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Workers Poised to Get Benefits as Rule Creates 'Employees' (1)

By Sara Hansard

Deep Dive

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- Businesses may see need to classify more workers as employees
- Health benefits, leave could ultimately be affected by rule

The Department of Labor's new rule making it harder to classify workers as independent contractors may mean more employers will be compelled to provide costly benefits like health care and paid leave.

The rule (RIN 1235-AA43), which takes effect March 11, officially only covers the status of workers under the Fair Labor Standards Act governing such factors as minimum wages and overtime. But the real-world spill-over effect is likely to mean businesses will move to treat more workers as nonexempt employees for wage and hour purposes, and for other purposes such as benefits, tax withholding, and anti-discrimination laws, employment attorneys say.

The rule "is intended to result in the classification of more workers as employees. As that plays out in practice, then that should result in more workers being eligible for benefits, as contractors typically are not benefits-eligible," said Mark Goldstein, a partner in the labor and employment group of Reed Smith LLP.

While the rule isn't expected to result in a massive number of re-classifications at companies, it adds more complications and possible liability for employers trying to figure out how they should treat their workers.

"One major impact of the rule's going to be somewhat increased legal unpredictability, because the new rule is returning to an old test that's open-ended," said Timothy Taylor, a partner with Holland & Knight. "It has a lot of factors in it. It's going to be harder to predict litigation outcomes. It's going to be harder to predict who is an employee."

‘Economic Realities’

The regulation cancels a Trump administration independent contractor test that gave greater weight to how much control workers have over their job duties as well as their opportunities for profit or loss when determining whether they were contractors or employees. That analysis that was viewed as generally more business-friendly.

The new Biden rule states that each factor in the legal test, known as the “economic realities” test, should be considered equally to determine worker status under the FLSA.

The consequences of misclassifying a worker as an independent contractor can be severe. “It can lead to a significant bill for the putative employer,” along with attorneys’ fees, penalties, and damages for employers found to have violated the FLSA, Taylor said. “It’s not a fun place to be in.”

A major problem for employers determining to whom they want to offer benefits is the a wide variety of tests under different laws they must consider, many of which have overlapping elements.

In addition to the DOL rule, the Internal Revenue Service has a 20-factor, narrower test for determining who is an employee for tax purposes. Social Security applies a common law test to determine whether workers should be covered, which includes determining if the employer has the right to tell the employee what to do, as well as how, when, and where to do the job.

States and local jurisdictions have their own definitions for determining who is considered an employee eligible for health or unemployment benefits.

“In practice it is very difficult, if not operationally impossible, to classify a worker as an independent contractor for one purpose but an employee for another, because of the things you have to do with respect to an employee that you don’t do with an independent contractor,” such as tracking work hours, said Alexander MacDonald, a shareholder with Littler Mendelson P.C.

Shannon Liss-Riordan, a labor attorney who is a partner with Lichten & Liss-Riordan P.C., said using stricter state tests like the “ABC” test favored by California and other states would simplify the issue.

“What the Department of Labor regulations are supposed to do is summarize the case law,” Liss-Riordan said. “That doesn’t make it easy for employers who are trying to navigate this.”

Benefits Changes

The possible addition of new “employees” to a company’s payroll to eliminate confusion over multiple tests would have potentially far-ranging consequences.

Under the Affordable Care Act, for instance, an employer that has the equivalent of at least 50 full-time employees must offer health coverage that meets minimum standards, and which doesn’t cost more than 8.39% of employees’ household income in 2024—or the employer is subject to large fines.

“If more workers are classified as ‘employees,’ those individuals will count towards the totals that employers have to cover under their group health plans, as required by the Affordable Care Act,” Roberta Casper Watson, leader of The Wagner Law Group’s health and welfare group, said in an email.

This would have an especially big impact on smaller businesses previously left untouched by these ACA requirements.

There is some ambiguity around the application of the new DOL rule in this context, however.

“This rule only applies to the Fair Labor Standards Act. The Department of Labor does not enforce the Affordable Care Act,” which generally uses a common law definition of employee, and ACA penalties are levied under tax law, said Allan Bloom, a partner with Proskauer Rose LLP.

“To the extent that a company is required to cover employees, if the company converts independent contractors to employees then they would be covered as would other employees,” Marc Freedman, vice president of workplace policy for the US Chamber of Commerce, said in an email. But whether a company converts current independent contractors to employees “is not a given,” he said.

Freedman says the decision may be individualized for employers. “Whether a company decides to convert an independent contractor to an employee is likely to be a company-by-company, worker-by-worker decision and therefore not knowable at this point,” he said.

Reclassification could affect company leave policies as well, including the need to cover more newly minted “employees” under the federal Family and Medical Leave Act, which provides up to 12 weeks of unpaid leave for a new child, or to take care of one’s own medical needs or a family member’s.

FMLA should be made available to workers at a location where the employer has at least 50 employees within 75 miles.

But there are bigger potential benefits changes at the state level, where a patchwork of state and sometimes local laws govern paid sick leave and family leave, leaving the door open for newly classified employees to trigger coverage.

Thirteen states plus Washington, D.C., for example, now guarantee workers at least 12 weeks off annually in paid family and medical leave.

Ultimately, employers struggling to make classification and benefits decisions will have to closely watch how the new DOL test plays out in litigation, including a lawsuit challenging the DOL rulemaking itself. And more legal complaints are likely to spring up around individual workers’ misclassification allegations.

“What this new final rule does is it equips the courts, the DOL, with a test to determine whether an individual is in fact a bona fide independent contractor or not,” said Jeffrey Ruzal, a member of Epstein Becker & Green P.C.

(Adds further information about employment status determinations under Affordable Care Act)

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