Audit of Advisory Neighborhood Commission 7C
For Fiscal Years 1999, 2000, 2001, and 2002
Through December 31, 2001
(10/01/98 Through 12/31/01)

May 2, 2002
OFFICE OF THE DISTRICT OF COLUMBIA AUDITOR
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May 2, 2002

Commissioner Mary L. Gaffney
Chairperson
Advisory Neighborhood Commission 7C
4651 Nannie Helen Burroughs Ave., NE, Suite 2
Washington, D.C. 20019

Letter Report: Audit of Advisory Neighborhood Commission
7C For Fiscal Years 1999, 2000, 2001, and
2002 Through December 31, 2001 (10/01/98
Through 12/31/01)

Dear Commissioner Gaffney:

Pursuant to D.C. Code, Section 1-309.13(d), as amended, the District of Columbia Auditor
carried out an audit of the financial operations and activities of Advisory Neighborhood Commission
(ANC) 7C.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of the audit were to determine whether ANC 7C’s:

1. disbursements complied with the Advisory Neighborhood Commissions Act of 1975
   (ANC Law), as amended, Advisory Neighborhood Commission Financial
   Management Guidelines issued by the Office of the District of Columbia Auditor,
   and legal opinions issued by the Office of the Corporation Counsel; and

2. internal controls were adequate to produce reliable financial information and ensure
   that its assets were safeguarded.

The scope of the audit covered the period October 1, 1998 through December 31, 2001. In
conducting the audit, the Auditor reviewed all ANC 7C checks written during this period, bank
statements, bank signature cards, quarterly financial reports, meeting minutes, vendor invoices, and
other related documents. The Auditor also confirmed an inventory of office equipment during the
field work portion of the audit. Further, the Auditor interviewed ANC 7C’s chairman, treasurer, and
other ANC 7C Commissioners.
FINDINGS

STATEMENT OF ANC 7C’S CASH BALANCE IN CHECKING ACCOUNT AND PETTY CASH FUND AS OF DECEMBER 31, 2001

Table I presents a statement of ANC 7C’s cash balance in its checking account and petty cash fund as of December 31, 2001.

<table>
<thead>
<tr>
<th>Petty Cash on Hand</th>
<th>$ 42.39</th>
</tr>
</thead>
<tbody>
<tr>
<td>Checking Account Balance</td>
<td>4,827.90*</td>
</tr>
<tr>
<td>Savings Account Balance</td>
<td>0.00**</td>
</tr>
<tr>
<td><strong>Total Cash Balance</strong></td>
<td><strong>$4,870.29</strong></td>
</tr>
</tbody>
</table>

*Checking account balance obtained from ANC 7C’s bank statement as of December 31, 2001.
**ANC 7C does not maintain a savings account.

ANC 7C’S FINANCIAL RECORDS AND DISBURSEMENTS WERE IN SUBSTANTIAL COMPLIANCE WITH THE ANC LAW AND FINANCIAL MANAGEMENT GUIDELINES

ANC 7C Maintained Sufficient Documentation In Support of Expenditures During The Audit Period

Overall, between fiscal years 1999 and 2002, through December 2001, ANC 7C maintained sufficient documentation to justify and support approximately 98% of expenditures totaling $42,431.66 as reported in quarterly financial reports filed with the Office of the District of Columbia Auditor. The Auditor found that ANC 7C complied with ANC Financial Management Guidelines by preparing voucher packages containing original invoices or receipts from vendors, verifying that goods and services were received, stamping the invoice paid, and including the check number used to pay the vendor written prominently on the voucher. Also, all checks, except one, were properly signed by the ANC chairperson and treasurer in accordance with the ANC Law. One check, as discussed later in this report, was signed by ANC 7C’s treasurer and secretary. Minutes reviewed revealed that ANC 7C Commissioners approved the payment of invoices in public meetings with
a quorum of Commissioners present. Additionally, the Auditor verified ANC 7C’s inventory of office equipment and furniture thereby ensuring that the ANC’s assets listed in the inventory were in fact located in the ANC’s office. Table II presents a summary of ANC 7C’s expenditures for fiscal years 1999, 2000, 2001, and 2002 through December 31, 2001.

**TABLE II**

**Summary of ANC 7C’s Expenditures**  
*For Fiscal Year 1999, 2000, 2001 and 2002*  
*Through December 31, 2001*

<table>
<thead>
<tr>
<th>Category of Expenditure</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002 Through 12/31/01</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Rent</td>
<td>3,060.00</td>
<td>3,060.00</td>
<td>$3,060.00</td>
<td>765.00</td>
</tr>
<tr>
<td>Telephone Services</td>
<td>1,017.10</td>
<td>1,125.83</td>
<td>1,129.62</td>
<td>335.82</td>
</tr>
<tr>
<td>Office Supplies/Repairs</td>
<td>223.49</td>
<td>662.46</td>
<td>1,331.20</td>
<td>1,116.17</td>
</tr>
<tr>
<td>Purchase of Service Contract</td>
<td>3,476.00</td>
<td>5,757.00</td>
<td>7,113.80</td>
<td>2,400.00</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>2,971.24</td>
<td>630.00</td>
<td>124.98</td>
<td>-0-</td>
</tr>
<tr>
<td>Printing and Duplicating</td>
<td>27.90</td>
<td>181.00</td>
<td>152.03</td>
<td>-0-</td>
</tr>
<tr>
<td>Flyer Distribution/Meetings</td>
<td>90.00</td>
<td>225.00</td>
<td>350.00</td>
<td>128.00</td>
</tr>
<tr>
<td>Grants</td>
<td>500.00</td>
<td>300.00</td>
<td>500.00</td>
<td>-0-</td>
</tr>
<tr>
<td>Petty Cash Replenishment</td>
<td>90.61</td>
<td>50.00</td>
<td>50.00</td>
<td>-0-</td>
</tr>
<tr>
<td>ANC Security Fund</td>
<td>118.00</td>
<td>60.00</td>
<td>65.00</td>
<td>-0-</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>24.00</td>
<td>52.00</td>
<td>106.96</td>
<td>1.45</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$11,598.34</strong></td>
<td><strong>$12,103.29</strong></td>
<td><strong>$13,983.59</strong></td>
<td><strong>$4,746.44</strong></td>
</tr>
</tbody>
</table>

Source: ANC 7C Quarterly Reports and Canceled Checks

**ANC 7C Held The Required Number of Public Meetings During The 39-Month Audit Period**

D.C. Code, Section 1-309.11(b)(1) states, in relevant part, that:

Each Commission shall meet in public session at regular intervals at least nine (9) times per year... [Auditor's Emphasis]

According to available minutes reviewed by the Auditor, ANC 7C was in compliance with D.C. Code, Section 1-309.11(b)(1), by meeting in public session at regular intervals at least nine times each fiscal year. The minutes revealed that ANC 7C held regularly scheduled monthly meetings, executive or special meetings, and quarterly community town hall meetings where District
officials were invited to address residents of the Commission area. Many of the meetings were held without a quorum of ANC 7C Commissioners present. For example, of the 24 meetings held during fiscal year 2001, 10 had quorums and 14 were held without quorums. Table III presents the types of meetings held by ANC 7C during fiscal years 1999 through 2002, through December 31, 2001.

**TABLE III**

ANC 7C Meetings Held During
Through December 31, 2001

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Regular Monthly Meetings</th>
<th>Special Meetings</th>
<th>Community Town Hall Meetings</th>
<th>Total Meetings Held</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>9</td>
<td>3</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>2000</td>
<td>10</td>
<td>3</td>
<td>3</td>
<td>16</td>
</tr>
<tr>
<td>2001</td>
<td>10</td>
<td>10</td>
<td>4</td>
<td>24</td>
</tr>
<tr>
<td>2002</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>7</td>
</tr>
</tbody>
</table>

ANC 7C Reasonably Complied With The ANC Law In Awarding Three Grants Totaling $1,300 During The Audit Period

D.C. Code, Section 1-309.13(m)(1) states, in relevant part, that:

A grant may not be awarded unless the grant is awarded pursuant to a vote of the Commission at a public meeting following the public presentation of the grant request. A Commission may approve grants only to organizations that are public in nature and benefit persons who reside or work within the Commission area.

