Employee vs. Independent Contractor? Depends on the Agency

Take-Away: Is a worker as a matter of economic reality in business for themselves? The answer can depend on which federal law, or federal agency, is looking at the worker's relationship with the party who hires the worker.

Background: Thirty-six percent (36%) of the U.S. workforce are classified by the Department of Labor (DOL) as independent contractors. Which is why it is important to note that on March 11, 2024, the DOL published its final rule that revised its guidance on what constitutes an independent contractor versus an employee. This *new* rule creates a six-factor test for the Fair Labor Standards Act (FLSA) coverage, and state and federal characterization of the relationship, which in turn may impact the ERISA characterization of the worker's relationship.

The classification of a worker is critical, considering that the FLSA classified employees must be paid minimum wage and overtime, along with employer contributions for payroll taxes, Social Security, and Medicare taxes. Misclassifying a worker can also lead to a class action lawsuit. By way of an eye-opening example, in 2015 FedEx settled a class action lawsuit for $228 million after it had mistakenly classified 2,300 truckdrivers as independent contractors.

Over the years, federal courts as well as federal agencies have come up with different 'tests' to determine if an individual worker is an employee or an independent contractor, all of which can either lead to confusion or possible abuse.

Supreme Court: Back in 1947 the Supreme Court in *U.S. v. Silk* used an *economic reality* test when it found that coal uploaders were employees within the meaning of the Social Security Act. This conclusion was reached because the coal uploaders had no opportunity to gain or lose, except from the work of their hands, with simple picks and shovels that the workers provided themselves. This *economic reality* test was consistent with the definitions used under the National Labor Relations Act.

FLSA: The DOL's newest test uses 6 factors to determine a worker's classification. Those 6 factors are the following:

1. Opportunity for profit or loss depending on managerial skill.

2. Investments by the worker and the employer.
3. Permanence of the work relationship.
4. Nature and degree of control.
5. Whether the work performed is integral to the employer's business.
6. Skill and initiative.

IRS: However, the IRS focuses on a different set of factors to determine if a worker is classified as an employee or independent contractor, which means that the Department of Labor (DOL) and the IRS can arrive at different conclusions as to whether a worker is an employee or an independent contractor. The IRS uses what it calls a '*common law*' test in making this employee-vs-independent contractor determination.

The DOL concedes in its FAQs that its 6-factor economic reality 'test' is much broader than the IRS's 'test' because as a matter of *economic reality*, a worker is often *economically dependent* on an employer for work.

The IRS uses its own 20-factor analysis, which looks at more *technical* factors such as: (i) level of instruction; (ii) amount of training; (iii) degree of business integration; (iv) extent of assistance; (v) continuity of relationship; (vi) flexibility of schedule; (vii) demands for full-time week; (viii) need for onsite services; (ix) sequence of work; and (x) requirements for reports, as just an example of the different factors the IRS looks at when applying its test. [Revenue Ruling 87-41.] The IRS concedes that its 20-factor 'test' is not exclusive. The IRS divides the various factors into three different categories of evidence: (A) behavior control; (B) financial control; and (C) relationships of the parties.

ERISA: Then we have ERISA which uses its own *common law* employee test to determine coverage and when apply its discrimination 'tests.' In *Nationwide v. Darden,* the U.S. Supreme Court adopted a common law 'test' using general *agency principles* to determine who qualifies as an employee under ERISA where 13 factors (not always the same FLSA 6-factors or the IRS 20-factors) are considered. An employer's *right to control* the manner and/or how work is done, and the skill of the worker are two of ERISA's 13 different factors. As with the FLSA and the IRS 'tests,' no one ERISA actor will be decisive.

Comparison: What the 6-factor FLSA test, the 20-factor IRS test, and ERISA's 13-factor *common law* test have in common include the worker's opportunity for and realization of profits and losses and the worker's investment in facilities and equipment balanced against a continuing permanent relationship

between the worker and the employer and the worker's integration within the employer's company, along with the employer's nature and degree of control in the relationship.

It is more difficult to describe where these 'tests' diverge from one another, since it may depend on how the various factors are weighed and interpreted, more so than the factors themselves.

As a generalization, the FLSA definition of employment probably encompasses a broader group of workers than those who might qualify as employees under either a traditional *agency* test or a common law *control* test. The focus of the DOL is on economic *dependence* rather than *control*, which tends to be the ultimate inquiry for purposes of the FLSA– is the worker as a matter of economic reality in business for themselves.

Conclusion: Application of the FLSA's 'test' is probably intended by the DOL to force more workers to be classified, or reclassified, as *employees*. Whether more employers will voluntarily go along with classifying more workers as their *employees* is another matter entirely.

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