CHURCH
PENSION FUND

2016 Federal Reporting Requirements

For Episcopal Churches

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CHURCH PENSION FUND

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Dear Treasurers, Wardens, and Administrators,

In keeping with The Church Pension Fund's ongoing commitment to conserving our natural and financial resources, this year the *2016 Federal Reporting Requirements for Episcopal Churches* is being offered exclusively as an online booklet.

The *2016 Clergy Tax Guide* also is being disseminated online. To access that document, please go to ***www.cpg.org/taxpubs*** and click the "Active Clergy" or "Retired Clergy" options.

Faithfully,

Mary Kate Wold

Mary Kate Wold
CEO and President

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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 and Medicare taxes. These payroll reporting requirements apply, in whole or in part, to almost every church.

Note: The term "church" is used broadly throughout this publication and refers to actions taken by the vestry and/or the congregation, depending on the nature of the action. This may include entities that are controlled by or legally associated with The Episcopal Church.

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

Warning

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

A number of special rules apply to churches:

1. **A definition of "minister" for IRS tax purposes**. Although all Christians are ministers, theologically speaking, for tax purposes the IRS designation of "minister" applies in The Episcopal Church exclusively to ordained ministers — bishops, priests, and deacons.
2. **Ministers are always self-employed for Social Security and Medicare tax purposes with respect to their church compensation**. While most clergy are employees for federal income tax reporting purposes, they are self-employed for Social Security and Medicare tax with respect to their church compensation. This means that they pay the "self-employment tax" (SECA) rather than the employee's share of Social Security and Medicare taxes. As such, it is incorrect for churches to withhold the employee's share of Social Security and Medicare taxes from their wages.
3. **A minister's wages are exempt from compulsory income tax withholding, whether the minister reports his/her income taxes as an employee or as self-employed**. Clergy may enter into a voluntary withholding agreement with their employing church.

4. **Because of liabilities attached to vestries and rectors, consider using a professional payroll service**. A payroll service makes tax payments, files tax reports, and produces all year-end paperwork.

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

Medical Insurance Reimbursement Plan/Employer Payment Plan — Internal Revenue Code Section 106

Employer payments and reimbursements of health insurance premiums for group health care coverage provided by the employer to the employee continue to be treated on a tax-favored basis pursuant to Internal Revenue Code ("Code") Section 106. However, pursuant to guidance issued by the Internal Revenue Service in Notice 2013-54, in most cases, it is no longer permissible for an employer to directly reimburse an employee for premiums paid by the employee for the purposes of purchasing an individual insurance policy. Further guidance was issued by the Department of Labor on November 6, 2014, which clarified that this type of reimbursement is prohibited, regardless of whether the reimbursement is treated as taxable or non-taxable.

Additionally, in Chief Counsel Memorandum 201547006, the Internal Revenue Service clarified that an employer may only exclude from an employee's gross income payments for the cost of health insurance coverage provided through the spouse's group health plan if the spouse paid for the coverage on an after-tax basis and not through salary reduction under a cafeteria plan. This rule applies whether or not the employer's payment for such coverage is paid directly to the employee or through a Health Reimbursement Arrangement (HRA). Therefore, before excluding a payment made to your employee for health insurance coverage provided through the spouse's group health plan, the employee must substantiate that the spouse paid for such group health coverage on an after-tax basis. This is an important limitation because most spouses will pay their health premiums on a pre-tax basis (through a Code Section 125 cafeteria plan) and, in fact, some employers require that any premiums be paid this way.

Reporting the Value of Health Coverage Provided to Non-Dependent Domestic Partners and Their Children and Adult Children Age 26 or Older

Health coverage provided to a domestic partner, children of domestic partners who are not the legal child of the employee, and adult children after the calendar year in which they turned 26 (collectively referred to as a "Non-Tax Dependent") is considered a taxable benefit for federal tax purposes and must be reported on the employee's Form W-2 (unless such individual qualifies as a tax dependent). As such, the fair market value of the health coverage provided to a Non-Tax Dependent must be included in the employee's income and applicable income tax and employment tax must be withheld from this imputed income each pay period.

The Internal Revenue Service has not issued guidance on how to calculate the fair market value of this health coverage, but the employer should identify a reasonable method to calculate and report the fair market value of health coverage even if there is no incremental cost to cover the Non-Tax Dependent. One way of obtaining this imputed value may be to go to the Health Insurance Marketplace and determine costs for comparable health coverage of the Non-Tax Dependent. Please consult your tax advisor for further information.

Example

Larry Leech, Jr., an adult child, turns 26 on July 1, 2016.
His health coverage is provided tax-free through the employer of Larry Leech, Sr., until December 31, 2016. After January 1, 2017, the value of his health coverage is considered a taxable benefit for federal income tax and employment tax purposes and should be reported on the Form W-2 issued to Larry Leech, Sr. as imputed compensation.

New Reporting Requirements for 2015 Calendar Year: Employer-Provided Health Insurance Offer and Coverage

The Affordable Care Act added Code Section 6056, which requires applicable large employers to file information returns with the IRS and provide statements to their full-time employees about the health insurance coverage the employer offered (reported on Form 1095-C). The Affordable Care Act also added Code Section 6055, which requires the health insurance issuer of fully insured coverage or the plan sponsor of self-insured coverage to file information returns with the IRS and provide statements to the responsible individual (policy holder) about their health coverage (reported on Form 1095-B).

For calendar year 2015, applicable large employers (those with 50 full-time equivalent employees or more) must file the required forms with the Internal Revenue Service by February 29, 2016 (or March 31, 2016, if filing electronically). The required forms must be furnished to the individual by February 1, 2016.

Key point

In order to prepare the relevant tax forms, the employer must maintain monthly records of their full-time employees (as defined in Code Section 4980H) and certain other information related to the health coverage provided to each full-time employee. Therefore, employers should consult with their advisors as soon as possible in order to prepare for these new tax reporting requirements and to avoid potential penalties under the Employer Shared Responsibility provisions.

Key point

Extension of 2016 Filing Due Dates: On December 28, 2015, in Notice 2016-04, the IRS extended the information reporting due dates for insurers, self-insuring employers, other health coverage providers, and applicable large employers.

