

## Helping churches determine volunteers, employees and independent contractors

Why is it difficult for church leaders to accept the fact they have made some volunteers employees and are misclassifying some or all employees as independent contractors?

This is NOT a new problem among our churches. Many have been doing this incorrectly for decades. In fact, it's been done wrong for so long, some don't believe it's a problem even when they're shown the facts. No one has ever complained, and the IRS has never said a word about it to them. While those two thoughts may be true, they don't change the fact that the church could be violating several federal and state laws in the process.

There are specific definitions of volunteers and of independent contractors, and if a worker is paid money or receives a money-equivalent in exchange for his or her labor, and does not exactly fit the definition of an independent contractor, that worker is an employee. This is true under federal labor laws, and also true under even stricter California laws.

Many have heard about "AB-5," a new law that took effect in California on January 1, 2020. Some may know about it because of the November 2020 election when more than 58 percent of voters (almost 10 million) voted "yes" on Proposition 22, creating an additional "carve out" for Uber and Lyft drivers allowing them to be classified as independent contractors rather than as employees, despite the rigorous A-B-C Test found in AB-5.

The A-B-C Test was actually a judicial creation of the California Supreme Court in 2018 – a legal precedent of the Court with no existing basis in law until the State Legislature codified the test, expanding its application and carving out numerous exceptions for certain workers (mostly tied to political influence), and Governor Newsom signed the bill in September 2019. Prior to the *Dynamex* decision in 2018, there was an 11-part test (which still exists for specific employment situations) that had been the standard for nearly 30 years, following the decision in the *Borello* case. For churches and their workers, even the *Borello* decision didn't change things in most cases. Which is why the statement can be made that many churches have been doing things incorrectly for decades.

A volunteer is a worker who provides services to the church with **absolutely no expectation of compensation in exchange for his or her labor**. When you "reward" volunteers with cash payments of any amount, or cash equivalents beyond a "*de minimis*" amount – which is broadly understood to be a benefit which would be more expensive or time-consuming to try to account for than the value of the benefit itself (such as giving employees a turkey at Thanksgiving or Christmas time) – the law understands that worker to be an employee of the church.

Because shopping cards or prepaid VISA or MasterCard debit cards are *not* at all difficult to account for, they are considered money-equivalents and not *de minimis* benefits. Handing out \$10 or \$25 gift cards to Starbucks, Safeway, or McDonald's, to volunteers for a job well done, probably makes them "slaves" as well as employees because the amount is likely to be far less than what they would have been paid at minimum wage for the number of hours they worked,

not to mention the potential for missed rest and meal breaks penalties. Giving them a devotional book, a fancy coffee cup, or something of similar value is perfectly OK – provided it was not announced in advance or a regular occurrence . . . which creates the “expectation of compensation.”

Can you provide a meal to volunteers or employees without having to report it as wages earned? Or coffee and donuts? Can you announce it in advance? Yes, those are exactly what *de minimis* benefits are – you put out the coffee and donuts, and some don’t take any while others take two. One takes a \$1.50 jelly donut as another takes a cake donut valued at \$0.95. Or you put out five or six different pizzas, and some take one slice, others take three or four. Who’s going to stand there and keep track of that? It’s entirely too much trouble to do so, and the IRS understand that and allows it.

So what’s the difference between an independent contractor and an employee? The A-B-C Test of AB-5 makes it very clear. Unless a person passes ALL three tests, he or she is an EMPLOYEE, not a contractor. And employees must be paid at least the minimum hourly wage for your location (there were 19 different minimum wages in California in 2020), must have FICA contributions deducted from their pay and the church pays an equal amount for Social Security and Medicare, and may have to have state or federal income tax withheld from their pay. Each employee must fill out the US Customs and Immigration Service Form I-9 (and provide required documentation) proving their right to work in the U.S., an IRS Form W-4, and be covered for Workers’ Compensation claims.

Here are the three tests:

- A. Is the worker free from the control and direction of the hiring entity in the performance of the work, both under the contract for the performance of the work and in fact?
- B. Does the worker perform work that is outside the usual course of the hiring entity’s business?
- C. Is the worker customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity?

