Engage PEO Client Alert

U.S. Department of Labor's Final Rule on Worker Classification

WHAT'S NEW: On January 9, 2024, the U.S. Department of Labor ("DOL") announced its final rule on evaluating and classifying workers as either employees or independent contractors under the Fair Labor Standards Act. The final rule is scheduled to go into effect on March 11, 2024.

WHY IT MATTERS: The new rule ultimately rescinds the 2021 Independent Contractor Rule which focused primarily on who maintained control of the worker's work and the extent of the worker's opportunity for profit or loss. The final rule restores the **"economic reality test"** that has long been used to determine whether a worker is in business for themselves (i.e., an independent contractor) or is economically dependent on an employer (i.e., an employee).

The economic reality test considers all of the following factors using a **totality of the circumstances analysis** without assigning more weight to a particular factor or set of factors:

1) Opportunity for profit or loss depending on managerial skill

This factor examines whether or not a worker exercises managerial skill that impacts the worker's economic success. This factor relates to the level of autonomy an individual exercises over the economic aspects of the work they perform. **If a worker has no opportunity for a profit or loss, then this factor suggests that the worker is an employee.**

2) Investments by the worker and the employer

This factor examines whether a worker's investment is "capital or entrepreneurial in nature." Costs incurred by a worker who performs a job, such as purchasing tools and equipment, are not considered capital or entrepreneurial in nature and instead indicate that the worker is an employee. **A worker's investment will be deemed to be "capital or entrepreneurial in nature" when it supports an independent business and serves a business-like function, such as increasing a worker's ability to do various types of work or additional work, reducing costs, or extending the worker's ability to work in a different or larger market.** Examples of such an investment might include the purchase of software to increase efficiency and decrease costs or the purchase of marketing services to expand the worker's reach into new markets.

3) Degree of permanence of the work relationship

This factor examines whether a work relationship is continuous or of indefinite duration. **If the work performed is indefinite (meaning there is no set date for completion) in duration or continuous, this suggests the worker is an employee.** If the work relationship is definite in duration, non-exclusive, project-based, or sporadic, then that suggests that the worker is an independent contractor.

4) Nature and degree of control

This factor examines the Company's control over the performance of the work. In short, this factor analyzes whether the individual performing the work controls how and when work is performed, or if the Company exercises the majority of control over this area.

Where there are more instances of control by a Company, it is more likely that a worker would be classified as an employee. Where there are more instances of control by the worker, then the worker is more likely to be classified as an independent contractor.

5) The extent to which work performed is an "integral" part of the Company's business

This factor does not consider whether or not an individual worker is an integral part of the business but rather **whether or not the function that the worker performs for the company is an integral part of the business**.

6) Skill and initiative

This factor evaluates whether or not the worker uses specialized skills or training, which are not provided by the Company, in order to perform the work. **A worker is more likely to be classified as an employee when the worker either does not use specialized skills in performing the work or utilizes skills and/or training acquired from the employer to perform work.** For example, workers who work on the sales floor of a department store and utilize training provided by the Company to generate sales are employees.

WHAT EMPLOYERS SHOULD DO: Employers should review workers who are currently classified as independent contractors and conduct an analysis under the six-factor test to determine if the designation will still be able to pass muster. Employers should also review procedures for designating independent contractors under the new rule moving forward.

Employers with operations in multiple states should keep in mind that different standards may apply when determining independent contractor status depending on the state in which they employ people. For example, California has adopted a more stringent "ABC test" that makes classifying workers as independent contractors much more difficult because it establishes a presumption that a worker is an employee and places the burden on employers to prove otherwise.

Please reach out to your Engage Human Resources Consultant if you have any questions concerning this alert or other H.R.-related matters.