Department of Labor Issues Final Rule on Employee Misclassification

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The United States Department of Labor (DOL) on Wednesday announced publication of its Final Rule addressing independent contractor misclassification under the federal Fair Labor Standards Act. The Final Rule (Rule) was scheduled for publication in the *Federal Register* on January 7, 2021, and will take effect 60 days later, on March 8, 2021, unless it is withdrawn before its effective date.

The Rule, which the DOL first proposed in September 2020, is aimed at providing a simplified test for employers to determine whether a worker may be classified as an independent contractor. In recent years, various enforcement efforts on both the state and federal level have attempted 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, as well as certain benefits and protections to which independent contractors are not entitled (such as wage and anti-discrimination protections). Though the DOL had previously issued guidance on worker misclassification, this is the DOL?s first formal rulemaking on the subject.

In the Rule, the DOL reaffirms the longstanding ?economic reality? test, one of multiple tests to determine whether a worker is an independent contractor. Under that test, the primary question is whether an individual is economically dependent on someone else?s business (an employee) or is essentially in business for herself (an independent contractor). The Rule expands upon the traditional economic realities test by identifying two ?core factors? that are most probative as to the question whether a worker is economically dependent on a putative employer:

- The nature and degree of control over the work.
- The worker?s opportunity for profit or loss based on initiative and/or investment.

Unlike previous iterations of the test, the Rule places emphasis on these two factors. However, it also identifies three other factors that may serve as ?additional guideposts in the analysis, particularly when

the two core factors do not point to the same classification.? These factors are:

- The amount of skill required for the work.
- The degree of permanence of the working relationship between the worker and the potential employer.
- Whether the work is part of an integrated unit of production.

The Rule also provides fact-specific examples of how the factors should be applied in different industries and circumstances. As always, the analysis is based on the nature of the working relationship in practice, and the existence of an independent contractor agreement is not determinative.

By reducing the number of factors to be applied, and by emphasizing two ?core factors,? the Rule relaxes the DOL?s previous guidance on worker misclassification. However, the Rule does not prevent states and localities from imposing more stringent worker classification requirements.

Virginia, for example, is one of those states with more stringent independent contractor laws. As noted in a prior article, the Virginia General Assembly was very active in 2020 and **passed a new law on worker misclassification**. Effective in July 2020, Va. Code § 40.1-28.7:7 mandates a legal presumption that each worker in Virginia is an employee unless the employer can prove that such individual is properly classified as an independent contractor using the Internal Revenue Service?s 20-factor test. Misclassified employees have a private right of action in Virginia courts and may recover back pay damages, such as unpaid wages and overtime, and other damages attributable to the misclassification, as well as attorney?s fees and costs. Virginia also imposes potential tax penalties and other sanctions on employers for worker misclassification.

Again, it is anticipated that the incoming Biden Administration may intervene before the Rule takes effect March 8. President-Elect Biden has long expressed concern that classifying workers as independent contractors prevents those workers from receiving many legal benefits and protections, and, as such, he advocates for a more stringent independent contractor test, similar to the ?ABC? test used in California. Still, if the Administration does not take steps to withdraw the Rule, it will become effective in less than 60 days. In light of this ever-changing landscape, as well as state-specific considerations, employers are cautioned to be diligent about worker classification to ensure compliance with all current federal and state laws. Employers should take steps now to ensure the proper classification for their workers and thus avoid future liability for misclassification.

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