



CHURCH
PENSION FUND

2013 Federal Reporting Requirements For Episcopal Churches

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Dear Treasurers, Wardens and Administrators,

In keeping with the Church Pension Fund's ongoing commitment to conserving our natural and financial resources, this year the *2013 Federal Reporting Requirements for Episcopal Churches* is being offered primarily as an online booklet, with a print-on-demand option. To download a copy, go to www.cpg.org/taxpubs and click "Administrators."

The *2013 Clergy Tax Guide* also is being disseminated online, with a print-on-demand option. To access that document, please go to www.cpg.org/taxpubs and click the "Active Clergy" or "Retired Clergy" options.

Faithfully,

A handwritten signature in blue ink that reads "Mary Kate Wold".

Mary Kate Wold
President and CEO

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The most important federal reporting obligation for most churches is the withholding and reporting of employee income taxes and Social Security taxes. These payroll reporting requirements apply, in whole or in part, to almost every church. **Note:** The term “church” is used broadly throughout this publication and refers to actions taken by the vestry and/or the congregation, depending on the nature of the action.

Many of the reporting obligations covered in *Federal Reporting Requirements for Episcopal Churches* can be met by using a payroll services provider.

Key Point

The American Taxpayer Relief Act of 2012 does not extend the “payroll tax holiday” reduction in Social Security taxes after 2012. This means that the employee’s share of Social Security taxes will increase from 4.2% in 2012 to 6.2% in 2013 (the employer’s share of Social Security was not affected). The self-employed worker’s Social Security tax will increase from 10.4% of self-employment earnings in 2012 to 12.4% in 2013.

Warning

Federal law specifies that any corporate officer, director, or employee who is responsible for withholding taxes and paying them over to the government may be liable for a penalty in the amount of 100% of such taxes if they are either not withheld or not paid over to the government. This penalty is of special relevance to church leaders, given the high rate of non-compliance by churches with payroll reporting procedures.

A number of special rules apply to churches:

1. **A definition of “minister” for IRS tax purposes.** Although all Christians are ministers, theologically speaking, for tax purposes the IRS designation of “minister” applies in the Episcopal Church exclusively to ordained ministers — bishops, priests, and deacons.
2. **Ministers are always self-employed for Social Security purposes with respect to their church compensation.** While most ministers are employees for federal income tax reporting purposes, they are self-employed for Social Security with respect to their church compensation. This means that they pay the “self-employment tax” (SECA) rather than the employee’s share of Social Security and

Medicare taxes — even if they report their federal income taxes as a church employee. It is incorrect for churches to treat ministers as employees for Social Security purposes and to withhold the employee's share of Social Security and Medicare taxes from their wages.

3. **A minister's wages are exempt from compulsory income tax withholding, whether the minister reports his/her income taxes as an employee or as self-employed.** Ministers may enter into a voluntary withholding agreement with their employing church.
4. **Because of liabilities attached to vestries and rectors, consider using a professional payroll service.** A payroll service makes tax payments, files tax reports, and produces all year-end paperwork.

Using a payroll service places responsibility on a third party, guarantees your employees are paid on time, and relieves the treasurer of producing W-2 Forms, 1099 Forms, and end-of-year tax reconciliations.

Small Employer Health Care Tax Credit

In 2010, the Patient Protection and Affordable Care Act established the Small Employer Health Care Tax Credit for small employers that have no more than 25 full-time equivalent employees with average wages of \$50,000 or less, and pay at least 50% of the premium for single coverage and pay a uniform percentage of the premium cost of all workers. The tax credit can be up to 25% of the premiums paid for health benefits and will take the form of a refundable credit limited to certain payroll taxes. Church institutions will claim the credit by completing Form 8941 (Credit for Small Employers Health Insurance Premiums) and filing Form 990-T, which is generally due by May 15, 2013. In February of 2013, the Medical Trust will provide all diocesan administrators with updated information on this tax credit. Consult your diocesan administrator or tax advisor if you believe your institution is eligible.

Maximizing Tax Benefits for Your Minister

Special Notes for New Clergy

- When negotiating the contract for a new minister, make certain that a proper housing allowance resolution has been adopted by the vestry (or other governing body) **before** compensation is earned.
- Also when negotiating contracts, arrange for reimbursable expense plans for automobile and other necessary business expenses.
- Recommend that the minister begin a personal retirement savings through a Section 403(b) (salary reduction plan) as soon as possible.

- Discretionary funds are the property of the church. The minister must use them only for proper purposes, and be ready to account to the church for such funds.
- Make certain the compensation details have been properly reported to the Church Pension Fund, and that regular payments are being made to the Church Pension Fund for required contributions to benefit plans.
- If you have questions, contact either of the following before taking action:
Matt Chew (877) 305-1414
Bill Geisler (877) 305-1415

Special Notes for Churches Hiring Those Receiving Pensions

- The pension received by a minister from the Episcopal Church, as well as the one-time resettlement benefit and distributions from the Church Pension Fund's Section 403(b) (RSVP) are designated as housing allowance for federal income tax purposes. To the extent that these amounts are spent for qualified expenses for the minister's primary residence, they may be excluded from taxation, subject to the housing allowance limitations.
- Earnings from ministerial services after retirement are also eligible for designation as housing allowance. If a minister's Church Pension Fund benefits and withdrawals from an RSVP plan are enough to cover qualified housing costs, he/she should not request additional housing allowance designation for any compensation for ministerial services.
- Self-employment tax (SECA) is due on all earned income, even if the minister is retired and collecting Social Security. The cleric should include any earned housing allowance and/or the fair rental value of any church-provided housing. Failure by the cleric to include the proper value of such housing could result in additional tax liabilities, plus interest and penalties. If this income is not reported, the statute of limitations on assessing tax adjustments may not apply.
- Housing provided to ministers employed for a short time away from home (short time is generally considered to be a contract for one year or less) in some cases can be treated as a reimbursable business expense and not be subject to income tax. Contracts for an indefinite period, or a specific period of more than one year, would not qualify for such exclusion. Such arrangements could result in moving the minister's "tax home" (primary residence). **Be very careful about the wording of interim ministry contracts.**

- Pensions are not earned income and therefore are not subject to self-employment tax (SECA), except possibly retirement benefits paid from a nonqualified deferred compensation plan.
- Moving expenses are not deductible unless the minister is moving at least 50 miles to a new, full-time position. See Form 3903.
- If the minister is covered by Medicare and accepts a position that qualifies for employer-provided medical insurance, it is **important** that the minister talk with a Medicare representative. It is likely that Medicare would expect the employer's insurance to become the minister's primary coverage. Likewise, when leaving such a position, it is again **important** that the minister contact Medicare to ensure proper coverage.
- Be aware of one important reporting requirement that is a "retirement plan" requirement, rather than a "federal" requirement. Some retired ministers who return to work may be considered to have "returned to active ministry" under the plan rules of the Church Pension Fund. To avoid such a determination, which may result in suspension of pension benefits and re-imposition of pension assessments, some retired ministers must receive the written permission of their "ecclesiastical authority" (usually their bishop), file a "Work After Retirement" application, and be granted an exception to the plan rule by a Church Pension Fund committee. Please note that all retired ministers returning to the paid employ of the parish or church organization from which they retired must undergo this procedure; others (those returning to work in a parish or organization other than the one from which they retired) must do so only if their compensation reaches 50% of the median compensation of U.S. Episcopal clergy as reported each year by the Church Pension Fund (for 2013, that limit is \$35,500 in salary and housing allowance; parish-provided housing does not count toward this limit). Note that not all clerics qualify for an exception to the plan rule; only those who are at least 65 years of age and have at least 25 years of credited service are eligible. No exception is required for clerics age 72 or over. Other strict limits and conditions also apply. Exceptions are granted rarely and for one year only (may be extended in some cases for an additional year). For more details, go to www.cpg.org and search for "Work After Retirement."
- If you have questions, it is always better to call our tax line before taking action. (See tax line information on page 2.)

