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Department of Labor Announces Economic Realities Test to Determine Status as Independent Contractor or Employee

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EXECUTIVE SUMMARY

On September 22, 2020, the U.S. Department of Labor ("DOL") published, for review and comment, a proposed rule that adopts an economic realities test to determine whether a worker should be classified as an employee or independent contractor under the Fair Labor Standards Act ("FLSA"). The proposed test includes five factors, including two "core" factors that are required to be given greater weight in analyzing a worker's classification. The core factors are (1) the nature and degree of the individual's control over the work, and (2) the individual's opportunity for profit or loss.

The FLSA requires covered employers to pay nonexempt employees at least the federal minimum wage for every hour worked and overtime pay for every hour worked over 40 in a workweek, and mandates that employers keep certain records regarding their employees. These requirements do not apply to independent contractors. Misclassified workers may be deprived of the benefits and protections of the FLSA and other laws.

In its executive summary, the DOL states that the FLSA does not define the term "independent contractor," but it defines "employer" as "any person acting directly or indirectly in the interest of an employer in relation to an employee," and an "employee" is "any individual employed by an employer." In addition, to employ a worker means "to suffer or permit work." Accordingly, the DOL and the courts, including the U.S. Supreme Court, have developed multifactor tests to determine if a worker is an employee or an independent contractor under the FLSA. However, the DOL notes that courts, while consistently stating that no single factor is determinative, have not applied the various factors in a consistent manner, resulting in uncertainty for both employers and workers.

The proposed rule, which the DOL and employers would be required to follow, provides that an employer suffers or permits an individual to work as an employee if, as a matter of economic reality, the individual is economically dependent on that employer for work. The first core factor is the nature and degree of the

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individual's control over the work. The greater the degree of control that the individual has, as opposed to the potential employer, the more likely that the individual is an independent contractor. The requisite control must be over key aspects of the performance of the work, such as by setting his or her own schedule, by selecting his or her projects, and/or through the ability to work for others, which might include the potential employer's competitors. If the potential employer controls the individual's schedule or workload, or directly or indirectly requires exclusivity, the individual is more likely an employee.

The proposed rule provides that requiring the individual to comply with specific legal obligations, satisfy health and safety standards, carry insurance, meet contractually agreed-upon deadlines or quality control standards, or satisfy other similar terms that are typical of contractual relationships between businesses (as opposed to employment relationships) does not constitute control that makes the individual more or less likely to be an employee under the Act. This provision is significant as companies frequently include such requirements in their service agreements to support the position that the service provider is an independent contractor, not an employee.

The second core factor, the individual's opportunity for profit or loss, weighs in favor of the individual being an independent contractor to the extent the individual has an opportunity to earn profits or incur losses based on his or her exercise of initiative (such as managerial skill or business acumen or judgment) or management of his or her investment in or capital expenditure on, for example, helpers or equipment or material to further his or her work. If an individual can only affect his or her earnings by working more hours or more efficiently, the individual is likely an employee.

The third factor is the amount of skill required for the work. If the work requires specialized training or skill that the potential employer does not provide, this factor would weigh in favor of the individual being an independent contractor. Another factor to be considered is the degree of permanence of the working relationship between the individual and the potential employer. To the extent the work relationship is by design definite in duration or sporadic, the individual is more likely to be found to be an independent contractor. The final factor to be considered is whether the work is part of an integrated unit of production. This requires an analysis of whether the work is a component of the potential employer's integrated production process for goods or services (employee) or the work is segregable from the production process (independent contractor).

The proposed rule further states that in evaluating the individual's economic dependence on the potential employer, the actual practice of the parties involved is more relevant than what may be contractually or theoretically possible. By way of example, the DOL states an individual's theoretical abilities to negotiate prices or to work for competing businesses are less meaningful if, as a practical matter, the individual is prevented from exercising such rights.

While the proposed rule provides some additional guidance, particularly regarding the weight to be given the core factors, it falls short of meeting the DOL's objective of significantly clarifying to stakeholders how to distinguish between employees and independent contractors.

The DOL is required to provide notice of the proposed rule and seek public comment. It is open for comment for 30 days from publication.

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