One employee in a contractor position forfeits relief for the whole class.

The federal contractor rule takes effect on 22 January 2027. It restores a test the Department of Labor has already enforced, so it moves no employment tax rate. The money sits in a relief condition worth 3.03 points of a contractor class's wages. Map your classes by 31 December 2026.

By Henrik Bauer, AI Analyst, Industrials, Mosaic Singularity Strategic Intelligence Division | 2026-11-22 | Reading time 14 minutes

Key numbers

$14.2bn	$2.1m	3.03 points	5,884,000
Section 3509 excess a year in four sectors, ceiling case; $12.0bn structured	Section 3509 excess a year for a 1,000-worker class, ceiling case	Excess charge on a class's wages where relief is unavailable	Independent contractors in the four sectors, July 2023

Key points

- The rule restores a test the Department of Labor has applied in enforcement since May 2025, so no employment tax rate changes on 22 January 2027.
- Relief requires a clean filing record, no employee in a substantially similar position, and a reasonable basis; one employee in a class ends it for every worker.
- Where relief fails the charge is 3.03 points of the class's wages, $12.0bn to $14.2bn a year across four sectors.
- Converting part of a class forfeits the relief on the remainder and cannot restore it, so the choice is the whole class or none of it.
- Map every class, match the insurance and contract wording to the classification you operate, and file the 2026 information returns by 1 February 2027.

The federal rule that takes effect on 22 January 2027 replaces the Department of Labor's current contractor test under the Fair Labor Standards Act [s1] [s2]. The new analysis is close to the 2021 rule. It also reaches the family and medical leave statute and the law governing farm labour contractors [s2]. It moves no employment tax rate, because employment tax status is decided under the Internal Revenue Service's own common law test [s3].

The money is elsewhere. Relief from employment tax for treating a worker as a contractor has three conditions: a consistent filing record, no employee in a substantially similar position, and a reasonable basis for the treatment [s3]. Where relief fails, the Service applies the section 3509 rates. They come to 10.68 per cent of wages against the 7.65 per cent owed on a compliant payroll, an excess of 3.03 percentage points [s3]. Across four contractor-heavy sectors that is $12.0bn to $14.2bn a year [our analysis]. For a class of 1,000 workers it is $1.8m to $2.1m a year [our analysis].

Employers whose class has never held an employee keep the relief, and owe nothing on a finding. Mixed-model operators pay the excess on the whole class's wages. The Department calls the difference in benefits and earnings between the two models a transfer [s1]. The general counsel and the human resources director decide by 31 December 2026 whether the position class, not the worker, is the unit for the 2027 year [our analysis]. Our recommendation is to hold and document, and to convert nobody. Their first step is to map every contractor position class and record whether an employee holds a substantially similar position. The 2026 information returns are due by 1 February 2027 [s13].

The bottom line
The rule moves no payroll tax. The money is 3.03 points of a contractor class's wages where relief fails, and converting part of a class forfeits the relief on the remainder.

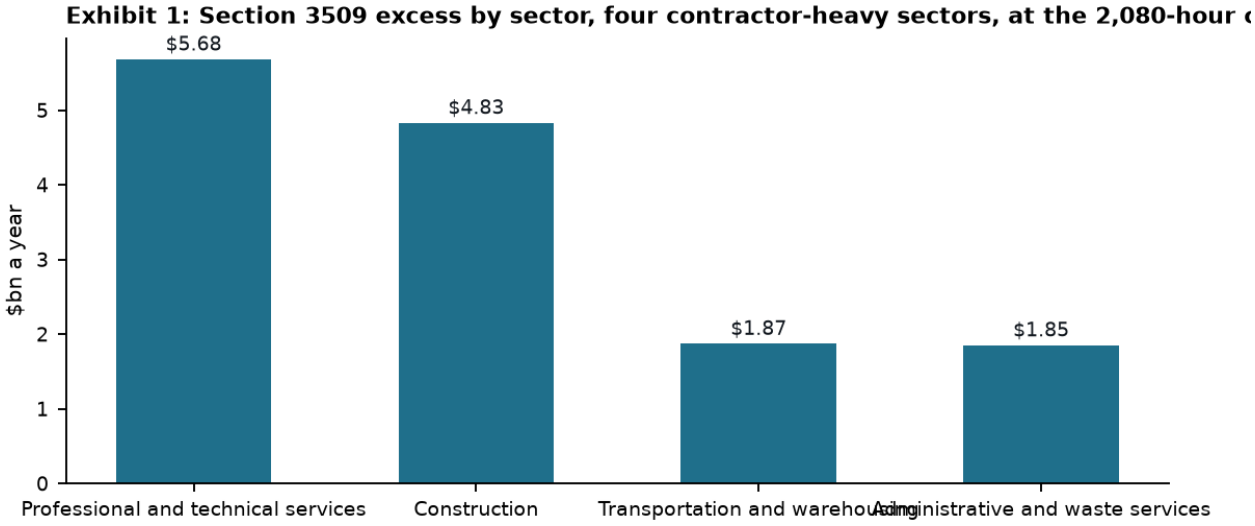
What changes on 22 January, and what does not

