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BLOG

Benefits Bulletin – DOL Final Independent Contractor Rules and Benefit Plans

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DEPARTMENT OF LABOR'S FINAL INDEPENDENT CONTRACTOR RULE CONTAINS IMPORTANT POTENTIAL IMPACTS FOR EMPLOYEE BENEFIT PLANS

Final Department of Labor Independent Contractor Rule

On January 10, 2024, the Department of Labor (DOL) published a final rule (the Final Rule) regarding independent contractors under the Fair Labor Standards Act (FLSA). The prior rule, which was issued by the DOL in January 2021 and faced a variety of litigation and administrative hurdles, used five "economic reality factors" to determine whether an employee is an independent contractor and considered two of these five factors—the nature and degree of control over the work and the worker's opportunity for profit or loss—as the "core factors" for determining whether an individual is an independent contractor.

The Final Rule, which is effective March 11, 2024, replaces the 2021 rule. The Final Rule applies a "six-factor" test that does not give a predetermined weight to any of the economic reality factors, but rather looks at the individual's activity as a whole in determining whether they are an independent contractor. The DOL believes the Final Rule is "more consistent with judicial precedent. . . ." However, the Final Rule significantly expands the definition of an employee to include more types of workers.

This Bulletin highlights the differences in worker classification between the Internal Revenue Service (IRS) rules that are applicable to employee benefit plans and the DOL Final Rule guidance that is applicable to FLSA determinations. Employers will need to determine how best to coordinate these agency guidelines when determining whether an individual should be treated as an employee and for what purpose. Below we outline the differences between the IRS and DOL guidance and certain implications in the area of employee benefits of such determinations.

IRS and DOL Rules for Determining Independent Contractor Status

The current IRS rule and DOL Final Rule for determining independent contractor status are summarized below:

IRS RULE FOR DETERMINING INDEPENDENT CONTRACTOR STATUS	DOL FINAL RULE FOR DETERMINING INDEPENDENT CONTRACTOR STATUS

The IRS looks at common law rules and considers three factors as evidence of the degree of control the employer has over the individual[1]:

- behavioral control (does the company control what the worker does or how the worker does a job);
- financial control (how the worker is paid, etc.) and
- type of relationship (are there written contracts, employee benefit plans?).

An individual does not have to meet all of the factors to be considered an independent contractor.

Under the Final Rule, the DOL looks at the following factors to determine independent contractor status under the FLSA:

- a worker's opportunity for profit or loss depending on managerial skill;
- the financial stake/investments by the worker;
- the degree of permanence of the work relationship;
- the nature and degree of control a potential employer has over the work;
- the extent to which the work performed is an integral part of the potential employer's business; and
- the worker's skill and whether those skills contribute to business-like initiative.

As noted above, the DOL has indicated that the Final Rule is limited to its impact on the provisions of the FLSA, and thus the Final Rule does not affect other laws such as National Labor Relations Board, state and local labor laws, and IRS and state tax laws, which use different standards for employee classification. While complying with the DOL Final Rule is not mandatory for employee benefit plans, an employer may need to consider how to navigate the potentially different results when addressing benefit plans and FLSA requirements. The following is a summary of the potential impact that employment status changes can have on employee benefit plans:

TYPE OF PLAN	POTENTIAL IMPACT
Qualified retirement plans	Misclassifying an individual as an employee when they should be considered an independent contractor (or classifying an independent contractor as an employee) can affect plan administration. For example: • Retirement plans are not prohibited from covering independent contractors, but neither are they legally required to cover them. (However, covering independent contractors would likely create a multiple employer plan, or MEP.) • Qualified retirement plans must undergo annual nondiscrimination testing. Independent contractors that are reclassified as employees may need to be included in annual compliance testing and could affect whether the plan meets these tests. • Independent contractors that are reclassified as employees may be entitled to retroactive

	coverage for retirement plan benefits, depending on the provisions of the plan document.
Health and welfare plans	Health and welfare plans are not prohibited from covering independent contractors, but neither are they legally required to cover them. (However, covering independent contractors would likely create a multiple employer welfare arrangement, or MEWA.) Employers should be aware that covering individuals designated as independent contractors under company health and welfare plan increases the possibility that they will be considered employees for other purposes, such as wages and retirement benefits, because such inclusion is a factor indicating employee status. In addition, independent contractors are not: • eligible to participate in cafeteria plans; • eligible to participate in health reimbursement arrangements; or • subject to Affordable Care Act (ACA) reporting requirements. An independent contractor being reclassified as an employee for prior plan years can result in retroactive penalties under the ACA as well as penalties for failing to file and/or filing inaccurate reports on Forms 1094-C and 1095-C. For independent contractors that obtain coverage on the Marketplace Exchange and receive government subsidies, having affordable employer-provided coverage available to such independent contractors will make them ineligible to further receive such subsidies.
Other benefits/nonqualified plans	It has been over two decades since the landmark *Vizcaino v. Microsoft* case in which certain temporary workers classified as independent contractors successfully sued Microsoft for the same benefits as permanent employees. Although things like employee stock purchase plans are popular with certain groups of employers (particularly tech startups), those employers need to be aware of the potential pitfalls of failing to offer these benefits to independent contractors who are more properly classified as employees.

Winton Takeaway: Please contact a member of the Winston & Strawn Employee Benefits and Executive Compensation Practice Group or your Winston relationship attorney for further information on the DOL's Final Rule and to discuss navigating the potentially different results of employment classification changes when addressing employee benefit plans and FLSA requirements.

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[1] Although the "20-factor test" set forth in IRS Revenue Ruling 87-42, 1987-2 C.B. 589, is still considered valid, the IRS has indicated it will focus on the three groupings of the factors, as shown above.

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