



WELS

Christ's Love, Our Calling.

TAX

INFORMATION

MANUAL

DISCLAIMER: The information contained in this tax manual is for informational purposes related to federal income taxes and is based only on the resources that WELS has at its disposal. Individuals, congregations, schools or other para-synodical entities using the information contained in this tax manual should consult a qualified tax consultant/professional to be sure that the information relied upon applies to their particular situation.

2020 FACTS & UPDATES

1. For 2020, the employee tax rate for social security is 6.2% and the employer tax rate for social security is 6.2%. The 2020 social security wage base limit is \$137,700.

In 2020, the Medicare tax rate is 1.45% each for employers and employees for wages up to \$200,000 for a combined rate of 2.9%. Wages above \$200,000 are subject to an extra 0.9% Additional Medicare Tax which will only be withheld from employees' wages as employers do not pay the extra tax.

The combined FICA withholding rate is 7.65% and the SECA (self-employment) tax rate is 15.3% for 2020.

2. In 2020, retirees under "full retirement age" may earn up to \$18,240/yr. (\$1,520/mo.) before social security benefits are reduced. *Note: If you are younger than full retirement age during all of 2020, \$1 will be deducted from your benefits for each \$2 you earned above \$18,240.*

The limit for individuals who reach "full retirement age" in 2020 is \$48,600/yr. (\$4,050/mo.) for months prior to attaining "full retirement age". *Note: If you reach full retirement age during 2020, \$1 will be deducted from your benefits for each \$3 you earned above \$48,600 until you reach "full retirement age".* There is no limit on earnings for workers who are "full" retirement age or older for the entire year. The Social Security Administration provides a chart to help determine when an individual reaches "full retirement age." See SSA's website at <http://www.socialsecurity.gov/pubs/ageincrease.htm> for additional information.

3. Effective January 1, 2020, the IRS announced a maximum allowed rate of 57.5¢ per mile for all business miles driven. This is a decrease of 0.5¢ from the 58.0¢ rate for 2019. The rate for medical or moving expenses decreased to 17¢ per mile for 2020. The standard rate for providing services for charitable entities remains at 14¢ per mile.

Effective March 1, 2020, the WELS standard mileage rate increased to 51¢ per mile by Synodical Council resolution.

Since the deduction for miscellaneous itemized deductions was eliminated by the Tax Cuts and Jobs Act (TCJA) of 2017, the difference (6.5¢) between the WELS and IRS mileage rates can no longer be deducted as an unreimbursed business expense on Schedule A – Itemized Deductions.

4. All moving expenses incurred on or after January 1, 2018, whether reimbursed to an individual or paid to a vendor on behalf of an employee, continue to be taxable income to the employee. The TCJA of 2017 included elimination of the personal deduction for relocation (moving) expenses as well as elimination of the exclusion from income of employer-paid relocation expenses.
5. The annual contributions limit in 2020 to 403(b) plans is \$19,500. If age 50 or older, employees may make "catch-up contributions" to a 403(b) plan up to \$6,500.

Employees with 15 years of service in a qualified WELS entity can make additional contributions. The annual limitation is increased by the smallest of: (1) \$3,000; (2) \$15,000 minus any additional elective deferrals made in prior years due to this rule; or (3) \$5,000 times the employee's years of service minus the elective deferrals made in earlier tax years. Participants who qualify for both "catch-up" plans must use the 15-year catch-up contributions first. The annual limit on an employee's elective deferrals generally applies to all of an employee's deferrals under any 403(b), SEP, SIMPLE or 401(k) plan. For assistance, please contact WELS Benefits Plan Office at bpo@wels.net or Hahn Financial Group at wels403b@hahnfinancialgroup.com.

6. The IRA contribution limit is \$6,000 (\$7,000 if age 50 or over) in 2020.
7. The 2020 contribution limit to health care Flexible Spending Accounts is \$2,750.
8. Due to an increase in the Consumer Price Index (CPI-W), Social Security and Supplemental Security Income (SSI) beneficiaries will receive a 1.6% cost-of-living adjustment (COLA) in 2020
9. The standard deduction has increased for married individuals filing a joint return to \$24,800, head of household filers increased to \$18,650, and to \$12,400 for all other taxpayers for the 2020 tax year.

The standard deduction was significantly increased by the TCJA of 2017 and reduced the number of people eligible to itemize deductions on Schedule A of Form 1040.

10. The “parking tax” provision in the TCJA of 2017 was repealed late in 2019. The repeal is retroactive to the original enactment date. Entities may file amended Forms 990-T to claim a refund for taxes paid related to relevant expenses paid or incurred after December 31, 2017.
11. As a result of the COVID-19 pandemic, the deadline for filing 2019 taxes was extended from April 15, 2020 to July 15, 2020. If taxpayers need additional time to file their taxes, they should request a filing exemption by filing Form 4868.
12. The IRS has announced changes to Form W-4, Employee’s Withholding Certificate, for 2020. The redesigned form is intended to make withholding more accurate as a result of changes made in the TCJA that first impacted filers as 2018 returns were filed in 2019. A “paycheck checkup” can be performed by using the IRS’s Tax Withholding Estimator at <https://www.irs.gov/individuals/tax-withholding-estimator>. To effectively use the estimator, it is helpful to have a copy of your most recent pay stub and tax return. As an additional resource, the IRS has also published *Frequently Asked Questions* at <https://www.irs.gov/newsroom/faqs-on-the-2020-form-w-4>.
13. Visit <https://www.stayexempt.irs.gov/> for information on various topics relevant to 501(c)(3) entities. Online training and downloadable documents are available for topics including unrelated business income, charitable contributions and employment issues.
14. According to a legal opinion received in May 2020, called female teachers and staff ministers who are synod ministry certified are considered “Ministers of the Gospel” according to the Internal Revenue Code (IRC). They are eligible to work with their calling body to declare a parsonage allowance on wages earned in the exercise of their ministry.

2019 FACTS & UPDATES

1. For 2019, the employee tax rate for social security is 6.2% and the employer tax rate for social security is 6.2%. The 2019 social security wage base limit is \$132,900.

In 2019, the Medicare tax rate is 1.45% each for employers and employees for wages up to \$200,000 for a combined rate of 2.9%. Wages above \$200,000 are subject to an extra 0.9% Additional Medicare Tax that will only be withheld from employees' wages as employers do not pay the extra tax.

The combined FICA withholding rate is 7.65% and the SECA (self-employment) tax rate is 15.3% for 2019.

2. In 2019, retirees under "full retirement age" may earn up to \$17,640/yr. (\$1,470/mo.) before social security benefits are reduced. *Note: If you are younger than full retirement age during all of 2019, \$1 will be deducted from your benefits for each \$2 you earned above \$17,640.*

The limit for individuals who reach "full retirement age" in 2019 is \$46,920/yr. (\$3,910/mo.) for months prior to attaining "full retirement age". *Note: If you reach full retirement age during 2019, \$1 will be deducted from your benefits for each \$3 you earned above \$46,920 until you reach "full retirement age".* There is no limit on earnings for workers who are "full" retirement age or older for the entire year. The Social Security Administration provides a chart to help determine when an individual reaches "full retirement age." See SSA's website at <http://www.socialsecurity.gov/pubs/ageincrease.htm> for additional information.

3. Effective January 1, 2019, the IRS announced a maximum allowed rate of 58¢ per mile for all business miles driven. This is an increase of 3.5¢ from the 54.5¢ rate for 2018. The rate for medical or moving expenses increased to 20¢ per mile for 2019. The standard rate for providing services for charitable entities remains at 14¢ per mile.

Effective March 1, 2019, the WELS standard mileage rate increased to 48¢ per mile by Synodical Council resolution.

Since the deduction for miscellaneous itemized deductions was eliminated by the Tax Cuts and Jobs Act (TCJA) of 2017, the difference (10¢) between the WELS and IRS mileage rates can no longer be deducted as an unreimbursed business expense on Schedule A – Itemized Deductions.

4. In December 2017, congress passed major tax reform in the Tax Cuts and Jobs Act which included elimination of the personal deduction for relocation (moving) expenses as well as eliminating the exclusion from income of employer-paid relocation expenses. As a result, all moving expenses incurred on or after January 1, 2018, whether reimbursed to an individual or paid to a vendor on behalf of an employee, are taxable income to the employee.
5. The annual contributions limit in 2019 to 403(b) plans is \$19,000. If age 50 or older, employees may make "catch-up contributions" to a 403(b) plan up to \$6,000.

Employees with 15 years of service in a qualified WELS entity can make additional contributions. The annual limitation is increased by the smallest of: (1) \$3,000; (2) \$15,000 minus any additional elective deferrals made in prior years due to this rule; or (3) \$5,000 times the employee's years of service minus the elective deferrals made in earlier tax years. Participants who qualify for both "catch-up" plans must use the 15-year catch-up contributions first. The annual limit on an employee's elective deferrals generally applies to all of an employee's deferrals under any 403(b), SEP, SIMPLE or 401(k) plan. For assistance, please contact WELS Benefits Plan Office at bpo@wels.net or Hahn Financial Group at wels403b@hahnfinancialgroup.com.

6. The IRA contribution limit is \$6,000 (\$7,000 if age 50 or over) in 2019.
7. The 2019 contribution limit to health care Flexible Spending Accounts is \$2,700.
8. Due to an increase in the Consumer Price Index (CPI-W), Social Security and Supplemental Security Income (SSI) beneficiaries will receive a 2.8% cost-of-living adjustment (COLA) in 2019
9. The standard deduction has increased for married individuals filing a joint return to \$24,400, head of household filers increased to \$18,350, and to \$12,200 for all other taxpayers for the 2019 tax year.

The standard deduction was significantly increased by the TCJA of 2017 and will reduce the number of people eligible to itemize deductions on Schedule A of Form 1040.

10. Recent changes to the tax law have resulted in lower taxes and lower estimated tax payments for many people. With the corresponding changes to the wage brackets and withholding tables, it is important for taxpayers to understand their tax liability and make sure withholdings or estimated tax payments are set appropriately.
11. Modifications to section 529 Education Savings plans, due to the TCJA of 2017, allows the plan to distribute up to \$10,000 tax free for tuition in connection with the enrollment or attendance of a designated beneficiary at a public, private or religious elementary or secondary school. It is important to check with your state's 529 plan for a complete list of requirements and benefits.
12. A provision in the TCJA of 2017 includes a provision that requires tax exempt entities, including religious entities, to report and pay taxes on qualifying amounts spent to provide parking to employees. Form 990-T would be used to report and calculate the unrelated business income taxes due on qualified parking benefits.

These benefits include employer-provided parking, mass transit passes and commuter vans and may come through payment of employee parking fees or by providing parking on the employer's premises.
13. Visit <https://www.stayexempt.irs.gov/> for information on various topics relevant to 501(c)(3) entities. Online training and downloadable documents are available for topics including unrelated business income, charitable contributions and employment issues.

PREFACE

The 1989 WELS Synod convention adopted a resolution instructing the synod's Board of Trustees to issue a tax information manual to each congregation and synodical-affiliated entity (Proceedings, p. 162).

Each WELS congregation and entity is responsible for reproducing and distributing the tax manual to its workers, treasurers and other interested parties. The tax manual is designed to be topical, so it is important that all congregational workers receive a copy of the entire manual. This distribution will help treasurers understand the nature of called workers' taxes and help called workers understand the complexities of congregational reporting.

Generally, the Internal Revenue Code ("IRC") applies to workers in our churches and related entities the same as they apply to workers in the secular world. However, four provisions in the IRC are unique to ministers:

1. Section 107 parsonage allowances
2. Ability to be exempted from social security coverage
3. Dual tax status of some ministers-employees for benefit and reporting purposes but self-employed for social security purposes
4. Statutory exemption from income tax withholding

For more information on subjects not covered in this manual or for a more in-depth review of subjects contained herein, we suggest the worker, congregation or entity purchase one of the many handbooks available prepared by clergy tax experts. The back page of this tax manual provides information on where several such sources of tax information may be ordered.

If professional assistance is needed, it is recommended that you find a competent tax professional, or lawyer who can provide specific advice and guidance. It may be helpful to reach out to local ministers or congregations, your circuit pastor or district president for their recommendations.

TABLE OF CONTENTS

TAX EXEMPT STATUS – WELS CONGREGATIONS AND ENTITIES.....	1
TAX STATUS - MINISTERS OF THE GOSPEL.....	4
EMPLOYER IDENTIFICATION NUMBER	5
SALES TAX EXEMPTION STATUS	6
PROPERTY TAX EXEMPTION	7
FEDERAL UNEMPLOYMENT TAX ACT (FUTA).....	8
WORKERS’ COMPENSATION INSURANCE	9
SUBSTITUTE PASTORS, TEACHERS AND INDEPENDENT CONTRACTORS.....	10
INCOME	11
HOUSING	12
PARSONAGE ALLOWANCE.....	14
SELF-EMPLOYMENT TAX SUPPLEMENTS.....	16
OTHER INCOME/RECEIPTS	17
MOVING EXPENSES	18
FRINGE BENEFITS	19
EMPLOYMENT TAX WITHHOLDING	20
SOCIAL SECURITY TAXES	22
SELF-EMPLOYMENT (SECA) TAXES	22
ESTIMATED TAX, FORM 1040ES	22
SCHEDULE SE (FORM 1040)	23
<i>Worksheet for Calculating Net Earnings from Self-Employment</i>	<i>23</i>
<i>Social Security Exemption - Filing Form 4361</i>	<i>23</i>
EMPLOYMENT-RELATED FORMS.....	25
FORM W-4	25
FORM I-9	25
NEW HIRE REPORTING	25
REPORTING WAGES AND SALARIES.....	26
FORM W-2	26
HEALTH CARE COSTS ON W-2.....	26
REPORTING WAGES AND SALARIES	27
<i>Worksheet for Calculating “Minister of the Gospel” Taxable Income.....</i>	<i>27</i>
<i>Sample W-2, Minister of the Gospel.....</i>	<i>28</i>
<i>Sample W-2, Non-synod certified Called Worker and Other Church Employee.....</i>	<i>29</i>
FORM W-3	30
FORM 941	30
AFFORDABLE CARE ACT REPORTING REQUIREMENTS (1094-C, 1095-C)	31
REPORTING OTHER PAYMENTS	32
BUSINESS EXPENSE REIMBURSEMENTS AND TAX CREDITS.....	34
BUSINESS EXPENSE REIMBURSEMENTS	34
<i>Auto Expenses</i>	<i>34</i>
<i>Employer-provided Automobiles</i>	<i>35</i>
<i>Moving Expenses</i>	<i>35</i>
<i>Computers and Cellular Phones</i>	<i>35</i>

TAX CREDITS.....	36
<i>Earned Income Credit (EIC)</i>	36
<i>Child Tax Credits</i>	36
<i>Child and Dependent Care Credit</i>	36
<i>Education Tax Credits</i>	36
<i>Retirement Savings Contributions Tax Credit</i>	37
CREDIT CARD FOR PERSONAL BENEFIT.....	38
RETIREEES - “SEMI-RETIRED” CALLS.....	39
OVERSEAS WORKERS OR EXPATRIATES.....	42
WELS 403(B) RETIREMENT PLAN AND TAX SAVINGS PLANS.....	43
<i>Individual Retirement Accounts – IRAs</i>	45
<i>Flexible Spending Arrangements</i>	45
CHARITABLE CONTRIBUTIONS.....	46
SUBSTANTIATION AND DISCLOSURE REQUIREMENTS FOR CHARITABLE CONTRIBUTIONS.....	47
NONCASH CONTRIBUTIONS.....	47
DONATED VEHICLES.....	48
TUITION AND SCHOLARSHIPS.....	48
SPECIAL OFFERINGS.....	49
BENEVOLENCE FUNDS.....	49
<i>IRS Required Substantiation for Contributions</i>	50
<i>Reporting End of Year Contributions</i>	50
LUTHERAN SCHOOLS & EARLY CHILDHOOD CENTERS.....	52
ENTITY.....	52
PROOF OF RACIAL NONDISCRIMINATION.....	52
CONTRIBUTIONS VS. TUITION.....	53
SCHOLARSHIP FUNDS.....	54
STUDENT AID GRANTS.....	54
QUALIFIED TUITION REDUCTION.....	54
UNRELATED BUSINESS INCOME.....	56
RECORDS RETENTION.....	58
SOURCES OF TAX INFORMATION.....	60

TAX EXEMPT STATUS – WELS CONGREGATIONS AND ENTITIES

Certain nonprofit corporations, such as churches and associations of churches, may qualify as tax exempt entities under the Internal Revenue Code (“IRC”) Section 501(c)(3). The synod has obtained a group exemption number for all churches and certain other qualifying entities listed in the *WELS Yearbook*. Therefore, it is not necessary for each church and other qualifying entity to obtain a separate tax exemption (Form 1023), if they are listed in the *WELS Yearbook*. However, churches and other qualifying entities are not precluded from obtaining their own 501(c)(3) status.

WELS churches and other qualifying entities listed in the WELS Yearbook are covered under IRS Group Exemption Number 1773 as 501(c)(3) tax exempt entities.

In a ruling dated August 28, 1944, and confirmed in a communication dated January 25, 1966, the Internal Revenue Service (“IRS”) classified the Wisconsin Evangelical Lutheran Synod (“WELS”), together with all of its districts, congregations, educational, charitable and religious entities as exempt from federal income tax as entities described in Section 501(c)(3) of the IRC. The IRS assigned Group Exemption Number (GEN) 1773 to the synod and its subordinate units. This IRS group ruling determination letter was extended and is continued by an additional group ruling determination letter dated September 21, 2000. Copies of the January 25, 1966 and September 21, 2000 IRS communications are available from the WELS Financial Services Office. Churches may be required to demonstrate their 501(c)(3) status when seeking a mailing permit from their post office, when opening a bank account, when applying for certain scholarship grants for students, employer matching funds programs, etc.

It is WELS Synodical Council’s policy to update and maintain a current listing of the subordinate units which are included in Group Exemption Number (GEN) 1773 as 501(c)(3) entities and to file such updates annually with the IRS.

In order to qualify for inclusion as a 501(c)(3) entity in GEN 1773, the church or other subordinate synodical unit is required to:

1. Qualify as a church or association of churches;
2. Be an integral part of the synodical structure;
3. Submit a request through the respective district president for inclusion in the synod’s Group Exemption Number 1773; and
4. Provide the Employer Identification Number (EIN) of the church or entity.

