

Employment tax issues important to all tax-exempt organizations

Nonprofit tax-exempt organizations – even those operated by volunteers – must be aware of employment tax issues.

Exempt organizations normally withhold and pay employment taxes under the same rules as other entities.

Like other employers, section 501(c)(3) organizations that pay wages to employees must withhold and deposit federal income tax and Social Security and Medicare taxes from employees' wages, and pay the employer's share of such taxes.

However, churches and some church-controlled organizations are not required to withhold or pay Social Security or Medicare taxes when doing so is inconsistent with their religious beliefs, but their employees may be required to pay self-employment taxes. For more information, review [Publication 15-A](#).

Section 501(c)(3) organizations generally do not pay [federal unemployment \(FUTA\) taxes](#) on employee wages, but some other types of tax-exempt organizations do pay such taxes.

An exempt organization generally must withhold 28% of certain taxable payments if the payee fails to furnish the exempt organization with the payee's taxpayer identification number (TIN) prior to payment. This withholding is referred to as "backup withholding."

Payments subject to backup withholding include payments to independent contractors. For more information, see Publication 1281, Backup Withholding for Missing and Incorrect Name/TIN(s). Generally, payments to independent contractors are subject to information reporting requirements. For more information, see the Instructions for Form 1099-MISC.

If an organization incorrectly classifies a worker as an independent contractor instead of an employee, it will owe employment taxes and may owe penalties. Therefore, understanding the worker classification rules is essential to properly fulfilling your organization's legal responsibilities for withholding and information reporting on workers.

For federal tax purposes, a worker can be classified as either an employee or an independent contractor. See explanations on [worker classifications](#).

To make a correct determination, an entity must consider the evidence of the right to control the worker (indicating employee status), and his autonomy (indicating independent contractor status). The IRS uses three principal categories to help analyze the relationship between an entity and a worker:

- **Behavioral control:** How much control does the organization have over the behavior of the worker?
- **Financial control:** Who controls the financial aspects of the worker's activities?

- **Relationship of the parties:** How do the parties – the organization and the worker – perceive their relationship?

For further assistance in determining worker classification, read [Publication 1779, Independent Contractor or Employee: Which Are You?](#)

An organization must be careful with volunteers. No organization wants to inadvertently turn a volunteer into an employee by recognizing her with a cash payment.

Even if it is a small amount, giving cash to a volunteer will require the organization to follow the same reporting and withholding requirements as it would for any other employee.

For more information on this or other IRS topics, go to [IRS.gov](#).

Helpful topics:

[Tax Information for Charities & Other Non-Profits](#)

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