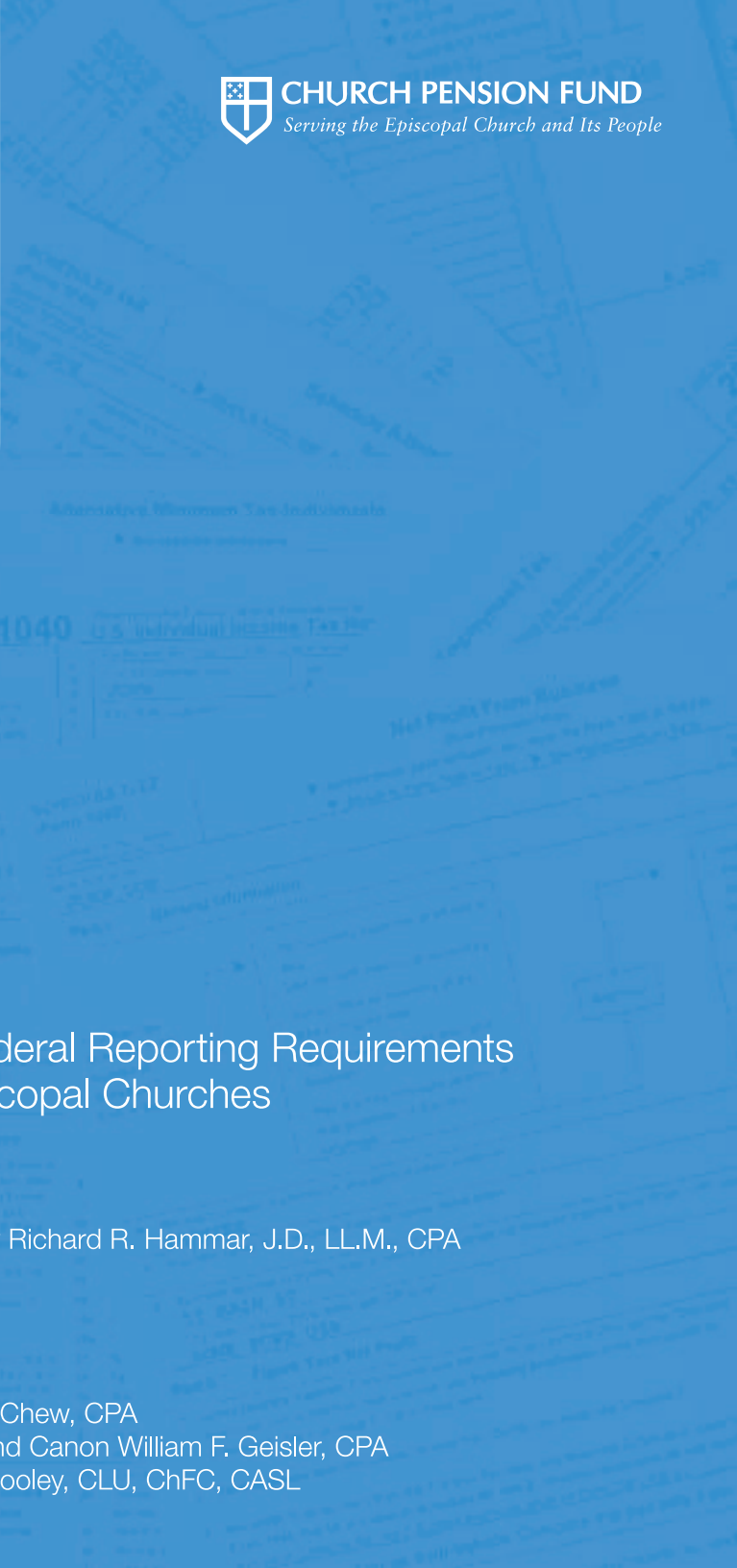




CHURCH PENSION FUND

Serving the Episcopal Church and Its People



2011 Federal Reporting Requirements For Episcopal Churches

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Helpful Numbers and Resources

To request IRS forms:

- (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 the online edition at www.cpg.org/taxpubs



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Serving the Episcopal Church and Its People

T. Dennis Sullivan
President

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New York, NY 10016
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Dear Treasurers, Wardens, and Administrators,

In keeping with the Church Pension Group's ongoing commitment to conserving our natural and financial resources, we have printed the *Federal Reporting Requirements for Episcopal Churches* as a stand-alone booklet.

The *2011 Clergy Tax Guide* is being disseminated online, with a print-on-demand option. To access that document or download additional copies of this *Federal Reporting Requirements* booklet, please go to www.cpg.org/taxpubs.

Faithfully,

T. Dennis Sullivan
President and CEO

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.

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. 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.
- 2. 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.
- 3. 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 liability 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.

