Insight

# The Department of Labor's Proposed Rule on Independent Work

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## Executive Summary


- The Department of Labor announced a proposed rule that would adopt an economic reality test to distinguish between employees and independent contractors under the Fair Labor Standards Act.
- If finalized, the rule could result in net savings of $369 million a year (over 10 years) and accrue $3.2 billion in total net savings to the regulatory budget.
- The proposed rule is an important step in clarifying worker classification amid a tumultuous period for independent workers.


## Introduction

On September 22nd, the Department of Labor's (DOL) Wage Hour Division announced a proposed rule that, if finalized, would determine worker classification as either an employee or independent contractor. The proposed rule would apply to worker status under the Fair Labor Standards Act (FLSA), which requires employers to adhere to certain regulations concerning employees such as paying overtime, paying minimum wage, and specific record keeping. Employers under the FLSA are not bound by the same obligations to independent contractors. This rule would mark the first time the DOL has defined the term "independent contractor" since the FLSA's enactment over 80 years ago. By finalizing the rule there is the potential for direct economic benefit by increasing clarity on independent contractor eligibility and reducing litigation. Furthermore, the rule could lead more businesses to use contracting, and thus allow more individuals to work as they want outside of the traditional employer-employee framework.

## Economic Reality Test

As currently written, the FLSA has no means of determining a distinction between an employee and independent contractor. When disputes over this question have come to light, they have been settled through a patchwork of legal precedent and sporadic DOL guidance. The most definitive pronouncement on classification occurred in the 1947 Supreme Court case *United States v. Silk*, where the five-part "economic realities test" was established. The economic realities test has been used as the de facto method of determining worker classification by the Social Security Administration and the DOL, but it was not until 2010 that attempts were made by the Department to formally incorporate the test into the FLSA. The DOL has decided to put forward this proposed rule in order to clearly articulate, and by extension predictably apply, its economic reality test.

## Proposed Rule

The proposed rule uses two central factors to determine classification. The central factors in determining

employer versus independent contractor status are:

- the nature and degree of a worker's control over the work, and
- the opportunity for profit (or loss) based on the worker's initiative.

If it is clear that if the working relationship in question is one of economic dependence via both control and profit opportunity, then an employer-employee relationship applies. If both factors point in the other direction, then a contracting relationship is present. The DOL identified three other factors to serve as "additional guideposts" under more complicated circumstances. They include:

- The amount of skill required for the work being done,
- The degree of permanence of the working relationship, and
- Whether the work is part of an integrated unit of production.

The proposed rule is not perfect, but it does mark an important movement toward a clearer standard definition around the work that exists outside of the traditional employer-employee relationship. The difficulty is that other agencies use different definitions. The Internal Revenue Service, for example, defines independent contracting using an 11-factor test. Further, certain states have slightly varied definitions of what makes an employer, and the uncertainty that the proposed rule is trying to correct is in part what led to the passage of California's controversial Assembly Bill 5 (AB5). These challenges will certainly be raised in the comment period for this rule, and a final version could be amended or clarified to take them into account.

**Economic Impact**

If finalized, the proposed rule would have a significant economic impact. Based on the DOL's economic impact analysis, the proposed rule would result in total net savings of $369 million per year over 10 years (discounted at 7 percent), as regulatory familiarization costs are outweighed by savings from increased clarity and reduced litigation. It would also accrue nearly $3.2 billion in total net savings to the Trump Administration's regulatory budget.

Whether these savings will be realized will depend on the outcome of this year's election. If President Trump loses, the proposed rule would likely be quickly withdrawn by a Biden Administration. Even if the rule is finalized in the waning days of the Trump Administration, it could become a target of Congressional Review Act resolution of disapproval should Democrats take over the Senate.

**Why This Matters**

This proposed rule is a move toward standardizing the confusing and inconsistent definitions surrounding employment and independent contracting at both the federal and state levels. The debate surrounding classification is ongoing, particularly with California's AB5 and similar legislation in New York and New Jersey , and the DOL's proposed rule is setting a marker under the FLSA that clarifies the difference between an employer-employee or a contractor relationship. The economic reality test would be far less restrictive than the ABC test that is part of AB5 and its national counterpart, the PRO Act. With the added clarity that this rule is expected to provide, businesses could be encouraged to hire independent contractors, creating higher demand for that kind of work. Furthermore it preserves and protects the advantages of contracting work, particularly worker autonomy. Self-employed workers generally report high job satisfaction by virtue of the flexibility and independence contracting allows.

**Conclusion**

While the proposed rule from the DOL would offer greater clarity around worker classification, it is by no means guaranteed implementation. The rule would result in net savings for both the DOL and the Trump Administration, but a Biden Administration could and likely would withdraw the proposed rule. The comment period is expected to begin later this week or early next.