FEDERAL REPORTING REQUIREMENTS FOR CHURCHES
WHAT YOU NEED TO KNOW IN 2013

Prepared by
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Senior Editor, Church Law & Tax Report

Presented by
Board University of the Board of Pensions
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Dear Church Treasurer/Business Administrator,

As we enter the new year and prepare for tax season, the Board of Pensions has prepared the Federal Reporting Requirements for Churches, which has been updated for the 2013 tax year to include any relevant tax code changes. We hope that you will find it helpful. The most important church-related tax laws generally involve the reporting and withholding of employee income and Social Security taxes, and they are complicated matters.

We rely on the expertise of Richard R. Hammar in preparing this valuable resource each year. Mr. Hammar is an attorney and CPA who specializes in legal and tax issues for churches and clergy. He also provides the information for our Tax Guide for Ministers, which could be of great help to teaching elders as they prepare their tax returns for 2012. If you would like a copy of the Tax Guide for Ministers, you may call the Board of Pensions at 800-773-7752 (800-PRESPLAN) and request one from a member service representative.

Each year, the Board also presents the Tax Tips Webcast for Ministers and Churches. The prerecorded Web module, which may be viewed at your convenience, is available on pensions.org.

If you have questions or need assistance, please call one of our member service representatives, who will be delighted to help you.

Sincerely,

Robert W. Maggs, Jr.
President and Chief Executive
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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. Yet many churches do not fully comply with them for various reasons, including the following:

- The church treasurer is elected by the congregation and does not remain in office long enough to understand the application of the payroll tax reporting rules to churches.
- Church leaders assume that churches are exempt from the payroll tax reporting requirements. This is a false assumption. The courts have rejected the argument that the application of the payroll tax reporting rules to churches violates the constitutional guaranty of religious freedom.
- There are a number of special payroll tax reporting rules that apply to churches, and these often are not clearly understood by church staff members. These special rules include the following:
  1. Ministers are self-employed for Social Security tax purposes when performing ministerial services. While most ministers are employees for federal income tax reporting purposes, they are self-employed for Social Security with respect to services they perform in the exercise of ministry. 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 and to withhold the employee’s share of Social Security and Medicare taxes from their wages.
  2. A minister’s wages are exempt from employer income tax withholding. Wages paid to a minister as compensation for ministerial services are exempt from employer income tax withholding whether the minister reports income taxes as an employee or as self-employed. Ministers use the estimated tax procedure to pay their federal taxes, unless they have entered into a voluntary withholding agreement with their employing church.
  3. Some churches are exempt from the employer’s share of Social Security and Medicare taxes because they filed a timely exemption application. For most churches, this exemption had to be filed before October 31, 1984. The exemption does not excuse the church from income tax withholding, filing Form 941, or issuing W-2 forms to church employees. The nonminister employees of a church that filed such an exemption application are treated as self-employed for Social Security, and must pay the self-employment tax (SECA) if they are paid $108.28 or more during the year.

For 2012

Congress provided a payroll tax holiday for 2012 in the form of a two percentage point reduction in Social Security taxes. This meant that the employee’s share of Social Security taxes dropped from 6.2 percent to 4.2 percent of wages (the employer’s share was not affected), and self-employed workers’ Social Security tax dropped from 12.4 percent to 10.4 percent of self-employment earnings. Congress did not extend the payroll tax holiday. Therefore, the employee’s share of Social Security taxes reverts back to 6.2 percent and self-employed workers’ Social Security tax reverts back to 12.4 percent beginning January 1, 2013.

Alternative minimum tax (AMT).
The American Taxpayer Relief Act (ATRA) also changed the alternative minimum tax rate for 2012, setting the exemption to $78,750 for households and $50,600 for individuals. The ATM will be indexed to inflation in future years.

Small employer healthcare tax credit

Churches and other small employers that offer healthcare coverage for one or more of their employees through the Medical Plan of the Presbyterian Church (U.S.A.) or other plan may qualify for the small employer healthcare tax credit (Tax Credit) established by the Affordable Care Act (ACA).

The IRS has clarified that the Tax Credit applies to churches and other small employers that obtain coverage through self-funded church health plans. If your church or employing organization provides coverage for one or more of your full-time or part-time employees through the Medical Plan or other health insurance plan, it might qualify for the Tax Credit. The IRS guidance also explained how clergy are to be counted under the Tax Credit and rules that apply when an employer offers more than one type of plan.

Small employers with fewer than 25 “full-time equivalent employees” and with average wages of less than $50,000 may be eligible for a credit of up to 25 percent of the amount paid if they contribute a uniform percentage of at least 50 percent towards the premiums or dues paid for their employees’ healthcare coverage. The tax credit of up to 25% is available for tax years 2010 through 2013.

Please visit the Board’s website, pensions.org, for more information about calculating this credit, including worksheets and other church-specific guidance. You may also visit the IRS’s website at IRS.gov for details, press releases, and updated forms and publications.
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 percent of such taxes if they are either not withheld or not paid over to the government.

For 2013

Medicare Surtax
An additional Medicare tax for upper-income tax payers scheduled to take effect on January 1, 2013, as a result of the Affordable Care Act. The additional tax of 0.99 percent is on those making over $200,000 as an individual or $250,000 as a business or family. An employer must withhold the additional Medicare tax from wages it pays to an individual in excess of $200,000 in a calendar year, without regard to the individual’s filing status or wages paid by another employer. An individual may owe more than the amount withheld by the employer, depending on the individual’s filing status, wages, compensation and self-employment income. If the individual believes that they will owe additional tax, they should make estimated tax payments and/or request additional income tax withholding using form W-4, Employee’s withholding allowance certificate.

