

U.S. Department of Labor Rule Broadens the Classification of Independent Contractors

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The United States Department of Labor (DOL) has issued a proposed rule addressing the definition of “independent contractor” in the context of the Fair Labor Standards Act (FLSA). Canadian companies with a presence in the United States should monitor the proposed rule and its impacts on their American operations. If adopted, the proposed rule would loosen restrictions on classifying workers as independent contractors for purposes of the FLSA and provide more flexibility for Canadian organizations.

While some states have adopted the DOL’s approach to independent contractor classification, others, such as Washington and California, have adopted more restrictive rules. Employers should be sure to confirm the laws regarding independent contractor classification in the states in which they wish to hire independent contractors to ensure compliance. Some state laws require different classification analyses for various state laws, including state wage and hour laws, workers’ compensation, and unemployment insurance benefits.

Likewise, Canadian employers should be aware that the proposed rule only addresses the independent contractor classification for purposes of the FLSA and should also be aware of the Internal Revenue Service (IRS) rules regarding classification of independent contractors for tax purposes.

The DOL’s proposed rule outlines a multi-factor test for classifying independent contractors. It includes two “core” factors and three “guidepost” factors, all of which are intended to determine the economic dependence or independence of the individual.

The proposed rule focuses on whether a worker is economically independent and in business for themselves, or if the worker is economically dependent on the company for work. Workers found to be economically dependent on the company for work are properly classified as employees. Workers found to be economically independent and in business for themselves are properly classified as independent contractors.

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I. “Core” Factors

The factors in the proposed rule are not exhaustive and no single factor is considered dispositive. However, under the proposed rule, the core factors are considered the most probative and carry the most weight. If both core factors support the same worker classification, there is a substantial likelihood that the status indicated by the core factors is the appropriate classification.

A. The “Control” Factor

The Control Factor focuses on whether the worker exercises substantial control over the key aspects of the performance of the work. Considerations include whether the worker sets their own schedule, chooses assignments, works without supervision, and/or is able to work for others.

The proposed rule clarifies that a company’s requirement that a worker comply with certain legal obligations, quality control, health and safety standards, and/or meet deadlines does not constitute the type of control that would necessitate the classification of a worker as an employee instead of an independent contractor.

B. The “Profit and Loss” Factor

The Profit and Loss Factor focuses on the worker’s opportunity for profit or loss based on their initiative or investment in the work. The Profit and Loss analysis addresses the worker’s personal initiative or management of expenditures.

It is important to note that under the proposed rule, whether investments made by a worker are similar to those made by the company is irrelevant. In this regard, the proposed rule favors independent contractor classification.

II. Secondary Factors

The proposed rule includes three secondary factors for determining the appropriate classification for workers: (1) the amount of skill required for the work; (2) the degree of permanence of the working relationship between the worker and the potential employer; and (3) whether the work performed is part of an integrated unit of production.

Under the proposed rule, the “skill” factor is intended to focus on skill alone, and should not consider initiative and other factors, which are to be analyzed as part of the “core” factors. The “permanence” factor addresses the continuity and duration of the relationship between the worker and the company. Under the proposed rule, work of a sporadic or definite duration favors independent contractor status. The “integrated unit” factor considers whether the work was part of the integrated unit of production. The proposed rule would assign limited probative value to the question of whether a worker’s work is important to the business.

III. Opportunity for Public Comment

The DOL has foregone the traditional 60-90 day notice period in favor of a 30 day notice period, signaling the administration's attempt to finalize the proposed rule before the Biden administration is seated in January.

While seeking comments on all aspects of the proposed rule, the DOL is specifically interested in comment on its theory that employers will increase utilization of independent contractors if the rule is finalized and whether the rule will entice companies to reclassify workers currently classified as employees as independent contractors. It also seeks feedback regarding how companies' use of independent contractors may change as a result of the proposed rule, particularly in light of the ongoing COVID-19 public health emergency.

IV. Takeaways for Employers

If the proposed rule is finalized, employers will have a clear and business-friendly test to use when classifying workers as independent contractors. It is important to note that the DOL's rules have no bearing on state laws that use different, and potentially more worker-friendly, analyses. Employers should carefully review existing independent contractor and employee classifications.

Canadian companies with American operations should address worker classifications with their American counsel. If and when the DOL adopts the proposed rule, Canadian companies may choose to reclassify some workers as independent contractors while maintaining compliance with the FLSA.