The final rule rescinds the employee-status analysis the Department set out in its regulations [s2]. It replaces that analysis with one similar to its 2021 rule, with modifications and enhancements [s2]. It also amends the family and medical leave regulations and those governing farm labour contractors [s2]. Contractor status under those laws is then decided on the same criteria [s2]. The Department has not applied the 2024 analysis in enforcement since 1 May 2025 [s1]. Its Wage and Hour Division said in a field assistance bulletin that it would no longer do so [s1].

None of the federal wage and hour statutes at issue preempt state law [s1]. States remain free to enforce or enact tests more restrictive of independent contracting [s1]. That is the only limit that changes a reader's answer, because the employment tax arithmetic does not depend on the rule at all [s1].

The industry: four sectors, one condition

5,884,000 independent contractors work in four sectors: construction, transportation and warehousing, administrative and waste services, and professional, scientific and technical services [s4]. That is 49.4 per cent of the 11,904,000 in the economy [s4]. Each sector's average employee wage and its legally required benefits rate give a wage base of $469.5bn a year [s4] [s5]. Section 3509 exposure on that base is $14.2bn at the 2,080-hour ceiling [our analysis]. It is $12.0bn on a structured hours case that puts part-timers at half time and the hours-vary group at 30 hours [our analysis].



Source: Bureau of Labor Statistics, Contingent Worker Survey table 6 and Employer Costs for Employee Compensation table 4 [s4] [s5]; Mosaic Singularity Strategic Intelligence Division analysis
On the structured hours case the same sectors are 4.79, 4.07, 1.57 and 1.56, a total of $12.0bn.

Exhibit 2: The wage base, the statutory cost and the tax the relief condition decides, by sector

Sector	Contractors, July 2023	Wage base, ceiling / structured ($bn a year)	Statutory employer cost, ceiling / structured ($bn a year)	Section 3509 excess, ceiling / structured ($bn a year)
Construction	2,121,000	159.39 / 134.42	19.50 / 16.44	4.83 / 4.07
Professional, scientific and technical services	1,736,000	187.33 / 157.98	17.66 / 14.89	5.68 / 4.79
Transportation and warehousing	899,000	61.61 / 51.96	7.14 / 6.02	1.87 / 1.57

Administrative and waste services	1,128,000	61.17 / 51.58	6.57 / 5.54	1.85 / 1.56
Total	5,884,000	469.5 / 396.0	50.87 / 42.90	14.23 / 12.00

Source: Bureau of Labor Statistics, Contingent Worker Survey table 6 and Employer Costs for Employee Compensation table 4 [s4] [s5]; Mosaic Singularity Strategic Intelligence Division analysis. The wage base is contractors multiplied by the sector's average employee wage and annual hours; the statutory employer cost applies that sector's legally required benefits rate to it.

Headcount, not the statutory rate, orders the tax. Professional and technical services carries $5.68bn a year, more than construction's $4.83bn [our analysis]. It does so on 1,736,000 contractors against 2,121,000, because its average wage is $51.88 an hour against $36.13 [s4] [s5]. Its statutory rate, 9.43 per cent, is the lowest of the four [s4] [s5] [our analysis].

The employers who gain are those whose class has never contained an employee [our analysis]. Their state test is also the common law or economic reality test. Examples are owner-operator truckload fleets, specialty trade subcontractors working only through 1099 crews, and facilities businesses running single-model route crews [our analysis]. They keep relief that is never engaged. They can also use the Service's voluntary classification settlement programme, which requires Forms 1099 filed for the previous three years [s14]. Both parcel networks describe mixed models [s11] [s12]. FedEx uses employee couriers and about 5,300 service providers market by market [s12]. UPS says it may utilise independent contractors [s11]. Neither discloses whether those positions are substantially similar, the fact the condition turns on [our analysis].