The notice extends the dates for furnishing individual taxpayers with their 2015 Form 1095-B and 2015 Form 1095-C from February 1, 2016, to March 31, 2016. The IRS also extended the due dates for filing the 2015 Forms 1094-B, 1095-B, 1094-C, and 1095-C from February 29, 2016, to May 31, 2016, if not filing electronically, and from March 31, 2016, to June 30, 2016, if filing electronically.

These extensions apply automatically to all health coverage information return issuers and are longer than the 30-day extensions that would otherwise be obtained by submitting Form 8809, Application for Extension of Time To File Information Returns. Therefore, the IRS will not process any previously requested extensions of these deadlines for 2016. The longer automatic extensions do not require a formal request using Form 8809 or other documentation. The IRS does not anticipate additional extensions.

Maximizing Tax Benefits for Your Minister

Special Notes for New Clergy

- When negotiating the contract for a new cleric, make certain that a proper housing allowance resolution has been adopted by the vestry (or other governing body) **before** compensation is earned.
- Also when negotiating contracts, arrange for reimbursable expense plans for automobile and other necessary business expenses.
- Recommend that the cleric begin saving for retirement through a Section 403(b) salary reduction plan as soon as possible.
- Discretionary funds are the property of the church. The cleric must use them only for proper purposes and account to the church for such funds.
- Make certain the compensation details have been properly reported to The Church Pension Fund, and that regular payments are being made to The Church Pension Fund for required contributions to benefit plans.
- If you have questions, contact either of the following before taking action:

  Nancy Fritschner (877) 305-1414

  Bill Geisler (877) 305-1415

Special Notes for Churches Hiring Those Receiving Pensions

- The pension received by a cleric from The Church Pension Fund Clergy Pension Plan (the "Clergy Pension Plan") and distributions from The Episcopal Church Retirement Savings Plan ("RSVP") sponsored by The Church Pension Fund are designated as housing allowance for federal income tax purposes. To the extent that these amounts were from contributions to the Clergy Pension Plan and the RSVP from earnings generated from ministerial services and are spent for qualified housing expenses for the cleric's primary residence, they may be excluded from taxation, subject to the housing allowance limitations.
- Earnings from ministerial services after retirement are also eligible for designation as housing allowance. If a cleric's Clergy Pension Plan benefits and withdrawals from an RSVP plan are enough to cover qualified housing costs, he/she should not request additional housing allowance designation for any compensation for ministerial services.
- Self-employment tax (SECA) is due on all currently earned income, even if the cleric is retired and collecting Social Security. The cleric should include any currently earned housing allowance and/or the fair rental value of any church-provided housing. Failure by the cleric to include the proper value of such housing could result in additional tax liabilities, plus interest and penalties. If this income is not reported, the statute of limitations on assessing tax adjustments may not apply. No SECA tax is due on qualified pension plan payments, including the amount excluded as housing.
- Housing provided to clergy employed for a short time away from home (short time is generally considered to be a contract for one year or less) in some cases can be treated as a reimbursable business expense and will not be subject to income tax or self-employment tax (SECA). Contracts for an indefinite period, or a specific period of more than one year, would not qualify for such exclusion. Such arrangements could result in moving the cleric's "tax home" (primary residence) to the interim location. **Be very careful about the wording of interim ministry contracts**.
- Pensions are not earned income and therefore are not subject to self-employment tax (SECA), except possibly retirement benefits paid from a non-qualified deferred compensation plan.
- Moving expenses are not deductible unless the cleric is moving at least 50 miles to a new, full-time position. See Form 3903.
- If the cleric is determined to be an exempt employee under the Fair Labor Standards Act (FLSA), as determined by the employer, or is determined to be a non-exempt employee under the FLSA but normally scheduled to work 1,000 or more compensated hours per year, the

cleric is eligible for active health coverage through The Episcopal Church Medical Trust's Episcopal Health Plan (EHP). If the cleric is eligible for active health coverage and is also covered by Medicare, under the Medicare Secondary Payer rules, Medicare will require the employer's active medical coverage to become the cleric's primary medical coverage unless the cleric is employed by an employer who qualifies for the EHP for Qualified Small Employer Exception. This means that the cleric, who is working while pensioned and eligible for active health coverage, could no longer be eligible for the Medicare Supplement Health Plan or post-retirement medical subsidy provided by The Church Pension Fund.

It is **important** that the employer and cleric talk with an Episcopal Church Medical Trust Client Services representative. Failure to comply with the Medicare Secondary Payer rules could result in penalties being assessed against the employer. When a cleric no longer qualifies for active medical coverage, it is **important** that the cleric contact Medicare and The Episcopal Church Medical Trust Client Services to reactivate proper coverage. This applies to lay employees, as well.

- Be aware of one important Clergy Pension Plan reporting requirement. Some retired clergy who return to work may be considered to have "returned to active ministry" under the Clergy Pension Plan. To avoid such a determination, which will result in suspension of pension benefits and re-imposition of pension assessments, eligible retired clergy (those age 65 or older with 25 years of credited service) who work for The Episcopal Church after retirement will be required to receive the written permission of their "ecclesiastical authority" (usually their bishop). Their bishop (or ecclesiastical authority) must file a "Working While Pensioned" application, which must be approved by The Church Pension Fund prior to beginning the position. Exceptions must be applied for annually and will be granted for a maximum of 24 months. For more details, go to ***www.cpg.org*** and search for "Working While Pensioned."
- The 2016 compensation limit for retired clergy is $37,200 for any 12-month period, including housing allowance (parish-provided housing does not count toward this limit; however, all contributions to a 403(b) do count toward this limit.) Note, however, that if a cleric returns to a position at the same organization from which he or she retired, he or she is required to apply for and receive a Working While Pensioned exception even if the compensation is below this compensation limit. This compensation limit applies only until the cleric attains age 72.
- If you have tax questions, it is always better to call our tax line before taking action. (See tax line information on page 4.)

Housing Allowance

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

A housing allowance is simply a portion of a cleric's compensation that is so designated in advance by the cleric's employing church. For example, in December of 2015 a church agrees to pay its cleric "total compensation" of $45,000 for 2016, and, **at the request of the cleric**, 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 cleric's salary as "housing allowance."

