Employee or Independent Contractor? New Administrator's Interpretation Issued by Department of Labor Provides Guidance

By: Tanya Salgado
Labor and Employment Alert
7.16.15

The question of whether a worker should be classified as an independent contractor or an employee is fraught with confusion and misunderstanding for many businesses. Compounding the problem is the fact that there are a number of different tests used to determine employee status, which vary by jurisdiction and by the particular law in question. For example, the Internal Revenue Service uses the common law rules which focus on the degree of control and independence exercised by the worker. In contrast, the United States Department of Labor uses the "economic realities" test which focuses on whether the worker is economically dependent on the employer.

In an effort to help combat the confusion over proper worker classification, the United States Department of Labor (DOL) has issued a new Administrator's Interpretation that provides a detailed explanation of the test used by the DOL to determine if a worker has been misclassified as an independent contractor. The DOL enforces the Fair Labor Standards Act (FLSA), which mandates that employees (but not independent contractors) be paid minimum wage and overtime. When a business misclassifies non-exempt workers as independent contractors, and those workers are not paid the minimum hourly wage for their labor, or are not paid overtime when they work more than 40 hours in a workweek, this violates the FLSA.

The DOL continues to direct enforcement efforts toward businesses that the agency believes have misclassified workers as independent contractors. In recent years, the Department of Labor's Misclassification Initiative has resulted in a large number of Wage and Hour Division investigations which have recovered millions of dollars in back wages for employees who were misclassified as independent contractors, and as a result were not paid the wages and overtime they were owed under the Fair Labor Standards Act. The agency states that it has directed particular attention to industries that engage low-wage workers that are improperly classified as independent contractors in order to cut costs.

In furtherance of the DOL Misclassification Initiative, on July 15, 2015, Administrator David Weil has issued a new Administrator's Interpretation, "The Application of the Fair Labor Standard's Act's 'Suffer or Permit' Standard in the Identification of Employees Who Are Misclassified as Independent Contractors."

The Interpretation emphasizes the fact that the FLSA's definition of employ as "to suffer or permit to work" is quite broad, and takes the position that the "economic realities" test factors should be applied in light of this broad standard. The "economic realities" test requires consideration of six factors: (1) the extent to which the work performed is an integral part of the employer's business; (2) the worker's opportunity for profit or loss depending on his or her managerial skill; (3) the extent of the relative investments of the employer and the worker; (4) whether the work performed requires special skills and initiative; (5) the permanency of the relationship; and (6) the degree of control exercised or retained by the employer. The Interpretation notes that in analyzing and applying these factors, it is necessary to keep in mind that the test is meant to determine "whether the worker is really in business for him or herself (and thus is an independent contractor) or is economically dependent on the employer (and thus is its employee)." The ultimate question, according to the Interpretation, is the question of economic dependence.

Administrator Weil stated in a blog post that the agency is committed to educating employers in addition to enforcement actions as a means of increasing compliance. To that end, the Interpretation provides a detailed explanation of the "economic realities" test to assist management in properly classifying workers. The new Interpretation does not change or alter existing law. Indeed, much of the Interpretation consists of discussion of existing case law interpreting the economic realities test. However, a review of the Interpretation provides a good indicator of the focus of the DOL and its approach toward independent contractor status. The fact that the Interpretation concludes with the statement, "In sum, most workers are employees under the FLSA's broad definitions" should serve as a somber warning to businesses that engage workers whom they classify as independent contractors, particularly when those workers are low-wage earners working more than 40 hours in a workweek.

For additional information on the Interpretation and how it may impact your business, contact Tanya Salgado (215.864.6368 | salgadot@whiteandwilliams.com) or another member of the Labor and Employment Group.