



B.O.P. Memo #2

Church Employees or Independent Contractors?

This memo is written as a help guide for the Church of God

"Dear Sirs:

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 literally hundreds of times in financial seminars, correspondence, and telephone conversations. The questions come as a 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.

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 be services provided by a janitorial service, snow removal service, roofing contractor, etc., which 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, retirement 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 later reimburse the employer 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 the IRS (www.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 \$600.00 to unincorporated, independent contractors.

More details and tax information may be found in MEMO #3 "Tax and Reporting Procedures for Congregations." While the Board of Pensions cannot offer legal or tax "advice," your comments and questions are welcomed. Please feel free to contact us if we may serve you in any way.

Disclaimer

The information contained in this MEMO series is of a general nature. It is not offered as specific legal or tax "advice." Each person and local church board should evaluate their own unique situation in consultation with their local legal and tax advisors.

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