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# Department of Labor Issues New Guidance on Classifying Independent Contractors

Categorizing a worker as an employee or an independent contractor can be a difficult task for many employers, given the often-blurry line between the two categories of workers and the myriad questions involved any such determination. Nonetheless, these decisions have significant ramifications for both employers and workers, affecting – among the many other protections provided to employees by state and federal law – workers' eligibility for overtime pay, unemployment insurance, and Social Security and Medicare tax withholding.

On July 15, 2015, as part of a growing effort to combat employers' misclassification of employees as independent contractors, the United States Department of Labor ("DOL") issued interpretive guidance clarifying the standards it applies to determine whether workers can be classified as independent contractors. The DOL's 15-page memorandum cautions that "most workers are employees under the [Fair Labor Standards Act]" ("FLSA") and provides a detailed discussion of the six-factor "economic realities" test that the agency applies to assess workers' independent contractor status.

The DOL describes the six factors that employers must consider in determining a worker's independent contractor status as follows:

1. Whether the work is an integral part of the employer's business;
2. Whether the worker's managerial skill affects his or her opportunity for profit or loss;
3. The relative investments of the employer and worker;
4. Whether the work requires special skill and initiative;
5. Whether the relationship between the employer and worker is permanent or indefinite; and
6. The nature and degree of the employer's control over the worker.

As articulated by the DOL, the "ultimate" question under the six-factor economic realities test is "whether the worker is economically dependent on the employer (and

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thus its employee) or is really in business for him or herself (and thus its independent contractor)." While the DOL provides examples for each factor, the guidance stresses that no one factor is determinative, that determinations of whether a worker is an employee or independent contractor are highly fact-specific, and that the addition or modification of any facts could change the outcome of each example. Notably, the DOL's guidance takes pains to emphasize that the agency does not rely on the traditional common law "control" test, specifically cautioning that the nature and degree of the employer's control over a given worker will not – in and of itself – be determinative of the worker's independent contractor status (and perhaps indicating that the agency has encountered frequent misclassification of employees as independent contractors based solely on the "control" factor).

While the DOL's guidance does not change existing law, it provides an informative and thorough overview of the considerations that the agency will weigh in investigating complaints of employee misclassification. The DOL has identified employee misclassification as one of its top enforcement priorities and, among other efforts, has announced information sharing and other partnership arrangements with the Internal Revenue Service and 23 state governments to support its enforcement initiative. The DOL has further indicated that employers who are found to have misclassified employees as independent contractors may be on the hook for more than just back pay and civil penalties. An October, 2014 blog post by the DOL's Wage and Hour Division Administrator, David Weil, discusses the agency's goal of using the remedies it imposes non-compliant employers to create "ripple effects" and improve industry-wide compliance. The post cites an example of the agency's strategy in practice: a drywall contractor that – following a determination that it misclassified employees as independent contractors – entered a consent judgment not only providing that it would pay $556,000 in back pay to misclassified employees and $44,000 in penalties, but also required the employer to: hire a "third-party monitor" to ensure the company's future compliance with the FLSA; ensure that future subcontractors comply with federal labor law and any licensure or insurance requirements; and "educate its peers about the importance of compliance, including making presentations to home builders."

Finally, because the determination of whether a worker is an employee or an independent contractor requires a fact-intensive analysis, responding to a DOL investigation can be both costly and time-consuming in and of itself (and even more so for the unprepared employer), regardless of whether or not the investigation ultimately results in a determination that the employer misclassified any employees. As such, employers would be well served to review their relationships with independent contractors in light of the DOL's guidance and assess whether these workers are properly classified. It is possible, for example, for a relationship to begin as an independent contracting relationship but evolve over time into something more like an employment relationship, especially if the individual works on-site over a period of many years. Other situations are also common. If the company remains

confident that the worker is best described as an independent contractor, it would be prudent to ensure that proper documentation is in place to demonstrate this to the satisfaction of a Department of Labor investigator, by, among other things, having a current and properly drafted contract in place, and ensuring that the company conducts business transactions at arms' length to properly reflect the fact that the individual is in business for him- or herself, rather than serving primarily or exclusively at the company's pleasure.

If you have any questions or would like detailed information about the DOL's new guidance, please contact Nick Bauer at (212) 758-7793 or any other attorney at the firm.