During the audit period, ANC 7C awarded three grants totaling $1,300. ANC 7C awarded a $500 grant in July 1999 to Fruit of the Spirit Baptist Church in support of a boys summer camp. In June 2000, ANC 7C awarded a $300 grant to Sign of the Times, a community program, in support of after school arts awareness, and a $500 grant to the Far Northeast/Southeast Council to provide funds for posters, postage, and other supplies needed in the Council’s efforts to oppose the construction of homes on swampland at 55th and Clay Sts., NE. Table IV presents the grant awards.
TABLE IV
ANC 7C Grant Awards
For Fiscal Years 1999, 2000, 2001 and 2002
Through December 31, 2001

<table>
<thead>
<tr>
<th>Grant Amount</th>
<th>Grant Recipient</th>
<th>Check Number</th>
<th>Date on Check</th>
<th>Approved in Public Meeting</th>
</tr>
</thead>
<tbody>
<tr>
<td>$500</td>
<td>Fruit of the Spirit Baptist Church</td>
<td>3701</td>
<td>7/27/99</td>
<td>Yes</td>
</tr>
<tr>
<td>$300</td>
<td>Sign Of The Times</td>
<td>3788</td>
<td>6/17/00</td>
<td>Yes</td>
</tr>
<tr>
<td>$500</td>
<td>Far NE/SE Council</td>
<td>5019</td>
<td>6/21/01</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Grant requests were presented to the Commission in public meetings prior to the awards and were subsequently approved by a majority of ANC 7C Commissioners. However, the Auditor observed that ANC 7C’s records did not reflect statements from the grant recipients or receipts showing how grantees’ actually used the grant funds. D.C. Code, Section 1-309.13(m)(3) states:

(3) Within 60 days following the issuance of a grant, the grant recipient shall forward to the Commission a statement as to the use of the funds consistent with the grant application, complete with receipts which support the expenditures.

ANC 7C must ensure that grant recipients provide receipts supporting grant expenditures and file copies of these documents with quarterly financial reports or the grants may be disallowed from future quarterly allotments.

RECOMMENDATION

ANC 7C’s chairperson, treasurer, and the Commissioner(s) in whose single member district the grantee organization is located must obtain from all grantees a statement as to how grant funds were used and provide receipts that support the expenditure of grant funds presented in Table IV. The statement along with receipts must be provided to the District of Columbia Auditor within 60 days of the date of this report. Grants awarded to grantees who fail to provide the statement complete with receipts to support expenditures will be disallowed from a future quarterly allotment released to ANC 7C.
SEVERAL ANC 7C FUNCTIONS AND OPERATIONS DID NOT FULLY COMPLY WITH RELEVANT PROVISIONS OF THE ANC LAW

ANC 7C Commissioners Did Not Approve A Spending Plan Budget For Fiscal Years 1999, 2000, or 2001

D.C. Code, Section 1-309.10(n), states, in relevant part, that:

Each Commission shall develop an annual fiscal year spending plan budget for the upcoming fiscal year ... Prior to adoption of the budget at a public meeting, the Commission shall present the budget at a public meeting of the Commission to elicit comments from the residents of the Commission area.

ANC 7C did not approve, by a majority of Commissioners present at a public meeting, a spending plan budget for fiscal years 1999, 2000, or 2001 as required by the ANC Law. While there were discussions, as noted in the minutes of February 2001 meetings on the budget, an official budget was never presented or approved. ANC 7C’s chairperson only provided copies of proposed budgets for fiscal years 2000 and 2001, but no record of the approval of these budgets was found in ANC 7C’s public meeting minutes. ANC 7C Commissioners did approve a spending plan budget for fiscal year 2002.

RECOMMENDATION

ANC 7C must approve an annual fiscal year spending plan budget each fiscal year as required by D.C. Code, Section 1-309.10(n). The Auditor will determine the status of implementing this recommendation within 60 days of the beginning of each new fiscal year.

ANC 7C Did Not Include “District of Columbia Government” On Its Bank Account or the Face of Its Checks Until May 1, 2001

D. C. Code, Section 1-309.13(b)(2), states, in relevant part, that:

Each Commission shall...include the phrase “District of Columbia Government” in each account name within 90 days after June 27, 2000. [Auditor’s Emphasis]
Further, D. C. Code, Section 1-309.13(f), states, in relevant part, that:

...Any check shall be pre-numbered, shall bear the name of the commission and “District of Columbia Government” on its face, and shall be issued in consecutive order. [Auditor’s Emphasis]

The Auditor found that ANC 7C did not comply with D.C. Code, Section 1-309.13(b)(2) until May 1, 2001, approximately eight months after the deadline established for compliance with this provision of law. The Auditor observed that the law allowed ANCs 90 days after June 27, 2000, to comply with these provisions. However, ANC 7C continued using non-compliant checks after the 90-day deadline expired and issued 60 checks totaling $8,846.01 that were not in compliance with the ANC Law. As a consequence of ANC 7C’s longstanding noncompliance with D.C. Code, Section 1-309.13(b)(2) and (f), all disbursements on non-compliant checking accounts and checks written after October 2000 will be disallowed from the ANC’s future quarterly allotments.

RECOMMENDATION

The Deputy Chief Financial Officer for Financial Operations and Systems withhold $8,846.01 from ANC 7C’s third and fourth quarter allotments for fiscal year 2002, and their first and second quarter allotments for fiscal year 2003, for violating D.C. Code, Sections 1-309(b)(2) and (f).

ANC 7C’s Treasurer Failed To Deposit Funds Into ANC 7C’s Account As Required By The Office Of The Corporation Counsel

On September 30, 1999, the District of Columbia Auditor issued a report entitled, “Auditor’s Review of Unauthorized and Improper Transactions of ANC 7C’s Chairperson.” The examination concerned the improper solicitation and use of approximately $1,556 by ANC 7C’s chairperson for a community day festival. In addition to the $1,556 in solicited funds, the Auditor found that ANC 7C’s chairperson and treasurer disbursed $1,547 of ANC 7C’s appropriated funds, from the ANC’s primary checking account at Industrial Bank, to pay “Amusements by Ironhorse” for entertainment provided at the community day festival. This action was taken because a $1,707 check written by the ANC 7C chairperson to Ironhorse from an improperly established checking account at Chevy Chase Bank was dishonored due to insufficient funds in the account. Minutes of an ANC 7C executive meeting held on February 1, 1999, reflected that ANC 7C Commissioners improperly authorized the payment of the outstanding bill from Ironhorse ($1,547) for services provided during the community festival.
In the September 30, 1999 report, the Auditor found that ANC 7C’s chairperson improperly solicited donations to fund a community festival. Further, without the ANC’s approval, she used ANC 7C’s name and tax identification number to improperly establish a checking account at Chevy Chase Bank into which some of the donated funds were deposited. ANC 7C already maintained a checking account at Industrial Bank, therefore, the opening of a second account by the chairperson violated the ANC Law. Funds deposited in the second account were improperly used to pay for food and entertainment. Further, the actions of the chairperson violated several provisions of the ANC Law, Corporation Counsel opinions regarding soliciting funds and spending ANC funds for food and entertainment, and did not comply with provisions of the Financial Management Guidelines issued by the Office of the District of Columbia Auditor. The Auditor recommended that the chairperson reimburse ANC 7C $1,556 for the improperly solicited funds and the subsequent mishandling and improper use of the funds.

On August 16, 2001, an Assistant Corporation Counsel (OCC) sent a letter and a $375 check to ANC 7C’s treasurer indicating the Corporation Counsel’s receipt of $375 on behalf of ANC 7C from its chairperson. The Assistant Corporation Counsel informed the treasurer that the funds should be deposited into ANC 7C’s bank account. These funds represented partial reimbursement of the $1,556 in funds improperly solicited and spent by ANC 7C’s chairperson. The OCC served as the collection agent for these funds. The Auditor’s review of ANC 7C’s bank statements through December 31, 2001 revealed that neither ANC 7C’s chairperson (who made the payment) nor its treasurer (who allegedly received the payments from the OCC) deposited the $375 into ANC 7C’s bank account.

Further discussions with the Assistant Corporation Counsel revealed that he had forwarded a total of $900 in six personal checks and one money order received from ANC 7C’s chairperson to ANC 7C’s treasurer with instructions that these funds were to be deposited into ANC 7C’s checking account. (See Attachment I for example of correspondence from the Office of the Corporation Counsel to the treasurer of ANC 7C) The checks and money order were sent to ANC 7C’s treasurer between August 28, 2000 and August 16, 2001. The Auditor reviewed all ANC 7C bank statements between January 30, 1999 and December 31, 2001 and found no record of these deposits. The current treasurer for ANC 7C stated that he received one check for $375 in August 2001 and that he discussed the check with the ANC chairperson. As a result of that discussion, the $375 was not deposited into ANC 7C’s checking account. The current treasurer stated that he did not know why the check had not been deposited. The Auditor observed that the OCC had sent all other letters and checks to ANC 7C’s prior treasurer, and all the letters and checks were mailed to the ANC’s office at 4651 Nannie Helen Burroughs Avenue, N.E., Suite 2. The prior ANC 7C
treasurer stated that she did not recall receiving any checks or money orders from the OCC or any letters pertaining to the deposit of the funds. The prior treasurer also stated that the chairperson was the primary person in the ANC who would have received the mail. The Auditor also attempted to question the current ANC 7C treasurer regarding this issue. Despite numerous attempts and messages to the treasurer, ANC 7C’s treasurer has not responded.

Subsequent discussions with ANC 7C’s chairperson revealed that the checks had not been deposited because they were “misplaced” and that the deposits would be made soon. The chairperson did not address or express any concern about the whereabouts of the checks or money order. The chairperson did not provide a basis for her belief that the checks and money order had been misplaced. Further, the Auditor’s review indicated that when the checks had not cleared the chairperson’s account, she did not inquire of the Assistant Corporation Counsel as to the disposition of the checks. It appears that someone in ANC 7C’s office was intercepting payments OCC officials forwarded to ANC 7C’s treasurer.

