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COMMENTARY

*The Small Business Implications of FLSA's Employee
Definition Changes*

BY MADISON CHAMBERS*

Small businesses face several challenges when trying to maintain compliance with applicable laws, including determining whether the people they hire are considered employees or independent contractors. The Department of Labor (DOL) issued a new rule, effective as of March 11, 2024, for how the Fair Labor Standards Act (FLSA) defines whether someone is an employee.¹ These changes can present additional hurdles for small businesses.

The new rule under FLSA defines who is considered an employee using the Economic Realities Test.² This test has six factors, though none are determinative and the entirety of the circumstances should be evaluated.³ The six factors include first, the opportunity for profit or loss depending on managerial skill; second, the investments by the worker and the potential employer; third, the degree of permanence of the work relationship; fourth, the nature and degree of control; fifth, the extent to which the work performed is an integral part of the potential employer's business; and sixth, the skill and initiative.⁴ Further the DOL maintains that additional factors may be considered in relation to the above factors if the ones are indicative of the worker in question may actually be in business for themselves rather than being economically dependent on the employer for work.⁵

The FLSA addresses the following areas of employment: federal minimum wage, overtime, hours of work spent at a jobsite or being on-call, recordkeeping, and child labor.⁶ The

* J.D. Candidate, Class of 2027, Sandra Day O'Connor College of Law at Arizona State University.

¹ *Small Entity Compliance Guide*, U.S. DEPARTMENT OF LABOR <https://www.dol.gov/agencies/whd/flsa/misclassification/small-entity-compliance-guide> (last visited Feb. 8, 2026).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ Mary Varano, *New Rule Modifies Federal Statute's Definitions of "Employee" and "Independent Contractor,"* CORRIGAN KRAUSE (May 2024), <https://www.corrigankrause.com/new-rule-modifies-federal-statutes-definitions-of-employee-and-independent-contractor/>.

FLSA applies to not only full and part-time employees in the private sector, but also those who work in federal, state, and local governments.⁷

If someone is determined to be an employee of a business that must follow FLSA, then that person is entitled to the benefits and protections that FLSA grants. Thus, if not treated like an employee before, then that person may be entitled to various forms of remedies.

The new test can have serious consequences for small businesses that fail to keep up with the changes. If a worker was misclassified by a small business employer, such as considering them an independent contractor when instead under the test they should have been considered an employee, then the worker can sue their employers for FLSA violations and recover remedies like monetary damages.⁸ Those damages include not only backpay, but also the repayment of tax obligations that the employer owes.⁹ And, misclassification of an employee also opens up the small business to expensive litigation.¹⁰

Small businesses are especially susceptible to the hurdles changing FLSA guidelines create because of resource constraints.¹¹ Unlike large companies, small businesses don't have the financial ability to employ a large human resources department to keep up to date about laws and guidelines, and, hiring separate legal counsel to advise on constantly changing laws is also very expensive.¹² Luckily, the DOL put together a reference guide for small businesses, detailing more about the new test and how FLSA is applicable.¹³ It is important for these businesses to stay up to date with changing guidelines and avoid violating any applicable laws surrounding employment classification.¹⁴ Regularly checking the DOJ's website and announcements, especially during administration changes can help a business stay on top of employment classification.

⁷ *Id.*

⁸ *Id.*

⁹ Anthony M. Batt, *Misclassifying Employees Can Have Major Consequences*, PILIERO MAZZA (Mar. 21, 2019), <https://www.pilieromazza.com/misclassifying-employees-can-have-major-consequences/>.

¹⁰ *Id.*

¹¹ *Navigating the New Fair Labor Standards Act Rules for Small Business Owners*, INTEGRA BUS. SOLUTIONS (Nov. 25, 2024) <https://www.integrabizsolutions.com/navigating-the-new-fair-labor-standards-act-rules-for-small-business-owners/#:~:text=Why%20the%20FLSA%20Matters%20to,for%20both%20employees%20and%20employers.>

¹² *Id.*; See also, Kate Lipp, *Top 10 Mistakes Small Businesses Make in FLSA Compliance and How to Avoid Them*, LIPP LAW (Feb. 10, 2025) <https://www.lipplawfirm.com/top-10-mistakes-small-businesses-make-in-flsa-compliance-and-how-to-avoid-them/>.

¹³ *Small Entity Compliance Guide*, *supra* note 1.

¹⁴ *Navigating the New Fair Labor Standards Act Rules for Small Business Owners*, *supra* note 11.