



*Federal Reporting Requirements for Churches**

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INTRODUCTION

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:

1. 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.
2. 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.
3. 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:
 - a. **Ministers are self-employed for Social Security with respect to their ministerial services.** While most ministers are employees for federal income tax reporting, they are self-employed for Social Security with respect to compensation they receive for ministerial services. This means that they pay the “self-employment tax” (SECA) rather than the employee’s share of Social Security and Medicare taxes (FICA)—even if they report their federal income taxes as a church employee. It is a common mistake 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.
 - b. **A minister’s wages are exempt from income tax withholding.** Wages paid to a minister as compensation for ministerial services are exempt from 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 (explained below).
 - c. **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 this 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.

✎ **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. This penalty is of special relevance to church leaders, given the high rate of noncompliance by churches with the payroll reporting procedures.*

MAXIMIZING TAX BENEFITS FOR YOUR MINISTER

Housing allowance (and parsonage 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 2016 a church agrees to pay its pastor “total compensation” of \$45,000 for 2017, 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).

- ★ **Key Point.** Under no circumstances can a church designate a housing allowance retroactively.
- ★ **Key Point.** Although repayments of principal and interest on a home mortgage loan qualify as a housing expense to which a housing allowance can be applied, costs associated with refinancing a principal residence or a home equity loan qualify only if the proceeds are used for housing expenses.

Ministers who live in a church-owned parsonage that is provided “rent-free” as compensation for ministerial services do not include the annual fair rental value of the parsonage as income in computing their federal income taxes. The annual fair rental value is not “deducted” from the minister’s income. Rather, it is not reported as additional income on Form 1040 (as it generally would be by non-clergy workers). Ministers who live in a church-provided parsonage do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a parsonage allowance, to the extent that the allowance represents compensation for ministerial services and is used to pay parsonage-related expenses such as utilities, repairs, and furnishings.

Note that the housing allowance and fair rental value of a parsonage are nontaxable only when computing federal income taxes. Ministers must include their housing allowance and rental value of a parsonage as taxable income when computing their self-employment taxes (except for retired ministers). In addition, any housing provided to a minister that is excludable from taxable income pursuant to IRC §119 (relating to housing provided on an employer’s premises “for the convenience of the employer”) also must be included in a minister’s taxable income when computing self-employment income.

✦ **Key Point.** Be sure that the designation of a housing allowance for the following year is on the agenda of the church or church board for its last meeting 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.

✦ **Key Point.** Lay ministers may be able to exclude income designated as a housing allowance if they meet the IRS requirements for ministers, which are: (1) the lay minister must be authorized by the terms of call to perform the sacerdotal functions; (2) the employing church must designate, in advance of payment, a portion of the lay minister’s salary as housing allowance; and (3) the lay minister must comply with the requirements for documentation of the housing expenses outlined above for ministers.

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, 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. This is the best way for churches to handle reimbursements of business expenses.

✦ **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. Instead, the entire amount of these reimbursements must be reported as taxable income on the minister’s Form W-2 and Form 1040.

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.

- ❖ **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.

FSAs are “use-it-or-lose-it” plans. This means that amounts in the account at the end of the plan year cannot be carried over to the next year. However, the plan can provide for a grace period of up to 2 ½ months after the end of the plan year. If there is a grace period, any qualified medical expenses incurred in that period can be paid from any amounts left in the account at the end of the previous year. An employer is not permitted to refund any part of the balance to the employee.

- ❖ **Key Point.** An employer, at its option, may amend its cafeteria plan document to provide for the carryover to the immediately following plan year of up to \$500 of any amount remaining unused as of the end of the plan year in a health FSA. The carryover of up to \$500 may be used to pay or reimburse medical expenses under the health FSA incurred during the entire plan year to which it is carried over. For this purpose, the amount remaining unused as of the end of the plan year is the amount unused after medical expenses have been reimbursed at the end of the plan's run-out period for the plan year. In addition to the unused amounts of up to \$500 that a plan may permit an individual to carry over to the next year, the plan may permit the individual to also elect up to the maximum allowed salary reduction amount (\$2,550 for 2016). Thus, the carryover of up to \$500 does not count against or otherwise affect the \$2,550 salary reduction limit applicable to each plan year. Although the maximum unused amount allowed to be carried over in any plan year is \$500, the plan may specify a lower amount as the permissible maximum (and the plan sponsor has the option of not permitting any carryover at all).