Housing Allowance

The most important tax benefit available to ministers who own or rent their home is the housing allowance exclusion. Unfortunately, many churches fail to designate a portion of their minister's compensation as a housing allowance, and thereby deprive the minister of an important tax benefit.

A housing allowance is simply a portion of a minister's compensation that is so designated in advance by the minister's employing church. For example, in December of 2012 a church agrees to pay its minister "total compensation" of \$45,000 for 2013, and, **at the request of the minister**, designates \$15,000 of this amount as a housing allowance (the remaining \$30,000 is salary). **This "costs" the church nothing.** It is simply a matter of designating part of a minister's salary as "housing allowance."

The Internal Revenue Code ("Tax Code") specifies that the housing allowance of a minister who owns or rents a home is nontaxable in computing federal income taxes to the extent that it is

1. declared in advance,
2. used for qualified housing expenses, and
3. does not exceed the fair rental value of the minister's home, furnished, plus utilities.

! Key Point

The housing resolution should ordinarily equal the fair rental value of the clergy-provided housing, unless the minister expects the housing expenses to be substantially less.

! Key Point

Note that it is the responsibility of the ordained employee who owns or rents his/her home to determine the fair rental value, furnished, plus utilities of that home; and — unless the housing allowance resolution amount suggested by the ordained employee exceeds his/her compensation — the employer or vestry should accept and duly approve it.

! Key Point

Under no circumstances can a church designate a housing allowance retroactively. Although the costs of a mortgage qualify as part of the housing allowance, costs associated with refinancing a principal residence or with a home equity loan qualify only if the proceeds are used for acquiring or maintaining a principal residence.

⚠ Key Point

Congress enacted the Clergy Housing Allowance Clarification Act in 2002. This act amended the Tax Code to limit the nontaxable portion of a church-designated housing allowance for ministers who own or rent their home to the fair rental value, furnished, plus utilities. As a result, ministers who own a home do not include the portion of their salary designated in advance by their church as a housing allowance as income in computing their federal income taxes to the extent that the allowance is used to pay for expenses incurred in owning the home (such as mortgage payments, utilities, repairs, property taxes, property insurance, and furnishings) and does not exceed the fair rental value of the home, furnished, plus utilities.

Ministers who live in “rent free” church-provided housing as compensation for ministerial services do not include the annual fair rental value of church-provided housing as income in computing their federal income taxes. The annual fair rental value is not “deducted” from the minister’s income. Neither is it reported as additional income anywhere on Form W-2.

Note, however, that an income tax exclusion that functions much like the clergy housing allowance resolution described above for clerics who own or rent also may be available to clerics in church-provided housing. In this case, the housing allowance resolution amount would be — NOT the fair rental value itself — but the added value that the cleric’s own furnishings bring to the fair rental value of the church-provided housing. Also note that determining these two values (the fair rental value plus the value that personal furnishings add to a fair rental value) is the responsibility of the ordained employee, NOT the employer or vestry.

Please note that qualified housing expenses for clerics who own/rent or the fair rental value of “rent free” church-provided housing are nontaxable when computing federal income taxes and most — though not all — state income taxes, but they are NOT nontaxable when computing self-employment taxes. Ministers who own or rent **may NOT exclude** housing allowance amounts from income when computing self-employment taxes. Ministers in church-provided housing **MUST include** the fair-rental value of church-provided housing as income when computing self-employment taxes.

⚠ Key Point

The housing allowance approved by the church should be included in the stipend reported to the Church Pension Fund.

⚠ Key Point

Church treasurers should be sure that the designation of a housing allowance for the following tax year is on the agenda of the church for one of its business meetings of the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS **may** recognize designations included in employment contracts and budget line items — assuming in each case that the church duly adopted the designation in advance — but these designations do not comply with Section 107 of the Internal Revenue Code and therefore may not be accepted by all IRS agents.

See this page and the next for two sample housing allowance resolutions from the vestry or other church governing body. Notice the use in both examples of so-called “safety-net” language (“and all future years unless otherwise provided”). Such language ensures that the previous year’s housing allowance figure will be effective in the new year even if the employer neglects to resolve an updated amount.

Sample housing allowance resolution for a minister who owns or rents his/her home:

The following resolution was duly adopted by the vestry of Christ Church at a regularly scheduled meeting held on December 13, 2012, a quorum being present:

Whereas, the Reverend Samuel Johnson is compensated by Christ Church exclusively for the services as a minister of the gospel; and

Whereas, Christ Church does not provide Fr. Johnson with a rectory, therefore, it is hereby

Resolved, that the total compensation paid to Fr. Johnson for calendar year 2013 shall be \$50,000 of which \$15,000 is hereby designated to be a housing allowance; and it is further

Resolved, that the designation of \$15,000 as a housing allowance shall apply to calendar year 2013 and all future years unless otherwise provided.

Sample housing allowance resolution for a minister who lives in a church-provided rectory:

The following resolution was duly adopted by the vestry of Grace Church at a regularly scheduled meeting held on December 13, 2012, a quorum being present:

Whereas, the Reverend John Smith is compensated by Grace Church exclusively for services as a minister of the gospel; and

Whereas, Grace Church provides Fr. Smith with rent-free use of a church-provided rectory as compensation for services that he renders to the church in the exercise of his ministry; and

Whereas, Fr. Smith incurs expenses for living in church provided housing; therefore it is hereby

Resolved, that the annual compensation paid to Fr. Smith for calendar year 2013 shall be \$50,000, of which, \$5,000 is hereby designated to be a housing allowance pursuant to Section 107 of the Internal Revenue Code, and it is further

Resolved, that the designation of \$5,000 as a housing allowance shall apply to calendar year 2013 and all future years unless otherwise provided by the vestry; and it is further

Resolved, that as additional compensation to Fr. Smith for calendar year 2013 and for all future years unless otherwise provided for by this vestry, Fr. Smith shall be permitted to live in the church-provided rectory located at 123 Main Street, and that no rent or other fee shall be payable by Fr. Smith for such occupancy and use.

Accountable reimbursements

The best way for ministers to handle their ministry-related business expenses is to have their employing church adopt an “accountable” expense reimbursement arrangement. An accountable arrangement is one that meets the following four requirements:

1. Only business expenses are reimbursed.
2. No reimbursement without an adequate accounting of expenses within a reasonable period of time (not more than 60 days after an expense is incurred).
3. Any excess reimbursement or allowance must be returned to the employer within a reasonable period of time (not more than 120 days after an excess reimbursement is paid).
4. An employer’s reimbursements must come out of the employer’s funds and not by reducing the employee’s salary.

Under an accountable plan, reimbursements of business expenses are not reported as taxable income on the minister's Form W-2 or Form 1040, and there are no deductions for the minister to claim. In effect, the minister is reporting to the church rather than to the IRS. Such a plan — which translates into significant tax savings for the minister — is the best way for a church and a minister to handle reimbursements of business expenses.

An accountable business expense reimbursement arrangement should be established by the vestry in an appropriate resolution. In adopting a resolution, pay special attention to the following rules:

1. **Condition the reimbursement of any expense on adequate substantiation:** written evidence for all expenses, substantiating the amount, date, place, and business nature of each expense, plus receipts for expenses of \$75 or more.

Key Point

A church must require the same degree of substantiation required for a deduction on the minister's income tax return.