On one level, the Corporation Counsel’s records indicated that reimbursements were made by the ANC’s chairperson and that the payments were forwarded to ANC 7C’s treasurer, however, on another level, the ANC’s accounting records did not reflect the receipt or deposit of the funds. Further, it appears that someone in ANC 7C may have intentionally “misplaced” the checks and money order for unexplained reasons. To clarify these matters and the apparent theft of the payments sent to ANC 7C by the Office of the Corporation Counsel, the District of Columbia Auditor will refer this matter to appropriate law enforcement authority for further investigation.

RECOMMENDATIONS

1. ANC 7C’s chairperson and treasurer must immediately locate the misplaced checks and money orders, promptly deposit at least $900 to ANC 7C’s bank account, and provide the Auditor with a copy of the deposit ticket and bank statement.

2. ANC 7C’s chairperson must immediately reimburse ANC 7C the remaining $656 and provide the Auditor with proof of the repayment of these funds as well as proof of deposit of the funds in ANC 7C’s checking account.

3. The Corporation Counsel of the District of Columbia must provide the Auditor with written notice of all reimbursements received from ANC 7C’s chairperson for deposit in ANC 7C’s checking account as well as the amounts so that the Auditor may ensure that these funds are received by the ANC and promptly deposited in the ANC’s checking account.
ANC 7C Reported Check Number 3721 As Void, But It Was Paid By The Bank In The Amount Of $800

On March 14, 2000, ANC 7C submitted its first quarter financial report for fiscal year 2000. The report was signed by ANC 7C’s chairperson, treasurer, and secretary. ANC 7C’s treasurer listed check numbers 3721, 3722, and 3723 as VOID. The Auditor found, however, that check number 3721 had been issued out of sequence on September 25, 1998. The check was made payable to a former ANC 7C treasurer, who was treasurer at the time of the transaction, in the amount of $800. The check had been signed by a former ANC 7C secretary and co-signed by the former treasurer.

The original check could not be found and the bank provided a photo-copy of the check which revealed that it had been endorsed by the former ANC 7C treasurer. There was no discussion or approval of this disbursement in any of ANC 7C’s minutes of public meetings. Upon being informed of this improper disbursement, the Auditor ordered the former treasurer to promptly repay the funds or the matter would be referred to law enforcement authority for further investigation. The Auditor found that a deposit of $400 was made to ANC 7C’s checking account on December 3, 1998, and another deposit of $403.65 was made on January 5, 1999. While both deposits were reflected on ANC 7C’s quarterly reports of financial activity, there was no explanation of who made the deposits, why they were made, or discussions regarding the deposits in any of ANC 7C’s minutes of public meetings. We believe that these were the reimbursements made by the former treasurer as directed by the Auditor.

Discussions with ANC 7C’s chairperson revealed that the former ANC 7C treasurer used ANC funds to allegedly pay his rent, and that he reimbursed the ANC several months after the fact. D.C. Code, Section 1-309.13(l)(2) states, in relevant part, that:

Funds allocated to the Commissions may not be used for a purpose that involves partisan political activity, personal subsistence expenses, Commissioner compensation, meals, . . .

The ANC 7C chairperson stated that she informed the D. C. Auditor about this incident right after the check was cashed. Further review of quarterly reports of financial activity revealed that the $800 disbursement was reported on ANC 7C’s fourth quarter financial report for fiscal year 1998 under expense category “other”. The expense category “other” required that the ANC attach an explanation of the expense. The only explanation provided was that the ‘payee’ was listed as the former ANC 7C treasurer; no further explanation of the expense was submitted. ANC 7C’s treasurer
misstated that the check was a void check in a subsequent quarterly financial report filed 1½ years later. This misstatement indicates a lack of competence or candor in reporting, improper reconciliation of canceled checks and bank statements to ANC 7C’s checkbook, and a poor internal control environment.

RECOMMENDATIONS

1. ANC 7C’s chairperson and treasurer must ensure that ANC funds are used only for authorized purposes that provide a public benefit in the Commission area as required by D.C. Code, Section 1-309.13(l)(2).

2. ANC 7C’s chairperson and treasurer must accurately report the disposition of public funds entrusted to their custody and care. If these officers cannot adhere to this standard both should resign from their respective positions as chairperson and treasurer.

3. ANC 7C’s chairperson and treasurer must ensure that all ANC checks and the checkbook are properly protected and the checks accounted for at all times, and that a reconciliation of bank statements to ANC 7C’s checkbook take place on a monthly basis.

ANC 7C May Have Misclassified an Individual Working For the ANC as a Consultant Rather than an Employee

The Auditor found that ANC 7C’s chairperson and treasurer had erroneously reported payments to its administrative staff person as “purchase of service”, expense category 14, rather than net salaries and wages, expense category 1, on quarterly financial reports filed with the Office of the District of Columbia Auditor. The individual worked in the ANC’s on a regular basis, usually four days a week, approximately 5 hours each day, during fiscal years 2000, 2001, and 2002, at a rate of $10 per hour. ANC 7C made payments to the individual totaling $7,140 through December 31, 2001. Payments were approved in ANC 7C public meetings by a majority of ANC 7C Commissioners.

The Auditor determined that ANC 7C failed to properly classify payments to this individual in accordance with Financial Management Guidelines issued by the Office of the District of Columbia Auditor, legal opinions issued by the Office of the Corporation Counsel, and guidance provided by the U.S. Internal Revenue Service. (See Attachments II, III, and IV) Based upon these guidelines and opinions, it appears that the individual providing administrative services to ANC 7C, currently carried as a consultant, should have been classified as an employee. Thus, the ANC should
have withheld appropriate taxes from wage payments and remitted the same to the Internal Revenue Service and to the District of Columbia Office of Tax and Revenue as required by law. Further, the ANC should have complied with other applicable provisions of federal and District tax and labor laws.

Discussions with ANC 7C’s chairperson revealed that the ANC is currently in the process of converting the administrative staff person from a consultant to an employee of the ANC and that all paperwork and tax documents should be completed by the end of the second quarter of fiscal year 2002. Notwithstanding these assertions, the Auditor will refer this matter to the Office of Tax and Revenue and the Internal Revenue Service for further investigation.

RECOMMENDATIONS

1. ANC 7C’s chairperson and treasurer must immediately obtain an opinion regarding the tax classification of the individual providing administrative services to ANC 7C from the District’s Office of Tax and Revenue and/or the Internal Revenue Service. Further, if either of these authorities determine that the individual was misclassified as a contractor, it is imperative that ANC 7C file the necessary tax forms and payments.

2. The Office of Tax and Revenue investigate the tax consequences of ANC 7C’s classification of the individual providing administrative services to the ANC is a contractor rather than an employee and provide its findings to the District of Columbia Auditor and ANC 7C.

ANC 7C Had Not Signed A Current Lease Agreement With Its Landlord

The Auditor found that ANC 7C had not signed a current lease agreement with its landlord as of the end of the Auditor’s field work. ANC 7C has leased its present office space at Glendale Gardens Apartment complex, 4651 Nannie Helen Burroughs Avenue, NE, for more than 23 years. ANC 7C currently pays a monthly rental fee of $255 to Glendale Gardens Management, Inc.

ANC 7C’s chairperson stated that she would contact Glendale Gardens Management and arrange to sign a new lease agreement. The Auditor cautioned ANC 7C’s chairperson that the lease agreement must be approved first by a majority of ANC 7C Commissioners in a public meeting and the vote recorded in the minutes of the meeting.
RECOMMENDATION

ANC 7C Commissioners must immediately approve a current written lease agreement.

CONCLUSION

As a result of the examination of ANC 7C’s quarterly financial reports, minutes of meetings, bank statements, canceled checks, check registry and other relevant documentation, the Auditor found that ANC 7C’s financial operations and activities partially complied with the ANC Law, Corporation Counsel opinions, and Financial Management Guidelines issued by the Office of the District of Columbia Auditor. The ANC maintained sufficient documentation to justify and support 98% of all expenditures, including voucher packages containing original invoices or receipts from vendors, verifying that goods and services were received, stamping invoices paid, and including the check number used to pay the vendor on the voucher. Also, all checks reviewed, with one exception, were properly signed by the ANC chairperson and treasurer in accordance with the ANC Law. Most expenditures were approved by a quorum of Commissioners in a public meeting. Further, three grants made by ANC 7C were in compliance with the ANC Law and Financial Management Guidelines issued by the Office of the District of Columbia Auditor.

The Auditor found that ANC 7C did not approve a spending plan budget for fiscal years 1999, 2000, or 2001. Further, ANC 7C did not include “District of Columbia Government” on its bank account or the face of its checks until eight months after the deadline for compliance with this provision of the ANC Law.

