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# ERA Member Alert: Independent Contractor Update

*Summary: The U.S. Department of Labor's new rule, effective March 11, 2024, aims to clarify worker classification under the Fair Labor Standards Act. It defines "independent contractor" based on economic dependence, utilizing a "six plus one" factor test. These factors slightly favor an employment relationship. Additionally, a Memorandum of Understanding between the DOL and IRS streamlines investigations into misclassification, potentially leading to more audits and enforcement actions. Businesses should review their worker classifications to avoid penalties and litigation.*

The U.S. Department of Labor (DOL) issued a final rule addressing worker classification under the Fair Labor Standards Act (FLSA) which goes into effect on March 11, 2024. According to the DOL, the new rule is designed to "reduce the risk that employees are misclassified as independent contractors while providing a consistent approach for businesses that engage with individuals who are in business for themselves."

The rule defines the term "independent contractor" as workers who, as a matter of economic reality, are not economically dependent on an employer for work and are in business for themselves. The ultimate inquiry is whether, as a matter of economic reality, the worker is economically dependent on the employer for work (and is thus an employee) or is in business for himself/herself (and is thus an independent contractor).

To determine the economic reality, the rule requires viewing the relationship under a "totality of the circumstances" standard, and utilizes a "six plus one" factor test for determining the economic reality. These factors appear below, and no one factor is presumed to carry more weight than another:

1. The opportunity for profit or loss depending on managerial skill;
2. Investments by the worker and potential employer;
3. The degree of permanence of the work relationship;

4. The nature and degree of control over performance of the work and working relationship;
5. The extent to which the work performed is an integral part of the potential employer's business;
6. The skill and initiative of the worker; and
7. Additional factors.

The six identified factors skew slightly in favor of an employment relationship, which is consistent with the DOL's historically pro-employee interpretation of prior court decisions on this subject. It is important to remember that existing court decisions will continue to control classification of workers, but the new rule will undoubtedly be relied upon as persuasive authority for federal courts considering the issues and shaping the law into the future.

It is worthy of note that on December 14, 2022, the DOL and the Internal Revenue Service (IRS) signed and published a Memorandum of Understanding for Employment Tax Referrals (the "MOU"). The MOU establishes a system for referrals from the DOL and the IRS, which is designed "to assist in the identification of emerging and ongoing employment tax compliance issues related to misclassification." The practical effect of this coordinated government action is to streamline the process for investigating and penalizing businesses that allegedly misclassify their employees as independent contractors. The MOU makes clear that the IRS will target businesses that lack a good-faith basis for worker misclassification, and which are thus more likely to be on the hook for substantial penalties.

These developments will likely result in more audits, as well as government enforcement actions (and litigation), which could cause turmoil for businesses and industries that rely on independent contractors. Businesses should take this coordinated focus on worker classification as an opportunity to assess their workers' classifications and mitigate the risk of penalties and litigation resulting from workforce misclassification.

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The attorneys at SFBBG law firm ("the go-to law firm for sales reps" nationwide), a longtime ERA benefit provider, have counseled sales reps and manufacturers for more than 40 years.

Adam Glazer is a litigator and Adam Maxwell is an employment lawyer and litigator, and their law firm, SFBBG, features corporate, estate planning, tax and mergers and acquisition attorneys, making full legal coverage available to ERA members. Visit SFBBG online.

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