Some entities listed in the annual *WELS Yearbook* are not included under the synod’s tax-exempt umbrella. **The synod’s legal counsel advises that entities which are associations of individuals or not part of the synodical structure do not qualify for inclusion under the tax-exempt umbrella.** They are required to obtain their own tax-exempt status and number from the IRS.

When a corporation is made up of an association of churches and individuals, it is imperative that the articles of incorporation include a section on dissolution which clearly states that all remaining assets shall become the property of the churches and not of the individuals. Without this provision, the IRS may not recognize the tax-exempt status of an entity. The assets of an exempt entity must be permanently dedicated to an exempt purpose. None of its assets can be used for the benefit of individuals unless those individuals are carrying out the exempt purpose of the entity.

It is the policy of the Synodical Council to communicate annually with the district presidents and request any new or terminated church or entities and/or any name or address changes of churches or entities in their district. The district presidents are also requested to disseminate copies of Form CM-1041 - *Request for Federal Tax-Exempt Status in Group 1773*, to all new units in their district. The completed Form CM-1041 is sent to Financial Services, which annually submits a group report listing the changes, deletions and additions in the Group Exemption Roster to the IRS, along with an entire Group listing. A request for Federal Tax-Exempt Status must be received in writing per IRS regulations.

To request Form CM-1041 or copies of the IRS determination letters, you may contact Financial Services via email Fin@wels.net. You may download the [CM-1041](#) request form at WELS Cloud – Finance under Tax Information. If you need proof of your 501(c)(3) tax exempt status or copies of the IRS determination letters, please fill out the form on WELS website at <http://synodadmin.welsrc.net/501c3-letter-request/>.

If your subordinate unit (church, school, entity) has any name/address changes, applied or received a new EIN, or has closed or left the synod, you need to file Form CM-1041 and send it to us. All new units that qualify under the group umbrella, must submit CM-1041 as written authorization in order to be included under the WELS group umbrella under the 501(c)(3) Internal Revenue Code.

Subordinate units that are included in group exemption letters are not listed separately under the **IRS Exempt Entity Select Check** online search tool. However, the listing for the central entity indicates that contributions to subordinate units covered by the group exemption are also deductible. For more information about group exemption requirements and procedures, see **IRS Publication 4573, Group Exemptions**. If you are having difficulty getting approved for a matching funds grant, this may be the reason why. Contact Financial Services via email Fin@wels.net for additional assistance.

Form 990 Filing Requirements: The majority of religious entities are exempt from filing Form 990. The following entities are exempt from the Form 990 reporting requirement:

- Churches;
- Interchurch entities of local units of a church;
- Conventions and associations of churches;
- Integrated auxiliaries of a church (such as a mission society);
- A church-affiliated entity that is exclusively engaged in managing funds or maintaining retirement programs;
- A school below college level affiliated with a church or operated by a religious order;
- A mission society sponsored by or affiliated with one or more churches or church denominations if more than half of the society's activities are conducted in or directed at persons in foreign countries; and
- An exclusively religious activity of any religious order

Political and Lobbying Activities

Under the IRC, all section 501(c)(3) entities are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office. Contributions to political campaign funds or public statements of position (verbal or written) made on behalf of the exempt entity in favor of or in opposition to any candidate for public office clearly violate the prohibition against political campaign activity. Violation of this prohibition may result in denial or revocation of tax-exempt status and the imposition of certain excise tax.

Certain activities or expenditures may not be prohibited depending on the facts and circumstances. For example, certain voter education activities (including the presentation of public forums and the publication of voter education guides) conducted in a non-partisan manner does not constitute prohibited political campaign activity.

In addition, other activities intended to encourage people to participate in the electoral process, such as voter registration and get-out-the-vote drives, would not constitute prohibited political campaign activity if conducted in non-partisan manner. On the other hand, voter education or registration activities with evidence of bias that: (a) would favor one candidate over another; (b) oppose a candidate in some manner; or (c) have the effect of favoring a candidate or group of candidates, will constitute prohibited participation or intervention. For more information, see **IRS Publication 1828**, *Tax Guide for Churches and Religious Entities*, fact sheet FS-2006-17 and Revenue Ruling 2007-41, all available on the IRS website (www.irs.gov).

TAX STATUS - MINISTERS OF THE GOSPEL

All synod ministry certified male and female called workers , who are listed in the WELS Yearbook, are considered “Ministers of the Gospel” because of the duties they are authorized to perform in the exercise of their ministry, according to a private letter ruling from the IRS dated March 2, 1955 and a legal opinion received in May 2020. Female called workers who are synod ministry certified are considered “Ministers of the Gospel” effective July 1, 2020 as a result of the May 2020 legal opinion received by WELS. Several documents have been prepared to help female called workers and calling bodies navigate this change. Please contact WELS Human Resources at hro@wels.net if there are questions regarding this change.

Ministers of the Gospel are considered employees of their calling bodies according to common law rules. Each is an employee because they perform services subject to the will and control of the calling body as to what will be done and how it will be done. It makes no difference if the congregation or entity (calling body) allows considerable discretion and freedom of action, if it has the legal right to control both the method and result of the services.

The duties of a duly ordained, commissioned or licensed minister are defined by two Treasury Regulations. In Treasury Regulation Section 1.107-1(a), examples of duties performed by a duly ordained, commissioned, or licensed minister of the gospel include - 1) performance of sacerdotal functions; 2) conduct of religious worship; 3) administration and maintenance of religious entities and their integral agencies; and 4) performance of teaching and administrative functions at theological seminaries. Treasury Regulation Section 1.1402(c)-5(b)(2) provides that services performed by a duly, ordained, commissioned or licensed minister in the exercise of their ministry include 1) the ministration of sacerdotal functions; 2) the conduct of religious worship and 3) the control, conduct, and maintenance of religious entities (including religious boards, societies, and other integral agencies of such organizations) under the authority of a religious body constituting a church or church denomination.

Several court cases have addressed the issue of who qualifies as a minister of the gospel. The courts have established that a Minister of the Gospel must be ordained, commissioned or licensed and that a balancing test should be applied to the remaining factors, with a majority being present to determine Minister of the Gospel status for tax purposes.

Knight v. Commissioner 92 T.C. 199 (1989) established that a ‘Minister’ must be ordained, commissioned or licensed and a balancing test of the remaining criteria should be applied.

Synod ministry certification is a necessary requirement for called workers to be considered Ministers of the Gospel. On rare occasions a called teacher or staff minister could be granted provisional certification but will need to meet certain requirements defined by their calling body and WELS in order to be considered a Minister of the Gospel. Some workers, even though called by the church or entity, may not qualify.

The IRS will not consider vicars or seminary students as Ministers of the Gospel according to **IRS Publication 517**. “You cannot exclude a rental allowance from your income if you are a theological student serving a required internship as an assistant pastor unless you are ordained, commissioned, or licensed as a minister.” Vicars, teacher interns, and staff ministry interns do not appear to pass the IRS tests for Minister of the Gospel. These positions are normally considered employees for social security and other purposes.

The IRC treats Ministers of the Gospel as self-employed for purposes of social security (Self-Employment Contributions Act, a.k.a. “SECA”) reporting and specifically exempts them from federal income tax withholding. *Therefore, Ministers of the Gospel have a dual tax status, they are considered self-employed for social security purposes, and employees for other tax and fringe benefit purposes.*

EMPLOYER IDENTIFICATION NUMBER

The IRS requires that every incorporated entity, including tax-exempt entities, obtain a federal Employer Identification Number (“EIN”). This number is used on all correspondence and employment filings with the federal government to identify the entity and is also required when opening a bank account, employer matching funds programs, in order to be listed as a subordinate in a group ruling, or if it files returns with the IRS (e.g., Forms W-2, W-3, 1099, 990-T, 941).

The EIN identifies you as an employer subject to tax withholding and reporting, and ensures that your church receives proper credit for payments of withheld taxes.

The Employer Identification Number is not a tax exemption number and has no relation to your nonprofit corporation status.

Applying for an EIN is a free service offered by the IRS and can be done on-line or with Form SS-4. All EIN applications must disclose the name and taxpayer identification number (SSN, ITIN, EIN) of the true principal officer, which the IRS calls “the responsible party”. The responsible party must be an individual who controls, manages or directs the applicant entity and disposition of its funds and assets. The person most likely to fit within this definition would be the Pastor of the congregation.

The on-line EIN application is the preferred method to apply for and obtain an EIN. If the required information passes the automatic validity checks, the IRS issues a permanent EIN. An EIN assigned through on-line submission is immediately recognized by IRS systems. Taxpayers can begin using the EIN immediately for most business purposes. You may obtain Form SS-4 and Instructions from irs.gov and submit via fax or mail. **Retain the IRS letter that issues your EIN in the church’s permanent records.**

Every incorporated church and entity within the synodical structure is required to provide the Financial Services Office with its federal EIN. The IRS requires WELS to supply the EINs for all its subordinates under the WELS group umbrella, Group Exemption Number (GEN) 1773. They are maintained in the WELS church database.

Exploratory (outreach) locations are part of the synod’s operation and have no independent legal existence. They may use WELS EIN only if they use the synod’s name, like “WELS Exploratory, d/b/a _____ Lutheran Church,” until such time that the congregation organizes and incorporates. As soon as the congregation (or any entity) incorporates, it is required to secure its own EIN.

TO VERIFY YOUR EIN: If you need to have your EIN verified for the WELS church database or if the IRS issues a new EIN and you need to provide WELS with the new EIN, please contact Financial Services via email Fin@wels.net or download [Form EIN-1 Verification of EIN](#) from WELS Cloud – Finance, under Tax Information and send the completed form to WELS Financial Services.

CHANGE OF ADDRESS OR RESPONSIBLE PARTY: As of January 1, 2014, any entity with an EIN must report a change of address or change in responsible party on Form 8822-B *Change of Address or Responsible Party – Business* within 60 days of the change. See instructions for Form 8822-B for further information and guidance regarding this form.

SALES TAX EXEMPTION STATUS

States which levy sales taxes on items purchased may exempt church entities from such tax by issuing the church, school or church-related entity a state sales tax exempt number or certificate of exemption. Forms may be obtained from your state's government agency on its website. Regulations vary from state to state on sales tax exemption. Regulations also vary from state to state when tax should be collected on sales of publications, periodicals or other products. We encourage you to check the state's website.

Each church and entity must obtain its own specific state tax exempt number or certificate of exemption. Before issuing such exemption, the states usually require that the church, school or church-related entity demonstrate that it has federal tax exemption status under the 501(c)(3) IRC.

Some states may grant a certificate of exemption indefinitely while other states may have a renewal application process. This information should also be available on your state's website.

Churches, schools and other nonprofit entities should fill out their own sales tax forms for their vendors' requirements. They should provide the necessary supporting documentation that's required.

If you need proof of 501(c)(3) tax exempt status for inclusion to your sales-tax exempt application forms, please fill out the request form found here <https://synodadmin.welsrc.net/501c3-letter-request/>, in the Resource Center, under Synod Administration on WELS.net.

To obtain a copy of WELS certificate of exemption for Florida, Illinois, Massachusetts, Michigan, Minnesota, Tennessee, Utah, Wisconsin, and Wyoming please contact Financial Services.

For more information on sales tax exemption, go to the [Tax Information Resources](#) link at the top of our Finance page on the WELS Cloud site or contact Financial Services via email at Fin@wels.net.

PROPERTY TAX EXEMPTION

All 50 states exempt church-owned property from property tax. However, the extent of the exemption varies from state to state. Some states exempt property used exclusively for religious worship, while others exempt property used for religious purposes. Parsonages are exempt in many states. Some exceptions may apply depending on use of parsonage or who is occupying the premises.

Laws are subject to change. To determine the current text of any statute, you should search on-line resources made available by your state, contact your local/county property tax office, or an attorney.

Application for exemption

An IRS determination letter acknowledging that a religious entity is exempt from federal income taxation as a 501(c)(3) entity does not necessarily entitle the entity to a property tax exemption. Property used for religious purposes is not automatically exempt from state property tax. An application must be filed with local tax authorities in such states. Failure to do so could result in loss of property tax exemption, at least for the current year.

Once property tax exemption is established in a state, the entity may be required to file a periodic exemption report.

Fees and Special Assessments

Typically, churches are required to pay special assessments or fees for streets, utilities, sewers or other improvements or services specific to their property.

FEDERAL UNEMPLOYMENT TAX ACT (FUTA)

According to the IRS, an entity that is exempt from income tax under section 501(c)(3) of the Internal Revenue Code is also exempt from FUTA. This exemption cannot be waived. If an entity is not a 501(c)(3) entity, they are not exempt from paying FUTA.

Section 501(c)(3) entities are not required to pay unemployment taxes for **any** of their workers. In addition, no workers are eligible for federal unemployment compensation benefits.

However, unemployment tax is primarily a state responsibility, and, in some states, the laws are different for churches and schools. In most cases, since the entity is exempt from the tax, all church and school employees are not eligible for coverage under the state unemployment laws.

If the entity does not participate in the tax, the entity's employee handbook should state that its employees are not eligible for an unemployment claim should they decide to leave the employment of the church or school.

Questions? Have any unemployment compensation related issues? **CONTACT:** WELS Human Resources at 414-256-3268 or hro@wels.net. Human Resources can assist the church or school in responding to any unemployment claims filed by a church worker.

WORKERS' COMPENSATION INSURANCE

Workers' compensation insurance helps insulate employers from lawsuits due to a bodily injury sustained by their employees during the course of employment. The laws in most states require all employers with one or more employees to carry workers' compensation insurance coverage although some states allow optional coverage for religious entities. The employee generally receives income replacement payments and paid medical expenses related to the injury.

Coverage and rates for such coverage are established by state law and are not negotiable for competitive bidding. However, non-rate factors such as dividends, claims history and other insurance company factors will also be considered by the company when establishing premiums. Premiums generally are based on the payroll of the employer.

WELS VEBA Group Health Plan excludes payment for claims if the injury or illness is work-related. Congregations or entities must have workers' compensation insurance to properly protect their workers.

For workers' compensation insurance purposes, "Ministers of the Gospel" are considered employees. *Most medical insurance programs, including WELS VEBA Group Health Plan, exclude coverage for work-related injuries.* For example, a pastor injured in an accident on his way to the hospital to make a sick call has insurance coverage under workers' compensation insurance and not under a regular medical insurance plan. The congregation's local insurance agent should be contacted to determine whether it has this coverage and, if not, how to obtain it.

Workers' compensation insurance should not be confused with unemployment compensation or long-term disability insurance coverage. Neither is a substitute for workers' compensation insurance because these coverage's generally do not pay medical or hospital expenses but only provide a form of income replacement for the worker.

Amounts received from a workers' compensation insurance policy for lost wages due to a work-related injury or illness are not taxable if they are paid under a state law. If the employer continues to pay a worker's salary during recuperation and the worker returns his workers' compensation benefits to the employer, the employer may reduce the taxable income reported on Form W-2 by the amount returned.

If you have any questions on workers compensation, contact Human Resources at 414-256-3268 or hro@wels.net.

SUBSTITUTE PASTORS, TEACHERS AND INDEPENDENT CONTRACTORS

In determining whether a substitute is an employee or an independent contractor, the congregation or entity must determine whether a significant relationship has formed. Consideration of a significant relationship may include how regularly the substitute is used. When an entity (employer) forms an employment relationship and pays a substitute teacher, substitute “Minister of the Gospel” or organist, it should place such a person on its payroll. The congregation or entity must withhold necessary social security and income taxes from the compensation paid and issue a Form W-2 at year-end to the employee.

According to **IRS Publication 1828** *Tax Guide for Churches and Religious Entities*, nonprofit entities that pay an employee less than \$108.28 in any given year need not withhold and match social security taxes. However, federal and state taxes, if any, must be withheld and such wages and withholdings must be reported on Form W-2. If another entity or person is responsible for the costs of the substitute, then that entity or person should reimburse the employing body for salary and any social security taxes paid by the congregation or entity.

In cases in which employers report an employee as an independent contractor, the law dictates that the employer “will be liable for income tax and employee social security tax if the taxes are not deducted and withheld.” (Refer to IRC Section 3509.) Additionally, these taxes will be subject to the payroll tax penalties up to 10% of total tax due with an interest charge retroactive to the date payments were first made.

The associated penalties make it prudent for any congregation or entity to closely scrutinize requests to pay a potential employee as an independent contractor. Several of the characteristics listed in guidelines provided in Revenue Ruling 87-41 indicate an employer/employee relationship exists when a person:

- ❖ Is required to comply with instructions about when, where and how work is to be done.
- ❖ Is trained by person for whom services are performed indicating services are to be performed in a particular manner
- ❖ Performs services which are integrated with the entity.
- ❖ Is hired, supervised and paid by the entity.
- ❖ Works hours as set by the entity.
- ❖ Worker devotes substantially full time to the business
- ❖ Submits regular reports to the entity.
- ❖ Receives compensation based on hours, days, weeks or months as opposed to a fixed amount per task or project.
- ❖ Is provided tools and materials by the entity.
- ❖ Is not able to recognize a profit or loss on duty performed.
- ❖ Worker has right to terminate the relationship at any time without incurring liability.

The list is not all-inclusive. Please contact your tax advisor as needed.

INCOME

Certain types of income are treated differently by “Ministers of the Gospel” than by other employees. Thus, it is important to be familiar with the income types and how each is treated for tax purposes. All income that is not specifically exempt is taxable. The taxpayer must keep accurate records of all income that is not subject to income tax. The following listing includes taxable and nontaxable income types according to **IRS Publication 525**:

INCOME ITEM	SUBJECT TO INCOME TAX	SUBJECT TO SECA/FICA TAX
Salary	Yes	Yes
Auto allowance	Yes	Yes
Honoraria for marriages, baptisms, etc.	Yes	Yes
Cash gifts from employer	Yes	Yes
SECA tax reimbursement	Yes	Yes
Writers fees	Yes	Yes
Cost of living allowance	Yes	Yes
Scholarship for room, board, living	Yes	Yes
Retirement gifts from employer	Yes	Yes
Personal use of church auto	Yes	Yes
Church provided housing		
- Ministers	No	Yes
- Non-ministers	Possible	Possible
Parsonage allowance (Sec 107)	No	Yes
Cash housing allowance		
- Ministers	Yes	Yes
- Non-ministers	Yes	Yes
Medical insurance paid by employer	No	No
Group term life insurance < \$50,000	No	No
Pension premium	No	No
Workers' compensation wage payments	No	No
Direct gifts from relatives, members	No	No
Accountable expense reimbursements	No	No
Tax Shelter Annuity contributions made by		
- Ministers	No	No
- Non-ministers	No	Yes
Moving expenses	Yes	Yes
Below fair market value sale of employer property to employee	Yes	Yes
Severance pay	Yes	Yes
Small, non-cash or non-cash equivalent gifts from employer	No	No
Tuition reduction for a school employee or their dependents	No	No
Meals provided by employer	Possible	Possible
Relocation allowance	Yes	Yes
Interest on below-market rate loans		
from employer	Yes	Yes
Cancellation of loan by employer	Yes	Yes
Free tour for the person guiding the tour	Yes	No
Utilities allowance		
- Ministers	Yes	Yes
- Non-ministers	Yes	Yes

HOUSING

Discrimination

Each congregation and entity is encouraged to consider that discrimination in providing housing, whether in the form of a cash housing allowance or provided housing, may be in violation of federal discrimination laws. Although this does not mean that all housing provided or cash allowances must be equal, there must not be discrimination in the determination of the benefit. If this benefit is provided, congregations and entities are strongly encouraged to provide it to its workers on an equal basis.

