Congressional Research Service
Informing the legislative debate since 1914

Legal Sidebar

Department of Labor's New Independent Contractor Rule

April 25, 2024

On January 10, 2024, the Department of Labor (DOL) issued a rule that identifies criteria for how it classifies whether a worker is an employee or independent contractor for purposes of the Fair Labor Standards Act (FLSA), the federal law that establishes minimum wage and overtime compensation standards for most private and public sector employees. Accurate employee classification is important because the rights and protections afforded by the FLSA are available only to employees and not to independent contractors. Misclassifying an individual as an independent contractor may result in not only financial loss for the individual but potential loss in tax revenues for federal and state governments. DOL contends that the new rule will provide uniform guidance to employers and is better aligned with judicial precedent that has interpreted the FLSA. Critics argue that the new rule may discourage the use of contract workers and will force companies to review their current contractor relationships to ensure they have properly classified their workers and avoid possible noncompliance. Some Members of Congress have also criticized the rule. In March, Senator Bill Cassidy and Representative Kevin Kiley introduced joint resolutions—S. J. Res. 63 and H. J. Res. 116—providing for the rule's disapproval under the Congressional Review Act. Still, other Members maintain that the rule will restore basic protections to workers who should be considered employees and not independent contractors. This Legal Sidebar provides background on the FLSA, examines the rule that went into effect on March 11, 2024, reviews the joint resolutions of disapproval, and discusses other proposed legislation in the 118th Congress that would amend the FLSA to identify when an individual may be considered an independent contractor and not an employee.

Background

The FLSA requires an employer to pay an employee a minimum wage as well as overtime compensation at a rate of not less than one and one-half times an employee's regular rate of pay for hours worked in excess of a 40-hour workweek. Section 3(e)(1) of the FLSA, codified at 29 U.S.C. § 203(e)(1), defines the term "employee" simply to mean "any individual employed by an employer." Courts have construed the term to exclude independent contractors, who are generally believed to be in business for themselves and not economically dependent on an employer for work.

Congressional Research Service
https://crsreports.congress.gov
LSB11156

Whether an individual is an employee or independent contractor is often a threshold question that must be answered to determine whether the FLSA's requirements apply. In a 1947 decision, *United States v. Silk*, the Supreme Court observed that "employees" are those workers who are "such as a matter of economic reality," with factors such as a company's control over a worker and the duration of the work relationship relevant for distinguishing between employees and independent contractors. In *Rutherford Food Corporation v. McComb*, decided the same day as *Silk*, the Court further observed that the existence of an employer-employee relationship "does not depend on ... isolated factors but rather upon the circumstances of the whole activity."

In subsequent decisions, the Court maintained that the economic reality of a working relationship will determine whether an individual should be considered an employee or independent contractor for FLSA purposes. Federal appellate courts have generally identified six factors as particularly relevant for evaluating the economic reality of such a relationship:

> (1) The nature and degree of the alleged employer's control as to the manner in which the work is to be performed;
>
> (2) The alleged employee's opportunity for profit or loss depending upon his managerial skill;
>
> (3) The alleged employee's investment in equipment or materials required for his task, or his employment of workers;
>
> (4) Whether the service rendered requires a special skill;
>
> (5) The degree of permanency and duration of the working relationship;
>
> (6) The extent to which the service rendered is an integral part of the alleged employer's business.

Because the economic reality test is fact-specific, workers in similarly labeled positions have sometimes been classified as "employees" covered by the FLSA, but in other instances, they have been considered independent contractors. For example, certain janitors have been classified as employees, whereas others have been classified as independent contractors, after applying the economic reality test. In *Bulaj v. Wilmette Real Estate & Management Company*, a janitor who provided maintenance, landscaping, and repair services for a real estate management company's residential properties alleged violations of the FLSA's overtime provisions. The defendant argued that the janitor was an independent contractor who was not subject to these provisions.

