

Employee or Independent Contractor?

Introduction

An important question arises when a church hires, retains or selects a new person to perform a particular job for the church - is the person an employee or independent contractor? Serious tax and other financial consequences may result if a person is misclassified. Most persons retained to do the day-to-day work of any organization, including a church, are considered employees. The Internal Revenue Service and courts have determined that United Methodist clergy at the local church are to be classified as employees for income tax purposes and are not self employed.¹ This analysis will not revisit the issue of clergy self-employment but is limited to looking at hiring or contracting with lay persons for work. The IRS may view independent contractor arrangements with suspicion and scrutiny, because of previous abuses and an underlying viewpoint that persons who are working for an organization should be considered employees for income tax purposes. Therefore it is crucial to carefully review the hiring and contracting classification process.

20 Factor IRS Test

The IRS uses a 20-factor test to determine whether a person is an employee. In connection with this test, the IRS has stated the following:

. . . 20 factors have been identified that indicate whether sufficient control is present to establish an employer-employee relationship. The degree of importance of each factor varies depending upon the occupation and the context in which the services are performed. It does not matter that the employer allows the employee freedom of action, so long as the employer has the right to control both the method and the result of the services . . . (Business Reporting, I.R.S. Publication 937).

¹ Weber v. Commissioner, 60 F.3d 1104 (4th Cir. 1995). However, Church polity is clear that clergy are not employees, *Book of Discipline* ¶ 141.

The 20 common law factors are:

- 1) **Instructions.** An employee must comply with instructions about when, where, and how to work. Even if no instructions are actually given, the control factor is present if the employer has the right to give instructions. Independent contractors direct themselves as to when, where and how to do their work.
- 2) **Training.** An employee is trained to perform services in a particular manner. Independent contractors ordinarily use their own methods and receive no training from the purchasers of their services.
- 3) **Integration.** An employee's services are integrated into the business operations because the services are important to the success or continuation of the business. This shows that the employee is subject to direction and control.
- 4) **Services rendered personally.** An employee renders services personally. This shows that the employer is interested in the methods as well as the results. Independent contractors are generally free to hire assistants or to sub-contract their work, since they are directing their own operations and making their own decisions about how to get the job done.
- 5) **Hiring, supervising and paying assistants.** An employee works for an employer who hires, supervises, and pays assistants under a contract that requires him or her to provide materials and labor and to be responsible only for the result.
- 6) **Continuing relationship.** An employee has a continuing relationship with an employer. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals. An independent contractor ordinarily is hired to do a particular job and then moves on to do work elsewhere for another organization.
- 7) **Set hours of work.** An employee has set hours of work established by an employer. An independent contractor is the master of his or her own time.
- 8) **Full-time work.** An employee normally works full-time for an employer. An independent contractor can work when and for whom he or she chooses.
- 9) **Work done on employer's premises.** An employee works on the premises of an employer, or works on a route or at a location designated by an employer. An independent contractor ordinarily sets his/her own place of work.

- 10) **Order or sequence set.** An individual who must perform services in the order or sequence set by an employer looks like an employee, subject to direction and control.
- 11) **Oral or written reports.** A person who regularly submits reports to a supervisor looks like an employee, who must account to the employer for his or her actions.
- 12) **Payments.** An employee is paid by the hour, week, or month. An independent contractor is paid by the job or on a straight commission.
- 13) **Expenses.** An employee's business expenses are customarily paid by an employer. This shows that the employee is subject to regulation and control. An independent contractor ordinarily pays for his/her own business expenses.
- 14) **Tools and materials.** An employee is furnished significant tools, materials, and other equipment by an employer (examples in a church: computer, books, music, uniforms).
- 15) **Investment.** An independent contractor has a significant investment in the facilities he or she uses in performing services for someone else.
- 16) **Profit or loss.** An independent contractor can make a financial profit or suffer a financial loss, whereas an employee ordinarily does not suffer any financial losses associated with his/her work.
- 17) **Works for more than one person or firm.** An independent contractor offers and ordinarily gives his or her services to two or more unrelated persons or firms at the same time (example: an outside snow removal or lawn service used by a church would do the same work for a number of clients and would be considered an independent contractor; a facilities maintenance person who does full time work for the church that includes snow removal and lawn service and does not have a snow removal/lawn service business for other clients probably would be considered an employee, absent other unique circumstances).
- 18) **Offers services to general public.** An independent contractor makes his or her services available to the general public.
- 19) **Right to Fire.** An employer can fire an employee. An independent contractor typically cannot be terminated so long as he or she produces a result that meets the specifications of the contract for the services.

