

HR How-to:

Determining Worker Classification Under the FLSA

Provided by Benefits Alliance Insurance Services, LLC



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HR professionals play a crucial role in ensuring their organizations properly classify their workers. Accurate classification helps ensure compliance with various regulatory requirements as well as effective management of an organization's relationships with its workers. Moreover, misclassifying an employee as an independent contractor can have serious financial and legal consequences. Therefore, it's vital that employers understand the differences between employees and independent contractors and how to correctly classify their workforce.

This HR How-to guide aims to provide employers and HR professionals with an understanding of determining a worker's status as either an employee or independent contractor under the Fair Labor Standards Act (FLSA). It explores an employer's legal obligations under the law, the process for determining worker classification and best practices for properly classifying workers. The steps outlined in this guide can help employers and HR professionals establish best practices for determining whether a worker is an employee or independent contractor under the FLSA. This information comes from the U.S. Department of Labor (DOL); employers can learn more by reviewing the department's [resources](#) on the FLSA. Employers can reference the checklist and other resources in the appendix for additional information related to worker classification.

While this guide focuses on worker classification under the FLSA, a worker's classification depends on the facts of a particular situation. Different legal standards or tests are used, often depending on the situation's context and its applicable laws (e.g., federal tax, the Americans with Disabilities Act, the Age Discrimination in Employment Act, Title VII of the Civil Rights Act), to determine whether an individual is an employee or independent contractor. Due to the complexities of worker classification, employers are encouraged to consult with local legal counsel if they have any specific questions or concerns.

Overview of the FLSA

The FLSA establishes minimum wage, overtime pay, recordkeeping, and child labor standards that affect nearly all workers in the United States. For a worker to be protected by the FLSA, the worker must be an employee, meaning the worker has an employment relationship with an employer. As a result, independent contractors are not entitled to FLSA protections.

When an employer-employee relationship exists and the employee is performing work that is covered under the FLSA, the employee must be paid at least the federal minimum wage (\$7.25 per hour) and overtime pay (one and one-half the regular rate of pay for all hours worked over 40 per week unless a relevant exemption applies). The DOL's Wage and Hour Division (WHD) administers and enforces the FLSA with respect to private employment.

Employers who fail to accurately classify their workers can find themselves in difficult and costly legal situations. Misclassification of employees occurs when employers classify employees as independent contractors and fail to provide those workers FLSA protections, such as overtime. This is a common problem that many employers face. In fact, employee misclassification is one of the most common violations of the FLSA.

The consequences of misclassifying workers range from monetary penalties to jail time and can add up quickly. The following are penalties for misclassification:

- Back pay
- Unpaid overtime
- Liquidated damages
- Attorney fees
- Civil penalties
- Lost benefits
- Interest
- Reputational damage

Penalties can become even more severe if the DOL determines the misclassification was intentional. Misclassification penalties are also determined by several factors, including the number of times a company avoided FLSA requirements. Therefore, it's vital that employers correctly classify their workers under the FLSA.

How to Determine Worker Classification Under the FLSA

One of the most fundamental questions in any employment relationship is whether an individual is an employee or an independent contractor. Knowing the difference is important to help an organization ensure compliance with applicable laws and avoid the risk of costly litigation and fines. However, understanding the difference can be confusing and complicated since it often depends on the facts of a particular situation.

Employee vs. Independent Contractor

Generally, an individual is typically an **employee** if they perform services for an organization that controls what work must be done and how it should be completed. Employers are responsible for withholding Social Security and Medicare taxes from employees' wages.

On the other hand, an individual is typically considered an **independent contractor** if the employer (or payer) has the right to control or direct only the result of the work and not what will be done and how it will be done. Independent contractors are self-employed individuals or entities contracted to provide services for or perform work for another entity as nonemployees. This work is typically for a specific project or time period. Independent contractors are responsible for paying their own Social Security and Medicare taxes.

Many professionals frequently work as independent contractors, including:

- | | | |
|---|---|--|
|  Electricians |  Auto mechanics |  Accountants |
|  Plumbers |  Florists |  Writers |
|  Carpenters |  Dentists |  Graphic designers |
|  Painters |  Veterinarians |  IT professionals |
| |  Lawyers | |

The Economic Reality Test

The **economic reality test** is used to determine whether a worker is an employee or an independent contractor under the FLSA. This test uses multiple factors to analyze if an employment relationship exists. The goal of the test is to decide if the worker is economically dependent on the employer for work or is instead in business for themselves. The economic realities of the entire working relationship are examined to decide whether a worker is an employee or an independent contractor.

