



## DOL Clarifies Worker Classification Test

Provided by Sullivan Benefits

### Quick Facts

- On July 15, 2015, the DOL issued guidance on determining whether a worker is an employee or an independent contractor.
- Workers who are employees are entitled to legal protections under federal law.
- The DOL uses the “economic realities test” to classify workers.
- The DOL’s guidance provides clarification on the six factors of the economic realities test.

Employers should use the six factors of the economic realities test as a guide in their efforts to determine whether a worker is an employee or an independent contractor.

On **July 15, 2015**, the U.S. Department of Labor (DOL) issued an [administrative interpretation](#) to clarify how to determine whether a worker is an employee or an independent contractor.

Employee misclassification is a growing concern for the DOL. An increasing number of U.S. workplaces are restructuring their business organizations, creating a higher risk of misclassifying employees as independent contractors.

Employer misclassification has a direct impact on employee eligibility for benefits, legal protections (such as minimum wage and overtime rights) and taxation.

### Worker Classification Tests

Several tests exist to determine whether a worker is an employee or an independent contractor. The most common tests include the common law or agency test, the economic realities test, the hybrid test and the IRS test.

Traditionally, the DOL has favored using the six-factor economic realities test because this test seeks to determine whether a worker is economically dependent on his or her employer or whether the worker is in business for him- or herself. The DOL’s rationale is that if the worker is economically dependent on the employer, the worker should be classified as an

employee and protected by employment laws, including the Fair Labor Standards Act (FLSA) and the Family and Medical Leave Act (FMLA).

### The Economic Realities Test

The six factors for the economic realities test are:

1. Whether the worker’s job 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. Whether the worker’s and the employer’s investments are comparable;
4. Whether the work performed requires special skills and initiative;
5. Whether the relationship between the worker and the employer is permanent or indefinite; and
6. An analysis of the nature and degree of the employer’s control over the worker.

In the administrative interpretation, the DOL emphasized repeatedly that no one factor is determinative and that the factors should not be applied in a mechanical fashion. Rather, the DOL encourages employers to use the six factors as a guide in their efforts to classify workers correctly.

The DOL further explains that the six factors should be interpreted within the context of the FLSA's definition of employment. The FLSA defines "to employ" as to suffer or permit someone to work. The DOL explains that this broad definition of employment was "specifically designed to ensure as broad of a scope of statutory coverage as possible." This "suffer or permit" standard prevents employers from using agents to evade labor and employment responsibilities. According to the DOL, under the economic realities test, most workers will be considered employees subject to the FLSA.

#### **An Integral Part of the Employer's Business**

A worker that performs activities that are an integral part of the employer's business is more likely to be dependent on the employer, and, therefore, should be classified as an employee.

The administrative interpretation states that the courts have found the "integral" factor to be compelling even when the activity in question is just one component of the business or is performed by hundreds or thousands of other workers. For example, the DOL states, "a worker answering calls at a call center along with hundreds of others is performing work that is integral to the call center's business, even if that work is the same as, and interchangeable with, many others' work."

The DOL also mentioned that work can be integral to an employer's business even if it is performed away from the employer's premises, at the worker's home or even on the premises of the employer's customers.

#### **Managerial Skill**

The focus of this factor is whether the worker's managerial skill can affect his or her opportunity for profit or loss. To determine profit or loss opportunities, employers should look beyond the job at hand and determine whether the worker's skills can lead to additional business from other parties or reduce the opportunities for future work.

When evaluating this factor, employers should consider a worker's decision to hire others, purchase materials and equipment, advertise, rent space and manage timetables.

The DOL specifically mentions that a worker's ability to work more hours and the amount of work available from the employer have "nothing to do with the worker's managerial skills and do little to separate employees from independent contractors." This is because both are likely to earn more if they work more and if there is more work available.

#### **Comparable Investments**

To determine whether the employer and worker investments are comparable, employers should look at the nature and the extent of the investments.

An independent contractor should make some investment and undertake at least some risk of loss if he or she is in business for him- or herself. The investment should support a business beyond any particular job. These types of investments include furthering the business' capacity to expand, reducing business cost structure and extending the reach of the independent contractor's market.

However, a worker's investments should not be considered in isolation. They should be compared to the employer's investment. If the worker's investment is relatively minor, the employer and the worker may not be on the same footing and the worker may be economically dependent on the employer.

Finally, investing in tools and equipment is not an automatic indication of significant investment or that the worker is an independent contractor. This type of investment must be compared to the worker's investment in his or her overall business and to the employer's investment in the project and perhaps in its overall activities.

#### **Special Skills and Initiative**

A worker's skills and initiative can be an indicator of economic independence.



However, when considering a worker's skill, employers should consider the worker's *business* skills, judgement and initiative, rather than his or her *technical* skills, which are often required to perform the work. Special skills and initiative are indicators of economic independence when the worker can use them in an independent way, such as demonstrating business-like initiative.

The DOL provides the following illustrative examples:

#### Example 1

A highly skilled carpenter provides carpentry services for a construction firm; however, such skills are not exercised in an independent manner. For example, the carpenter does not make any independent judgments at the job site beyond the work that he is doing for that job; he does not determine the sequence of work, order additional materials, or think about bidding the next job, but rather is told what work to perform where. In this scenario, the carpenter, although highly-skilled technically, is not demonstrating the skill and initiative of an independent contractor (such as managerial and business skills). He is simply providing his skilled labor.

#### Example 2

In contrast, a highly skilled carpenter who provides a specialized service for a variety of area construction companies, for example, custom, handcrafted cabinets that are made-to-order, may be demonstrating the skill and initiative of an independent contractor if the carpenter markets his services, determines when to order materials and the quantity of materials to order, and determines which orders to fill.

#### Permanent or Indefinite Employment

Employment that is permanent or indefinite in character suggests that the worker is an employee. Most independent contractors will avoid permanent or indefinite work relationships and are usually hired to work until a job or a project is complete (even if this takes several months or years). Moreover, once a job or project is complete, the independent contractor does not necessarily

continue to provide his or her services to the employer.

Employers should consider a worker's reasons for intermittent, seasonal, permanent or indefinite employment. Neither working for others nor having multiple sources of income transforms a worker into an independent contractor. The key is to determine "whether the lack of permanence or indefiniteness is due to operational characteristics intrinsic to the industry (such as employers that hire part-time workers or use staffing agencies) or the worker's own business initiative."

For seasonal employment, the proper test to determine permanency is whether the employees worked for the entire operative period of a particular season, not whether the worker returns from season to season.

#### Nature and Degree of Employer Control

An independent contractor controls meaningful aspects of the work he or she performs. This type of control should lead objective observers to conclude that the worker is conducting his or her own business.

Control over meaningful aspects of the work may extend beyond controlling working hours and could include work schedules, dress code and task prioritization.

The DOL asserts that this control cannot be theoretical and explains that what counts is not what the worker *could have done*, but what the worker *actually does*.

Finally, the DOL warns that the control factor should not "play an oversized role" and dwarf other factors in the economic realities test when determining whether a worker is an employee or an independent contractor.

#### More Information

Please contact Sullivan Benefits for additional information on appropriate worker classification.