Code Section 107 specifies that the housing allowance of clergy who own or rent their primary residence is non-taxable in computing federal income taxes to the extent that it is:

1. Declared in advance
2. Used for qualified housing expenses
3. Does not exceed the fair rental value of the cleric's home, furnished, plus utilities

Key Point

The housing resolution should ordinarily equal the fair rental value of the clergy-provided housing, furnished, plus estimated utilities. Any excess housing allowance must be reported by the cleric as taxable income on Form 1040.

Key Point

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

Key Point

Under no circumstances can a church designate a housing allowance retroactively.

Key Point

Although the costs of a mortgage qualify as part of the housing allowance, costs associated with refinancing a principal residence or with obtaining a home equity loan qualify only if the proceeds are used for acquiring, improving, or maintaining a principal residence.

Clergy who live in "rent-free" church-provided housing, which is provided as compensation for ministerial services, do not include the annual fair rental value of church-provided housing as income in computing their federal income taxes. The annual fair rental value is not "deducted" from the cleric's income. Neither is it reported as additional income anywhere on Form W-2.

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

Please note that qualified housing expenses for clergy who own/rent or the fair rental value of "rent-free" church-provided housing are non-taxable when computing federal income taxes and most — though not all — state income taxes, but they are taxable when computing self-employment taxes. Clergy who own or rent **may NOT exclude** housing allowance amounts from income when computing self-employment taxes. Clergy in church-provided housing **MUST include** the fair rental value of church-provided housing as income when computing self-employment taxes. In addition, any housing provided to a cleric that is excludable from taxable income pursuant to Code Section 119, under the convenience of the employer statute, also must be included in the cleric's taxable income when computing self-employment income.

Key Point

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

Key Point

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

Key Point

Clergy who live in “rent-free” church-provided housing will NOT be allowed to claim a housing allowance for any other real property that they own while living in “rent-free” church-provided housing.

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

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

> *The following resolution was duly adopted by the vestry of Christ Church at a regularly scheduled meeting held on December 20, 2015, a quorum being present:*
>
> Whereas, the Reverend Samuel Johnson is compensated by Christ Church exclusively for the services as a minister of the gospel; and
>
> Whereas, Christ Church does not provide Fr. Johnson with a rectory; therefore, it is hereby
>
> ***Resolved***, that the total compensation paid to Fr. Johnson for calendar year 2016 shall be $50,000, of which $15,000 is hereby designated to be a housing allowance pursuant to Section 107 of the Internal Revenue Code; and it is further
>
> ***Resolved***, that the designation of $15,000 as a housing allowance shall apply to calendar year 2016 and all future years unless otherwise provided.

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

The following resolution was duly adopted by the vestry of Grace Church at a regularly scheduled meeting held on December 20, 2015, a quorum being present:

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

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

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

Resolved, that the annual compensation paid to Fr. Smith for calendar year 2016 shall be $50,000, of which $5,000 is hereby designated to be a housing allowance pursuant to Section 107 of the Internal Revenue Code, and it is further

Resolved, that the designation of $5,000 as a housing allowance shall apply to calendar year 2016 and all future years unless otherwise provided by the vestry; and it is further

Resolved, that as additional compensation to Fr. Smith for calendar year 2016 and for all future years unless otherwise provided for by this vestry, Fr. Smith shall be permitted to live in the church-provided rectory located at 123 Main Street, and that no rent or other fee shall be payable by Fr. Smith for such occupancy and use.

Accountable reimbursements

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

1. Only business expenses are reimbursed.
2. No reimbursement without an adequate accounting of expenses within a reasonable period of time (not more than 60 days after an expense is incurred).
3. Any excess reimbursement or allowance must be returned to the employer within a reasonable period of time (not more than 120 days after an excess reimbursement is paid).

4. An employer's reimbursements must come out of the employer's funds and not by reducing the employee's salary.

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

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

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

Key Point

A church must require the same degree of substantiation required for a deduction on the employee'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 employees for non-business expenses. Such reimbursements, though they require an accounting, ordinarily must be included in the employee's wages for income tax reporting purposes, and they are not deductible by the employee. Such personal, living, or family expenses are not deductible, and the entire amount of a church's reimbursement must be included on the employee's Form W-2 and Form 1040.

Mass Transit Benefits

For 2015, the exclusion for employer-provided reimbursement for van-pooling and mass transit passes was $130 per month. However, the Protecting Americans From Tax Hikes Act of 2015, enacted on December 18, 2015, retroactively increased the exclusion to $250 per month for 2015 and increased the exclusion to $255 per month for 2016. The exclusion for parking costs was $250 per month in 2015 and is $255 for 2016. The exclusion for bicycle costs was $20 per qualified bicycle commuting month in 2015 and is $20 per qualified bicycle commuting month in 2016.

Flexible Spending Accounts (FSA)

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, subject to reimbursement maximums and other conditions.

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

1. The salary reduction is established in advance (this is interpreted to mean prior to both the compensation and the expense).
2. Reimbursement is made only when a bona fide expense has been incurred by the participant.
3. The participant agrees to forfeit any unused balance in the account at the end of the plan year (although see the “grace period” that applies to Health FSAs below).
4. The plan must be properly structured (contact a CPA or attorney experienced in such programs) and formally adopted by the vestry.

Health Flexible Spending Accounts (Health FSA)

Health FSAs have several benefits, including the following:

- Employer contributions can be non-taxable
- No income taxes or payroll taxes are deducted from employee contributions
- Amounts used for qualified medical expenses may be tax-free
- Employees can withdraw funds from a Health FSA to pay qualified medical expenses even if they have not yet placed the funds in the account

Generally, distributions from a Health FSA must be paid to reimburse the employee for qualified medical expenses. See Publication 502 for a list of 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).

To date, 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.

Health 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 2½ months after the end of the plan year. If the plan provides for a grace period, any qualified medical expenses incurred in that grace 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 Health FSA 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 any amount (up to $500) 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 qualified 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 2015 and 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.

The maximum amount available for reimbursement of incurred qualified medical expenses of an employee and the employee's dependents under a Health FSA cannot exceed $2,550 for 2015 and 2016.