Employer-provided health coverage information reporting requirements
The ACA requires certain employers to report the cost of coverage under an employer-sponsored group health plan on the employee’s Form W-2. Coverage provided through a church plan, such as the Medical Plan of the PC(USA), is exempt from this reporting requirement. Qualified employers who purchase healthcare through a health insurance company are also exempt. This requirement is optional in 2011 and 2012. Qualified employers are those who file fewer than 250 W-2 forms for the previous calendar year. The number of W-2 forms the employer files includes any forms it files itself and any filed on its behalf by an agent. Reporting for church plans and qualified employers is not required until future guidance is provided by the IRS. However, reporting by qualified employers may be made on a voluntary basis.

Key Point
Churches and employing organizations with more than 250 employees that provide healthcare coverage to employees through another entity should contact their insurance provider or broker, as they may be required to provide covered employees with the value of that coverage beginning with their 2012 W-2s (i.e., on W-2s issued in January 2013).

Notice of state health insurance exchanges: The ACA also provides for written notice to all employees about the existence of health insurance exchanges in 2013. The federal government will be providing guidance as to the form and content of this notice. The Board will provide guidance to employing organizations about this requirement when it is available.

Coverage for qualified domestic partners
Effective January 1, 2013, the Benefits Plan of the Presbyterian Church (U.S.A.) will provide benefits coverage for eligible same-gender, qualified domestic partners of members and those partners’ children on the same basis as it does for opposite-gender married partners (and their children), if applicable. To be eligible for Benefits Plan coverage as a qualified domestic partner, the member and his or her same-gender partner must be married under civil law or in another form of legally sanctioned relationship affording rights of inheritance equivalent to a spouse under the laws of the jurisdiction where the union occurred. As of January 1, 2013, 18 states and the District of Columbia license a form of marriage, civil union, or domestic partnership that the Board would recognize for these purposes. A chart listing those jurisdictions is available on pensions.org.
The value of employer-provided qualified domestic partner benefits generally must be included in the income of the employee for federal income tax purposes. Because federal law does not provide a tax exemption for employer-provided healthcare benefits to same-gender spouses or domestic partners, employers are required to report the value of the provided coverage to the employee as “imputed income,” unless the domestic partner qualifies as a dependent for federal tax purposes. The imputed income can be reported incrementally on the employee’s paycheck or can be handled as a one-time entry on IRS Form W-2. Employer-provided coverage includes direct contributions made by the employer towards the cost of the domestic partner’s coverage and pre-tax contributions made by the employee for his or her domestic partner.

The value of domestic partner coverage may not be taxable for federal income tax purposes if the domestic partner is considered an IRS qualified dependent. To be an IRS qualified dependent, the domestic partner must, at a minimum, meet the following criteria:

1) The domestic partner received 50 percent of his or her support from the taxpayer
2) The individual must reside with the employee for the tax year at issue
3) The domestic partner is a member of the taxpayer’s household, as defined by the IRS

If a plan extends eligibility to the children of a domestic partner and those children are not otherwise dependents of the employee, the tax treatment will generally be the same as for coverage provided to the domestic partner. Tax laws vary by state. Employers should work with their payroll providers and tax counsel to ensure that deductions are properly established.

**Key Point**

If the employer offers domestic partner coverage and makes a contribution to the cost of coverage, the employer must address the imputed income requirements. The amount of imputed income should be based on the fair market value of the benefit provided, which the Board determines to be equal to the cost of medical continuation benefits. Domestic partner benefits are still subject to imputed income even if adding the domestic partner does not increase the premium.

**Key Point**

In addition to the soft costs associated with payroll reporting administration, the employer is subject to FICA matching on the value of employer-provided domestic partner coverage for lay employees.
Housing allowance (and manse 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 designated in advance by the minister’s employing church. For example, in December of 2012 a church agrees to pay its pastor “total compensation” of $45,000 for 2013, and 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 a 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 housing expenses, and (3) does not exceed the fair rental value of the minister’s home (furnished, plus utilities).

Note that the housing allowance and fair rental value of a manse are nontaxable only when computing federal income taxes. Ministers must include their housing allowance and rental value of a manse as taxable income when computing their self-employment taxes (except for retired ministers).

**KEY POINT** Be sure that the designation of a housing allowance for the following year is on the agenda of the church for one of its final 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 also recognizes designations in employment contracts and budget line items—assuming that the church duly adopted the designation and it is reflected in a written document.

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 will be made 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, an employee reports to the church rather than to the IRS. The reimbursements are not reported as taxable income to the employee, and the employee does not claim any deductions.

**KEY POINT** Reimbursements of business expenses under an accountable arrangement are not reported as taxable income on an employee’s Form W-2 or Form 1040, and there are no deductions to claim. In effect, the employee is reporting to the church rather than to the IRS. This often translates into significant tax savings for the employee.
An accountable reimbursement arrangement should be established by the church board or congregation 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. This will include written evidence for all expenses and receipts for expenses of $75 or more. For most expenses, the evidence must substantiate the amount, date, place, and business nature of each expense. The key point is this: A church must require the same degree of substantiation as would be 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 reported as taxable income on the minister's Form W-2 and Form 1040.