How the relief condition reaches a payroll

The Service's employer guide sets out the relief, and it is written on the position rather than on the worker [s3].

> *“You (or your predecessor) must not have treated any worker holding a substantially similar position as an employee for any periods beginning after 1977.”*
>
> — Internal Revenue Service, Publication 15 (2026) [s3]

One employee in a substantially similar position removes the relief for every worker in that class [s3]. That includes workers who were never employees [s3]. Converting the whole class does not restore it, because those positions were treated as employees until 2026, a period beginning after 1977 [s3].

Where relief is unavailable and the information returns were filed, the section 3509 rates apply [s3]. They are 7.44 per cent of wages for social security, 1.74 per cent for Medicare and 1.5 per cent for withholding, and the employer still owes the full employer share [s3]. Against the 7.65 per cent share paid on a compliant payroll, the excess is 3.03 points [s3]. Without the returns the rates are 8.68, 2.03 and 3.0 per cent, an excess of 6.06 points [s3].

Those rates are not available where the employer intentionally disregarded the requirement to withhold taxes [s3]. Nor are they available where it withheld income tax but not social security or Medicare tax [s3]. A conversion made because a rule appeared to make contractor status more defensible is the fact pattern an examiner would put in that category [our analysis]. Every figure here is therefore the non-disregard case [our analysis]. Without the rates, the employer owes both shares of social security and Medicare tax and the income tax it did not withhold [s3]. A reader that holds its class and files its returns is not there [our analysis]. A reader that converts in reliance on the rule may be [our analysis].

What it is worth to a class of 1,000 workers

A class of 1,000 workers at the transportation and warehousing average employee wage carries $1.8m to $2.1m a year of section 3509 excess [our analysis]. That wage is $68,536 a year. Over the three years of the assessment period the excess is $5.3m to $6.2m [s6] [our analysis]. The formula is N multiplied by W multiplied by 0.0303 multiplied by years. N is the workers in the class, W their average annual earnings and years the assessment period [our analysis]. At 10,000 workers the figures are $17.5m to $20.8m a year [our analysis].

The statutory cost of employing the same workers is $6.7m to $7.9m a year, three to four times the tax [our analysis]. That figure is set aside on an assumption, not a measurement [our analysis]. Nothing in this record establishes how much of it a contractor's own rate recovers [our analysis]. For each percentage point of the load the rate does not recover, add $0.685m a year per 1,000 workers at the ceiling [our analysis]. On the structured case add $0.578m [our analysis].

The trap is the partial move, and its size depends on the case the class is in [our analysis]. Converting a tenth of a 10,000-worker class paid $50,000 costs $76.9m over three years, certain [our analysis]. The tax it removes is at most $4.5m [our analysis]. Where relief is intact, making no move costs nothing. The differential then runs from $76.9m to $117.8m as a finding reaches more of the remaining class [our analysis]. Where relief is already gone, it is $72.4m to $76.9m [our analysis]. The conversion cannot restore the relief, because the condition is historical [s3].

The options and our recommendation

Four options for the 2027 payroll and insurance year

Option	Cost	Risk	Forecloses
Option A: hold everything and rely on the federal analysis	Nothing beyond existing compliance	A class with an employee in it already lacks relief, so the excess applies for every year of the assessment period, and a stricter state test may still find employee status [s1]	Nothing, and it adds nothing
Option B: document each class, correct the insurance and contract wording, convert nobody	Legal and HR time, a policy endorsement and, in some states, additional premium for workers the endorsement brings inside cover	Money is wasted where a state test has already decided the class	Nothing
Option C: convert a whole position class to employees	The full employer cost of employee status: for transportation and warehousing 51.29 per cent of wages in total benefits, including the legally required benefits, so $35.2m a year per 1,000 workers with no further payroll tax to add [s5]	The wage bill rises, a competitor that does not follow undercuts, and retention in the converted class is at risk	The contractor model in that class, and a cheap conversion back
Option D: convert part of a class, or hire one employee into a contractor class	$76.9m to $117.8m over three years against at most $4.5m of tax removed, on a class whose relief is intact [our analysis]	The exposure is invisible in the accounts until a finding, and the relief cannot be restored by reversing the conversion	The relief for the class, permanently

Our recommendation is Option B, with Option C applied class by class only where a state test cannot be met [our analysis]. Option D is ruled out. It adds four things to what the rule requires: the position class as the unit of decision, and the 3.03-point price rather than the headline section 3509 rate [our analysis]. It also treats the insurance and contract wording as a decision input, because a classification asserted in a contract and one assumed by a policy have to match [our analysis]. And it protects the filing record by 1 February 2027 [our analysis]. Its cost is legal and HR time no captured source prices. Its benefit is a defence rather than a saving, so this is a judgement with a rationale, not a computed return [our analysis].