2. Expenses must be substantiated, and excess reimbursements returned to the church, within a reasonable time. Expenses will be deemed substantiated within a reasonable time if they are substantiated within 60 days. Excess reimbursements will be deemed to be returned to the employer within a reasonable time if they are returned within 120 days.

Churches occasionally reimburse ministers for nonbusiness expenses. Such reimbursements, though they require an accounting, ordinarily must be included in the minister's wages for income tax reporting purposes, and they are not deductible by the minister. Such personal, living, or family expenses are not deductible, and the entire amount of a church's reimbursement must be included on the minister's Form W-2 and Form 1040.

Medical Insurance Reimbursement Plan — Section 106

Pursuant to Section 106 of the Tax Code, it is permissible for an employee to reduce his or her taxable compensation by the amount of medical insurance premiums paid by the church, either directly or through reimbursement of premiums paid by the employee (this assumes that the church confirms prior to the reimbursement that the employee, in fact, paid the premiums).

Mass Transit Benefits

For 2012 and 2013, the exclusion for employer-provided parking reimbursement as well as van pooling and mass transit reimbursement will be \$240 and \$245 per month respectively.

Flexible Spending Accounts

A church or employing organization may set up a flexible spending account for ministers and lay employees. A flexible spending account utilizes a salary reduction agreement for the purpose of reimbursing ministers and lay employees for certain health care and dependent care expenses.

Section 125 of the Tax Code allows salary reductions for a flexible spending account if these conditions are met:

1. the salary reduction is established in advance (this is interpreted to mean prior to both the compensation and the expense);
2. reimbursement is made only when a bona fide expense has been incurred by the participant;
3. the participant agrees to forfeit any unused balance in the account at the end of the plan year (although see the “grace period” Key Point below);
4. the plan must be properly structured (contact a CPA or attorney experienced in such programs) and formally adopted by the vestry;
5. The maximum amount available for reimbursement of incurred medical expenses of an employee, the employee’s dependents, and any other eligible beneficiaries with respect to the employee, under the health FSA for a plan year after 2012 must not exceed \$2,500. The \$2,500 limitation is indexed to the CPI-U (consumer price index — urban areas) with any increase that is not a multiple of \$50 rounded to the next lowest multiple of \$50 for years beginning after December 31, 2012.

❗ Key Point

The IRS has amended the “use it or lose it” rule for flexible spending accounts. The amendment allows employers to amend their flexible spending accounts to provide for a “grace period” of 2½ months. Expenses for qualified benefits incurred during the grace period may be paid or reimbursed from benefits or contributions remaining unused at the end of the immediately preceding plan year.

Health Care Spending Accounts

These accounts allow an employee (ordained or lay) to set aside pre-tax dollars to pay for eligible medical, dental, vision, and hearing care expenses. Unspent amounts carry over to the following year. Eligible expenses include:

- special equipment such as crutches, wheelchairs, guide dogs, and artificial limbs;

- deductibles or co-payments required by either the employee or his or her spouse's medical or dental plan;
- expenses that exceed the employee's medical or dental coverage, such as physical exams and orthodontics;
- hearing aids;
- vision exams, eyeglasses, contact lenses;
- co-payment for prescription drugs, insulin, birth control pills;
- psychoanalyst and psychologist fees not covered under the medical plan;
- exercise expenses (including the cost of equipment to use in the home) if required to treat an illness (including obesity) diagnosed by a physician, and the purpose of the expense is to treat a disease rather than to promote general health and the taxpayer would not have paid the expense but for this purpose.

Some church employers offer medical reimbursement arrangements for medical expenses that are not reimbursed by a medical plan. These arrangements are not subject to income tax or Social Security tax if they are provided as a group plan established to reimburse employees for medical expenses not covered by the plan (for example, deductibles, coinsurance). For more information, see IRS Publication 535.

Section 403(b) Plans

Contributions to the Retirement Savings Program (RSVP), administered by the Church Life Insurance Corporation, or to other retirement income accounts for employees, are not reportable income for tax purposes as long as these payments do not exceed contribution limits under Code Sections 415 and 402(g). See IRS Publication 571.

Complying With Federal Payroll Tax

❗ Key Point

You may be eligible for the Small Employer Health Care Credit for tax year 2012. See page 2 of this booklet.

Reporting Obligations

Step 1. Obtain an employer identification number (EIN) from the federal government if this has not been done.

This number must appear on some of the returns listed below. It is used to reconcile a church's deposits of withheld taxes with the Forms W-2 issued to employees. The EIN is a nine-digit number that looks like this: 00-0246810. If your church does not have an EIN, you may apply for one

online. Go to the IRS website at www.irs.gov and click on the “Apply for an EIN Online” link. You may also apply for an EIN by calling (800) 829-4933, or you may fax or mail Form SS-4 to the IRS. You should have only one EIN.

! Key Point

The employer identification number is not a “tax exemption number” and has no relation to your nonprofit status. It merely identifies you as an employer subject to tax withholding and reporting and ensures that your church receives proper credit for payments of withheld taxes.

Step 2. Determine whether each church worker is an employee or self-employed.

In some cases, it is difficult to determine whether a particular worker is an employee or is self-employed. If in doubt, churches always should treat a worker as an employee, since substantial penalties can be assessed against a church for treating a worker as self-employed whom the IRS later reclassifies as an employee. In general, a self-employed worker is one who is not subject to the control of an employer with respect to how a job is to be done. Further, a self-employed person typically is engaged in a specific trade or business and offers his or her services to the general public. The IRS has developed several criteria to assist in classifying a worker as an employee or self-employed. **Factors that tend to indicate employee status include the following:**

- The worker is required to follow an employer’s instructions regarding when, where, and how to work.
- The worker receives “on-the-job” training from an experienced employee.
- The worker is expected to perform the services personally, and not use a substitute.
- The employer rather than the worker hires and pays any assistants.
- The worker has a continuing working relationship with the employer.
- The employer establishes set hours of work.
- The worker is expected to work full time.
- The work is done on the employer’s premises.
- The worker must submit regular oral or written reports to the employer.
- The worker’s business expenses are reimbursed by the employer.
- The employer furnishes the worker’s tools, supplies, and equipment.
- The worker does not work for other employers.
- The worker does not advertise his or her services to the general public.

Not all of these factors must be present for a worker to be an employee. But if most of them apply, the worker is an employee. Once again: if in doubt, treat the worker as an employee.

Warning

The IRS is becoming much more aggressive in classifying workers as employees. Improper classification can result in significant back taxes and penalties.

Key Point

Fringe benefits are nontaxable only when received by employees. A common example is employer-paid medical insurance.

Step 3. Obtain the Social Security number of each worker.

After determining whether a worker is an employee or self-employed, you must obtain the worker's Social Security number. A worker who does not have a Social Security number can obtain one by filing Form SS-5. If a self-employed worker performs services for your church (and earns at least \$600 for the year), but fails to provide you with his or her Social Security number, then the church is required by law to withhold a specified percentage of compensation as "backup withholding." The backup withholding rate is 28% for 2013. Of course, a self-employed person can stop backup withholding by providing the church with a correct Social Security number.

The church will need the correct number to complete the worker's Form 1099-MISC (discussed later). Churches can be penalized if the Social Security number they report on a Form 1099-MISC is incorrect, unless they have exercised "due diligence." A church will be deemed to have exercised due diligence if it has self-employed persons provide their Social Security numbers using Form W-9. As a result, it is a good idea for churches to present self-employed workers (e.g., guest speakers, contract laborers) with a Form W-9, and then to withhold 28% for 2013 of total compensation as backup withholding unless the worker returns the form. The church should retain each Form W-9 to demonstrate its due diligence.