A plan adopting this carryover provision is not permitted to also provide a grace period with respect to health FSAs.

Health Care Spending Accounts

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.

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.

The maximum amount available for reimbursement of incurred medical expenses of an employee and the employee's dependents under a health FSA cannot exceed \$2,550 for 2016 or \$2,600 for 2017.

Note that the Affordable Care Act prohibits employers from using an FSA to pay for, or reimburse, the cost of individually-owned health insurance policies with pre-tax dollars.

- ❖ **Key Point.** Non-prescription medicines (other than insulin) do not qualify as an expense for FSA purposes

Dependent Care Accounts

This account allows a minister or lay employee to set aside pretax dollars to pay for eligible child care expenses incurred for children under the age of 13, such as nursery school tuition and day care fees. In some cases, it can also be used for other dependent relatives. The maximum allowed is \$5,000. Money set aside for a health spending account cannot be transferred to a dependent care account or vice versa.

Section 403(b) plans

Contributions to the Comprehensive Plan, the Retirement Only Plan and the Member Contribution Plan administered by MMBB – or other qualified employer-sponsored retirement income accounts 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) plan, including those made under a salary reduction agreement. (2) Earnings and gains on amounts in an employee's 403(b) 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) account.

There are limits on the amount of contributions that can be made to a 403(b) account each year. If contributions made to a 403(b) account are more than these contribution limits, penalties may apply. Generally, annual contributions to a 403(b) plan cannot exceed either the limit on annual additions or the limit on elective deferrals. See IRS Publication 571 for details.

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 2017 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.

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 2017.

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 (page 11).

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 2016 must be filed with the IRS by January 31, 2017. However, if you made deposits on time in full payment of the taxes for the year, you may file the return by February 12, 2017.

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 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 arrangement with their employing 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.

⊕ **TIP.** The “Withholding Calculator” found on the IRS website (irs.gov) can help employees determine the proper amount of federal income tax withholding.

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. This method works for any number of withholding allowances an employee claims and any amount of wages.

⊕ **Recommendation.** Be sure to obtain a new IRS Publication 15 in January of 2017. It will contain updated tables for computing the amount of income taxes to withhold from employees’ 2017 wages and other helpful information.

Both of these methods are explained in detail in IRS 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 often difficult task of budgeting for four significant tax payments.

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.

The tax code specifies that ministers are 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 self-employment taxes. 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. Many churches incorrectly report these additional withholdings as Social Security and Medicare taxes.

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 (together, these two kinds of taxes are called "FICA" for Federal Insurance Contributions Act) 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 2016, the maximum wages subject to the Social Security tax (the 6.2 percent amount) was \$118,500. It increases to \$127,200 for 2017.

Beginning in 2013, the Affordable Care Act increases the employee portion of the Medicare (HI) tax by an additional tax of 0.9 percent on wages received in excess of a threshold amount. However, unlike the general 1.45 percent HI tax on wages, this additional tax is on the combined wages of the employee and the employee's spouse, in the case of a joint return. The threshold amount is \$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married individual filing a separate return, and \$200,000 for single persons. The \$250,000 and \$200,000 and \$125,000 amounts are not adjusted for inflation and remain the same for 2017.

The Social Security tax rates for 2016 and 2017 are shown in the following table:

Year	Tax on Employee	Tax on Employer	Combined Tax
2016	7.65%	7.65%	15.3%
2017	7.65%	7.65%	15.3%

★ **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 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 941 form to file the exemption application. Churches can revoke their exemption by filing a Form 941 accompanied by full payment of Social Security and Medicare taxes for that quarter. 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:

1. income taxes withheld from employees' wages,
2. the employees' share of Social Security and Medicare taxes (withheld from employees' wages), and
3. the employer's share of Social Security and Medicare taxes.

