

2022 Federal Reporting Requirements for Episcopal Churches, Schools, and Institutions



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Publish date: January, 2022

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In keeping with The Church Pension Fund's ongoing commitment to conserving our natural and financial resources, the *2022 Federal Reporting Requirements for Episcopal Churches, Schools, and Institutions* is being offered exclusively as an online booklet.

The 2022 Clergy Tax Return Preparation Guide for 2021 Returns also is being disseminated online.

To access that document, please go to cpg.org/taxpubs.

Faithfully,



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. It refers to the vestry and/or the governing body, depending on the nature of the action taken, not just of churches but also of additional entities, such as schools and other institutions, that are controlled by or associated with The Episcopal Church.

Many of the reporting obligations covered in the *2022 Federal Reporting Requirements* 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 noncompliance with payroll reporting procedures by churches.

Definition of “Minister” for IRS Tax Purposes

Key Point

The IRS has its own criteria for determining who is a minister for tax purposes. See *IRS Publication 517*.

In The Episcopal Church, only bishops, priests, and deacons (ordained ministers as opposed to lay ministers), regardless of the responsibilities of the work done for the church, meet the criteria for the IRS designation of “minister.”

Whether or not one qualifies as a minister for tax purposes is a very important question, since special tax and reporting rules apply to ministers under federal income tax law, including these:

- Eligibility for housing allowances
- Self-employed status for Social Security and Medicare tax purposes
- Exemption of federal and state wages from income tax withholding. Ministers must use the quarterly estimated tax procedure to pay their taxes, unless they elect voluntary income tax withholding. If ministers elect voluntary income tax withholding, they should withhold sufficient income taxes to cover both federal income taxes and self-employment taxes.

These special rules apply only with respect to compensation for services performed in the exercise of ministry. The approval of an Extension of Ministry under The Church Pension Fund Clergy Pension Plan does not automatically qualify a clergy member for clergy tax treatment. See *IRS Publication 517*. If the clergy member does not qualify for clergy tax treatment, they will be treated as a lay person for payroll tax purposes and will not be eligible for the housing allowance exclusion.

Work performed directly for the Church is considered “exercise of ministry,” no matter the nature of the work. Generally, work for nonchurch organizations must be primarily sacerdotal to qualify for the housing allowance, and the clergy member must be assigned to the position by the bishop.

Example

John is a minister at his church. In addition, he works a second job as a counselor for a private, nondenominational school. Assume that John qualifies as a minister for federal income tax purposes. Since his church duties constitute services performed in the exercise of ministry, the church can designate a housing allowance for him. However, the secular employer cannot designate any portion of John’s compensation as a housing allowance since this work would not be service in the exercise of ministry.

- **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” (Self-Employment Contributions Act, or SECA, tax) rather than the employee’s share of Social Security and Medicare taxes. As such, the church should not withhold the employee’s share of Social Security and Medicare taxes from their wages, nor should the church pay the employer portion of these taxes. If a church chooses to pay the minister a portion of Social Security and Medicare taxes, this payment is considered taxable compensation to the minister and is assessable for pension calculation.

There is much confusion regarding this issue.

Most Episcopal ministers with continuing relationships with their employers are considered employees for federal income tax purposes under the tests currently used by the IRS and the courts, and they should receive IRS Form W-2, Wage and

Tax Statement, from their churches reporting their taxable compensation. This statement applies to part-time as well as full-time employees. However, all ministers are self-employed for Social Security and Medicare tax purposes (with respect to services they perform in the exercise of their ministry). This means that they are responsible for paying 100% of their Social Security and Medicare taxes.

- A minister's wages are exempt from compulsory income tax withholding. Clergy may, however, enter into a voluntary income tax withholding agreement with their Episcopal employer. Be sure to have the clergy member complete Form W-4, Employee's Withholding Certificate. See page 11 for additional information.
- **Because the liabilities for the reporting of compensation paid to employees and the depositing of payroll taxes attach to vestries and rectors, consider using a professional payroll service.** A payroll service deposits taxes with the Internal Revenue Service and state governments, files tax reports, and produces all year-end required tax reporting. Using a payroll service places responsibility on a third party to pay your employees on time and relieves the treasurer of producing Forms W-2 and end-of-year tax reconciliations.

❗ Key Point

Care should be taken to ensure that the payroll service understands how clergy are taxed and that each clergy member has been properly classified in their system. There should be no withholding for FICA and/or Medicare taxes for employees classified as clergy.

Health Insurance

Employer Reimbursement / Payment of Group Health Insurance Premiums

Employer payments and reimbursements of health insurance premiums for group healthcare 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. Additionally, in Chief Counsel Memorandum 201547006, the Internal Revenue Service clarified that an employer may exclude from an employee's gross income payments for the cost of health insurance coverage provided through the spouse's group health plan only if the spouse paid for the coverage on an after-tax basis and not through salary reduction under a Code Section 125 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 pretax basis (through a Code Section 125 cafeteria plan), and, in fact, some employers require that any premiums be paid this way.

Employer Reimbursement / Payment of Individual Health Insurance Policies

—Premium Reimbursement Account (PRA)

Generally, it is no longer permissible for an employer to reimburse an employee directly, or directly pay on behalf of an employee, the premiums for their individual health insurance policy. This type of reimbursement / direct payment of an employee's individual health insurance policy is prohibited, regardless of whether the reimbursement / direct payment is treated as taxable or nontaxable compensation.

If certain conditions are met, some employers may have the option of establishing a qualified small employer health reimbursement arrangement (QSEHRA) or an individual coverage health reimbursement arrangement (ICHRA). Given the restrictions that apply to these types of arrangements, employers should speak to their personal tax and benefits advisors before establishing a QSEHRA or ICHRA.

Employee shared cost of group health insurance plan

Churches may wish to have their employees contribute to the cost of their group health insurance plan. For this to be considered a pretax deduction, a Section 125 cafeteria plan must be established. Key legal requirements include these:

- Having a written plan document
- Allowing only common law employees to participate on a pretax basis
- Making elections generally irrevocable for an entire plan year
- Passing certain nondiscrimination tests

❗ Key Point

Use an experienced professional to establish a Section 125 cafeteria plan.

Reporting the Value of Healthcare Coverage Provided to Nontax Dependents and Adult Children Who Have Attained Age 27 by Calendar Year End

The fair market value of health coverage provided for an employee's child aged 27 or older, or individuals who do not qualify as the employee's tax dependents, is a taxable benefit. This taxable benefit is imputed income. It must be included in the employee's compensation and reported on the employee's Form W-2. 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 Nontax 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 Nontax Dependent. Please consult your personal tax advisor for further information.