The economic reality test weighs the following six factors to assess whether a worker is economically dependent on a potential employer for work according to the totality of the circumstances:

- 1 The opportunity for profit or loss, depending on managerial skill
- 2 Investments by the worker and the potential employer
- 3 The degree of permanence of the work relationship
- 4 The nature and degree of control
- 5 The extent to which the work performed is an integral part of the potential employer's business
- 6 The worker's skill and initiative

No single factor (or set of factors) automatically determines a worker's status as either an employee or independent contractor under this test. Moreover, additional factors may be relevant to determine a worker's classification if they indicate whether the worker is in business for themselves, as opposed to being economically dependent on the potential employer for work.

In January 2024, the WHD issued a **final rule** implementing a new standard for worker classification under the FLSA, effective March 11, 2024. This rule rescinds the prior rule, which was established in 2021 and gave two core factors—control over the work and opportunity for profit and loss—greater weight in determining independent contractor status. Under the final rule, the six economic reality factors are all weighed to assess whether a worker is economically dependent on a potential employer for work according to the totality of the circumstances.

Accurate worker classification requires employers to evaluate the economic reality factors when determining a worker's status for FLSA purposes. The following factors outline considerations to help employers determine whether an individual is an employee or independent contractor under the FLSA. Employers can learn more by reviewing the DOL's [FLSA reference guide](#) for employers.

Factor 1:

The Opportunity for Profit or Loss, Depending on Managerial Skill

This factor considers whether the worker has opportunities for profit or loss based on managerial skills, including initiative, business acumen or judgment, that affect the worker's economic success or failure in performing the work.

Relevant considerations when evaluating whether a worker has opportunities for profit or loss based on managerial skill include the following:

Whether the worker determines or can meaningfully negotiate the charge or pay for the work provided

Whether the worker accepts or declines jobs or chooses the order or time in which the jobs are performed

Whether the worker engages in marketing, advertising or other efforts to expand their business or secure more work

Whether the worker makes decisions to hire others, purchase materials and equipment or rent space

A worker's decision that impacts the amount of pay they receive, such as working more hours or jobs, when they are paid a fixed rate per hour or job generally does not suggest the worker exercises managerial skill.

If a worker has no opportunity for a profit or loss, then this factor suggests the worker is an **employee**.

Example:

A worker for a landscaping company performs assignments for its corporate clients only as decided by the company. The worker does not independently choose assignments, ask for additional work from other clients, advertise the landscaping services or try to reduce costs. The worker regularly agrees to work additional hours to earn more money.

In this example, the worker does not exercise managerial skill that affects their profit or loss. Rather, their earnings may change based on the work available and their willingness to work more. Because this lack of managerial skill affects their opportunity for profit or loss, these facts indicate employee status under the opportunity for profit or loss factor.

Factor 2:

Investments Made by the Worker and the Potential Employer

This factor considers whether any investments by a worker are capital or entrepreneurial in nature. Costs to a worker of tools and equipment to perform a specific job, costs of workers' labor, and costs that the potential employer imposes unilaterally on the worker are not evidence of capital or entrepreneurial investment; as a result, they indicate **employee status**.

Investments that are capital or entrepreneurial in nature, indicating **independent contractor status**, generally support an independent business and serve a business-like function. Such investments may include:

- Increasing a worker's ability to do different types of or more work
- Reducing costs
- Extending market reach

A worker's investments should be considered relative to the potential employer's investments in its overall business. If the worker is making similar investments as the potential employer, even on a smaller scale, it suggests that the worker operates independently, indicating independent contractor status.

Example:

A graphic designer provides design services for a commercial design firm. The firm provides software, a computer, office space, and all the equipment and supplies for the worker. The company invests in marketing and finding clients and maintains a central office to manage services. The worker occasionally uses their own preferred drafting tools for certain jobs.

In this scenario, the worker's relatively minor investment in supplies is not capital in nature and does little to further a business beyond completing specific jobs. These facts indicate employee status under the investment factor.

Factor 3:

The Degree of Permanence of the Work Relationship

This factor weighs in favor of the worker being an **employee** when the work relationship is:

- Indefinite in duration
- Continuous
- Exclusive of work for other employers

On the other hand, this factor weighs in favor of an **independent contractor** relationship when the work arrangement is:

- Definite in duration
- Nonexclusive
- Project-based
- Sporadic based on the worker being in business for themselves and marketing their services or labor to multiple entities

Such conditions may include regularly occurring fixed periods of work; however, seasonal or temporary work by itself would not necessarily indicate independent contractor classification.

Where a lack of permanence is due to operational characteristics that are unique or intrinsic to particular businesses or industries and the workers they employ rather than the workers' own independent business initiative, this factor is not necessarily indicative of independent contractor status unless the worker is exercising their own independent business initiative.