Healthcare spending accounts
Tax laws currently provide for several types of accounts that an employer may establish to permit an employee to set aside pre-tax dollars to pay for eligible medical, dental, vision, and hearing care expenses. Eligible expenses include:

- Special equipment such as crutches, wheelchairs, guide dogs, and artificial limbs
- Deductibles or copayments required by either the member or his or her spouse's medical or dental plan
- Expenses that exceed the member's medical or dental coverage, such as physical exams and orthodontics
- Hearing aids
- Vision exams, eyeglasses, contact lenses
- Copayments 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

Types of Accounts

- Employer medical reimbursement arrangements (sometimes referred to as wrap-around plans) - Some churches offer medical reimbursement arrangements for medical expenses that are not reimbursed by the 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 969.

- Flexible Spending Accounts (FSA)
- Health Reimbursement Arrangements (HRA)
- Health Savings Accounts (HSA)

Employers may establish and offer two additional benefits to employees to help ease the payment of their unreimbursed medical expenses. These two benefits include the FSA and the HRA.

Flexible Spending Accounts

**KEY POINT** The IRS has amended the “use it or lose it” rule for FSAs. The amendment allows employers to amend their FSA to provide for a grace period of two-and-a-half months. For example, if an employee incurs expenses in February 2012, the employee may be reimbursed for 2011 funds if the FSA plan provides for the grace period. 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.

**KEY POINT** The HIPAA medical privacy rules apply to health flexible spending arrangements.

A Health Flexible Spending Arrangement (FSA) allows employees to be reimbursed for medical expenses. FSAs are usually funded through voluntary salary reduction agreements with one's employer. No payroll taxes are deducted from employee contributions. The employer also may contribute.
A dependent care FSA offers a better way to manage dependent care expense. It helps reimburse for the work-related cost of care for a qualifying dependent (See IRS Publication 503 for details of a qualifying dependent). Unlike the health FSA, the full amount of the dependent care election is not available at the beginning of each year. An employee can only be reimbursed for the dependent care expense that already occurred and is limited to the amount already contributed to the dependent care FSA.

**KEY POINT**

Unlike health spending arrangements which must be reported on Form 1040, FSA contributions are not reported on the employee’s Form 1040.

FSAs have several benefits, including the following: (1) employer contributions can be nontaxable; (2) no payroll taxes are deducted from employee contributions; (3) withdrawals may be tax-free if used to pay qualified medical expenses; (4) employees can withdraw funds from an FSA to pay qualified medical expenses even if they have not placed the funds in the account.

Generally, distributions from a health FSA must be paid to reimburse the employee for qualified medical expenses. Qualified medical expenses are those incurred by an employee, or the employee’s spouse and certain dependents (including a child under age 27 at the end of the year).

Employees must be able to receive the total amount they have elected to contribute for the year at any time during the year, regardless of the amount they have actually contributed.

**KEY POINT**

Non-prescription medicines (other than insulin) do not qualify as an expense for FSA purposes

For more information regarding FSAs, see IRS Publication 502. In addition visit the Board of Pensions website at Pensions.org and locate the publication titled “Sample Guide for Employers Considering Health Flexible Spending Accounts” (FSA-001) for more information.

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.

**Limit on FSA contributions**

On January 1, 2013, the limit for contributions to all healthcare Flexible Spending Accounts (FSAs) will be limited by federal law to $2,500.

**Health Reimbursement Arrangements**

A Health Reimbursement Arrangement (HRA) is a program established under Section 105 of the Internal Revenue Code through which an employer can offer to reimburse employees for certain medical expenses on a nontaxable basis. The employing organization pays all HRA expenses; no employee salary reduction contribution is permitted. Reimbursements under an HRA are subject to fewer restrictions than Health FSAs. The unused portion of the employing organization’s contribution can be carried over and accumulated for future reimbursements from year to year if the employing organization chooses to offer such an arrangement. Medical expenses reimbursed through an HRA for an employee and his/her dependents are not subject to federal income, Social Security, or SECA taxes.

**Establishing an HRA**

An employing organization must adopt a written plan document setting forth the terms and conditions of the HRA. HRAs are subject to certain Internal Revenue Code nondiscrimination rules.

**Eligible Participants**

An employing organization sets the eligibility requirements for employees who may participate in the HRA. Reimbursements may be provided to current and former employees (including retired employees), their spouses and dependents, and the spouses and dependents of deceased employees. “Employee” does not include a self-employed individual.

A minister employed by a congregation is considered self-employed for Social Security purposes but an employee for federal income tax purposes. Employed ministers are eligible to participate in HRAs.

**How the HRA Works**

The employing organization determines a set dollar amount that it will reimburse annually or contribute to an account for reimbursement of an employee’s medical expenses. The employee may submit requests for reimbursement of expenses incurred for medical care up to the annual amount (or the accumulated amount if the employing organization’s plan provided for year-to-year accumulations). The types of expenses eligible for reimbursement from an HRA are the same as those under the Health FSA. However, unlike the Health FSA, amounts paid for dues or premiums for accident or healthcare coverage for current employees, retirees, continuation beneficiaries, and their dependents may also be reimbursed from the HRA.

**Administering the HRA**

The employing organization may administer the HRA internally or appoint a third-party administrator. Ultimately, the employing organization will be considered “plan administrator” for purposes of the HRA and will have a fiduciary duty to operate the plan solely in the interest of plan participants and their beneficiaries.
For more information regarding Health Reimbursement Arrangements, see IRS Publication 502. In addition, visit the Board of Pensions website at pensions.org for more information about HRAs and FSAs including sample FSA plan documents.

**Health Savings Accounts**

An HSA is an account that an employee may establish to pay for current health expenses and save for future qualified medical and health-related expenses on a tax-free basis. Employers may make contributions to HSAs.