Example

Larry Jones Jr., an adult child, turned 26 on July 1, 2021. His health coverage was provided taxfree through the employer of Larry Jones Sr. until December 31, 2021. Beginning January 1, 2022, 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 Jones Sr. as imputed compensation.

Reporting Requirements for 2021 Calendar Year for Employer-Provided Health Insurance Offer and Coverage

The reporting requirements consist of the following forms:

- 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. 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 Affordable Care Act (the "employer mandate" or "play or pay" provisions).

Key Points

- The due date for furnishing Forms 1095-B to individuals and Forms 1095-C to employees is February 28, 2022, if filed by mail, or March 31, 2022, if filed electronically.
- See the instructions for these forms on the IRS website ([irs.gov](https://www.irs.gov)) for more information.
- 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 is required to file the Forms 1094-B and 1095-B.
- If required to prepare the relevant tax forms, the employer must maintain monthly records of its 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 personal advisors as soon as possible to comply with these tax reporting requirements and to avoid potential penalties under the Employer Shared Responsibility provisions.
- 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 taxpayers about individuals who are covered by minimum essential coverage. The Episcopal Church Medical Trust files these forms for members who participate in the Medical Trust Plan.

Maximizing Tax Benefits for Your Minister

Special Notes for New Clergy

- When negotiating the contract for a new clergy member, make certain that a proper housing allowance resolution has been adopted by the vestry or other governing body before compensation is earned. The amount of housing allowance should not be included in the letter of agreement with the clergy member.
- Also, when negotiating contracts, arrange to have an accountable reimbursable plan in place to ensure the taxfree reimbursement of automobile and other necessary business expenses.
- Recommend that the clergy member begin saving for retirement through a Code Section 403(b) salary reduction plan as soon as possible. Enrollment forms for The Episcopal Church Retirement Savings Plan ("RSVP"), a Code Section 403(b) salary reduction plan, are available on the Church Pension Group website ([cpg.org](https://www.cpg.org)).
- Discretionary funds are the property of the church. The clergy member must use them only for proper purposes and is accountable to the church for such funds.

- Make certain that the compensation details have been properly reported to The Church Pension Fund and the required employer contributions are being paid pursuant to The Church Pension Fund Clergy Pension Plan. The employer's failure to pay contributions on time could result in the loss of Active status under the Clergy Pension Plan and the loss of certain benefits (e.g., life insurance and disability benefits). The employer will also be assessed interest on late assessment payments.

If you have questions pertaining to clergy tax issues, contact one of the following individuals before taking action:

Nancy Fritschner, CPA	(877) 305-1414
Mary Ann Hanson, CPA	(877) 305-1415
Dolly Rios, CPA	(833) 363-5751 <i>Fluent in English and Spanish</i>

Special Notes for Churches Pertaining to Current Employees, Including Those Receiving Pensions

- The pension received by a clergy member from The Church Pension Fund Clergy Pension Plan and distributions from the 403(b) sponsored by The Church Pension Fund (RSVP) 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 clergy member's primary residence, they may be excluded from taxation, subject to the housing allowance limitations. See CPF Form B, Clergy Housing Allowance and Federal Income Tax Status of The Church Pension Fund Benefits found at cpg.org.
- Earnings from ministerial services after retirement are also eligible for designation as housing allowance. If a clergy member's Clergy Pension Plan benefits and distributions from an RSVP are enough to cover qualified housing costs, they need not request additional housing allowance designation for any compensation for ministerial services, since it would not provide any tax benefit.
- SECA tax is due on all currently earned income, even if the clergy member is retired and collecting Social Security. The clergy member should include any currently earned housing allowance and/or the fair rental value of any church-provided housing. Failure by the clergy member 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.

Key Point

No SECA tax is due on qualified pension plan distributions paid pursuant to retirement nor on any long-term disability payments received after the first six months.

- Interim ministry contracts: lodging, meals, and incidentals provided to clergy employed for a short time away from home (a short time is generally considered to be a contract for one year or less) can in some cases be treated as reimbursable business expenses and will not be subject to income tax or 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 clergy member's "tax home" (primary residence) to the interim location. **Be very careful about the wording of interim ministry contracts.**
- Reimbursement for the cost of commuting to work does not qualify for a taxfree treatment since it is not considered business travel for tax purposes. Any reimbursement of commuting mileage must be reported as wages on the Form W-2.
- Pensions are not earned income and therefore are not subject to SECA.
- Payment or reimbursement of moving expenses to any employee will need to be reported as wages on the Form W-2 and is assessable for pension calculation.
- If a clergy member meets the eligibility requirements for active health coverage through their employer and is also covered by Medicare, under the Medicare Secondary Payer rules, Medicare will require the employer's active medical coverage to become the clergy member's primary medical coverage unless they are employed by an institution that qualifies for the Medicare Secondary Payer—Small Employer Exception. See cpg.org for details.
- The employer is prohibited from excluding employees or their spouses who are age 65 or older from active healthcare coverage if they otherwise meet the eligibility requirements. This means that a clergy member who is enrolled in Medicare and eligible for employer-provided active health coverage is no longer eligible for the Medical Trust's Group Medicare Advantage Health Plan or the post-retirement medical subsidy provided by The Church Pension Fund.

Warning

It is **important** that the employer and clergy member talk with a diocese administrator or Church Pension Group representative. Failure to comply with the Medicare Secondary Payer rules could result in penalties being assessed against the employer. When a clergy member no longer qualifies for active health coverage, it is important that the clergy member contact Medicare and a representative from The Episcopal Church Medical Trust Client Services Team at (800) 480-9967 to reactivate proper coverage. This applies to lay employees as well.

- Be aware that some retired clergy who return to work may be considered to have “returned to active ministry” under The Church Pension Fund Clergy Pension Plan, which will result in the suspension of pension benefits and the re-imposition of pension assessments. Retired clergy pursuing compensated ministry in the church should consult the Clergy Pension Plan’s *Working While Pensioned guidelines*.

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 properly designate a portion of their clergy member’s compensation as a housing allowance and thereby deprive the clergy member of an important tax benefit.

A housing allowance is simply a portion of a clergy member’s compensation that is so designated in advance by their employing church. For example, in December 2021 a church agrees to pay its clergy member “total compensation” of \$65,000 for 2022, and, at the request of the clergy member, designates \$20,000 of this amount as a housing allowance. This “costs” the church nothing. It is simply a matter of properly designating part of a clergy member’s salary as “housing allowance.”

Internal Revenue Code Section 107 specifies that the housing allowance of clergy who own or rent their primary residence is nontaxable in computing federal income taxes to the extent that it

1. is declared in advance by resolution of the vestry or governing body,
2. is used for qualified housing expenses, and
3. does not exceed the fair rental value of the clergy member’s home, furnished, plus utilities.