Example:

A cook has prepared specialty meals occasionally for an entertainment venue for certain events over the past three years. The cook markets their meal preparation services to multiple venues and private individuals and turns down work from the entertainment venue for any reason, including because the cook is too busy with other meal preparation jobs. The cook has a sporadic or project-based nonexclusive relationship with the entertainment venue. These facts indicate independent contractor status under the permanence factor.

Factor 4:

The Nature or Degree of Control

This factor considers the potential employer's control, including reserved control, over the performance of the work and the economic aspects of the working relationship. Facts relevant to the potential employer's control over the worker include whether the potential employer:

- Sets the worker's schedule
- Supervises the performance of the work
- Explicitly limits the worker's ability to work with others
- Uses technological means of supervision to supervise the performance of the work (such as using a device or electronic monitoring)
- Reserves the right to supervise or discipline workers
- Places demands on the workers' time or restrictions on workers that do not allow them to work for others or work when they choose

It's important to also examine whether the potential employer controls economic aspects of the working relationship, including prices or rates for services and the marketing of the services or products provided by the worker.

Actions taken by the potential employer for the sole purpose of complying with a specific, applicable federal, state, tribal or local law or regulation are not indicative of control. However, actions taken by the potential employer that go beyond compliance with a specific, applicable federal, state, tribal or local law or regulation and instead serve the potential employer's compliance methods, safety, quality control, or contractual or customer service standards may be indicative of control.

Example:

A registered nurse provides nursing care for Alpha House, a nursing home. The nursing home sets the work schedule with input from staff regarding their preferences and determines the staff assignments. Alpha House's policies prohibit nurses from working for other nursing homes while employed with Alpha House to protect its residents. In addition, the nursing staff are supervised by regular check-ins with managers, but nurses generally perform their work without direct supervision.

While nurses at Alpha House work without close supervision and can express preferences for their schedule, Alpha House maintains control over when and where a nurse can work and whether a nurse can work for another nursing home. These facts indicate employee status under the control factor.

This factor considers whether the work performed is an integral part of the potential employer's

Factor 5:

The Extent to Which the Work Performed Is an Integral Part of the Potential Employer's Business

business. It does not depend on whether any individual worker in particular is an integral part of the business; instead, it relies on whether the function they perform is an integral part of the business.

This factor weighs in favor of the worker being an **employee** when the work they perform in relation to the potential **employer's principal business** is:

- Critical
- Necessary
- Central

This factor weighs in favor of the worker being an **independent contractor** when the work they perform is **not** critical, necessary or central to the potential employer's principal business.

Example:

A large farm grows tomatoes that it sells to distributors. The farm pays workers to pick the tomatoes during the harvest season. Because a necessary part of a tomato farm is picking the tomatoes, the tomato pickers are integral to the company's business. These facts indicate employee status under the integral work factor.

Factor 6:

The Worker's Skill and Initiative

This factor considers whether the worker uses specialized skills to perform the work and whether those skills contribute to a business-like initiative or if the work is dependent on training from the potential employer.

This factor indicates **employee status** where the worker does not use specialized skills to perform the work or is dependent on training from the potential employer to perform the work.

Where the worker brings specialized skills to the work relationship, this fact is not indicative of independent contractor status since both employees and independent contractors may be skilled workers. It's the worker's use of those specialized skills in connection with business-like initiative that indicates that the worker is an **independent contractor**.

Example:

A highly skilled welder provides a specialty welding service, such as custom aluminum welding, for multiple area construction companies. The welder uses these skills for marketing purposes, to generate new business and to obtain work from multiple companies. The welder is not only technically skilled but also uses and markets those skills in a manner that evidences business-like initiative. These facts indicate independent contractor status under the skill and initiative factor.

Additional Factors

The FLSA economic reality test allows additional factors beyond the six factors discussed above to be considered if they are relevant to the overall question of whether the worker is in business for themselves or is economically dependent on the employer for work.

Certain facts are **not relevant** to whether an employment relationship exists, including:

- What the worker is called—a worker may be an employee under the FLSA regardless of the title or label they are given
- Whether a worker is paid off the books or receives a Form 1099
- Whether the work agrees verbally or in writing to be classified as an independent contractor—including by signing an independent contractor agreement

These factors do not make a worker an independent contractor under the FLSA.

Additionally, such facts as the place where work is performed, whether a worker is licensed by a state or local government, and the time or mode of pay do not determine whether a worker is an employee or an independent contractor under the FLSA.

Summary

Correctly classifying workers as employees or independent contractors is essential for an organization to comply with the FLSA. Misclassifying a worker can have serious financial and legal consequences. Misclassification denies employees access to critical benefits and protections and creates a competitive disadvantage for employers who comply with the law, resulting in unfair competition. As the misclassification of workers remains a top workplace issue today, employers need to be aware of how to accurately classify workers under the FLSA.