New for the 2010 Tax Year. The Patient Protection and Affordable Care Act established the Small Employer Health Care Tax Credit, which is available beginning with the 2010 tax year to 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. 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 and filing Form 990-T, which is generally due by May 15, 2011. In February of 2011, the Medical Trust will provide all diocesan administrators with additional information on how this tax credit applies to church institutions. 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 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 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 tax, subject to the housing allowance limitations.
- Earnings from ministerial services after retirement are also eligible for designation as housing allowance. If your Church Pension Fund benefits and withdrawals from your RSVP plan are enough to cover your qualified housing costs, you should not request additional housing allowance designation for any ministerial services.

- Self-employment tax (SECA) is due on all earned income, even if the minister is retired and collecting Social Security. Include any earned housing allowance and/or the fair rental value of any church-provided housing. Failure 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. 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 2011, that limit is \$34,000 in salary and housing allowance; parish-provided housing does not count toward this limit). 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 2010 a church agrees to pay its minister “total compensation” of \$45,000 for 2011, 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 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

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 church-owned housing that is provided “rent-free” 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 that the housing allowance and fair rental value church-provided housing are nontaxable only when computing federal income taxes.

Ministers must include their housing allowance and fair rental value of any church-provided housing as taxable earnings when computing their 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 the next page for two sample housing allowances resolutions from the vestry or other church governing body.

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

The following resolution was duly adopted by the vestry of Grace Church at a regularly scheduled meeting held on December 13, 2010, 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-owned rectory as compensation for services that he renders to the church in the exercise of his ministry; and

Whereas, as 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 2011 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 2011 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 2011 and for all future years unless otherwise provided for by this vestry, Fr. Smith shall be permitted to live in the church-owned rectory located at 123 Main Street, and that no rent or other fee shall be payable by Fr. Smith for such occupancy and use.

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

The following resolution was duly adopted by the vestry of Christ Church at a regularly scheduled meeting held on December 13, 2010, 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 2011 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 2011 and all future years unless otherwise provided.

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 IRS 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).

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 provided that:

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 parish must file a Form 5500 annually.

! Key Point

The IRS has amended the “use it or lose it” rule for flex plans. The amendment allows employers to amend their flex plan 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 new Small Employer Health Care Credit for tax year 2010. See pp. 1–2 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 Online EIN Application 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 corporation 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 20 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 (more than 20 hours a week).
- 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.

📌 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 was 28% through 2010. It will remain at 28% through 2011. 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% 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 2010 must be filed with the IRS by January 31, 2011. However, if you made deposits on time in full payment of the taxes for the year, you may file the return by February 10, 2011.

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. Ministers need not file a Form W-4 unless they enter into a voluntary withholding agreement with the church. 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.

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 page 16.

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) 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 2011. It will contain updated tables for computing the amount of income taxes to withhold from employees' 2011 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.

📌 Key Point

Effective for 2011 only, an employee's OASDI tax is reduced from 6.2% to 4.2% on all earnings up to \$106,800. The employer's share remains at 6.2%. A similar reduction applies to self-employed individuals, reducing their self-employment (SECA) tax for 2011 from 15.3% to 13.3% on all earnings up to \$106,800.

Churches and their lay employees are subject to Social Security and Medicare taxes. The combined Social Security and Medicare tax rate is 13.3% of each employee’s wages. This rate is paid unequally by the employer and employee, with the employer paying a tax of 7.65% of the employee’s wages and the employee paying 5.65%. Churches must withhold the employee’s share of Social Security and Medicare taxes from the wages of lay employees, and in addition must pay the employer’s share of these taxes. This 7.65% rate includes:

1. a Medicare hospital insurance tax of 1.45%, and
2. an “old-age, survivor and disability” (“Social Security”) tax of 6.2%.

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. The “Social Security” rate (6.2% for the employer and 4.2% for the employee) applies to an employee’s wages up to but not exceeding a maximum amount (\$106,800 in both 2010 and 2011). 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 2010 and 2011 are as follows:

<i>Year</i>	<i>Tax on Employee</i>	<i>Tax on Employer</i>	<i>Combined Tax</i>
2010	7.65%	7.65%	15.3%
2011	5.65%	7.65%	13.3%

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.

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 either a monthly or semiweekly basis, as determined by IRS guidelines based on total yearly payroll taxes. An employer’s deposit status is determined by the total taxes reported in a

four-quarter “lookback” period. For 2011, the lookback period will be July 1, 2009, through June 30, 2010.

Monthly depositor rule. Churches that reported payroll taxes of \$50,000 or less in the lookback period will deposit their withheld taxes for 2011 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. The following schedule applies: 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 the employer accumulates less than a \$2,500 tax liability during the quarter, the payment must be made with Form 941 instead of depositing monthly. This rule will affect most churches’ deposit schedules. See IRS Publication 15, Circular E, for more information.

Key Point

If a church deposited more than \$200,000 of payroll taxes in 2009, it must begin depositing payroll taxes “electronically” beginning on January 1, 2011, in order to avoid penalties. The electronic deposit procedure is known as the Electronic Federal Tax Payment System (or EFTPS). For deposits made by EFTPS to be on time, the church must initiate the transaction at least one business day before the date the deposit is due. Very few churches make enough deposits to trigger the electronic deposit procedure. However, many churches are voluntarily complying with this procedure because of its ease and convenience. To enroll or get more information about EFTPS, call (800) 555-4477.