📌 Key Points

- The housing allowance resolution should equal the fair rental value of the clergy member’s primary residence, furnished, plus estimated utilities or the anticipated housing expenses, whichever is lower. Any excess housing allowance must be reported by the clergy member as taxable income on their Form 1040.
- For clergy living in church-provided housing, the portion of the fair rental value test that applies is the portion not provided by the church. Therefore, if the church provides the house and pays the utilities, the value added for furnishings is the only relevant amount to be used in determining step 3 above.
- The amount of the housing allowance should not be included in the Letter of Agreement.
- It is the responsibility of the ordained employee who owns or pays rent for their primary residence to determine the fair rental value, furnished, plus utilities of their home; and—unless the housing allowance resolution amount suggested by the ordained employee exceeds their compensation—the employer or vestry should accept and duly approve it.
- Under no circumstances can a church designate a housing allowance retroactively. A housing allowance resolution can be amended prospectively.
- Although the costs of a mortgage may 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 specifically used for acquiring, improving, or maintaining a principal residence.
- If an office in the home deduction is taken on a Schedule C for a business in the home, those amounts should be excluded from the actual expenses used for qualified housing expenses. A clergy member receiving a Form W-2 will no longer get a tax benefit for federal income tax from taking a home office deduction; however, these expenses could be deducted from self-employment taxable income when calculating SECA tax.

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 clergy member’s income, nor is it reported as additional taxable compensation on Form W-2.

In addition, clergy living in church-provided housing should have a portion of their cash compensation designated by the vestry or governing body as a housing allowance for housing-related expenses that they pay, such as utilities, repairs, and furnishings. This exclusion from income tax works like the housing allowance for clergy who own or rent their home. The exclusion is limited to the lower of

- the amount designated by the vestry,
- the actual expenses incurred, or
- the fair rental value (FRV) test.

Please note that qualified housing expenses for clergy who own/rent or the fair rental value of “rent-free” church-provided housing are nontaxable when computing federal income taxes and most—though not all—state income taxes, but they are 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.

Key Points

- The cash housing allowance approved by the church should be included in the compensation reported to The Church Pension Fund. The church must also report whether housing is provided to the clergy member. The amount used to compute the assessment is a calculation made just for purposes of the assessment and is not the same as fair market rental value when calculating self-employment tax.
- 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.
- 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 or rent while living in “rent-free” church-provided housing. This is because “rent-free” church-provided housing will be considered their primary residence for tax purposes.

See the two sample housing allowance resolutions below from the vestry or other governing body. Notice the use in both examples of so-called “safety-net” language (“and all future years unless otherwise provided”). Such language provides a basis for continuing the housing allowance at its current level but is not a substitute for the annual resolution.

Sample housing allowance resolution for a minister who owns or rents their home:

The following resolution was duly adopted by the vestry of Christ Church at a regularly scheduled meeting held on December 18, 2021, 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 2022 shall be \$65,000, of which \$20,000 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 \$20,000 as a housing allowance shall apply to calendar year 2022 and all future years unless otherwise provided.

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

The following resolution was duly adopted by the vestry of Grace Church at a regularly scheduled meeting held on December 18, 2021, 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 2022 shall be \$65,000, of which \$6,000 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 \$6,000 as a housing allowance shall apply to calendar year 2022 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 2022 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 Business Expense Reimbursement Plan

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

1. Only business expenses are reimbursed.
2. There is 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 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.
5. An accountable business expense reimbursement plan should be established by the vestry or governing body in an appropriate resolution.

Under an accountable business expense reimbursement plan, reimbursements of business expenses are not reported as taxable compensation on the employee's Form W-2 and Form 1040. The Tax Cuts and Jobs Act of 2017 eliminated the ability for employees to deduct unreimbursed business expenses for federal income tax purposes. Therefore, an accountable business expense reimbursement plan is the best way for a church and an employee to handle reimbursements of business expenses.

An *accountable* reimbursement arrangement should be established by the vestry or governing body in an appropriate resolution. Be sure to condition the reimbursement of any expense on adequate substantiation. This will include written evidence for all expenses and receipts for most expenses of \$75 or more and for all lodging expenses, no matter the amount. For most expenses, the evidence must substantiate the amount, date, place, and business nature of each expense.

Key Point

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

Churches occasionally reimburse employees for nonbusiness 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.

Qualified Transportation Fringe Benefits

For 2022, the monthly limit that may be excluded from an employee's income under Code Section 132(f) for contributions toward qualified transportation and parking benefits increases from \$270 for 2021 to \$280. The exclusion for qualified bicycle commuting costs was eliminated effective January 1, 2018. Certain localities and jurisdictions have laws requiring certain employers to offer this benefit to their employees. Please check your local taxing authority to make sure you are in compliance.

Flexible Spending Accounts (FSAs)

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 healthcare and dependent care expenses.

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 (however, see the "carry-over provision" 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 or governing body.

Health Flexible Spending Accounts (Health FSAs)

Health FSAs have several benefits, including these:

- Employer contributions can be nontaxable.
- No income taxes or employment 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. 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). The maximum salary reduction allowed for 2022 is \$2,850, up from \$2,750 in 2021. See [IRS Publication 502](#) for a list of qualified medical expenses.

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 or refunded to the employee. However, employers, at their discretion, may amend their plans to choose one of the following two modifications to the “use-it-or-lose-it” provision:

- **Option 1:** An employer may amend its cafeteria plan document to provide for a carryover amount from one plan year to the next. The maximum carryover amount is now indexed for cost-of-living changes and will increase to \$570 for the 2022 plan year. The carryover amount was \$550 for the 2021 plan year; however, the Consolidated Appropriations Act temporarily increased the carryover amount for the 2021 plan year to allow up to the full account balance at year-end to be carried over to 2022. The amount carried over may be used to pay or reimburse qualified medical expenses incurred during the entire plan year to which it is carried over. The carryover amount does not impact the maximum allowed annual salary reduction contribution.
- **Option 2:** The plan can be modified to provide for a grace period of up to two and a half months after the end of the plan year to spend unused amounts from the prior year. The Consolidated Appropriations Act temporarily increased the allowable grace period to up to 12 months for the 2021 plan year. If the plan provides for a grace period, any qualified medical expenses incurred during that grace period can be paid from amounts left in the account at the end of the previous year.

! Key Points

- An employer, at its option, may amend its cafeteria plan document to provide for the carryover to the immediately following plan year and may roll over any remaining amount if previously elected as an option by the employer.
- 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 pretax dollars. An employee covered by a High Deductible Health Plan (HDHP) and a **Health FSA** or a **Health Reimbursement Account (HRA)** that pays or reimburses qualified medical expenses generally cannot contribute to an **HSA**. See [IRS Publication 969](#) for more detailed information.