Classifying workers properly is often not a simple task. By understanding the factors for determining whether a worker is an employee or independent contractor under the FLSA, employers and HR professionals can help ensure their organizations avoid potential legal pitfalls and promote proper worker classification. The information presented in this guide can help employers and HR departments better implement strategies and solutions to improve their FLSA operations and compliance efforts.

Due to the potential risks and liabilities of worker misclassification, employers should consider consulting with an experienced employment attorney if they have any questions or concerns. Employers can also visit the DOL's [website](#) for more information.

Contact Benefits Alliance Insurance Services, LLC today for more FLSA-related resources.



Appendix

Employees vs. Independent Contractors:

Cheat Sheet

Provided by [B_Officialname]

Correctly classifying workers as employees or independent contractors is essential for a company to comply with various federal and state laws, including the federal Fair Labor Standards Act (FLSA). In general, independent contractors do not receive the same benefits and protections under federal law as employees. For example, independent contractors are not:

- Protected by the FLSA's minimum wage and overtime requirements;
- Eligible for job-protected leave under the federal Family and Medical Leave Act (FMLA);
- Entitled to the National Labor Relations Act's (NLRA) rights to organize and bargain collectively and engage in other protected concerted activity; or
- Subject to the Affordable Care Act's employer mandate requirement, which generally requires applicable large employers to offer affordable health coverage to full-time employees or risk tax penalties.

In addition, employers are not required to withhold or pay any taxes on payments to independent contractors.

Classifying workers as either employees or independent contractors is not always a simple or straightforward task. Unfortunately, there is no single standard or test for an employer to use. The U.S. Department of Labor (DOL) has finalized a new economic reality test to determine worker status under the FLSA and FMLA. However, for purposes of federal tax laws, employee benefit laws and the NLRA, agencies and courts have adopted a common-law test. Additional standards may apply for state law purposes, including for worker's compensation programs.

This cheat sheet outlines the DOL's economic reality test for classifying workers. It also includes the IRS' description of the common law test for determining worker status. [Employers can use this information to help confirm they are considering the relevant factors when classifying workers.](#) Misclassifying an employee as an independent contractor can have serious financial and legal consequences for an employer. Accordingly, employers are encouraged to seek legal counsel to address specific issues and concerns.

Economic Reality Test: FLSA and FMLA

A [final rule](#) issued by the DOL's Wage and Hour Division implements a new standard for worker classification under the FLSA, effective March 11, 2024. The final rule applies **six economic reality factors** to analyze employee or independent contractor status under the FLSA. No single factor (or set of factors) automatically determines a worker's status as either an employee or an independent contractor. Instead, the economic reality factors are all weighed to assess whether a worker is economically dependent on a potential employer for work according to the totality of the circumstances.

Additional factors may be relevant in determining whether the worker is an employee or independent contractor for purposes of the FLSA if the factors indicate whether the worker is in business for themselves, as opposed to being economically dependent on the potential employer for work.

The FMLA uses the same framework for worker classification as the FLSA.

Economic Reality Factors

1 Opportunity for profit or loss depending on managerial skill

This factor considers whether the worker has opportunities for profit or loss based on managerial skills that affect the worker's economic success or failure in performing the work. The following facts, among others, can be relevant:

- Whether the worker determines or can meaningfully negotiate the charge or pay for the work provided;
- Whether the worker accepts or declines jobs or chooses the order and/or time in which the jobs are performed;
- Whether the worker engages in marketing, advertising or other efforts to expand their business or secure more work; and
- Whether the worker makes decisions to hire others, purchase materials and equipment, and/or rent space.

If a worker has no opportunity for a profit or loss, then this factor suggests the worker is an employee.

2 Investments by the worker and the employer

This factor considers whether any investments by a worker are capital or entrepreneurial in nature. Costs to a worker of tools and equipment to perform a specific job, costs of the worker's labor and costs that the potential employer imposes unilaterally on the worker, for example, are not evidence of capital or entrepreneurial investment and indicate employee status. Investments that are capital or entrepreneurial in nature and thus indicate independent contractor status generally support an independent business and serve a business-like function, such as increasing the worker's ability to do different types of or more work, reducing costs or extending market reach.

3 Degree of permanence of the work relationship

This factor weighs in favor of the worker being an employee when the work relationship is indefinite in duration, continuous or exclusive of work for other employers. This factor weighs in favor of the worker being an independent contractor when the work relationship is definite in duration, nonexclusive, project-based or sporadic based on the worker being in business for themselves and marketing their services or labor to multiple entities. This may include regularly occurring fixed periods of work, although the seasonal or temporary nature of work by itself would not necessarily indicate independent contractor classification.

