

# HR Insights

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## In-depth Analysis: The New Independent Contractor Rule's 6 Economic Reality Factors

The U.S. Department of Labor (DOL) recently issued a [final rule](#) rescinding and replacing the current independent contractor rule that was published on Jan. 7, 2021. This new rule changes the agency's guidance on how to analyze who is an employee or independent contractor under the Fair Labor Standards Act (FLSA), implementing a six-factor economic reality test (ERT) that employers must consider when making such an analysis. Proper worker classification requires employers to evaluate these factors when determining a worker's status for FLSA purposes. Employers who fail to classify workers accurately may be subject to lawsuits and government action, resulting in costly civil and criminal penalties, back pay, liquidated damages, attorneys' fees and costs.

The final rule will not impose any new requirements on employers until it becomes effective on March 11, 2024; however, the implementation of the DOL's new independent contractor rule could be delayed due to legal challenges. Nevertheless, it's vital that employers start preparing now and familiarize themselves with the rule and the ERT for evaluating proper worker classification to avoid potential legal violations. This article provides a general overview of the DOL's new independent contractor rule and the ERT factors for assessing whether a worker is an employee or independent contractor.

### Overview of the DOL's Final Rule

Under the FLSA, employees are entitled to minimum wage, overtime pay and other benefits that independent contractors are not. Misclassifying workers

as independent contractors can have serious financial and legal consequences for employers, including costly litigation, penalties and attorney fees.

The DOL's final rule rescinds the current independent contractor rule and restores the multifactor analysis to assess whether a worker is an employee or an independent contractor under the FLSA. The final rule establishes the following six economic reality factors to consider when making that determination:

1. The opportunity for profit or loss, depending on managerial skill
2. Investments by the worker and the potential employer
3. The degree of permanence of the work relationship
4. The nature and degree of control
5. The extent to which the work performed is an integral part of the potential employer's business
6. The worker's skill and initiative

The final rule analyzes all six factors equally without assigning a predetermined weight to a particular factor or set of factors. In addition to focusing on the factors of the ERT, the new rule allows additional factors to be considered if they are relevant to the overall question of economic dependence. According to experts, the DOL's

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new rule will likely result in classifying a greater number of workers as employees.

## Understanding the Economic Reality Factors

The DOL states that the six-factor ERT aligns both the agency's pre-2021 guidance and the federal courts' approach to evaluating worker classification under the FLSA. The DOL's new independent contractor rule adopts a totality-of-the-circumstances analysis, which means that no one factor is weighed more heavily than others. The following is an in-depth analysis of the six economic reality factors under the DOL's final rule.

### 1. *Opportunity for Profit or Loss, Depending on Managerial Skill*

This factor considers whether a worker has opportunities for profit or loss based on managerial skill, including initiative, business acumen or judgment that affects the worker's economic success or failure in performing the work. If a worker doesn't have an opportunity for profit or loss, it suggests that the worker is an employee. Relevant facts to consider include:

- Whether the worker determines or can meaningfully negotiate the charge or pay for the work provided
- Whether the worker accepts or declines jobs or chooses the order or time in which the jobs are performed
- Whether the worker engages in marketing, advertising or other efforts to expand their business or secure more work
- Whether the worker makes decisions to hire others, purchase materials and equipment or rent space

A worker's decision that impacts the amount of pay they receive, such as working more hours or jobs, when they are paid a fixed rate per hour or job generally does not suggest the worker exercises managerial skill.

### 2. *Investments by the Worker and the Potential Employer*

This factor considers whether any investments by a worker are capital or entrepreneurial in nature. Costs to a worker of tools and equipment to perform a specific job, costs of workers' labor, and costs that the potential employer imposes unilaterally on the worker are not evidence of capital or entrepreneurial investment; as a result, they indicate employee status. Investments that are capital or entrepreneurial in nature, indicating independent contractor status, generally support an independent business and serve a business-like function. Such investments may include increasing a worker's ability to do different types of or more work, reducing costs or extending market reach. A worker's investments should be considered relative to the potential employer's investments in its overall business. If the worker is making similar investments as the potential employer, even on a smaller scale, it suggests that the worker operates independently, indicating independent contractor status.

