

CONTRACT LABOR IN THE CHURCH

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Many churches view contract labor as any services that are not performed by a regular employee. As long as the church issues Form 1099 to the worker who is paid more than \$600 during the calendar year, they believe that they are complying with the law. As this article will demonstrate, contract labor is defined very narrowly by the courts and the Internal Revenue Service (IRS). As a result, the vast majority of churches will owe additional payroll taxes if they are examined by the IRS. This article will assist churches in properly classifying contract labor so that they can better comply with the law.

EMPLOYEE VERSUS CONTRACT LABOR

In effort to avoid the hassle of setting up a worker on payroll, many churches simply pay the worker as contract labor. They wrongfully assume that because smaller dollar amounts are involved that they have no liability for payroll taxes. They also wrongfully assume that irregular or infrequent payments must indicate contract labor instead of an employment relationship.

These erroneous assumptions frequently lead to costly errors. If the church improperly classifies a worker as contract labor instead of employee, the church is liable for payroll taxes, penalties and interest. In some states, the church is also liable for state withholding taxes and workers compensation premiums. In some cases, the pastors and board members can be personally held liable for this misclassification.

THE TESTS

The IRS and the courts have developed various tests to determine whether a worker is truly a contract labor. The IRS uses a twenty factor test. The United States Tax Court uses a seven factor test. A detailed analysis of these tests would take lots of pages and would not likely be helpful to most churches. In most cases, both of these tests are usually determined by a single factor: the amount of control exercised over the details and means of how the work was to be performed. Since this single factor controls the outcome in many cases, the remainder of this article will discuss this single factor.

RECENT CASE

The United States Tax Court was recently requested to award attorney's fees to a dance studio where the IRS had wrongfully determined that dance instructors were employees. The dance studio had correctly classified its instructors as contract labor. This case is instructive to churches because it demonstrates the "amount of control" application in a setting similar to many churches.

When the dance studio believes that sufficient students exist for a class, it requested instructors to bid on the class. Stated another way, the instructors chose which classes they wanted to instruct. The dance studio and the instructors never assumed that the relationship extended beyond the class being bid upon.

The dance studio never provided any training or instruction regarding the classes. The instructor was in total control of the class and curriculum. The instructors purchased all music and costumes used in the classes. The studio never reimbursed the instructors for any expenses the instructor incurred.

The instructors believed that they were entering into an independent contractor relationship. They were compensated as a percentage of the tuition received by the studio or based on the number of hours of instruction provided.

The IRS determined the instructors were employees because (1) the studio had a large investment in the venue while the instructors had a comparatively small investment in music and costumes, (2) the studio controlled actions of the instructors because they required the instructors to dress appropriately and not to select obscene music for use in classes, and (3) some instructors were given a manual about how to conduct a class.

The Tax Court, and the IRS after the suit was filed, found that the instructors were correctly classified as contract labor because the studio did not control the details and means of how the dance classes were conducted.

APPLICATION TO CHURCHES

If the church controls the details and means by which a task is performed, then the worker is an employee. Nursery workers are always employees because the church controls the detail of how they care for the children. Musicians are almost always employees because the church controls the music to be performed. Office workers performing services in the church office will also be employees. Maintenance workers that perform services using church supplies and equipment will also be employees.

If the church wants to classify a worker as a contract labor it must proactively structure the relationship to achieve that result. It must surrender control over the details and means of accomplishing the task to the worker. For example, a church invites a guest speaker without controlling the details and means of the speech. This means that the church does not dictate when and where any preparation occurs, does not dictate the topic of the speech, the length of the speech and the content of the speech. Under these circumstances, the guest speaker is a contract worker. Ideally, a written contract should demonstrate this lack of control. On the other hand, if the church tells the guest speaker that he must speak for twenty minutes on Matthew 13 and the church will provide the preparation materials, then the guest speaker is an employee (even if this is the only speech he gives to the church this year).

If you have any questions about a particular worker, IRS will give churches written guidance if the church files Form SS-8. If you do not want IRS' input, you can contact me at fsommerville@wkpz.com for further information.