4 Nature and degree of control

This factor considers the potential employer's control, including reserved control, over the performance of the work and the working relationship's economic aspects. Facts relevant to the potential employer's control over the worker include whether the potential employer sets the worker's schedule, supervises the performance of the work, or explicitly limits the worker's ability to work for others. Additional relevant facts include whether the potential employer uses technological means to supervise the performance of the work (such as using a device or electronic monitoring), reserves the right to supervise or discipline workers, or places demands or restrictions on workers that do not allow them to work for others or work when they choose.

Whether the potential employer controls economic aspects of the working relationship, including prices or rates for services and the marketing of the services or products provided by the worker, should also be considered. Actions taken by the potential employer for the sole purpose of complying with a specific, applicable federal, state, tribal or local law or regulation are not indicative of control. Actions taken by the potential employer that go beyond compliance with a specific, applicable federal, state, tribal or local law or regulation and instead serve the potential employer's own compliance methods, safety, quality control, or contractual or customer service standards may be indicative of control.

5 Extent to which the work performed is an integral part of the employer's business

This factor considers whether the work performed is an integral part of the potential employer's business. This factor does not depend on whether any individual worker is an integral part of the business but rather whether the function they perform is an integral part of the business. This factor weighs in favor of the worker being an employee when the work they perform is critical, necessary or central to the potential employer's principal business. This factor weighs in favor of the worker being an independent contractor when the work they perform is not critical, necessary or central to the potential employer's principal business.

6 Skill and initiative

This factor considers whether the worker uses specialized skills to perform the work and whether those skills contribute to business-like initiative. This factor indicates employee status when the worker does not use specialized skills to perform the work or is dependent on training from the potential employer to perform the work. Where the worker brings specialized skills to the work relationship, this fact is not indicative of independent contractor status because both employees and independent contractors may be skilled workers. It is the worker's use of those specialized skills in connection with business-like initiative that indicates that the worker is an independent contractor.

Common-law Test – Federal Tax Law, ERISA and NLRA

A common-law test applies to determine whether a worker is an employee or independent contractor for purposes of federal tax law, employee benefits law (ERISA) and the NLRA. In general, the common-law test involves looking at various factors regarding the relationship between the parties, including the degree of control and independence between the parties.

Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while others indicate that the worker is an independent contractor. Also, factors relevant in one situation may not be relevant in another.

To help employers make this determination for federal tax purposes, the IRS has grouped the common law factors into three categories: (1) behavioral control, (2) financial control and (3) the relationship between the parties.

Common-law Factors

1

Behavioral control

Facts that show whether the business has a right to direct and control how the worker does the task for which they were hired.

A Instructions the business gives to the worker

An employee is generally subject to the business's instructions about when, where and how to work. The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals. In other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

B Training that the business gives to the worker

An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

2

Financial control

Facts that show whether the business has a right to control the business aspects of the worker's job.

A The extent to which the worker has unreimbursed business expenses

Independent contractors are more likely to have unreimbursed expenses than employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services they perform for their employer.

B The extent of the worker's investment

An independent contractor often has a significant investment in the facilities or tools they use in performing services for someone else. However, a significant investment isn't necessary for independent contractor status.

C The extent to which the worker makes their services available to the relevant market

An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

2

Financial control (cont.)

Facts that show whether the business has a right to control the business aspects of the worker's job.

D How the business pays the worker

An employee is generally guaranteed a regular wage amount for an hourly, weekly or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is often paid a flat fee or on a time and materials basis for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

E The extent to which the worker can realize a profit or loss

Having the possibility of making a profit or incurring a loss indicates that the worker is an independent contractor.

A Written contracts

Written contracts describe the relationship the parties intend to create. Although a contract may state that the worker is an employee or an independent contractor, it is not sufficient to determine the worker's status. How the parties work together determines whether the worker is an employee or independent contractor.

B Employee benefits

This factor depends on whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay or sick pay. Businesses generally do not grant these benefits to independent contractors. However, a lack of these benefits does not necessarily mean the worker is an independent contractor.

C The permanency of the relationship

If an employer engages a worker with the expectation that the relationship will continue indefinitely rather than for a specific project or period, this is generally considered evidence that the employer's intent was to create an employer-employee relationship.

D The extent to which services performed by the worker are a key aspect of the regular business of the company

If a worker provides services that are a key aspect of an organization's regular business activity, it is more likely that the company has the right to direct and control their activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

3

Type of relationship

Facts that show the type of relationship between the worker and the employer.

In addition, there are certain types of employees that must be treated as [employees](#) or [nonemployees](#) under federal tax law. For more information on worker classification for federal tax purposes, see [IRS Publication 15-A](#).



