Department of Labor Targets Use of Independent Contractors

Legal Alert
July 31, 2015
Foster Pepper News Alert

Contact

Steven R. Peltin

Related Services

Labor, Employment & Immigration

On July 15, 2015, the U.S. Department of Labor (DOL) released an Administrator's Interpretation addressing how to determine whether a worker is an independent contractor or employee under the Fair Labor Standards Act (FLSA). The FLSA is the primary federal law regulating minimum wage and overtime pay. The Interpretation puts employers on notice that the DOL is increasing efforts to curtail the misclassification of workers.

The "Economic Realities" Test Under the FLSA

To determine whether a worker is an employee or independent contractor under the FLSA, courts apply the "economic realities" test. The test focuses on whether the worker is economically dependent on the company or in business for himself or herself. The "economic realities" test has six factors:

- Extent the work performed is integral to the company's business
- Degree of control held by the company over the worker
- Whether the worker's opportunity for profit or loss depends on managerial skill
- The worker's investment in equipment or materials required for work tasks, or the worker's employment of others
- Whether the service rendered requires a special skill
- Degree of permanency and duration of the working relationship

The DOL interprets each factor in a way that favors employment status. In particular, the DOL places special emphasis on the importance of the "integral to the business" prong. If a worker is critical to the business, according to the DOL, it is more likely that the worker is economically dependent.

DOL's "Economic Realities" Test v. the IRS's "Right-to-Control"

In earlier articles, we described how federal and state courts and agencies determine if an individual is an employee or independent contractor under other statutes. The most significant of those other statutes is the Internal Revenue Code. Aside from the risk of overtime liability, federal tax enforcement poses the greatest danger to an enterprise that misclassifies employees as independent contractors. The Internal Revenue Service does not apply the "economic realities" test, instead using the "right-to-control" test, which focuses on "control" of the worker in determining employee status. The IRS primarily analyzes whether the company controls or has the right to control what the worker does and how he or she does the job. In contrast, the DOL in the Interpretation discourages emphasis on the "control" factor.

Impact of the DOL's Interpretation of the Economic Realities Test

The Interpretation signals DOL's commitment to aggressively pursue companies that rely on independent contractors rather than treating workers as employees. These companies should carefully examine their relationship with workers under the Interpretation and under the tests applied by other courts and agencies.

If you have questions about your engagement of independent contractors, please contact Foster Pepper's Employment & Labor group.