Fair Rental Value

This designation is given to the “value” of a house or parsonage, including utilities, provided as part of a Minister of the Gospel's compensation. For the “Minister of the Gospel” who has not received an exemption from self-employment tax, this value must be included in net earnings for self-employment (social security) tax purposes.

The “fair rental value” may be based on a professional appraisal of the home or some other reasonable, documentable means of determining the value such as newspapers or realtors considering the location and neighborhood. Realtors use the “rule of thumb” that fair rental value (without furnishings) amounts to 1% of the appraised value per month. For example: a home appraised at \$100,000 could have a fair rental value of \$1,000 per month. However, the facts of each situation must be taken into consideration, including the condition and location of the house, the local market demand and local economic conditions. It is also important that a reasonable method of determining the fair rental value is consistently applied from year to year.

*IRC Section 1402(a)(8) requires that “Ministers of the Gospel” add the fair rental value of their **provided** home when calculating social security tax liability.*

Some churches, to assist their “Ministers of the Gospel” in calculating their self-employment taxes, set the ‘fair rental value’ of their workers’ housing. To do this, the amount of rent needs to be the same amount the church would charge an unrelated party.

Cash Housing Allowance

A cash allowance is paid to a worker who owns or rents his/her own housing. It is treated as salary for tax purposes, included in the calculation of what is reportable on Form W-2, and subject to federal and state income tax as well as self-employment social security taxes for all workers who receive it. (Also see “Parsonage Allowance”.)

Lodging Furnished Employees

For non-ministers of the gospel, such as a called worker that is not synod ministry certified and lay employees, the value of employer-furnished lodging is taxable unless all three of the following conditions are met:

1. Lodging is on the employer’s business premises,
2. It is for the employer's convenience, and
3. It is a condition of employment.

In most cases, these three conditions are not met and the value of living quarters that are provided are considered taxable income and subject to social security taxes. Item one, “Lodging on the employer’s business premises” has been interpreted by the IRS, in Letter Ruling 8213005, and the courts, in *Goldsboro Christian School, Inc. v. Commissioner*, 436 F. Supp. 1314 (D.D.C.1978), as not merely housing owned by the church or entity but at the actual place of business. In one situation, the value of housing provided to hospital employees in an apartment across the street from the hospital was taxable because the apartments were not where the employees conducted their business (IRS Letter Ruling 8938014, June 23, 1989).

Benefits of Home Ownership

A “Minister of the Gospel” owning their own home may have additional tax benefits, a “double deduction” for the mortgage interest and real estate taxes paid on the home. These items may be included when calculating the non-income taxable parsonage allowance and may also be deductible when itemizing deductions on *Schedule A* of *Form 1040*. However, recent tax law changes have increased the standard deduction and will minimize the number of filers who itemize deductions.

In some situations, a congregation provides a home for a “Minister of the Gospel” that is located either on or near the church and/or school property and requires that they live in the home provided. The called worker may want to consider purchasing a home for investment purposes and/or to provide a place for retirement. The purchased home could be rented to outside parties, providing additional income to pay for the home’s expenses. However, if the “Minister of the Gospel” does not live in the home, the parsonage allowance cannot be claimed with respect to that home.

Home ownership provides additional benefits to the minister: Equity is built through the house payments made over time and money spent on improvements; freedom to make changes to the house without securing congregational approval; and entitled to the “double deduction” mentioned above. Up to \$500,000 in gain on the sale of a residence may be excluded from taxes for qualified married couples and \$250,000 for single taxpayers. This allows the homeowner to exclude from income the appreciation on his/her residence. To qualify, the owner must have owned the home for five years before the sale and used it as the primary residence during two of those five years. This benefit can be used once every two years, unless the move is a result of a job change. If you cannot meet the two-year residency test because of unplanned events such as a job change or health problem, you can exclude the portion of profit that is proportional to the time you lived there.

Depending on the situation, it may be less expensive for the congregation to pay a cash housing allowance than to provide housing. The proceeds from the sale or rental of the church-owned home can be invested generating interest income to offset a portion of the cash housing allowance. If the home is sold, related repairs, maintenance and insurance costs disappear, and an adequate cash housing allowance can be paid to the “Minister of the Gospel.”

PARSONAGE ALLOWANCE

Under IRC Section 107, “Ministers of the Gospel” may have a portion of their compensation designated as a parsonage allowance, also known as a rental allowance. Only workers who are correctly classified as “Ministers of the Gospel” are eligible for the parsonage allowance benefit. See “*Tax Status - Ministers of the Gospel*” for additional information on this distinction.

According to **IRS Publication 517**, the maximum amount that a “Minister of the Gospel” may consider a parsonage allowance is the lowest of the following three amounts:

1. The amount actually used to provide a home;
2. The amount officially designated as a parsonage/rental allowance; or
3. The fair rental value of the home, including furnishings, utilities, garage, etc.

For “Ministers of the Gospel” qualifying for a parsonage allowance, the allowance is not income for federal income tax purposes to the extent it is used by the worker in the year received to provide for a home and pay utilities. The congregation or entity receives the request from the eligible “Minister of the Gospel” and passes a resolution officially designating the requested amount as a “parsonage allowance.” This resolution should be noted in the minutes of the congregational or board meeting as official documentation of the amount designated. An amount may be designated for a partial year or may be changed to a new amount, prospectively, for the balance of the calendar year. The resolution may read as follows:

Under provisions of Section 107 of the Internal Revenue Code, the “Ministers of the Gospel” listed below may have a portion of their compensation designated as a parsonage allowance. The amount indicated shall be the designated parsonage allowance for the year 20xx and all future years unless otherwise provided. Should any of the workers listed be provided with a home, he/she shall have the rent-free use of the home for the year 20xx and all future years unless otherwise provided.

Rev. John J. Doe’s housing allowance designation is \$12,000.

Principal Mr. David D. Davis’s housing allowance designation is \$18,000.

Teacher Ms. Sara M. Smith’s housing allowance designation is \$15,000.

Mid-year changes in personnel, delayed changes, and other unexpected contingencies: “___% or \$_____ of the salary of every “Minister of the Gospel” on staff, regardless of when hired, is hereby designated as a housing allowance for the current and all future years, unless otherwise specifically provided.”

The parsonage allowance resolution **cannot be retroactive** to a specific date. It is suggested that the congregation or entity pass the parsonage allowance resolution late in the calendar year to apply to the next calendar year. The recommended resolution provides a “safety net” in the event the congregation or entity fails to record a designation in a particular calendar year. Resolutions for indefinite periods may be used although they become obsolete over time and need to be reviewed periodically.

For new employees beginning during the year, the second paragraph of the recommended resolution provides a “safety net,” but should be reviewed with the called worker for any modifications they might need for the balance of the year. The resolution takes effect on the first of the month in which it is approved and noted in the minutes. Congregations and entities should make every effort to pass the parsonage allowance resolution before a new employee commences employment.

When a “Minister of the Gospel” leaves the congregation or entity, the approved parsonage allowance should be pro-rated on a per payroll or monthly basis from the first of the year. The new congregation or entity should then pro-rate their parsonage allowance from their first payroll to the end of the calendar year.

A “Minister of the Gospel” who rents or is provided a church-owned home may include in the parsonage allowance expenditures for the utilities paid such as gas, electricity, sewer and water, cable TV, basic internet and landline telephone. Other expenses that may be included in computing the amount of parsonage allowance are rent payments, furniture, appliances, property insurance and other expenses directly related to providing a home. Expenses specifically excluded by the regulations under IRC Section 107, such as costs for food and services, are not allowable under the parsonage allowance.

Food and services cannot be claimed under the parsonage allowance. Items that may be claimed (not all inclusive) are:

- Rent or entire house payment*
- Property taxes*
- Property insurance (homeowners or rental)*
- Furniture and appliances*
- Utilities*
- Water/sewer*

“Ministers of the Gospel” providing their own homes may consider mortgage interest, property taxes, and down payments on a home, in addition to those listed in the preceding paragraph. Taxes and interest paid on a home mortgage can be deductible as itemized deductions on *Schedule A of Form 1040* if itemizing is favorable over taking the standard deduction.

A parsonage allowance can only be claimed on the residence in which a “Minister of the Gospel” lives and not on any other residence owned by him/her. In addition, a parsonage allowance deduction for mortgage payments will be fully allowed for first mortgages. Parsonage allowance deductions for second mortgages or home equity loans will not be allowed if the proceeds are used for other than home improvements, such as college tuition or auto purchases.

Once the parsonage allowance has been approved, the treasurer deducts that amount from the worker's gross compensation to arrive at the Form W-2 wages. The worker does not have to substantiate his house-related expenses to the congregation or entity unless it requires him to do so but should maintain adequate records of expenditures. Any excess or unused parsonage allowance should be included on line 7 of *IRS Form 1040* and described as “EXCESS PARSONAGE ALLOWANCE.”

SELF-EMPLOYMENT TAX SUPPLEMENTS

Congregations and entities may choose to reimburse their “Ministers of the Gospel” for a portion of their self-employment (social security) taxes. This is acceptable to the IRS, but any such reimbursements must be considered additional compensation (even if the congregation or entity considers this reimbursement a gift) and reported on the worker’s Form W-2 along with other forms of compensation.

Because several factors are relevant to such a reimbursement policy, a uniform policy is virtually impossible to establish. Provided below are several considerations that the congregation or entity should keep in mind when deciding how much to reimburse a “Minister of the Gospel” for self-employment taxes.

Self-employment (social security) tax supplements are taxable income in the year paid for both income and self-employment tax purposes.

- Self-employment tax is paid by a “Minister of the Gospel” on all forms of compensation including the fair rental value of a residence provided and the parsonage allowance.
- A “Minister of the Gospel” can no longer deduct unreimbursed professional expenses when calculating his self-employment earnings due to recent tax law changes.
- Some “Ministers of the Gospel” opt out of social security and therefore pay no self-employment tax.
- A “Minister of the Gospel” must make estimated tax payments on these self-employment supplements during the year and therefore needs the cash reimbursement during the year rather than after the end of the year.
- A “Minister of the Gospel” must pay federal income, state income and self-employment taxes on the reimbursements in the year such reimbursements are received.
- The effective self-employment tax rate is not necessarily twice the FICA tax rate because of certain deductions that the IRS grants to self-employed individuals (See “Social Security Tax”).
- A “Minister of the Gospel” does not pay self-employment tax on pre-tax amounts contributed to their tax-sheltered annuity (403(b) plan).

The congregation or entity should consider documenting such a reimbursement plan through a formal resolution of the congregation. A simple resolution might read as follows:

“Within the provisions of the Internal Revenue Code of 1986, as amended, to assist our ‘Ministers of the Gospel’ with their self-employment tax liability brought on by their dual tax status, the congregation elects to provide additional compensation to its ‘Ministers of the Gospel’ to be calculated as [Form W-2 compensation plus parsonage allowance plus fair rental value of housing provided times the effective self-employment tax rate of xx.x%].”

Note that the percentage used in the resolution should be determined and inserted by the congregation. The resolution should be reviewed annually.

OTHER INCOME/RECEIPTS

Honoraria, Gifts and Awards: Payments from individuals for performing weddings, baptisms, funerals, etc. are taxable income and reported on Schedule C along with corresponding expenses. All monetary awards paid through the congregation or entity to the employee is taxable income reportable by the employer in Box 1, Form W-2 according to IRC Section 102(c). The employer stipulating the award as a gift does not change the taxability to the employee. Taxable cash or cash equivalent (gift certificates, coupons, etc.) gifts include Christmas gifts, service awards, anniversary awards, honoraria and retirement and termination gifts. Hams, turkeys and all such non-cash or non-cash equivalent items of a nominal value given to employees are not taxable income to them.

“Ministers of the Gospel” must include in income offerings and fees/gifts for services performed in addition to salary. However, if the offering is made to the religious institution, it is not taxable to the “Minister of the Gospel.”

Pension and Support Payments: Concerning pension and support payments, **IRS Publication 525** states:

“A pension or retirement pay for a member of the clergy is usually treated as any other pension or annuity and must be reported on line 16a and lines 16b, Form 1040.”

Upon retirement, the benefits paid under the synod’s or any other qualified pension plan is taxable income on the federal return. State requirements vary so please contact your tax advisor to determine whether pension benefits are taxable in your state. “Ministers of the Gospel” receiving such payments may have a parsonage allowance designated by the synod or other employing body with which he/she is associated. Thus, the cost of housing can be treated as a non-taxable pension to the extent used for parsonage expenses under regular IRC Section 107 requirements.

Barter Income: Barter is the exchanging of property or services. For example, a secretary may perform secretarial services for the church in exchange for the church school educating her child. The fair market value of property or services received in bartering must be included in income at the time received. If services are exchanged with another person and both parties have agreed upon the value at that time, the agreed upon value will be considered the fair market value unless it can be shown to be otherwise. The value must be established objectively without regard to any relationship or partiality between the parties involved. This income should be reported on Schedule C or Schedule C-EZ on Form 1040.

MOVING EXPENSES

Moving expenses of employees, whether pastors, teachers, or lay employees, may be paid by the congregation or entity.

Due to recent changes in the tax laws in effect from 2018 through 2025, if an employer reimburses an employee or pays a third party directly, the moving costs must be added to the employee's taxable income.

To prevent employees from being adversely affected by this change, a congregation or entity may choose to provide an additional reimbursement to the employee to help offset the additional tax liability. It is important to note that this additional reimbursement is also taxable income to the employee.

IRS Publication 521 *Moving Expenses* provides more details regarding the suspension of moving expense deductions and the taxability of moving expense reimbursements.

Form 3903 - *Moving Expense Adjustment*, is now only relevant to members of the Armed Forces, who are still eligible to deduct some moving expenses.

The standard mileage rate for moving and medical purposes is 17¢/mile for 2020 and 20¢/mile for 2019.

FRINGE BENEFITS

For tax purposes, gross income includes all income from whatever source unless specifically excluded under the IRC. If the employer follows the strict requirements, submits necessary reports and does not discriminate among its employees, certain fringe benefits excluded by the IRC are “qualified” and, therefore, are not taxable income to the employee. Any non-qualified fringe benefits provided to the employee are considered taxable fringe benefits and are included on the employee’s Form W-2 as compensation in the amount paid or at the fair market value of the benefit provided.

Generally, qualifying non-taxable fringe benefits can be provided to any employee, called or lay. Because “Ministers of the Gospel” are considered “employees” they may also receive fringe benefits tax-free. The following is a list of some of the more common fringe benefits that an employer can provide to employees tax-free:

- ❖ Medical and health insurance
- ❖ Disability insurance
- ❖ Dental Insurance
- ❖ Group term life insurance up to \$50,000
- ❖ Pension payments on behalf of the employee
- ❖ Medical expense reimbursements under a proper plan
- ❖ Dependent care expense reimbursements under a proper plan
- ❖ Tuition reduction below graduate level provided the employer is a school
- ❖ Scholarships if used for tuition, fees, books, etc., but not for room and board
- ❖ Continuing education cost reimbursement up to \$5,250 for undergraduate study and graduate level courses
- ❖ Occasional personal use of entity’s copy machine
- ❖ Local telephone calls
- ❖ Subscriptions to professional publications paid for by the employer on behalf of an employee
- ❖ Employer-provided group legal services
- ❖ Employer-provided dependent care
- ❖ Employer paid or reimbursed adoption expenses up to \$14,300 in 2020 *

Other fringe benefits may also be provided on a tax-free basis. Congregations, other entities, and employees are encouraged to review IRS Publication 15-B, Employer’s Guide to Fringe Benefits, and seek advice from their tax advisor when determining the taxability of any fringe benefit.

* For 2020, the adoption credit is phased out ratably for taxpayers with a modified adjusted gross income (MAGI) over \$214,520 and no credit is allowed for taxpayers with a modified AGI of \$254,520 or more.

EMPLOYMENT TAX WITHHOLDING

IRS Publication E, Employer's Tax Guide, provides federal income tax and social security tax withholding tables for employers to use when calculating payroll tax withholding. The employer must remit all employment taxes to the federal government within the time periods detailed in Publication E or as required by the IRS in their annual letter to the employer. All employers receive a copy of Publication E and the previously mentioned letter automatically from the IRS each year as it is updated. State tax withholding regulations and deposits may differ from federal regulations. Contact the appropriate state authorities for current information.

Generally, all compensation including taxable fringe benefits paid to employees is subject to withholding unless specifically exempted by the IRC. The congregation or entity should contact their tax advisor if it is unsure whether an item of compensation is subject to withholding.

Ministers of the Gospel

The congregation or calling body is not required to withhold any taxes from compensation paid to "Ministers of the Gospel." However, if the employer agrees, a "Minister of the Gospel" may establish a withholding agreement to have income taxes withheld from their paycheck based on a fully completed Form W-4. **Social Security taxes may not be withheld.** However, a voluntary increase in the Federal taxes withheld is acceptable and may be used to cover estimated self-employment tax liability. Sufficient federal tax withholding would mean the "Minister of the Gospel" would not need to make estimated Federal tax payments (social security) each quarter. No social security taxes or social security wages are reported on Form W-2. Any withholding agreement between the congregation or calling body should be written and must contain:

1. The name and address of the church or entity,
2. The name of the "Minister of the Gospel", address and social security number, and
3. A statement that the "Minister of the Gospel" agrees to have taxes withheld.