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

Dependent Care Flexible Spending Accounts (Dependent Care FSA)

Dependent Care FSAs can also be established to pay for certain expenses to care for eligible dependents. While this type of plan generally covers expenses related to child care of children up to age 13, it can also be used for children of any age who are physically or mentally incapable of self-care, as well as adult day care for senior citizen dependents who live with the person, such as parents or grandparents. Additionally, the person or persons on whom the dependent care funds are spent must be able to be claimed as a dependent on the employee's federal tax return. The funds cannot be used for summer camps (other than "day camps") or for long-term care for parents who live elsewhere (such as in a nursing home).

The Dependent Care FSA is federally capped at $5,000 per year, per household. Married spouses can each elect an FSA, but their total combined elections cannot exceed $5,000. At tax time, all withdrawals in excess of $5,000 are taxed. If married, both spouses must have earned taxable income to be eligible to participate in a Dependent Care FSA.

Unlike Health FSAs, Dependent Care FSAs are not "pre-funded"; employees cannot receive reimbursement for the full amount of the annual contribution on day one. Employees can only be reimbursed up to the amount they have contributed during that plan year.

Section 403(b) Plans

A Section 403(b) plan, such as The Episcopal Church Retirement Savings Plan ("RSVP"), is a retirement plan for certain employees of churches and other tax-exempt organizations. These plans have the following tax benefits:

1. Employees do not pay income tax on amounts currently contributed until they begin making withdrawals from the plan, usually after they retire. Note, however, that Social Security and Medicare taxes are due on all contributions to a 403(b) plan for lay employees.
2. Earnings and gains on pre-tax contributions to an employee's Section 403(b) account are not taxed until they are withdrawn, unless such distributions otherwise qualify for a housing allowance exclusion.
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.

Warning

Deferred compensation not placed into a 403(b) plan or other qualified plan may be subject to Code Section 409A. Failure to comply with Code Section 409A may result in significant tax consequences. Please consult a tax professional.

Step 1. Obtain an employer identification number (EIN) from the federal government if this has not been done.
This number must appear on some of the returns listed below. It is used to reconcile a church's deposits of withheld taxes with the Forms W-2 issued to employees. The EIN is a nine-digit number that looks like this: 00-0246810. If your church does not have an EIN, you may apply for one online. Go to the IRS website at ***www.irs.gov*** and click on the "Apply for an EIN Online" link. You may also apply for an EIN by calling (800) 829-4933, or you may fax or mail Form SS-4 to the IRS. You should have only one EIN.

Key Point
The employer identification number is not a "tax exemption number" and has no relation to your non-profit status. It merely identifies the organization as an employer subject to tax withholding and reporting and ensures that your church receives proper credit for payments of withheld taxes.

Step 2. Determine whether each church worker is an employee or self-employed.
In some cases, it is difficult to determine whether a particular worker is an employee or is self-employed. If in doubt, churches always should treat a worker as an employee, since substantial penalties can be assessed against a church for treating a worker as self-employed whom the IRS later reclassifies as an employee. In general, a self-employed worker is one who is not subject to the control of an employer with respect to how a job is to be done. Further, a self-employed person typically is engaged in a specific trade or business and offers his or her services to the general public. The IRS has developed several criteria to assist in classifying a worker as an employee or self-employed. **Factors that tend to indicate employee status include the following:**

- The worker is required to follow an employer's instructions regarding when, where, and how to work.
- The worker receives "on-the-job" training from an experienced employee.
- The worker is expected to perform the services personally, and not use a substitute.
- The employer rather than the worker hires and pays any assistants.
- The worker has a continuing working relationship with the employer.

- The employer establishes set hours of work.
- The 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. In addition, the Department Labor issued Administrator's Interpretation No. 2015-1 (***www.dol.gov/whd/workers/Misclassification/AI-2015_1.htm***) which strengthens the government's definition of employee and narrows the definition of independent contract even further. Once again: if in doubt, treat the worker as an employee.

Warning
The IRS and other governmental agencies are becoming much more aggressive in classifying workers as employees. Improper classification can result in significant back taxes and penalties.

Key Point
Fringe benefits are non-taxable only when received by employees. A common example is employer-paid group medical insurance.

Warning
When paying an active cleric more than $200 for three consecutive months, the church is required to pay pension assessments to The Church Pension Fund, whether or not the cleric is classified as an employee or independent contractor. If the cleric is regarded as self-employed, these payments would normally be included in the compensation reported on the Form 1099. If, instead, the cleric is classified as a part-time employee who receives a Form W-2, the employer will not have to report the paid assessments as additional income.

Step 3. Obtain the Social Security number of each worker.
After determining whether a worker is an employee or self-employed, you must obtain the worker's Social Security number. A worker who does not have a Social Security number can obtain one by filing Form SS-5. If a self-employed worker performs services for your church (and earns at least $600 for the calendar year) but fails to provide you with his or her Social Security number, then the church is required by law to withhold

a specified percentage of compensation as “backup withholding.” The backup withholding rate is 28% for 2016. Of course, a self-employed person can stop backup withholding by providing the church with a correct Social Security number.

The church will need the correct number to complete the worker’s Form 1099-MISC (discussed later). Churches can be penalized if the Social Security number they report on a Form 1099-MISC is incorrect, unless they have exercised “due diligence.” A church will be deemed to have exercised due diligence if it has required self-employed persons provide their Social Security numbers using Form W-9. As a result, it is a good idea for churches to present self-employed workers (e.g., guest speakers, contract laborers) with a Form W-9, and then to withhold 28% of total compensation for 2016 as backup withholding unless the worker returns the form. The church should retain each Form W-9 to demonstrate its due diligence.

All taxes withheld through backup withholding must be reported to the IRS on Form 945. The Form 945 for 2015 must be filed with the IRS by February 1, 2016. However, if you made deposits on time in full payment of the taxes for the year, you may file the return by February 10, 2016.

Step 4. Have each employee complete a Form W-4.
These forms are used by employees to claim withholding allowances. A church will need to know how many withholding allowances are claimed by each lay employee in order to withhold the correct amount of federal income tax. A withholding allowance lowers the amount of tax that will be withheld from an employee’s wages. Allowances generally are available for the employee, the employee’s spouse, each of the employee’s dependents, and in some cases for itemized deductions.

