

GUIDE FOR NONPROFIT ORGANIZATIONS

Employees, Independent Contractors and Volunteers

Whether an individual is classified as an employee, independent contractor, or volunteer depends on the substance of the relationship between the individual and the organization, rather than any label given the individual by the organization.

I. Employee or Independent Contractor?

If an organization can direct the end result of the work done by a worker, but not how the work is done, that individual is generally considered an independent contractor. In contrast, if the organization can direct both the end result of the work and how it is done, the worker is generally considered an employee.

The criteria for classification of employees and independent contractors are largely the same under federal and Montana law. The IRS has a helpful publication on the issue¹ and will determine an individual's status upon request via Form SS-8.²

The Montana Department of Labor and Industry uses a two-part test³ to evaluate whether an individual is an employee or an independent contractor:

- Whether the individual is and shall continue to be free from control or direction over the performance of the services, both under contract and in fact; and
- Whether the individual is engaged in an independently established trade, occupation, profession, or business.

1. Control Test. The first of Montana's two-part test is known as the "control" test. There is a strong presumption in favor of employee status, and it takes a "convincing accumulation" of the factors to create independent contractor status. The Department evaluates four factors under the control test:

- a. Direct evidence of right or exercise of control.** Who controls the details, methods, or means of accomplishing the work?

Factors in favor of employee status:

- The organization has the right to give instructions on how the work is done.
- The individual is trained by the organization to perform tasks in a particular manner.
- Hiring, supervising, and payment are directed by the organization.

¹ IRS Publication 15-A, available at <http://www.irs.gov/pub/irs-pdf/p15a.pdf>.

² Available at <http://www.irs.gov/pub/irs-pdf/fss8.pdf>.

³ See Administrative Rule of Montana 24.35.202, available at <http://www.mtrules.org/gateway/ruleno.asp?RN=24%2E35%2E202>.

GUIDE FOR NONPROFIT ORGANIZATIONS

- The services the individual provides are a key aspect of the organization’s regular business activities.
- The individual works for the organization indefinitely, or there is a frequent relationship between the individual and the organization (even if part time).
- The work is performed on the premises of the organization.
- The individual is restricted from working for others.

Conversely, the absence of the factors above indicates a possible independent contractor relationship.

b. Method of payment. How is the individual compensated for work done?

Factors in favor of employee status:

- a. The individual earns a regular wage for a specific time period (hourly, daily, weekly, annually) from the organization.
- b. The organization provides benefits to the individual typically given to employees, such as health insurance, pension plans, vacation pay, or sick pay.

Payment on a completed-project basis, such as a flat fee or time-and-materials, indicates an independent contractor relationship. Independent contractors also typically do not receive benefits as compensation.

- c. **Furnishing of Equipment.** An independent contractor typically has a significant investment in the facilities, tools, materials or other equipment used to perform the work, whereas employees are generally supplied with all necessary materials by the organization. This factor is not determinative, however, and an employee may supply his or her own equipment.
- d. **Right to fire.** Generally, independent contractors are contracted to perform a specific job, whereas an employee works at the will of the employer. The organization or individual may not end relationships with independent contractors at will without incurring liability. Conversely, organizations may discharge employees at will or for failure to perform certain details unrelated to the end result. (Subject, of course, to Montana’s Wrongful Discharge from Employment Act).⁴

2. Independently Established Business. The second part of Montana’s two-part test is known as the “independently established business” test. Although no one factor is determinative and each individual case varies, the following factors generally indicate the individual is an independent contractor:

⁴ Montana Code Annotated § 39-2-901 et seq., available at http://leg.mt.gov/bills/mca_toc/39_2_9.htm.

Nonprofit Law Section

State Bar of Montana

GUIDE FOR NONPROFIT ORGANIZATIONS

- The individual has a different place of business than the organization.
- The individual performs similar services for other clients.
- The individual advertises their services.
- The individual may make a profit or a loss on the project.
- The individual files federal or state business tax forms.
- The individual performs the services under a contract.