### 3. *The Degree of Permanence of the Work Relationship*

This factor weighs in favor of the worker being an employee when the work relationship is indefinite in duration, continuous or exclusive of work for other employers. On the other hand, this factor weighs in favor of an independent contractor relationship when the work arrangement is definite in duration, nonexclusive, project-based, or sporadic based on the worker being in business for themselves and marketing their services or labor to multiple entities. Such conditions may include regularly occurring fixed periods of work; however, seasonal or temporary work by itself would not necessarily indicate independent contractor classification. Where a lack of permanence is due to operational characteristics that are unique or intrinsic to particular businesses or industries and the workers they employ rather than the workers' own independent business initiative, this factor is not necessarily indicative of independent contractor status unless the worker is exercising their own independent business initiative.

#### 4. *The Nature and Degree of Control*

This factor considers the potential employer's control, including reserved control, over the performance of the work and the economic aspects of the working relationship. Facts relevant to the potential employer's control over the worker include whether the potential employer:

- Sets the worker's schedule
- Supervises the performance of the work
- Explicitly limits the worker's ability to work with others

Additionally, considerations relevant to the potential employer's control over the worker include whether the potential employer:

- Uses technological means of supervision to supervise the performance of the work
- Reserves the right to supervise or discipline workers
- Places demands on the workers' time or restrictions on workers that do not allow them to work for others or work when they choose

Whether the potential employer controls economic aspects of the working relationship should also be considered, including control over prices or rates for services and the marketing of the services or products provided by the worker.

#### 5. *The Extent to Which the Work Performed Is an Integral Part of the Potential Employer's Business*

This factor considers whether the work performed is an integral part of the potential employer's business. It does not depend on whether any individual worker in particular is an integral part of the business but whether the function they perform is an integral part of the business. This factor tilts in favor of an independent contractor relationship when the work performed is not critical, necessary or central to the potential employer's principal business.

#### 6. *The Worker's Skill and Initiative*

This factor considers whether the worker uses specialized skills to perform the work and whether those skills contribute to business-like initiative or if the work is dependent on training from the potential employer. This factor indicates employee status where the worker does not use specialized skills to perform the work or where the worker is dependent on training from the potential employer to perform the work. Where the worker brings specialized skills to the work relationship, this fact is not indicative of independent contractor status since both employees and independent contractors may be skilled workers. It's the worker's use of those specialized skills in connection with business-like initiative that indicates that the worker is an independent contractor.

#### *Additional Factors*

The new rule allows additional factors beyond the six ERT factors to be considered if they are relevant to the overall question of economic dependence.

#### **Summary**

It's likely that the DOL's new independent contractor rule will be challenged in court. This could delay the final rule's implementation. There's currently a lawsuit pending over the Biden administration's attempt to withdraw the 2021 Independent Contractor Rule. In this case, a federal court concluded that the Biden administration violated federal law in rescinding the regulation, and it reinstated the 2021 rule. This lawsuit has been delayed for months while the DOL prepared its new rule. The case will now likely restart since the agency released the final rule.

If the DOL's final rule becomes effective, it will significantly impact most employers. Accordingly, employers should start evaluating their worker classifications and understand the final rule's potential impact on their organizations. Failing to do so could result in worker misclassification, resulting in civil and criminal penalties, government audits, back pay, liquidated damages, attorney fees and costs. By taking a proactive approach and revisiting worker classification, employers can help ensure they meet any compliance requirements and mitigate any potential legal risks.

It's critical for employers to stay informed on and proactive about the DOL's final rule. Contact us today for more workplace guidance and resources.