Require that all new employees give you a signed Form W-4 when they start work. If an employee does not complete such a form, then the church must treat the employee as a single person without any withholding allowances or exemptions. Employers must put into effect any Form W-4 that replaces an existing certificate no later than the start of the first payroll period ending on or after the 30th day after the day on which the replacement Form W-4 is received. Of course, you can put a Form W-4 into effect sooner, if you wish. Employers are not responsible for verifying the withholding allowances that employees claim.

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

Step 5. Compute each employee's taxable wages.
The amount of taxes that a church should withhold from an employee's wages depends upon two things: the information contained on the employee's Form W-4 and the amount of the employee's wages. Wages subject to federal withholding include pay given to an employee for service performed. The payment may be in cash or in other forms, which are measured by their fair market values. A comprehensive list of types of wages — other than salary — may be found in Step 10 on pp. 22–23.

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 (***www.irs.gov***).

Percentage method. Under the percentage method, the employer multiplies the value of one withholding allowance (derived from a table contained in Publication 15) by the number of allowances an employee claims on Form W-4, subtracts the total from the employee's wages, and determines the amount to be withheld from another table. 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 2016. It will contain updated tables for computing the amount of income taxes to withhold from employees' 2016 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 income tax is being withheld.

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

A cleric initiates voluntary withholding by providing the church with a completed 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 cleric, or by mutual consent.

The tax code specifies that clergy are self-employed for Social Security and Medicare taxes with respect to services performed in the exercise of ministry. Clergy 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 is applied against a cleric's self-employment taxes on Form 1040. It is reported by the church as income taxes withheld on its quarterly Form 941 and on the cleric's Form W-2.

Since any tax paid by voluntary withholding is deemed to be timely paid, a cleric 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 non-ordained employees' wages.

Employees and employers each pay Social Security and Medicare taxes (FICA) equal to 7.65% of an employee's wages. The 7.65% tax rate is comprised of two components:

1. A Medicare hospital insurance tax of 1.45%
2. An "old age, survivor, and disability" (Social Security) tax of 6.2%

There is no maximum amount of wages subject to the Medicare tax. For 2015, the maximum wages subject to the Social Security tax (the 6.2% amount) was $118,500. For 2016, the maximum wages subject to the Social Security tax (the 6.2% amount) is $118,500.

The church must withhold the lay employee's share of Social Security and Medicare taxes from each wage payment. Simply multiply each wage payment by the applicable percentage above. Special tables in IRS Publication 15 help in making this computation. Wages of less than $100.00 per year (this amount is adjusted each year for inflation) paid to an employee of an exempt organization are exempt from these taxes.

A new Additional Medicare Tax went into effect in 2013. The 0.9% Additional Medicare Tax applies to an individual's wages and self-employment income that exceed a threshold amount based on the individual's filing status. The statute requires an employer to withhold Additional Medicare Tax on wages it pays to an employee in excess of $200,000 in a calendar year (this amount is not indexed for inflation). There is no employer match for the Additional Medicare Tax.

Step 8. The church must deposit the taxes it withholds.
Churches accumulate three kinds of federal payroll taxes:

- Income taxes withheld from employees' wages
- The employees' share of Social Security and Medicare taxes (withheld from employees' wages)
- The employer's share of Social Security and Medicare taxes

Most employers must deposit payroll taxes on a monthly or semi-weekly basis. An employer's deposit status is determined by the total taxes reported in a four-quarter "lookback" period. For 2016, the lookback period will be July 1, 2014, through June 30, 2015.

Monthly depositor rule. Churches that reported payroll taxes of $50,000 or less in the lookback period will deposit their withheld taxes for 2016 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.

Semi-weekly depositor rule. Churches that reported payroll taxes of more than $50,000 in the lookback period must deposit their withheld taxes on a semi-weekly 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 electronically deposited, unless you have reasonable cause for doing so.

To enroll in EFTPS, call (800) 555-4477, or to enroll online, visit ***www.eftps.gov***.

If you do not want to use EFTPS, you can arrange for your tax professional, financial institution, payroll services, or other trusted third party to make deposits electronically 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 (January – March)	March 31	April 30
2nd (April – June)	June 30	July 31
3rd (July – September)	September 30	October 31
4th (October – December)	December 31	January 31

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

Key Point

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

Key Point

Form 1099 need NOT be provided to a non-employee cleric who receives 100% of his or her compensation as housing. Many churches with this situation remind the cleric by letter that compensation of (insert $ amount) should be reported for determining SECA (self-employment) tax.

Key Point

Form 944 replaces Form 941 for eligible small employers. The purpose of Form 944 is to reduce the burden on the smallest employers by allowing them to file their employment tax returns annually and, in most cases, to pay the employment tax due with their return. Generally, the employer is eligible to file this form only if the payroll taxes for the year are $1,000 or less. **You must file Form 944 if the IRS has notified you to do so, unless you contact the IRS to request, and receive written notice, to file quarterly Form 941 instead.**

Step 10. Prepare a Form W-2 for every employee, including ordained ministers on the church's staff.
A church reports each employee's wages and withheld income taxes as well as Social Security and Medicare taxes on this form. Wages of a cleric who reports his income taxes as an employee do not include the housing allowance exclusion. A church should furnish copies B, C, and 2 of the 2015 Form W-2 to each employee by February 1, 2016. File Copy A with the Social Security Administration by March 1, 2016. Send all Copies A with Form W-3, Transmittal of Wage and Tax Statements. If you file electronically, the due date is **March 31, 2016**.

Key Point

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 2015 Forms W-2 with the Social Security Administration electronically, the due date is extended to **March 31, 2016**. For information on how to file electronically, call the SSA at (800) 772-6270. You may file a limited number of Forms W-2 and W-3 online using the SSA website at ***www.ssa.gov/employer***. The site also allows you to print out copies of the forms for filing with state or local governments, distribution to your employees, and for the church's records.

Key Point

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

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

Box a. Report the employee's Social Security number. Insert "applied for" if an employee does not have a Social Security number but has applied for one. 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 a 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, a church that operates a school may have separate numbers for the church and the school). Be sure that the EIN listed on an employee's Form W-2 is the one associated with the employee's actual employer.

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

Box d. 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.