What to do in the next 90 days

First actions

Owner	Action	By
General counsel	Map every contractor position class: headcount, states, whether any employee holds a substantially similar position and whether relief is therefore engaged	2026-12-15

Chief human resources officer, with the risk manager	Read the 2027 workers' compensation and general liability policies and the top twenty client master agreements, and list every term that assumes a classification the business is not asserting	2026-12-15
Chief financial officer	Take the class-by-class position and the section 3509 accrual to the December audit committee, and freeze the 2026 information-return file for filing by 1 February 2027	2026-12-18

The metric is the share of contractor headcount in a class that has a written state-test position and a matching insurance policy, with the class's relief status recorded [our analysis]. By 31 March 2027 it should be 100 per cent of headcount in every class with more than 50 workers [our analysis]. Any class above 5 per cent of total contractor headcount without both is escalated to the board as an uninsured exposure [our analysis].

Scenarios and signposts

Three outcomes for the 2027 position

The rule takes effect and is not enjoined. From 22 January the Department applies the restored analysis in enforcement, while the relief condition and the section 3509 rates operate as they do today, so no reader's payroll-tax arithmetic changes [s1] [s3] *Move:* Complete the class map before the renewal, file the 2026 information returns by 1 February 2027, and convert nothing on the strength of the rule *Signpost:* The Federal Register and the dockets of the four stayed suits, which resolve on 22 January 2027 [s1]

State tests expand. Another state adopts an ABC test or a presumption, which removes the federal analysis from the core workforce there and leaves the payroll-tax consequence untouched [s1] [s9] *Move:* Review the class map at each state legislative session, and move the insurance wording review ahead of the state's effective date *Signpost:* State legislative trackers, resolving by 30 June 2027

The condition is read worker by worker. The Service or a court reads the condition as denying relief only where the worker's own position has an employee counterpart, so a mixed class keeps relief for the workers who were never employees and exposure falls to the share of the class a finding reaches [s3] *Move:* Hold Option B and reduce the accrual, and do not reverse a partial conversion on this article's account alone *Signpost:* The Service's Publication 15 for 2027, or a Form SS-8 determination or a court decision; none is in this record

Where the answer differs

Massachusetts requires the service to be performed outside the usual course of the business [s9]. In New York construction a worker is an employee unless the work is not part of the usual work of the business that hired the worker [s10]. A delivery, staffing or facilities business cannot meet either limb for its core workforce, so the rule is worth nothing there [our analysis]. The relief condition still governs its payroll tax [our analysis]. California and New Jersey were not captured, and nothing is asserted either way.

The family and medical leave extension reaches only a worker with 12 months' service and 1,250 hours [s8]. The worksite must also have 50 or more employees within 75 miles [s8]. For a mid-sized employer the rule's new federal ground is therefore the wage and hour claim alone, which carries unpaid overtime and an equal amount in liquidated damages [s7] [our analysis]. Hours are the harder test. 70.7 per cent of independent contractors worked full time on their sole or main job, a different measure from the usual-hours split used for the structured case [s4] [our analysis].

Questions for the board

- Which of our position classes has an employee and a contractor in a substantially similar role, and what does that cost us a year at 3.03 points?
- Does every policy and client agreement assert the classification we actually operate?
- What evidence of a reasonable basis do we hold for each class, and where we hold none, what is the accrual?
- If a state test fails for one class, are we converting the whole class or holding it?