HSAs are only available if the individual is covered by a high deductible health plan (HDHP) and there is no other secondary coverage. The Board of Pensions’ Medical Plan is not a HDHP. As a result, HSAs are not suitable for Benefits Plan members or their covered dependents or Medicare beneficiaries.

For more information regarding HSAs, see http://treas.tpaq.treasury.gov/offices/public-affairs/hsa.

**Defined Contribution Retirement Accounts**

**Section 403(b)(9) plans**

A 403(b)(9) plan, also known as a tax-sheltered annuity or retirement income account, is a retirement plan for certain employees of churches and other tax-exempt organizations. The Board of Pensions sponsors the Retirement Savings Plan, which all PC(USA) employers, even if the employer does not participate in the Benefits Plan’s other programs. These plans have the following tax benefits: (1) Employees do not pay income tax on allowable contributions until they begin making withdrawals from the plan, usually after they retire. Note, however, that lay employees must pay Social Security and Medicare tax on their contributions to a 403(b)(9) plan, including those made under a salary reduction agreement. (2) Earnings and gains on amounts in an employee’s 403(b)(9) account are not taxed until they are withdrawn. (3) Employees may be eligible to claim the retirement savings contributions credit (“saver’s credit”) for elective deferrals contributed to a 403(b)(9) account.

There are limits on the amount of contributions that can be made to a 403(b)(9) account each year. If contributions made to a 403(b)(9) account are more than these contribution limits, penalties may apply. See IRS Publication 571 for details.

Contributions to the Retirement Savings Plan administered by the Board of Pensions or other retirement income account for the minister or other church employees are not subject to federal income tax as long as these payments do not exceed the annual addition contribution limits under Internal Revenue Code (IRC) Code Sections 415 and 402(g). See IRS Publication 571. In 2012, the annual addition limit was the lesser of 100 percent of includible compensation (which does not include housing allowance) or $50,000. The limit increases to $51,000 in 2013.

**Employee Contribution Limits**

The employee elective deferral contributions limit is $17,000 for 2012 and increases to $17,500 in 2013. The “catch-up” contribution limit is $5,500 in 2012 and 2013.

**Employer Contribution Limits**

The employer contribution limit (the sum of employee elective deferrals and employer contributions) is the lesser of 100 percent of compensation or $50,000. In 2013, the limit increases to $51,000.

**Ministers and Church Employees**

Self-employed ministers and church employees who participate in 403(b)(9) plans generally follow the same rules as other 403(b)(9) plan participants. This means that a self-employed minister’s or a church employee’s maximum allowable contribution generally is the lesser of: (a) the limit on annual additions, or (b) the limit on elective deferrals.

**Self-Employed Ministers**

If you are a self-employed minister, you are treated as an employee of a tax-exempt organization that is a qualified employer. Your includible compensation is your net earnings from your ministry minus the contributions made to the retirement plan on your behalf and the deduction for one-half of the self-employment tax.

**Changes to Years of Service**

Generally, only service with the employer who maintains your 403(b)(9) account can be counted when figuring your limit on annual additions. If you are a church employee, treat all of your years of service as an employee of a church or a convention or association of churches as years of service with one employer.

However, if you are a self-employed minister, your years of service include full and partial years during which you were self-employed.

**KEY POINT**

_The Retirement Savings Plan is available to all church employees, even though they may not be members of the Benefits Plan. This is the most cost-effective way of establishing a retirement plan for all church employees. Call the Board of Pensions at 800-773-7752 (800-PRESPLAN) for more information._
COMPLYING with FEDERAL PAYROLL
TAX REPORTING OBLIGATIONS

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

This number must be recited on some of the returns listed below and is used to reconcile a church’s deposits of withheld taxes with the W-2 forms it issues 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 irs.gov for information. You may also apply for an EIN by calling 1-800-829-4933, or you can fax or mail Form SS-4 to the IRS. You should have only one EIN.

**KEY POINT** An 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. You can obtain an EIN by submitting a Form SS-4 to the IRS.

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 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 and the courts have applied various tests 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 guaranteed a regular wage amount for an hourly, weekly, or other period of time.
- 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.

**KEY POINT** For 2013, churches must withhold 28 percent of the compensation paid to a self-employed person who fails to provide his or her Social Security number to the church. This is referred to as “backup withholding” and is designed to promote the reporting of taxable income.

**KEY POINT** Some fringe benefits are nontaxable only when received by employees. A common example is employer-paid medical insurance.

STEP 3. Obtain the Social Security number for 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. This is a Social Security Administration form, not an IRS form. 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 percent for 2013 since ATRA approved this extension.

A self-employed person can stop backup withholding simply 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. It is a good idea for churches to present self-employed workers (e.g., guest speakers, contract laborers) with a Form W-9, and to backup withhold 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 11, 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 each nonminister employee claims to withhold the correct amount of federal income tax. Ministers need not file a Form W-4 unless they enter into a voluntary withholding arrangement 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 you received the replacement Form W-4. 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.

To help employees determine the proper amount of federal income tax withholding, the IRS provides a withholding calculator and other useful resources. The “withholding calculator” found on the IRS website (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 5. Compute each employee’s taxable wages.**

The amount of taxes that a church should withhold from an employee’s wages depends on the amount of the employee’s wages and the information contained on his or her Form W-4. A church must determine the wages of each employee that are subject to withholding. Wages subject to federal withholding include pay given to an employee for service performed. The pay may be in cash or in other forms. Measure pay that is not in money (such as property) by its fair market value. Wages often include a number of items in addition to salary. (There is a comprehensive list of examples in Step 10.)

