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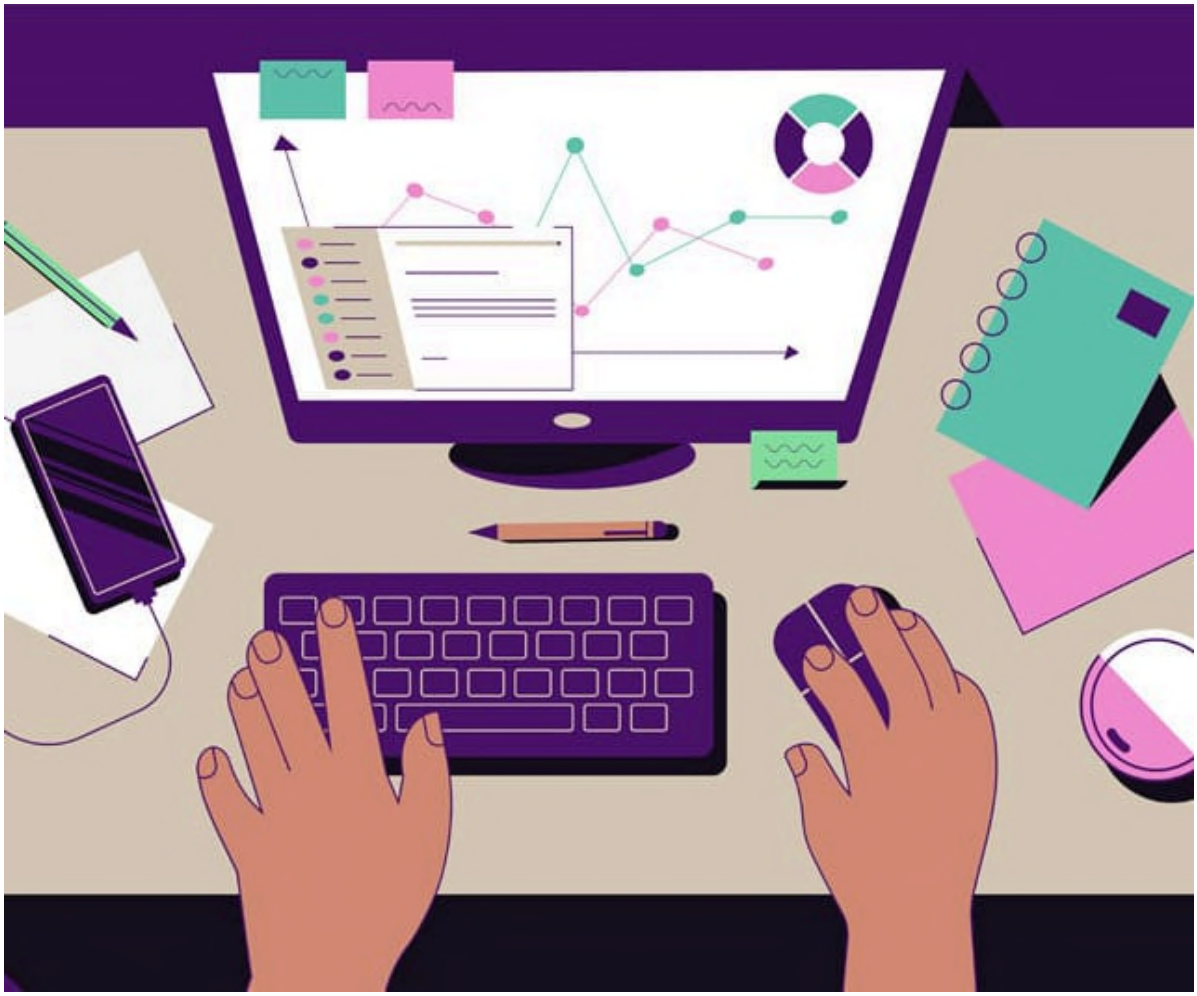
'Staggering Penalties' Possible For Financial Firms Because of DOL Rules



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New Department of Labor rules that determine who is an independent contractor and who is an exempt employee will have a big impact on financial firms and the potential for "staggering" penalties.

But firms that do their due diligence can insulate themselves from potential liability and save money, said two attorneys with the Wagner Law Group, a Boston-headquartered firm specializing in labor law. The attorneys, David Gabor and Katherine Brustowicz, discussed how to navigate the new rules in a recent webinar.

The DOL's final rule, Employee or Independent Contractor Classification Under the Fair Labor Standards Act (FLSA), published on January 10 and effective on March 11, reverses a rule published in January 2021 by the Trump administration. The "business-friendly" 2021 rule made it easier for employers to classify a worker as an independent contractor, but the DOL subsequently determined that it was inconsistent with the FLSA as interpreted by longstanding judicial precedent, Brustowicz said.

Six Factors Determine Contractor Status

The 2024 rule weighs six factors in determining whether a worker is an employee or independent contractor under the FLSA:

- **The worker's opportunity for profit or loss, depending on managerial skill:** For example, if a worker negotiating fees engages in marketing, advertising or other efforts to expand their business, that would weigh in favor of classifying them as a contractor, Brustowicz said.
- **Investments by the worker and the potential employer:** The DOL guidance distinguishes between a worker's investment that is "entrepreneurial," meriting independent contractor status, as opposed to fulfilling basic requirements of the job. A worker's purchase of tools and equipment for a specific job as requested by the employer would weigh toward classification as an employee, according to Brustowicz.
- **Degree of permanence of the work relationship:** A relationship that is for a set period of time and not exclusive, so the worker can market services to multiple entities, suggests that the worker is an independent contractor. A continuing relationship exclusive of work for other employers indicates an employer-employee relationship, she said.
- **Nature and degree of control:** The more that the employer sets the schedule, supervises work or disciplines work, the more likely that this is an employer-employee relationship, Brustowicz said. Additionally, imposing demands or restrictions on a worker to control fees or prices, and not allowing them to work for others, also indicates employee status.
- **Extent to which the work performed is an integral part of the potential employer's business:** If the work is not critical or necessary for the firm's primary purpose, this would favor an independent contractor classification.
- **Specialized skill or initiative:** A worker's specialized skill alone does not indicate independent contractor status, and when a worker relies on the employer for training to perform the work, that indicates employee status, according to Brustowicz.

