Independent Contracting Proposed Rule – Department of Labor

Updated on 3/19/24

Final rule: https://www.federalregister.gov/public-inspection/2024-00067/employee-or-independent-contractor-classification-under-the-fair-labor-standards-act

Summary:

Independent contracting has become a controversial issue as administrative agencies, Congress, and even states have been attempting to redefine who is an employee and who is an independent worker.

Many leaders, including President Joe Biden, are pushing for more restrictive tests in order to stop self-employed workers from working for themselves and instead force them into being employees even if they prefer their status. Reasons include making it possible to unionize these workers, increasing taxes on them, and expanding regulatory control over more businesses and workers.

The Biden Department of Labor (DOL) proposed a new independent contractor rule on October 11, 2022 to address what Secretary Walsh deems "misclassification" of workers. This now-final rule replaced the DOL rule from the Trump administration that went into effect in March 2021 – a rule which the Biden administration improperly attempted to rescind that provided clarity to the "economic realities" test used to determine the employment status of workers under the Fair Labor Standards Act (FLSA).

DOL is no longer accepting public comments on this regulation, which was published as a final rule on January 10, 2024 with an effective date of March 11, 2024. Legislation has been introduced in the U.S. House and Senate, utilizing the Congressional Review Act to repeal the rule. There are other legal challenges as well.

Notable aspects of the newly proposed DOL rule

The DOL has argued that its proposed rule is a return to a "longstanding judicial precedent" and a more accurate interpretation of the economic realities test used for worker classification and furthermore that the new rule will improve "clarity" and "will be helpful for both workers and employers in understanding how to apply the law in this area."

However, the final published rule neither simply returns to the previous multifactor economic realities test nor provides greater certainty and clarity for businesses and workers. Instead, the rule adds new

interpretations of economic reality factors, removes emphasis on the factors that are most important for businesses and workers to be aware of, and worst of all guides DOL to make employment determinations around merely theoretical control – a pandora's box of subjective interpretations by DOL that cloud the legal landscape for businesses and workers more than ever before.

Highlights include:

- De-emphasizing a focus on the core factors of "nature and degree of control over the work" and the "worker's opportunity for profit and loss" established in the 2021 DOL rule, which provided clarity on the most important economic reality factors. Although DOL indicates the rule is a return to emphasizing the six factors together, it in fact modifies its interpretation and emphasis within the factors, essentially creating new definitions outside of previous rulemaking. The six factors included in the final rule are:
  - Worker's opportunity for profit or loss;
    - DOL newly indicates that "decisions by a worker that can affect the amount of pay that a worker receives, such as the decision to work more hours or take more jobs *when paid a fixed rate per hour or per job*, generally do not reflect the exercise of managerial skill indicating independent contractor status under this factor."
  - Investments by the worker and potential employer;
    - DOL newly emphasizes that "the focus should be on comparing the investments to determine whether the worker is making similar types of investments as the potential employer (even if on a smaller scale) to suggest that the worker is operating independently."
    - DOL newly includes "language recognizing that costs that are unilaterally imposed are not indicative of a worker's capital or entrepreneurial investment." In other words investments by a worker may be ignored in certain circumstances even if they are an investment of value and necessity for a worker's independent work.
  - Degree of permanence of the relationship;
  - Nature and degree of the potential employer's control over the work;
  - Extent to which the work is "integral" to the potential employer's business;
  - Worker's skill or initiative. DOL indicates that the skill must be "in connection with business-like initiative."
- Elevating consideration of certain factors such as investment and initiative as well as consideration of how work performed by independent contractors (ICs) may be "central or important" to a business they provide services for. Determining whether certain work is central or important to a business leaves considerable leeway for DOL to impose its own interpretations in unpredictable fashion.
- The new DOL rule would also emphasize new factors and perspectives in evaluating control by a business, including around price-setting, scheduling, and "the ability to work for others," again expanding subjective, unpredictable interpretations by DOL.
- Perhaps most concerning, the rule would give DOL the ability to make employment determinations based on "reserved" or theoretical control, not requiring that control actually be exerted. Such a broad interpretation would have a chilling effect on self-employment, putting conceivably all independent contracting work in jeopardy.

Background:

Note the National Labor Relations Board (NLRB) is also considering changes to its independent contracting test. For more on NLRB actions, please see our "Independent Contracting – NLRB" page.

President Biden and Labor Secretary Marty Walsh have consistently signaled interest in undermining independent contracting with new pushes to increase so-called "misclassification" determinations via destructive legislation like the PRO Act, new determinations at the National Labor Relations Board (NLRB), and also the DOL through a new rule officially announced on October 11, 2022.

What is the DOL role in independent contracting?

One responsibility of the United States DOL is to enforce the Fair Labor Standards Act (FLSA) of 1938, which among other things sets wage, hourly, and reporting requirements for employees. Because ICs are not employees, FLSA requirements do not apply to the work they complete, but this requires the DOL to determine whether workers are to be classified as employees or ICs. Through court precedent, DOL has come to utilize what is known as "economic realities" factors to make employment designations.