(Visit [https://www.dir.ca.gov/dlse/faq\\_independentcontractor.htm](https://www.dir.ca.gov/dlse/faq_independentcontractor.htm) for more FAQs)

Now here is why musicians, custodians, clerical workers, and nursery/child care workers – the four most commonly misclassified paid workers in a church – are probably NOT independent contractors. They are highly likely to fail at least one or two, if not all, of the three tests:

“A” . . . musicians, clerical workers, and nursery/child care workers are almost always told when to be “at work.” They don’t choose the hours, they are directed by the church in the performance of their duties, and they are dependent on the church for their income.

“B” . . . What is “in the usual course” of the church’s business? Worship, evangelism, outreach, education, and more. Music is part of worship, child care may only be offered at the same time worship happens or when church educational programs or outreach events are conducted. Office duties are a normal activity in almost any business, and so is housekeeping and other custodial services. What may not be in the usual course of a church’s business are things like plumbing repairs, painting, carpentry, carpet cleaning, landscaping, heating and air conditioning maintenance, caterers, and similar services which are performed by persons who have contractor’s licenses or their own businesses in those fields. You usually write checks to the business by name.

Which leads us directly to

“C” . . . your church musicians probably don’t have separate businesses as musicians, your custodian may not even have his/her own cleaning equipment – using those owned by the church – and doesn’t provide custodian services to any other business, 14-year-old Suzy doesn’t have a babysitting LLC, and your office workers probably don’t come from a local temporary employment agency that you pay to supply clerical staff. These businesses must have existed prior to creating the working relationship.

It’s a bitter pill for many churches to swallow. The custodian may enjoy being paid \$100 per week for five or six hours of work, especially if the church doesn’t issue him a W-2 or 1099-NEC (formerly 1099-MISC) at the end of the year – those wages often go unreported as income, the worker gets no earnings credited toward Social Security retirement or Medicare, and the church pays less for its Workers’ Compensation insurance. Change the \$100 per week to \$100 or \$200 per month and you also have a minimum wage violation based on 20-30 hours of work. Same thing for the musicians who come for rehearsal at 8:30, perform for 15-20 minutes beginning at 10:30 and six or eight minutes at 11:50, then start packing up their gear after worship ends at noon and are gone by 1:00. Did they get a duty-free rest break? Were they paid minimum wage from 8:30 to 1:00? Or did they just get a check for \$50 or \$75?

What about the volunteer who works in the church office Tuesdays and Thursdays from 9:00 to noon, answering phone calls, filing papers, inputting weekly donations, writing checks? When she knows you will give her a grocery shopping card for \$25 or \$50 instead of a paycheck each week, that’s an expectation of compensation which means she’s no longer a volunteer. And she’s not an independent contractor because she doesn’t have an existing secretarial business from which she earns other income.

*“OK, you got us on those. But we don’t pay the nursery workers, that’s for sure. The parents know we expect them to give the girls a \$10 or \$20 tip each week. So they’re not our employees.”* How sure are you? If there is an expectation of compensation, you have an employment relationship. How do the parents know a “tip” is “expected”? If the church has any involvement in soliciting such amounts, if the worker doesn’t have an independently established business, you have an employee, regardless of from whom the money comes – and you have to know how much it is and report it accurately, deducting FICA and paying the

church's half of FICA, and listing the nursery employees on your EDD DE-9/9C, and in your Workers' Compensation insurance audit. And you must go back to the "A" test . . . who sets the hours and work rules for the nursery service? Not the workers, right?

Each of these tests has existed in some form prior to the 2018 *Dynamex* decision. These workers were rarely independent contractors before AB-5. Enacting AB-5 didn't change anything for churches, it only made it easier to see, if not understand – except there are still too many churches that turn a blind eye to the law.

Why have churches "gotten away with it" for so long? There are several reasons, including the fact that the state does not proactively go looking for violations, it relies on complaints and then responds – the premise being that the employer is at fault for something. Church members are highly reluctant to complain, especially when intimidated by others in the church. Many churches, understandably, cannot always afford the expense of an employee . . . having to comply with payroll issues, tax and FICA withholding and reporting, and dealing with W-2s at year end. But that's still no excuse.