Both the control test and the independently established business test must be met in order for the individual to be considered an independent contractor. Misclassification of workers can lead to penalties, so if you are unsure of how to classify the worker, it is wise to err on the side of caution, and classify the worker as an employee. The penalties for misclassification include, but are not limited to:

- Liability for federal and state taxes, plus penalties and interest.
- Liability for unpaid contributions to state unemployment and workers' compensation funds.
- Liability for unpaid overtime compensation.
- Potential liability as an uninsured employer if the individual has a job-related accident.
- Potential liability under state and federal discrimination or wrongful discharge statutes.

II. Volunteers

An individual who serves on a part-time basis without expecting compensation for their service is typically considered a volunteer. Ordinarily, such a person will not be considered an employee or independent contractor if they volunteer freely. The U.S. Department of Labor considers a number of factors when determining whether a particular activity is “ordinary volunteerism”:

- The nature of the entity receiving the services.
- The receipt by the worker (or expectation thereof) of any benefits from those whom the services are performed.
- Whether the services are offered freely without pressure or coercion.
- Whether the services are of the kind typically associated with volunteer work.

The relevant Montana statute⁵ defines “volunteer” as “a person who performs services on behalf of an employer . . . but who does not receive wages.” Under Montana law,⁶ wages include the cash value of all noncash remuneration, and include but are not limited to:

⁵ Montana Code Annotated § 39-71-118.

⁶ Montana Code Annotated § 39-71-123.

Nonprofit Law Section

State Bar of Montana

GUIDE FOR NONPROFIT ORGANIZATIONS

- Commissions, bonuses, and hourly wages.
- Tips or other gratuities, to the extent that the tips are documented for tax purposes.
- Board, lodging, rent or housing, if it is intended to be part of compensation and is based on its actual value.
- Any payments made on bases other than time worked, such as incentive plans or profit-sharing.

Wages do not include expense reimbursements, allowances for meals, lodging, and travel. Specifics can be found at Montana Code Annotated § 39-71-123.

According to the IRS, some methods of recognizing and thanking volunteers may create employment tax responsibilities.⁷ In general, non-cash items of nominal value do not amount to taxable wages. However, cash items like gift certificates (even donated gift certificates) may amount to payment of taxable wages. Tax responsibilities are not the only penalties associated with misclassification of volunteers; employees of organizations who “volunteer” at your events may be entitled to overtime pay and possibly workers’ compensation.

Federal regulations⁸ state that “time spent in work for public or charitable purposes at the employer’s request, or under his direction or control, or while the employee is required to be on the premises, is working time.” In other words, if your organization directs an employee to volunteer, that time is compensable. The regulation also states that “time spent voluntarily in such activities outside of the employee’s normal working hours is not hours worked.” However, if the activities are the same or similar to the activities the employee is employed to perform, the activity does not qualify as a volunteer activity. The policy of the U.S. Department of Labor’s Wage and Hour Division is that an “employer must compensate employees for the hours spent volunteering during their normal working hours or when the volunteer work performed is similar to their regular duties.”

Volunteer classification can become an issue when your organization holds an event and the organization’s employees “volunteer” at the event. Make sure your organization’s employees are not performing duties that are similar to their normal duties and are doing so outside of their normal working hours. Volunteer classification is also particularly important for organizations running raffles or casino nights. This is because “substantially all” of the work performed for a gaming event must be performed by volunteers in order to ensure that revenue generated from a gaming event is not classified as unrelated business income (see the “Charitable Gaming Laws” tip sheet for more information on gaming events).

* * * * *

⁷ See IRS Publication 3079, available at <http://www.irs.gov/pub/irs-pdf/p3079.pdf>.

⁸ 29 CFR 785.44.

Nonprofit Law Section

State Bar of Montana

GUIDE FOR NONPROFIT ORGANIZATIONS

NOTICE: THIS GUIDE IS NOT LEGAL ADVICE

This guide has been prepared as a public service and for general information purposes only. The information in this guide is not legal advice. Legal advice is dependent upon the specific facts and circumstances of each situation. Furthermore, the information contained in this guide is not guaranteed to be up to date. This guide should not be used as a substitute for obtaining legal advice from an attorney licensed or authorized to practice in your jurisdiction. You should always consult a suitably qualified attorney regarding any specific legal problem or matter.