The withholding agreement may be terminated at any time in writing by either the congregation or calling body or the "Minister of the Gospel."

Vicars, Teacher Interns, and Staff Minister Interns

According to the IRS, students serving in the role of vicar and intern have an employee relationship with the church or school. Since they do not qualify as "Ministers of the Gospel", they are not exempt from employment taxes. The employer is required to withhold all taxes, including social security and Medicare from the students' wages.

Other Employees

Effective January 1, 1984, social security coverage is mandatory and therefore social security tax must also be paid by all nonprofit entities on all salaries and wages paid to non-synod ministry certified called and all lay employees. The social security tax is separated into two parts -- social security and Medicare. For social security, the employee's share is currently 6.2% and the employer's share is 6.2%. The current rate of 1.45% is the same for both the employee's and employer's portion of Medicare. The combined Medicare and social security rate for employees is currently 7.65%. The congregation or entity must pay a tax of 7.65% and must also withhold Social Security tax at the combined rate of 7.65% on compensation paid to its employees. The IRS may update this rate on January 1 of each year. In addition, the maximum wage on which congregations or entities must withhold and match Social Security tax can also change each year.

The maximum wages for social security tax in 2019 are \$132,900, and in 2020 are \$137,700. There is no limit for the Medicare portion.

The congregation or entity is also required to withhold and remit federal income taxes and, if applicable, state income taxes. Information on Form W-4 determines the amount to withhold. Based on Form W-4, the congregation or entity withholds federal income taxes according to the tables listed in the current year's Publication E.

The employer must remit all taxes to the government and must report all taxes withheld in each pay period to the individual when the salary is paid. At year-end, the total withheld for social security, federal income and state income taxes is reported to the employee and the government on Form W-2.

Congregations and entities created after September 30, 1984, may elect to be exempt from withholding and matching social security taxes. To elect exemption, the congregation or entity files IRS Form 8274 prior to the date on which the first quarterly Form 941, Employer's Quarterly Federal Tax Return, is due. **A congregation or entity that exempts itself makes its non-synod ministry certified called and lay workers liable for paying self-employment taxes on their personal tax returns. If it elects exemption, the congregation or entity must notify any prospective employees of this requirement.**

SOCIAL SECURITY TAXES

The social security and Medicare taxes are collected under two acts: Federal Insurance Contributions Act (“FICA”) that requires both the employer and employee pay the taxes, and the Self-Employment Contributions Act (“SECA”) which requires a person who is self-employed to pay all of the taxes. No earnings are subject to both of these systems. Therefore, a worker either pays FICA tax or SECA tax on earnings from a particular occupation. The current SECA tax rate is at 15.3%. Self-employed workers, including Ministers of the Gospel, may deduct one-half of their self-employment taxes as an adjustment to gross income on page one of their *Form 1040*.

Self-Employment (SECA) Taxes

A “Minister of the Gospel” has a dual tax status. They are considered both an employee and a self-employed person for tax reporting purposes. **IRS Publication 517** states: “...you are considered a self-employed individual in performing your ministerial services for social security tax purposes. However...you may be considered an employee for income or retirement plan tax purposes.”

Earnings from self-employment include the gross income earned minus the expenses related to the gross income. Honoraria and offerings for marriages, baptisms, funerals, etc., minus the deductions reported on Schedule C that are related to the income are considered when figuring net earnings from self-employment. Payments made to “Ministers of the Gospel” to pay half or some other portion of the SECA tax is taxable income and treated as compensation. The fair rental value of a provided home and the parsonage allowance are added back to earnings for self-employment tax but are not taxable for federal income tax purposes.

Self-employed individuals may be able to deduct the amount paid for medical and dental insurance and qualified long-term care insurance for themselves and their spouse, and their dependents. See Chapter 6 in **IRS Publication 535** for more information about the self-employed health insurance deduction.

Expatriate ministers determine net earnings from self-employment without regard to foreign earned income exclusion or the foreign housing exclusion or deduction. “Ministers of the Gospel” living abroad should consult either **IRS Publication 54**, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*, or **IRS Publication 570**, *Tax Guide for Individuals in U.S. Possessions*.

Estimated Tax, Form 1040ES

All taxpayers must pay their federal income and social security taxes as earned. The employer withholds and makes payment to state and federal tax collection agencies for his employees. The only exception is for “Ministers of the Gospel” unless the congregation or entity has entered into a withholding agreement with the “Minister of the Gospel.”

The “Minister of the Gospel” is generally required to pay an estimate of their taxes on a quarterly basis. Failure to make estimated tax payments or under paying could result in the assessment of a penalty. Generally, most taxpayers will avoid this penalty if they owe less than \$1,000 in tax after subtracting their withholdings and credits, or if they paid at least 90% of the tax for the current year, or 100% of the tax shown on the return for the prior year, whichever is smaller. If adjusted gross income (AGI) exceeds \$150,000, 110% of the prior year’s taxes must be paid in the following year.

One-fourth of the estimated tax for a calendar year is due on April 15th. The remaining due dates are June 15, September 15, and January 15. The January 15 payment may be made with the filing of the tax return if filing is done by January 31 and the entire balance is paid with the file returned. State estimated payments may also be required. You should seek advice of a tax advisor.

Schedule SE (Form 1040)

All “Ministers of the Gospel” participating in the social security program are subject to the SECA tax and must calculate their net profit or loss from services as a minister on Line 2, Part I of Schedule SE. This schedule is a part of Form 1040.

The computation of earnings from self-employment is based on the data shown on the Form W-2 worksheet prepared by the calling body and delivered with the Form W-2. However, there are some differences reflected in the computation format shown below:

Worksheet for Calculating Net Earnings from Self-Employment	
Net Compensation (Box 1, Form W-2)	\$ <u>34,034</u>
<u>Add:</u>	
Parsonage provided - Fair Rental Value	<u>10,500</u>
Section 107 Parsonage Allowance, (Box 14 PRSNG, Form W-2)	<u>6,400</u>
Honoraria and other income not included in Form W-2 (from Schedule C)	<u>100</u>
Subtotal of Additions	<u>17,000</u>
<u>Deduct:</u>	
Other Business Expenses (Schedule C)	
Subtotal of Deductions	<u>20</u>
Net earnings from self-employment	\$ <u>50,914</u>

No deductions may be claimed for SECA tax purposes for the actual expenses in providing or renting a home (IRC Section 1402(a)). However, a “Minister of the Gospel” can reduce net earnings from self-employment by the amount of tax-sheltered annuity contributions made during the year (Rev. Rul. 68-395). Since Form W-2 does not include the amount contributed to the TSA, no adjustment need be made on the above worksheet. **This form should be replicated, completed, and a copy given to the person who does your payroll.**

The fair rental value of the parsonage provided should include such items as utilities, maintenance, furnishings, etc. if these items were paid by the congregation or calling body and not by the minister.

Social Security Exemption - Filing Form 4361

“Ministers of the Gospel” have a choice, in the beginning of their ministry, to exempt themselves from social security coverage. However, any service not performed in the exercise of one’s ministry is subject to either FICA or SECA tax. Obtaining exemption by filing *Form 4361* Application for Exemption from Self-Employment Tax for Use by Ministers, does not cause one to waive his right to receive social security benefits from earnings other than as a minister. **IRS Publication 517**, *Social Security for Members of the Clergy and Religious Workers*, states that Form 4361:

“ . . . includes a statement certifying that you are conscientiously opposed to, or because of your religious principles you are opposed to, accepting, for services performed as a member of the clergy, any public (governmental) insurance that makes payments in the event of death, disability, old age, or retirement. This includes public insurance that makes payments toward the cost of, or provides services for, medical care, including the benefits of any insurance system established by the social security Act. You do not have to be opposed to accepting public insurance for services you perform in a capacity other than as a minister . . . ”

Form 4361 must be filed by April 15th of the second tax year in which the minister has net earnings from self-employment of \$400 or more. The two tax years do not need to be consecutive. Ministers opting out of social security are required, by law, to notify the ordaining body, i.e. the Wisconsin Evangelical Lutheran Synod. The federal employer identification number (EIN) that needs to be filled in is the **congregation's or entity's EIN** which you are employed and on payroll, not necessarily the ordaining body's EIN like in this case, the WELS. See Box #4 of the form.

WELS has no conscientious opposition because of religious principles for its "Ministers of the Gospel" participation in Social Security. WELS, as a church body that ordains ministers, does not recognize a theological basis of opposing participation in Social Security. The Social Security Administration or the IRS may challenge your request of exemption. It is not an automatic approval.

FILING FORM 4361: Should you decide to opt out of social security, you must do the following:

1. Complete Form 4361 and file with the IRS.
2. Send a copy of your Form 4361 (completed/signed) to:
WELS Financial Services
N16W23377 Stone Ridge Drive
Waukesha, WI 53188-1108
3. Your Form 4361 copy will remain on file per IRS instructions.

EMPLOYMENT-RELATED FORMS

Form W-4

When an entity calls or hires an employee, the IRC requires it to obtain and keep a Form W-4 for that employee in a permanent file. This form is used by the congregation/entity to calculate the amount of Federal tax to be withheld from an employee's paycheck each pay period. **NEW IN 2020** – The IRS made significant improvements to the Form W-4 in response to the 2017 Tax Cuts and Jobs Act that took place in 2018. The redesigned form eliminated the need for allowances. The change was meant to increase simplicity and accuracy, permitting easy adjustments for deductions, anticipated tax credits, and other income. Form W-4 can be found on the IRS website at <https://www.irs.gov/forms-pubs/about-form-w-4>.

Although “Ministers of the Gospel” should also complete a Form W-4 with basic information (name, address and SSN), they need not complete Steps 2-4 unless the congregation or entity established a withholding agreement with them. If no withholding agreement exists, the “Minister of the Gospel” simply writes *Minister of the Gospel, Exempt from Withholding* in the space below Step 4c and the congregation or entity keeps the form in his permanent personnel file.

The changes to the Federal Form W-4 imposed a challenge for congregations/entities that relied on the form for their state withholding. Most states have their own version of Form W-4 and it is recommended that congregations/entities have their employees complete their states version of Form W-4.

Without a Form W-4, withholding must be done at the highest rate, as if the employee was a single filer.

Form I-9

All United States employers are required to ensure proper completion of Form I-9, Employment Eligibility Verification, for each individual that is hired for employment in the U.S, both citizen and non-citizen. The form is used to verify the identity and employment eligibility of the individual. Both employees and employers must complete a section of the form. The employee must attest to their employment eligibility and provide the employer with the appropriate documentation to support their identity and authorization to be employed. The employing body must examine the completed form and all documentation required by the form within three business days after hiring.

Form I-9, all proper forms of documentation and instructions for completing and maintaining the form can be found on the U.S. Citizen and Immigration Services website (<https://www.uscis.gov/i-9>). Both the employer and the employee must sign the completed form. The completed form must be retained while an employee is actively employed. Once an employee is no longer employed, forms are to be retained for three years after date of hire, or one year after termination of employment, whichever is later.

New Hire Reporting

Federal law requires employers to notify their state government of all new hires within 20 days after the date the employee begins work. A new hire is defined as either an individual who reports to work with an employer for the first time or one that is rehired, recalled or returns to work after an unpaid interval of more than 60 days (or is rehired after a separation of 60 days or more and who remained on payroll during the separation). The following information must be reported:

- Employee's Full Name, Address, SSN, Date of Birth and Date of Employment.
- Employer's Name, Address and Federal ID Number.

This is a federal law that requires all states to comply. There are no exceptions for small entities or not-for-profit entities. Most states prefer an electronic reporting of new hire information through a dedicated website.

REPORTING WAGES AND SALARIES

The wages and salaries paid to all employees of the employing body *including “Ministers of the Gospel”* must be reported on Form W-2 at year-end for income tax purposes. The congregation or entity is required to withhold both federal income and social security taxes on all employees other than “Ministers of the Gospel” who have not requested voluntary tax withholding.

“Ministers of the Gospel” are employees and should be issued a Form W-2 for the compensation they receive from their congregation or entity.

Form W-2

Form W-2 for a calendar year is issued to each employee by January 31 of the subsequent year. Wages, cash allowances and other amounts listed below paid or given to employees must be included as taxable income in Box 1, Form W-2:

- ❖ Wages and salaries to “Ministers of the Gospel” and employees
- ❖ Wages paid to Vicars, Teacher Interns and Staff Ministry Interns
- ❖ Cash housing allowances
- ❖ Vacation pay
- ❖ Automobile, Utility or any other type of allowance
- ❖ Cost of living allowance (COLA)
- ❖ Bonuses and commissions
- ❖ Christmas and other gifts paid to employees *
- ❖ Honoraria (payments for service on which custom forbids a price to be set)
- ❖ Moving Expenses
- ❖ Taxable tuition expenses for the worker or worker’s dependents
- ❖ Social security tax supplements
- ❖ Value of an employer provided vehicle (personal use portion)
- ❖ Group term life insurance premium for coverage in excess of \$50,000

*Christmas and other gifts to employees are subject to income and all social security taxes. Gift certificates or vouchers are considered cash equivalents and would be included in an employee’s taxable income. Non-cash gifts of *de minimis* value, less than \$75, such as a ham, turkey, gift basket or item of clothing can be excluded from an employee’s taxable income.

Please note that the above listing is not all-inclusive. **The general rule is that if the payment is in any way processed through the books of the church or entity or paid out of its funds, then the payment should be reported as taxable compensation and included on the Form W-2.**

Health Care Costs on W-2

The Affordable Care Act requires employers who filed more than 250 W-2’s in the prior calendar year to report the cost of coverage under an employer-sponsored group health plan. This reporting is for informational purposes only and is reported in Box 12 of the W-2 with code DD. The amount should include both the portion paid by the employer and the employee. The value of the employer’s contribution to health care coverage continues to be excludable from an employee’s income and is not taxable.

Please refer to the chart provided at <https://www.irs.gov/Affordable-Care-Act/Form-W-2-Reporting-of-Employer-Sponsored-Health-Coverage> for the types of coverage that employers must report on Form W-2 and for additional reporting requirements.

REPORTING WAGES AND SALARIES

It may be helpful to prepare a worksheet for each “Minister of the Gospel” in order to arrive at the total shown in Box 1, Form W-2. The worker may be given a copy of the worksheet so that they know how the taxable income amount was calculated. A sample worksheet is shown below.

THIS WORKSHEET IS INFORMATIONAL ONLY, DO NOT SEND TO THE IRS.

Worksheet for Calculating “Minister of the Gospel” Taxable Income

Name: Rev John Smith

For the year: 20XX

1. Base Pay (before deducting parsonage allowance)	\$ <u>42,740</u>
2. Add: Cost-of-Living Adjustment (COLA)	<u>2,400</u>
3. Cash Housing Allowance or	<u>0</u>
4. Fair Market Rental Value of provided housing (parsonage or teacherage)	<u>14,000</u>
5. Housing Equity Allowance (for called workers in provided housing)	<u>590</u>
6. Automobile Allowance	<u>1,200</u>
7. Utilities Allowance	<u>0</u>
8. Moving Expenses	<u>5,000</u>
9. Children’s Paid Education	<u>2,400</u>
10. Social Security (SECA) Allowance	<u>4,970</u>
GROSS PAY	<u>72,710</u>
11. Tax Sheltered Annuity (Box 12, Form W-2)	<u>(1,800)</u>
12. Parsonage Allowance, Sec. 107 (Box 14, Form W-2)	<u>(6,400)</u>
13. Fair Rental Value (Rent free usage under Sec. 107)	<u>(14,000)</u>
14. Health Insurance Premiums-Employee Paid under a qualified Section 125 plan	<u>(500)</u>
15. Flexible Spending Account (FSA) deductions under a qualified Section 125 plan	<u>(500)</u>
W-2 WAGES, BOX 1	<u>\$ 49,510</u>

NOTES:

1. Base Pay is the amount approved per the congregation or entity’s compensation plan.
2. Cost-of-Living Adjustment as determined by applicable source.
3. Cash Housing Allowance is cash paid for worker-owned or rented housing which worker is furnishing. (should not have both cash housing allowance and fair market rental value)
4. Fair Market Rental Value is the value of the housing provided the worker on a rent-free basis. (value excluded from income but subject to self-employment taxes)
5. Housing equity allowance is for called workers in provided housing who do not have the benefit of accumulating housing equity.
6. Auto Allowance is fully taxable. Reimbursements under an “accountable” plan are non-taxable.
7. Utilities Allowance is cash paid to a worker and is fully taxable. Payments directly to a utility company on a worker’s behalf are also taxable and should be reflected on the workers W-2.
8. Moving Expenses are either paid directly to employee as reimbursement for expenses or paid directly to a third-party.
9. Children’s Paid Education are payments to a school (other than where the worker is employed) for a worker’s child.
10. Social Security (SECA) Allowance is the equivalent of FICA paid for lay and non-synod ministry certified called workers. Calculated on base pay, cola, other taxable income, less deductions for tax sheltered annuities (403b) and Section 125 (health insurance, flex spending).
11. Tax Sheltered Annuity is the pre-tax deduction for 403b plans.
12. Parsonage Allowance is the amount that the congregation designates as such by resolution. (value excluded from income but subject to self-employment taxes)
13. Fair market rental value is explained in #4 above.
14. Health insurance pre-tax deductions for health coverage under a qualified Section 125 plan.
15. FSA pre-tax deductions under a qualified Section 125 plan for health or dependent care.

Sample W-2, Minister of the Gospel

		a Employee's social security number 123-45-6789		OMB No. 1545-0008		This information is being furnished to the Internal Revenue Service. If you are required to file a tax return, a negligence penalty or other sanction may be imposed on you if this income is taxable and you fail to report it.	
b Employer identification number (EIN) 99-1234567				1 Wages, tips, other compensation 49,510		2 Federal income tax withheld	
c Employer's name, address, and ZIP code ABC Lutheran Church 1000 Main Street City, ST 00000-1234				3 Social security wages		4 Social security tax withheld	
				5 Medicare wages and tips		6 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 John Smith		Last name Smith		Suff.		11 Nonqualified plans	
1002 Main Street City, ST 00000-1234				12a See instructions for box 12 E 1,800		12b	
				13 Statutory employee <input type="checkbox"/> Retirement plan <input checked="" type="checkbox"/> Third-party sick pay <input type="checkbox"/>		12c	
				14 Other PSNG 6,400		12d	
f Employee's address and ZIP code							
15 State ST	Employer's state ID number 00-0000000	16 State wages, tips, etc. 49,510	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	

Form **W-2 Wage and Tax Statement**
2019
 Copy C—For EMPLOYEE'S RECORDS (See Notice to Employee on the back of Copy B.)