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

- Salary, bonuses, prizes, and awards
- Taxable fringe benefits:
    1. Imputed value of employer-provided group term life insurance coverage that exceeds $50,000, and cost of coverage of spouse and dependents over $2,000 which is paid by the church, the diocese, The Church Pension Fund, or other church organizations combined
    2. Imputed value of employer-provided health coverage to non-dependent domestic partners, their children, and employee's adult children age 26 or older
- The value of the personal use of an employer-provided car
- Most Christmas, birthday, anniversary, and other special occasion gifts paid by the church to the employee
- Business expense reimbursements paid under a non-accountable 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)
- 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. Use code L in Box 12 to report the amount equal to the IRS-approved rates. Refer to IRS Publications 463 and 1542 for sources of additional information on per diem rates.

- If you reimburse employee travel expenses under an accountable plan using a standard business mileage rate in excess of the IRS-approved rate (57.5 cents per mile for 2015; 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. Use code L in Box 12 to report the amount equal to the IRS-approved rates. If volunteer travel expenses are reimbursed at more than 14 cents per mile, the excess must be reported on a Form 1099.
- Employer reimbursements of an employee's non-qualified (non-deductible) moving expenses
- Any portion of a cleric's self-employment taxes paid by the church
- Amounts includable in income under a non-qualified 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 an employee on a business trip represent income to the employee 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 cleric of at least $10,000 create taxable income to the cleric (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 cleric's debt to the church create taxable income to the cleric.
- Severance pay
- Payment of a cleric'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
- Retirement gifts from the parish vestry or retirement gifts for which the donors were given a tax deduction
- Grants and other funds received for sabbatical purposes, except for eligible reimbursed business expenses

Key Point

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

Warning

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

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

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

Box 3. Report the lay employee's wages subject to the "Social Security" component of FICA taxes. Box 3 should not list more than the maximum wage base for the "Social Security" component of FICA taxes ($118,500 for 2015 and 2016). This box usually will be the same as Box 1, but not always. For example, certain retirement contributions are included in Box 3 that are not included in Box 1. To illustrate, contributions to a 403(b) plan by salary reduction agreement may be excludable from income and not reportable in Box 1, but lay employees are subject to FICA taxes, and accordingly they represent Social Security and Medicare wages for such employees. **Remember that clergy (including those who report their income taxes as employees) are self-employed for Social Security and Medicare tax with respect to their ministerial services, and so they pay self-employment taxes rather than the employee's share of Social Security and Medicare taxes.** For ordained clergy, this box should be left blank.

Box 4. Report the "Social Security" component of FICA taxes that are withheld from lay employee's wages. This tax is imposed on all wages up to a maximum of $118,500 for 2015 and 2016. Do not report the church's portion (the "employer's share") of Social Security and Medicare taxes. Clergy who report their income taxes as employees are still treated as self-employed for Social Security and Medicare tax purposes with respect to their ministerial services. For ordained clergy, this box should be left blank.

Box 5. Report the lay employee's current and deferred (if any) wages subject to the Medicare component of FICA taxes. This will be an employee's entire wages regardless of amount. There is no ceiling. For most workers (earning less than $118,500 in 2015 or 2016), 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 $118,500 to a lay employee in 2015, Box 3 should show $118,500 ($118,500 for 2016) and Box 5 should show the full amount of wages paid. For ordained clergy, this box should be left blank.

Box 6. Report the Medicare component of FICA taxes that are withheld from the lay employee's wages. This tax is imposed on all wages, current and deferred (if any), regardless of amount. For ordained clergy, this box should be left blank.

Box 10. Show the total dependent care benefits under a dependent care assistance program (Code Section 129) paid or incurred for your employee. Include the fair market value of employer-provided daycare facilities and amounts paid or incurred for dependent care assistance in a Code Section 125 cafeteria plan. Report all amounts paid or incurred, including those in excess of the $5,000 exclusion. Include any amounts over $5,000 in Boxes 1, 3, and 5. For more information, see IRS Publications 15 and 957.

Box 11. Report the total amount that you distributed to an employee under a non-qualified deferred compensation (NQDC) plan. Also report these distributions in Box 1. Unlike qualified plans, NQDC plans do not meet the qualification requirements for tax-favored status for this purpose. NQDC plans include those arrangements traditionally viewed as deferring the receipt of current compensation, and include termination pay and rabbi trusts. If you did not make distributions this year, show deferrals (plus earnings) under a NQDC plan that became taxable for Social Security and Medicare taxes during the year (but were for prior year services) because the deferred amounts were no longer subject to a substantial risk of forfeiture. Also report these amounts in Boxes 3 (up to the Social Security wage base) and 5. Do not report in Box 11 any deferrals included in Boxes 3 or 5, or any deferrals for current year services (such as those with no risk of forfeiture). The purpose of Box 11 is for the Social Security Administration (SSA) to determine whether any part of the amount reported in Box 1 or Boxes 3 or 5 was earned in a prior year. The SSA uses this information to verify that it has properly applied the Social Security earnings test and paid the correct amount of benefits. If your church made distributions and is reporting any deferrals in Boxes 3 and 5, do not complete Box 11. For additional information, see IRS 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 four codes in this box. If more are needed, use another Form W-2. Use capital letters for the codes, and remember not to use dollar signs or commas. For example, to report a $3,000 contribution to a Section 403(b) tax-sheltered annuity, you would report "E 3000.00" in this box. The codes are as follows:

A This will not apply to church employees.

B This will not apply to church employees.

C The employee was provided with more than $50,000 of group term life insurance. Report the cost of coverage in excess of $50,000. It should also be included in Box 1 (and in Boxes 3 and 5 for lay employees).

D Generally not applicable to churches.

E The church made contributions to a 403(b) plan pursuant to a "salary reduction agreement" on behalf of the employee. Report the amount of the contributions. While this amount ordinarily is not reported in Box 1, it is included in Boxes 3 and 5 for lay employees, since it is subject to Social Security and Medicare taxes with respect to such workers.

F Generally not applicable to churches.

G Generally not applicable to churches.

H Generally not applicable to churches.

J The church is reporting sick pay. Show the amount of any sick pay that is not includable in the employee's income because he or she contributed to the sick pay plan.

K Generally not applicable to churches.

