



DEPARTMENT OF EDUCATION

**Dr. Jennifer McCormick**  
Superintendent of Public Instruction

*Working Together for Student Success*

## MEMORANDUM

**To:** Superintendents  
Federal Program Administrators  
Treasurers

**From:** Brenda Martz, State Equitable Services Ombudsman  
Nathan Williamson, Director of Title Grants & Support

**Date:** August 10, 2018

**RE:** IRS Potential Penalties Related to the Provision of Equitable Services: All LEAs with Nonpublic Schools

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*Please note that below does not represent legal advice nor represents information on behalf of the Internal Revenue Service (IRS). This memo solely serves as technical assistance, and further requests for information or support should be directed to local counsel or IRS staff.*

The *Every Student Succeeds Act* (ESSA) requires all LEAs who receive federal funding under covered programs, such as Title I, A and programs governed under Title VIII, to provide equitable services to eligible nonpublic students, teachers, and families. After timely and meaningful consultation with appropriate nonpublic school officials, federal regulations allow the LEA to determine the manner in which the equitable services are provided, either through the LEA directly, hire nonpublic educators beyond the school day, or contract with a third party vendor.

No matter the method chosen, the LEA retains the responsibility to ensure that the equitable services are provided only to eligible children and teachers, remain secular in nature, and meet the intents and purposes of the federal program. As such, the LEA must provide regular oversight to the instructional program at the nonpublic school(s).

**This causes an inherent compliance concern** with the IRS when an LEA chooses to contract with individuals as independent contractors, rather than employees, in order to deliver equitable services. Due to the oversight that the LEA must provide, the IDOE recommends the LEA hire staff delivering equitable services as employees, including through supplemental contracts, or contract with a third party vendor. Contracting with individuals should be avoided unless the individual is paid as an employee and all appropriate withholdings are followed. This includes payment of any stipends to nonpublic school teachers for attending training offered by the LEA.

During recent IRS audits of at least three Indiana schools, the IRS issued determinations against the schools for failing to treat nonpublic school teachers as employees. The IRS determined that the teachers with whom the LEAs contracted to provide equitable services to nonpublic school students were not independent contractors. Instead, the IRS determined that these teachers were common law employees of the school district per Employment Tax Treasury Regulations §§31.3121(d)-1 and 31.34019c)-1, which define an employee as an individual whom the entity paying the individual has

the right to control what the individual does and how the individual does his or her job. Thus, the IRS determined that the LEAs should have withheld the federal taxes typically withheld for all of its employees, i.e. FICA, disability and Medicare see §§ 3102 and 3111.

These teachers also participated in professional development opportunities along with the LEA teachers, and, like the teachers employed full-time by the LEA, received stipends for attendance at professional development events that occurred outside the regular school day. The IRS determined that the stipends were wages, meaning the LEAs were required to withhold income taxes on wages.

The IRS further determined that the LEAs had not met the requirements needed for relief under Section 530 of the Revenue Act of 1978, which acts as a safe harbor from the statutory penalties that can be levied against an employer when the IRS determines that individuals were not properly treated as employees. As a result, the audited school districts were subject to statutory penalties. The IRS and the LEAs, however, entered into agreements under the Classification Settlement Program (CSP) wherein the LEAs agreed to begin treating nonpublic teachers and staff as employees of the LEA and agreed to a one-time assessment of roughly 10% of the total payments due under IRC 3509(a).

### **Additional Administrative Costs:**

Many LEAs currently contract with nonpublic school teachers to provide services on behalf of the LEA to eligible nonpublic school students. Treating these individuals as employees will result in increased administrative burdens on the LEAs, which will also result in increased human resource and payroll costs. From the proportionate share of Title I funds available to provide equitable services, an LEA may reserve an amount that is reasonable and necessary<sup>1</sup> for administrative expenses. See 34 CFR § 200.77(f). LEAs must determine this amount separately from the funds needed to administer the Title I program for students enrolled at the LEA. LEAs must discuss the administrative costs for implementing equitable services during consultation with appropriate nonpublic school officials, even if that causes an additional consultation meeting to be held.

### **Title II and Professional Development:**

The Department is aware that LEAs often pay stipends to LEA and non-LEA teachers who participate in professional development opportunities outside the normal school hours. LEAs use their Title II allocations to pay for the stipends as well as the costs associated with professional development for both the LEA and non-LEA teachers. Based on the findings by the IRS, schools will need to consider how professional development—specifically stipends—will be handled going forward. There are numerous scenarios for how professional development is provided to LEA and non-LEA teachers. This guidance is not intended to direct schools on the manner in which professional development is provided. However, if a school pays a stipend, which is considered wages, to either LEA or non-LEA teachers, the school will likely be required to withhold income taxes for those teachers. For nonpublic teachers, this means the LEA will need to treat them as employees.

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<sup>1</sup> The concept of “reasonable and necessary” costs comes from federal regulations known as the Uniform Grant Guidance (UGG). See, for example, the discussion in Basic Considerations of the UGG, available at [https://www.ecfr.gov/cgi-bin/textidx?SID=1ab34260fd33363573a554baedb4aa24&mc=true&node=pt2.1.200&rgn=div5#sg2.1.200\\_1401.sg12](https://www.ecfr.gov/cgi-bin/textidx?SID=1ab34260fd33363573a554baedb4aa24&mc=true&node=pt2.1.200&rgn=div5#sg2.1.200_1401.sg12).