Employee or Contractor?

Department of Labor issues final rule on classifications

by: Greg Goldberg, incoming BTA General Counsel

The rapid expansion of the gig economy has brought an important legal issue into focus: how to properly characterize workers as employees or independent contractors. In January, the U.S. Department of Labor (DOL) issued its final classification rule under the Fair Labor Standards Act, which takes effect this month.

DOL's final rule adopts a six-factor framework known as the "economic reality test" to assess a worker's financial dependence on an employer. Under the new rule, the six factors are not regarded as exhaustive and no individual factor is deemed to be outcome determinative. The six factors:

(1) Opportunity for profit or loss

(2) Investments by the worker and the potential employer

(3) Degree of permanence of the work relationship

(4) Nature and degree of control over the work

(5) Extent to which the work performed is an integral part of the employer's business

(6) Skill and initiative

The first factor considers whether a worker has opportunities for profit or loss based on managerial skill and typically hinges upon whether the worker's rate of pay is fixed or variable. In other words, a worker's decision to put in additional hours or take on more jobs will not generally reflect the exercise of managerial skill when the worker's rate of pay is fixed per hour or per job. In those cases, the worker is more likely to be classified as an employee. On the other hand, a worker who can choose jobs with variable rates of pay per hour or per job is more likely to be considered an independent contractor.

The second factor weighs the relative investments by the worker and the employer. Investments that are capital or entrepreneurial in nature suggest independent contractor status. Because investments made by workers and employers may differ vastly in financial terms, the relevant question is whether the worker is operating independently or at the employer's behest. For instance, a worker who purchases a car to make deliveries is more likely to be judged an independent contractor.

The third factor looks at the degree of permanence of the employer/worker relationship. Open-ended, continuous or exclusive arrangements are more likely to be deemed employment. Arrangements that are intermittent, project-based, nonexclusive or limited in duration lean toward independent contractor status. Under certain circumstances where short periods of work are unique to a particular business or industry, an employment relationship may nonetheless exist — unless workers are able to exercise their own independent business initiative.

The fourth factor involves the nature and degree of the employer's control over the worker. Employers exerting control over workers solely to comply with applicable federal, state or local laws or regulations may permissibly classify workers as independent contractors (provided other factors are consistent). However, employers seeking to implement and enforce their own standards — such as safety, quality control or customer service — are more likely to create employment relationships.

The fifth factor is whether a worker's output is integral to the employer's business. This analysis must be conducted on a case-by-case basis across different industries. In the office technology industry, employees like salespeople and service technicians are more likely to be considered integral, whereas more peripheral roles may be independent contractors.

The sixth factor evaluates a worker's skill and initiative. In general, the more specialized skills a worker possesses, the more likely he (or she) is an independent contractor. The decisive question is whether the worker utilizes those specialized skills with independent, businesslike initiative. For instance, a graphic designer engaged to create a logo for a dealership is likely to be considered an independent contractor unless the designer's output is continuously exclusive to the dealership.

The impact of the DOL's new rule is significant. In some instances, employers may need to reclassify workers, as the risks of misclassification are simply too great. Specifically, employers may face exorbitant costs, not limited to unpaid minimum wages and overtime, liquidated damages, civil penalties and employee benefit obligations. To safeguard against these consequences, employers should proactively audit their independent contractors and immediately correct any misclassified roles. In addition, independent contractor agreements should incorporate all applicable DOL standards. Sample agreements are available at www.bta.org/LegalDocuments. ■

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