Helpful Shortcut

She said the DOL rule does not favor any one factor over another, but she offered a shortcut for employers in doubt trying to determine their relationship to a worker. "Remember that where the worker is dependent on the employer for work, they will be deemed an employee under this rule."

Employers Should Take the Initiative

Employers need to be proactive in determining the status of workers and making changes as needed, Gabor said.

First, they should do an analysis based on the new rules to determine if a worker is an employee or a contractor and update their policies to reflect the changes in the, he said. "If you don't have a policy, I think it's a good time to create a policy."

Employees who supervise contractors should be instructed on what they can and cannot do, "because the more they're controlling what a contractor does, the greater the risk that the person will be classified as an employee and not an independent contractor," Gabor said.

He also suggests that employers centralize their hiring process to avoid incorrect contractor classifications. "If people can bring someone in without checking with HR or Legal or the CFO and business, then you're at risk of a misclassification, and those are important mistakes," said Gabor.

Employers also should audit their current workforce contracts. "I know you're going to roll your eyes at this one, because who's got the time to do it?" Gabor said, adding that it's essential to determine whether worker classifications are accurate.

All too often, an employer will assume that a long-time worker classified as an independent contractor should continue in that role, when shifting responsibilities and conditions may mean they should be treated as employees.

Financial Firms and Advisors are Affected

Gabor said financial advisory firms need to be especially careful with the independent contractor rule.

"Here's the deal: If you look closely at your contracts, and you're proactive in terms of what you put in the contract, you can make a profound difference," he advised. "The devil is in the details. If your workers have a separate business, i.e. their own tax ID number, that can be a viable workaround for them, so that you can have them working with you."

Gabor said independent financial advisors are concerned that the rule may reclassify them as employees of a broker-dealer firm. But if an advisor retains control over their own firm, controls their financial plans, determines their services and pursues their own marketing, they won't necessarily be considered employees, he said.

Employers should also consider whether hiring a worker as a contractor makes sense for the business. "You figure, we can save money, we don't have to worry about benefits for them, we don't have to worry about overtime, target plans … and we can save," Gabor said. But a business doesn't have the same degree over a contractor as an employee, which could have a negative impact on the brand, he cautioned. "And sometimes it's actually easier to train employees who are going to stay with you for an extended period of time and have them provide those services."

Pay Threshold Rises for Nonexempt Workers

The other big change, the Department of Labor's new overtime rule, announced on April 23 and effective July 1, raises the salary threshold above which certain employees can be classified as exempt, meaning they do not qualify for overtime pay.

The current threshold is $35,568 annually, below which all employees (including managers and professionals) must be paid time-and-a-half for overtime. On July 1, the threshold increases to $43,888 annually, and on Jan. 1, 2025 it rises again, to $58,656. The rule includes an automatic salary threshold increase every three years, "so this is something that's not going away," Brustowicz said.

Workers who meet the threshold test and qualify under FLSA for executive, administrative, professional, or computer and outside sales exemptions are not eligible for overtime pay, she said. Employees who meet the duties test but not the new salary thresholds should be treated as nonexempt employees, eligible for time-and-a-half pay for overtime.

The threshold is higher for certain workers classified as "highly compensated employees," who perform office work and the duties of an exempt executive, administrative or professional employee. The threshold

for them, currently $107,432, increases to $132,964 on July 1 and to $164,000 on Jan. 1.

As with the issue of classifying workers as employees or independent contractors, companies should perform analysis to determine which positions will be impacted by the salary threshold increases, Brustowicz said.

What Really Counts

The attorneys said the actual work an employee does, not their job description, determines whether they are exempt or nonexempt.

"You have a job description, and it looks a lot like this person in that job description is exempt," Gabor said. "But is the person actually doing what's in the job description, or has their role changed?" For example, if a worker was managing an office with several staff members but is now working remotely, they may no longer be exempt, he said.

In some cases, employers may save money by raising a managerial employee's salary above the nonexempt pay threshold, meaning they would no longer be eligible for overtime pay, Brustowicz said. However, employers should notify affected employees explaining why they are now eligible for overtime or why their salaries are being increased. Any notice should also be carefully timed in case the final rule ends up being delayed, she added.

Heavy Penalties for Noncompliance

Penalties for failure to comply with the new rules could be costly.

If an employer misclassifies an employee as an independent contractor, the damages include unpaid wages and overtime, double or triple damages depending on the state, lost benefits, attorney fees and costs. Additionally, there can be employment tax liability, including 100% of the combined worker-employer contribution under FICA, and penalties and interest.

"If the misclassification affects multiple workers over a period of years, the total amounts of these penalties can actually be staggering," Brustowicz warned.

Willful violations of FLSA can result in a fine of up to $10,000 and up to six months imprisonment. Similar penalties apply to misclassification of an employee's exempt status.

"So, you don't want to accidentally violate the FLSA, but you certainly don't want to violate it intentionally," Brustowicz said.

In a four-decade career in journalism, Ed Prince has served as an editor with many of New Jersey's leading newspapers, including the Star-Ledger, Asbury Park Press and Home News Tribune.

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