Department of the Treasury—Internal Revenue Service

Safe, accurate, FAST! Use 

Federal and state wages (boxes 1 and 16) and voluntary income taxes withheld (boxes 2 and 17) must be reported on Form W-2. "Ministers of the Gospel" who are not subject to social security and Medicare taxes as employees, boxes 3 and 5 should be left blank. "Ministers of the Gospel" who are an active participant in the pension plan or 403B for any part of the year, check **Retirement Plan** in box 13. Include parsonage allowance designations in box 14. Please refer to *Instructions for Form W-2* at www.irs.gov/pub/irs-pdf/iw2w3.pdf for box 12 codes. Please refer to **Employment Tax Withholding** for additional information.

Sample W-2, Non-synod ministry certified Called Worker and Other Church Employee

		a Employee's social security number 123-45-6780		OMB No. 1545-0008		This information is being furnished to the Internal Revenue Service. If you are required to file a tax return, a negligence penalty or other sanction may be imposed on you if this income is taxable and you fail to report it.							
b Employer identification number (EIN) 99-1234567			1 Wages, tips, other compensation 64,940		2 Federal income tax withheld 7,793								
c Employer's name, address, and ZIP code ABC Lutheran Church 1000 Main Street City, ST 00000-1234			3 Social security wages 67,740		4 Social security tax withheld 4,200								
			5 Medicare wages and tips 67,740		6 Medicare tax withheld 982								
			7 Social security tips		8 Allocated tips								
d Control number			9		10 Dependent care benefits								
e Employee's first name and initial Sarah Jones		Last name 1004 Main Street		Suff.		11 Nonqualified plans		12a See instructions for box 12 E 1,800					
f Employee's address and ZIP code		13 Statutory employee <input type="checkbox"/>		Retirement plan <input checked="" type="checkbox"/>		Third-party sick pay <input type="checkbox"/>		12b					
		14 Other				12c							
						12d							
15 State ST		Employer's state ID number 00-0000000		16 State wages, tips, etc. 64,940		17 State income tax 4,357		18 Local wages, tips, etc.		19 Local income tax		20 Locality name	

Form **W-2** Wage and Tax Statement

2019

Department of the Treasury—Internal Revenue Service

Copy C—For EMPLOYEE'S RECORDS (See Notice to Employee on the back of Copy B.)

Safe, accurate, FAST! Use 

Federal and state wages (boxes 1 and 16) and income taxes withheld (boxes 2 and 17) must be reported on Form W-2. Social Security and Medicare wages are reported in boxes 3 and 5 and tax withheld is reported in boxes 4 and 6. Generally, the amount in Boxes 3 and 5 are equal. However, if annual wages exceed the 2019 maximum social security wage limit of \$132,900 (\$137,700 for 2020), box 3 cannot exceed this amount. There is no wage limit for Medicare. If an employee is an active participant in the pension plan or 403B for any part of the year, check **Retirement Plan** in box 13. Please refer to *Instructions for Form W-2* at www.irs.gov/pub/irs-pdf/iw2w3.pdf for box 12 codes. Please refer to **Employment Tax Withholding** for additional information.

Non-synod ministry certified called workers are considered employees for both federal income tax and social security purposes according to a legal opinion received May 27, 2020. Compensation paid to non-synod ministry certified called workers and other full and part-time workers such as organists and janitors must be reported using Form W-2. Wages, allowances and other amounts listed in the previous section must be included as taxable income. Generally, housing provided will have to be included in taxable income and social security wages. See **Housing** for additional information.

Form W-3

Form W-3 is a transmittal form for mailing Copy A of all Forms W-2 prepared for the year. Box 1 wages on Form W-3 should equal the total of Box 1 wages reported on all attached Forms W-2. Additionally, Boxes 2-6 on Form W-3 should equal the total of the corresponding Forms W-2. Forms W-2 and W-3 information are sent to the Social Security Administration (SSA) by the last day of February for the previous year's information. The SSA strongly encourages employers to report Form W-3 and Forms W-2 Copy A electronically. For information on filing electronically, go to www.ssa.gov to register with SSA's Business Services Online. The IRS requires certain businesses to file their tax information returns electronically. For more detailed information on electronic filing, see "Reporting Other Payments."

Form 941

All employee compensation must be reported to the IRS annually on Forms W-3 and the employee's Form W-2 as well as quarterly on Form 941, Employer's Quarterly Federal Tax Return. Form 941 reports total W-2 wages, social security wages, federal withholding taxes and social security taxes as well as a record of when those taxes should have been remitted to the IRS.

Form W-2 wages should be reported quarterly on Form 941 even if the only employee is a "Minister of the Gospel". In this case, the congregation or entity enters total Box 1, Form W-2 wages on line 2 and submits the form each quarter as long as those wages are paid. At the end of each tax year, the total of line 2 of the four quarterly Form 941's should equal the total Box 1, Form W-2 wages reported to the IRS. In addition, the total of line 3 should equal the total amount of federal income taxes withheld as reported in Box 2 of Forms W-2. Note that the Parsonage allowance is earned proportionately during the year. To avoid large negative adjustments in the final quarter, report only the wages that are subject to income taxes on line 2 of Form 941.

Form 941 also details when withheld taxes should have been deposited. The IRS requirements for making tax deposits are found in the Form 941 instructions, the annual Circular E, and in a letter that each employer should receive from the IRS every year. There are severe penalties and interest charges for untimely tax deposits. Therefore, the congregation or entity should regularly review how often it needs to remit these taxes, especially if there are substantial personnel changes such as adding or terminating an employee.

Electronic funds transfer must be used to make all federal tax deposits. Generally, electronic fund transfers are made using the Electronic Federal Tax Payment System (EFTPS), a free service provided by the Department of Treasury. If you do not want to use EFTPS, you can arrange for your tax professional, financial institution, payroll service or other trusted third party to make deposits on your behalf. Services provided by your tax professional, financial institution, payroll service or other third party may have a fee. For more information on making federal tax deposits, refer to IRS Publication 15, (Circular E), Employer's Tax Guide www.irs.gov/pub/irs-pdf/p15.pdf. To get more information about EFTPS or to enroll in EFTPS, visit www.eftps.gov.

Corrections to prior quarters' filings of Form 941 are made on Form 941c. Form 941c is to be attached to the Form 941 to explain the correction. Contact the IRS for Form 941c and instructions. If the congregation or entity is not filing Form 941 currently, contact the local IRS office to request a blank form. After the first filing of the form, the IRS will automatically send a new form near the end of each quarter.

NOTE: Be sure that amounts reported on Form W-3 reconcile to amounts reported on quarterly 941 forms. Verify accuracy of social security numbers and employer identification numbers.

Affordable Care Act Reporting Requirements (1094-C, 1095-C)

Under section 4980H (the Employer Shared Responsibility Provisions) of the IRC, applicable large employers (ALEs) are required to offer qualifying health coverage to their full-time equivalent (FTE) employees, and their dependents, or potentially be liable for an assessable payment if at least one FTE employee receives the premium tax credit for coverage in the Marketplace. An ALE is defined as having at least 50 FTE employees on average during the preceding calendar year. For ACA purposes, an FTE employee is defined as working on average at least 30 hours per week or at least 130 hours during any calendar month.

Section 6056 (Health Insurance Coverage Reporting Requirements) of the IRC requires ALE's, as defined by the employer shared responsibility provisions, to file Forms 1094-C and 1095-C with the IRS about health coverage offered to their FTE employees. The IRS will use this information in determining an employer's potential liability for a payment under the employer shared responsibility provision and the eligibility of the employee for a premium tax credit.

In addition, ALEs are required to distribute copies of Form 1095-C to their full-time employees which contains information the employee may need to report as part of their income tax submission.

For additional information on the ACA Tax Provisions for Employers and reporting requirements, refer to <https://www.irs.gov/affordable-care-act>.

REPORTING OTHER PAYMENTS

The federal government requires that certain kinds of non-employee payments be reported if the payment is made to an individual or partnership. Generally, the Form 1099 series is used to report these kinds of payments and common forms that may be applicable to the congregation or entity are Forms 1099-MISC and 1099-INT.

To file these forms, the filing entity will need the taxpayer's social security number. To obtain this number, the individual should complete a Form W-9 *Payer's Request for Taxpayer Identification Number*. The Form W-9 should be retained by the congregation or entity along with its other tax information as proof of receiving the information from the taxpayer. It is suggested that this form be completed **prior** to the work being done and payment being made. The congregation or entity may wish to consider finding a new contractor if the original contractor refuses to complete the Form W-9.

Miscellaneous Payments

The congregation or entity must issue and file a Form 1099-MISC when it makes payments of \$600 or more in a calendar year to the same individual, partnership or business for 1) rent or 2) any kind of service (such as carpentry, electrical work, roofing, etc.), performed by a non-employee individual during the course of business. There are other less common circumstances when the Form 1099-MISC may need to be filed. Please refer to the Instructions for Form 1099-MISC at www.irs.gov/pub/irs-pdf/i1099misc.pdf for details on such circumstances. If payments are less than \$600 the entity has the option to issue the Form 1099-MISC. As a reminder, payments to called and lay workers, both full and part time, including organists, janitors and maintenance workers must be reported using Form W-2.

Congregations and entities must issue Form 1099-MISC to individuals and partnerships to who they pay \$600 or more in a year for performing services.

Interest Payments

Congregations and entities that borrow from their members and pay interest should issue and file Form 1099-INT. This form is filed for each individual to whom the church body pays \$600 or more in interest in a calendar year. If the congregation or entity issues regular statements to the loaning members, it may not have to mail a separate copy of Form 1099-INT to the individual. Please refer to the Instructions for Form 1099-INT at www.irs.gov/pub/irs-pdf/i1099int.pdf for details.

Transmitting Forms 1099

Regardless of which Forms 1099 are issued, a Form 1096 transmittal should also be completed and filed with the IRS. This form simply summarizes the statements being transmitted. The original of each Form 1099 is sent with the Form 1096, one copy of the Form 1099 is mailed to the individual and one copy is retained by the filing entity. Forms 1099 for the prior year must be issued by January 31 of each year to the individual who received the interest or payment and filed by February 28 with the IRS. The congregation or entity will need to file electronically, see the following section for further details.

Penalties exist for not filing or for late filing of proper information returns. Generally, you are subject up to \$100 per return if the entity does not file a timely return, does not furnish a copy of the return to the payee, or does not include a social security number on the information return. Please refer to the General Instructions for Forms 1099, 1098, 5498 and W-2G at <http://www.irs.gov/pub/irs-pdf/i1099gi.pdf> which gives details on other penalties and how they apply. For complete filing instructions, see **IRS Publication 1220, Specifications for Electronic Filing of forms 1097, 1098, 1099, 3921, 3922, 5498 and W-2G.**

Electronic Filing

Any corporation, partnership, employer, estate and/or trust, who files 250 or more of the following: Forms 1042-S, 1098, 1099, 3921, 5498, 8027, and W-2G for any calendar year must file their Information Returns electronically. However, even if you have less than 250, the IRS still encourages you to file these returns electronically. Churches or entities that are required to file should submit Form 4419, *Application for Filing Information Returns Electronically* (FIRE), to request authorization to file Information Returns with the IRS. Once approved, a five-character alpha/numeric Transmitter Control Code (TCC) will be assigned. Form 4419 should be submitted at least 45 days before the due date of the returns for current year processing.

Your electronically transmitted file(s) must follow the record format that is required for the type of form(s) you are filing. Filing deadlines for electronic reporting is the same as for paper reporting. Filers may contact the IRS toll-free at (866)455-7438 or email them at fire@irs.gov. For first time connection to the FIRE System, you would need to create a new account, enter your User ID and password before you can login and file electronically. See **IRS Publication 1220**, *Specifications for Electronic Filing or forms* for additional information.

Forms W-2 are filed with the Social Security Administration (SSA), therefore, Form 4419 for the IRS is not used. All wages must be filed either electronically or on paper. Registration to file electronically is required. Go to SSA's Business Services Online (BSO) and register. A User ID and password is needed to login to the BSO website. Verifying names and social security numbers (SSNs) with Social Security Number Verification Service (SSNVS) before you submit can speed the processing of your submissions. Correct names and SSNs on W-2 wage statements are the keys to the successful filing. For more information, see the SSA Business Services Online Handbook. For help with registering or annual wage reporting, contact Employer Reporting Assistance at (800)772-6270 (toll free) or email employerinfo@ssa.gov. For BSO Technical Assistance, call (888)772-2970 (toll free) or email bsu.support@ssa.gov.

PRIVATE AND CONFIDENTIAL: User ID, Password and PIN for both electronic filings to the IRS and SSA should always be kept private and in a secured location.

BUSINESS EXPENSE REIMBURSEMENTS AND TAX CREDITS

BUSINESS EXPENSE REIMBURSEMENTS

A congregation or entity should consider establishing a business expense reimbursement policy in which the employee submits an expense report along with receipts documenting the business expenses and is reimbursed dollar for dollar or cents-per-mile based on that report. When the business expense has been properly accounted for and reimbursed, no taxable income is created. **The employer need not report these “accountable” expense reimbursements on the employee’s Form W-2.** Reimbursed personal expenses, however, are generally considered taxable income and should be reported as such on the employee’s Form W-2. No deduction is allowed for non-employee spouse or dependent’s travels even if they accompanied for a business purpose.

*Allowances are taxable **in full** without an “accountable” reimbursement policy. Accountable reimbursement plans are recommended and are tax-free.*

Any reimbursement for spouse/dependent must be included as taxable income in Box 1, Form W-2. Spouses or dependents who are also employees of the congregation or entity may be reimbursed if they accompanied for a true business purpose. In situations where the spouse/dependent is also an employee of the congregation or entity, it is suggested that requests for reimbursement be separately submitted by the employee and spouse/dependent.

When an employer pays an allowance to an employee, the IRS considers the entire allowance additional compensation unless the employee is required to: Substantiate the expenses to the employer within a reasonable time, and return any excess amount not used for business expenses in a reasonable time.

The IRS allows two ways to satisfy the reasonable time requirements:

1. The employer may issue a statement at least quarterly indicating the excess reimbursement and asking for substantiation or its return within 120 days, or,
2. The expenses may be substantiated within 60 days after they are incurred, and the excess returned within 120 days after the expenses are incurred.

If these two requirements are not met, the IRS views the allowance as additional compensation rather than an expense reimbursement and the entire allowance must be added to Form W-2 wages. As a result of the Tax Cuts and Jobs Act (TJCA) passed in 2017, employee business expenses are no longer eligible as itemized deductions on Schedule A, Form 1040.

Any business expense reimbursement policy that a congregation or entity may establish must require adequate documentation. Adequate documentation includes receipts and, in the case of travel, a statement indicating the time and place, business purpose and business relationship for which the expense was incurred. A photocopy of an expense or mileage log with this information clearly indicated and supporting receipts may serve as adequate documentation for the employee. Currently the IRS requires that a receipt support all lodging expenses, regardless of amount, and all other expenses greater than \$75. Employers are strongly encouraged to have expense substantiation requirements at least equal to those of the IRS.

Auto Expenses

Automobile expenses are a major business expense for most church staff members. These expenses can be reported using either a standard mileage rate or the actual expenses incurred while operating the car for business miles. Keep a log of your business miles, including the mileage, date, destination and business purpose for each trip made. You must provide your employer with the record of your business mileage when receiving direct reimbursement.

Employer-provided Automobiles

The value of an employee's personal use of an employer-provided vehicle must be included in his income minus any reimbursement he made to this employer. **IRS Publication 15-B**, "Employer's Tax Guide to Fringe Benefits," contains instructions for the employer providing this "working condition" fringe benefit. In order for an employer to exclude from the employee's gross income the value of an employer-provided vehicle, the employee must keep a log of business miles and submit the log to the employer. If the employer does not receive such a log of business miles, the whole value of the vehicle is income to be reported on Form W-2.

Under the cents-per-mile rule, an employer values the benefit using the standard mileage rate multiplied by the total miles the employee drives the vehicle for personal purposes. The follow conditions must be met:

1. Employer must request from the employee a statement of the business mileage and the total mileage driven by the employee.
2. This rule cannot be used if the FMV of the vehicle exceeds \$50,400 (See notice 2019-34)
3. It is reasonably expected that the auto will be regularly used in employer's business, or actually driven primarily by employees at least 10,000 (personal and business) miles during a calendar year.
4. The cents-per-mile rule includes all costs of operating the vehicle. Neither the employer nor the employee may adjust the rate for services not provided, such as repairs. The only adjustment allowed is that if fuel is not provided by the employer, the cents-per-mile value may be reduced by no more than 5.5¢.

Moving Expenses

As mentioned previously, due to recent changes in the tax laws in effect from 2018 through 2025, if an employer reimburses an employee or pays a third party directly for moving costs, those costs must be added to the employee's taxable income. See **IRS Publication 521** for more information.

Computers and Cellular Phones

It is advisable to have one computer for business use and one for the family and personal use. The computer for personal use can be deducted as a parsonage allowance purchase. When employees purchase and own a computer and it is used for both business and personal, a log of time must be kept to know the business use percentage.

If an employer provides an employee with a cell phone, primarily for business reasons, both business and personal use is generally excluded from an employee's gross income, provided the personal use can be defined as a de minimis fringe benefit as defined in **IRS Publication 15-B**. If an employer requires an employee to use a personal cell phone for business use, reasonable reimbursements of the employee expenses are also tax free. This treatment does not apply to reimbursements of unusual or excessive expenses or to reimbursements made as a substitute for a portion of the employee's regular wages. A church cannot reimburse employees' expenses under an accountable reimbursement arrangement that do not qualify as business expenses. Such reimbursements are non-accountable.

TAX CREDITS

Earned Income Credit (EIC)

A refundable earned income credit is available to certain qualified taxpayers based on adjusted gross income (Code Sec. 32). To be eligible to claim the credit, a taxpayer must have earned income with an adjusted gross income (AGI) below a certain level, have a valid social security number, use a filing status other than married filing separately, be a U.S. citizen or resident alien, have no foreign income, and investment income less than \$3,600. The EIC could either reduce the tax that is owed, or it could generate a refund if there is no tax owed.