Employment Case Studies:

Today's Misclassifications of
Employees as Independent
Contractors

Provided by [B_OfficialName]

Introduction

When an employee is misclassified as an independent contractor instead of an employee, they are denied crucial benefits and standard labor protections under the Fair Labor Standards Act (FLSA). The FLSA, enforced by the U.S. Department of Labor (DOL) Wage and Hour Division (WHD), establishes standards for recordkeeping, overtime pay, minimum wage and youth employment in the private sector and for federal, state and local governments.

This article provides an overview of the key differences between employees and independent contractors. It also highlights case studies of real-world instances where employers were found to be in violation of FLSA regulations over independent contractor misclassifications and explains how these employers could have avoided such infractions. Employers should use these case studies to learn from the mistakes of other organizations and ensure the proper designation of all workers.

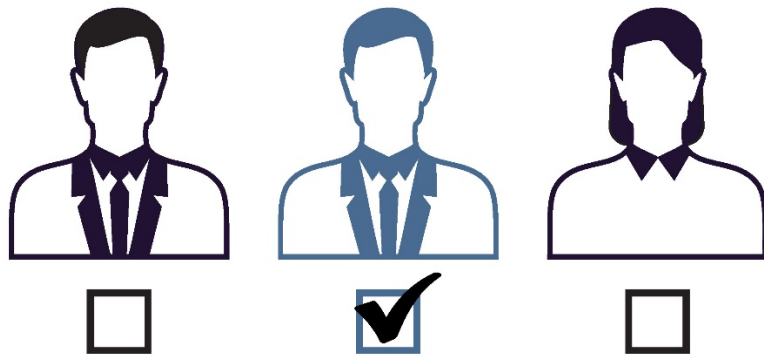


Critical Differences Between Employees and Independent Contractors

Understanding the difference between independent contractors and employees under the current FLSA guidelines is crucial to avoid violations. Generally, a worker is an employee when an employer exercises greater control over how their work is completed. On the other hand, independent contractors are distinguished by the freedom to complete a job at their discretion.

It is the role of the WHD to determine if an employee has been misclassified as an independent contractor and is therefore illegally denied benefits, wage and labor standard protections defined by the FLSA.

The DOL provides the [following guidance](#) regarding the differences between employees and independent contractors:



Employee	Independent Contractor
Works for someone else's business	Runs their own business
Receives hourly, salary or piece rate pay	Receives pay upon completion of the project
Uses employer's materials, tools and equipment	Provides own materials, tools and equipment
Typically works for one employer	Works with multiple clients
Continues relationship with the employer	Maintains a temporary relationship with the employer until the project is completed
Is instructed by the employer on when and how the work will be performed	Decides when and how they will perform the work
Is assigned work to be performed by the employer	Decides what work they will do

Additionally, the classification of workers as employees or independent contractors carries tax implications. With employees, employers are generally required to withhold some pay for taxes; for independent contractors, this is not usually the case. Employers and workers can file [Form SS-8](#) with the IRS to request a determination of a worker's status for federal employment taxes and income tax-withholding purposes. The IRS will review the facts and circumstances and determine the worker's status.

For more information, visit the IRS resource "[Independent Contractor \(Self-Employed\) or Employee?](#)"

Real-world Case Studies



New York City, New York—A hotel management company [paid \\$113,613](#) in back wages and liquidated damages to 71 employees at 20 city hotels and an airport. Most (69) affected workers were misclassified as independent contractors and therefore denied their full earned wages, including overtime pay and bonuses.

What went wrong:

- The employer paid affected workers straight time for all hours worked, even when they worked over 40 hours a week, which means they did not receive the overtime pay they were owed.
- The employer did not provide incentive pay, such as quarterly and performance bonuses or shift pay for overnight work, when determining overtime pay.



Boston, Massachusetts—A courier service [paid \\$575,000](#) in back wages and liquidated damages to 62 drivers because they misclassified the workers as independent contractors and denied them their full pay and overtime wages.

What went wrong:

- The employer paid workers less than the federal minimum wage of \$7.25 per hour by paying drivers for delivery instead of an hourly wage and requiring workers to pay for gasoline, vehicle upkeep and insurance.
- The employer failed to pay overtime to drivers who worked more than 40 hours per week.
- The employer did not keep accurate records of hours worked by affected employees as required by the FLSA.



Philadelphia, Pennsylvania—A home health care staffing agency [paid \\$410,000](#) in back wages and liquidated damages to 43 workers wrongly classified as independent contractors and \$22,295 in civil penalties for repeat and willful violations.

What went wrong:

- The employer paid workers straight pay, failed to combine hours worked when workers saw multiple patients in a pay period or performed home care services on top of full-time positions, and did not include on-call hours into overtime calculations, therefore failing to pay workers overtime as required under the FLSA.