**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. You can obtain a copy of IRS Publication 15 at any IRS office by calling the IRS forms number (800-829-3676), or by downloading a copy from the IRS website (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.

**Recommendation**

Be sure to obtain a new 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.

Both of these methods are explained in detail in Publication 15. Each year, a church should obtain a copy of Publication 15 to ensure that the correct amount of taxes is being withheld.

Wages paid to a minister as compensation for ministerial services are exempt from income tax withholding. However, ministers who report their income taxes as employees can enter into a voluntary withholding arrangement with their church. Under such an arrangement, the church withholds federal income taxes from the minister’s wages as if the
Minister’s wages are not exempt from withholding. Some ministers find voluntary withholding attractive, since it avoids the additional work and discipline associated with the estimated tax procedure.

A minister initiates voluntary withholding by providing the church with a completed IRS Form W-4 (Employee’s Withholding Allowance Certificate). The filing of this form is deemed to be a request for voluntary withholding.

Voluntary withholding arrangements may be terminated at any time by either the church or minister, or by mutual consent of both.

The tax code specifies that ministers are deemed self-employed for Social Security with respect to services performed in the exercise of ministry. Therefore, a church whose minister elects voluntary withholding is only obligated to withhold the minister’s federal income taxes. The minister is still required to use the estimated tax procedure to report and prepay the self-employment tax (the Social Security tax on self-employed persons). However, ministers electing voluntary withholding can indicate on line 6 of Form W-4 that they want an additional amount of income taxes to be withheld from each pay period that will be sufficient to pay the estimated self-employment tax liability by the end of the year. This additional withholding of income taxes becomes a credit that can be applied against a minister’s self-employment taxes on Form 1040. It is reported by the church as additional income taxes withheld on its quarterly Form 941.

Since any tax paid by voluntary withholding is deemed to be timely paid, a minister who pays self-employment taxes using this procedure will not be liable for any underpayment penalty (assuming that a sufficient amount of taxes are withheld).

**STEP 7. Withhold Social Security and Medicare taxes from nonminister employees’ wages.**

Employees and employers each pay Social Security and Medicare taxes (FICA) equal to 7.65 percent of an employee’s wages. The 7.65 percent tax rate is comprised of two components: (1) a Medicare hospital insurance tax of 1.45 percent, and (2) an "old age, survivor and disability" (Social Security) tax of 6.2 percent. There is no maximum amount of wages subject to the Medicare tax. For 2013, the maximum wages subject to the Social Security tax (the 6.2 percent amount) is $113,700.

Congress provided a payroll tax holiday for 2011 and 2012 in the form of a two percentage point reduction in Social Security taxes. This meant that the employee’s share of Social Security taxes dropped from 6.2 percent to 4.2 percent of wages (the employer’s share was not affected), and self-employed workers’ Social Security tax dropped from 12.4 percent to 10.4 percent of self-employment earnings. Congress did not extend this tax reduction after 2012. Accordingly, the employee rate reverts back to 6.2 percent and a total of 12.4 percent in 2013.

**New.** A new Additional Medicare Tax goes into effect starting in 2013. The 0.9 percent 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 ($250,000 for married filing jointly, $125,000 for married filing separately, and $200,000 for all other filers). Employers are responsible for withholding the Additional Medicare Tax from wages or compensation it pays to an employee in excess of $200,000 in a calendar year.

The Social Security tax rates for 2012 and 2013 are shown in the following table (this assumes that the payroll tax holiday is not extended to 2013):

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax on Employee</th>
<th>Tax on Employer</th>
<th>Combined Tax</th>
<th>Additional Medical Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>5.65%</td>
<td>7.65%</td>
<td>13.3%</td>
<td>0%</td>
</tr>
<tr>
<td>2013</td>
<td>7.65%</td>
<td>7.65%</td>
<td>15.3%</td>
<td>0.9%</td>
</tr>
</tbody>
</table>

**KEY POINT** Federal law allowed churches that had nonminister employees as of July 1984 to exempt themselves from the employer's share of Social Security and Medicare taxes by filing a Form 8274 with the IRS by October 30, 1984. Many churches did so. The exemption was available only to those churches that were opposed for religious reasons to the payment of Social Security taxes. The PCUSA does not oppose these programs for religious purposes and encourages churches to participate in the Social Security program. The Benefits provided under the Benefits Plan assume participation in Social Security. The effect of such an exemption is to treat all nonminister church employees as self-employed for Social Security purposes. Such employees must pay the self-employment tax (SECA) if they are paid $108.28 or more for the year. Churches hiring their first nonminister employee after 1984 have until the day before the due date for their first quarterly Form 941 to file the exemption application. Churches can revoke their exemption by filing a Form 8274 with the IRS by October 30, 1984. Many churches have done so, often inadvertently.
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)
- the employer’s share of Social Security and Medicare taxes

Most employers must deposit payroll taxes on a monthly or semiregular 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(Circular E) for more information.

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 etfps.gov. For information regarding due dates, balances due, payment mailing addresses, penalties, and payments made with errors, call 800-829-4933. If you do not want to use EFTPS, you can arrange for your tax professional, financial institution, payroll service, or other trusted third party to make deposits on your behalf.

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.

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Ending</th>
<th>Due date of Form 941</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st (Jan. - Mar.)</td>
<td>March 31</td>
<td>April 30</td>
</tr>
<tr>
<td>2nd (April - June)</td>
<td>June 30</td>
<td>July 31</td>
</tr>
<tr>
<td>3rd (July - Sept.)</td>
<td>September 30</td>
<td>October 31</td>
</tr>
<tr>
<td>4th (Oct. - Dec.)</td>
<td>December 31</td>
<td>January 31</td>
</tr>
</tbody>
</table>

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 be filed electronically. For more information, visit the IRS website at irs.gov/efile or call 866-255-0654.