Earned income includes the rental value of a home or a housing allowance provided a “Minister of the Gospel” because it is included in net earnings from self-employment. If a “Minister of the Gospel” has filed form 4361 – Exemption from Self Employment Tax for Use by Ministers, a nontaxable rental allowance or nontaxable housing allowance is not considered earned income.

IRS Publication 596 and the Instructions for Form 1040 contain detailed instructions, tables and worksheets to calculate the correct amount of earned income credit.

Child Tax Credits

The Child Tax Credit is a partially refundable credit and may be as much as \$2,000 per qualifying child under the age of 17. There is also a \$500 nonrefundable credit for qualifying dependents other than children. The credit begins to be phased out if your adjusted gross income reaches \$400,000 for joint filers; \$200,000 for all other filers.

If you qualify for the Child Tax Credit, you may qualify for the Additional Child Tax Credit. The Additional Child Tax Credit is a refundable credit that you may receive if the Child Tax Credit is greater than the total amount of taxes you owe. File Form 8812 to claim the Additional Child Tax Credit.

IRS Publication 972 contains information if you have a qualifying child and where to calculate and report the child tax credits.

Child and Dependent Care Credit

A taxpayer may be able to claim this credit if they pay someone to care for a dependent who is under age 13 or for a spouse or other dependent who is not able to care for themselves.

The credit can be 20% to 35% of up to \$3,000 in expenses paid for one qualifying person or up to \$6,000 of expenses for two or more qualifying persons. To qualify, you must pay for these expenses. The credit is computed on Form 2441 – *Child and Dependent Care Expenses*.

Education Tax Credits

The *American Opportunity Credit* and the *Lifetime Learning Credit* are available for qualified tuition and related expenses for post-secondary education.

Please refer to **Table 33-1 Comparison of Education Credits** from **IRS Publication 17, Your Federal Income Tax** on the next page.

Caution. You can claim both the American Opportunity credit and the Lifetime Learning credit on the same return—but not for the same student.

	American Opportunity Credit	Lifetime Learning Credit
Maximum credit	Up to \$2,500 credit per eligible student	Up to \$2,000 credit per return
Limit on modified adjusted gross income (MAGI)	\$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er)	\$136,000 if married filing jointly; \$68,000 if single, head of household, or qualifying widow(er)
Refundable or nonrefundable	40% of credit may be refundable	Nonrefundable - Credit limited to the amount of tax you must pay on your taxable income
Number of years of postsecondary education	Available ONLY if the student had not completed the first 4 years of postsecondary education before 2019	Available for all years of postsecondary education and for courses to acquire or improve job skills
Number of tax years credit available	Available ONLY for 4 tax years per eligible student	Available for an unlimited number of years
Type of program required	Student must be pursuing a program leading to a degree or other recognized education credential	Student does not need to be pursuing a degree or other recognized education credential
Number of courses	Student must be enrolled at least half time for at least one academic period beginning in 2019 (or first three months of 2020 if expenses paid in 2019)	Available for one or more courses
Felony drug conviction	At the end of 2019, the student had not been convicted of a felony for possessing or distributing a controlled substance	Felony drug convictions do not make the student ineligible
Qualified expenses	Tuition, required enrollment fees, and course materials that the student needs for a course of study whether or not the materials are bought at the educational institution as a condition of enrollment or attendance	Tuition and required enrollment fees, including amounts required to be paid to the institution for course-related books, supplies, and equipment.
Payments for academic periods	Payments made in 2019 for academic periods beginning in 2019 or beginning in the first 3 months of 2020	
TIN Needed by filing due date	Filers and students must have a TIN by the due date of their 2019 return (including extensions)	
Educational institution's EIN	You must provide the educational institution's employer identification number (EIN) on your Form 8863	

Retirement Savings Contributions Tax Credit

The Retirement savings contributions credit (saver's credit) provides an incentive for certain qualified taxpayers to start a tax-sheltered annuity or contribute to an already existing one.

If you are a joint filer with an adjusted gross income of \$64,000 or less in 2019 (\$65,000 in 2020), or a single filer with an adjusted gross income of \$32,000 or less in 2019 (\$32,500 in 2020), you are eligible to receive a tax credit for your tax-sheltered annuity contribution. The maximum annual contribution eligible for credit is \$4,000 if you are a joint filer, or \$2,000 for all other filers and the maximum credit is 50% of eligible contributions. The nonrefundable credit is figured on Form 8880 which must also be attached to your return. See for additional details.

CREDIT CARD FOR PERSONAL BENEFIT

Question: Our pastor wants to purchase church supplies with his personal credit card so that he will receive the points that accrue to the purchases made with his card. A recent example is a new copier machine that cost \$10,000. Is it appropriate for the pastor to purchase and then be reimbursed for this church asset in order to gain points from his credit card program?

Two answers: First, a few years ago the IRS announced that it “will not assert that any taxpayer has understated his federal tax liability by reason of the receipt or personal use of frequent-flyer miles attributable to the taxpayer’s business travel.” Thus, any frequent-flyer miles allocated to a pastor from business travel need not be reported by the church as taxable income on the pastor’s W-2 form.

Church Expenses on a Personal Credit Card for Personal Benefit

But there is a second issue to consider. One of the requirements for a church to maintain its exemption from federal income taxation is that none of its income or assets “inures” to the benefit of a private individual, other than as reasonable compensation for services rendered. There is no materiality requirement. Any distribution of a church’s income or assets for the private benefit of an individual may constitute prohibited inurement.

The IRS has observed that “those in control may not, by reason of their position, acquire any of the charitable entity’s funds [or assets]. If funds [or assets] are diverted from exempt purposes to private purposes, exemption is in jeopardy. The test is whether, at every stage of the transaction, those controlling the entity guarded its interests.”

It is certainly possible that the IRS would view the use of a pastor’s personal credit card to purchase church assets in order to divert points to his account as an example of prohibited inurement. The church could benefit from those points on its card, perhaps receiving a rebate or saving travel expenses due to free flights the church has earned. Because of the risk, church leaders are advised to consult with a tax professional before pursuing such an arrangement.

RETIREES - “SEMI-RETIRED” CALLS

Social Security Earnings Limitation

Virtually all earnings from employment or self-employment are taxable for social security purposes even if earned during retirement. Earnings received beyond the limits shown below will affect the amount of social security the retiree can draw.

The Retirement Earning Test applies to people age 62 and above who are below “normal retirement age”. A modified test applies for the year an individual reaches full retirement age (66 for those persons born in 1943 through 1954, 67 for those born in 1960 or later). Retirees may earn up to the following amounts without sacrificing a portion of social security benefits:

	<u>2019</u>
Under full retirement age	\$17,640/yr. (\$1,470/mo.)
The year an individual reaches full retirement age	\$46,920/yr. (\$3,910/mo.)
After an individual reaches full retirement age	Unlimited

	<u>2020</u>
Under full retirement age	\$18,240/yr. (\$1,520/mo.)
The year an individual reaches full retirement age	\$48,600/yr. (\$4,050/mo.)
After an individual reaches full retirement age	Unlimited

Benefits are reduced \$1 for every \$2 earned over the lower earnings limitation while under full retirement age. The reduction in benefits is \$1 for every \$3 earned over the higher earnings limitation in the year full retirement age is reached. In the year that full retirement age is reached, the higher earnings limitation is only applied to earnings from months before reaching full retirement age. Beginning with the month full retirement age is met, full benefits can be received with no limit on earnings.

Any benefits withheld due to the earnings test will be reinstated once full retirement age is reached. Once full retirement age is reached, the monthly benefit will be increased to account for the months when benefits were withheld.

For more information on how retirement earnings may affect your social security benefits, please visit www.ssa.gov.

The fair rental value of the parsonage (or cash housing allowance paid to the worker) is counted as income in arriving at the earnings limitation amount. Unearned income such as pension and retirement payments, interest and dividends, rental income, and sales of property are not counted as earnings. Reimbursements for business and professional expenses are also not counted toward the earnings limitation if an accountable expense reimbursement plan is used.

Benefits in Retirement

If an individual works beyond “full retirement age” and does not begin receiving social security benefits, the benefits will be increased by a percentage factor. For those born after 1943, the percentage increase is 8% per year of delay up to age 70. The benefit increase no longer applies after age 70.

Retired called workers are included in the WELS Pension Plan and may be enrolled in the WELS VEBA Group Health Plan. Workers approaching retirement should review these plans to familiarize themselves with the benefits of each. Questions relating to either plan should be directed to the WELS Benefit Plans Office at 414-256-3860.

The Personal Earnings and Benefit Estimate Statement provide the individual with the estimated amount of benefit they may expect to receive upon retirement. This statement can be requested at any time during your working years. You can request it by either contacting your local SSA office or go to the SSA's website (www.ssa.gov).

Benefits under the Social Security program must be applied for through the Social Security Administration and it is suggested that workers get in touch with Social Security if:

- ❖ They are unable to work because of an illness or injury that is expected to last a year or longer.
- ❖ They are 62 or older and plan to retire.
- ❖ They are within 3 months of their "full retirement age," even if they do not plan to retire.
- ❖ Someone in their family dies.
- ❖ They are 65 or older, blind, or disabled with limited income and resources (to apply for supplemental security income (SSI)).

It is important to call, visit, email or write any Social Security Administration office before reaching 65, not only about retirement checks, but also about Medicare insurance.

Retirees must not only consider the reduction of benefits but also the taxation of social security benefits. A two-tier, progressive system adds taxation of some social security benefits. In the worst-case scenario, 85% of social security benefits may be taxed for "provisional income" in excess of \$34,000 for single persons and \$44,000 for married persons. "Provisional income" is generally calculated as adjusted gross income (all forms of taxable income before deductions) **plus** tax exempt interest **and** one half of the social security benefits received during the year.

"Semi-Retired" Calls

A few congregations and entities within the synod issue a semi-retirement type of call because the nature of the work is less than full time. Generally, semi-retired calls are issued to "Ministers of the Gospel" who have retired from active work in the church and are drawing social security and other retirement benefits. Occasionally an active pastor who is about to retire may be extended this type of call. When issuing or considering a semi-retired call, the congregation or pastor should consider the possible reduction in retirement benefits and the tax consequences of issuing or accepting such a call.

Both WELS VEBA Group Health Care and Pension Plans consider a person an 'active' employee if he works 20 or more hours a week. This is the threshold that has been established for distinguishing between a retiree and an active employee. If the call is for less than 20 hours per week, the worker continues receiving Medicare Supplement health care benefits and pension benefits. If the worker is compensated for 20 hours per week or more, the pension is discontinued, and the worker is then covered under the active WELS VEBA Group Health Plan.

Additional factors which must be reviewed by the congregation or entity and the pastor when considering a semi-retired call include: 1) All earnings will be taxable for self-employment tax purposes if the services performed are ministerial services and, 2) tax-sheltered annuities are allowable up to the standard 403(b) amounts. However, salary reduction agreements for TSA's are not considered when calculating the earnings limitation.

Retired Minister of the Gospel's Parsonage Allowance

Synod pension benefits received are included as income for income tax purposes but excluded for social security purposes. The WELS Pension Commission typically designates all pension benefits as a Section 107 parsonage allowance.

In addition to designating their pension, a retired "Minister of the Gospel" may request the calling body to designate a portion of their part-time earnings as a parsonage allowance. In any case, the parsonage allowance is limited to the least of the fair rental value of the house provided including utilities; the amount designated; or the amount actually spent.

The Church Retirement Benefits Simplification Act clarified that a retired "Minister of the Gospel's" parsonage allowance designated by a denominational Pension Board is exempt from social security taxes. Ministers may also be eligible for a refund of taxes paid previously. Contact a tax professional for more information.

Retirement Gifts

The IRS has indicated that its position that retirement gifts generally will be considered compensation for past services, and the amount paid will be taxable income to the recipient.

If congregations or entities wish to provide a form of retirement gift to their workers, it is recommended that the payments be made directly to the worker from its members and that no charitable contribution receipt be issued for those contributing to the gift. It is likely that such payments will be considered tax-free gifts from one individual to another with no tax consequences to the retiree.

OVERSEAS WORKERS OR EXPATRIATES

The expatriate or WELS worker going abroad is directed to the following IRS publications for detailed discussions on the treatment of foreign income and general tax questions:

- Publication 54 - Tax Guide for U.S. Citizens and Resident Aliens Abroad
- Publication 514 - Foreign Tax Credit for Individuals
- Publication 570 - Tax Guide for Individuals with Income from U.S. Possessions
- Publication 901 - U.S. Tax Treaties

IRS Publication 54 states:

“If you are a U.S. citizen or resident alien, your worldwide income generally is subject to U.S. income tax regardless of where you are living. Also, you are subject to the same income tax filing requirements that apply to U.S. citizens or resident aliens living in the United States... (Certain) income tax benefits might apply if you meet certain requirements while living abroad. You may qualify to exclude from your income a limited amount of your foreign earned income. You also may be able either to exclude or deduct your housing amount from gross income. To claim these benefits you must file a tax return and attach Form 2555 Foreign Earned Income.”

The expatriate worker may be able to claim a credit against U.S. income tax liability, or take an itemized deduction, for the foreign income taxes paid. The taxpayer must be familiar with possible tax treaties or conventions the United States may have with the country in which he is resident, as well as foreign country tax laws and filing requirements.

If the expatriate worker’s tax home (the place of business or employment where the worker is permanently or indefinitely engaged to work as an employee or self-employed individual) is in a foreign country and the bona fide residence test (must be a resident for one full tax year) or the physical presence test (must be physically present in a foreign country or countries 330 full days during a period of 12 consecutive months) is met, up to \$105,900 for 2019, and \$107,600 for 2020, of foreign earned income may be excluded from taxable income during the year. The maximum amount you can exclude is adjusted annually for inflation. Foreign housing amounts may also be excluded.

*Foreign earned income may qualify for an exclusion allowance from income tax if the worker meets **either one of two tests.***

Form 2555 *Foreign Earned Income* or Form 2555-EZ *Foreign Earned Income Exclusion*, must be filed with Form 1040 to claim the foreign earned income exclusion. Only Form 2555 can be used to claim the foreign housing exclusion or deduction.

As the US and foreign country tax laws for expatriates and overseas workers contain complex provisions, overseas workers are encouraged to contact a tax advisor familiar with these issues regarding their specific situation.

WELS 403(b) RETIREMENT PLAN AND TAX SAVINGS PLANS

The Synod adopted the WELS Shepherd Plan (the Plan) as the denominational 403(b) retirement income account plan for WELS. Any WELS-affiliated entity considering establishing and/or participating in a plan outside the synod's denominational plan should seek legal and tax advice. WELS-affiliated entities can initiate adoption of the Plan by contacting the Hahn Financial Group, which is the Plan's investment advisor, at wels403b@hahnfinancialgroup.com, or by contacting WELS Benefit Plan at bpo@wels.net.

A 403(b) plan generally will reduce the employee's current federal and state income tax liability because it reduces taxable compensation in the year the wages are deferred to a 403(b) account. Any eligible employee of a qualified employer may benefit from reduced income taxes under a tax-deferred arrangement such as the synod's WELS Shepherd Plan. **IRS Publication**

571 states: "Full or part-time employment is not a factor in determining whether you are an employee [for 403(b) eligibility purposes]." "Ministers of the Gospel" may also benefit from reduced self-employment taxes by establishing a 403(b) since pre-tax contributions to a 403(b) are not included in self-employment earnings. However, the congregation or

entity must withhold and match social security taxes for non-synod ministry certified called workers and lay employees on the total amount of compensation including any 403(b) contributions.

Contributions to a 403(b) by "Ministers of the Gospel" are not included in self-employment earnings.

A qualified employer for these purposes includes any "entity that is tax exempt because it is organized and operated exclusively for religious, charitable, scientific, public safety testing, literary, or educational purposes..." per **IRS Publication 571**. In addition, only qualified employees may participate in a tax-sheltered annuity plan, such as a 403(b), offered by their employer. Qualified employees include all eligible employees of the qualified entity and self-employed "Ministers of the Gospel" who are treated as employed for other tax and fringe benefit purposes by the qualifying entity.

A 403(b) plan requires a written agreement between the employee and employer to have the employee's compensation reduced by a specified amount or percentage and for the employer to contribute that amount into a 403(b) plan. The 403(b) plan can invest in annuity contracts, custodial accounts that hold mutual fund shares, or in retirement income accounts. The custodian of the plan may be a life insurance company, bank, mutual fund company, or the congregation or entity itself, provided that the IRS has approved its written plan.

The 403(b) contributions can be handled in one of two ways, through a salary reduction agreement or through employer contributions to a "defined contribution plan". Employees can make changes to reduction agreements multiple times during the taxable year.

1. The congregation or entity can first establish the annual salary of the employee and then establish a salary reduction agreement with the employee on how much will be contributed. The employee's gross and net pay is reduced each month by an equal portion of the agreed-upon amount and the congregation or entity remits the same amount each month to the custodian of the tax-sheltered plan. At year-end, the employee's Form W-2 will show the agreed-upon salary less the amount contributed to the tax-sheltered plan.

2. The congregation or entity can establish the annual salary and contribute an agreed upon amount into a tax-sheltered, defined contribution plan in addition to the annual salary. No monthly reduction of the employee's established salary occurs but the congregation or entity still makes monthly contributions to the tax-sheltered plan. At year-end, the employee's Form W-2 will show only the annual salary and not the contributions to the tax-sheltered account. Since this is, in effect, a pension plan, additional governmental reporting may be necessary under this option.

The maximum annual non-taxable contribution amount to a 403(b) plan for any employee is \$19,000 for 2019 and \$19,500 for 2020. The WELS Shepherd Plan offers the pre-tax 403(b) **and** after-tax Roth provisions. Employee contributions to the Plan under each of these provisions are combined to determine when the maximum annual 403(b) contributions limit is met.

Note that two catch-up provisions exist to allow for higher annual contributions: (1) age 50 catch-up contributions, and (2) 15-year service catch-up contributions.

Age 50 catch-up contributions. Employees who will be at least age 50 by the end of the year may make "catch-up contributions" to a 403(b) plan of up to \$6,000 for 2019 and \$6,500 for 2020.

15-year service catch-up contributions. If an employee has at least 15 years of service with a church, the limit on elective deferrals is increased by the least of the following amounts:

1. \$3,000
2. \$15,000, reduced by increases to the general limit the employee was allowed in earlier years because of this rule; or
3. \$5,000 times the number of the employee's years of service for the entity, minus the total elective deferrals made by the employer on the employee's behalf for earlier years.