Correcting the Problems



Identify the Type of Worker

The recurring problem across all three case studies was the failure to correctly identify a worker as an employee. By doing so, these employers inadequately compensated workers under the FLSA, leading to costly financial ramifications. Employers should be diligent in classifying workers properly to ensure they comply with federal law.



Pay Overtime

One of the most common issues in these case studies was the failure to provide overtime pay to workers. FLSA-covered employers must compensate employees 1.5 times their regular pay rate for all hours worked over 40 in a workweek.



Pay Minimum Wage

In one of the case studies, misclassifying workers as independent contractors caused a Boston courier service to pay workers below the legal minimum wage. The FLSA mandates that all employees covered under the law receive a minimum wage of \$7.25 per hour. Many states have additional minimum wage requirements. In cases where an employee is subject to a federal minimum wage and a state minimum wage, they are entitled to the higher wages. For more information on state wage requirements, visit the DOL resource "[State Minimum Wage Laws](#)."



Record Hours Diligently

Real-world examples show that employers who fail to keep accurate records of hours worked by employees risk costly violations. Under the FLSA, employers must keep accurate records for every covered, nonexempt employee. These records must include accurate employee information and data on hours worked and wages earned. To learn more about employee information employers must keep, go to the DOL resource, "[Recordkeeping and Reporting](#)."

Conclusion

As these case studies show, misclassifying workers can be costly. The most common mistake made by organizations in these examples was the failure to properly classify workers as employees. However, these cases should not be viewed as dispositive when determining if an organization is in compliance with the FLSA. Employers should seek legal advice if they are concerned that their organization is not in compliance with the FLSA.

It's essential for employers to learn from these mistakes and accurately distinguish between types of workers. Federal resources can help employers understand the critical differences between employees and independent contractors.

Employers should continue to monitor the FLSA and related changes that may occur. They can also explore the [DOL website](#) and contact us for more information regarding the FLSA.

Determining Independent Contractor Status Chart

Provided By [B_Officialname]

One of the most fundamental questions in any employment relationship is whether a worker is an employee or an independent contractor. Knowing the difference is important to ensure legal compliance and avoid the risk of costly litigation and fines. Generally, an independent contractor is a self-employed individual or entity contracted to provide services or perform work for another entity as a nonemployee. As a result, an independent contractor is self-employed and subject to self-employment tax. On the other hand, an individual is typically an employee if they perform services for an organization that controls what work must be done and how it should be completed. Employers are responsible for withholding Social Security and Medicare taxes from employees' wages.

Employers are responsible for determining the true nature of their relationships with their workers. However, classifying an individual as either an employee or an independent contractor is not a simple task. No standard test has emerged to determine the true characteristics of an independent contractor relationship. Employers may have to apply various tests to determine how issues of employment benefits, workers' compensation, unemployment compensation, wage and hour laws, taxes or protection under federal laws—such as Title VII of the Civil Rights Act (Title VII), the Americans with Disabilities Act (ADA), and the Family and Medical Leave Act (FMLA)—affect their workforces. Moreover, various federal government agencies and some states and localities have their own tests to determine independent contractor status.

The following chart contains the most common tests used for purposes of federal statutes to determine independent contractor status. Employers can use this chart as a guide when classifying their workers. Due to the complexities of accurate worker classification, employers are encouraged to seek legal counsel to discuss specific issues and concerns.

The Common Law Agency Test

The common law agency test applies a multifactor approach approved by the U.S. Supreme Court and found in the Restatement (Second) of Agency. Several courts have favored this test for issues related to the Copyright Act, the Employee Retirement Income Security Act and the National Labor Relations Act. It requires an intense consideration of different factors that may not determine the relationship between the employer and the worker individually but, as a whole, allow for an understanding of how much control an employer exerts over a particular individual.

The common law agency test evaluates the following factors:

- The extent of control by the employer
- Whether or not the individual is engaged in a distinct occupation or business
- Whether the work is usually done under the direction of the employer or by a specialist without supervision
- The skill required in the occupation
- Whether the employer or individual supplies instrumentalities, tools and place of work
- The length of time for which the individual is employed
- The method of payment
- Whether or not the work is part of the regular business of the employer
- Whether or not the parties believe they are creating an independent contractor relationship
- Whether the principal is or is not in business
- Whether the evidence tends to show that the individual is, in fact, rendering services as an independent business

The Economic Reality Test

The economic reality test is used to determine a worker's status under the Fair Labor Standards Act (FLSA), the Equal Pay Act and the FMLA. This test uses multiple factors to determine if an employment relationship exists. The goal of the test is to decide if the worker is economically dependent on the employer for work or is instead in business for themselves.