The Auditor found that a total of $900 in personal checks and money orders from ANC 7C’s chairperson had been sent by the Office of the Corporation Counsel to ANC 7C’s treasurer between August 28, 2000 and August 16, 2001 with instructions that the funds be deposited into ANC 7C’s checking account. The payments represented partial reimbursement of $1,556 in funds improperly solicited and spent by ANC 7’s chairperson. It appears that someone in ANC 7C intercepted the checks and money orders and failed to deposit them, perhaps, in an effort to avoid reimbursing the ANC. Further, ANC 7C’s treasurer failed to deposit the $900 into ANC 7C’s account as directed by the Office of the Corporation Counsel.

The Auditor also found that ANC 7C’s treasurer reported a check as being void when, in fact, the check was written for $800 and cashed by the former treasurer of ANC 7C to pay his rent. The $800 was reimbursed by the former treasurer as ordered by the District of Columbia Auditor.
Further, ANC 7C erroneously reported payments to an individual providing administrative services to ANC 7C were wages rather than payments to a contractor. Financial Management Guidelines issued by the Office of the District of Columbia Auditor, legal opinions issued by the Office of the Corporation Counsel, and guidance provided by the Internal Revenue Service indicated that the individual providing administrative services to ANC 7C may be an employee, and that the ANC should be withholding federal, state, and local taxes in accordance with applicable law. This matter has been referred to the Office of Tax and Revenue and the Internal Revenue Service for further investigation.

Additionally, ANC 7C has not signed a current lease agreement with its landlord, Glendale Gardens Management, Inc., and has rented office space on a month-to-month basis during the audit period. Although longstanding, this arrangement is tenuous and places the assets of the ANC at risk should the tenancy be terminated under provisions in the D.C. Code concerning month-to-month tenancy.

Pursuant to D.C. Code, Section 1-309.13(d)(3), ANC 7C must respond in writing, within 90 days, to each violation detailed herein. The failure to do so may result in the forfeiture of ANC 7C’s next scheduled quarterly allotment.

Respectfully submitted,

[Signature]

Deborah K. Nichols
District of Columbia Auditor
ATTACHMENTS
March 19, 2001

Dear [Name]

As part of an agreement with Commissioner [Name], I have received a money order in the amount of $150.00 made payable to ANC 7C. These funds represent reimbursement payments for ANC funds the D.C. Auditor’s Office found to be improperly solicited and disbursed in a September 30, 1999 audit. The total amount to be reimbursed is $1,556.00. The balance to be reimbursed is $1,031.00.

Please deposit these funds into the ANC 7 account.

Sincerely,

[Signature]
Arthur J. Parker
Assistant Corporation Counsel

Enclosures

cc: Deborah K. Nichols

---

Pay to the Order of Advisory Neighborhood Commission 7C $ 150.00

One Hundred Fifty

Dollars

CHEVY CHASE BANK

CHEVY CHASE, MARYLAND 20815
Treasurer
Advisory Neighborhood Commission 7C
4651 Nannie Helen Burroughs Avenue, N.E., Suite 2
Washington, D.C. 20019

RE: Reimbursement payments

Dear [Blank]

As part of an agreement with Commissioner [Blank], I have received a money order in the amount of $375.00 made payable to ANC 7C. These funds represent reimbursement payments for ANC funds that the D.C. Auditor’s Office found to be improperly solicited and disbursed in a September 30, 1999 audit. The total amount to be reimbursed is $1,556.00. The balance to be reimbursed is $656.00.

Please deposit these funds into the ANC 7 account.

Sincerely

Arthur J. Parker
Assistant Corporation Counsel

Enclosures

cc: Deborah K. Nichols
If you are not sure whether you are an employee or an independent contractor, get Form SS-8, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding. Publication 15-A, Employer's Supplemental Tax Guide, provides additional information on independent contractor status.

IRS Electronic Service

You may download and print IRS publications, forms, and other tax information materials on the Internet at www.irs.gov and you may call the IRS at 1-800-829-3676 (1-800-TAX-FORM) to order free tax publications and forms.

From a fax machine, dial (703) 368-9694 and you will immediately get a list of IRS tax forms faxed back to you. Follow the voice prompts to get specific forms faxed to you.

Publication 1796, Federal Tax Products on CD-ROM, of current and prior year tax publications and forms, can be purchased from the National Technical Information Service (NTIS). You may order Publication 1796 toll-free through the IRS at 1-877-233-6767 or via the Internet at www.irs.gov/orders.

Working to Put Service First

www.irs.gov

Often your tax questions can be answered by reading tax publications and related forms. But when you need more information, you may call the IRS at 1-800-829-1040.
Which are you?

For federal tax purposes, this is an important distinction. Worker classification affects how you pay your federal income tax, social security and Medicare taxes, and how you file your tax return. Classification affects your eligibility for employer and social security and Medicare benefits and your tax responsibilities. If you aren't sure of your work status, you should find out now. This brochure can help you.

The courts have considered many facts in deciding whether a worker is an independent contractor or an employee. These relevant facts fall into three main categories: behavioral control, financial control, and relationship of the parties. In each case, it is very important to consider all the facts - no single fact provides the answer. Carefully review the following definitions.

Behavioral Control

These facts show whether there is a right to direct or control the business part of the work. For example:

- **Instructions** - if you receive extensive instructions on how work is to be done, this suggests that you are an employee. Instructions can cover a wide range of topics, for example:
  - how, when, or where to do the work
  - what tools or equipment to use

- **Significant Investment** - if you have a significant investment in your work, you may be an independent contractor. While there is no precise dollar test, the investment must have substance. However, a significant investment is not necessary to be an independent contractor.

- **Expenses** - if you are not reimbursed for some or all business expenses, then you may be an independent contractor, especially if your unreimbursed business expenses are high.

- **Opportunity for Profit or Loss** - if you can realize a profit or incur a loss, this suggests that you are in business for yourself and that you may be an independent contractor.

Relationship of the Parties

These are facts that illustrate how the business and the worker perceive their relationship. For example:

- **Employee Benefits** - if you receive benefits, such as insurance, pension, or paid

leave, this is an indication that you may be an employee. If you do not receive benefits, however, you could be either an employee or an independent contractor.

Written Contracts - a written contract may show what both you and the business intend. This may be very significant if it is difficult, if not impossible, to determine status based on other facts.

When You Are an Employee

- Your employer must withhold income tax and your portion of social security and Medicare taxes. Also, your employer is responsible for paying social security, Medicare, and unemployment (FUTA) taxes on your wages. Your employer must give you a Form W-2, Wage and Tax Statement, showing the amount of taxes withheld from your pay.

- You may deduct unreimbursed employee business expenses on Schedule A of your income tax return, but only if you itemize deductions and they total more than two percent of your adjusted gross income.

When You Are an Independent Contractor

- The business may be required to give you Form 1099-MISC, Miscellaneous Income, to report what it has paid to you.

- You are responsible for paying your own income tax and self-employment tax (Self-Employment Contributions Act - SECA). The business does not withhold taxes from your pay. You may need to make estimated tax payments during the year to cover your tax liabilities.

- You may deduct business expenses on Schedule C of your income tax return.
ATTACHMENT III

Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding

Name of firm (or person) for whom the worker performed services
Worker's name

Firm's address (include street address, apt. or suite no., city, state, and ZIP code)
Worker's address (include street address, apt. or suite no., city, state, and ZIP code)

Trade name
Telephone number (include area code)
Firm's employer identification number
Worker's employer identification number (if any)

Important Information Needed To Process Your Request

If this form is being completed by the worker, the IRS must have your permission to disclose your name to the firm. Do you object to disclosing your name and the information on this form to the firm? □ Yes □ No
If you answered "Yes" or did not check a box, stop here. The IRS cannot act on your request and a determination will not be issued.

You must answer ALL items OR mark them "Unknown" or "Does not apply." If you need more space, attach another sheet.

A This form is being completed by. □ Firm □ Worker, for services performed ___________________________ to ___________________________.

B Explain your reason(s) for filing this form (e.g., you received a bill from the IRS, you believe you received a Form 1099 or Form W-2 erroneously, you are unable to get worker's compensation benefits, you were audited or are being audited by the IRS)

C Total number of workers who performed or are performing the same or similar services

D How did the worker obtain the job? □ Application □ Ad □ Employment Agency □ Other (specify) ____________

E Attach copies of all supporting documentation (contracts, invoices, memos, Forms W-2, Forms 1099, IRS closing agreements, IRS rulings, etc.) in addition, please inform us of any current or past litigation concerning the worker's status. If no income reporting forms (Form 1099-MISC or W-2) were furnished to the worker, enter the amount of income earned for the year(s) at issue $ ___________

F Describe the firm's business

G Describe the work done by the worker and provide the worker's job title

H Explain why you believe the worker is an employee or an independent contractor

I Did the worker perform services for the firm before getting this position? □ Yes □ No □ N/A
If "Yes," what were the dates of the prior service?
If Yes, explain the differences, if any, between the current and prior service

J If the work is done under a written agreement between the firm and the worker, attach a copy (preferably signed by both parties) Describe the terms and conditions of the work arrangement

For Privacy Act and Paperwork Reduction Act Notice, see page 5.
Part I  Behavioral Control

1. What specific training and/or instruction is the worker given by the firm?  

2. How does the worker receive work assignments?  

3. Who determines the methods by which the assignments are performed?  

4. Who is the worker required to contact if problems or complaints arise and who is responsible for their resolution?  

5. What types of reports are required from the worker? Attach examples  

6. Describe the worker’s daily routine (i.e., schedule, hours, etc.)  

7. At what location(s) does the worker perform services (e.g., firm’s premises, own shop or office, home, customer’s location, etc.)?  