Most employers must deposit payroll taxes on a monthly or semiweekly basis. An employer's deposit status is determined by the total taxes reported in a four-quarter "lookback" period. For 2017, the lookback period will be July 1, 2015 through June 30, 2016.

Monthly depositor rule. Churches that reported payroll taxes of \$50,000 or less in the lookback period will deposit their withheld taxes for 2017 on a monthly basis. Payroll taxes withheld during each calendar month, along with the employer's share of FICA taxes, must be deposited by the 15th day of the following month.

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

or by the following Wednesday. For all other paydays, the payroll taxes must be deposited on the Friday following the payday.

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

❖ **Key Point.** All deposits must be made using the Electronic Federal Tax Payment System (EFTPS). There are penalties for depositing late, or for mailing payments directly to the IRS that are required to be deposited, unless you have reasonable cause for doing so. To enroll in EFTPS, call 800-555-4477, or to enroll online, visit eftps.gov. 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.

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

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 or call 1-866-255-0654.

❖ **Key Point.** Form 944 replaces Form 941 for eligible small employers. The purpose of new Form 944 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 return. 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 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 ministers employed by the church.

New in 2016. Congress enacted legislation in 2015 requiring that Forms W-2, W-3, 1099-MISC, and 1096, be filed by January 31, and eliminates the extended due date (March 31) for electronically filed Forms W-3 and 1096. These changes are effective for returns and statements relating to calendar years beginning after 2015.

A church reports each employee’s taxable income and withheld income taxes as well as Social Security and Medicare taxes on this form. A church should furnish copies B, C, and 2 of the 2016 Form W-2 to each employee by January 31, 2017. File Copy A with the Social Security Administration by January 31, 2017. Send all Copies A with Form W-3, Transmittal of Wage and Tax Statements. If you file electronically the due date remains January 31, 2017.

❖ **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 the 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 W-2 forms. 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).
- 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 (54 cents per mile for 2016) 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.
- 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) 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 plan.
- 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.
- "Love gifts" from the church to a pastor.

For ministers who report their income taxes as employees, do not report in box 1 the annual fair rental value of a parsonage 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*

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 through Friday, 8:30 a.m. to 4:30 p.m. Eastern Standard Time.

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 parsonage 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 941 forms.

Box 3. Report an employee's wages subject to the "Social Security" component (the 6.2 percent rate for 2016) of FICA taxes. Box 3 should not list more than the maximum wage base for the "Social Security" component of FICA taxes (\$118,500 for 2016, \$127,200 for 2017). 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 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 (6.2 percent) of Social Security and Medicare taxes that you withheld from a nonminister employee's wages. This tax is imposed on all wages up to a maximum of \$127,200 for 2017. 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 with respect to compensation from the performance of ministerial services. For ministers, this box should be left blank.

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 persons earning less than the annual maximum earnings subject to the 6.2 percent

Social Security tax (\$127,200 for 2017) Boxes 3 and 5 should show the same amount. If you pay more than \$127,200 to a nonminister employee in 2017, Box 3 should show \$127,200 and Box 5 should show the full amount of wages paid.

Box 6. Report the Medicare component 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 daycare facilities and amounts paid or incurred for dependent care assistance 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. 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 they have properly applied the Social Security earnings test and paid the correct amount of benefits. Report distributions to an employee from a nonqualified plan in box 11. Also report these distributions in box 1. Under nonqualified plans, deferred amounts that are no longer subject to a substantial risk of forfeiture are taxable even if not distributed. 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).

If you made distributions and also are reporting any deferrals in boxes 3 or 5, do not complete box 11. See IRS Publication 957.

Unlike qualified plans, nonqualified plans do not meet the qualification requirements for tax-favored status. Nonqualified plans include those arrangements traditionally viewed as deferring the receipt of current compensation, such as a rabbi trust. Welfare benefit plans and plans providing termination pay, or early retirement pay, are not generally nonqualified plans.

For additional information, see IRS Publications 15 and 957.

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 ex-

ample, 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 12 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.

Q – Generally not applicable to churches.

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.

V – Generally not applicable to churches.

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.

AA – Generally not applicable to churches.

