



Insight

DOL's Independent Contractor Classification Proposed Rule Will Disrupt the Labor Market

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Executive Summary

- The Department of Labor recently published its long-anticipated proposed rule, the “Employee or Independent Contractor Classification Under the Fair Labor Standards Act.”
- The rule proposes to rescind the 2021 Independent Contractor Rule and return to a worker classification model that widens the scope of the so-called “economic realities test” used to determine whether a worker is an employee, making it harder for workers to be classified as independent contractors.
- The expansion of the employee definition would reclassify many workers operating as independent contractors as employees, and result in significant disruption to an already volatile labor market with more than [10 million](#) job openings and over [6 million](#) missing workers.

Introduction

The Department of Labor (DOL) recently published its “[Employee or Independent Contractor Classification Under the Fair Labor Standards Act](#)” proposed rule. The rule proposes to rescind the 2021 Independent Contractor Rule (IC Rule) and broaden the scope of the so-called “economic realities test” used to classify workers, likely making it more difficult for workers to be classified as independent contractors. This would create significant disruption for the approximately 73 million workers who operate in the gig economy, around 80 percent of whom [report](#) preferring the flexibility and lifestyle of an independent contractor. Under the rule, many independent contractors would likely be reclassified as employees, creating churn in an already volatile labor market with [10.1 million](#) job openings and [6.3 million](#) missing workers.

The Proposed Rule

The purpose of the DOL’s “Employee or Independent Contractor Classification Under the Fair Labor Standards Act” proposed rule is to redefine how a worker is classified and therefore whether the worker is eligible for employee protections such as minimum wage and overtime pay under the Fair Labor Standards Act (FLSA). Classification is ultimately based on whether a worker is found dependent on a particular entity for work – and is thus operating as an employee and eligible for worker protections – or is in business for themselves and is therefore an independent contractor without those protections.

The rule proposes to rescind the Trump Administration’s 2021 IC Rule and broaden the scope of the economic realities test, which is used to determine worker classification under the FLSA. The test is composed of six factors: the extent to which the work performed is an integral part of the employer’s business, the worker’s opportunity for profit or loss, the nature and extent of the worker’s investment in his/her business, whether the work performed requires special skills, the permanency of the relationship, and the degree of control exercised

or retained by the employer. Under the new proposed rule, each of the factors will be considered holistically and equally, deviating from the 2021 IC Rule which prioritized the degree of employer control and worker's opportunity for profit and loss as "core factors." The proposed changes are likely to favor classification of workers as employees by more regularly asserting economic dependency between workers and their employers.

The Potential Impact

Worker classification has remained a prominent labor issue as gig economy workers and others have [spoken out](#) against legislation such as California's AB5 rule, which significantly expanded the definition of an employee, reclassifying many of the state's independent contractors as traditional employees. The recent proposed rule would represent a significant disruption to work in the gig economy.

There are currently approximately [73.3 million](#) gig workers in the United States, and it is [estimated](#) that over half (52 percent) of U.S. workers will have participated in the gig economy by the end of 2023. Under the DOL's proposed rule, many of these workers would be at risk of being reclassified as traditional employees, which would disrupt the labor market on both the demand and supply side. The resulting churn in the labor market could mean a few different outcomes for these workers. Some will be reclassified as employees and gain worker protections that may guarantee them higher wages, benefits, and other employment perks. Others may find themselves without employment opportunities or choose to remove themselves from the workforce. Employees present a greater cost to employers than gig workers, as they tend to have higher wages and benefit requirements. As such, employers are unlikely to retain every reclassified employee. Some independent contractors may also choose to leave the labor force if they deem it undesirable, inconvenient, or simply impossible to work in a traditional employee position. As a result, the proposed rule has the potential to create disruptions in an already volatile labor market with more than 10 million job openings and over 6 million missing workers.

Such disruptions to the gig economy are likely to worsen as other agencies in addition to the DOL look to crack down on the "misclassification" of employees. The Federal Trade Commission considers employee misclassification a barrier to a competitive labor market and recently promised to [increase enforcement](#) to prevent the misclassification of employees as independent contractors, citing the importance of wage and hour protections promised to employees under the FLSA. While employee misclassification is a concern, most independent contractors choose to work in the gig economy and prefer their work arrangements: [79 percent](#) (approximately 58 million) of freelancers report living their preferred lifestyle, compared to 9 percent of freelancers who would prefer traditional employment. For many of these workers, wage protections that could result in higher wages are not a priority, with over [50 percent](#) reporting that they "wouldn't return to the traditional workforce for any amount of money." In addition, [53 percent](#) of gig workers consider their gig positions a secondary source of income and therefore see it as supplemental. Most freelancers cite the ability to set their own schedules and work for multiple hiring entities as an enticing feature of gig work, with [60 percent](#) reporting that gig work gives them the flexibility they need, compared to just 27 percent of traditional employees.

Independent Contractor Classification Background

The new proposed rule is the latest action in the ongoing debate over how to determine worker classification. In 2015, under the Obama Administration, the Wage and Hour Division of the DOL issued "[The Application of the Fair Labor Standards Act's 'Suffer or Permit' Standard in the Identification of Employees Who Are Misclassified as Independent Contractors.](#)" Under the 2015 interpretation, each factor of the "economic realities test" was to be analyzed in relation to one another without one factor being determinative. The factors were

considered in their totality, providing a wide definition of what an employee may be and making it more difficult to be classified as an independent contractor.

In January 2021, the Trump-era DOL supported a 2019 National Labor Relations Board decision to narrow the definition of an employee by publishing a final rule that introduced the “[Independent Contractor Classification Under the Fair Labor Standards Act](#).” Upon President Biden entering office, the DOL delayed and withdrew the rule. In March 2022, a district court in Texas vacated the delay and withdrawal, reinstating the final rule and backdating it to March 2021.

The 2021 IC Rule differed from the 2015 interpretation by considering two of the six factors of the economic realities test to be probative of the economic dependence decision and therefore carried most of the weight in the analysis. The two factors were the degree of control exercised by the employer and the worker’s opportunity for profit or loss. The focus on these factors made it easier for a worker to be classified as an independent contractor. The new proposed rule is now returning to the 2015 interpretation.

Conclusion

Many workers will likely be reclassified as employees under the DOL’s new independent contractor rule, causing significant disruptions to the already volatile labor market. In attempting to protect workers from unfair misclassification, the rule is more likely to harm a greater percentage of gig workers than it would help.