8. Describe any meetings the worker is required to attend and any penalties for not attending (e.g., sales meetings, monthly meetings, staff meetings, etc.)  

9. Is the worker required to provide the services personally?  

10. If substitutes or helpers are needed, who hires them?  

11. If the worker hires the substitutes or helpers, is approval required?  

12. Who pays the substitutes or helpers?  

13. Is the worker reimbursed if the worker pays the substitutes or helpers?  

Part II  Financial Control

1. List the supplies, equipment, materials, and property provided by each party  
   - The firm  
   - The worker  
   - Other party  

2. Does the worker lease equipment?  

3. What expenses are incurred by the worker in the performance of services for the firm?  

4. Specify which, if any, expenses are reimbursed by  
   - The firm  
   - Other party  

5. Type of pay the worker receives  
   - Salary  
   - Commission  
   - Hourly Wage  
   - Piece Work  
   - Lump Sum  
   - Other (specify)  

6. If the worker is paid by a firm other than the one listed on this form for these services, enter name, address, and employer identification number of the payer  

7. Is the worker allowed a drawing account for advances?  

8. Whom does the customer pay?  

9. Does the firm carry worker’s compensation insurance on the worker?  

10. What economic loss or financial risk, if any, can the worker incur beyond the normal loss of salary (e.g., loss or damage of equipment, material, etc.)?
Part III  Relationship of the Worker and Firm

1  List the benefits available to the worker (e.g., paid vacations, sick pay, pensions, bonuses)

2  Can the relationship be terminated by either party without incurring liability or penalty?  ☐ Yes ☐ No
   If "No," explain your answer

3  Does the worker perform similar services for others?  ☐ Yes ☐ No
   If "Yes," is the worker required to get approval from the firm?  ☐ Yes ☐ No

4  Describe any agreements prohibiting competition between the worker and the firm while the worker is performing services or during any later period. Attach any available documentation.

5  Is the worker a member of a union?  ☐ Yes ☐ No

6  What type of advertising, if any, does the worker do (e.g., a business listing in a directory, business cards, etc.)? Provide copies, if applicable.

7  If the worker assembles or processes a product at home, who provides the materials and instructions or pattern?

8  What does the worker do with the finished product (e.g., return it to the firm, provide it to another party, or sell it)?

9  How does the firm represent the worker to its customers (e.g., employee, partner, representative, or contractor)?

10 If the worker no longer performs services for the firm, how did the relationship end?

Part IV  For Service Providers or Salespersons—Complete this part if the worker provided a service directly to customers or is a salesperson

1  What are the worker’s responsibilities in soliciting new customers?

2  Who provides the worker with leads to prospective customers?

3  Describe any reporting requirements pertaining to the leads

4  What terms and conditions of sale, if any, are required by the firm?

5  Are orders submitted to and subject to approval by the firm?  ☐ Yes ☐ No

6  Who determines the worker’s territory?

7  Did the worker pay for the privilege of serving customers on the route or in the territory?  ☐ Yes ☐ No
   If “Yes,” whom did the worker pay?
   If “Yes,” how much did the worker pay? $________

8  Where does the worker sell the product (e.g., in a home, retail establishment, etc.)?

9  List the product and/or services distributed by the worker (e.g., meat, vegetables, fruit, bakery products, beverages, or laundry or dry cleaning services). If more than one type of product and/or service is distributed, specify the principal one.

10 Does the worker sell life insurance full time?  ☐ Yes ☐ No

11 Does the worker sell other types of insurance for the firm?  ☐ Yes ☐ No
   If “Yes,” enter the percentage of the worker’s total working time spent in selling other types of insurance ______%.

12 If the worker solicits orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments, enter the percentage of the worker’s time spent in the solicitation ______%.

13 Is the merchandise purchased by the customer for resale or use in their business operations?  ☐ Yes ☐ No
   Describe the merchandise and state whether it is equipment installed on the customers’ premises

Part V  Signature (see page 4)

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete.

Signature  ___________________________ Title  ___________________________ Date  ___________________________

(Type or print name below)
General Instructions
Section references are to the Internal Revenue Code unless otherwise noted

Purpose
Firms and workers file Form SS-8 to request a determination of the status of a worker for purposes of Federal employment taxes and income tax withholding.

A Form SS-8 determination may be requested only in order to resolve Federal tax matters. The taxpayer requesting a determination must file an income tax return for the years under consideration before a determination can be issued. If Form SS-8 is submitted for a tax year for which the statute of limitations on the tax return has expired, a determination letter will not be issued. The statute of limitations expires 3 years from the due date of the tax return or the date filed, whichever is later.

The IRS does not issue a determination letter for proposed transactions or on hypothetical situations. We may, however, issue an information letter when it is considered appropriate.

Definition
Firm. For the purposes of this form, the term "firm" means any individual, business enterprise, organization, state, or other entity for which a worker has performed services. The firm may or may not have paid the worker directly for these services. If the firm was not responsible for payment for services, please be sure to complete question 6 in Part II of Form SS-8.

The SS-8 Determination Process
The IRS will acknowledge the receipt of your Form SS-8. Because there are usually two (or more) parties who could be affected by a determination of employment status, the IRS attempts to get information from all parties involved by sending those parties blank Forms SS-8 for completion. The case will be assigned to a technician who will review the facts, apply the law, and render a decision. The technician may ask for additional information before rendering a decision. The IRS will generally issue a formal determination to the firm or payer (if that is a different entity), and will send a copy to the worker. A determination letter applies only to a worker (or a class of workers) requesting it, and the decision is binding on the IRS. In certain cases, a formal determination will not be issued. Instead, an information letter may be issued. Although an information letter is advisory only and is not binding on the IRS, it may be used to assist the worker to fulfill his or her Federal tax obligations. This process takes approximately 120 days.

Neither the SS-8 determination process nor the review of any records in connection with the determination constitutes an examination (audit) of any Federal tax return. If the periods under consideration have previously been examined, the SS-8 determination process will not constitute a reexamination under IRS reopening procedures. Because this is not an examination of any Federal tax return, the appeal rights available in connection with an examination do not apply to an SS-8 determination. However, if you disagree with a determination and you have additional information concerning the work relationship that you believe was not previously considered, you may request that the determining office reconsider the determination.

Completing Form SS-8
Please answer all questions as completely as possible. Attach additional sheets if you need more space. Provide information for all years the worker provided services for the firm. Determinations are based on the entire relationship between the firm and the worker.

Additional copies of this form may be obtained by calling 1-800-TAX-FORM (1-800-829-3676) or from the IRS Website at www.irs.gov.

Fee
There is no fee for requesting an SS-8 determination letter.

Signature
The Form SS-8 must be signed and dated by the taxpayer. A signed signature will not be accepted.

The person who signs for a corporation must be an officer of the corporation who has personal knowledge of the facts. If the corporation is a member of an affiliated group filing a consolidated return, it must be signed by an officer of the common parent of the group.

The person signing for a trust, partnership, or limited liability company must be, respectively, a trustee, general partner, or member-manager who has personal knowledge of the facts.

Where to File
Send the completed Form SS-8 to the address listed below for the firm’s location. However, for cases involving Federal agencies, send the form to the Internal Revenue Service, Attn: CC-CORP T.C., Ben Franklin Station, P.O. Box 7604, Washington, DC 20044.

Firm’s Location: Send to:

<table>
<thead>
<tr>
<th>State/Location</th>
<th>Internal Revenue Service</th>
<th>SS-8 Determinations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama, Connecticut, Delaware, District of Columbia, Florida, Georgia, Indiana, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, West Virginia, all other locations not listed</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Instructions for Workers
If you are requesting a determination for more than one firm, complete a separate Form SS-8 for each firm.

Form SS-8 is not a claim for refund of social security and Medicare taxes or Federal income tax withholding.

If you are found to be an employee, you are responsible for filing an amended return for any corrections related to this decision. A determination that a worker is an employee does not necessarily reduce any current or prior tax liability. For more information, call 1-800-829-1040.
Time for filing a claim for refund. Generally, you must file your claim for a credit or refund within 3 years from the date your original return was filed or within 2 years from the date the tax was paid, whichever is later.

Form SS-8 does not prevent the expiration of the time in which a claim for a refund must be filed. If you are concerned about a refund, and the statute of limitations for filing a claim for refund for the year(s) at issue has not yet expired, you should file Form 1040X, Amended U.S. Individual Income Tax Return, to protect your statute of limitations. File a separate Form 1040X for each year.