Applying the economic reality test, the federal district court in *Bulaj* contended that all six of the relevant factors weighed in the janitor's favor. For example, the court noted that the company exercised control over the manner of the janitor's work by instructing him to perform specific duties, setting his work schedule, monitoring the quality of his work, and disciplining him when his work did not meet expectations. The court also found that the janitor did not possess an opportunity for additional profit or loss because his compensation consisted of a fixed salary and a rent-free apartment at one of the properties.

In contrast, the U.S. Court of Appeals for the Tenth Circuit concluded that another janitor was an independent contractor and not an employee for purposes of the FLSA. Like the janitor in *Bulaj*, the janitor in *Barlow v. C.R. England* argued that the defendant, a trucking company that operated a maintenance yard, violated the FLSA's overtime provisions. The defendant contended that the janitor provided his services as an independent contractor, particularly because he formed his own cleaning company and provided his services pursuant to an agreement between the parties.

Applying the economic reality test, the Tenth Circuit acknowledged that some of its factors supported the janitor's position, while others favored the trucking company. For example, the court explained that the company, and not the janitor, provided cleaning supplies for the work. Ultimately, however, the court determined that the janitor was an independent contractor. The court found that the relationship between

the trucking company and the janitor did not involve employment but instead resembled a business relationship the company would have with any other cleaning service. The court also acknowledged the janitor's freedom to determine how he would accomplish his work. Rather than being an employee of the trucking company, the plaintiff "was in business for himself as a janitor[.]"

2021 Independent Contractor Rule

Background Concerns About Consistency and Predictability

Motivated by its belief that the economic reality test had become "less clear and consistent" in its application, DOL proposed an independent contractor rule in September 2020. The rule was intended to be the agency's sole authoritative interpretation of independent contractor status under the FLSA. Discussing the need for the new rule, DOL explained:

> [T]he [economic reality] test's underpinning and the process for its application lack focus and have not always been sufficiently explained by courts or the Department, resulting in uncertainty among the regulated community. The Department believes that clear articulation will lead to increased precision and predictability in the economic reality test's application, which will in turn benefit workers and businesses and encourage innovation and flexibility in the economy.

Like the economic reality test, the rule described factors that should be evaluated to determine whether an individual is properly classified as an employee or individual contractor. The rule identified the following five factors to be considered:

> (1) The nature and degree of control over the work;
>
> (2) The individual's opportunity for profit or loss;
>
> (3) The amount of skill required for the work;
>
> (4) The degree of permanence of the working relationship between the individual and the potential employer;
>
> (5) Whether the work is part of an integrated unit of production.

Unlike the economic reality test, however, the rule characterized the first two factors—the nature and degree of control over the work and the individual's opportunity for profit or loss—as "core factors" that were the most probative for determining employee status. If both factors pointed toward the same classification, DOL contended, there was a substantial likelihood that this was the accurate classification. The rule observed that "[t]his is because other factors are less probative and, in some cases, may not be probative at all, and thus are highly unlikely, either individually or collectively, to outweigh the combined probative value of the two core factors." The rule also eliminated consideration of an individual's investment in equipment or materials needed to perform the work.

DOL issued a final independent contractor rule in January 2021. When the final rule was issued, DOL maintained that a focus on the two core factors would "improve the certainty and predictability of the economic reality test[.]" Some commenters viewed the rule as inconsistent with the economic reality test. They argued, for example, that the test requires equal consideration of all of the various factors rather than prioritization of the first two. They also argued that emphasizing the two core factors would narrow the scope of who would be considered an employee, which they viewed as counter to the purpose of the economic reality test.

Response to Rule

After the 2020 U.S. presidential election and a change in leadership, DOL delayed the independent contractor rule's effective date and later proposed the rule's withdrawal. DOL contended that the rule was

inconsistent with the FLSA's text and purpose, as well as the economic reality test applied by courts. The agency explained that the rule's approach was "in tension with the language of the Act as well as the position, expressed by the Supreme Court and in appellate cases from across the Circuits, that no single factor is determinative in the analysis of whether a worker is an employee or independent contractor."