State and federal taxing agencies communicate with each other. If the state discovers a violation, it reports it to the IRS. If the IRS discovers a violation, it reports it to the Employee Development Department and the Franchise Tax Board. In labor friendly California, the state agencies, more so than the IRS, view the employer as a guilty-until-proven-innocent party. Although there is no requirement to maintain a formal timekeeping system, having even an informal record of a person's work hours will help establish a basis for refuting any overtime or missed break wage and hour complaints.

This also raises one other problem churches create for themselves with regard to the folks they do recognize as employees. Many believe that simply paying a fixed salary instead of an hourly rate makes an employee "exempt" from overtime wages. This is not true. California has its own set of laws concerning "exempt" and "nonexempt" employees which is more stringent than federal law, and the first test is one of income. Regardless of the actual number of hours worked, or the actual duties of the employee (with the singular exception of "ministers" who are generally exempt from most employment laws), if an employee's annual fixed salary is not two times the minimum hourly wage for a 40-hour workweek and a 52-week year, that employee is NOT "exempt" from being paid overtime wages for more than 8 hours in one 24-hour workday or 40 hours in one 168-hour workweek.

In 2020, based on the state's \$12.00 per hour minimum wage, the minimum annual "exempt" salary amount was \$49,920 if the employer has fewer than 26 employees. In 2021, that amount has increased to \$54,080 as the state minimum wage rises to \$13.00 on January 1. There is no "prorated" salary amount – a 20-hour per week CPA-bookkeeper paid a fixed salary of \$27,040 in 2021 would still be a "nonexempt" employee whose work hours are subject to overtime premium pay. If the employee does meet the wage test, there are only a limited number of employee classifications that qualify for "exempt" status. These employees are generally executives, managers who exercise "discretion" in their roles, and professional employees

(primarily doctors, dentists, engineers, accountants) with highly specialized skills, including certain computer/IT employees.

If the IRS and EDD become involved, they will come looking for the church's payroll and tax reporting, and the IRS will look at employee tax returns (if it hasn't already). The FTB will look at employees for their personal income and tax reporting. Evidence of failure to report or underreporting employee wages triggers additional referrals to the Division of Labor Standards Enforcement and to the Department of Insurance, both state agencies. DLSE comes in and audits records to see if minimum wage, rest and meal breaks, and overtime requirements, paid sick leave accumulations, and paystubs are all in compliance; violations could be processed administratively or criminally, or both. CDI comes looking for a certificate of Workers' Compensation insurance, and if it doesn't find it, can charge the church with Workers' Compensation insurance fraud.

Compliance failures on the part of the church carry potentially severe fines as well as penalties and interest for unpaid and/or underpaid taxes, and could actually land someone in jail or state prison under the right set of circumstances. Employees could also be at risk for penalties and interest for under- or unreported income.

Based on evidence reviewed or uncovered during an investigation, which will include looking at church business meeting minutes, board of directors' meeting minutes, budgets, financial reports, and bank statements, church officers and board members could be held individually responsible and subject to fines or imprisonment in a worst case scenario. Unfortunately, having good meeting minutes and financial reports is not something all churches can provide for an investigation.

The HR & Church Compliance Ministry wants CSBC churches to understand and comply with employment, wage and hour, and other laws and regulations that apply to them. It is important for church leaders to understand and know how to take and compile good meeting minutes as well as preparing and keeping proper and complete financial reports, which are easy to provide when the church uses a true fund-accounting system. *QuickBooks*® is not a true fund-accounting system unless significant additional manual effort on the part of the treasurer is made part of the data entry routine.

While there may be a "separation of church and state" when it comes to religious vs secular practices, churches are businesses and their "civil" side is exposed to many governmental requirements just the same as commercial operations in communities. Failure to be aware of these requirements is inappropriate. CSBC is committed to helping its congregations know and understand compliance responsibilities. The CSBC HR & Church Compliance Ministry tries to stay ahead of the curve and keep churches informed of issues that may affect them.

For more information, please contact the CSBC HR & Church Compliance Ministry by calling 559.256.0858 or by emailing [hrcc@csbc.com](mailto:hrcc@csbc.com).