Form 444 replaces Form 941 for eligible small employers. The purpose of new Form 444 is to reduce burden on the smallest employers by allowing them to file their employment tax returns annually and, in most cases, pay the employment tax due with their returns. Generally, you are eligible to file this form only if your payroll taxes for the year are $1,000 or less. Do not file Form 444 unless the IRS has sent you a notice telling you to file it.
STEP 10. Prepare a Form W-2 for every employee, including ministers employed by the church.

Starting in 2011, the healthcare reform legislation (PPACA) required certain 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, superseded in 2012 by IRS Notice 2012-9, 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 guidance also exempts reporting of church plan coverage. Accordingly, church employers are not required to report Medical Plan coverage on W-2 Forms in 2011 or 2012. The Board of Pensions intends to provide guidance as to the reportable amount for coverage under the Medical Plan Traditional and Affiliated Benefits programs to church employing organizations covering employees in the Medical Plan prior to the onset of this reporting obligation.

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 healthcare coverage.”

If your employees give their consent, you may be able to furnish Forms W-2 to your employees 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 ssa.gov/employer. The site also allows you to print out copies of the forms for filing with state or local governments, distribution to your employees, and for your records.

A church reports each employee’s taxable income and withheld income taxes as well as Social Security and Medicare taxes on Form W-2. A church should furnish copies B, C, and 2 of the 2012 Form W-2 to each employee by January 31, 2013. File copy A with the Social Security Administration by February 28, 2013. Send all copies A with Form W-3, Transmittal of Wage and Tax Statements. If you file electronically, the due date is April 1, 2013.

**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)!

You may need some assistance with some of the boxes on Form W-2. Consider the following:

**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. If you do not provide the correct employee name and Social Security number on Form W-2, you may owe a penalty unless you have reasonable cause.

**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, some churches that operate a private school have a number for both 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 your church’s name, address, and ZIP code. This should be the same address reported on your Form 941.

**Box d.** You may use this box to identify individual Forms W-2. You are not required to use this box.

**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. This includes:

- Salary, bonuses, prizes, and awards
- Taxable fringe benefits (including cost of employer-provided group term life insurance coverage that exceeds $50,000). Death benefits provided under the Traditional Program may exceed this limit. See the Board of Pensions’ calculator for determining the amount of imputed income to include on the employee’s Form W-2 for this coverage. It is available at pensions.org.
- The value of the personal use of an employer-provided car
- Most Christmas, birthday, anniversary, and other special occasion gifts paid by the church
- Business expense reimbursements paid under a nonaccountable plan (one that does not require substantiation of business expenses within a reasonable time, or does not require excess reimbursements to be returned to the church, or reimburses expenses out of salary reductions). Also note that such reimbursements are subject to income tax and Social Security withholding if paid to nonminister employees.
- If you reimburse employee travel expenses under an accountable plan using a per diem rate, include in Box 1 the amount by which your per diem rate reimbursements for the year exceed the IRS-approved per diem rates. Also note that such excess reimbursements are subject to income tax and Social Security withholding if paid to nonminister employees or ministers who have elected voluntary tax withholding. Use code L in Box 12 to report the amount equal to the IRS-approved rates.
- If you reimburse employee travel expenses under an accountable plan using a standard business mileage rate in excess of the IRS-approved rate (55.5 cents per mile for 2012) include in Box 1 the amount by which your mileage rate reimbursements for the year exceed the IRS-approved rates. Also note that such excess reimbursements are subject to income tax and Social Security withholding if paid to nonminister employees or ministers who have elected voluntary tax withholding. Use code L in Box 12 to report the amount equal to the IRS-approved rates (The rate for 2013 is 56.5 cents per mile.)
- Employer reimbursements of an employee’s nonqualified (nondeductible) moving expenses
- Any portion of a minister’s self-employment taxes paid by the church
- Amounts includible in income under a nonqualified deferred compensation plan because of section 409A
- Designated Roth contributions made under a section 403(b)(9) salary reduction agreement
- Church reimbursements of a spouse’s travel expenses incurred while accompanying a minister on a business trip represent 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 arrangement).
- Churches that make a “below-market loan” to a minister of at least $10,000 create taxable income to the minister (some exceptions apply) (A below market loan is a loan on which no interest is charged, or on which interest is charged at a rate below the applicable federal rate.)
- 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
- Employee contributions to a Health Savings Account (HSA)
- Employer contributions to an HSA if includable in the income of the employee

For ministers who report their income taxes as employees, do not report in Box 1 the annual fair rental value of a manse or any portion of a minister’s 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.

Caution
Taxable fringe benefits not reported as income in Box 1 may constitute an automatic excess benefit transaction exposing the recipient and members of the church board to intermediate sanctions in the form of substantial excise taxes.

KEY POINT
Churches should not include in Box 1 the annual fair rental value of a manse or a housing allowance provided to a minister as compensation for ministerial services.
Box 2. List all federal income taxes that you withheld from the employee’s wages. The amounts reported in this box (for all employees) should correspond to the amount of withheld income taxes reported on your four Forms 941.

Box 3. Report an employee’s wages subject to the “Social Security” component (the 4.2 percent rate for 2012 and 6.2 percent for 2013) 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)(9) plan by salary reduction agreement may be excludable from income and not reportable in Box 1, but they are subject to FICA taxes, and accordingly they represent Social Security and Medicare wages for nonminister employees.