In May 2021, DOL issued a final rule withdrawing the independent contractor rule. Later that month, however, the U.S. District Court for the Eastern District of Texas held that DOL violated the Administrative Procedure Act when it delayed the rule's effective date and withdrew the rule. The court vacated the Biden Administration rules and concluded that the prior Administration's 2021 independent contractor rule "became effective as of March 8, 2021, the rule's original effective date, and remains in effect." DOL appealed the district court's decision to the U.S. Court of Appeals for the Fifth Circuit. Since that time, the Fifth Circuit has entered successive orders staying the appeal in light of DOL's recent rulemaking on a new independent contractor standard.

2024 Independent Contractor Rule

In October 2022, DOL proposed a new independent contractor rule, contending that the 2021 rule does not "fully comport with the FLSA's text and purpose ... and departs from decades of case law applying the economic reality test." The agency maintained that retaining the rule would have a "confusing and disruptive effect on workers and businesses" because it does not consider the totality of the circumstances when applying the multifactor economic reality test established by federal appellate courts.

On January 10, 2024, DOL issued a new independent contractor rule that identifies six factors for evaluating the economic reality of a work relationship:

> (1) The worker's opportunity for profit or loss;
>
> (2) Investments by the worker and the potential employer;
>
> (3) The degree of permanence of the work relationship;
>
> (4) The nature and degree of the potential employer's control over the worker;
>
> (5) The extent to which the work performed is an integral part of the potential employer's business;
>
> (6) Whether the worker uses specialized skills to perform the work and whether those skills contribute to business-like initiative.

According to the agency, consideration of these factors will help to establish whether a worker is economically dependent on an employer for work and thus should be classified as an employee under the FLSA. The rule states that the six factors are not exhaustive and that additional factors may be relevant if they "in some way indicate whether the worker is in business for themself, as opposed to being economically dependent on the potential employer for work." The rule also emphasizes that no one factor is dispositive and that the factors should guide an analysis that considers the totality of a work relationship. The new rule went into effect on March 11, 2024.

Response to Rule

Since the rule's publication, freelance workers and others have filed lawsuits challenging the rule. The plaintiffs argue generally that the rule violates the Administrative Procedure Act. In one lawsuit filed by a group of freelance writers and editors, the plaintiffs also contend that the rule is unconstitutionally vague because it fails to provide sufficient guidance to stakeholders about who is covered by the FLSA.

Whether the new rule will result in more workers being classified as employees is not entirely certain. The rule's six factors generally resemble those that have been considered by federal courts when making determinations about employee status. Nevertheless, some argue that the rule could have a notable impact

on companies, such as those in the gig economy, that rely on the services provided by independent contractors.

Considerations for Congress

In March, Senator Bill Cassidy and Representative Kevin Kiley introduced joint resolutions—S. J. Res. 63 and H. J. Res. 116—providing for congressional disapproval of the 2024 independent contractor rule under the Congressional Review Act (CRA). The sponsors contend that the rule "seeks to destroy the gig economy and jeopardizes the ability of 27 million Americans to work as independent contractors." If both chambers were to pass the joint resolution and the President signed it or Congress overrode the President's veto, the rule would not be permitted to continue in effect. In addition, a rule that has been subject to an enacted joint resolution of disapproval "may not be reissued in substantially the same form, and a new rule that is substantially the same as such a rule may not be issued, unless the reissued or new rule is specifically authorized by a law enacted after the date of the joint resolution disapproving the original rule."

If efforts to invalidate the independent contractor rule under the CRA are unsuccessful, Members of Congress who oppose the multifactor analysis prescribed by the rule could attempt to amend the FLSA's definition of "employee" or prescribe an explicit standard for determining employee status. For instance, in the 118th Congress, Senator Tim Scott and Representative Elise Stefanik have introduced legislation (S. 3018/H.R. 5513) that would amend the FLSA to provide that an individual will be considered an independent contractor and not an employee of another person if that person does not exercise "significant control" over the individual's work and the individual possesses the "opportunities and risks inherent with entrepreneurship" while performing such work.

Author Information

Jon O. Shimabukuro
Legislative Attorney

Disclaimer