Dependent Care Flexible Spending Accounts (Dependent Care FSAs)

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 employee, 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 American Rescue Plan Act of 2021 provides a temporary increase in the federally capped maximum annual contribution amount for Dependent Care FSAs from \$5,000 per household to **\$10,500 per household**. For now, this increase applies only to the 2021 plan year. Married spouses can each elect a Dependent Care FSA, but their total combined elections cannot exceed the maximum contribution allowed per household. If married, both spouses must have earned taxable income to be eligible to participate in a Dependent Care FSA. If an employee makes ineligible contributions, the withdrawal of those contributions will be taxable income.

A Dependent Care FSA is a “use-it-or-lose-it” plan. However, for the 2021 plan year only, the Consolidated Appropriations Act permits an employer to modify its plan to allow a grace period of up to 12 months or a carryover amount of up to the full account balance to the 2022 plan year.

! Key Point

Employers who wish to implement any of the plan changes permitted by the Consolidated Appropriations Act for the 2021 plan year must amend their plan documents no later than **December 31, 2022**.

Unlike Health FSAs, Dependent Care FSAs are not “prefunded”; employees cannot receive reimbursement for the full amount of the annual contribution on day one. Employees can be reimbursed only 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 attributes:

1. Contributions are made by employees’ elective deferral of current taxable income. Compensation already designated as housing allowance is ineligible for contribution to a Section 403(b) plan.
2. Employees pay no income tax on the amounts contributed. Lay employee contributions are subject to Social Security and Medicare taxes.
3. Clergy elective deferrals are not subject to self-employment tax. This is a permanent tax savings.
4. Employers may contribute to the employee’s Section 403(b) account.

5. Withdrawals from a Section 403(b) plan will be subject to income tax and are eligible for exclusion by clergy as housing allowance. Plan withdrawals before age 59½ may be subject to early withdrawal penalties.

For 2021, the maximum combined contribution (i.e., employer contributions and employee salary deferrals) was the lesser of 100% of taxable compensation or \$58,000 (\$64,500 for those aged 50 or older). For 2022, these amounts increase to **\$61,000** (or \$67,500 for those aged 50 or older).

The maximum employee pretax salary deferral for 2021 was the lesser of 100% of taxable compensation or \$19,500 (\$26,000 for those aged 50 or older). For 2022, these amounts are **\$20,500** (\$27,000 for those aged 50 or older).

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

Qualified Charitable Distributions are not eligible from a Section 403(b) account, but only from an IRA. See page 22 for more details.

❗ Key Point

Contributions to a Section 403(b) plan can still be made from current church earnings even after an employee has started to receive their required minimum distribution (RMD) from their Section 403(b) plan.

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 appear on some of the tax forms and returns listed below. The EIN is a nine-digit number that looks like this: 99-9999999. If your church does not have an EIN, you may apply for one online. Go to the IRS website at [irs.gov](https://www.irs.gov) and click on the “Apply for an Employer ID Number (EIN)” link. You may also apply for an EIN by calling (800) 829-4933, or you may fax or mail Form SS-4 to the IRS. You should have only one EIN.

❗ Key Point

The employer identification number is not a “tax exemption number” and has no relation to your nonprofit status. It merely identifies 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 their 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 these:

- 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, not the worker, hires and pays any assistants.
- The worker has a continuing working relationship with the employer.
- The worker receives a regular wage amount for an hourly, weekly, or other period of time, regardless of whether the worker is full time or part 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/businesses.
- The worker does not advertise their 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.

Warnings

- 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.
- State employment laws may differ significantly from federal employment laws when it comes to the classification of a church worker. Please ensure compliance with state and city employment laws as well as federal employment laws.

Key Points

- The determination of employment status for income tax and federal payroll reporting purposes discussed above is different from the determination of employment status for Clergy Pension Fund assessment purposes.
- Effective January 1, 2018, a church is required to pay pension assessments to The Church Pension Fund, whether or not a clergy member is classified as an employee or independent contractor, if a clergy member is “regularly employed” for five or more consecutive months and is compensated. Note that compensation will include employer-provided housing even if no salary is paid to the clergy member.

For purposes of The Church Pension Fund Clergy Pension Plan, a clergy member is considered regularly employed if they meet one or more of these criteria:

- Has a letter of agreement or contract of employment
- Is duly called by bishop, vestry, or rector
- Has a formal title indicating a substantial ongoing relationship
- Is issued a Form W-2 (or equivalent)
- Is scheduled to work at least 20 hours per week

If a clergy member would otherwise meet the plan criteria above except that they are expected to work for fewer than five consecutive months, the clergy member and employer may choose to participate in The Church Pension Fund Clergy Pension Plan if they have a Letter of Agreement (or other contract of employment) that provides for the payment of assessments by the employer.

After a clergy member turns age 72, the employer may not pay assessments to The Church Pension Fund.

The payment of pension assessments for a clergy member determined to be an employee of the church will not be taxable to the clergy member. However, pension assessments paid by the church for a clergy member who is classified as an independent contractor are taxable to the clergy member and should be included on Form 1099-NEC provided to the clergy member / independent contractor.

Employer-provided fringe benefits, such as group medical insurance and flexible savings accounts, are nontaxable only for employees. A clergy member who is receiving employer-provided fringe benefits must be considered an employee and receive a Form W-2.

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

A worker who does not have a Social Security number can obtain one by filing Form SS-5 (Social Security Administration). 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 their 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 24% for 2022. 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 self-employed worker’s Form 1099-NEC (discussed below). Churches can be penalized if the Social Security number they report on a Form 1099-NEC is incorrect, unless they have exercised “due diligence.” A church will be deemed to have exercised due diligence if it has required self-employed workers to provide their Social Security numbers using Form W-9, Request for Taxpayer Identification Number and Certification. As a result, it is a good idea for employers to establish a policy of obtaining a Form W-9 from all self-employed individuals prior to issuing any payments for services rendered. 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 2021 must be filed with the IRS by January 31, 2022, or—if the church made deposits on time in full payment of the taxes for the year—by February 10, 2022.

Step 4. Have each employee complete a Form W-4, Employee’s Withholding Certificate.

