



Church Employees or Independent Contractors?

“Dear P&B: The only employee we have besides our pastor is a part-time custodian (or secretary). Do you know of any way we could pay them by contract and save the trouble of withholding income taxes and Social Security/Medicare (FICA) taxes?”

In one form or another, this question has been asked hundreds of times in financial seminars, correspondence, and telephone conversations. The questions come in response to the increasing responsibilities of churches and other employers for reporting employee compensation information to the IRS. Fortunately, the answer is fairly straightforward; however, it is frequently not the answer desired by the questioner.

Who Are Employees?

There are basically two types of employees defined by the Tax Code: statutory employees and common law employees. Statutory employees have specifically defined jobs that on the surface might appear to be self-employed positions were it not for the statutes that define the work as that of an employee. The common law employee is the category which affects local churches most often.

A common law employee is generally anyone who performs services that can be controlled by the employer. That is, the employer has *the legal right to control* (even if not enforced) the means, methods, and results of the services provided. If the employer/employee relationship is deemed to exist based on the facts in each case, *it does not matter what it is called*, nor how the payments are measured or paid, nor if the services are performed full-time or part-time. The employer must determine any taxable amounts paid, withhold appropriate taxes for *lay* employees, make appropriate tax payments, and report those taxes to the IRS. Virtually all pastors, associate ministers, church custodians, church secretaries, paid choir directors, paid nursery workers, etc., are viewed by the IRS as common law employees. Their compensation is reported on Form W-2. See Memo #3: *Tax and Reporting Procedures for Congregations*, for a discussion of the difference between lay employees and ministerial employees for tax purposes.

Remember!

If the employer has the legal right to control the services provided by any worker, then the IRS considers that worker to be an employee, and it expects the employer to withhold and report appropriate taxes for that employee.



See:

Memo #3: *Tax and Reporting Procedures for Congregations*

Who Are Independent Contractors?

Some local churches do hire independent contractors who offer specific services to the general public. Generally, in a year's time, an independent contractor usually works for more than one organization. Examples would



Remember!

If any *unincorporated*, independent contractor (including an unincorporated evangelist) is paid \$600 or more in one year, Forms 1099-MISC and 1096 must be completed and sent to the IRS.



Caution!

Serious penalties apply to *employers* who willfully fail to comply with withholding and reporting requirements.



See:

IRS Publication 15 and 15-A for additional information. Both are available from irs.gov or by calling 800-TAX-FORM.



See:

Memo #3: *Tax and Reporting Procedures for Congregations.*

be services provided by a janitorial service, snow removal service, roofing contractor, etc., that are advertised city-wide. No employer/employee relationship exists between the church and persons performing such services as an independent contractor. Therefore, no withholding is required. However, the local church may still be required to report to the IRS those payments made to an unincorporated, independent contractor. The Tax Code provides that payments for services to an unincorporated, independent contractor in excess of \$600 per year must be reported to the IRS on Form 1099-MISC and transmittal Form 1096.

NOTE: An unincorporated evangelist would be considered an independent contractor. Any payments of \$600 or more in a calendar year, (excluding any housing allowance properly designated in advance by the board, Nazarene 403(b) Retirement Savings Plan contributions, or reimbursed expenses) would require the issuing of a Form 1099-MISC and transmittal Form 1096.

What if We Do Not Withhold and Report?

There are criminal and civil penalties for willful failure to comply with requirements for withholding and reporting. In addition, the amount of certain taxes not withheld at the time of payment from an employee's salary (that must later be paid) becomes the responsibility of the employer. The employee has no obligation to reimburse the employer later for such amount. Further, in some cases, an officer or responsible employee may become personally liable for the taxes and penalties involved.

The IRS has noted, for special review, tax returns of individuals reporting a significant proportion of income on Form 1099 from one source. Many such individuals are being reclassified as employees rather than independent contractors. This has resulted in additional cost—including penalties—for both the individual and the now-determined employer. It is best to make the proper determination prior to such a review by the IRS.

What if We Are Not Sure Which Employment Relationship Exists?

The local church should carefully consult IRS Publication 15: *Circular E—Employer's Tax Guide*, and IRS Publication 15-A: *Employer's Supplemental Tax Guide*, for examples that might be similar to the church's situation. Both are available from irs.gov or by calling 800-TAX-FORM. Consultation should be made with a local legal and/or tax counselor for advice. If questions still arise, a special form is available from the IRS to request that they determine if such person has an employment relationship with the local church. In no case should the questions be ignored, nor should there be willful failure to abide by legal requirements for withholding and reporting either wages paid to employees or payments in excess of \$600 to unincorporated, independent contractors.

More details and tax information may be found in **Memo #3: Tax and Reporting Procedures for Congregations**. While Pensions and Benefits USA cannot offer legal or tax "advice," your comments and questions are welcomed.

The information contained in this memo series is of a general nature reflecting USA Nazarene Church polity. It is **not** offered as specific legal or tax "advice." Each person, local church board, and district should evaluate their own unique situation in consultation with their local legal and tax advisors.