Please note that catch-up contributions for an employee who is eligible for both the age 50 catch-up and the 15-year service catch-up is treated first as a 15-year service catch-up to the extent a 15-year service catch-up is permitted, and then as an amount contributed as an age 50 catch-up.

Housing equity accounts. Housing equity accounts, as part of a qualified 403(b) plan, are available to "Ministers of the Gospel" and allow for contributions to be set aside and used for qualifying housing expenses under Section 107 of the IRC, including a down payment on a house. Standard 403(b) contribution guidelines and limits apply to housing equity accounts.

Funds used for qualifying housing expenses can be distributed on a non-taxable basis to the employee prior to age 59 ½. If the housing equity account assets are distributed to the employee prior to age 59 ½ and are not used for qualifying expenses, the distributions will be taxed as income and subject to an additional 10% federal tax penalty for early withdrawal.

If the assets in the housing equity account are not distributed prior to the employee reaching age 59 ½, non-taxable distributions can be made after age 59 ½, or in retirement, if used for qualifying housing expenses. Distributions after age 59 ½ will be taxed as income if not used for qualifying housing expenses but are not subject to the 10% early withdrawal penalty.

As these calculations can become quite involved, a qualified financial, investment or tax adviser and **IRS Publication 571** should be consulted for further details.

A self-employed person may also make contributions to a SEP IRA, SIMPLE 401(k) or self-employed (solo) 401(k) or similar type retirement plan up to the annual contribution limit of \$56,000 for 2019 and

\$57,000 for 2020. Self-employed ministers are treated as an employee of a tax-exempt entity that is a qualified employer. Your includible compensation is your net earnings from your ministry minus the contributions made to the retirement plan on your behalf and the deduction for one-half of the self-employment tax.

403(b) contributions are generally tax-deferred (not included in employee's gross income in the year earned; not taxable until withdrawn). Employee elective deferrals are shown on Form W-2 in Box 12a, coded E, but not as income in Box 1, and checked as "Retirement Plan" in Box 13, Form W-2.

Note that an employee cannot transfer 403(b) amounts into any other pension plan unless there is a "triggering event" such as termination of employment.

Individual Retirement Accounts – IRAs

Contributions to an Individual Retirement Account (IRA) may be made by "Ministers of the Gospel," non-synod ministry certified called workers, and lay employees. However, they may not be deductible on Form 1040 if the worker is eligible for participation in the employer's retirement plan or if the worker participates in a 403(b) plan or the WELS Shepherd Plan. Contributions to an IRA, whether tax deductible or not, are subject to social security taxes. The IRA contribution limit is \$6,000 for 2019 and 2020. An individual who will be at least age 50 by the end of the tax year can contribute up to \$7,000. A tax, legal, or other consultant should be contacted for specific questions about IRAs.

The "spousal IRA" allows for a working spouse to contribute to an IRA in the name of a non-working spouse. However, the working spouse's income must be greater than the total of both spouses' IRA deposits.

Contributions to a Roth IRA are not deductible, but distributions may not be taxable. With many called workers in lower tax brackets, the benefit of the conventional IRA's deductibility is limited. The Roth IRA may provide much greater tax relief in later years. As with any type of tax and retirement planning, many variables must be weighed as it applies to a workers' unique situation. For traditional and Roth IRAs, the maximum catch-up contribution is \$1,000 for 2019 and 2020.

Flexible Spending Arrangements

Internal Revenue Code Section 125 allows entities to set up Flexible Spending Arrangements (FSA). The FSA is a calendar year program that allows employees to designate a certain amount of money each year to be withheld for specified purposes (medical and/or dependent care expenses) without paying income or social security taxes. This money is then used to reimburse the employee for out-of-pocket expenses as detailed in the program. The limit on pretax employee contributions to health care FSAs is \$2,700 in 2019 and \$2,750 in 2020.

In general, any money not used before year-end cannot be carried over to a subsequent year by the employee and becomes general funds of the entity. To provide employees with greater flexibility, the entity may choose to include either a grace period provision or a rollover provision in the FSA plan document (but not both). A grace period allows up to an additional 75 days after the end of each plan year during which unused benefits remaining at the end of the plan year may be reimbursed to employees for qualified expenses incurred during the grace period. A rollover provision allows up to \$500 of unused benefits remaining at the end of a plan year to be reimbursed to employees for qualified expenses incurred during the following plan year.

The entity must approve a formal, written FSA plan document before it is implemented.

CHARITABLE CONTRIBUTIONS

A charitable contribution is a donation or gift to, or for the use of, a qualified entity. It is voluntary and is made without getting, or expecting to get, anything of equal value. Qualified entities include nonprofit groups that are religious, charitable, educational, scientific, or literary in purpose, or that work to prevent cruelty to children or animals. To deduct a charitable contribution, you must file Form 1040 and itemize deductions on Schedule A. The amount of your deduction may be limited if certain rules and limits apply to you. See **IRS Publication 526**, *Charitable Contributions*.

In the WELS 501(c)(3) group ruling determination letters, dated January 25, 1966 and September 21, 2000, the IRS states “Contributions made to you and your listed districts, congregations, educational charitable and religious entities are deductible by donors as provided by Section 170 of the Code. Bequests, legacies, devices, transfers, or gifts to or for the use of your listed districts, are deductible for Federal estate and gift tax purposes . . .” Refer to “*Tax Exempt Status – WELS Congregations and Entities*” section.

The church or entity should arrange its financial affairs in such a way as to only accept contributions and gifts that will further its ministry. A church or entity may lose its tax-exempt status from income tax if it accepts gifts that are given only to provide direct financial benefits to its members (except as allowed by law such as an itemized charitable contribution deduction).

Six Requirements: *Charitable contributions generally must satisfy six requirements. A charitable contribution must be (1) a gift of cash or property, (2) claimed as a deduction in the year in which the contribution is made, (3) unconditional and without personal benefit to the donor, (4) made “to or for the use of” a qualified charity, (5) within the allowable legal limits, and (6) properly substantiated.*

Congregations and entities that qualify as charitable entities can accept gifts in good faith from any donor and acknowledge receipt of the gift from the donor. It is not responsible for deciding whether a donor can or cannot take a tax deduction for a charitable contribution. In addition, the congregation or entity should not indicate the value of contributed non-cash gifts without a written appraisal from a qualified appraiser. Either the donor or the charitable entity, by agreement, may arrange and pay for the cost to appraise non-cash gifts.

Cash or physical property may be donated to a charitable entity. **The value of time or services is not a charitable contribution** for tax purposes and should not be acknowledged in such a way as to lead the volunteer to believe that they are. However, some unreimbursed out-of-pocket expenses may be deductible by the volunteer. The standard mileage allowance rate for volunteers remains at 14¢ per mile. See **IRS Publication 526**, *Charitable Contributions*, for more detail.

Voluntary Payroll Deductions

Withholding of monies from an employee’s net pay which are then passed on to a charitable entity is an allowable form of making a charitable contribution. However, a reduction in an employee’s salary in lieu of making a charitable contribution, which is not reported on Form W-2, is not allowed. Congregations and entities should not consider a reduction in salary as an acceptable charitable contribution by one of its employees. To do so is to consider the contribution as a professional expense and IRC Section 162(b) states: “No deductions shall be allowed under subsection 162(a) for any contribution or gift which would be allowable as a deduction under Section 170 (Schedule A) were it not for the percentage limitations, the dollar limitations or the requirements as to the time of payment, set forth in such section.” The only place that charitable deductions are allowed is on Form Schedule A.

Substantiation and Disclosure Requirements for Charitable Contributions

For specific instructions, refer to **IRS Publication 1771, Charitable Contributions – Substantiation and Disclosure Requirements.**

Donors **must have a substantiation receipt or statement** that is prepared by the charitable entity to claim an income tax deduction on single payments or gifts worth \$250 or more. Individual gifts, even though totaling greater than \$250, are not aggregated together. Cash donations less than \$250 may still be substantiated by the donor's canceled checks or bank records. Also acceptable as substantiation would be a receipt or statement from the entity. Valid substantiation means a canceled check, bank record, or receipt listing the recipient entity's name along with the date and amount of the donation. A proper annual "year-end" statement provided to each donor is the best form of Offering Substantiation of individual receipts if it contains the appropriate disclosures and is received by the donor before filing their tax return. If the sole service exchanged is an "intangible religious benefit" or small goods given to members (e.g. a bookmark or inexpensive cross to new members) without regard to their contributions, no value need be assigned, and the receipt should state that the only benefits are intangible religious benefits. The statement may read as follows:

WELS churches or entities should issue substantiation receipts/statements for every contribution of \$250 or more. Donors cannot take a tax deduction without a proper receipt/statement. An Annual Statement is the best form of Offering Substantiation.

The donor received no goods or services, other than intangible religious and spiritual benefits, in exchange for the gifts listed on this receipt.

Noncash Contributions

For non-cash donations which a donor claims are worth greater than \$250, the receipt only needs to contain a description of the property with no estimate of value. Additional requirements apply to contributions of noncash property valued by the donor at \$500 or more. For non-cash gifts over \$500, the donor needs to complete Form 8283 to receive the tax deduction on his tax return. This form describes the item, how it was valued, the signature of the certified appraiser, if needed, and the signature of the entity acknowledging receipt of the items. The entity receiving the goods does not give a monetary value to any non-cash good received. Additionally, if any assets received on Form 8283 are sold within two years of the donation, the donee is required to file Form 8282 with the IRS. Form 8282 lists the item and the amount for which the item was sold.

Substantiation Requirements

1. *It must be in writing.*
2. *It must identify the donor by name.*
3. *For contributions of noncash property valued by the donor at \$250 or more, it must describe the property. No value should be stated.*
4. *It must show separately each individual contribution of cash or noncash of \$250 or more.*
5. *It must state whether or not the church provided any goods or services to the donor in exchange for a contribution or, if the only goods or services the church provided were "intangible religious benefits." It must contain a statement to that effect.*
6. *It must be received by the donor on or before the earlier of the a) date of the donor files a tax return claiming a deduction or b) the due date for filing the return.*

If you contribute property to a qualified entity, the amount of your charitable contribution is generally the fair market value of the property at the time of your contribution. Reference **IRS Publication 561, Determining the Value of Donated Property**, for general guidelines for determining the fair market value of various types of donated property.

Appraisals are required for donations of property worth more than \$5,000 (\$10,000 for stock in closely held firms), but not for donations of listed securities. Appraisers must be members of a recognized professional group or meet minimum education and experience guidelines, otherwise, deductions will be disallowed. Please note that if your appraiser isn't qualified, you'll have to find another who is.

No deduction is allowed for a charitable donation of clothing or household items "unless the clothing or household item is in good used condition or better." By regulation, the IRS is authorized to deny a deduction for any contribution of clothing or a household item that has minimal monetary value. Household items are defined as furniture, furnishings, electronics, appliances, linens, and other similar items. A deduction will not be disallowed for a charitable contribution of a single item of clothing or a household item which is not in good used condition or better if the amount of the deduction claimed for the item is more than \$500 and the taxpayer includes with their return a qualified appraisal with respect to the property. Food, paintings, antiques, and other objects of art, jewelry and gems, and collections are specifically excluded from the definition of household items.

Donor's Required Records for Non-cash Contributions:

1. *Name and address of the entity to which you contributed.*
2. *Date and location of the contribution.*
3. *A description of the property in reasonable detail. For a security, keep the name of the issuer, the type of security, and whether it is regularly traded on a stock or over-the-counter market.*
4. *The fair market value of the property at the time of the contribution and how you figured the fair market value. If determined by appraisal, a signed copy should be kept.*
5. *The cost or other basis of the property.*
6. *The amount you claim as a deduction for the tax year.*

Charitable entities **must** give notification of *quid pro quo* contributions. These are a combination of contributions and payments for goods or services furnished by the charity to the donor. Thus, if a donor receives some economic or financial benefit from making the donation, their only charitable contribution is the amount over the benefit they received. If the congregation or entity receives \$75 or more and the donor receives economic or financial benefit as a direct result of the contribution, the congregation or entity is required to provide the donor a receipt advising them of the estimated value or the benefit and the amount that is deductible. In contrast to the substantiation requirement which has no penalties, congregations or entities that fail to meet these disclosure requirements are subject to a penalty of \$10 per contribution to a maximum of \$5,000 per particular fund-raising event.

Donated Vehicles

A vehicle donation may be a tax deduction if it is a qualified vehicle. The charity entity must also be a qualified 501(c)(3) entity. What information is needed for written acknowledgment and tax reporting requirements for the donor and charity can be found in **IRS Publication 4303, A Donor's Guide to Vehicle Donations** and **IRS Publication 4302, A Charity's Guide to Vehicle Donations**. The guides provide general guidelines on selecting a charity, qualifying for tax deduction, and valuation.

Tuition and Scholarships

Contributions made by parents of students to churches or entities operating schools may be allowable as charitable contributions so long as they are true contributions and not tuition. The major factor is the degree of compulsion and/or lack of compulsion under which the payments are made. Note that merely making a payment to a church with instructions to forward all or a portion of the payment does not change the reason payment is made, the compulsion is the major factor. A church or entity that imposes a charge or so called "minimum contribution" on parents and if not met denies continued enrollment in the school is in fact imposing tuition. On the other hand, a church that suggests a minimum but does not deny continued

enrollment if not met is merely guiding its parents on grounds of good Christian stewardship and the financial needs of the church. If the payment must be made for the child to continue to receive the benefit of the school's education, no charitable contribution exists, and the church or entity should not acknowledge receipt of a contribution to the extent of the required amount.

A church or entity may set up a scholarship fund to provide educational grants to members or others. This scholarship fund should be controlled by the church or entity and administered under written guidelines. Contributions made to this fund should be considered charitable contributions providing that the donor does not specify the student/family to receive the grant. Additionally, the IRS may question a scholarship fund that benefits a specific donor. **IRS Publication 526, Charitable Contributions**, states "Direct contributions to needy or worthy individuals are not deductible. The contributions must be made to or for the use of a qualified entity and not be earmarked by you for the use of a specific person."

For more information, see *Contributions vs. Tuition* in "Lutheran Schools and Early Childhood Centers" section of this tax manual.

Special Offerings

The most common special offerings are for employees in honor of either their retirement or anniversary at the church or entity. If members give a gift **directly** to the employee, the employee probably has no taxable income and the member has no charitable contribution. Special offerings given through the church or entity may be deductible by the member and are generally additional compensation when given to the employee. The gift must be added to the employee's W-2 and would be subject to taxes. Since this issue has been the subject of several cases and IRS interpretations, the congregation or entity is advised to contact a tax advisor **before** any such offering is implemented.

Benevolence Funds

Other common special offerings may be for occurrences such as serious illness, accident, severe weather damage, etc. to the recipients. Separate funds for these one-time occurrences, which benefit one individual, may have adverse tax and other consequences for an employee, the church or entity. It is recommended that the church or entity set up a policy for benevolence/family in need funds and that the organizational documents of the entity state the purpose as both "charitable" and "religious". A benevolence fund can be set up to accept both undesignated and designated contributions. To maintain the deductibility of the donors offering, certain rules are recommended –

- Donors or other church members may anonymously recommend desired recipients
- A committee should be appointed by the church board to review and recommend recipients
- The committee should not be aware of the specific donors to the benevolence fund
- The entity's board should approve the recipients based on committee recommendations
- If a donor specifies a certain recipient, the policy must state the recommendation is advisory only, the entity controls the use of the funds and the board has final authority regarding the recipient of the funds

Benevolence funds are tax-free gifts to the recipients, unless the recipient is an employee of the entity. If the recipient is an employee of the entity, the payments should be reported on the employee's W-2 and will be subject to taxes.

IRS Required Substantiation for Contributions

Contribution Type and Amount	Required Substantiation	Prepared/Maintained by	
		Congregation	Donor
Cash less than \$250	Substantiation receipt/statement Canceled checks/bank record	Prepared No	Maintained Maintained
Cash/noncash of \$250 or more	Substantiation receipt/statement Property records	Prepared No	Maintained Prepared Maintained
Cash/noncash quid-pro-quo of \$75 or less	Substantiation receipt/statement Canceled checks Property records	Prepared No No	Maintained Maintained Prepared Maintained
Cash/noncash quid-pro-quo of more than \$75	Disclosure receipt/statement Property records	Prepared No	Maintained Prepared Maintained
Noncash less than \$250	Receipt Property records	Prepared No	Maintained Prepared Maintained
Noncash less than \$500 AND \$250 or more	Disclosure receipt/statement Property records	Prepared No	Maintained Prepared Maintained
Noncash \$5,000 or less AND more than \$500	Disclosure receipt/statement Property records Individual's IRS Form 8283	Prepared No No Signed-No	Maintained Prepared Maintained Prepared Maintained Prepared Signed-Yes
Noncash more than \$5,000	Disclosure receipt/statement Property records Individual's IRS Form 8283 Congregation's IRS Form 8282	Prepared No No Signed-Yes Prepared Signed-Yes if within 2 yrs	Maintained Prepared Filed Prepared Signed-Yes No Signed-No
Out-of-Pocket expenses of \$250 or more	Acknowledgement describing services related to volunteer Property records/receipts	Prepared No	Maintained Maintained

Reporting End of Year Contributions

Charitable contributions must be claimed in the year they are delivered. One exception is a check mailed to a charity: it is deductible in the year the check is mailed (and postmarked), even if it is received early in the next year. See the table on the next page for an overview of when to report end-of-year contributions. A check that is mailed to a church (or other charity) is considered delivered on the date it is mailed and postmarked. A contribution of real estate generally is deductible in the year that a deed to the property is delivered to the charity. A contribution of stock is deductible in the year that a properly endorsed stock certificate is mailed or otherwise delivered to the charity. **Predated checks:** A donor cannot deduct a check on his 2019 federal tax return if the check is backdated to read "December 31, 2019." Churches that receive checks during the first worship service in January cannot credit the checks to the previous year. Section 1.170A-1(b) of the income tax regulations states: "*Ordinarily, a contribution is made at the time delivery is affected. The unconditional delivery or mailing of a check which subsequently clears in due course will constitute an effective contribution on the date of delivery or mailing.*" According to this regulation, a check dated December 31, 2019, but physically delivered in January 2020, is deductible only on the donor's 2020 federal tax return. The only exception to this rule is a check that is dated, mailed, and postmarked in December 2019. **Postdated checks:** Churches

occasionally receive a postdated check. Such checks are often received at the end of the year, when some donors decide they will be better off for tax purposes if they delay their contribution until the following year. A court case defines a postdated check as follows: “A postdated check is not a check immediately payable but is a promise to pay on the date shown. It is not a promise to pay presently and it does not mature until the day of its date, after which it is payable on demand the same as if it has not been issued until that date.” In other words, a postdated check is treated like a promissory note. A church should simply retain a postdated check until the date on the check occurs. There is no need to return it.