Employees need to provide their employer with a Form W-4 to enable the employer to determine how much income tax to withhold from their compensation. In the past, income tax withholding was calculated based on the number of “withholding allowances” an employee claimed on their Form W-4. The IRS made major changes to Form W-4 for 2020. Note the following:

- The new design reduces the form's complexity and increases the transparency and accuracy of the withholding system. While it uses the same underlying information as the old design, it replaces complicated worksheets with more straightforward questions that make accurate withholding easier for employees.
- In the past, the value of a withholding allowance was tied to the amount of the personal exemptions. Due to changes in tax law, currently your employees cannot claim personal exemptions or dependency exemptions.
- Employees who have submitted a Form W-4 in any year before 2020 are not required to submit a new form merely because of the redesign. Employers will continue to compute withholding based on the information from the employee's most recently submitted Form W-4
- To provide maximum accuracy, employees should be encouraged to use the Tax Withholding Estimator available at irs.gov/W4app. Ministers generally are exempt from income tax withholding with respect to compensation received from the exercise of ministry (unless they have elected voluntary withholding).

📌 Key Point

Please visit the IRS website to make sure that you are using the most up-to-date version of the Form W-4.

Step 5. Compute each employee's taxable wages.

The amount of income 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 income tax withholding include pay given to an employee for service performed. The payment may be in cash or in other forms, which are measured by their fair market values. A comprehensive list of types of wages, other than salary, may be found in Step 10 on page 14.

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

Employers may use *IRS Publication 15-T*, Federal Income Tax Withholding Methods, to determine the amount of federal income tax to be withheld from employee wages. The computations described in Publication 15-T will allow employers to figure withholding for all versions of the W-4 form. Publication 15-T also allows employers to figure withholding based on their payroll system (automated or manual) and withholding method of choice.

Publication 15-T describes five methods for determining the amount of income taxes to be withheld from an employee's wages::

1. Percentage method tables for automated payroll systems
2. Wage bracket method tables for manual payroll systems with Forms W-4 from 2020 or later
3. Wage bracket method tables for manual payroll systems with Forms W-4 from before 2020
4. Percentage method tables for manual payroll systems with Forms W-4 from 2020 or later
5. Percentage method tables for manual payroll systems with Forms W-4 from before 2020

In addition to Publication 15-T, the IRS has a downloadable Excel worksheet to help employers easily determine the right amount of federal tax to withhold from their employee's compensation. Known as the Income Tax Withholding Assistant for Employers, this worksheet can be accessed at irs.gov/itwa.

Voluntary withholdings on clergy compensation

Wages paid to a clergy member as compensation for ministerial services are exempt from federal 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 clergy member's wages as if these wages are not exempt from income tax withholding. Some clergy find voluntary income tax withholding attractive since it eliminates the additional work and discipline associated with the estimated tax procedure.

A clergy member initiates voluntary income tax withholding by providing the church with a completed Form W-4. The filing of this form is deemed to be a request for voluntary income tax withholding. Voluntary income tax withholding arrangements may be terminated at any time by either the church or clergy member, or by mutual consent.

The tax code specifies that clergy are self-employed for Social Security and Medicare tax purposes with respect to services performed in the exercise of ministry. Therefore, there will be no withholding of Social Security or Medicare taxes. However, clergy electing voluntary income tax withholding can indicate on Form W-4 that they want an additional amount of federal income tax to be withheld from each pay period to satisfy their total estimated tax liability (self-employment and federal income tax) by the end of the year. The amount of income tax withholding will be applied toward the clergy member's self-employment and income tax liabilities on Form 1040. The amount withheld is reported by the church as federal income taxes withheld on its quarterly Form 941 (or annual 944) and on the clergy member's Form W-2.

Since any federal income tax paid by voluntary income tax withholding is deemed to be timely paid, a clergy member who pays their income and self-employment taxes using this procedure will not be liable for any underpayment penalty (assuming that a sufficient amount of federal income taxes is 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 2021, the maximum wages subject to the Social Security tax (the 6.2% amount) was \$142,800. For 2022, the amount increases to **\$147,000**.

A church must withhold a 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 per year paid to an employee of a nonprofit organization are exempt from these taxes.

The Affordable Care Act increased the Medicare tax by an additional 0.9% on taxable compensation and self-employment income received in excess of a threshold amount based on the individual's filing status (the Additional Medicare Tax).

The statute requires an employer to withhold the Additional Medicare Tax on wages it pays to an employee in excess of **\$200,000** (**\$250,000** for married couples) in a calendar year (this amount is not indexed for inflation). There is no employer match for the Additional Medicare Tax.

Step 8. Deposit taxes that have been withheld.

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)
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—the 12 months (covering four quarters) ending on June 30 of the prior year. For 2022, the lookback period was July 1, 2020, through June 30, 2021.

Monthly depositor rule. Churches that reported payroll taxes of \$50,000 or less in the lookback period will deposit their withheld taxes for 2022 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 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 federal payroll tax liability during the current or previous quarter, you may remit your payroll taxes with your timely filed Form 941 instead of depositing monthly. If you aren't sure your total tax liability for the current quarter will be less than \$2,500 (and your liability for the prior quarter wasn't less than \$2,500), make deposits using the semiweekly or monthly rules so you won't be subject to a failure-to-deposit penalty. 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. It is the employer's responsibility to ensure that federal taxes are deposited in a timely basis by the payroll vendor. Failure to timely deposit payroll taxes will result in substantial penalties to the employer.

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 services, or other trusted third party to make deposits electronically on your behalf.

The CARES Act allowed employers to defer the deposit of the employer's share of Social Security taxes and self-employed individuals to defer the deposit of their SECA taxes (clergy are considered self-employed for SECA tax purposes) for the period March 27, 2020, through December 31, 2020. If either an employer or clergy member took advantage of this deferral, 50% of the taxes deferred were required to be deposited by December 31, 2021, and the remaining 50% must be paid by December 31, 2022. More information can be found at irs.gov/coronavirus.

Step 9. File Form 941 or Form 944, as required.

All employers subject to federal income tax withholding or Social Security and Medicare taxes, or both, must file Form 941 quarterly or, in the case of eligible small employers, Form 944 annually. Generally, total payroll tax for the year must be \$1,000 or less to qualify as an eligible small employer. Forms 941 and 944 report the number of employees and amount of Social Security and Medicare taxes and withheld federal income taxes that are payable.

Form 941 is due on the last day of the month following the end of each calendar quarter. Form 944 is due on January 31 after the close of the year.

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 [irs.gov](https://www.irs.gov) or call (800) 829-1040.

Quarter	Ending	Due Date of Form 941
1st (January to March)	March 31	April 30
2nd (April to June)	June 30	July 31
3rd (July to September)	September 30	October 31
4th (October to December)	December 31	January 31

Key Points

- 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 clergy member—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 Form W-2) but no Form 941 filings.
- Form 1099-NEC need **not** be provided to a nonemployee clergy member who receives 100% of their compensation as housing. Instead, the church should remind the clergy member by letter that compensation of [insert dollar amount] has been excluded from income reporting since it has been set aside as a housing allowance but yet is reportable as self-employment income for SECA tax purposes.
- 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 federal income taxes as well as Social Security and Medicare taxes on this form. A church should furnish copies B, C, and two of the 2021 Forms W-2 to each employee by January 31, 2022. File Copy A with the Social Security Administration by January 31, 2022. Send all Copies A with Form W-3, Transmittal of Wage and Tax Statements.

