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Labor & Employment Client Alert

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What Independent Contractors and Dodo Birds May Soon Have In Common

Yesterday, the Wage and Hour Division (WHD) of the U.S. Department of Labor (DOL) issued its first Administrator Interpretation of 2015 on the heels of the proposed white collar exemption revisions that would greatly expand the universe of overtime-eligible employees, as addressed in our Client Alert dated July 1, 2015. Aimed at rectifying what the WHD views as an increasing and widespread misclassification of employees as independent contractors, the interpretation proclaims that "most workers are employees under the FLSA." Conceding that independent contractor relationships can be advantageous for workers and businesses, the WHD cites the loss of payroll tax revenues to the government and loss of workplace protections and benefits for workers, such as overtime, minimum wage, and insurance, as the need for additional guidance regarding who is an employee under the Fair Labor Standards Act (FLSA). The full text of the Interpretation can be found here.

FLSA Definitions

One word concisely sums up the FLSA's definitions that describe who is an employee – *expansive.* The FLSA defines "employ" as "to suffer or permit to work," a phrase originating from pre-FLSA laws regulating child labor and intended to have broad applicability. "Employee" means "any individual employed by an employer." And, "employer" means "any person acting directly or indirectly in the interest of an employer in relation to an employee," a phrase that has been interpreted broadly enough to include individuals and make them personally liable for FLSA violations.

Economic Realities Test

The multi-factor economic realities test applies to determine whether a company "suffers or permits" an individual to work, thereby making him an employee. Employee status is conferred if, as a matter of economic reality, the worker is dependent on the company. While no one factor is determinative and the evaluation is qualitative rather than quantitative, the economic realities test considers: (1) whether the work performed is an integral part of the company's business; (2) the worker's opportunity for profit or loss based on his use of managerial skill; (3) the relative investments of the worker and the company; (4) whether the work performed requires special skills; (5) the permanency of the relationship; and (6) the degree of control exercised by the company. Labels, titles, and written contracts will not determine whether a worker is an independent contractor. The question is whether, in light of these factors, the worker has economic independence and operates a business of his own or whether he is economically dependent on the employer.

Internal Revenue Code Test

It is clear that the WHD interpretation of who constitutes an employee is more expansive than the Internal Revenue Service's historical interpretation of who constitutes an employee. While the two interpretations are legally distinct, the reality faced by employers is that it is not practical to treat a worker as an employee for FLSA purposes and an independent contractor for tax purposes. As a result, employers are now faced with applying the expansive interpretation of the WHD even for tax purposes. Applying the expansive interpretation of the FLSA for tax purposes can have significant effects under the tax rules even beyond employment taxes. For example, the application of provisions of the Affordable Care Act, eligibility under many retirement and welfare benefit plans, and other tax and benefits consequences flow from a worker's classification as an employee for tax purposes.

Fewer Contractors, More Employees

Whether the independent contractor will become extinct like the Dodo bird remains to be seen. The interpretation offers specific scenarios to illustrate the differences between employees and independent contractors, and how the economic realities factors should be applied. What is clear is that the WHD believes many current employees are misclassified as independent contractors, and the guidance is a wake-up call to companies who have not enlisted their labor and tax attorneys to evaluate worker classifications. Just because a worker might pass muster as an independent contractor for one purpose, say for the purpose of an unemployment compensation claim, doesn't mean the same outcome will hold under the FLSA, the Internal Revenue Code, or another federal or state law. Government investigations and private lawsuits challenging worker classification are on the rise, and yesterday's guidance is sure to increase that activity. So, don't wait ... seek a qualified legal evaluation now to be sure that your practices are compliant and to correct them if they aren't compliant.

For further information, please contact Jennifer L. Anderson, Mary Margaret LeBato, or B. Trevor Wilson.

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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