TYPE OF CONTRIBUTION	CHURCH REPORTS AS A 2019 CONTRIBUTION	CHURCH REPORTS AS A 2020 CONTRIBUTION
Checks written in December 2019 and deposited in church offering in January 2020		X
Checks written and deposited in church offering in January 2020 but backdated to December 2019		X
Checks written and deposited in church offering in December 2019 but postdated to January 2020		X
Checks written in December 2019 and deposited in the mail and postmarked in December 2019 but not received by the church until January 2020	X	
Checks written in December 2019 and deposited in the mail in December 2019 but not postmarked until January 2020 and not received by the church until January 2020		X

LUTHERAN SCHOOLS & EARLY CHILDHOOD CENTERS

Entity

Schools operated by one congregation are encouraged not to incorporate separately but to operate fiscally as an agency of the congregation.

However, some Lutheran schools or preschools are separately incorporated because of their special nature or relationship with the congregation or congregations operating them. An attorney can explain both the advantages and disadvantages that come with a separate corporation (childcare agency, early childhood center, preschool, elementary school or high school). Whether the school operates as an agency of the congregation or organizes as a separate legal entity, its organizational documents must contain certain provisions for recognition of federal income tax exemption.

Proof of Racial Nondiscrimination

Churches and other religious entities that operate, supervise, or control a private school must file a certificate of racial nondiscrimination (Form 5578) annually with the IRS. The certificate is due by the 15th day of the fifth month following the end of the entity's fiscal year. This is May 15th of the following year for entities that operate on a calendar year basis. This means that the Form 5578 for 2019 is due May 15, 2020.

A "private" school" is defined as an educational entity that normally maintains a regular faculty and curriculum and normally has a regularly enrolled student body 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.

The term "school" also includes preschools, and this is what makes the reporting requirement relevant for many churches, since many churches operate a preschool program. Private religious schools that are not affiliated with or controlled by a church also must file the form.

Form 5578: "*Annual Certification of Racial Nondiscrimination for a Private School Exempt from Federal Income Tax*" (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." These requirements are explained in the instructions to Form 5578 and summarized below:

- 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 on its primary publicly accessible internet homepage at all times during the taxable year in a manner reasonably expected to be noticed by visitors on the homepage. However, such notice is not required if one or more exceptions apply. These include the following: (1) During the preceding three years, the enrollment consists of students at least 75% of whom are members of the sponsoring church or religious denomination, and the school

publicizes its nondiscriminatory policy in religious periodicals distributed in the community. (2) The school draws its students from local communities and follows a racially nondiscriminatory policy toward students and demonstrates that it follows a racially nondiscriminatory policy by showing that it currently enrolls students of racial minority groups in meaningful numbers.

- The school can demonstrate that all scholarships or other comparable benefits are offered on a racially nondiscriminatory basis.

To preserve the tax-exempt status of WELS Schools, each year the Commission on Lutheran Schools is required to complete Form 5578 for the Internal Revenue Service (IRS Revenue procedure 75-50) listing which of our WELS Schools fully comply with the regulations concerning the publication of a racially non-discriminatory policy as required by federal law. Each school is expected to report this information on the annual online school statistics form. This segment of the form requests that you indicate whether your school adheres to the federal description of non-discrimination policies, where the policy is published, and if you can produce a hard copy if requested to do so.

Some independent religious schools that are not operated or controlled by a church or other religious entity are required to file Form 990 with the IRS annually. Form 990 is an annual information return. Churches and some other religious entities are exempt from this filing requirement. Schools that are required to file Form 990 make their annual certification of racial nondiscrimination directly on Schedule A of Form 990, and not on Form 5578.

Contributions vs. Tuition

The IRS in Revenue Ruling 83-104 provides guidance in determining when payments to private schools must be regarded as tuition payments and when they may be treated as deductible charitable contributions. WELS congregations with schools as well as those that support another Lutheran school and pay a portion, or all, of the education costs of its members are subject to this ruling.

The IRS has stated that the presence of one or more of the following four factors creates a presumption that the payment is not a charitable contribution (Revenue Ruling 83-104):

- The existence of a contract under which a taxpayer agrees to make a “contribution” and which contains provisions ensuring the admission of the taxpayer’s child,
- A plan allowing taxpayers either to pay tuition or to make “contributions” in exchange for schooling,
- The earmarking of a contribution for the direct benefit of a particular individual, or
- The otherwise unexplained denial of admission or readmission to a school of children of taxpayers who are financially able but who do not contribute.

The IRS has observed that if none of these factors is determined, a combination of several additional factors may indicate that a payment is not a charitable contribution, including but not limited to:

- ✓ The absence of a significant tuition charge,
- ✓ Substantial or unusual pressure to contribute applied to parents of children attending a school,
- ✓ Contribution appeals made as part of the admissions or enrollment process,
- ✓ The absence of significant potential sources of revenue for operating the school other than contributions by parents of children attending the school, and
- ✓ Other factors suggesting that a contribution policy has been created as a means of avoiding the characterization of payments as tuition. If a combination of such factors is not present, payments by a parent will normally constitute deductible contributions, even if the actual cost of educating the child exceeds the amount of any tuition charged for the child’s education.

An income tax regulation further specifies that the term “scholarship” does not include “any amount provided by an individual to aid a relative, friend, or other individual in pursuing his studies where the grantor is motivated by family or philanthropic considerations.” Treas. Reg. 1.117-(3)(a).

For more information, see “Tuition and Scholarships” within the Charitable Contributions section of this Tax Manual.

Scholarship Funds

Scholarship Funds for the purpose of paying a student’s tuition to a parochial school will not jeopardize tax deductions when they are established by a church and are not used to replace what would otherwise be characterized as tuition. The operation of any scholarship fund should be carefully documented to clarify that contributions to the fund are controlled and expended solely by the governing board or another appropriate agency of the church or entity operating the school. Scholarship funds, in themselves, are not harmful to the deductibility of contributions to the church or fund if properly structured and administered.

Proper structure includes defining beneficiaries based on nondiscriminatory criteria. The congregation must use great care if its grants or awards are provided for students who are employees or related to employees of the congregation.

Student Aid Grants

Any amount given by a church as a qualified scholarship to someone who is a candidate for a degree at a qualified educational entity, should not be considered part of the recipient’s gross income if the amount is used for qualified tuition and related expenses, such as fees, books, supplies and equipment required for instruction. If the recipient of the gift has met the requirements, no Form 1099 is required.

If the scholarship is used for living expenses or travel, it must be added to the individual’s Form 1040A or Form 1040 on the wages line and identified with “SCH” in the margin (**IRS Publication 520**).

Qualified Tuition Reduction

Many churches operate schools and offer tuition discounts to employees of both the school and church whose children attend the school. Qualified requirements in Section 117(d) of the IRC specifies that qualified tuition reductions are not taxable. To be qualified, certain conditions must be met, including:

- The tuition reduction is provided to an employee of an “entity described in section 170(b)(1)(A)(ii) of the IRC. This section refers to “an educational entity which normally maintains a regular faculty and curriculum and normally has a regularly enrolled student body in attendance at the place where its educational activities are regularly carried on.”
- The tuition reduction must be for education below the graduate level.
- The qualified tuition reduction must be provided to a current school employee; a former school employee who retired or became disabled; or a dependent child of a school employee.
- Highly compensated employees cannot exclude qualified tuition reductions from gross income unless the same benefit “is available on substantially similar terms” to non-highly compensated employees. The term “highly compensated employee” refers to any employee whose annual compensation was \$130,000 or more in 2020 and \$125,000 or more in 2019.

A tuition **reduction** (up to 100%) may be granted, tax free, to employees of a school, their spouses or dependent children if it is granted equally to all employees. The congregation or entity should formally adopt such a policy, if it chooses to provide this benefit to its workers.

Churches that pay tuition for their employees' children to attend a school must report those payments as taxable compensation. It is possible that church employees who are also employees of the school (teaching one or two courses each year) may qualify for a nontaxable tuition reduction on account of the services they perform for the school. A call document listing sufficient responsibilities for the school would strengthen the pastor's eligibility for this benefit. The issue is addressed in IRS Private Letter Rulings 9821053 and 200149030.

UNRELATED BUSINESS INCOME

Unrelated business income: Unrelated business income is the income from a trade or business that is regularly carried on by an exempt entity and that is not substantially related to the performance by the entity of its exempt purpose or function, except that the entity uses the profits derived from this activity. Certain trade or business activities are not treated as an unrelated trade or business. Watch a video about unrelated business income at stayexempt.irs.gov, under “Exempt Entity”, or read **IRS Publication 598, Tax on Unrelated Business Income of Exempt Entities**.

Trade or Business: The unrelated business income tax (“UBIT”) provisions in IRC Section 512 apply to churches or exempt entities that have income from “operating a trade or business.” Three criteria must exist for a tax-exempt entity to be taxed on unrelated business income:

1. The church or exempt entity must be operating a trade or business;
2. The trade or business must function as an ongoing business; and
3. The conduct of the trade or business must not be substantially related to the church’s tax-exempt purpose.

If these three criteria are present, the income generated by the trade or business will be subject to income taxes. The main reason that UBIT is imposed is to put not-for-profit and for-profit entities on a comparable basis for activities related to carrying on a business. To do otherwise would be to give an advantage to not-for-profit entities.

Examples of Unrelated Business Activities: The key for churches is to determine which activities the IRS considers to be unrelated business income and if the activity is not substantially related to the tax-exempt purpose. The following lists present examples of activities which ARE and ARE NOT considered unrelated. More examples in **IRS Publication 598**.

Activities Which ARE Unrelated

1. Soliciting, selling and publishing commercial advertising in an exempt entity periodical
2. Operating a commercial parking lot, even if one day each week
3. Operating a concession stand on a seasonal basis
4. Selling greeting cards on a regular basis that do not contribute importantly to achieving the entity’s exempt purpose
5. Rental of member lists to commercial firms
6. Rental of real estate that is debt-financed (see ¶ below)
7. Raffles, bingo and other games of chance
8. Conducting travel tours similar to commercial ones

Activities Which ARE NOT Unrelated

1. Rental of member lists to other charitable and religious entities
2. Selling Christian books on a regular basis, solely for the convenience of members where the product contributes importantly to the entity’s exempt purpose
3. Tickets sold to an annual soup supper, dance or musical endeavor
4. A thrift shop that consists of selling merchandise, substantially all of which has been received by the entity as gifts or contributions
5. Gain or loss on the sale of real property

6. Rental of real estate that is not debt-financed (see ¶ below)
7. A fellowship event at which attendance prizes are drawn and awarded
8. Travel tours substantially related to the entity's exempt purpose

Exceptions: Section 513(a) of the tax code states that the term “unrelated trade or business” does NOT include:

- Activities in which substantially all the work is performed by unpaid volunteers’
- Activities carried on by a church or other charitable entity primarily for the convenience of its members, students, or employees; or
- Selling merchandise, substantially all of which has been received by the exempt entity as gifts or contributions.

Several income-producing activities of churches are exempt from the UBIT for more than one reason. For example, church bake sales ordinarily are exempt because all of the work is performed by unpaid volunteers, the bakery goods are donated to the church, and the activity is not regularly carried on. Another example, income from a thrift shop operated by a church or other exempt entity ordinarily is exempt from the tax on unrelated business income because all or most of the work is performed by unpaid volunteers and because most of the merchandise sold by the thrift shop is donated. Car washes, fund-raising dinners, bazaars, and many similar income-producing activities of churches are exempt from the tax on unrelated business income because of one or more of the exceptions shown above or because the activity is not regularly carried on.

Real estate rentals: If a church or entity rents or leases property that it owns to others, the rental income is not subject to UBIT pursuant to IRC Section 512(b). However, it may be subject to UBIT if the property is debt-financed with external debt, i.e. the property is mortgaged by outside parties. Inter-fund borrowing does not qualify as debt financed. Limited exceptions exist to exempt property even if it is debt-financed. “Debt-financed” property means any income-producing property on which the church owes money, such as a mortgage. One such exception states that if substantially all (85% or more) of a property is used for the church’s exempt purpose, the property is not treated as “debt-financed” property. Additionally, if a church’s use of the property for its exempt purpose will begin within 15 years from the date the property is acquired, income from the property is not treated as income from “debt-financed” property. The congregation or exempt entity is advised to contact a qualified tax advisor if it owns mortgaged real property that it rents out or leases to others.

Reporting: Unrelated business income is subject to regular federal corporate income tax rates with a \$1,000 deduction from net income before applying the rates. IRS Form 990-T or Form 990-EZ are used to report income, deductions and tax due. In addition, many states have similar reporting and taxpaying requirements.

Public Disclosure of Information: The 2006 Pension Protection Act amends the tax code to make the annual unrelated business income tax return (Form 990-T) subject to public inspection. The new law specifies that certain information may be withheld by the exempt entity from public disclosure and inspection if public availability would “adversely affect” the entity. This means that the church or exempt entity must make the form available for public inspection during regular business hours to any person who asks to see it, without charge other than a reasonable fee for any reproduction or mailing costs. The request to inspect may be made in person or in writing. If made in person, the copy must be provided immediately and, if made in writing, it must be provided within 30 days.

RECORDS RETENTION

Congregations and entities should develop **written** record retention guidelines for all important documents. Requirements on different types of records vary so it is difficult to establish a comprehensive guide on how long specific records should be retained. A publication titled “Guide to Record Retention Requirements” is available for a nominal cost from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

According to IRS Publication 1828 Tax Guide for Churches and Religious Entities, the law does not specify a length of time that records must be retained; however, the following guidelines should be applied in event that the records may be material to the administration of any federal tax law.

Records of revenue and expenses, including payroll records.	Retain for at least four (4) years after filing the return(s) to which they relate.
Records relating to acquisition and disposition of property (real and personal, including investments).	Retain for at least four (4) years after the filing of the return for the year in which disposition occurs.

IRS Publication 15 (*Circular E*) *Employer’s Tax Guide* provides a list of important records to keep **four** years:

- Your employer identification number (EIN).
- Amounts and dates of all wage, annuity, and pension payments.
- The fair market value of in-kind wages paid.
- Names, addresses, social security numbers and occupations of employees and recipients.
- Any employee copies of Forms W-2 and W-2c that were returned to you as undeliverable.
- Dates of employment for each employee.
- Periods for which employees and recipients were paid while absent due to sickness or injury, and the amount and weekly rate of payments you or third-party payers made to them.
- Copies of employees’ and recipients’ income tax withholding allowance certificates (Forms W-4).
- Dates and amounts of tax deposits made and acknowledgment numbers for deposits made by EFTPS.
- Copies of returns filed and confirmation numbers.
- Records of fringe benefits provided and expense reimbursements provided to your employees, including substantiation.

As a guideline, other records which the congregation or entity may consider keeping include:

- Offering envelopes – one year
- Financial secretary offering summaries – indefinitely
- Purchase, construction or major improvements of buildings or residences – indefinitely
- Movable asset purchases – indefinitely, or until asset is disposed of
- Financial asset records such as for stocks, bonds, mutual funds including dividend reinvestment plans – until sold
- Member loan documents – four years after payoff
- Evidence of indebtedness, i.e. mortgage notes – until paid in full and evidence of satisfaction received

- Expense reports and paid invoices – four years
- Canceled checks – four years
- General ledgers, cash receipts journals, cash disbursement journals – indefinitely
- Financial statements – one copy indefinitely
- Minutes of official board, council and voter meetings – indefinitely
- Ministrations, i.e. baptisms, marriages, burials, confirmations – indefinitely
- Articles of Incorporation and Bylaws – indefinitely
- Tax Exemption Certificates and/or IRS Determination Letters – indefinitely
- State Government Reports (Domestication purposes) and Certificate of Authority – indefinitely.

After the recommended time has lapsed for various records to be disposed of, we highly recommend that all documents that obtain private/confidential information such as social security numbers, etc. be shredded.

SOURCES OF TAX INFORMATION

Church & Clergy Tax Guide by Richard R. Hammar, J.D., LL.M., CPA

Order online: www.churchlawandtax.com/catalog

Order by phone: (800) 222-1840

Worth's Income Tax Guide for Ministers and Religious Workers by B. J. Worth, EA, ATA, CTP

Order: Worth Financial Service
PO Box 242
Winona Lake, IN 46590

(574) 269-2121

Order online: worthfinancial.com

IRS Publications: Order from: IRS (800) 829-1040 or download from www.irs.gov

- 15 (Circular E) Employer's Tax Guide
- 15A Employer's Supplemental Tax Guide
- 15B Employer's Tax Guide to Fringe Benefits
- 17 Your Federal Income Tax
- 54 Tax Guide for US Citizens and Resident Aliens Abroad
- 463 Travel, Entertainment, Gift and Car Expenses
- 505 Tax Withholding and Estimated Tax
- 514 Foreign Tax Credit for Individuals
- 517 Social security and Other Information for Members of the Clergy and Religious Workers
- 521 Moving Expenses
- 524 Credit for the Elderly or the Disabled
- 525 Taxable and Nontaxable Income
- 526 Charitable Contributions
- 529 Miscellaneous Deductions
- 535 Business Expenses
- 554 Tax Guide for Seniors
- 557 Tax Exempt Status for Your Entity
- 560 Retirement Plans for Small Business (Self-Employed)
- 561 Determining the Value of Donated Property
- 570 Tax Guide for Individuals in U.S. Possessions
- 571 Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations
- 575 Pension and Annuity Income
- 587 Business Use of Your Home
- 590 Individual Retirement Accounts
- 596 Earned Income Credit
- 598 Tax on Unrelated Business Income
- 901 U.S. Tax Treaties
- 915 Social Security and Equivalent Railroad Retirement Benefits
- 929 Tax Rules for Children and Dependents
- 969 Health Savings Accounts and Other Tax-Favored Health Plans
- 970 Tax Benefits for Education
- 972 Child Tax Credit
- 1220 Specifications for filing Form 1097, 1098, 1099, 3921, 3922, 5498, and W-2G Electronically
- 1546 The Taxpayer Advocate Service of the IRS
- 1771 Charitable Contributions – Substantiation and Disclosure Requirements
- 1828 Tax Guide for Churches and Religious Organizations