KEY POINT 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.

Churches that filed a timely Form 8274 exempting themselves from the employer’s share of FICA taxes do not report the wages of nonminister employees in this box, since such employees are considered self-employed for Social Security purposes.

Box 4. Report the “Social Security” component (4.2 percent in 2012 and 6.2 percent for 2013) of FICA taxes that you withheld from the employee’s wages. This tax is imposed on all wages up to a maximum of $110,100 for 2012 and $113,700 for 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 ministers, this box should be left blank.

For 2012
The Tax Relief Act provided a payroll tax holiday for 2011 and 2012 in the form of a two percentage point reduction in Social Security taxes. This meant that the employee’s share of Social Security taxes dropped from 6.2 percent to 4.2 percent of wages (the employer’s share was not affected), and self-employed workers’ Social Security tax dropped from 12.4 percent to 10.4 percent of self-employment earnings. The payroll holiday was not extended by ATRA, and the rate reverts back to 6.2 percent in 2013.

Box 5. Report a nonminister employee’s current and deferred (if any) wages subject to the Medicare component (1.45 percent) 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 nonminister employee in 2012, Box 3 should show $110,100 and Box 5 should show the full amount of wages paid. This amount increases to $113,700 for 2013. In addition, for individuals earning over $200,000 and married couples filing jointly with income over $250,000, there is an additional 0.9 percent Medicare tax beginning January 1, 2013. However, employers must withhold the Additional Medicare Tax from all employees, regardless of marital status, on wages exceeding $200,000.

Box 6. Report the Medicare component (1.45 percent) of FICA taxes that you withheld from the nonminister 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 by you for your employee. Include the fair market value of employer-provided day-care 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 Publication 15-B.

Box 11. Report the total amount you distributed to an employee under a nonqualified deferred compensation (NQDC) plan, including some rabbi trusts. Also report these distributions in Box 1. Unlike qualified plans, NQDC plans do not meet the qualification requirements for tax-favored status. 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 deferrals included in Boxes 3 or 5 and deferrals for current year services (such as those with no risk of forfeiture). Boxes 3 and 5 are used to report nonminister employees’ wages subject to Social Security and Medicare taxes.
Security and Medicare taxes, and are generally blank for ministers with respect to compensation received for ministerial services.

The purpose of Box 11 is for the Social Security Administration (SSA) to determine if 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 – You (the church) provided your employee 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 nonminister employees). See page 21 for additional information.
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 nonminister 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 – You (the church) are 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 – You (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 nonminister employees, report the excess in Boxes 3 (up to the Social Security wage base) 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, N – Generally not applicable to churches.
P – You (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 you paid directly to a third party on behalf of the employee (for example, to a moving company), or 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). Include amounts the employee elected to contribute using a cafeteria plan.
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 all amounts deferred (including earnings on deferrals) under a nonqualified deferred compensation plan that are included in income under section 409A of the tax code because the NQDC fails to satisfy the requirements of section 409A. Do not include amounts properly reported on Forms 1099-MISC or W-2 for a prior year. Also, do not include amounts considered to be subject to a substantial risk of forfeiture for purposes of section 409A. The amount reported in box 12 using code Z is also reported 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. Church plan coverage is also optional for 2012 and continues until further guidance is issued.

**Box 13.** Check the appropriate box.

- **statutory employee.** Churches rarely, if ever, have statutory employees. These include certain drivers, insurance agents, and salespersons.

- **retirement plan.** Mark this checkbox if the employee 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.

- **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. 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 your 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, you should determine that the reasons are valid.

**STEP 11.** Prepare a Form 1099-MISC for every self-employed person receiving nonemployee compensation of $600 or more.

**KEY POINT**

The PPACA, enacted by congress in 2010, contained a provision eliminating the exemption of payments to corporations from the Form 1099-MISC reporting requirement for payments made after 2011. This provision ignited a firestorm of protests. Congress responded by enacting the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Over-Payments Act of 2011, which repealed the Form 1099-MISC requirement for payments made to corporations.

A Form 1099-MISC must be issued to any nonemployee who is paid self-employment earnings of at least $600 during any year. For compensation paid in 2012, furnish Copy B of this form to the recipient by January 31, 2013, and file Copy A with the IRS by February 28, 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.
Self-employment earnings include compensation paid to any individual other than an employee. Examples include ministers who report their income as self-employed for income tax reporting purposes, some part-time custodians, and certain self-employed persons who perform miscellaneous services for the church (plumbers, carpenters, lawn maintenance providers, etc.) and who are not incorporated.

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 reimbursed under an accountable plan) then the church must issue the person a Form 1099MISC before February 1, 2013.

Exceptions apply. For example, a church need not issue a 1099MISC 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 1099MISC, 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 a Social Security number, then the church is required to withhold a percentage of the person’s total compensation as “backup withholding.” See “Step 2,” on page 11. The backup withholding rate is 28 percent for 2013 since ATRA approved this extension.
Reporting group term life insurance

You must 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. You must 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.

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

Example

Church A pays the premiums on a $70,000 group term insurance policy on the life of Pastor B with B’s wife as beneficiary. Pastor B is 29 years old. Church A also pays the premium on a $5,000 group term policy which covers Pastor B’s wife who is 30 years old. The church would have to report $21.90 as the imputed cost of the insurance provided to Pastor B and his wife.