L The church reimbursed the employee for employee business expenses using the standard mileage rate or the per diem rates, and the amount you reimbursed exceeds the amounts allowed under these methods. Enter code "L" in Box 12, followed by the amount of the reimbursements that equals the allowable standard mileage or per diem rates. Any excess should be included in Box 1. For lay employees, report the excess in Boxes 3 (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 Generally not applicable to churches.

N Generally not applicable to churches.

P The church paid qualified moving expense reimbursements directly to an employee. Report the amount of these reimbursements but only if they were made under a non-accountable arrangement. Do not report reimbursements of qualified moving expenses that are paid directly to a third party on behalf of the employee (for example, to a moving company), or to the employee under an accountable arrangement.

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 non-qualified deferred compensation plan in Box 12 using code Y.

Z Report all amounts deferred (including earnings on deferrals) under a non-qualified deferred compensation (NQDC) 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 certain employers to report the cost of coverage under an employer-sponsored group health plan. IRS Notice 2012-9 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. Also, coverage provided through a self-funded church plan, such as The Episcopal Church Medical Trust Plans, is exempt from this reporting requirement until further guidance is issued. If you have 250 or more employees and do not provide coverage through The Episcopal Church Medical Trust Plans, contact your broker as you may need to report the cost of coverage on your employees' Forms W-2. 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:

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

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

Tax Tip

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

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

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

Step 11. Prepare Forms 1099-MISC.
The church must issue a Form 1099-MISC to every non-employee to whom the church pays "non-employee" compensation of $600 or more during the year. To illustrate, if a guest speaker visited a church in 2015 and received compensation from the church in an amount of $600 or more (net of any travel expense reimbursement properly accounted for by the recipient) then the church must issue the person a Form 1099-MISC before February 1, 2016, and file Copy A with the IRS before March 1, 2016.

If you file electronically, the due date for filing Copy A with the IRS is March 31, 2016. Form 1099-MISC is designed to induce self-employed persons to report their full taxable income. The same rule applies to other "non-employees," including some part-time custodians, and certain self-employed people who perform miscellaneous services for the church (plumbers, carpenters, lawn maintenance, etc.). Exceptions apply. For example, a church need not issue a Form 1099-MISC to a corporation, or to a person who will be receiving a Form W-2 for services rendered to the church. Also, travel expense reimbursements paid to a self-employed person under an accountable reimbursement plan do not count toward the $600 figure.

To send the individual a properly completed Form 1099-MISC, the church will need to obtain his or her name, address, and Social Security number. Churches should obtain this information at the time of the person's visit, since it often can be difficult to obtain the necessary information at a later date. IRS Form W-9 can be used to obtain this information. If a self-employed person who is paid $600 or more during the course of a year by a church refuses to provide his or her Social Security number, then the church may be required to withhold 28% of the person's total compensation as "backup withholding." See "Step 3," on page 16. The backup withholding rate is 28% for 2016.

Warning

Misclassifying your workers as "non-employees" can result in significant tax arrearages and penalties. The IRS is aggressively pursuing employers who misclassify their workers.

Key Point

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

Other Important Requirements for Churches

Reporting Group Term Life Insurance

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

Cost per $1,000 of protection for 1-month period

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+	$2.06		

Example

The Church Pension Fund pays the premiums on a $100,000 group term life insurance policy on the life of Benjamin. St. George's Church pays the premiums on a $20,000 group term life insurance policy on the life of Benjamin, with Benjamin's wife as beneficiary. Benjamin is 29 years old. St. George's Church also pays the premium on a $5,000 group term policy which covers Benjamin's wife, who is 30 years old. The church must report $55.20 as the imputed cost of the insurance provided to Benjamin and his wife. This amount is computed as follows:

1. For Benjamin, the table shows the "cost" per month for each $1,000 of group term life insurance in excess of $50,000. To compute the cost for Benjamin, take 6 cents x 12 months = 72 cents x 70 (corresponding to $70,000 of group term insurance in excess of $50,000) = $50.40.

2. In addition, the cost of the entire $5,000 of insurance provided to Benjamin's wife must be computed. Take 8 cents x 12 months = 96 cents x 5 = $4.80. Combine this amount with the cost of Benjamin's excess insurance to obtain the taxable amount of $55.20. St. George's should include this amount with wages in Box 1 of Form W-2. This amount should also be reported in Box 12 and labeled "C." Any includable amount is subject to income tax as well as Social Security and Medicare withholding for lay church employees.

New Hire Report

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

Form I-9

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

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

Churches should:

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

- Accept documents that appear to be genuine (i.e., appear genuinely to identify the new employee). If churches act reasonably when deciding that a document is genuine, they will not be held responsible for a mistake. Churches may keep photocopies of original identification and verification documents with each employee form. This is not required by law but may be helpful if there is ever a question about any document's authenticity.
- Keep each Form I-9 for at least three years. If a church employs a person for more than three years, the church must retain the form until one year after the person leaves employment. Forms should be kept confidential.
- Upon request, show completed forms to authorized officials of the Department of Homeland Security, Department of Labor, or the Justice Department's Office of Special Counsel for Unfair Immigration-Related Employment Practices. Officials will give three days' notice before inspection.
- Churches, like any employer, can be penalized for failing to comply with the Form 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.

Annual Certification of Racial Non-discrimination

Churches and other religious organizations that operate, supervise, or control a private school must file a certificate of racial non-discrimination (Form 5578) each year with the IRS. The certificate is due by the 15th day of the fifth month following the end of the organization's fiscal year. This is May 15 of the following year for organizations that operate on a calendar year basis. This means that the Form 5578 for 2015 is due May 15, 2016. A "private school" is defined as an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly conducted. The term includes primary, secondary, preparatory or high schools, and colleges and universities, whether operated as a separate legal entity or an activity of a church.

Key Point

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

Key Point

Private 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 non-discrimination 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 Section 4.01 through 4.05 of Revenue Procedure 75-50." This reference is to the following requirements:

- The school has a statement in its charter, bylaws, or other governing instrument, or in a resolution of its governing body, that it has a racially non-discriminatory policy toward students.
- The school has a statement of its racially non-discriminatory policy toward students in all its brochures and catalogs dealing with student admissions, programs, and scholarships.
- The school makes its racially non-discriminatory policy known to all segments of the general community served by the school through the publication of a notice of its racially non-discriminatory policy at least annually in a newspaper of general circulation or through utilization of the broadcast media; **however, such notice is not required if one or more of these exceptions apply**:

  1. During the preceding three years, the enrollment consists of students at least 75% of whom are members of the sponsoring church or religious denomination and the school publicizes its non-discriminatory 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 non-discriminatory 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 non-discriminatory basis.

