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U.S. Department of Labor Issues Guidance on Misclassification of Workers

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Employment

Last week, the Wage and Hour Division of the U.S. Department of Labor ("DOL") issued new guidance on misclassification of employees as independent contractors, which DOL stated "is found in an increasing number of workplaces." From the perspective of DOL, classification of workers is significant because it dictates the availability of protections such as minimum wage, overtime compensation, unemployment insurance, and workers' compensation. Although DOL's guidance does not have the effect of law or regulations, it indicates a heightened focus on misclassification and suggests that DOL will increase its investigation and enforcement in this area.

DOL's key points in the guidance are that (1) most workers are employees under the broad definitions of the Fair Labor Standards Act ("FLSA"); (2) no single factor is determinative and employers should be wary of classifying workers as independent contractors merely because the workers control some aspects of their work; and (3) the ultimate question is whether a worker "is really in business for him or herself (and thus is an independent contractor) or is economically dependent on the employer (and thus is an employee)."

DOL is not the only government agency concerned about the misclassification of employees. The Internal Revenue Service has developed its own twenty-factor test for classifying workers because employers are not required to withhold taxes from payments made to independent contractors and misclassification thus lowers tax revenues significantly. And additional tests have been created to classify workers for purposes of workers' compensation eligibility (the "relative nature of the work" test) and for state unemployment benefits (the "ABC" test).

The tests of the various agencies include overlapping considerations, but DOL's focus is on the meaning of "employ" under the FLSA, which is defined in the statute as "to suffer or permit to work." Courts have developed a multi-factor "economic realities" test to interpret that language and determine whether a worker is an employee or an independent contractor under the FLSA. The factors considered under this test are (1) whether the worker's work is integral to the employer's business; (2) whether the worker's managerial skills affect the worker's opportunity for profit or loss; (3) the nature and extent of the worker's and the employer's investments; (4) whether the work requires the worker to exercise business skills, judgment, and initiative; (5) the permanency or indefiniteness of the work relationship; and (6) the nature and degree of control exercised by the employer and the worker.

In the guidance, DOL analyzed each factor and aimed to correct certain misconceptions that could lead to misclassification. For example, DOL noted that a worker is not necessarily an independent contractor simply because the worker invests in tools and equipment, possesses specialized or technical skills, or lacks a permanent relationship with the employer.

Moreover, as to the control factor, which DOL highlighted throughout the guidance, DOL cautioned that "an employer's lack of control is not particularly telling if the workers work from home or offsite" and noted that "workers' control over the hours when they work is not indicative of independent contractor status." The control factor, according to the DOL, tends to be overemphasized by employers classifying workers as contractors. DOL cautioned that no single factor is determinative in the test, and the guidance suggests that the control factor is not as clear as some employers may expect.

Employers should be aware of the risks and liabilities associated with misclassification of employees. Workers misclassified under the FLSA, who may come to light as a result of private lawsuits or DOL audits, may be entitled to additional pay, overtime, and the value of missed benefits, in addition to liquidated damages, if it is determined that they should have been treated as employees. In light of DOL's guidance, employers should be vigilant in ensuring that their classification of workers comports with DOL's interpretation of the "economic realities" test. While the answer may not always be readily apparent, employers should focus on facts that help them determine whether the employee is really in business for him or herself or is economically dependent on the employer.

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