill and initiative.

The final rule provides detailed guidance regarding the application of each of these six factors. No factor or set of factors among this list of six has a predetermined weight, and additional factors may be relevant if such factors in some way indicate whether the worker is in business for themself (i.e., an independent contractor), as opposed to being economically dependent on the employer for work (i.e., an employee under the FLSA).

8. Can a worker voluntarily waive employee status and choose to be classified as an independent contractor?

No. Under the FLSA, a worker is an employee and not an independent contractor if they are, as a matter of economic reality, economically dependent on the employer for work. While businesses are certainly able to organize their businesses as they prefer consistent with applicable laws, and workers are free to choose which work opportunities are most suitable for them, if a worker is an employee under the FLSA, they cannot waive FLSA-protected rights (such as minimum wage or overtime pay). The Supreme Court has explained that permitting employees to waive their FLSA rights would harm other employees and undermine the Act's goal of eliminating unfair methods of competition in commerce.

9. How is this final rule similar to the Department's 2021 Independent Contractor Rule?

This final rule has several similarities to the 2021 Independent Contractor Rule. For example, both rules advise that independent contractors are workers who, as a matter of economic reality, are in business for themselves, whereas FLSA-covered employees are workers who are, as a matter of economic reality, economically dependent on the employer for work. Both rules identify economic dependence as the "ultimate inquiry" of the analysis; both rules provide a non-exhaustive list of factors to assess economic dependence, and both rules caution that no single factor is determinative. Both rules also clarify that economic dependence does not focus on the amount of income the worker earns or whether the worker has other sources of income.

10. How does the final rule differ from the Department's 2021 Independent Contractor Rule?

This final rule differs from the guidance provided in the 2021 Independent Contractor Rule in several important ways. Specifically, consistent with the approach taken by federal courts, this final rule:

- Returns to a totality-of-the-circumstances economic reality test, where no single factor or group of factors is assigned any predetermined weight;
- Considers six factors (instead of five), including the investments made by the worker and the potential employer;
- Provides additional analysis of the control factor, including a detailed discussion of how scheduling, supervision, price-setting, and the ability to work for others should be considered when analyzing the nature and degree of control over a worker;
- Returns to the Department's long-standing consideration of whether the work is integral to the employer's business (rather than whether it is exclusively part of an "integrated unit of production");
- Provides additional context to some factors, including a discussion of exclusivity in the context of the permanency factor and initiative in the context of the skill factor; and
- Omits a provision from the 2021 Independent Contractor Rule, which minimized the relevance of an employer's reserved but unexercised rights to control a worker.

With these features, the final rule's guidance aligns with the analysis currently applied by courts, providing greater consistency for workers and businesses alike.

11. How does the final rule differ from the Notice of Proposed Rulemaking (NPRM) published on October 13, 2022 (87 FR 62218)?

The Department received approximately 55,400 comments in response to the NPRM from a diverse array of stakeholders, including employees, self-identified independent contractors, businesses, trade associations, labor unions, advocacy groups, law firms, members of Congress, state and local government officials, and other interested members of the public. The Department carefully considered those comments and consequently made several adjustments to the analysis that was proposed in the NPRM, including revisions regarding the control factor and the investment factor. For example, the final rule states that actions taken by the potential employer for the sole purpose of complying with specific, applicable federal, state, tribal, or local law or regulation would not indicate "control." The final rule also advises that costs to a worker that are unilaterally imposed by a potential employer are not "investments" indicative of independent contractor status.

12. Are any of the economic reality factors adopted in this rule more important than others when evaluating a worker's employment status?

No. Different factors might be more or less important in different cases depending on the facts of each individual case. For example, a factor leaning strongly towards one classification outcome (employee or independent contractor status) could be more relevant in the overall analysis for a particular worker than a different factor, which might be a closer call. However, this final rule does not categorically weigh certain factors more than others in every case like the 2021 Independent Contractor Rule.

13. How does the final rule explain "opportunity for profit or loss depending on managerial skill?"

This factor considers whether the worker has opportunities for profit or loss based on managerial skills (including initiative, business acumen or judgment) that affect the worker's economic success or failure in performing the work. The following facts, among others, can be relevant: whether the worker determines or can meaningfully negotiate the charge or pay for the work provided; whether the worker accepts or declines jobs or chooses the order and/or time in which the jobs are performed; whether the worker engages in marketing, advertising, or other efforts to expand their business or secure more work; and whether the worker makes decisions to hire others, purchase materials and equipment, and/or rent space. If a worker has no opportunity for a profit or loss, then this factor suggests that the worker is an employee. Some decisions by a worker that can affect the amount of pay that a worker receives, such as the decision to work more hours or take more jobs when paid a fixed rate per hour or per job, generally do not reflect the exercise of managerial skill indicating independent contractor status under this factor.