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

Small Employer Health Care Tax Credit

The Affordable Care Act created the Small Employer Health Care Tax Credit to encourage small employers to continue to offer healthcare coverage to their employees. The credit was first effective for the 2010 tax year, and will continue through the 2016 tax year, although beginning in 2014, only employers who purchase coverage through the Small Business Health Options Program (SHOP) are eligible.

Under the current state of the Affordable Care Act, Episcopal employers participating in The Episcopal Church Medical Trust (Medical Trust) plans will not be eligible to claim the Small Employer Health Care Tax Credit for 2014, 2015, and 2016 because the credit is only available to those employers that purchase coverage through the SHOP.

In summary, a small church employer may receive a refundable credit of up to 25% (increasing to 35% for 2014 through 2016) of the employer contributions towards health insurance, limited to the amount of certain payroll taxes paid and the average premium in the small group market in the state. The employer must have fewer than 25 full-time equivalent employees, have average wages of less than $50,000 (not including clergy wages), and pay premiums equal to a uniform percentage (but not less than 50%) of the healthcare premium for each employee enrolled in benefits.

The Medical Trust has posted a memorandum on the CPG website to explain the Small Employer Health Care Tax Credit, and to describe who is eligible, and how to apply. ***Click here to view the most recent memorandum***.

In addition, ***click here to see more information from the Internal Revenue Service website about the Small Employer Health Care Tax Credit***.

Charitable Contribution Substantiation Rules

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

Cash contributions. The Pension Protection Act of 2006 amended the Tax Code to require all cash contributions, **regardless of amount**, to be substantiated by either a bank record (such as a canceled check) or a written communication from the charity showing the name of the charity, the date of the contribution, and the amount of the contribution. Previously, donors could substantiate cash contributions of less than $250 with “other reliable written records showing the name of the charity, the date of the contribution and the amount of the contribution” if no canceled check or receipt was available. **This is no longer allowed.**

As noted below, additional substantiation requirements apply to contributions (of cash or property) of $250 or more, and these must be satisfied as well.

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

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

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

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

A written statement need not be issued if only "token" goods or services are provided to the donor. For 2015, token goods or services were those having a value not exceeding the lesser of $105 or 2% of the amount of the contribution. This amount is adjusted annually for inflation. In addition, the rules do not apply to contributions in return for which the donor receives solely an intangible religious benefit that generally is not sold in a commercial context outside the donative context.

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

For contributions of non-cash property valued at more than $5,000 ($10,000 for privately held stocks), 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.

Note: Extension of tax-free distributions from individual retirement plans for charitable purposes. The PATH Act of 2015 has permanently extended (both retroactively and prospectively) the ability of individuals at least 70½ years of age to exclude from gross income qualified charitable distributions from Individual Retirement Accounts (IRAs). The exclusion may not exceed $100,000 per taxpayer in any tax year. Regardless of the intentions of the donor, the church receiving the gift must report the amount of the contribution and the date received (making note also of the date the gift was postmarked).

22222	a Employee's social security number	OMB No. 1545-0008	
b Employer identification number (EIN)		1 Wages, tips, other compensation (1)	2 Federal income tax withheld (4)
c Employer's name, address, and ZIP code		3 Social security wages (2)	4 Social security tax withheld (5)
		5 Medicare wages and tips (3)	6 Medicare tax withheld (6)
		7 Social security tips	8 Allocated tips
d Control number (14)		9	10 Dependent care benefits (7)
e Employee's first name and initial	Last name Suff.	11 Nonqualified plans	12a Code (7)
		13 Statutory employee ☐ Retirement plan ☐ Third-party sick pay ☐	12b Code
		14 Other (13)	12c Code
			12d Code
f Employee's address and ZIP code			

15 State	Employer's state ID number	16 State wages, tips, etc. (12)	17 State income tax (11)	18 Local wages, tips, etc. (10)	19 Local income tax (9)	20 Locality name (8)

Form **W-2** Wage and Tax Statement **2015** Department of the Treasury—Internal Revenue Service

Copy 1—For State, City, or Local Tax Department

Legend

1. Your total pay for the year, minus your housing allowance and certain elective deferrals, such as 403(b) plans

2. Clergy W-2 wages not subject to Social Security. This box should be empty on a clergy Form W-2

3. Clergy W-2 wages not subject to Medicare. The box should be empty on a clergy Form W-2

4. Federal taxes withheld from paycheck. Clergy default to $0 unless optional withholding is set up with the employer

5. Social Security is not withheld. This box should be empty on a clergy Form W-2

6. Medicare is not withheld. This box should be empty on a clergy Form W-2

7. Amounts deducted from wages for dependent care (Box 10) or other salary reduction plans (Box 12)

   Code C: Taxable cost of group-term life insurance over $50,000

   Code E: Elective deferrals under a Section 403(b) salary reduction agreement

   Code W: Employer contributions (including an employee's contributions through an Internal Revenue Code Section 125 cafeteria plan) to Health Savings Account (HSA)

8. Name or code of local tax jurisdiction in Boxes 18 & 19

9. Local taxes withheld from paycheck. Clergy default to $0 unless optional withholding is set up with the employer

10. Wages reported that are subject to locality income tax

11. State taxes withheld from paycheck. Clergy default to $0 unless optional withholding is set up with the employer

12. Wages reported that are subject to state income tax

13. **Clergy Own/Rent Home**
    Housing Allowance

    Church-Provided Housing
    Utilities (if paid by church)

14. Control Number used by employer to identify your W-2

Helpful Numbers and Resources

To request IRS forms:

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

The Church Pension Fund:

- (800) 223-6602
- ***www.cpg.org***
- Online version of *Federal Reporting Requirements for Episcopal Churches*: ***www.cpg.org/taxpubs***, then click Administrators
- Tax Lines: Nancy Fritschner: (877) 305-1414
  Bill Geisler: (877) 305-1415

CHURCH
PENSION FUND

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