All taxes withheld through backup withholding must be reported to the IRS on Form 945. The Form 945 for 2012 must be filed with the IRS by January 31, 2013. However, if you made deposits on time in full payment of the taxes for the year, you may file the return by February 10, 2013.

Step 4. Have each employee complete a Form W-4.

These forms are used by employees to claim withholding allowances. A church will need to know how many withholding allowances are claimed by each lay employee in order to withhold the correct amount of federal

income tax. A withholding allowance lowers the amount of tax that will be withheld from an employee's wages. Allowances generally are available for the employee, the employee's spouse, each of the employee's dependents, and in some cases for itemized deductions. Ask all new employees to give you a signed Form W-4 when they start work. If an employee does not complete such a form, then the church must treat the employee as a single person without any withholding allowances or exemptions. Employers must put into effect any Form W-4 that replaces an existing certificate no later than the start of the first payroll period ending on or after the 30th day after the day on which the replacement Form W-4 is received. Of course, you can put a Form W-4 into effect sooner, if you wish. Employers are not responsible for verifying the withholding allowances that employees claim.

Although withholding of income tax is not required for ministers, they nonetheless should complete page 1 of Form W-4 with their employers as this information may be necessary when issuing Form W-2; also this form allows ministers to indicate any voluntary withholding requested.

Step 5. Compute each employee's taxable wages.

The amount of taxes that a church should withhold from an employee's wages depends upon two things: the information contained on the employee's Form W-4 and the amount of the employee's wages. Wages subject to federal withholding include pay given to an employee for service performed. The payment may be in cash or in other forms, which are measured by their fair market values. A comprehensive list of types of wages — other than salary — may be found in Step 10 on pp. 19–20.

Step 6. Determine the amount of income tax to withhold from each employee's wages.

The amount of federal income tax the employer should withhold from an employee's wages may be computed in a number of ways. The most common methods are the wage bracket method and the percentage method.

Wage bracket method. Under the wage bracket method, the employer simply locates an employee's taxable wages for the applicable payroll period (that is, weekly, biweekly, monthly) on the wage bracket withholding tables in IRS Publication 15 ("Circular E"), and determines the tax to be withheld by using the column headed by the number of withholding allowances claimed by the employee. Copies of IRS Publication 15 can be obtained at any IRS office or by calling the IRS forms number (800) TAX-FORM or (800) 829-3676 or by downloading a copy from the IRS website www.irs.gov.

Percentage method. Under the percentage method, the employer multiplies the value of one withholding allowance (derived from a table contained in Publication 15) by the number of allowances an employee claims on Form W-4, subtracts the total from the employee’s wages, and determines the amount to be withheld from another table (also found in Publication 15).

Both of these methods are explained in detail in IRS Publication 15. A new copy of Publication 15 should be obtained every year in order to ensure that correct tax amounts are being withheld.

Key Point

Be sure to get IRS Publication 15 (Circular E) in January of 2013. It will contain updated tables for computing the amount of income taxes to withhold from employees’ 2013 wages and other helpful information.

Tax Tip

The “withholding calculator” found on the IRS website www.irs.gov can help employees determine the proper amount of federal income tax withholding. Another useful resource, Publication 919 (*How Do I Adjust My Tax Withholding?*), is available on the IRS website.

Step 7. Withhold Social Security and Medicare taxes from nonordained employees’ wages.

For 2012, an employee’s OASDI tax was reduced from 6.2% to 4.2% on all earnings up to \$110,100. The employer’s share remained at 6.2%. A similar reduction applied to self-employed individuals, reducing their self-employment (SECA) tax for 2012 from 15.3% to 13.3% on all earnings up to \$110,100. For 2013, the rates have been restored to 6.2% and 15.3% respectively on earnings up to \$113,700.

The Medicare tax rate (1.45% for both the employer and employee) applies to all wages. There is no maximum amount of wages subject to the Medicare tax. Wages subject to Social Security and Medicare taxes include a number of items in addition to a church salary, including voluntary contributions (by a salary reduction agreement) to a 403(b) retirement plan and the value of group term life insurance in excess of \$50,000 paid by the employer.

The Social Security tax rates for 2012 and 2013 are as follows:

Year	Tax on Employee	Tax on Employer	Combined Tax
2012	5.65%	7.65%	13.3%
2013	7.65%	7.65%	15.3%

The church must withhold the employee's share of Social Security and Medicare taxes from each wage payment. Simply multiply each wage payment by the applicable percentage above. Special tables in IRS Publication 15 help in making this computation. Wages of less than \$108.28 per year (this amount is adjusted each year for inflation) paid to an employee of an exempt organization are exempt from these taxes.

A new Additional Medicare Tax goes into effect starting in 2013. The 0.9% Additional Medicare Tax applies to an individual's wages and self-employment income that exceeds a threshold amount based on the individual's filing status. The statute requires an employer to withhold Additional Medicare Tax on wages it pays to an employee in excess of \$200,000 in a calendar year, beginning January 1, 2013. There is no employer match for Additional Medicare Tax.

Step 8. The church must deposit the taxes it withholds.

Churches accumulate three kinds of federal payroll taxes:

- income taxes withheld from employees' wages;
- the employees' share of Social Security and Medicare taxes (withheld from employees' wages); and
- the employer's share of Social Security and Medicare taxes.

Most employers must deposit payroll taxes on a monthly or semiweekly basis. An employer's deposit status is determined by the total taxes reported in a four-quarter "lookback" period. For 2013, the lookback period will be July 1, 2011 through June 30, 2012

Monthly depositor rule. Churches that reported payroll taxes of \$50,000 or less in the lookback period will deposit their withheld taxes for 2013 on a monthly basis. Payroll taxes withheld during each calendar month, along with the employer's share of FICA taxes, must be deposited by the 15th day of the following month.

Semiweekly depositor rule. Churches that reported payroll taxes of more than \$50,000 in the lookback period must deposit their withheld taxes on a semiweekly basis. This means that for paydays falling on Wednesday, Thursday, or Friday, the payroll taxes must be deposited on or by the following Wednesday. For all other paydays, the payroll taxes must be deposited on the Friday following the payday.

Payment with return rule. If you accumulate less than a \$2,500 tax liability during the current or previous quarter, you may make a payment with Form 941 instead of depositing monthly. See IRS Publication 15 for more information.

! Key Point

All deposits must be made using the Electronic Federal Tax Payment System (EFTPS). There are penalties for depositing late, or for mailing payments directly to the IRS that are required to be deposited, unless you have reasonable cause for doing so.

To enroll in EFTPS, call (800) 555-4477, or to enroll online, visit www.eftps.gov. For general information about EFTPS, call (800) 829-4933.

Step 9. All employers subject to income tax withholding, Social Security and Medicare taxes, or both, must file Form 941 quarterly.

Form 941 reports the number of employees and amount of Social Security and Medicare taxes and withheld income taxes that are payable. Form 941 is due on the last day of the month following the end of each calendar quarter:

<i>Quarter</i>	<i>Ending</i>	<i>Due date of Form 941</i>
<i>1st (January – March)</i>	<i>March 31</i>	<i>April 30</i>
<i>2nd (April – June)</i>	<i>June 30</i>	<i>July 31</i>
<i>3rd (July – September)</i>	<i>September 30</i>	<i>October 31</i>
<i>4th (October – December)</i>	<i>December 31</i>	<i>January 31</i>

If any due date for filing shown above falls on a Saturday, Sunday, or legal holiday, you may file your return on the next business day. Form 941 may now be filed electronically. For more information, visit the IRS website at www.irs.gov/efile or call (800) 829-1040.