On the Form 1040X you file, do not complete lines 1 through 24 on the form. Write “Protective Claim” at the top of the form, sign and date it. In addition, you should enter the following statement in Part II, Explanation of Changes to Income, Deductions, and Credits: “Filed Form SS-8 with the Internal Revenue Service Office in (Austin, TX, Newport, VT, or Washington, DC, as appropriate). By filing this protective claim, I reserve the right to file a claim for any refund that may be due after a determination of my employment tax status has been completed.”

Form SS-8 does not alter the requirement to timely file an income tax return. Do not delay filing your tax return in anticipation of an answer to your SS-8 request. You must file an income tax return for related tax years before a determination can be issued. In addition, if applicable, do not delay in responding to a request for payment while waiting for a determination of your worker status.

Instructions for Firms

If a worker has requested a determination of his or her status while working for you, you will receive a request from the IRS to complete a Form SS-8. In cases of this type, the IRS usually gives each party an opportunity to present a statement of the facts because any decision will affect the employment tax status of the parties. Failure to respond to this request will prevent the IRS from issuing an information letter to the worker based on the information he or she has made available so that the worker may fulfill his or her Federal tax obligations. However, the information that you provide is extremely valuable in determining the status of the worker.

If you are requesting a determination for a particular class of worker, complete the form for one individual who is representative of the class of workers whose status is in question. If you want a written determination for more than one class of workers, complete a separate Form SS-8 for one worker from each class whose status is typical of that class. A written determination for any worker will apply to other workers of the same class if the facts are not materially different for these workers. Please provide a list of names and addresses of all workers potentially affected by this determination.

If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker under section 530 of the 1978 Revenue Act. However, this relief provision cannot be considered in conjunction with a Form SS-8 determination because the determination does not constitute an examination of any tax return. For more information regarding section 530 of the 1978 Revenue Act and to determine if you qualify for relief under this section, you may visit the IRS Web site at www.irs.gov

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. This information will be used to determine the employment status of the worker(s) described on the form. Subtitle C, Employment Taxes, of the Internal Revenue Code imposes employment taxes on wages. Sections 3121(d), 3306(a) and 3401(c) and (d) and the related regulations define employee and employer for purposes of employment taxes imposed under Subtitle C. Section 6001 authorizes the IRS to request information needed to determine if a worker(s) or firm is subject to these taxes. Section 6109 requires you to provide your taxpayer identification number. Neither workers nor firms are required to request a status determination, but if you choose to do so, you must provide the information requested on this form. Failure to provide the requested information may prevent us from making a status determination. If any worker or the firm has requested a status determination, and you are being asked to provide information for use in that determination, you are not required to provide the requested information. However, failure to provide such information will prevent the IRS from considering it in making the status determination. Providing false or fraudulent information may subject you to penalties. Routine uses of this information include providing it to the Department of Justice for use in civil and criminal litigation, to the Social Security Administration for the administration of social security programs, and to cities, states, and the District of Columbia for the administration of their tax laws. We may also provide this information to the affected worker(s) or the firm as part of the status determination process.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is Recordkeeping, 22 hrs. Learning about the law or the form, 47 min., and Preparing and sending the form to the IRS, 1 hr., 11 min. If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. Do not send the tax form to this address. Instead, see Where To File on page 4.
Employer’s Supplemental Tax Guide
(Supplement to Circular E, Employer’s Tax Guide (Publication 15))

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Introduction

This publication supplements Circular E, Employer’s Tax Guide. It contains specialized and detailed employment tax information supplementing the basic information provided in Circular E. Publication 15-B, Employer’s Tax Guide to Fringe Benefits, contains information about the employment tax treatment of various types of noncash compensation. This publication contains:

- Alternative methods and tables for figuring income tax withholding.
- Combined income tax, employee social security tax, and employee Medicare tax withholding tables.
- Tables for withholding on distributions of Indian gaming profits to tribal members.

Telephone help. You can call the IRS with your tax questions. Check your telephone book for the local number or call 1-800-829-1040.

Help for people with disabilities. Telephone help is available using TTY/TDD equipment. You can call 1-800-829-4059 with your tax question or to order forms and publications. You may also use this number for problem resolution assistance.
Ordering publications and forms. See page 61 for information on how to obtain forms and publications.

Useful Items
You may want to see:

Publication
- 15 Circular E, Employer's Tax Guide
- 51 Agricultural Employer's Tax Guide
- 509 Tax Calendars for 2002
- 225 Farmer's Tax Guide
- 515 Withholding of Tax on Nonresident Aliens and Foreign Corporations
- 535 Business Expenses
- 533 Highlights of 2001 Tax Changes
- 583 Starting a Business and Keeping Records
- 1635 Understanding Your EIN

Items To Note

Furnishing Form W-2 to employees electronically.
You may set up a system to furnish Forms W-2 to employees who choose to receive them in this format beginning with Forms W-2 due after December 31, 2000. Each employee participating must consent electronically, and you must notify the employees of all hardware and software requirements to receive them. You may not send Form W-2 electronically to any employee who does not consent or who has revoked consent previously provided.

To furnish Forms W-2 electronically, you must meet the following disclosure requirements and provide a clear and conspicuous statement of each of them to your employees.

1) The employee must be informed that he or she may receive a paper Form W-2 if consent is not given to receive it electronically. The consent statement must be made electronically in a way that demonstrates that the employee can access the Form W-2 in the electronic form that will be used to furnish the statement.

2) The employee must be informed how to obtain a paper copy and whether any fee will be charged for a paper copy.

3) The employee may withdraw consent in writing at any time on 30 days notice. The employer will confirm the withdrawal in writing, and inform the employee of the consequences of the withdrawal.

4) The employer will notify the employee of the scope and duration of the consent.

5) The employer will inform the employee that the form may be required to be attached to his or her tax returns, and that the employee may need to print the forms.

The employer must furnish the electronic statements by the due date of the paper forms. The employer must notify the employees that the Forms W-2 will be posted on a web site by January 31. This notice may be delivered by mail, electronic mail, or in person.

For more information, see Temporary Regulation 31.6051-T.

Electronic deposit requirement. Certain employers are required to make deposits of employment taxes using the Electronic Federal Tax Payment System (EFTPS). If you are required to use EFTPS and fail to do so, you may be subject to a 10% penalty. See Circular E for more information.

If you are not required to use EFTPS, you may participate voluntarily. To enroll in or get more information about EFTPS, call 1-800-945-8400 or 1-800-555-4477 or visit the EFTPS Web Site at www.eftps.gov.

Electronic submission of Forms W-4, W-4P, W-4S, W-4V, and W-5. You may set up a system to electronically receive any or all of the following forms from an employee or payee.

- Form W-4, Employee's Withholding Allowance Certificate
- Form W-4P, Withholding Certificate for Pension or Annuity Payments
- Form W-4S, Request for Federal Income Tax Withholding From Sick Pay
- Form W-4V, Voluntary Withholding Request
- Form W-5, Employee's Advance Earned Income Credit Certificate

If you establish an electronic system to receive any of these forms, you do not need to process that form in a paper version.

For each form that you establish an electronic submission system for, you must meet the following requirements.

1) The electronic system must ensure that the information received by the payer is the information sent by the payee. The system must document all occasions of user access that result in a submission. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and submitting the form is the person identified on the form.

2) The electronic system must provide exactly the same information as the paper form.

3) The electronic submission must be signed with an electronic signature by the payee whose name is on the form. The electronic signature must be the final entry in the submission.

4) Upon request, you must furnish a hard copy of any completed electronic form to the IRS and a state-
ment that, to the best of the payer's knowledge, the electronic form was submitted by the named payee. The hard copy of the electronic form must provide exactly the same information as, but need not be a facsimile of, the paper form. For Forms W-4 and W-5, the signature must be under penalty of perjury, and must contain the same language that appears on the paper version of the form. The electronic system must inform the employee that he or she must make a declaration contained in the perjury statement and that the declaration is made by signing the Form W-4 or W-5.

5) You must meet all recordkeeping requirements that apply to the paper forms.

For more information, see:
- Form W-4—Regulations section 31.3402(f)(5)-1
- Form W-5—Announcement 99-3 (99-3 IRB 15)
- Forms W-4P, W-4S, and W-4V—Announcement 99-6 (99-4 IRB 24)

Photographs of Missing Children

The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this booklet on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

1. Who Are Employees?

Before you can know how to treat payments you make for services, you must first know the business relationship that exists between you and the person performing the services. The person performing the services may be—
- An independent contractor
- A common-law employee
- A statutory employee.
- A statutory nonemployee.

This discussion explains these four categories. A later discussion, Employee or Independent Contractor? (section 2), points out the differences between an independent contractor and an employee and gives examples from various types of occupations. If an individual who works for you is not an employee under the common-law rules (see section 2), you generally do not have to withhold Federal income tax from that individual's pay. However, in some cases you may be required to withhold under backup withholding requirements on these payments. See Circular E for information on backup withholding.

Independent Contractors

People such as lawyers, contractors, subcontractors, public stenographers, and auctioneers who follow an independent trade, business, or profession in which they offer their services to the public, are generally not employees. However, whether such people are employees or independent contractors depends on the facts in each case. The general rule is that an individual is an independent contractor if you, the person for whom the services are performed, have the right to control or direct only the result of the work and not the means and methods of accomplishing the result.