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 – The Affordable Care Act requires employers to report the cost of coverage under an employer-sponsored group health plan. IRS Notice 2011-28 provided relief for smaller employers filing fewer than 250 W-2 forms by making the reporting requirement optional for them until further guidance is issued by the IRS. 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.

EE – Generally not applicable to churches.

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 an 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). (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.

By January 31, 2017, churches must furnish Copy B of Form 1099-MISC (“statement for recipient of miscellaneous income”) to any self-employed person to whom the church paid nonemployee compensation of \$600 or more in 2016. This form (rather than a W-2) should be provided to clergy who report their federal income taxes as self-employed, since the Tax Court and the IRS have both ruled that a worker who receives a W-2 rather than a 1099-MISC is presumed to be an employee rather than self-employed. Other persons to whom churches may be required to issue a 1099-MISC include evangelists, guest speakers, contractors, and part-time custodians.

Churches must send Copy A of Forms 1099-MISC, along with Form 1096, to the IRS by January 31, 2017, if nonemployee compensation is reported in box 7. If you file electronically, the due date for filing Copy A with

the IRS is also January 31, 2017, if you are reporting nonemployee compensation box 7. Otherwise the deadline is February 28 if you file on paper, or March 31 if you file electronically.

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 2016 and received compensation from the church in an amount of \$600 or more (net of any housing allowance or travel expenses reimbursed under an accountable plan) then the church must issue the person Copy B of Form 1099-MISC by January 31, 2017.

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 complete Form 1099-MISC the church will need to obtain the recipient’s 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,” above. The backup withholding rate is 28 percent for 2017.

OTHER IMPORTANT REQUIREMENTS FOR CHURCHES

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 Comprehensive 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.

<i>Cost per \$1,000 of protection for 1-month period</i>			
Age Brackets	Cost	Age Brackets	Cost
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		

The death benefit under the Comprehensive Plan is shown in the following table:

Thru age 40	5 times compensation
41 thru age 50	4 times compensation
51 thru age 60	3 times compensation
61 thru age 65	2 times compensation
66 and to retirement	1.5 times compensation

The payment during the first year of membership is 1/3 of the above schedule and 2/3 during the second year of membership. Compensation used in determining the death benefit is the figure reported to MMBB for calculating the Comprehensive Plan premiums, with a maximum compensation of \$250,000. Compensation includes cash salary, rental value of parsonage and utilities and/or housing allowance. The inclusion of a Social Security/Medicare tax offset is optional for determining premiums. If there was a compensation change during the tax year, the compensation should be prorated in the group term life insurance tax liability calculation. Also, the age of the member at the end of the year should be used in determining the death benefit and the age bracket in the IRS table shown above.

Example. Rev. B is 52 years old and her church reports compensation of \$50,000 to MMBB. The Comprehensive Plan provides \$150,000 of group term life insurance protection for her. The imputed cost of the excess coverage of Rev. B is \$276. You must include in Rev. B's income \$276 computed as follows:

$\$50,000 \times 3$	\$150,000.00
Total insurance coverage	150,000.00
"Tax-free" amount	-50,000.00
Insurance subject to tax:	\$100,000.00

Taxable income calculation:

Cost per \$1,000 for each month of protection
 $\$100,000 \text{ divided by } \$1,000 = \$100.00$
 $\$100.00 \times .23 = \$23.00 \times 12 = \$276.00$

Total reportable income: \$276.00

Rev. B's church should include the \$276 with wages in Box 1 of Form W-2. This amount should also be reported in Box 12 and labeled "C" (see page 10). Any includable amount is subject to income tax as well as Social Security/Medicare Tax withholding for nonordained church employees.

The imputed cost of group term life insurance does not apply for members of the Comprehensive Plan if:

- The members have designated their employer or a charitable organization as their sole primary beneficiary for the group term life insurance; or
- The first \$50,000 is designated to a person, estate or noncharitable institution and the balance is designated to charitable organizations.

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:

1. 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 3 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.
2. 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.
3. 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.
4. 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.