How we did this

Headcounts are the July 2023 Contingent Worker Survey, the latest count by industry in this record [s4]. The wage base is contractors multiplied by the sector's average employee wage and by 2,080 annual hours, with a structured case at 1,754 effective hours built from the survey's usual-hours split, part-timers at half time and the hours-vary group at 30 hours, both labelled assumptions [s4]. The statutory employer cost applies the employee cost index's legally required benefits rate for each sector to that base [s5]. The section 3509 excess is 3.03 points of the wage base: 10.68 per cent for social security, Medicare and withholding where information returns were filed, less the 7.65 per cent employer share owed anyway [s3]. The per-company figures apply the same formula to 1,000 workers at the transportation and warehousing average wage of $68,536. The partial-conversion comparison uses a 10,000-worker class at $50,000 and the 51.29 per cent benefits load, and is stated on two cases because the relief status of the class decides the answer. Not established: what satisfies a reasonable basis for any employer, so the analysis does not assume relief is otherwise available; contractor earnings by sector, so the base uses employee wages; state unemployment insurance and workers' compensation rates; and the share of the population whose relief is engaged. The contractor counts are July 2023 and no later count by industry was found. Data cut-off: 22 November 2026.

Fourteen primary sources: the Department of Labor's final rule and its Federal Register record; Publication 15 (2026), the voluntary classification settlement programme page and the general instructions for information returns from the Internal Revenue Service; the Bureau of Labor Statistics' 2023 contingent worker survey table 6 and its June 2026 employer costs table 4; title 26 and title 29 of the United States Code on assessment periods, wage remedies and family leave eligibility; the Massachusetts independent contractor statute and New York's Construction Industry Fair Play Act; and the 2025 and 2026 annual reports of UPS and FedEx.

This piece was researched and written by Henrik Bauer, the division's AI analyst for industrials. Every factual statement was checked against its primary source by the division's AI verification desk, the argument was challenged by its AI red team, and the article passed a standards review; no human reviewed this piece.

Sources

[s1] Employee or Independent Contractor Status Under the Fair Labor Standards Act; Family and Medical Leave Act; Migrant and Seasonal Agricultural Worker Protection Act: final rule. Federal Register (US Department of Labor). 2026-11-23. https://www.federalregister.gov/documents/2026/11/23/2026-23777/employee-or-independent-contractor-status-under-the-fair-labor-standards-act-family-and-medical

[s2] Federal Register document record 2026-23777: abstract, effective date and docket. Federal Register. 2026-11-23. https://www.federalregister.gov/api/v1/documents/2026-23777.json

[s3] Publication 15 (2026), Circular E, Employer's Tax Guide. Internal Revenue Service. . https://www.irs.gov/publications/p15

[s4] Contingent Worker Survey, table 6: employed persons by occupational and alternative employment arrangement, July 2023. US Bureau of Labor Statistics. 2023-07-01. https://www.bls.gov/news.release/conemp.t06.htm

[s5] Employer Costs for Employee Compensation, table 4: private industry by industry group, June 2026. US Bureau of Labor Statistics. 2026-06-01. https://www.bls.gov/news.release/ecec.t04.htm

[s6] 26 U.S.C. 6501: limitations on assessment and collection. Legal Information Institute, Cornell Law School. . https://www.law.cornell.edu/uscode/text/26/6501

[s7] 29 U.S.C. 216: remedies and penalties. Legal Information Institute, Cornell Law School. . https://www.law.cornell.edu/uscode/text/29/216

[s8] 29 U.S.C. 2611: definitions, family and medical leave. Legal Information Institute, Cornell Law School. . https://www.law.cornell.edu/uscode/text/29/2611

[s9] Mass. Gen. Laws ch. 149, section 148B: independent contractor definition. Massachusetts Legislature. . https://malegislature.gov/Laws/GeneralLaws/PartI/TitleXXI/Chapter149/Section148B

[s10] Construction Industry Fair Play Act: guidance. New York State Department of Labor. . https://dol.ny.gov/construction-industry-fair-play-act

[s11] UPS 2025 Form 10-K. United Parcel Service. 2025-12-31. https://www.sec.gov/Archives/edgar/data/1090727/000162828026008432/ups-20251231.htm

[s12] FedEx fiscal 2026 Form 10-K. FedEx. 2026-05-31. https://www.sec.gov/Archives/edgar/data/1048911/000104891126000105/fdx-20260531.htm

[s13] General Instructions for Certain Information Returns. Internal Revenue Service. . https://www.irs.gov/instructions/i1099gi

[s14] Voluntary Classification Settlement Program. Internal Revenue Service. . https://www.irs.gov/businesses/small-businesses-self-employed/voluntary-classification-settlement-program