This amount is computed as follows: (1) For Pastor B, 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 Pastor B, take 6 cents x 12 months = 72 cents x 20 (corresponding to $20,000 of group term insurance in excess of $50,000) = $14.40.

(2) In addition, the cost of the entire $5,000 of insurance provided to Pastor B’s wife would have to be computed. Take 8 cents x 12 months = 96 cents x 5 = $4.80. Combine this amount with the cost of Pastor B’s excess insurance to obtain the taxable amount of $19.20. Church A should include this amount with wages in Box 1 of Form W-2. This amount should also be reported in Box 12 and labeled code C. Any includable amount is subject to income tax as well as Social Security and Medicare withholding for nonminister church employees.

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 on or before his or her first day of compensated work. 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 website (uscis.gov) for instructions that will assist you in completing the Form I-9. You can also download Form I-9 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 and relate to the 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 in case there is ever a question about whether a document was genuine.

- 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.

Note: The Board of Pensions provides additional information on the taxation of death benefits on its website (pensions.org). Also included on the website is a calculator that will compute the appropriate imputed premiums.
Upon request, show completed forms to authorized officials of the Department of Homeland Security (DHS), the Department of Labor, or the Justice Department’s Office of Special Counsel for Unfair Immigration-Related Employment Practices (OSC). Officials will give a minimum of three days’ notice before inspection.

Churches, like any employer, can be penalized for failing to comply with the I-9 requirement. If you fail to complete, retain, or make available for inspection a Form I-9 as required by law, you may face a civil penalty of not less than $110 and not more than $1,100 per violation. If DHS determines that you knowingly hired unauthorized aliens, you may be ordered to cease and desist from such an activity and pay a civil penalty of not less than $375 and not more than $3,200 for the first offense. These penalties increase significantly for repeat offenses.

Annual certification of racial nondiscrimination

Churches and other religious organizations 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 5th 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. For example, 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, high schools, colleges, and universities, whether operated as a separate legal entity or an activity of a church.

The term “school” also includes preschools, and this is what makes the reporting requirement relevant for many churches. As many as 25 percent of all churches operate a preschool program.

Independent religious schools that are not affiliated with a church or denomination that file Form 990 do not file Form 5578. Instead, they make their annual certification of racial nondiscrimination directly on Form 990.

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 sections 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 the following: (1) During the preceding three years, the enrollment consists of students at least 75 percent 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 non-discriminatory 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 (1-800-829-3676).
Charitable contribution substantiation rules

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

Cash contributions

All cash contributions, regardless of amount, must be substantiated by either a bank record (such as a cancelled 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. The recordkeeping requirements may not be satisfied by maintaining other written records. In the past, 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 cancelled 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 acknowledgement 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:

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. 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 two percent 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, call 800-TAX-FORM or 800-829-3676.

- IRS homepage
  - irs.gov

- ChurchLawandTax.com
  - A Christianity Today website featuring Richard Hammar and a host of other professionals who provide information on church law, tax, finance, and risk management

- YourChurchResources.com
  - An online store with church management resources to keep your church safe, legal, and financially sound

- Church & Clergy Tax Guide
  - Richard Hammar's comprehensive tax guide published annually by Christianity Today International

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IRS RESOURCES

Publication 1  Your Rights as a Taxpayer
Publication 15  Circular E, Employer's Tax Guide
Publication 15-A  Employer's Supplemental Tax Guide
Publication 334  Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)
Publication 463  Travel, Entertainment, Gift, and Car Expenses
Publication 517  Social Security and Other Information for Members of the Clergy and Religious Workers
Publication 521  Moving Expenses
Publication 524  Credit for the Elderly or the Disabled
Publication 525  Taxable and Nontaxable Income
Publication 526  Charitable Contributions
Publication 550  Investment Income and Expenses
Publication 554  Tax Guide for Seniors
Publication 557  Tax-Exempt Status for Your Organization
Publication 561  Determining the Value of Donated Property
Publication 571  Tax-Sheltered Annuity Plans (403(b) Plans)
Publication 598  Tax on Unrelated Business Income of Exempt Organizations
Publication 910  Guide to Free Tax Services
Publication 1771  Charitable Contributions: Substantiation and Disclosure Requirements
Publication 1828  Tax Guide for Churches and Religious Organizations
Publication 3079  Gaming Publication for Tax-Exempt Organizations

Visit IRS.gov or call 800-829-1040 for forms or information. These and many other publications can be downloaded from the Board’s website, Pensions.org, or call 800-773-7752 (800-PRESPLAN) for a copy.

BOARD OF PENSIONS RESOURCES

Dues & Invoices
• Understanding Effective Salary
• 2013 Dues Schedule
• Worksheet for Full-Time Equivalent Salary Basis for Healthcare Dues

Dues
• BoardLink (online billing service)
• Church Treasurer & Business Administrator News, Fall 2012
• Your Benefits as a Member Couple
• Taxation of Death Benefits
• USERRA Q & A

Flexible Spending Accounts – Sample Forms and Plan
• Sample Guide for Employers Considering Health Flexible Spending Accounts
• Sample Session Resolution
• Sample Health Flexible Spending Plan Employee Summary
• Sample Health Flexible Spending Account Plan Document
• Sample Health Flexible Spending Account Enrollment
• Sample Health Flexible Spending Account Worksheet
• Sample Reimbursement Claim Form for Health Flexible Spending Account

Calculators
• Total Effective Salary Calculator
• Dues Calculator
• Supplemental Death Benefit Rate Checker
• Optional Dental Benefit Rate Checker
• Taxation of Death Benefits Dues Calculator

Other
• What’s New in Healthcare Reform