! Key Point

All employers who provide Forms W-2 would be wise to file quarterly Forms 941, even if there are no withholdings. In such a case — as can happen in a parish whose only employee is its minister — one can argue that the form is not strictly necessary (given that the IRS requires a Form 941 for any given calendar quarter only if the employer is “required to deduct and withhold” income taxes in that quarter). However, failing to file Form 941 may invite IRS inquiries because of the apparent discrepancy of having an employee (as evidenced by a W-2) but no Form 941 filings.

! Key Point

Neither Form W-2 nor Form 1099 need be provided to a minister who receives 100% of his or her compensation as housing. Many churches with this situation remind the minister by letter that compensation of (insert \$ amount) should be reported for determining SECA (self-employment) tax.

! Key Point

Form 944 replaces Form 941 for eligible small employers. The purpose of new Form 944 is to reduce the burden on the smallest employers by allowing them to file their employment tax returns annually and, in most cases, to pay the employment tax due with their return. Generally, the employer is eligible to file this form only if the payroll taxes for the year are \$1,000 or less. **Do not file Form 944 unless the IRS has sent you a notice telling you to file it.**

Step 10. Prepare a Form W-2 for every employee, including ordained ministers on the church's staff.

Starting in 2011, the healthcare reform legislation (Affordable Care Act) required employers to report the cost of coverage under an employer-sponsored group health plan on employees' W-2 forms. IRS Notice 2011-28, issued in 2011, provided further relief by making this requirement optional for smaller employers in calendar year 2012 (for W-2 forms filed in January of 2013). Small employers are defined as those issuing fewer than 250 W-2 forms for the previous year. The IRS has further announced that this reporting requirement will not apply to small employers after 2012 until it publishes guidance "giving at least six months of advance notice of any change to the transition relief."

The IRS has stressed that "there is nothing about the reporting requirement that causes or will cause excludable employer-provided health coverage to become taxable. The purpose of the reporting requirement is to provide employees useful and comparable consumer information on the cost of their health care coverage."

! Key Point

If employees give their consent, you may be able to furnish Copies B, C, and 2 of Forms W-2 to them electronically. See IRS Publication 15-A for additional information. If you file your 2012 Forms W-2 with the Social Security Administration electronically, the due date is extended to **April 1, 2013**. For information on how to file electronically, call the SSA at (800) 772-6270. You may file a limited number of Forms W-2 and W-3 online using the SSA website at www.ssa.gov/employer. The site also allows you to print out copies of the forms for filing with state or local governments, for distribution to the employees, and for the church's records.

A church reports each employee's wages and withheld income taxes as well as Social Security and Medicare taxes on this form. Wages of a minister who reports his income taxes as an employee do not include the housing allowance exclusion. A church should provide triplicate copies of Form W-2 directly to employees before February 1 of the

following year, and submit an additional copy for each employee to the Social Security Administration before March 1 (along with a Form W-3 transmittal form).

 **Key Point**

Be sure to add cents to all amounts. Make all dollar entries without a dollar sign and comma, but with a decimal point and cents. For example, \$1,000 should read “1000.00.” Government scanning equipment assumes that the last two figures of any amount are cents. If you report \$40,000 of income as “40000,” the scanning equipment would interpret this as 400.00 (\$400)!

Here are some tips on filling in the boxes on Form W-2:

Box a. Report the employee’s Social Security number. Insert “applied for” if an employee does not have a Social Security number but has applied for one.

Box b. Insert your church’s federal employer identification number (EIN). This is a nine-digit number that is assigned by the IRS. If you do not have one, you can obtain one by submitting a completed Form SS-4 to the IRS. Some churches have more than one EIN (for example, a church that operates a school may have separate numbers for the church and the school). Be sure that the EIN listed on an employee’s Form W-2 is the one associated with the employee’s actual employer.

Box c. Enter the church’s name, address, and ZIP Code (enter same address used for Form 941).

Box d. Enter the employee’s Social Security number.

Box e. Enter the employee’s name.

Box f. Enter the employee’s address and ZIP Code.

Box 1. Report all wages paid to workers who are treated as employees for federal income tax reporting purposes.

Among the types of wages that may be reported in Box 1 of Form W-2 are the following:

- salaries, bonuses, and prize awards;
- the cost of sending a minister to the Holy Land (if paid by the church);
- most Christmas and special occasion offerings;
- retirement payments made from church funds;
- the portion of a minister’s Social Security tax paid by a church;

- the value of the personal use of a church-provided car;
- purchases of church property for less than fair market value;
- reimbursements the church made for the minister's moving expenses (but not if the minister substantiated the reimbursed expenses under an accountable arrangement);
- imputed cost of group term life insurance coverage exceeding \$50,000 and cost of coverage of spouse and dependents over \$2,000 which is paid by the church, the diocese, the Church Pension Fund, or other church organizations combined;
- church reimbursements of a spouse's travel expenses incurred while accompanying a minister on a business trip; this represents income to the minister unless the spouse's presence serves a legitimate and necessary business purpose and the spouse's expenses are reimbursed by the church under an accountable plan;
- any funds to which a minister has access (including the church's discretionary funds) are taxable income to the minister, if the minister is not accountable to the church for the expenditures; personal expenditures from church funds, even if accounted for are taxable income to the minister;
- churches that make a "below-market interest loan" to a minister of at least \$10,000 create taxable income to the minister;
- churches that forgive a minister's debt to the church create taxable income to the minister;
- severance pay;
- payment of a minister's personal expenses by the church;
- business expense reimbursements paid under a "nonaccountable plan" (a nonaccountable business expense reimbursement arrangement is one that does not require substantiation of business expenses, or does not require excess reimbursements to be returned to the church, or that reimburses expenses out of salary reductions); also note that such reimbursements are subject to income tax and Social Security withholding if paid to lay employees.

! **Key Point**

A housing equity allowance paid directly to a cleric's RSVP (403(b) account) should not be included in box 1 of Form W-2.

Warning

The failure to report the use of nonaccountable funds on the Form W-2 as income could result in the imposition of “Intermediate Sanctions” by the Internal Revenue Service. The penalty is 200% of the unreported income, plus interest and penalties, plus a fine of up to \$20,000 levied on the vestry.

If you reimburse employee travel expenses under an accountable plan using a “per diem” rate, include the amount by which the per diem rate used for reimbursements for the year exceeds the IRS-approved per diem rates in Box 1. Refer to IRS Publications 463 and 1542 for sources of additional information on per diem rates.

If the employee’s travel expenses under an accountable plan are reimbursed using a mileage rate in excess of the IRS-approved standard rate, include in Box 1 the amount by which the reimbursements for the year exceed the IRS-approved rate. If volunteer travel expenses are reimbursed at more than 14 cents per mile, the excess must be reported on a Form 1099.

Ministers who report their income taxes as employees do not report the annual fair rental value of any church-provided housing and do not include any portion of their compensation that was designated (in advance) as a housing allowance by the church. Also, some contributions made to certain retirement plans out of an employee’s wages are not reported. But amounts distributed to an employee by the employer under a nonqualified deferred compensation plan are included in Box 1. Also see Boxes 11 and 13.

Box 2. List all federal income taxes that you withheld from the employee’s wages. Also include any voluntary federal taxes withheld for ordained ministers. The amounts reported in this box (for all employees) should correspond to the amount of withheld income taxes reported on the four 941 forms.

