When Is an Independent Contractor Really an Employee? New USDOL Rule Sheds Light On Issue

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On January 10, 2024, the United States Department of Labor (USDOL) published a Final Rule that establishes a totality-of-the-circumstances six-factor economic reality test to determine whether a worker is an employee or independent contractor under the federal Fair Labor Standards Act (FLSA). See Employee or Independent Contractor Classification Under the Fair Labor Standards Act. This Rule, which goes into effect on March 14, 2024, rescinds an earlier 2021 Rule that the USDOL now recognizes was "a departure from the consistent, longstanding adoption and application of the economic reality test by [the] courts."

Under the new Rule, a worker's classification as an employee or independent contractor will focus on "the economic realities of the worker's relationship with the worker's potential employer and whether the worker is either economically dependent on the potential employer for work or in business for themselves." 29 C.F.R. § 795.105(a). "Economic dependence" is not based on "the amount of income the worker earns, or whether the worker has other sources of income." 29 C.F.R. § 795.105(b).

The six non-exhaustive factors that the USDOL will now consider are:

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

29 C.F.R. § 795.110(b)(1)-(6).

No factor, or subset of factors, is dispositive because the totality of the circumstances must be considered. Moreover, "the weight to give each factor may depend on the facts and circumstances of the particular relationship." In certain circumstances, other factors may be relevant.

While the Rule establishes a new test under the federal FLSA, employers should keep in mind that the laws of many states apply a different test to determine whether a worker is an employee or independent contractor under state law. For

instance, the majority of states, including New Jersey, use the “ABC” test to determine a worker's status. Other states use a common law control test. Notably, the USDOL expressly declined to adopt the “ABC” test and the common law control test in the Rule.

Under the “ABC” test, a worker is an employee unless all of the following are true:

7. The individual has been and will continue to be free from control or direction over the performance of work performed, both under contract of service and in fact.
8. The work is either outside the usual course of the business for which such service is performed, or the work is performed outside of all the places of business of the enterprise for which such service is performed.
9. The individual is customarily engaged in an independently established trade, occupation, profession, or business.

If one or more elements are not met, the worker is an employee.

The common law control test focuses on whether the potential employer has the right to tell the worker what must be done and how it must be done.

When there is uncertainty as to the classification of a worker, the better course of action in general is to classify them as an employee. A worker should only be classified as an independent contractor if the applicable tests can be satisfied because the law almost always presumes that a worker is an employee unless and until proven otherwise. In light of the varying legal landscape at the federal and state levels, companies and other organizations should consult with experienced employment counsel because the same worker may—in some circumstances—be classified differently depending on what law and test is being applied.