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The stakes are being raised on worker classification decisions

In March, the Chicago regional office of the National Labor Relations Board decided that scholarship football players at Northwestern University are "employees" under the National Labor Relations Act.

A few days prior, President Barack Obama announced an initiative to make it more difficult for companies to claim employees are "exempt" from overtime requirements under the Fair Labor Standards Act (FLSA).

Employers continuously are faced with classification decisions about their workers. Employee or independent contractor? Exempt or non-exempt? Permanent or temporary? Mistakes or inaccuracies can result in massive tax penalties, government enforcement actions and bet-the-company class-action lawsuits.

Yet, many companies overlook the importance of making judicious classification decisions by resting on surface-level labels and assumptions. As increasing government scrutiny and eager plaintiffs' lawyers raise the stakes on classification issues, companies would be wise to re-examine how their workers are classified.

The trend for worker classification is clear: Government agencies and courts increasingly are expanding the definition of "employee," thereby increasing the number of workers guaranteed rights under various labor and employment statutes.

In recent years, courts have found many workers previously not thought of as traditional employees — from unpaid interns to cable installers to exotic dancers — to be non-exempt employees. This trend, at least in part, is borne out of self-interest by government agencies: More employees lead to additional revenue and funding for the Internal Revenue Service, Department of Labor, NLRB and other like-minded state and federal agencies.

For employers, the stakes have never been higher. The IRS received a $14 million bump in its 2015 budget to expand its collection efforts based on worker misclassification and has pledged to conduct up to 6,000 random audits over the next three years.

On the wage-and-hour front, at least 16 states, including Illinois, have joined the IRS and DOL in committing to share information as part of a jointly coordinated "Misclassification Initiative." Since the start of the Initiative, the DOL has seen a 97 percent increase in its collection of back wages based on misclassification.

In addition, the number of private lawsuits filed under the FLSA has increased every year since 2008 as companies such as Wal-Mart, FedEx, Rite-Aid and TGI Fridays have entered into multimillion-dollar settlements based on allegations of misclassification.

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There is no single factor that answers the question: Who is an employee? As a starting point, the label on a worker's job description or employment agreement largely is irrelevant. Instead, courts and government agencies will weigh a number of factors on a case-by-case basis in making this determination.

For workers not already defined as employees by statute, the IRS applies a "common law" test — similar to the test used by the NLRB — to examine three factors: (1) the degree of behavioral control a company has over a worker's job performance; (2) the degree to which the company controls the business aspects of a worker's job, including payment; and (3) any written or understood employment relationship between the worker and the company.

While each factor breaks down into more nuanced and fact-specific considerations, the general principle is the more control a company has, the more likely it is that a worker is an employee.

The FLSA broadly defines employees as anyone an employer "suffer[s] or permit[s] to work." While the Supreme Court has applied a six-factor "economic realities" test to find limited circumstances where a worker may be considered an independent contractor, the presumption is that all but the most autonomous of contractors will be deemed employees.

The FLSA also requires a second-level determination of whether employees are "exempt" or "non-exempt" for the purpose of overtime laws. As a starting point, companies should assume all workers are non-exempt unless they specifically qualify for all requirements of an exemption.

To justify an exemption, a company must be able to show that an employee receives a salary and can be categorized as an executive, administrative, professional or computer-related employee. This process is not as simple as it sounds.

The FLSA's detailed regulations require a factually specific comparison of an employee's primary duties with the exacting requirements of the applicable exemption categories. Companies should know the applicable law and weigh the potential risks before classifying an employee as exempt under the FLSA.

The importance of prudent categorization decisions is not limited to taxes and wages, either. It can affect a number of other areas, including Employee Retirement Income Security Act (ERISA) benefits, unemployment obligations, union organization rights and employer defenses to discrimination claims. The Affordable Care Act has introduced another area of potential liability.

Even a company's patent or copyright ownership may depend on how a worker is categorized. Based on the success of the IRS and DOL initiatives, the issue of worker categorization will become even more significant in coming years.

Companies and their counsel should follow several basic principles when analyzing worker categorization decisions. First, be honest. Instead of trying to "fit" a worker into a particular category, be candid about how a worker would describe the day-to-day tasks of his or her job if questioned by an investigator.

The second rule is to stay current. Job duties, workplace environments and the law are constantly changing and classification decisions must keep pace.

Finally, companies must enforce their classification decisions with their workers. Rules, policies and accurate job descriptions should be established and consistently followed. By proactively acknowledging and carefully addressing worker categorization practices, companies can greatly reduce their exposure to future investigations and lawsuits.