Common-Law Employees

Under common-law rules, anyone who performs services for you is your employee if you can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed. For a discussion of facts that indicate whether an individual providing services is an independent contractor or employee, see Employee or Independent Contractor? (section 2).

If you have an employer-employee relationship, it makes no difference how it is labeled. The substance of the relationship, not the label, governs the worker's status. Nor does it matter whether the individual is employed full time or part time.

For employment tax purposes, no distinction is made between classes of employees. Superintendents, managers, and other supervisory personnel are all employees. An officer of a corporation is generally an employee, however, an officer who performs no services or only minor services, and neither receives nor is entitled to receive any pay, is not considered an employee. A director of a corporation is not an employee with respect to services performed as a director.

You generally have to withhold and pay income, social security, and Medicare taxes on wages you pay to common-law employees. However, the wages of certain employees may be exempt from one or more of these taxes. See Employees of Exempt Organizations (section 3) and Religious Exemptions (section 4).

Leased employees. Under certain circumstances, a corporation furnishing workers to various professional people and firms is the employer of those workers for employment tax purposes. For example, a professional service corporation may provide the services of secretaries, nurses, and other similarly trained workers to its subscribers.

The service corporation enters into contracts with the subscribers under which the subscribers specify the services to be provided and the fee to be paid to the service corporation for each individual furnished. The service corporation has the right to control and direct the worker's services for the subscriber, including the right to discharge or reassign the worker. The service corporation hires the workers, controls the payment of their wages, provides them with unemployment insurance and other benefits, and is the employer for employment tax purposes. For
information on employee leasing as it relates to pension plan qualification requirements, see Leased employees in Pub. 560, Retirement Plans for Small Business (SEP, SIMPLE, and Keogh Plans).

Additional information. For more information about the treatment of special types of employment, the treatment of special types of payments, and similar subjects, get Circular E or Circular A (for agricultural employers).

Statutory Employees

If workers are independent contractors under the common law rules, such workers may nevertheless be treated as employees by statute ("statutory employees") for certain employment tax purposes if they fall within any one of the following four categories and meet the three conditions described under Social security and Medicare taxes, below.

1) A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.

2) A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.

3) An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name. If you also furnish specifications for the work to be done.

4) A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer’s business operation. The work performed for you must be the salesperson’s principal business activity. See Salesperson in section 2.

Social security and Medicare taxes. Withhold social security and Medicare taxes from the wages of statutory employees if all three of the following conditions apply.

- The service contract states or implies that substantially all the services are to be performed personally by them.
- They do not have a substantial investment in the equipment and property used to perform the services (other than an investment in transportation facilities).
- The services are performed on a continuing basis for the same payer.

Federal unemployment (FUTA) tax. For FUTA tax, the term employee means the same as it does for social security and Medicare taxes, except that it does not include statutory employees in categories 2 and 3 above, thus, any individual who is an employee under category 1 or 4 is also an employee for FUTA tax purposes and subject to FUTA tax.

Income tax. Do not withhold income tax from the wages of statutory employees.

Reporting payments to statutory employees. Furnish a Form W-2 to a statutory employee, and check "statutory employee" in box 13. Show your payments to the employee as other compensation in box 1. Also, show social security wages in box 3, social security tax withheld in box 4, Medicare wages in box 5, and Medicare tax withheld in box 6. The statutory employee can deduct his or her trade or business expenses from the payments shown on Form W-2. He or she reports earnings as a statutory employee on line 1 of Schedule C or C-EZ (Form 1040). (A statutory employee’s business expenses are deductible on Schedule C or C-EZ (Form 1040) and are not subject to the reduction by 2% of his or her adjusted gross income that applies to common-law employees.)

Statutory Nonemployees

There are two categories of statutory nonemployees. direct sellers and licensed real estate agents. They are treated as self-employed for all Federal tax purposes, including income and employment taxes, if:

1) Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked and

2) Their services are performed under a written contract providing that they will not be treated as employees for Federal tax purposes.

Direct sellers. Direct sellers include persons falling within any of the following three groups:

1) Persons engaged in selling (or soliciting the sale of) consumer products in the home or place of business other than in a permanent retail establishment.

2) Persons engaged in selling (or soliciting the sale of) consumer products to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis prescribed by regulations, for resale in the home or at a place of business other than in a permanent retail establishment.

3) Persons engaged in the trade or business of delivering or distributing newspapers or shopping news (including any services directly related to such delivery or distribution).

Direct selling includes activities of individuals who attempt to increase direct sales activities of their direct sellers and who earn income based on the productivity of their direct sellers. Such activities include providing motivation and encouragement; imparting skills, knowledge, or experience; and recruiting. For more information on direct sellers, see Pub. 911, Direct Sellers.
Licensed real estate agents. This category includes individuals engaged in appraisal activities for real estate sales if they earn income based on sales or other output.

Misclassification of Employees

Consequences of treating an employee as an independent contractor. If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker (the relief provisions, discussed below, will not apply). See Internal Revenue Code section 3509 for more information.

Relief provisions. If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker. To get this relief, you must file all required Federal information returns on a basis consistent with your treatment of the worker. You (or your predecessor) must have treated any worker holding a substantially similar position as an employee for any periods beginning after 1977.

Technical service specialists. This relief provision does not apply to a worker who provides services to another business (the client) as a technical service specialist under an arrangement between the business providing the worker, such as a technical services firm, and the client. A technical service specialist is an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work.

This rule does not affect the determination of whether such workers are employees under the common-law rules. The common-law rules control whether the specialist is treated as an employee or an independent contractor. However, if you directly contract with a technical service specialist to provide services for your business rather than for another business, you may still be entitled to the relief provision. See Employee or Independent Contractor? below.

2. Employee or Independent Contractor?

An employer must generally withhold income taxes, withhold and pay social security and Medicare taxes, and pay unemployment tax on wages paid to an employee. An employer does not generally have to withhold or pay any taxes on payments to independent contractors.

Common-Law Rules

To determine whether an individual is an employee or an independent contractor under the common law, the relationship of the worker and the business must be examined. All evidence of control and independence must be considered. In any employee-independent contractor determination, all information that provides evidence of the degree of control and the degree of independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties. These facts are discussed below.

Behavioral control. Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include the type and degree of—

Instructions the business gives the worker. An employer is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work:

- When and where to do the work
- What tools or equipment to use
- What workers to hire or to assist with the work
- Where to purchase supplies and services
- What work must be performed by a specified individual
- What order or sequence to follow

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

Training the business gives the worker. An employer may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

Financial control. Facts that show whether the business has a right to control the business aspects of the worker's job include:

The extent to which the worker has unreimbursed business expenses. Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services they perform for their business.

The extent of the worker's investment. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status

The extent to which the worker makes services available to the relevant market. An independent contractor is generally free to seek out business opportunities.
Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

*How the business pays the worker.* An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

*The extent to which the worker can realize a profit or loss.* An independent contractor can make a profit or loss.

**Type of relationship.** Facts that show the parties’ type of relationship include:

- **Written contracts describing the relationship the parties intended to create.**

- **Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.**

- **The permanency of the relationship.** If you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that your intent was to create an employer-employee relationship.

- **The extent to which services performed by the worker are a key aspect of the regular business of the company.** If a worker provides services that are a key aspect of your regular business activity, it is more likely that you will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney’s work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

**IRS help.** If you want the IRS to determine whether a worker is an employee, file Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with the IRS.

**Industry Examples**

The following examples may help you properly classify your workers.

**Building and Construction Industry**

*Example 1.* Jerry Jones has an agreement with Wilma White to supervise the remodeling of her house. She did not advance funds to help him carry on the work. She makes direct payments to the suppliers for all necessary materials. She carries liability and workers’ compensation insurance covering Jerry and others he engaged to assist him. She pays them an hourly rate and exercises almost constant supervision over the work. Jerry is not free to transfer his assistants to other jobs. He may not work on other jobs while working for Wilma. He assumes no responsibility to complete the work and will incur no contractual liability if he fails to do so. He and his assistants perform personal services for hourly wages. They are employees of Wilma White.

*Example 2.* Milton Manning, an experienced tilesetter, orally agreed with a corporation to perform full-time services at construction sites. He uses his own tools and performs services in the order designated by the corporation and according to its specifications. The corporation supplies all materials, makes frequent inspections of his work, pays him on a piecework basis, and carries workers’ compensation insurance on him. He does not have a place of business or hold himself out to perform similar services for others. Either party can end the services at any time. Milton Manning is an employee of the corporation.

*Example 3.* Wallace Black agreed with the Sawdust Co. to supply the construction labor for a group of houses. The company agreed to pay all construction costs. However, he supplies all the tools and equipment. He performs personal services as a carpenter and mechanic for an hourly wage. He also acts as superintendent and foreman and engages other individuals to assist him. The company has the right to select, approve, or discharge any helper. A company representative makes frequent inspections of the construction site. When a house is finished, Wallace is paid a certain percentage of its cost. He is not responsible for faults, defects of construction, or wasteful operation. At the end of each week, he presents the company with a statement of the amount he has spent, including the payroll. The company gives him a check for that amount from which he pays the assistants, although he is not personally liable for their wages. Wallace Black and his assistants are employees of the Sawdust Co.