In November of each year, the IRS will notify employers of their deposit status for the coming year. Special rules and exceptions carry over from the prior rules. Employers accumulating \$100,000 during a monthly or semiweekly period must deposit by the next banking day.

If your church is not required to deposit payroll taxes electronically, use Form 8109 (Federal Tax Deposit Coupon) to deposit all employment taxes at an authorized financial institution. It is very important to mark the correct type of tax and tax period clearly on each Federal Tax Deposit Coupon. This information is used by the IRS to credit the church’s account. Make the check or money order payable to the depository where the deposit is made. Deposit taxes with a check drawn on another financial institution only if the depository is willing to accept that form of payment. However, authorized depositories must accept checks drawn on and made payable to the depository itself. Deposits are considered “timely” if they are delivered

on or before the institution's daily cutoff deadline. A penalty is charged when taxes are not deposited when due. A penalty may be assessed when deposits are overstated. Both penalties can be waived if the mistake was due to reasonable cause rather than willful neglect.

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>
1st (January – March)	March 31	April 30
2nd (April – June)	June 30	July 31
3rd (July – September)	September 30	October 31
4th (October – December)	December 31	January 31

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

Should a church with only one employee, its minister, file a Form 941?

It is the position of the IRS national office that churches with only one employee (the minister) need not file a Form 941. This opinion is based in part on an income tax regulation specifying that every employer shall file a Form 941 for each calendar quarter in which it is “required to deduct and withhold” income taxes. Since a church with only one employee (its minister) is not required to withhold income taxes (ministers’ wages are exempt from income tax withholding), there is no need for a church under such circumstances to file Form 941. This assumes that the minister has not elected voluntary withholding. Of course, issuing the minister a Form W-2 without filing a quarterly Form 941 will present an apparent discrepancy that may trigger an IRS inquiry. On the other hand, submitting a Form 941 that reports a minister’s wages but no withholdings for Social Security or Medicare taxes will also raise questions. In either case, the apparent discrepancy can be easily explained.

! 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 less than \$2,500. **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.

New in 2010. Health care reform legislation passed by Congress in 2010 contained a provision requiring the 2011 Form W-2 to be modified to include a box for employers to report the value of the health care insurance they provide for their employees. The IRS announced late in 2010 that it will defer this requirement in order to provide employers with the time they need to make changes to their payroll systems or procedures in preparation for compliance with the new reporting requirement. In a public announcement, the IRS stated: "Although reporting the cost of coverage will be optional with respect to 2011, the IRS continues to stress that the amounts reportable are not taxable. Included in the Affordable Care Act passed by Congress in March, the new reporting requirement is intended to be informational only, and to provide employees with greater transparency into overall health care costs." *IRS News Release IR-2010-103.*

📌 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 2010 Forms W-2 with the Social Security Administration electronically, the due date is extended to March 31, 2011. 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.

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:

- bonuses;
- 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

business purpose and the spouse's expenses are reimbursed under an accountable arrangement;

- 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.

Warning

The failure to report the use of nonaccountable funds on the W-2 as income could result in "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 (50 cents for 2010, 51 cents for 2011), 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 (the 6.2% rate for 2010 and 4.2% rate for 2011) of FICA taxes. Box 3 should not list more than the maximum wage base for the "Social Security" component of FICA taxes (\$106,800 for both 2010 and 2011). 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 (6.2%) of FICA taxes that are withheld from lay employee's wages. This tax is imposed on all wages up to a maximum of \$106,800 in both 2010 and 2011. 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 \$106,800 in 2010 or 2011), 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 \$106,800 to a lay employee in 2010, Box 3 should show \$106,800 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 three 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.
- I** 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 equal 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 expenses 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.
- CC** Wages exempt under the HIRE Act (for employer use only).

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.

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 2010 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, 2011. 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 2,” on page 10.

Key Point

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

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 if those employees were hired after November 6, 1986. 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 2010 is due May 15, 2011. 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 preschools. This is what makes the 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 exceptions apply. These include:

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) 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 that satisfies the following requirements:

- The receipt must be in writing.
- The receipt must identify the donor by name (a Social Security number is not required).
- 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 state whether or not the church provided any goods or services to the donor in exchange for the contribution, and if so, the receipt must include a good faith estimate of the value of those goods or services.
- If the church provides no goods or services to a donor in exchange for a contribution, or if the only goods or services the church provides are “intangible religious benefits,” then the receipt must contain a statement to that effect.
- 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 2010, token goods or services were those having a value not exceeding the lesser of \$96 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 noncash

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.

Helpful Numbers and Resources

To request IRS forms:

- (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 the online edition at www.cpg.org/taxpubs

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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.



CHURCH PENSION FUND

Serving the Episcopal Church and Its People

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