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The Employee/Independent Contractor Pendulum Swings Back Again

Throughout this decade, the U.S. Department of Labor (DOL) has repeatedly changed the criteria for determining whether a worker is an employee or an independent contractor under the Fair Labor Standards Act (FLSA), going back and forth with tests that are more favorable to classification as an employee or an independent contractor. On February 27, the DOL announced a new proposed rule that would rescind the Biden administration's 2024 rule and replace it with one similar to the Trump administration's 2021 rule. The proposed rule, if adopted, will make it easier for employers to classify workers as independent contractors.

The proposed rule applies an "economic reality" test using two "core" factors and three secondary factors to determine employee or independent contractor status under the FLSA. The two core factors, which would carry greater weight than other factors, are the nature and degree of control over the work and the worker's opportunity for profit or loss. The proposed rule would apply the new independent contractor test not only to the FLSA, but also to other federal employment laws such as the Family and Medical Leave Act and the Migrant and Seasonal Agricultural Worker Protection Act.

To understand the new proposed rule, it is important to review the back-and-forth history that preceded it.

2015 Guidance

In July 2015, under President Obama, the DOL Wage and Hour Division (WHD) issued guidance that applied a six-factor economic realities test for determining independent contractor status under the FLSA. The 2015 guidance stated that all six factors should receive equal weight and that the FLSA's definition of "employment" should be interpreted broadly to include most workers. The Trump administration withdrew the 2015 guidance in 2017.

2021 Rule

In January 2021, under President Trump, the DOL published a final rule that applied a five-factor test to determine employee or independent contractor status under the FLSA. Two of the factors were designated core factors and would receive more weight than the others: the nature and degree of the worker's control over the work and the worker's opportunity for profit or loss. The three other factors were the amount of skill required for the work, the degree of permanence of the working relationship, and whether the work is part of an integrated unit of production. The 2021 rule tipped the scales to result in more workers being considered independent contractors under the FLSA.

2024 Rule

In January 2024, under President Biden, the DOL published a final rule rescinding and replacing the 2021 rule. The 2024 rule (which we discussed in the January 26, 2024, alert, U.S. Department of Labor Finalizes Independent Contractor Rule) applied a totality-of-the-circumstances test to determine employee or independent contractor status under the FLSA, identifying six non-exhaustive factors having equal weight. The six factors were (1) opportunity for profit or loss depending on managerial skill, (2) investment by the worker and the 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, and (6) skill and initiative. The 2024 rule signaled a reversal in course from the 2021 rule to broaden the scope of workers considered employees under the FLSA.

2026 Proposed Rule

The new proposed rule would rescind the 2024 rule and essentially restore the 2021 rule. It states that the ultimate inquiry in determining whether an individual is an independent contractor or an employee asks whether the individual is in business for themselves (independent contractor) or is economically dependent on an employer for work (employee). Like the 2021 rule, the proposed rule applies two core factors as part of the economic reality test used to determine employee or independent contractor status, with other factors carrying less weight. The two core factors are:

- **The Nature and Degree of the Individual's Control over the Work.** This factor weighs toward the individual being an independent contractor where the individual, rather than the potential employer, exercises substantial control over key aspects of the performance of the work such as scheduling, selection of projects, and the ability to work for others (which may include the potential employer's competitors). By contrast, this factor weighs in favor of the individual being an employee where the potential employer, rather than the individual, exercises substantial control over key aspects of the performance of the work, such as by controlling the individual's schedule or workload or by requiring the individual to work exclusively for the potential employer.
- **The Individual's Opportunity for Profit or Loss.** This factor weighs toward the individual being an independent contractor to the extent the individual has an opportunity to earn profits or incur losses based on their exercise of initiative (such as managerial skill, business acumen or judgment) or management of their investment in or capital expenditure on, for example, helpers or equipment or material to further his or her work. This factor weighs toward the individual being an employee to the extent the individual is unable to affect earnings or is able to do so only by working more hours or more quickly.

The proposed rule states that the two core factors should be considered first, and if they both point toward the same classification, there is a substantial likelihood that it is the accurate classification. There are also three secondary factors, which may serve as additional guideposts but are less probative than the core factors and, in some cases, may not be probative at all. These are:

- **The Amount of Skill Required for the Work.** This factor weighs in favor of independent contractor status to the extent the work at issue requires specialized training or skill that the potential employer does not provide. It weighs in favor of employee status to the extent the work at issue requires no specialized training or skill and/or the individual is dependent on the potential employer to provide any skills or training necessary to perform the job.
- **The Degree of Permanence of the Working Relationship.** This factor weighs in favor of the individual being an independent contractor to the extent the work relationship is by design definite in duration or sporadic, which may include regularly occurring fixed periods of work, although the seasonal nature of work by itself does not necessarily indicate independent contractor classification. This factor weighs in favor of the individual being an employee to the extent the work relationship is by design indefinite in duration and not on a fixed schedule or continuous potentially over a long period of time without a break in service.
- **Whether the Work Is Part of an Integrated Unit of Production.** This factor weighs in favor of the individual being an independent contractor to the extent their work is segregable from the potential employer's production process. It weighs in favor of the individual being an employee to the extent his or her work is a component of the potential employer's integrated production process for a good or service. This factor is different from the concept of the importance or centrality of the individual's work to the potential employer's business.

The identified factors are not exhaustive, and additional factors may be considered to the extent they help answer the question of whether the individual is in business for themselves or is economically dependent on the employer for work. The proposed rule explains that when evaluating an individual's economic dependence on a potential employer, the parties' actual practice is more relevant than what may be contractually or theoretically possible.

Bottom Line

The proposed rule is not yet final. The public comment period runs through April 26, and employers may submit comments on the Regulations.gov website, either on their own or through counsel. Employers should start thinking about how the proposed rule may affect their classification of employees and independent contractors. As most states have their own independent contractor tests, this should be done in conjunction with an evaluation of any applicable test at the state level so employers are prepared to make any appropriate changes if and when the rule becomes final.

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