5. Employers must retain an employee's completed Form I-9 for as long as the individual works for the employer. Once the individual's employment has terminated, the employer must determine how long after termination the Form I-9 must be retained, which is either three years after the date of hire, or one year after the date employment is terminated, whichever is later. Forms I-9 can be retained either on paper or microform, or electronically.
6. Upon request, show completed forms to authorized officials of the Department of Homeland Security (DHS), 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 for each violation. There are additional penalties for knowingly hiring unauthorized aliens.

Providing an employee's Social Security number on Form I-9 is voluntary for all employees unless an employer participates in the USCIS "E-Verify" program.

 **Caution.** In 2016 USCIS approved a new Form I-9. Employers may continue using the previous version of Form I-9 with a revision date of March 8, 2013 until January 21, 2017. After January 21, 2017, all previous versions of Form I-9 will be invalid.

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 2016 is due May 15, 2017.

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, and this is what makes the reporting requirement relevant for many churches. As many as 25 percent of all churches operate a preschool program.
- ★ **Key Point.** Independent religious schools that are not affiliated with a church or denomination, and 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:

1. 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.
2. 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.
3. 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 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.
4. 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 Form 5578 from the IRS website (irs.gov) or 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:

1. 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.

2. 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:

- a. Name of the church.
- b. Name of the donor (a Social Security number is not required).
- c. Date of the contribution.
- d. Amount of any cash contribution.
- e. 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.
- f. 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.
- g. The church may either provide separate acknowledgements 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.

h. 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.

3. 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:

a. 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.

b. A written statement need not be issued if only “token” goods or services are provided to the donor. For 2016, token goods or services were those having a value not exceeding the lesser of \$104 or 2 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.

4. 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. 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 (\$10,000 for privately held stock), 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. The appraisal must be enclosed for contributions of property (other than inventory and publicly traded securities) in excess of \$500,000.

Affordable Care Act reporting

The ACA imposes the most significant reporting obligations since the introduction of Form W-2 in 1943. In fact, the new reporting obligations are similar to Form W-2 in that there are forms that must be issued to individual employees, and a “transmittal” form that is sent to the IRS along with copies of all the forms issued to employees. And, as with Form W-2, the IRS can assess penalties for failure to comply with the new reporting obligations. Because of the similarities of the new reporting requirements to Form W-2, some are calling them the “Health Care W-2s.” Of course, the analogy is not perfect. The W-2 form reports compensation and tax withholding, while the new forms report health insurance information. The reporting requirements consist of the following forms:

- Providers of minimum essential coverage are required to file Forms 1094-B and 1095-B. These forms are used to report certain information to the IRS and to employees about individuals who

are covered by minimum essential coverage and therefore aren’t liable for the individual shared responsibility payment penalty. These forms must be filed by February 28, 2017 (March 31, 2017 if filed electronically).

- Applicable Large Employers, generally employers with 50 or more full-time employees (including full-time equivalent employees) in the previous year, must file one or more Forms 1094-C (including a Form 1094-C designated as the Authoritative Transmittal, whether or not filing multiple Forms 1094-C), and must file a Form 1095-C for each employee who was a full-time employee of the employer for any month of the calendar year. Generally, the employer is required to furnish a copy of the Form 1095-C (or a substitute form) to the employee. These forms must be filed by February 28, 2017 (March 31, 2017 if filed electronically). The information reported on Forms 1094-C and 1095-C is used to determine whether an employer owes a payment under the employer shared responsibility provisions of the ACA (the “employer mandate” or “play or pay” provisions).

See the instructions to these forms on the IRS website (irs.gov) for more information.

- ★ **Key Point.** Churches with fewer than 50 full-time employees, and an insured group health plan, generally have no reporting obligation. They are not required to file Forms 1094-C and 1095-C since they have fewer than 50 employees, and their group plan insurer files the Forms 1094-B and 1095-B.

HELPFUL NUMBERS AND RESOURCES

- **To request IRS forms:** 800-TAX-FORM or 800-829-3676
- **MMBB Financial Services:** 800-986-6222 or mmbb.org
- **Internal Revenue Service (IRS):** 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
- **ChurchLawAndTaxStore.com**—Christianity Today’s 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