

DOL's New Six-Factor "Economic Realities" Test: Navigating Changes in Independent Contractor Classification

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The U.S. Department of Labor's (DOL) recently published a final rule on the definition of "independent contractor" under the Fair Labor Standards Act (FLSA) on January 9, 2024. This rule introduces a six-factor "economic realities" test, replacing the 2021 rule and aiming to bring clarity to the classification of workers as independent contractors or employees.

The definition of "independent contractor" holds paramount importance as it determines the coverage under federal wage-and-hour laws. The FLSA's regulations on minimum wages, overtime, and record-keeping apply exclusively to employees and not independent contractors. Thus, understanding and correctly applying this distinction is crucial for compliance with federal labor laws.

Historically, the DOL had not defined "independent contractor" through regulation but relied on informal guidance, such as Fact Sheet 13, which outlined seven non-determinative factors for worker classification. Prior to this, the DOL had proposed a new five-factor test in 2020, emphasizing the principal's right to control and the worker's opportunity for profit or loss. The rule was finalized in 2021, however, almost immediately the new rule faced legal challenges, resulting in a lack of clarity on what the definitive independent contractor rule should guide employers' actions.

To resolve this issue, the DOL published a new rule on January 09, 2024. This rule adopts a six-factor test that delves into the economic dynamics between potential employers and workers:

- Opportunity for profit or loss depending on managerial skill.
- Investments by the worker and the potential employer.
- Degree of permanence of the work relationship.
- Nature and degree of control.
- Extent to which the work performed is an integral part of the potential employer's business.
- Skill and initiative.
- Additional factors.

As noted above, the 2024 rule introduces some adjustments to the DOL's prior versions. First, in terms of legal compliance, the rule clarifies that the control necessary to comply with specific legal

requirements does not automatically classify a worker as an employee. However, additional control exercised for convenience beyond legal necessities may influence the overall analysis. Second, the rule shifts from a dollar-for-dollar comparison in the assessment of relative investments. Instead, it focuses on whether the worker is making “similar types of investments,” indicating a move towards independent operation. Third, in evaluating tools and equipment, the final rule considers costs unilaterally imposed by the potential employer, distinguishing them from those initiated by the worker, in determining independence. Fourth, regarding profit or loss, the rule specifies that the ability to earn more by working more is not entrepreneurial when paid a fixed rate per hour or job, but other payment methods may suggest independence. Lastly, the rule emphasizes that specialized skill alone does not automatically confer independent contractor status; the key factor is whether the worker uses specialized skill in connection with business-like initiative. These nuanced adjustments aim to provide clearer guidance for employers and workers navigating the intricate landscape of independent contractor classification.

The legal landscape remains dynamic, with a lawsuit over the 2021 rule still pending and lawsuits regarding the new rule's validity likely to follow. Employers should, however, carefully study the final rule, as the DOL will treat the new rule as the controlling standard for audits and compliance actions. In navigating these changes, employers should seek guidance from experienced counsel and stay vigilant to potential legal developments in the evolving realm of independent contractor classifications.

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