The Biden administration has provided clear indication of its intent to sweep many independent contractors into traditional employment arrangements and, with DOL's proposed rule, seeks to do so by erasing the Trump IC rule and reverting to a standard similar to the Obama-era rule. Previously a U.S. District Court invalidated the Biden administration's attempt to remove a positive DOL independent contractor rule published on January 7, 2021 due to improper procedures.

See further below a brief timeline of court cases and rules for additional context on independent contracting related to DOL.

What is independent contracting?

Independent contracting is the process where self-employed workers perform services for clients on a contractual basis for income. While ICs do have to meet certain standards and other expectations of clients regarding the quality and timing of their work product, they are not under the direct control of business clients like traditional employees are and retain entrepreneurial opportunity for their own profit and loss.

Of the over 70 million freelancers in the U.S. economy as of 2022, tens of millions earn income as ICs across many industries including in transportation, construction, medical, educational, entertainment, financial, legal, housing, agriculture, and other service roles. ICs with their small businesses also employ tens of millions of additional workers and create many of the small businesses that fuel communities. In addition to pursuing self-employment for more income, many prefer the additional flexibility in these careers to raise children and often to deal with personal or family health issues.

A federal study by the Bureau of Labor Statistics (BLS) also found that nearly 80 percent of ICs prefer independent work over traditional jobs and less than 10 percent would switch to a traditional job if given the choice.

Because ICs are self-employed, their business clients do not collect payroll taxes or enforce certain federal and state labor laws that apply to traditional employees such as government-mandated hourly and wage requirements among others.

In order to determine if a worker is a traditional employee or an IC, the process is not as simple as ICs making a personal choice about their self-employed status with clients. Instead, different federal and state agencies utilize employment tests to make determinations. At the federal level alone, this

includes different processes for determinations by the Internal Revenue Service (IRS), Department of Labor (DOL), and National Labor Relations Board (NLRB). Being classified as an employee by one agency jeopardizes a person's IC status broadly. Examples of employment tests include:

- US Department of Labor (DOL) economic realities test – In enforcing the Fair Labor Standards Act of 1938 (FLSA), DOL utilizes an "economic realities test" that has largely been set by court precedent over decades. Subjective factors to determine IC vs. employee status include opportunities for profit and loss, operation of an independent business, nature and degree of control by principals, permanency of relationship, and extent to which services are integral to a principal's business.
- IRS and NLRB Common Law Tests – The IRS and NLRB common law tests are similar. Of note, both tests allow for a broad interpretation such that ICs and employees can share some factors in common but remain classified differently as a result of reviewing a totality of individual situations.
    - NLRB common law test – Over time, federal courts interpreted how the NLRB must enforce the National Labor Relations Act (NLRA) in making employment determinations, which particularly governs whether workers are eligible for unionization. While specific factors have been changed by the NLRB over time and through ensuing court decisions because no statute provides a specific test, the recurring perspective supported in courts is determining workers to be ICs if they have entrepreneurial opportunities for profit and loss. The 2019 SuperShuttle case reinstated the common law standards that were used prior to Obama era changes that failed to persuade courts to modify their historical interpretations.
    - Internal Revenue Service (IRS) common law test – The IRS makes employment determinations for federal taxation purposes using a common law test that has also been established through court precedent rather than formally through statute. Traditionally, the common law test was a 20 factor test that has since evolved into three primary categories: behavioral, financial, and type of relationship. These evaluate the degree of control and dependence of workers with no definitive factors used solely to determine employment status.
- ABC tests – Used by states like California, ABC tests are particularly restrictive against independent contracting. A range of factors are established under three main categories – **A**bsence of Control, **B**usiness of the Worker, and the Usual **C**ourse of Business. Unlike other tests, ABC tests presume all workers are employees, and failing to fully meet any of the subjective criteria in an ABC test is grounds for governments reclassifying ICs to employees. Among other harmful provisions, the NLRB would be required to utilize an ABC test if the PRO Act were enacted. This legislation passed the U.S. House in 2021 and is endorsed by President Joe Biden. At her confirmation hearing on September 13, 2022, DOL Wage and Hour Administrator-nominee Jessica Looman said the Department does not have the authority to impose an ABC test via the regulatory process. Her view was also articulated in DOL's NPRM.

While the proposed rule spoke favorably of the ABC test, ultimately DOL rejected the test noting that:

the Department believes it is legally constrained from adopting an ABC test because the Supreme Court has held that the economic reality test is the applicable standard for determining workers' classification under the FLSA as an employee or independent contractor. Moreover, the Supreme Court has stated that the existence of employment relationships under the FLSA "does not depend on such isolated factors" as the three independently determinative factors in the ABC test, "but rather upon the circumstances of the whole activity." Because the ABC test is inconsistent with Supreme Court precedent interpreting the FLSA, the

Department believes that it could only implement an ABC test if the Supreme Court revisits its precedent or if Congress passes legislation to amend the FLSA.

