

PUBLICATION

DOL Announces Final Rule Relaxing Independent Contractor Test

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On January 6, 2021, the Department of Labor (DOL) announced a final rule clarifying the standard for classifying a worker as an independent contractor under the Fair Labor Standards Act (FLSA). This final rule adopts the "economic reality" test focusing primarily on control over work and the opportunity for profit or loss. The effective date of the final rule is March 8, 2021 and makes it easier for employers to classify workers as independent contractors under the FLSA.

Under the economic realities test adopted by the DOL, "an individual is an employee if he or she is dependent on an employer for work and is an independent contractor if he or she is, as a matter of economic reality, in business for him- or herself." The final rule explains that there are two "core factors" that are most important to this inquiry and carry the greatest weight:

1. The nature and degree of control over the work, and
2. The worker's opportunity for profit or loss based on initiative and/or investment.

The first core factor, the nature and degree of control over the work, weighs in favor of an individual being classified as an independent contractor "to the extent the individual, as opposed to the potential employer, exercises substantial control over key aspects of the performance of the work, such as by setting his or her own schedule, by selecting his or her projects, and/or through the ability to work for others, which might include the potential employer's competitors." The second core factor, the opportunity for profit or loss, "weighs towards the individual being an independent contractor to the extent the individual has an opportunity to earn profits or incur losses based on his or her exercise of initiative (such as managerial skill or business acumen or judgment) or management of his or her investment in or capital expenditure on, for example, helpers or equipment or material to further his or her work."

The final rule also explains that there are additional factors that may be considered when the two core factors do not point to the same classification; these factors are:

3. The amount of skill required for the work,
4. The degree of permanence of the working relationship between the worker and the potential employer, and
5. Whether the work is part of an integrated unit of production.

Under this inquiry, the actual practices of the worker are more important than what may be contractually or theoretically possible. This final rule expressly rejects the stringent ABC test adopted by 13 states and codified into law by California in January 2020. Under the ABC test, the worker must be free from the control of the hiring entity, perform work outside the hiring entity's business and be in business for himself/herself in order to be classified as an independent contractor.

Takeaway

While this is a significant development for employers, the final rule is limited to the DOL's interpretation under the FLSA, which means state and local laws that address this issue will still apply. Moreover, there are also different standards for determining employee/independent contractor status from a variety of other federal

administrative agencies, such as the Internal Revenue Service (IRS) and National Labor Relations Board (NLRB), and the state-level counterparts of these agencies. The applicability and longevity of this rule is also uncertain. Under the Obama administration, the DOL issued an Administrative Interpretation (AI) on independent contractors that was far stricter than this new rule. The Obama DOL rejected the "control" factor of the economic realities test and instead focused on the worker's entrepreneurial activities and whether the worker was "economically dependent" on the hiring entity or actually in business for himself or herself. The Trump DOL withdrew the independent contractor AI and began drafting the new, more expansive "economic reality" rule. Employers will just have to wait and see whether this new rule will stand or be rescinded under the incoming Biden administration.

If you have any questions on this topic or any other labor and employment topic, contact any member of Baker Donelson's [Labor & Employment Team](#).