Key Points

- 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. For information on how to file electronically, call the Social Security Administration (SSA) at (800) 772-6270. You may file a limited number of Forms W-2 and W-3 online using the SSA website at ssa.gov/employer. The site also allows you to print out copies of the forms for filing with state or local governments, for distribution to your employees, and for the church’s records.
- **Be sure to add cents to all amounts.** Do not use dollar signs or commas. Use a decimal point and cents. For example, \$1,000 should be entered as 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.

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
- Any portion of a clergy member's self-employment taxes paid by the church to the clergy member
- 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 that is paid by the church, the diocese, The Church Pension Fund, or other church organizations combined (refer to table on page 19)
- Imputed value of employer-provided health coverage to nondependent domestic partners, their children, and employee's adult children aged 27 or older
- Moving expenses either provided or reimbursed to the employee
- The value of the personal use of an employer-provided car

(Please be aware that the IRS issued [Notice 2021-7](#), which provided that if certain requirements are satisfied, employers and employees who are using the automobile lease valuation rule to determine the value of an employee's personal use of an employer-provided automobile can instead use the vehicle cents-per-mile valuation rule.)

- Most Christmas, birthday, anniversary, and other special occasion gifts paid by the church to the employee
- 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)
- 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 lay employees. 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 (56 cents per mile for 2021; 58.5 cents per mile for 2022), 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 lay employees. For nonemployee service to a charitable organization, the mileage rate remains unchanged 14 cents per mile.
- Use code L in Box 12 to report the amount of reimbursed employee travel expenses 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.
- Amounts includable in income under a nonqualified deferred compensation plan because of Code Section 409A
- Designated Roth contributions made under a Code Section 403(b) salary reduction agreement
- Reimbursements of a spouse's travel expenses incurred while accompanying an employee on a business trip, 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 clergy member of at least \$10,000 create taxable income to the clergy member (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. For this type of transaction, please contact the church's legal advisor.
- A clergy member's debt to the church that has been forgiven by the church
- Severance pay
- Payment of a clergy member's personal expenses by the church
- 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 Points

- An employer contribution such as a housing equity allowance paid directly to a clergy member's RSVP (Code Section 403(b) account) should not be included in Box 1 of Form W-2.

- 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. In addition, pretax salary deferrals made to certain retirement plans (such as a Code Section 403(b) plan like the RSVP) are not reported in Box 1. However, amounts distributed to an employee by the employer under a nonqualified deferred compensation plan are included in Box 1. Also, see Boxes 11 and 13.
- Amounts reported as imputed income, noncash compensation, such as the imputed value of employer-provided life insurance, are not eligible to be excluded under a housing allowance since there was no cash compensation provided.

Warning

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

Box 2. List all federal income taxes that you withheld from the employee’s wages. Also, include any voluntary federal income 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. Do not report more than the maximum wage base subject to this tax (\$142,800 for 2021 and \$147,000 for 2022). 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 Code Section 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, contributions to a Code Section 403(b) plan by salary reduction 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 taxes 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 employees’ wages. This tax is imposed on all wages up to a maximum of \$142,800 for 2021 and \$147,000 for 2022. 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 wages (such as 403(b) contributions, if any) subject to the Medicare component of FICA taxes. This will be the lay employee’s entire wages regardless of amount. There is no ceiling for the Medicare component. Note that Box 3 and 5 will be the same for lay employees who earn less than the maximum social security wage base amount (\$142,800 for 2021 and \$147,000 for 2022). **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. For 2021, the American Rescue Plan of 2021 (ARP) permits employers to increase the maximum amount of dependent care benefits that can be excluded from an employee’s income from \$5,000 to \$10,500 (\$5,250 for Married Filing Separately). You must amend your plan timely for the increase to take effect. For more information, see [IRS Publication 15-B](#).

Box 11. The purpose of Box 11 is for the Social Security Administration 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 Box 3 (up to the Social Security wage base) and Box 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.

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.** If 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). See the discussion of employer-provided group term life insurance below for additional information.
- D.** This is generally not applicable to churches.
- E.** If the church made contributions to a Section 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 Box 3 (up to the Social Security wage base) and Box 5 for lay employees, since it is subject to Social Security and Medicare taxes with respect to such workers.
- F.** This is generally not applicable to churches.
- G.** This is generally not applicable to churches.
- H.** This is generally not applicable to churches.
- J.** If the church is reporting sick pay. Show the amount of any sick pay that is not includable in the employee’s income because they contributed to the sick pay plan.
- K.** This is generally not applicable to churches.
- L.** Reimbursement of mileage. If the church reimbursed the employee for employee business expenses using the standard mileage rate or the per diem rates, and the amount 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 Box 3 (up to the Social Security wage base) and Box 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.** This is generally not applicable to churches.
- N.** This is generally not applicable to churches.
- P.** This is generally not applicable to churches.
- Q.** This is generally not applicable to churches.
- R.** Show any employer contributions to an Archer MSA. See [IRS Publication 969](#) for information.
- S.** Show deferrals under a Section 408(p) salary reduction SIMPLE retirement account. However, if the SIMPLE plan is part of a section 401(k) arrangement, use code D.
- T.** Adoption benefits. Show the total that you paid or reimbursed for qualified adoption expenses furnished to your employee under an adoption assistance program. Also include adoption benefits paid or reimbursed from the pretax contributions made by the employee under a Section 125 cafeteria plan. However, do not include adoption benefits forfeited from a Section 125 cafeteria plan. Report all amounts, including those in excess of the \$14,440 exclusion for 2021. For 2022, the exclusion has been increased to \$14,890.
- V.** This is generally not applicable to churches.
- W.** Report employer contributions to a health savings account (HSA). Include amounts the employee elected to contribute using a Section 125 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 (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.** This is 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 Forms W-2 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 informational purposes only; the amounts reported are not included in taxable wages and are not subject to any taxes.

EE. This is generally not applicable to churches.

FF. Use to designate permitted benefits under a Qualified Small Employer Health Reimbursement Arrangement (QSEHRA) for tax year 2021. The maximum reimbursement for an eligible individual employee under a QSEHRA employee for tax year 2021 is \$5,300, or \$10,700 if the benefit includes reimbursements for family members. For 2022, it is \$5,450 for an individual and \$11,050 for a family.