Brief DOL Independent Contractor Timeline:

- 1947 – Rutherford Food Corp. v. McComb, 331 U.S. 722. In this U.S. Supreme Court decision, the court found that employment status was not dependent on isolated factors but instead "upon the circumstances of the whole activity."
- 1947 – United States v. Silk, 331 U.S. 704. In another case involving independent contractor status as it related to the Social Security Act, the Supreme Court clarified that workers were evaluated as a matter of "economic reality."
- 1961 – Goldberg v. Whitaker House Cooperative, Inc., 366 U.S. 28. In this Supreme Court case, the Court further solidified looking at full circumstances around employment status as based on "economic reality."
- 2015 – President Barack Obama's DOL published Administrators Interpretation No. 2015-1 on July 15, which instructed the DOL's Wage and Hour Division (WHD) in making employment determinations to focus on the "suffer or permit to work" standard when considering economic realities factors. This interpretation was an attempt to more aggressively classify workers as employees, not ICs.
- 2017 – On June 7, the Trump administration withdrew the Obama 2015 DOL guidance on independent contracting, restoring traditional emphasis on the economic realities test.
- 2020-21 – On September 25, 2020, the Trump DOL proposed a new independent contractor rule regarding IC status under FLSA. This was finalized and published in January 2021 and went into effect in March 2021. This rule adhered to DOL's economic realities factors but sought to provide clarity in consideration of the modern workforce. This rule prioritized two factors, the nature and degree of control over the work and a worker's opportunity for profit or loss based on initiative and investment, over three other traditional economic realities factors.
- 2021-2022 – In May 2021, the Biden DOL withdrew the Trump DOL independent contractor rule, but as summarized by DOL, "On March 14, 2022 a district court in the Eastern District of Texas vacated the Department's Delay Rule, Independent Contractor Status Under the Fair Labor Standards Act (FLSA): Delay of Effective Date, 86 FR 12535 (Mar. 4, 2021), and the Withdrawal Rule, Independent Contractor Status Under the Fair Labor Standards Act (FLSA): Withdrawal, 86 FR 24303 (May 6, 2021). The district court further stated that the Independent Contractor Rule, Independent Contractor Status Under the Fair Labor Standards Act, 86 FR 1168 (Jan. 7, 2021), became effective as of March 8, 2021, the rule's original effective date, and remains in effect."
- 2022 – On September 28, 2022, the White House's Office of Information and Regulatory Affairs (OIRA) concluded internal review of a new DOL independent contractor rule.
- 2022 – On October 13, 2022, DOL published a Notice of Proposed Rulemaking (NPRM) to rescind the 2021 rule and impose a new IC rule based on a multi-factored economic realities test. A period for public comment will run for 45 days, closing on November 28, 2022.

Further Reading:

- U.S. Department of Labor Finalizes Independent Contractor Regulation. https://i4aw.org/regulation-watch/independent-contracting-proposed-rule/
- Coalition Letter signed by I4AW supporting 2021 DOL IC rule and opposing a new anti-IC rule by Biden administration. https://americansforprosperity.org/wp-content/uploads/2022/07/AFP-DOL-Anticipated-IC-Rule-Letter_07.21.22.pdf

- Worker Classification: Employee Status Under the National Labor Relations Act, the Fair Labor Standards Act, and the ABC Test. https://crsreports.congress.gov/product/pdf/R/R46765/1
- Amidst inflation, President Biden should refocus his efforts on expanding flexible work careers for Americans. https://thehill.com/opinion/congress-blog/3593484-amidst-inflation-president-biden-should-refocus-his-efforts-on-expanding-flexible-work-careers-for-americans/
- THE ROLE OF INDEPENDENT CONTRACTORS IN THE U.S. ECONOMY. https://iccoalition.org/wp-content/uploads/2014/07/Role-of-Independent-Contractors-December-2010-Final.pdf
- RESOLUTION IN SUPPORT OF INDEPENDENT CONTRACTING. https://alec.org/model-policy/statement-of-principles-on-independent-contracting/
- Freelance Forward Economist Report. https://www.upwork.com/research/freelance-forward-2021
- 11TH ANNUAL STATE OF INDEPENDENCE. The Great Realization. https://www.mbopartners.com/state-of-independence/
- Who are independent contractors, and how would the PRO Act limit their opportunity? https://americansforprosperity.org/who-are-independent-contractors-pro-act/
- Biden must reverse course and protect independent contractors. https://thehill.com/opinion/white-house/3526515-biden-must-reverse-course-and-protect-independent-contractors/
- The State of Gig Work in 2021. https://www.pewresearch.org/internet/2021/12/08/the-state-of-gig-work-in-2021/
- Three-in-Ten U.S. Jobs Are Held by the Self-Employed and the Workers They Hire. https://www.pewresearch.org/social-trends/2015/10/22/three-in-ten-u-s-jobs-are-held-by-the-self-employed-and-the-workers-they-hire/
- Ready, Fire, Aim. How State Regulators Are Threatening the Gig Economy and Millions of Workers and Consumers. https://www.uschamber.com/assets/archived/images/ready_fire_aim_report_on_the_gig_economy.pdf
- An Empirical Snapshot of the Gig Economy. https://www.cato.org/regulation/fall-2021/empirical-snapshot-gig-economy

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