14. How does the final rule explain "investments by the worker and the employer?"

This factor considers whether any investments by a worker are capital or entrepreneurial in nature. Costs to a worker of tools and equipment to perform a specific job, costs of workers' labor, and costs that the potential employer imposes unilaterally on the worker, for example, are not evidence of capital or entrepreneurial investment and indicate employee status. Investments that are capital or entrepreneurial in nature and thus indicate independent contractor status generally support an independent business and serve a business-like function, such as increasing the worker's ability to do different types of or more work, reducing costs, or extending market reach. Additionally, the worker's investments should be considered on a relative basis with the potential employer's investments in its overall business. The worker's investments do not have to be equal to the potential employer's investments and should not be compared only in terms of the dollar values of investments or the sizes of the worker and the potential employer. Instead, the focus should be on comparing the investments to determine whether the worker is making similar types of investments as the potential employer (even if on a smaller scale) to suggest that the worker is operating independently, which would indicate independent contractor status.

15. How does the final rule explain "degree of permanence of the work relationship?"

This factor weighs in favor of the worker being an employee when the work relationship is indefinite in duration, continuous, or exclusive of work for other employers. This factor weighs in favor of the worker being an independent contractor when the work relationship is definite in duration, non-exclusive, project-based, or sporadic based on the worker being in business for themself and marketing their services or labor to multiple entities. This may include regularly occurring fixed periods of work, although the seasonal or temporary nature of work by itself would not necessarily indicate independent contractor classification. Where a lack of permanence is due to operational characteristics that are unique or intrinsic to particular businesses or industries and the workers they employ, this factor is not necessarily indicative of independent contractor status unless the worker is exercising their own independent business initiative.

16. How does the final rule explain "nature and degree of control?"

This factor considers the potential employer's control, including reserved control, over the performance of the work and the economic aspects of the working relationship. Facts relevant to the potential employer's control over the worker include whether the potential employer sets the worker's schedule, supervises the performance of the work, or explicitly limits the worker's ability to work for others. Additionally, facts relevant to the potential employer's control over the worker include whether the potential employer uses technological means to supervise the performance of the work (such as by means of a device or electronically), reserves the right to supervise or discipline workers, or places demands or restrictions on workers that do not allow them to work for others or work when they choose. Whether the potential employer controls economic aspects of the working relationship should also be considered, including control over prices or rates for services and the marketing of the services or products provided by the worker. Actions taken by the potential employer for the sole purpose of complying with a specific, applicable federal, state, tribal, or local law or regulation are not indicative of control. As examples of such compliance actions that are not indicative of control, the final rule identifies a publication's requirement that a writer comply with libel law and a home care agency's requirement that all individuals with patient contact undergo background checks in compliance with a specific Medicaid regulation. Actions taken by the potential employer that go beyond compliance with a specific, applicable federal, state, tribal, or local law or regulation and instead serve the potential employer's own compliance methods, safety, quality control, or contractual or customer service standards may be indicative of control. For example, a home care agency's imposition of extensive provider qualifications, such as fulfilling comprehensive training requirements (beyond training required for relevant licenses), may be probative of control. More control by the potential employer favors employee status; more control by the worker favors independent contractor status.

17. How does the final rule explain "extent to which the work performed is an integral part of the employer's business?"

This factor considers whether the work performed is an integral part of the potential employer's business. This factor does not depend on whether any individual worker, in particular, is an integral part of the business, but rather whether the function they perform is an integral part of the business. This factor weighs in favor of the worker being an employee when the work they perform is critical, necessary, or central to the potential employer's principal business. This factor weighs in favor of the worker being an independent contractor when the work they perform is not critical, necessary, or central to the potential employer's principal business.

18. How does the final rule explain "skill and initiative?"

This factor considers whether the worker uses specialized skills to perform the work and whether those skills contribute to the business-like initiative. This factor indicates employee status where the worker does not use specialized skills in performing the work or where the worker is dependent on training from the potential employer to perform the work. Where the worker brings specialized skills to the work relationship, this fact is not itself indicative of independent contractor status because both employees and independent contractors may be skilled workers. It is the worker's use of those specialized skills in connection with business-like initiatives that indicate that the worker is an independent contractor.

19. When might "additional factors" matter in determining a worker's employment status?

Under the final rule, additional factors may be relevant in determining whether the worker is an employee or independent contractor for purposes of the FLSA, if the factors in some way indicate whether the worker is in business for themself, as opposed to being economically dependent on the potential employer for work. This guidance is identical to guidance provided in the 2021 Independent Contractor Rule and is consistent with judicial precedent.

20. Under the final rule, does a worker have to satisfy all the economic reality factors to qualify as an independent contractor?

No. Under the economic reality test, no single factor (or set of factors) automatically determines a worker's status as either an employee or an independent contractor. Instead, the economic reality factors are all weighed to assess whether a worker is economically dependent on a potential employer for work, according to the totality of the circumstances.

21. I have questions about this rule and/or worker classification. Who should I contact?

For questions about this final rule, you may call the Wage and Hour Division's (WHD) Division of Regulations, Legislation, and Interpretation (DRLI) at (202) 693-0406. For questions about the employment classification of a particular worker or group of workers, please contact your nearest WHD District Office, as displayed at https://www.dol.gov/agencies/whd/contact/local-offices.

Source: Department of Labor

LINKS AND RESOURCES

- Final Rule: Employee or Independent Contractor Classification under the FLSA
- News release announcing final rule on classifying workers as employees or independent contractors under the FLSA.

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