

## WHO IS AN EMPLOYEE?

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One of the most frequent questions I receive relates to whether a particular individual is an employee. Most are really asking: Can I legitimately treat this person as an independent contractor? Using a simplistic analysis, it appears to cost the church less money to treat a worker as an independent contractor. The church is not required to match Social Security or Medicare taxes. The worker is not eligible for fringe benefits. The classification as an independent contractor may reduce the cost of workers compensation insurance. As discussed below, these benefits usually prove to be illusory.

## WHAT LAW APPLIES?

One cannot start this discussion without first considering which law(s) will apply. Since the tests to determine a worker's status as an independent contractor have evolved under different statutes, dozens of different tests now exist. While the tests are similar, they differ in the details and may produce differing results. Further, some statutes dictate that a worker be treated as an employee although they must be treated as an independent contractor for other purposes. The first task is to determine the correct test for the purposes of the question. For the purposes of this article, I will only discuss one test under federal tax laws.

The question is further complicated because federal tax law provides up to 18 different tests to determine whether a worker is an employee for specific taxes and purposes. The key to arriving at the correct answer is asking the correct question. This article will only discuss whether a worker is an employee for payroll tax reporting purposes.

## WHAT IS THE TEST?

Whether the employer-employee relationship exists in a particular situation is a factual question. Common law rules are applied to determine whether an individual is an employee. Section 31.3401(c)-1(b), Employment Tax Regs., provides guidelines for the determination of employer-employee status for payroll tax reporting:

“In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee.”

**It is the extent of church's right to control the worker that is critical to the analysis.** The IRS and courts will examine not only the control actually asserted over the details of a worker's performance, but also the degree to which a church may intervene to impose such control. Generally, professionals require much less control than clerical workers to be found an employee.

Most courts base their decision on the factors listed in Professional & Executive Leasing, Inc. v. Commissioner, 89 T.C. 225, 232 (1987), aff'd, 862 F.2d 751 (9th Cir. 1988). The factors that guide the analysis are:

1. The degree of control over the details of the work
2. Investment in work facilities
3. Opportunity for profit or loss
4. Type of work that is part of the principal's regular business
5. The right to discharge
6. Permanency of the relationship
7. The relationship the parties think they are creating
8. The provision for employee benefits

### APPLICATION SAMPLES

The Tax Court has decided that ministers may be either self-employed or an employee, depending on the facts and circumstances present in each case. Shelley v. Commissioner, T.C. Memo 1994-432 (1994) and Weber v. Commissioner, 103 T.C. 378 (1994), aff'd, 60 F.3d 1104, (4th Cir. 1995). Typically, a minister serving in a local congregation will be treated as an employee for purposes of issuing Form W-2.<sup>1</sup>

All of the determinations are made using the individual circumstances of a particular worker. Musicians typically request that they be treated as independent contractors. The courts and the IRS have consistently treated them as employees. By application of the test above, one can see why the courts and the IRS treat them as employees. The church controls the details of the musicians whereby dictating the music to be performed, the venue of performance, the time and place for rehearsals and performances, and the musician is supervised by the church's music director. The musician has an investment in his or her instrument, while the church has an investment in the venue and sound equipment. The musician will never lose money working for the church. Since music is an integral part of a church's operation, the musician's role in the church is critical to the church's operations. Generally, a church reserves the right to discharge musicians for any reason. Further, churches tend to use the same musicians year after year. Since musicians are typically part-time workers, the church does not provide employee benefits to musicians. Six of the eight factors favor employee status. More importantly, the degree of control factor usually is weighted heavier than any of the other seven factors. Since it favors employee status, musicians will nearly always be employees.

### WHAT HAPPENS IF THE CHURCH GUESSES WRONG?

Since the tests are difficult to find and apply, the IRS has provided Form SS-8 to assist employers in determining whether a worker is an employee. If the church will

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<sup>1</sup> By statute, ministers are treated as self employed for Social Security and Medicare purposes. Ministers may choose to be treated either as an employee or and self-employed for the purposes of federal income tax withholding.

submit Form SS-8 for a particular worker, the IRS will issue a letter to the church classifying the worker. My experience with Form SS-8 shows that the IRS will usually find the worker is an employee.

If the church does not submit Form SS-8 and misclassifies a worker as an independent contractor, the church will owe back payroll taxes for the previous three years. Further, the worker will be eligible to receive a refund of overpaid Social Security and Medicare taxes, but the disallowance of business expenses will also increase the amount of taxes the worker owes.