*Example 4.* Bill Plum contracted with Elm Corporation to complete the roofing on a housing complex. A signed contract established a flat amount for the services rendered by Bill Plum. Bill is a licensed roofer and carries workers’ compensation and liability insurance under the business name, Plum Roofing. He hires his own roofers who are treated as employees for Federal employment tax purposes. If there is a problem with the roofing work, Plum Roofing is responsible for paying for any repairs. Bill Plum, doing business as Plum Roofing, is an independent contractor.

*Example 5.* Vera Elm, an electrician, submitted a job estimate to a housing complex for electrical work at $16 per hour for 400 hours. She is to receive $1,280 every 2 weeks for the next 10 weeks. This is not considered payment by the hour. Even if she works more or less than 400 hours to complete the work, Vera Elm will receive $6,400. She also performs additional electrical installations under contracts with other companies, which she obtained through advertisements. Vera is an independent contractor.
Trucking Industry

**Example.** Rose Trucking contracts to deliver material for Forest Inc. at $140 per ton. Rose Trucking is not paid for any articles that are not delivered. At times, Jan Rose, who operates as Rose Trucking, may also lease another truck and engage a driver to complete the contract. All operating expenses, including insurance coverage, are paid by Jan Rose. All equipment is owned or rented by Jan, and she is responsible for all maintenance. None of the drivers are provided by Forest Inc. Jan Rose, operating as Rose Trucking, is an independent contractor.

Computer Industry

**Example.** Steve Smith, a computer programmer, is laid off when Megabyte Inc. downsizes. Megabyte agrees to pay Steve a flat amount to complete a one-time project to create a certain product. It is not clear how long it will take to complete the project, and Steve is not guaranteed any minimum payment for the hours spent on the project. Megabyte provides Steve with no instructions beyond the specifications for the product itself. Steve and Megabyte have a written contract, which provides that Steve is considered to be an independent contractor, is required to pay Federal and state taxes, and receives no benefits from Megabyte. Megabyte will file a Form 1099-MISC. Steve does the work on a new high-end computer which cost him $7,000. Steve works at home and is not expected or allowed to attend meetings of the software development group. Steve is an independent contractor.

Automobile Industry

**Example 1.** Donna Lee is a salesperson employed on a full-time basis by Bob Blue, an auto dealer. She works 6 days a week and is on duty in Bob's showroom on certain assigned days and times. She appraises trade-ins, but her appraisals are subject to the sales manager's approval. Lists of prospective customers belong to the dealer. She has to develop leads and report results to the sales manager. Because of her experience, she requires only minimal assistance in closing and financing sales and in other phases of her work. She is paid a commission and is eligible for prizes and bonuses offered by Bob. Bob also pays the cost of health insurance and group-term life insurance for Donna. Donna is an employee of Bob Blue.

**Example 2.** Sam Sparks performs auto repair services in the repair department of an auto sales company. He works regular hours and is paid on a percentage basis. He has no investment in the repair department. The sales company supplies all facilities, repair parts, and supplies; issues instructions on the amounts to be charged, parts to be used, and the time for completion of each job; and checks all estimates and repair orders. Sam is an employee of the sales company.

**Example 3.** An auto sales agency furnishes space for Helen Bach to perform auto repair services. She provides her own tools, equipment, and supplies. She seeks out business from insurance adjusters and other individuals and does all the body and paint work that comes to the agency. She hires and discharges her own helpers, determines her own and her helpers' working hours, quotes prices for repair work, makes all necessary adjustments, assumes all losses from uncollectible accounts, and receives, as compensation for her services, a large percentage of the gross collections from the auto repair shop. Helen is an independent contractor and the helpers are her employees.

Attorney

**Example.** Donna Yuma is a sole practitioner who rents office space and pays for the following items: telephone, computer, on-line legal research linkup, fax machine, and photocopier. Donna buys office supplies and pays bar dues and membership dues for three other professional organizations. Donna has a part-time receptionist who also does the bookkeeping. She pays the receptionist, holds and pays Federal and state employment taxes, and files a Form W-2 each year. For the past 2 years, Donna has had only three clients, corporations with which there have been long-standing relationships. Donna charges the corporations an hourly rate for her services, sending monthly bills detailing the work performed for the prior month. The bills include charges for long distance calls, on-line research time, fax charges, photocopies, postage, and travel, costs for which the corporations have agreed to reimburse her. Donna is an independent contractor.

Taxicab Driver

**Example.** Tom Spruce rents a cab from Taft Cab Co for $150 per day. He pays the costs of maintaining and operating the cab. Tom Spruce keeps all fares he receives from customers. Although he receives the benefit of Taft's two-way radio communication equipment, dispatcher, and advertising, these items benefit both Taft and Tom Spruce. Tom Spruce is an independent contractor.

Salesperson

To determine whether salespersons are employees under the usual common-law rules, you must evaluate each individual case. If a salesperson who works for you does not meet the tests for a common-law employee, discussed earlier, you do not have to withhold income tax from his or her pay (see Statutory Employees earlier). However, even if a salesperson is not an employee under the usual common-law rules, his or her pay may still be subject to social security, Medicare, and FUTA taxes. To determine whether a salesperson is an employee for social security, Medicare, and FUTA tax purposes, the salesperson must meet all eight elements of the statutory employee test: A
salesperson is a statutory employee for social security, Medicare, and FUTA tax purposes if he or she:

1) Works full time for one person or company except, possibly, for side line sales activities on behalf of some other person,
2) Sells on behalf of, and turns his or her orders over to, the person or company for which he or she works,
3) Sells to wholesalers, retailers, contractors, or operators of hotels, restaurants, or similar establishments,
4) Sells merchandise for resale, or supplies for use in the customer's business,
5) Agrees to do substantially all of this work personally,
6) Has no substantial investment in the facilities used to do the work, other than in facilities for transportation,
7) Maintains a continuing relationship with the person or company for which he or she works, and
8) Is not an employee under common-law rules.

3. Employees of Exempt Organizations

Many nonprofit organizations are exempt from income tax. Although they do not have to pay income tax themselves, they must still withhold income tax from the pay of their employees. However, there are special social security, Medicare, and Federal unemployment (FUTA) tax rules that apply to the wages they pay their employees.

Section 501(c)(3) organizations. Nonprofit organizations that are exempt from income tax under section 501(c)(3) of the Internal Revenue Code include any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, fostering national or international amateur sports competition, or for the prevention of cruelty to children or animals. These organizations are usually corporations and are exempt from income tax under section 501(a).

Social security and Medicare taxes. Wages paid to employees of section 501(c)(3) organizations are subject to social security and Medicare taxes unless one of the following situations applies.

1) The organization pays an employee less than $100 in a calendar year.
2) The organization is a church or church-controlled organization opposed for religious reasons to the payment of social security and Medicare taxes and has filed Form 8274, Certification by Churches and Qualified Church-Controlled Organizations Electing Exemption From Employer Social Security and Medicare Taxes, to elect exemption from social security and Medicare taxes. The organization must have filed for exemption before the first date on which a quarterly employment tax return (Form 941) would otherwise be due.

An employee of a church or church-controlled organization that is exempt from social security and Medicare taxes must pay self-employment tax if the employee is paid $108.28 or more in a year. However, an employee who is a member of a qualified religious sect can apply for an exemption from the self-employment tax by filing Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits. See Members of recognized religious sects opposed to insurance in section 4.

Federal unemployment tax. An organization that is exempt from income tax under section 501(c)(3) of the Internal Revenue Code is also exempt from the Federal unemployment (FUTA) tax. This exemption cannot be waived.

Note: An organization wholly owned by a state or its political subdivision should contact the appropriate state official for information about reporting and getting social security and Medicare coverage for its employees.

Other than section 501(c)(3) organizations. Nonprofit organizations that are not section 501(c)(3) organizations may also be exempt from income tax under section 501(a) or section 521. However, these organizations are not exempt from withholding income, social security, or Medicare tax from their employees' pay, or from paying FUTA tax. Two special rules for social security, Medicare, and FUTA taxes apply.

1) If an employee is paid less than $100 during a calendar year, his or her wages are not subject to social security and Medicare taxes.
2) If an employee is paid less than $50 in a calendar quarter, his or her wages are not subject to FUTA tax for the quarter.

The above rules do not apply to employees who work for pension plans and other similar organizations described in section 401(a).

4. Religious Exemptions

Special rules apply to the treatment of ministers for social security purposes. An exemption from social security is available for ministers and certain other religious workers and members of certain recognized religious sects. For more information on getting an exemption, see Pub. 517, Social Security and Other Information for Members of the Clergy and Religious Workers.

Ministers. Ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination. They are given the authority to conduct religious worship, perform sacramental functions, and administer ordainances and sacraments according to the prescribed tenets and practices of that religious organization.