Box 3. Report the lay employee’s wages subject to the “Social Security” component of FICA taxes. Box 3 should not list more than the maximum wage base for the “Social Security” component of FICA taxes (\$110,100 for 2012 and \$113,700 for 2013). This box usually will be the same as Box 1, but not always. For example, certain retirement contributions are included in Box 3 that are not included in Box 1. To illustrate, contributions to a 403(b) plan by salary reduction agreement may be excludable from income and not reportable in Box 1, but lay employees are subject to FICA taxes, and accordingly they represent Social Security and Medicare wages for such employees. **Remember that ministers (including those who report their income taxes as employees) are self-employed for**

Social Security with respect to their ministerial services, and so they pay self-employment taxes rather than the employee's share of Social Security and Medicare taxes. For ordained ministers, leave Boxes 3, 4, 5, and 6 blank.

Box 4. Report the "Social Security" component of FICA taxes that are withheld from lay employee's wages. This tax is imposed on all wages up to a maximum of \$110,100 in 2012 and \$113,700 in 2013. Do not report the church's portion (the "employer's share") of Social Security and Medicare taxes. Ministers who report their income taxes as employees are still treated as self-employed for Social Security purposes with respect to their ministerial services. For ordained ministers, this box should be left blank.

Box 5. Report the lay employee's current and deferred (if any) wages subject to the Medicare component (1.45%) of FICA taxes. This will be an employee's entire wages regardless of amount. There is no ceiling. For most workers (earning less than \$110,100 in 2012 or \$113,700 in 2013), the maximum amount of wages subject to the "Social Security" tax (Boxes 3 and 5) should show the same amount. If you paid more than \$110,100 to a lay employee in 2012, Box 3 should show \$110,100 (\$113,700 for 2013) and Box 5 should show the full amount of wages paid.

Box 6. Report the Medicare component (1.45%) of FICA taxes that are withheld from the lay employee's wages. This tax is imposed on all wages, current and deferred (if any), regardless of amount.

Box 10. Show the total dependent care benefits under a dependent care assistance program (section 129) paid or incurred for your employee. Include the fair market value of employer-provided daycare facilities and amounts paid or incurred in a section 125 cafeteria plan. Report all amounts paid or incurred, including those in excess of the \$5,000 exclusion. Include any amounts over \$5,000 in Boxes 1, 3, and 5. For more information, see IRS Publications 15-A and 15-B.

Box 11. Report the total amount that you distributed to an employee under a nonqualified deferred compensation (NQDC) plan. Also report these distributions in Box 1. Unlike qualified plans, NQDC plans do not meet the qualification requirements for tax-favored status for this purpose. NQDC plans include those arrangements traditionally viewed as deferring the receipt of current compensation, and include termination pay and rabbi trusts. If you did not make distributions this year, show deferrals (plus earnings) under a NQDC plan that became taxable for Social Security and Medicare taxes during the year (but were for prior year services) because the deferred amounts were no longer subject to a substantial risk of forfeiture. Also report these amounts in Boxes 3 (up to the Social

Security wage base) and 5. Do not report in Box 11 any deferrals included in Boxes 3 or 5, or any deferrals for current year services (such as those with no risk of forfeiture). The purpose of Box 11 is for the Social Security Administration to determine whether any part of the amount reported in Box 1 or Boxes 3 or 5 was earned in a prior year. The SSA uses this information to verify that it has properly applied the Social Security earnings test and paid the correct amount of benefits. If your church made distributions and is reporting any deferrals in Boxes 3 and 5, do not complete Box 11. For additional information, see IRS Publication 15.

Box 12. Insert the appropriate code and dollar amount in this box. Insert the code letter followed by a space and then insert the dollar amount on the same line within the box. Do not enter more than four codes in this box. If more are needed, use another Form W-2. Use capital letters for the codes, and remember not to use dollar signs or commas. For example, to report a \$3,000 contribution to a section 403(b) tax-sheltered annuity, you would report “E 3000.00” in this box. The codes are as follows:

- A** This will not apply to church employees.
- B** This will not apply to church employees.
- C** The employee was provided with more than \$50,000 of group term life insurance. Report the cost of coverage in excess of \$50,000. It should also be included in Box 1 (and in Boxes 3 and 5 for lay employees).
- D** Generally not applicable to churches.
- E** The church made contributions to a 403(b) plan pursuant to a “salary reduction agreement” on behalf of the employee. Report the amount of the contributions. While this amount ordinarily is not reported in Box 1, it is included in Boxes 3 and 5 for lay employees, since it is subject to Social Security and Medicare taxes with respect to such workers.
- F** Generally not applicable to churches.
- G** Generally not applicable to churches.
- H** Generally not applicable to churches.
- J** The church is reporting sick pay. Show the amount of any sick pay that is not includable in the employee’s income because he or she contributed to the sick pay plan.
- K** Generally not applicable to churches.
- L** The church reimbursed the employee for employee business expenses using the standard mileage rate or the per diem rates, and the amount you reimbursed exceeds the amounts allowed under these methods.

Enter code “L” in Box 12, followed by the amount of the reimbursements that equals the allowable standard mileage or per diem rates. Any excess should be included in Box 1. For lay employees, report the excess in Boxes 3 and 5 as well. Do not include any per diem or mileage allowance reimbursements for employee business expenses in Box 12 if the total reimbursements are less than or equal to the amount deemed substantiated under the IRS-approved standard mileage rate or per diem rates.

- M** Generally not applicable to churches.
- N** Generally not applicable to churches.
- P** The church paid qualified moving expense reimbursements directly to an employee. Report the amount of these reimbursements but only if they were made under a nonaccountable arrangement. Do not report reimbursements of qualified moving expenses that are paid directly to a third party on behalf of the employee (for example, to a moving company), or to the employee under an accountable arrangement.
- R** Report employer contributions to a medical savings account on behalf of the employee. Any portion that is not excluded from the employee’s income also should be included in Box 1.
- S** Report employee salary reduction contributions to a SIMPLE retirement account. However, if the SIMPLE account is part of a 401(k) plan, use code D.
- T** Report amounts paid (or expenses incurred) by an employer for qualified adoption expenses furnished to an employee under an adoption assistance program.
- W** Report employer contributions to a health savings account (HSA).
- Y** It is no longer necessary to report deferrals under a section 409A nonqualified deferred compensation plan in Box 12 using code Y.
- Z** Report income under section 409A on a nonqualified deferred compensation plan that was included in Box 1.
- BB** Report designated Roth contributions under a section 403(b) salary reduction agreement. Do not use this code to report elective deferrals under code E.
- DD** Starting in tax year 2011, the Affordable Care Act requires employers to report the cost of coverage under an employer-sponsored group health plan. To give employers more time to update their payroll systems, IRS Notice 2010-69 made this requirement optional for all employers in 2011. IRS Notice 2011-28 provided further relief for

smaller employers filing fewer than 250 W-2 forms by making the reporting requirement optional for them for 2012 as well and continuing this optional treatment for smaller employers until further guidance is issued. The reporting under this provision is for information only; the amounts reported are not included in taxable wages and are not subject to new taxes.

Box 13. Check the appropriate box:

- **retirement plan.** This box should be checked for ministers covered by the Clergy Pension Plan and for any lay employee who was an active participant (for any part of the year) in any of the following: (1) a qualified pension, profit-sharing, or stock bonus plan described in section 401(a) (including a 401(k) plan); (2) an annuity contract or custodial account described in section 403(b); (3) a simplified employee pension (SEP) plan; or (4) a SIMPLE retirement account.
- **statutory employee.** Churches rarely if ever have statutory employees. These include certain drivers, insurance agents, and salespersons.
- **third-party sick pay.** Churches generally will not check this box.