In January 2024, the U.S. Department of Labor issued a [final rule](#) implementing a new standard for worker classification under the FLSA, effective March 11, 2024. This rule rescinds the prior rule, which was established in 2021 and gave two core factors—control over the work and opportunity for profit and loss—greater weight in determining independent contractor status.

Under the final rule, the economic reality test weighs the following six factors to assess whether a worker is economically dependent on a potential employer for work according to the totality of the circumstances:

1. The opportunity for provide or loss, depending on managerial skill
2. Investments by the worker and the potential employer
3. The degree of permanence of the work relationship
4. The nature and degree of control
5. The extent to which the work performed is an integral part of the potential employer's business
6. The worker's skill and initiative

No single factor (or set of factors) automatically determines a worker's status as either an employee or an independent contractor. Moreover, additional factors may be relevant in determining worker classification if they indicate whether the worker is in business for themselves, as opposed to being economically dependent on the potential employer for work.

The Hybrid Test

The hybrid test combines elements of the common law agency and the economic realities tests. The factors measured under this test are a combination of those described in the previous two tests, but they consider special details in the relationship between an employer and a worker, such as:

- The kind of occupation the individual is performing (does it require the supervision of an expert or can it be done by a specialist working alone?)
- Whether a termination procedure exists for terminating the work relationship and whether it resembles the procedure used for terminating employees
- Whether the worker accrues time off
- The parties' intentions

Though federal lower courts have used this test to deal with issues related to Title VII, the Age Discrimination in Employment Act and the ADA, the Supreme Court has criticized this approach and is leaning more toward using the common law test for similar issues.

The IRS Test

The IRS uses the common-law rules when determining whether an individual is an employee or an independent contractor. In addition, some states use this test to determine a worker's status. In general, the common-law rules involve 11 factors regarding the relationship between the parties, including the degree of control and independence between the parties. Organizations must weigh all these factors when determining worker classification. Some factors may indicate that the worker is an employee, while others may suggest the worker is an independent contractor.

To help employers make this determination for federal tax purposes, the IRS has grouped the common-law factors into three categories: behavioral control, financial control and the relationship between the parties. Employers can also file [Form SS-8](#) with the IRS if they want the agency to determine whether or not a worker is an employee.

- 1. Behavioral Control**—Facts that show whether the employer has a right to direct and control how the worker does the task for which the worker is hired include the type and degree of the following:
 - Instructions that the business gives to the worker
 - Training that the business gives to the worker
- 2. Financial Control**—Facts that show whether the employer has a right to control the business aspects of the worker's job include the following:
 - The extent to which the worker has unreimbursed business expenses
 - The extent of the worker's investment
 - The extent to which the worker makes their services available to the relevant market
 - How the business pays the worker
 - The extent to which the worker can realize a profit or loss

3. Type of Relationship—Facts that show the type of relationship between the worker and the employer include the following:

- Written contracts
- Employee benefits
- The permanency of the relationship
- The extent to which services performed by the worker are a key aspect of the regular business of the company

For more information on worker classification for federal tax purposes, see [IRS Publication 15-A](#).

The ABC Test

The ABC test is similar to the common-law rules test used by the IRS; however, this test presumes a worker is an employee unless the facts and circumstances provide evidence of independent contractor status based on three criteria:

- 1. Whether there is an absence of control**—The absence of control exists if the worker is free from the direction or control of the hiring organization both by contract or agreement and in fact.
- 2. Whether the business of the worker is unusual to and/or away from the hiring organization's facilities**—The worker must perform work that is “unusual” in regard to the employing organization's business and/or off the hiring entity's premises to be considered an independent contractor.
- 3. Whether the worker is customarily engaged as an independent contractor in this trade or occupation**—Many professions or trades are customarily independent contractors who have their own business identity and engage in business for profit on the open market.

These criteria are similar to the common-law rules test, but there are critical differences that must be carefully examined because it's possible for a worker to be an independent contractor under the common-law rules test and an employee under the ABC test. For example, a worker may be classified as an independent contractor by the IRS, but the same individual may be classified by their state unemployment benefits agency when trying to obtain unemployment benefits.

The ABC test is used by several states when determining a worker's status. Other states use a slightly modified version of the ABC test that only requires workers to meet some of the test's elements to be classified as independent contractors.

Summary

Correctly classifying workers as employees or independent contractors is essential for an organization to comply with various federal and state laws. Misclassifying a worker can have serious financial and legal consequences. While classifying workers properly is often not a simple task, understanding the common classification tests can help employers ensure legal compliance. Using this chart can help guide employers as they classify their workers.

Due to the potential risks and liabilities of worker misclassification, employers should consider consulting with an experienced employment attorney if they have any questions or concerns.

Contact us for more workplace resources.