Lawyers Alliance *for* New York

Connecting lawyers, nonprofits, and communities

October 2015

USDOL Announces Focus on Employees Misclassified as Independent Contractors

On July 15, 2015, the Wage and Hour Division of the United States Department of Labor (DOL) issued an Administrator's Interpretation on the standards for identifying employees who are misclassified as independent contractors.[1] This Administrative Interpretation provides guidance on how the DOL will apply the very broad definition of "employ" under the Fair Labor Standards Act (FLSA) to determine if a worker is an employee, and therefore covered by the protections of the FLSA, and other employment laws and regulations. The Interpretation can be accessed here: http://www.dol.gov/whd/workers/Misclassification/AI-2015_1.htm.

The lens through which the DOL analyzes the relationship focuses on the "economic realities" test to determine whether the worker is economically dependent on the employer, and should be classified as an employee, or essentially in business for him or herself, and then properly classified as an independent contractor. The DOL's focus on the overall economic realities of the work relationships, and de-emphasis on the control factor, is not binding on the courts and has not yet been tested. Nonetheless, this guidance is a clear indication of the DOL's approach in its enforcement activities and its position that most workers are employees rather than independent contractors.

The correct classification of workers is important because of the legal protections provided by various labor and employment laws applicable to employees but not independent contractors, as well as the potential revenue to the government from various payroll taxes. The DOL also has in interest in leveling the playing field for employers who properly classify their workers with those employers who attempt to cut costs through the intentional misclassification of workers as independent contractors. Employers are responsible for maintaining the proper documentation and demonstrating that a worker is indeed an independent contractor and not an employee.

Multi-Factor Analysis to Determine the Economic Realities of the Relationship

The DOL's interpretation starts with the expansive definition of "employ" under the FLSA which is to "suffer or permit to work."[2] The "economic realities" of the worker's relationship with the employer is then analyzed based on several factors generally followed by the courts, with no single factor being determinative. The six factors summarized in the Administrator's Interpretation are as follows:

---

[1] U.S. Department of Labor Administrator's Interpretation No. 2015-1; Subject: The Application of the Fair Labor Standards Act's "Suffer or Permit" Standard in the Identification of Employees Who are Misclassified as Independent Contractors.

[2] FLSA, 29 U.S.C. 203 (g).

1. **The extent to which the work performed is an integral part of the employer's business.**

   If the work performed is an integral part of the employer's business, even if it is just one component of the business, it is more likely that the worker is an employee.

2. **The worker's opportunity for profit or loss depending on the exercise of managerial skill.**

   The focus is on the exercise of managerial skill. The worker's ability to impact profit or loss must be a consequence of the exercise of managerial skill consistent with operating a business, such as purchasing materials or advertising, and not merely working more hours.

3. **The extent of the relative investments of the worker and the employer.**

   The key element is the comparison of the worker's investment to the employer's overall investment in the business. Consequently, a worker's investment in his or her own tools and equipment will not support independent contractor status where that investment is relatively minor compared to the employer's capital investment in the business.

4. **Whether the work performed requires special skills and initiative.**

   The "special skill and initiative" indicative of an independent contractor status must be business skills and judgment consistent with operating one's own business, and not simply technical skills.

5. **The permanency of the relationship.**

   The permanency of the relationship must be assessed based on the operational and seasonality in the industry. The greater the continuity of the relationship, the stronger the suggestion of an employee/employer relationship.

6. **The degree of control exercised or retained by the employer.**

   The control factor is not given any special weight by the DOL, particularly in light of the impact of technology on today's work environment and ability to work remotely from the employer's premises. The FLSA statutory definition of "employ" and the fact specific "economic realities" test is much broader than the common law standard that emphasizes the degree of control that the employer exercises over the worker.

Each of these factors should be evaluated as indicators of the broad concept of economic dependence which will signal that the worker is an employee and entitled to the protections of the FLSA, and other employment laws and regulations. No single factor is controlling and the specific details of the relationship must be evaluated to discern the degree of economic dependence. The DOL also cautions that working for others in itself is not determinative of an independent contractor status; indeed, any individual might simply hold several part-time jobs.

The DOL believes that most workers are employees and not independent contractors. The definition of "employ" is broadly applied in a fact sensitive, multi-factor analysis to assess the "economic realities" of the relations between a worker and an employer. The essential question will be: is the worker economically dependent on the employer regardless of how autonomously he or she performs services, or is the worker in business for him or herself? Labels and private agreements do not establish an independent contractor relationship. Contractual arrangements describing the worker as an independent contractor carry no weight if a consideration of the "economic realities" indicates that the worker should be encompassed within the broad definition of employee under FLSA. A worker cannot waive employee status through a contract.

WHAT SMART NONPROFITS MUST DO NOW: While the DOL Administrator's Interpretation does not change the law and has not yet been tested by the courts, employers would be well advised to conduct an audit of any existing independent contractor arrangements, and potential engagements, in light of this guidance. The DOL has a clear position that the definition of employee is very broad and the definition of an independent contractor is very narrow. This perspective will inform its enforcement proceedings pursuant to its Misclassification Initiative launched in 2011, including its memorandum of understanding with the Internal Revenue Services to share information. The misclassification of workers as independent contractors continues to be a target of coordinated enforcement efforts.

Organizations may also consider alternative classifications of workers as temporary or part-time employees for certain shorter-term assignments where they find that an analysis of the multi-factors under an economic realities test leads to the conclusion that the workers are likely to be deemed an employee based on their economic dependence on the organization, rather than independent contractors in business for themselves.

This alert is meant to provide general information only, not legal advice. If you have any questions about this alert please contact Judith Moldover at (212) 219-1800 ext. 250 or visit our website at www.lawyersalliance.org for further information.