Box 14. This box is optional. Use it to provide information to the church employee. Some churches report a church-designated housing allowance in this box (for ministers who report their income taxes as employees). The IRS uses Box 14 for this purpose in a comprehensive minister tax example in the current edition of its Publication 517, **but this is not a requirement.**

Tax Tip

The IRS has provided the following suggestions to reduce the discrepancies between amounts reported on Forms W-2, W-3, and Form 941:

First, be sure the amounts on Form W-3 are the total amounts from Forms W-2. Second, reconcile Form W-3 with the four quarterly Forms 941 by comparing amounts reported for:

1. Income tax withholding (Box 2);
2. Social Security and Medicare wages (Boxes 3, 5, and 7); and
3. Social Security and Medicare taxes (Boxes 4 and 6). Amounts reported on Forms W-2, W-3, and 941 may not match for valid reasons. If they do not match, be sure to determine that the reasons are valid.

Key Point

Starting in 2011, the healthcare reform legislation (Affordable Care Act) required employers to report the cost of coverage under an employer-sponsored group health plan on employees' W-2 forms.

To allow employers more time to update their payroll systems, the IRS announced in late 2011 that it was making this reporting requirement optional for all employers in 2011. IRS Notice 2011-28, issued in 2011, provided further relief by making this requirement optional for smaller employers in calendar year 2012 (for W-2 forms filed in January of 2013). Small employers are defined as those issuing fewer than 250 W-2 forms for the previous year. The IRS has further announced that this reporting requirement will not apply to small employers after 2012 until it publishes guidance “giving at least six months of advance notice of any change to the transition relief.” The IRS has stressed that “there is nothing about the reporting requirement that causes or will cause excludable employer-provided health coverage to become taxable. The purpose of the reporting requirement is to provide employees useful and comparable consumer information on the cost of their health care coverage.”

Step 11. Prepare Forms 1099-MISC.

The church must issue a Form 1099-MISC to every nonemployee to whom the church pays “nonemployee” compensation of \$600 or more during the year. To illustrate, if a guest speaker visited a church in 2012 and received compensation from the church in an amount of \$600 or more (net of any travel expense reimbursement properly accounted for by the recipient) then the church must issue the person a Form 1099-MISC before February 1, 2013 and file Copy A with the IRS before March 1, 2013.

If you file electronically, the due date for filing Copy A with the IRS is **April 1, 2013**. Form 1099-MISC is designed to induce self-employed persons to report their full taxable income. The same rule applies to other “nonemployees,” including some part-time custodians, and certain self-employed people who perform miscellaneous services for the church (plumbers, carpenters, lawn maintenance, etc.). Exceptions apply. For example, a church need not issue a 1099-MISC to a corporation, or to a person who will be receiving a Form W-2 for services rendered to the church. Also, travel expense reimbursements paid to a self-employed person under an accountable reimbursement plan do not count toward the \$600 figure.

To send the individual a properly completed Form 1099-MISC, the church will need to obtain his or her name, address, and Social Security number. Churches should obtain this information at the time of the person’s visit, since it often can be difficult to obtain the necessary information at a later date. IRS Form W-9 can be used to obtain this information. If a self-employed person who is paid \$600 or more during the course of a year by a church refuses to provide his or her Social Security number, then the church may be required to withhold 30% of the person’s total compensation as “backup withholding.” See “Step 3,” on page 13. The backup withholding rate is 28% for 2013.

⚠ Warning

Misclassifying your workers as “nonemployees” can result in significant tax arrearages and penalties. The IRS is aggressively pursuing employers who misclassify their workers.

❗ Key Point

Before paying any nonemployee for personal services, obtain a Form W-9.

⚠ Warning

If you are paying pension assessments for independent contractors receiving a Form 1099 (including supply clergy), tax complications may result under certain circumstances. Call the Church Pensions Fund’s toll-free tax lines for assistance (see page 34).

Need Help Completing a W-2, W-3, 1099, or 1096 Form?

The IRS operates a centralized call site to answer questions about reporting information on these forms. If you have any questions about completing these forms, call the IRS at (866) 455-7438, Monday – Friday, 8:30AM – 4:30PM eastern time.

Other Important Requirements for Churches

Reporting Group Term Life Insurance

Include in the income of employees an imputed cost of employer-provided group term life insurance coverage (including death benefits under the Benefits Plan) that exceeds \$50,000. Also include the imputed cost of all employer-provided group term life insurance on the life of a spouse or dependent if the coverage provided exceeds \$2,000. The imputed cost can be determined according to the following table.

Cost per \$1,000 of protection for 1-month period			
<i>Age brackets</i>	<i>Cost</i>	<i>Age brackets</i>	<i>Cost</i>
Under 25	5 cents	25 to 29	6 cents
30 to 34	8 cents	35 to 39	9 cents
40 to 44	10 cents	45 to 49	15 cents
50 to 54	23 cents	55 to 59	43 cents
60 to 64	66 cents	65 to 69	\$1.27
		70 and above	\$2.06

📌 Example

The Church Pension Fund pays the premiums on a \$100,000 group life insurance policy on the life of Benjamin. St. George’s Church pays the premiums on a \$20,000 group term insurance policy on the life of Benjamin, with Benjamin’s wife as beneficiary. Benjamin is 29

years old. St. George's Church also pays the premium on a \$5,000 group term policy which covers Benjamin's wife who is 30 years old. The church must report \$55.20 as the imputed cost of the insurance provided to Benjamin and his wife. This amount is computed as follows:

1. For Benjamin, the table shows the "cost" per month for each \$1,000 of group term life insurance in excess of \$50,000. To compute the cost for Benjamin, take 6 cents x 12 months = 72 cents x 70 (corresponding to \$70,000 of group term insurance in excess of \$50,000) = \$50.40.
2. In addition, the cost of the entire \$5,000 of insurance provided to Benjamin's wife must be computed. Take 8 cents x 12 months = 96 cents x 5 = \$4.80. Combine this amount with the cost of Benjamin's excess insurance to obtain the taxable amount of \$55.20. St. George's should include this amount with wages in Box 1 of Form W-2. This amount should also be reported in Box 12 and labeled "C." Any includable amount is subject to income tax as well as Social Security and Medicare withholding for lay church employees.

New Hire Report

Be sure to file this report with the state as soon as someone is hired — including clergy. The church's payroll service should do this for you.

Form I-9

All employers are responsible for verifying the identity and eligibility of employees to work in the United States. As employers, churches must complete an Employment Eligibility Verification form for each new employee. This form is better known as Form I-9.

Form I-9 is not an IRS form and is not filed with any government agency. However, it is important for churches to be familiar with this form, because they can be assessed fines for failing to comply with the requirements summarized below.

Churches should:

- Ensure that each new employee completes Section 1 of the Form I-9 at the time of the hire. Review the employee's documents and fully complete Section 2 of the Form I-9 within three business days of the hire. Collect a Form I-9 for all employees, including ministers, hired after November 6, 1986, even if the church has no doubt that someone is a U.S. citizen. An employee signs part of the form and the employer signs part of the form. The form's instructions list documents employees may show to verify their identity and eligibility to work in the United States.
- Review the United States Citizenship and Immigration Services (USCIS) website for instructions on completing the Form I-9. Form I-9 can be downloaded from the USCIS website.

- Collect forms from new employees only, not from all applicants. When extending job offers, churches should clarify that employment is conditioned on completion of a Form I-9. Employers should remind new employees to bring their documents the first day of work. Forms should be completed no later than the end of the employee’s third day at work.
- Accept documents that appear to be genuine (i.e., appear genuinely to identify the new employee). If churches act reasonably when deciding that a document is genuine, they will not be held responsible for a mistake. Churches may keep photocopies of original identification and verification documents with each employee form. This is not required by law but may be helpful if there is ever a question about any document’s authenticity.
- Keep each Form I-9 for at least three years. If a church employs a person for more than three years, the church must retain the form until one year after the person leaves employment. Forms should be kept confidential.
- Upon request, show completed forms to authorized officials of the Bureau of Immigration and Customs Enforcement, Department of Labor, or the Justice Department’s Office of Special Counsel for Unfair Immigration-Related Employment Practices. Officials will give three days’ notice before inspection.