Box 13. Check the appropriate box:

- **Retirement plan.** This box should be checked for clergy covered by The Church Pension Fund Clergy Pension Plan and for any clergy member 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 about a housing allowance or qualified sick and family leave wages.

Some churches report a church-designated housing allowance in this box (for clergy who are classified as employees). **Do not report the value of church-provided housing.** 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. This box can be used to also report the amount of utilities paid by the employer.

In September 2021, the Treasury Department and the Internal Revenue Service issued Notice 2021-53 to provide guidance to employers about reporting on Form W-2 the amount of qualified sick and family leave wages paid to employees for leave taken in 2021. Employers are required to report these amounts either on Form W-2, Box 14, or in a separate statement provided with the Form W-2. The guidance provides employers with model language to use as part of the Instructions for Employee for the Form W-2 or on the separate statement. The wage amount reported on Form W-2 will provide employees who are also self-employed with the information necessary to determine the amount of any sick and family leave equivalent credits they may claim in their self-employed capacities. See [Notice 2021-53](#) for details.

Tax Tip

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

- Income tax withholding (Box 2)
- Social Security and Medicare wages (Boxes 3, 5, and 7)
- Social Security and Medicare taxes (Boxes 4 and 6)

Amounts reported on Forms W-2, W-3, and Forms 941 may not match for valid reasons. If they do not match, be sure to determine that the reasons are valid.

Step 11. Prepare Form 1099-NEC. The church must issue a Form 1099-NEC to every nonemployee to whom the church pays “nonemployee” compensation of \$600 or more during the year. To illustrate, if a guest speaker visited a church in 2021 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-NEC no later than January 31, 2022, and file Copy A with the IRS before February 1, 2022, using either paper or electronic filing procedures.

Form 1099-NEC is designed to induce self-employed persons to report their full taxable income. The form applies to “nonemployees,” including certain self-employed individuals who perform miscellaneous services for the church (plumbers, carpenters, lawn maintenance, etc.). Exceptions apply. For example, a church need not issue a Form 1099-NEC to a corporation. Nor should a church issue a Form 1099-NEC to an individual who will be receiving a Form W-2 for services rendered to the church as an employee. Also, travel expense reimbursements paid to a self-employed person under an accountable reimbursement plan do not count toward the \$600 reporting threshold.

To send the individual a properly completed Form 1099-NEC, the church will need to obtain their 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 individual who is paid \$600 or more during the course of a year by a church refuses to provide their Social Security number, then the church may be required to withhold 24% of the person's total "nonemployee" compensation as "backup withholding."

📌 Key Point

To report nonemployee compensation, use form 1099-nec.

⚠️ Warning

Misclassifying your workers as "nonemployees" can result in significant tax penalties and interest. Both the IRS and state governments are aggressively pursuing employers who misclassify their workers.

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 one-month period			
Age bracket	Cost	Age bracket	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 \$150,000 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 that covers Benjamin's wife, who is 30 years old. The church must report \$91.20 as the imputed cost of the insurance provided to Benjamin and his wife. This amount is computed as follows:

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 120 (corresponding to \$120,000 of group term life insurance provided in excess of \$50,000) = \$86.40.

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 \$91.20. St. George's Church 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 federal income tax as well as Social Security and Medicare tax withholding for lay church employees.

📌 Key Point

Effective January 1, 2018, the maximum life insurance provided to Eligible Active Clergy by The Church Pension Fund increased to six times Total Assessable Compensation (TAC) with a maximum of \$150,000.

New Hire Report

Be sure to file this report with the state as soon as anyone is hired by your organization—including a clergy member. The church's payroll service vendor should do this for you.

Form I-9

All employers, including church-related employers, are responsible for verifying the identity and eligibility of employees to work in the United States using 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 take these steps:

- 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 United States citizen. An employee signs part of the form, and the employer signs part of the form. The form's instructions list documents that 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, uscis.gov.
- Collect Form I-9 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 only 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 a minimum of 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.
- 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.

Warning

Caution. As of September 18, 2017, all employers must use the updated Form I-9. **Make sure you're using the most recent version.**

Annual Certification of Racial Nondiscrimination. Churches and other religious organizations that operate, supervise, or control a private school must file Form 5578, Annual Certification of Racial Nondiscrimination for a Private School Exempt from Federal Income Tax, 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 15th of the following year for organizations that operate on a calendar year basis. This means that the Form 5578 for 2021 is due **May 15, 2022**, for organizations that operate on a calendar year basis.

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, as well as colleges and universities, whether operated as a separate legal entity or an activity of a church.

Key Points

- The term "school" also includes preschools, which makes this reporting requirement relevant for many churches. As many as 25% of all churches operate a preschool program.
- Private religious schools that are not affiliated with 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 Section 4.01 through 4.05 of Revenue Procedure 75-50." This reference is to the following requirements:
 - ~ The school has a statement in its charter, bylaws, or other governing instrument, or in a resolution of its governing body, that it has a racially nondiscriminatory policy toward students.
 - ~ The school has a statement of its racially nondiscriminatory policy toward students in all its brochures and catalogs dealing with student admissions, programs, and scholarships.
 - ~ The school makes its racially nondiscriminatory policy known to all segments of the general community served by the school through the publication of a notice of its racially nondiscriminatory policy at least annually in a newspaper of

general circulation, through utilization of the broadcast media, or by displaying a notice of its racially nondiscriminatory policy on its primary publicly accessible internet homepage at all times during its taxable year (excluding temporary outages due to website maintenance or technical problems) in a manner reasonably expected to be noticed by visitors to the homepage. (Allowing the notice to be placed on a school's website homepage is a new concession granted by the IRS in 2019. See *IRS Revenue Procedure 2019-22*).

- However, such notice is not required if one or more of these exceptions apply:
 - ~ During the preceding three years, the enrollment consists of students at least 75% of whom are members of the sponsoring church or religious denomination and the school publicizes its nondiscriminatory policy in religious periodicals distributed in the community.
 - ~ The school draws its students from local communities, follows a racially nondiscriminatory policy toward students, and demonstrates that it follows a racially nondiscriminatory policy by showing that it currently enrolls students of racial minority groups in meaningful numbers. The school can demonstrate that all scholarships or other comparable benefits are offered on a racially nondiscriminatory basis.

Warning

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

Charitable Contribution Substantiation Rules

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

Cash contributions. All cash contributions, **regardless of amount**, must 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:
 - ~ A statement that no goods or services were provided by the church in return for the contribution
 - ~ A statement that goods or services that a church provided in return for the contribution consisted entirely of intangible religious benefits
 - ~ 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 provide either 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:
 - ~ The date the donor files a tax return claiming a deduction for the contribution
 - ~ 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 both of these 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. Token goods or services were those having a value not exceeding the lesser of **\$113 for 2021 (\$117 for 2022)** or 2% of the amount of the contribution. This amount is adjusted annually for inflation. In addition, the rules do not apply to contributions in return for which the donor receives solely an intangible religious benefit that generally is not sold in a commercial context outside the donative context.

