

Washington Pulse

March 25, 2024

DOL Releases Final Rule Clarifying Employee or Independent Contractor Status

The Department of Labor (DOL) issued a [final rule](#) to assist employers when determining whether a worker is considered an employee or an independent contractor under the Fair Labor Standards Act (FLSA). This determination is important for employers to understand because a worker who is considered an employee is afforded certain protections (such as minimum wage and overtime pay) that generally are not provided to workers who are considered independent contractors.

The 2024 final rule provides a comprehensive test to determine whether a worker is considered an employee or an independent contractor. While the final rule does not directly impact retirement or health and welfare benefits governed under the Employee Retirement Income Security Act of 1974 (ERISA) or the Internal Revenue Code, there are potential indirect impacts that employers should consider, as explained below.

Background

Historically, the FLSA was silent on how to distinguish a worker's status as either an employee or an independent contractor. Instead, the courts developed standards for employers to follow when making this determination. But each court applied the factors independently, often resulting in inconsistent worker classification. In 2021, the DOL attempted to resolve these inconsistencies by adopting final regulations; however, the application of this formal independent contractor rule conflicted with decades of judicial precedence. The 2024 final rule rescinds and replaces the [2021 final regulation](#), and returns to a broader, more comprehensive test when determining a worker's employment status.

DOL Criteria Used to Establish Worker Status

Historically, the DOL has used two concepts to establish a worker's status as either an employee or an independent contractor for wage and hours purposes. The first concept requires an employer to determine if the worker is "economically dependent" on the employer for work or is in business for themselves, by considering six economic reality factors. Employers must then apply the second concept, the "totality of the circumstances" when analyzing each of the six economic reality factors (and other factors as appropriate) as they relate to the facts and circumstances of a worker's employment arrangement. The six economic reality factors are listed below.

- **Opportunity for Profit or Loss Depending on Managerial Skill.**
This factor takes into consideration whether a certain business skill directly affects a worker's economic success or failure.
- **Investments by the Worker and Employer.**
This factor analyzes whether financial investments made by a worker are considered capital or entrepreneurial in nature.

- **Degree of Permanence in the Work Relationship.**
This factor analyzes the work relationship that a worker has with a potential employer.
- **Nature and Degree of Control.**
This factor considers the potential employer's control over the performance of the work and economic aspects of the working relationship when determining whether a worker is considered an employee or independent contractor.
- **Extent to Which the Work Performed is an Integral Part of the Employer's Business.**
This factor analyzes whether the *function* that a worker performs is an integral part of the business.
- **Skill and Initiative.**
This factor considers if a worker uses specialized skills to perform their work and whether these skills contribute to a business-like initiative.
- **Additional Factors.**
The 2024 final rule permits additional factors to be considered if they indicate in some way whether a worker is in business for themselves as opposed to being economically dependent on the potential employer for work.

More information about each of the factors and how to analyze each is available using the [FAQ: Final Rule: Employee or Independent Contractor Classification Under the FLSA](#) and [Small Entity Compliance Guide](#).

Impact on Retirement Plans

The 2024 final rule went into effect March 11, 2024, and applies only to the determination of a worker's status under the FLSA. While the final rule does not directly apply to ERISA, the determination of a worker's status using the FLSA standard may affect an individual's eligibility to participate in an employer-sponsored retirement plan. In addition, employers also need to consider the standard used by the Internal Revenue Service (IRS) to determine a worker's status for tax purposes. Under the IRS standard, known as the 20-factor test, workers may be reclassified as an employee after initially being classified as an independent contractor. In this situation, a worker reclassified as an employee may become entitled to benefits under an employer-sponsored retirement plan as of the date the reclassification occurred, even retroactively. Many plans prohibit reclassified workers from retroactive entitlement to plan benefits based on a determination under the IRS rule; however, it is uncertain if workers determined to be employees under the FLSA would be prohibited from seeking retroactive benefits.

Ascensus will continue to follow any new guidance as it is released. Visit ascensus.com for the latest developments.