20) **Right to quit.** An employee can quit his or her job at any time without incurring liability. An independent contractor usually agrees to complete a specific job and is responsible for its satisfactory completion, or is legally obligated to make good for failure to complete it.

The IRS has attempted to streamline these questions and considerations. For example, see IRS Publication 15-A, "Employer Supplemental Tax Guide". In this Publication the IRS sets forth the employee versus independent contractor analysis by grouping concerns and questions into three categories, Behavioral Control, Financial Control, and Type of Relationship. The Publication also notes that an individual may request a specific determination from the IRS by filing Form SS-8.

Examples in a Church Setting

- A church organist/music director who holds the position of Minister of Music, who works 35 hours a week and who works under the direction of the church, **probably is an employee.**
- An organist who works for six area churches when their regular organist is sick or on vacation (and offers his/her services to other churches) **probably is an independent contractor.**
- A maintenance person who works 20 hours a week for the church on evenings, weekends (and after weddings and funerals) and who has a regular day job elsewhere but does not have a facilities maintenance business **probably would be viewed by the IRS as an employee of the church,** absent other facts.
- A maintenance person who works for ABC Maintenance Company and is sent to different job locations, including the church, depending on the work schedule set by ABC, would be an employee of ABC Maintenance Company. ABC Maintenance Company **would be an independent contractor** in its relationship with the church.
- A painter who walks in off the street and offers to spend the next four weeks painting the church for a flat fee **is probably an independent contractor.** S/he will do the assigned painting tasks and then go on to paint other churches, businesses or homes.

Problems With Improper Classification

Typically churches will attempt to classify a worker as an independent contractor to avoid the paperwork and expense of a new employee. Churches are well aware of the many reporting, withholding and payment obligations that exist if an individual is classified as a lay employee. To name a few, the church must complete an I-9 form for immigration purposes; begin social security and income tax withholding; report the hiring of the employee on state or federal informational forms; issue a W-2; possibly enroll the person in state unemployment compensation programs (many states exempt churches); enroll the employee in worker's compensation; possibly enroll the person in insurance, medical or pension plans; and create an employee personnel folder. If a church considers a person as a self-employed independent contractor, generally none of the above need be done. However, if the church is held to have *improperly* classified that person as an independent contractor, then the church will be responsible for back taxes, withholding, interest, possibly tax penalties, back insurance premiums, etc.² That is why it is so crucial that a church make the right decision when deciding how to classify a new person.

What A Church Can Do To Protect Itself

There are different steps that a church can take to protect itself.

Complete Review and Written Opinion. Each church organization needs to do its own analysis, in close consultation with legal and/or tax counsel, for any "job" that is in a gray area if the church wants to classify the person as an independent contractor. The church needs to explain the complete fact scenario, provide a job description, and review the above 20 factors with its outside consultant. Where there might be disagreement with classification as an independent contractor, it is advisable to have

² In a well-publicized recent case, Microsoft was sued by "permanent temporary" workers that Microsoft treated as independent contractors. Some of these individuals worked at Microsoft for over a year. The court found in that case the differences between employees and these "independent contractors" were not clear and that the temporary workers were entitled to benefits. (Vizcaino v. Microsoft, 97 F. 3d 1187, 1996)

the outside attorney or qualified tax professional put their opinion in writing to demonstrate the church's good faith effort to comply with the law.

Uniform Application. Make sure that you treat people the same way, by consistently applying the rules. Make sure independent contractors receive 1099s (for payments exceeding \$600.00).

Written Contracts. It is also very useful to have a written agreement with the hired individual stating that he or she understands and agrees that the work being performed is done as an independent contractor. While such an agreement will not in and of itself convince the IRS of independent contractor status, it can help clarify what work is being done, how and where it is to be done, the time frame for completion and the person's understanding and agreement that s/he is self employed. This will also confirm that the church is not doing any tax withholding for the person, not paying any insurance or pension benefits, not responsible for unemployment compensation or worker's compensation, etc. Any contract should be reviewed by legal counsel to comply with your specific needs.

Remember the Job is Being Performed by an "Independent" Contractor. Try not to manage or control how the contractor performs the job. The more day-to-day oversight that is exerted, the more it will look like supervising an "employee."

The General Council on Finance and Administration is not engaged in providing legal or accounting services. The service of a competent professional should be sought for legal and tax advice.