Annual Certification of Racial Nondiscrimination

Churches that operate, supervise, or control a private school must file a certificate of racial nondiscrimination (Form 5578) each year with the IRS. The certificate is due by the 15th day of the fifth month following the end of the organization’s fiscal year. This is May 15 of the following year for organizations that operate on a calendar year basis. This means that the Form 5578 for 2012 is due May 15, 2013. A “private school” is defined as an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly conducted. The term includes primary, secondary, preparatory, or high schools, and colleges and universities, whether operated as a separate legal entity or an activity of a church.

❗ Key Point

The term “school” also includes preschool, which makes this reporting requirement relevant for many churches. As many as 25% of all churches operate a preschool program.

Private religious schools that are not affiliated with or controlled by a church also must file the form. Form 5578 is easy to complete. A church official simply identifies the church and the school, and certifies that the school has “satisfied the applicable requirements of section 4.01 through 4.05 of Revenue Procedure 75-50.” This reference is to the following requirements:

- the school has a statement in its charter, bylaws, or other governing instrument, or in a resolution of its governing body, that it has a racially nondiscriminatory policy toward students;
- the school has a statement of its racially nondiscriminatory policy toward students in all its brochures and catalogs dealing with student admissions, programs, and scholarships;
- the school makes its racially nondiscriminatory policy known to all segments of the general community served by the school through the publication of a notice of its racially nondiscriminatory policy at least annually in a newspaper of general circulation or through utilization of the broadcast media; **however, such notice is not required if one or more of these exceptions apply:**
 1. during the preceding three years, the enrollment consists of students at least 75% of whom are members of the sponsoring church or religious denomination and the school publicizes its nondiscriminatory policy in religious periodicals distributed in the community;
 2. the school draws its students from local communities and follows a racially nondiscriminatory policy toward students and demonstrates that it follows a racially nondiscriminatory policy by showing that it currently enrolls students of racial minority groups in meaningful numbers. The school can demonstrate that all scholarships or other comparable benefits are offered on a racially nondiscriminatory basis.

Filing the certificate of racial nondiscrimination is one of the most commonly ignored federal reporting requirements. Churches that operate a private school (including a preschool), as well as independent schools, may obtain copies of Form 5578 by calling the IRS forms number (800) TAX-FORM or (800) 829-3676 or by visiting the IRS website at www.irs.gov.

Charitable Contribution Substantiation Rules

Several important rules apply to the substantiation of charitable contributions, including the following:

Cash contributions. The Pension Protection Act of 2006 amended the Tax Code to require all cash contributions, **regardless of amount**, to be substantiated by either a bank record (such as a canceled check) or a

written communication from the charity showing the name of the charity, the date of the contribution, and the amount of the contribution. Previously, donors could substantiate cash contributions of less than \$250 with “other reliable written records showing the name of the charity, the date of the contribution, and the amount of the contribution” if no canceled check or receipt was available. This is no **longer allowed**. As noted below, additional substantiation requirements apply to contributions (of cash or property) of \$250 or more, and these must be satisfied as well.

Substantiation of contributions of \$250 or more. Donors will not be allowed a tax deduction for any individual cash (or property) contribution of \$250 or more unless they receive a written acknowledgment from the church containing the following information:

- name of the church;
- name of the donor (a Social Security number is not required);
- date of the contribution;
- amount of any cash contribution;
- for contributions of property (not including cash) valued by the donor at \$250 or more, the receipt must describe the property (no value should be stated);
- the receipt must contain one of the following: (1) a statement that no goods or services were provided by the church in return for the contribution; (2) a statement that goods or services that a church provided in return for the contribution consisted entirely of intangible religious benefits; or (3) a description and good faith estimate of the value of goods or services other than intangible religious benefits that the church provided in return for the contribution;
- the church may either provide separate acknowledgments for each single contribution of \$250 or more or one acknowledgment to substantiate several single contributions of \$250 or more (separate contributions are not aggregated for purposes of measuring the \$250 threshold);
- the written acknowledgment must be received by the donor on or before the earlier of the following two dates: (1) the date the donor files a tax return claiming a deduction for the contribution, or (2) the due date (including extensions) for filing the return.

“Quid pro quo” contributions of more than \$75. If a donor makes a “quid pro quo” contribution of more than \$75 (that is, a payment that is partly a contribution and partly a payment for goods or services received in exchange), the church must provide a written statement to the donor that satisfies two conditions:

1. The statement must inform the donor that the amount of the contribution that is tax-deductible is limited to the excess of the amount of any money (or the value of any property other than money) contributed by the donor over the value of any goods or services provided by the church or other charity in return.
2. The statement must provide the donor with a good faith estimate of the value of the goods or services furnished to the donor.

A written statement need not be issued if only “token” goods or services are provided to the donor. For 2012, token goods or services were those having a value not exceeding the lesser of \$99 or 2% of the amount of the contribution. This amount is adjusted annually for inflation. In addition, the rules do not apply to contributions in return for which the donor receives solely an intangible religious benefit that generally is not sold in a commercial context outside the donative context.

Gifts of property. Several additional rules apply to the substantiation of contributions of noncash property valued by the donor at \$500 or more. Donors who claim a deduction over \$500 but not over \$5,000 for a non-cash charitable contribution must retain certain records and complete the front side (Section A, Part I, and Part II if applicable) of IRS Form 8283 and enclose the completed form with the Form 1040 on which the charitable contribution is claimed. Special rules apply to donations of cars, boats, and planes valued by the donor at more than \$500. The church must provide the donor with a written acknowledgment, and send a Form 1098-C to the IRS containing required information about the donation. The Form 1098-C can be used as the written acknowledgment that must be issued to a donor. See the instructions to Form 1098-C for more information.

For contributions of noncash property valued at more than \$5,000, a donor must obtain a qualified appraisal of the donated property from a qualified appraiser and complete a qualified appraisal summary (Section B of Form 8283) and have the summary signed by the appraiser and a church representative. The completed Form 8283 is then enclosed with the Form 1040 on which the charitable contribution deduction is claimed.

Note that the provision allowing tax-free qualified charitable distributions of up to \$100,000 from an IRA to a church has been extended by the American Taxpayers Relief Act of 2012 through the year 2013. Contained in this legislation is a transition rule that allows an individual to make a rollover during January of 2013 and have it count as a 2012 rollover. Regardless of the intentions of the donor, the proper business of the church receiving the gift is to report the amount of the contribution and the date received (making note also of the date the gift was postmarked).

Helpful Numbers and Resources

To request IRS forms:

- (800) TAX-FORM or (800) 829-3676
- IRS home page: www.irs.gov

The Church Pension Fund:

- Toll-free: (800) 223-6602
- Website: www.cpg.org
- Online version of *Federal Reporting Requirements for Episcopal Churches*: www.cpg.org/taxpubs
- Tax Lines: Matt Chew: (877) 305-1414
Bill Geisler: (877) 305-1415

Need an additional copy of *Federal Reporting Requirements for Episcopal Churches*? Go to www.cpg.org/taxpubs and then select Administrator. Or call (866) 802-6333.

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Throughout this document tax examples are given that include fictional first names of clergy, lay employees, and parish names. The names for the persons and places in these examples were chosen at random, and do not refer to any particular clergy, lay employees, parishes, or institutions of the Episcopal Church.



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