Department of Labor Publishes Guidance on Employee Misclassification

07.16.2015

In recent years, various initiatives and enforcement efforts on both the state and federal level have arisen in an attempt to combat the misclassification of employees as independent contractors. Misclassification occurs when an employer improperly classifies a worker as an independent contractor when the worker should be classified as an employee, thereby allowing the employer to avoid the employment expenses associated with employees. On July 15, as part of its own Misclassification Initiative, the Department of Labor ("DOL") published its Administrator's Interpretation **No. 2015-1**, a fifteen-page memorandum which discusses how to determine whether a worker is an employee or an independent contractor, and stresses that "most workers are employees under the [Fair Labor Standards Act]'s broad definitions" and thus entitled to the legal benefits associated with employee status.

Classifying a worker as an independent contractor rather than an employee significantly affects an employer's obligations towards the worker. Employees are entitled by law to certain benefits and protections to which independent contractors are not entitled. Therefore, employers who misclassify their employees as independent contractors face potential liability for various unpaid employee expenses such as payroll taxes, workers' compensation and unemployment insurance premiums, and even minimum wage and overtime payments, which are not owed to independent contractors. Employees are protected by various federal and state anti-discrimination and medical leave protections under which independent contractors are not protected. As the DOL notes in its recent guidance, misclassification also results in "lower tax revenues for government and an uneven playing field for employers who properly classify their workers."

The July 15 memorandum provides helpful guidance for employers regarding how to properly classify workers in compliance with the Fair Labor Standards Act ("FLSA"). The guidance outlines the broad definition of "employee" under the FLSA, which defines "employ" as "to suffer or permit to work." The DOL argues that, by rejecting the common law control test that was prevalent at the time, Congress specifically designed the FLSA to ensure as broad a scope of statutory coverage as possible. The memorandum highlights the distinction between an employee, who is economically dependent on his or her employer, and an independent contractor, who is in business for himself or herself and not economically dependent on an employer. Thus, few workers meet the requirements of an independent contractor, and most workers are in fact employees.

The July 15 memorandum also provides an overview of the multi-factor "economic realities" test applied by courts to determine whether a worker is an employee or an independent contractor under the FLSA. Although some courts have applied variations of the economic realities test, the factors typically include:

- the extent to which the work performed is an integral part of the employer's business;
- the worker's opportunity for profit or loss depending on his or her managerial skill;
- the extent of the relative investments of the employer and the worker;
- whether the work performed requires special skills and initiative;
- the permanency of the relationship; and,
- the degree of control exercised or retained by the employer.

These factors, in the aggregate, are illustrative of whether the worker is economically dependent on the employer (an employee) or is in business for himself or herself (an independent contractor). Although the memorandum provides detailed descriptions of how each factor has been applied historically, it also stresses that the application of the economic realities factors must be consistent with the broad "suffer or permit to work" definition, that each factor must be examined and analyzed in relation to the others, and that no single factor is determinative.

The DOL guidance comes in the wake of recent enforcement efforts in both Virginia and North Carolina designed to address worker misclassification in those states. Other states have "acknowledged this problematic trend and have responded with legislation and misclassification task forces." In Virginia, an inter-agency task force on worker misclassification and payroll fraud was established in 2014. In North Carolina, House Bill 482 was proposed that would create the Employee Classification Division within the State Department of Revenue to address misclassification complaints. Among other powers, the Division would investigate reports of misclassification; assess civil monetary penalties; coordinate with District Attorneys' offices to prosecute employers who fail to pay fines; pursue the suspension or revocation of licenses for certain trade contractors; and coordinate with other relevant State agencies to recover back taxes, wages, benefits and other losses arising from misclassification. Senate Bill 694 has likewise been proposed which contains similarly aggressive penalties.

It is anticipated that one of these proposed pieces of legislation will be passed into law. As these efforts indicate, employers in both states (and others) will face increased state enforcement of payroll requirements and potential liability and state-imposed penalties for employees who are misclassified as independent contractors. In light of these enforcement efforts, and with the aid of the DOL's new guidance, employers are cautioned to be diligent about worker classification to ensure compliance with the FLSA and applicable state laws. You should take steps now to ensure the proper classification for your workers and thus avoid future liability for misclassification.

Related People

- D. Earl Baggett – 804.420.6478 – ebaggett@williamsmullen.com
- Edward S. Schenk III – 919.981.4303 – eschenk@williamsmullen.com
- Amanda M. Weaver – 804.420.6226 – aweaver@williamsmullen.com

Related Services

- Labor, Employment & Immigration