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

For contributions of noncash property valued at more than \$5,000 (\$10,000 for privately held stocks), a donor must obtain a qualified appraisal of the donated property from a qualified appraiser, 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: Taxfree 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 their gross income qualified charitable distributions (QCD) made 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).

While the SECURE Act did not change the age at which an individual can make a QCD from their IRA, which remains at age 70½, the SECURE Act does place a limit on the amount of a QCD based on the amount of deductible IRA contributions made for any tax year after an individual reaches age 70½.

❗ Key Point

QCD tax-favored treatment is **not** available for a distribution from a Code Section 403(b) account to a charity. If such a distribution is made, it will not be eligible for tax-favored treatment. Only a QCD received from an IRA is eligible for tax-favored treatment.

Consolidated Appropriations Act

The Consolidated Appropriations Act was signed into law on December 27, 2020. Here are some provisions of that act.

- **Payroll Protection Program (PPP):** The Act permits taxpayers whose PPP loans are forgiven to deduct the expenses relating to their loans to the extent they would otherwise qualify as ordinary and necessary business expenses. This rule applies retroactively to the effective date of the CARES Act so that expenses paid using funds from PPP loans previously issued under the CARES Act are deductible, regardless of when the loan was forgiven.
The Act permits an employer that receives a PPP loan to receive the employee retention tax credit. However, to prevent any double-dipping, an employer must either exclude “qualified wages” that allowed the employer to claim employee retention tax credits from “payroll costs” for purposes of determining its loan forgiveness under the PPP (so as to reduce the amount of loan forgiveness), or exclude “qualified wages” that qualified for PPP loan forgiveness from “payroll costs” (so as to reduce the employee retention tax credit). This change applies retroactively to the effective date of the CARES Act.
- **Recovery Rebates:** Provide for a second round of payments to taxpayers of \$600 per taxpayer with a social security number, including \$600 per child up to age 17. Payments are made based on your 2019 Adjusted Gross Income (AGI) with the payments phasing out for AGI of \$75,000 for single filers, \$150,000 for married filing joint, and \$112,500 for head of household.
- **Extends paid sick and family leave credits through March 31, 2021:** Under the American Rescue Plan (ARP), employers are entitled to tax credits for providing paid leave to employees who take time off related to COVID-19 vaccinations. ARP credits are available to eligible employers that pay sick and family leave for leave from April 1, 2021, through September 30, 2021. See [IRS news bulletin](#) for more information.

- **Above-the-line charitable deduction for cash donations to qualifying charities:** For non-itemizers, the maximum amount for 2021 is \$600 for married filing joint return, \$300 for single taxpayers, and \$300 for married filing separate returns. Noncash donations do not qualify for this deduction.
- **Deferral of employee side payroll tax:** If the deferral was elected, the repayment was extended to 12/31/21 from 4/1/21.
- **Certain “tax extenders” were made permanent:**
 - ~ Lowered the AGI threshold for medical expense deduction for itemized deductions to 7.5%.
 - ~ Repealed the above-the-line deduction for education expenses after 2020, and increased the phase-out for Lifetime Learning Credit.
- **Extended for five years to January 1, 2025:**
 - ~ Employer credit for paid family and medical leave originally enacted as part of the Tax Cuts and Jobs Act of 2017.
 - ~ Expanded exclusion for employer provided educational assistance, including student loan repayment benefits from the CARES Act.
- **Temporary 100% deduction for business meals:** The Tax Cuts and Jobs Act of 2017 limited the deductibility of business meal expenses to 50% of the cost for food and beverages provided by a restaurant. The Act permits businesses to deduct 100% of these business meal expenses provided by a restaurant during 2021 and 2022.

Sample W-2

22222		a Employee's social security number		OMB No. 1545-0008	
b Employer identification number (EIN)			1 Wages, tips, other compensation		2 Federal income tax withheld
c Employer's name, address, and ZIP code			3 Social security wages		4 Social security tax withheld
			5 Medicare wages and tips		5 Medicare tax withheld
			7 Social security tips		8 Allocated tips
d Control number			9		10 Dependent care benefits
e Employee's first name and initial		Last name	Suff.	11 Nonqualified plans	
f Employee's address and ZIP code			13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>		12a
			14 Other		12b
					12c
					12d
15 State Employer's state ID number		16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax
					20 Locality name

Form **W-2** Wage and Tax Statement
 Copy 1—For State, City, or Local Tax Department

2022

Department of the Treasury—Internal Revenue Service

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 are not subject to Social Security tax. This box should be empty on a clergy Form W-2.
- 3 Clergy W-2 wages are not subject to Medicare tax. This 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 for members of the clergy. This box should be empty on a clergy Form W-2.
- 6 Medicare is not withheld for members of the clergy. 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 12a).
 - 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 and 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 local 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).
 - Qualified sick leave wages and qualified family leave wages paid to employees under the Families First Coronavirus Response Act, P.L. 116-127
- 14 Control Number used by employer to identify an employee's W-2.

Sample 1099-NEC

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		OMB No. 1545-0118 Form 1099-NEC (Rev. January 2022) For calendar year 20__	Nonemployee Compensation
PAYER'S TIN	RECIPIENT'S TIN		
RECIPIENT'S name		1 Nonemployee compensation \$	Copy B For Recipient <small>This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.</small>
Street address (including apt. no.)		2 Payer made direct sales totaling \$5,000 or more of consumer products to recipient for resale <input type="checkbox"/>	
City or town, state or province, country, and ZIP or foreign postal code		3	
Account number (see instructions)		4 Federal income tax withheld \$	
		5 State tax withheld \$	
		6 State/Payer's state no.	7 State income \$

Form **1099-NEC** (Rev. 1-2022)

(keep for your records)

www.irs.gov/Form1099NEC

Department of the Treasury - Internal Revenue Service

Helpful Numbers and Resources

To request IRS forms

- (800) TAX-FORM or (800) 829-3676
- IRS homepage: [irs.gov](https://www.irs.gov)

The Church Pension Fund

- (800) 223-6602
- [cpg.org](https://www.cpg.org)
- Online version of *Federal Reporting Requirements for Episcopal Churches, Schools, and Institutions* and other tax resources: [cpg.org/taxpubs](https://www.cpg.org/taxpubs)

Tax Lines

- Nancy Fritschner, CPA (877) 305-1414
- Mary Ann Hanson, CPA (877) 305-1415
- Dolly Rios, CPA (833) 363-5751 *Fluent in English and Spanish*

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