

Year-End Reporting: What Churches Need to Know

By Michella Duque and Rollie Dimos

The calendar year is winding down and several year-end deadlines are quickly approaching. Churches have a few important reporting requirements to help them stay compliant with federal and state laws. From compensation reporting, to tax form submissions, to donor notifications, there are several tasks and responsibilities that church leaders, treasurers and bookkeepers need to be aware of.

Charitable Contribution Receipts.

In order for taxpayers to deduct their charitable contributions as itemized expenses on Schedule A of their income tax return, the taxpayer must be able to substantiate all donations. For an individual charitable contribution of \$250 or more, the donor must obtain a receipt from the charity. For this reason, many churches regularly prepare annual summaries of donor contributions. This annual summary should list the church's name, the date and amount of each contribution (including any donation over \$250) and properly state whether any goods or services were provided in exchange for the donations.

Special reporting rules apply for non-cash donations, especially donations valued greater than \$5,000, or donations of art, cars, boats, or planes. Quid pro quo transactions, where a donor provides a contribution and receives an item or service in return, also have special reporting requirements. For further information on how to properly handle these types of donations, see Richard Hammar's annual *Church and Clergy Tax Guide*.

Remember, in order to record a contribution in the current year, the contribution must be delivered by December 31. There is an exception for donations that are mailed—if the donation is postmarked by December 31, it will qualify as a 2012 donation.

The church should provide the contribution receipt or annual summary as soon as possible after year-end, and donors should not submit their tax return until they receive the church's contribution summary.

IRS Form W-2, Wage and Tax Statement.

Payroll tax reporting can be confusing. Employers are required to withhold federal income taxes and Social Security taxes from their employee's wages, deposit those taxes with the IRS, file quarterly tax returns (Form 941), and issue W-2 forms to employees. Most churches are subject to these rules, but special rules and exceptions exist for ministerial staff, which contributes to the confusion. Here are some key points to remember when completing W-2 forms.

- Properly include all wages and taxable income in box 1. Here are some common items that should generally be included as income:
 - › Cash bonuses for birthdays and holidays.
 - › Cash equivalents, like gift cards for restaurants and retail stores.
 - › Monthly allowances that are non-accountable; such as allowances for cell phone, automobile expenses, or purchasing health insurance.
 - › Love offerings and pastor appreciation gifts given through the church.
 - › Payments to pastors to help offset social security taxes.
 - › Mileage reimbursements in excess of IRS approved mileage rates.
 - › Church-paid golf-club memberships.
 - › Church-paid utilities or lawncare at staff members' personal homes.
 - › Personal use of church-owned vehicles.
 - › Non-accountable reimbursements of business expenses.

Continued on next page...

Year-End Reporting: What Churches Need to Know (cont.)

- Make sure ministerial staff members are properly classified as ministers for federal tax purposes. (In order to determine this, review the five factors prescribed by the IRS, and explained further in Richard Hammar's annual *Church and Clergy Tax Guide*.)
- Ministers (as defined by the IRS) are exempt from federal tax withholding, but they may elect voluntary withholding of both income taxes and self-employment taxes, like an employee. Box 2 of the W-2 should be blank, unless the minister has elected voluntary withholding.
- Ministers are also treated as self-employed for social security purposes. Therefore, FICA and Medicare taxes are not withheld. Boxes 3 through 6 of the W-2 should be blank. A minister who is subject to self-employment tax and has not opted out of Social Security, should report their own income from self-employment (taxable income plus housing) on Schedule SE of their personal federal income tax return.
- Ministers who receive a housing allowance or parsonage allowance can have the housing allowance amount reported in box 14 of the W-2. The housing allowance amount should not exceed the amount authorized by the board.

Failure to properly classify taxable income could have severe consequences for the employees and organization. For example, besides the unpaid taxes, the employee faces a 25% penalty and a 200% excise tax. Organizational leaders also face a 20% penalty up to \$20,000, and the organization could lose their non-profit status which would impact donor contributions and confidence.

The W-2 form must be provided to the employee by January 31, and generally speaking, employees

should not receive a W-2 and a 1099 from the same employer.

IRS Form 1099, Miscellaneous Income.

Often church leaders and bookkeepers seem confused as to how to handle 1099 issues and exactly who should receive one. While this may seem confusing, here are some important facts to help you complete these forms accurately and timely.

- Any self-employed person, independent contractor or service provider who is not incorporated, that receives \$600 or more from the church in any calendar year should receive a 1099-Misc. Examples would include lawn maintenance providers, guest speakers, plumbers, carpenters, and evangelists.
- In order to correctly prepare a 1099-Misc, you will need to have the independent contractor fill out an IRS Form W-9, Request for Taxpayer Identification Number and Certification. The W-9 is a form that lists the name, address and social security number of the independent contractor and can be downloaded from the IRS website at [irs.gov](https://www.irs.gov).
- Unlike the W-9 form, the 1099-Misc forms can be ordered from the IRS website at [irs.gov](https://www.irs.gov) or purchased at your local office supply store. They cannot be downloaded from any website.
- 1099-Misc forms are due to the payee by January 31 and to the IRS by February 28. The IRS can impose penalties if you fail to file a correct form by the due date. So you want to make sure you file correctly and timely. Avoid common mistakes like not including the church or recipient's complete information, or mailing the forms after the due date.

Continued on next page...

Year-End Reporting: What Churches Need to Know (cont.)

IRS Form W-4, Employee's Withholding Allowance Certificate.

December is a good time to provide federal and state W-4 forms to all employees and give them an opportunity to update them if necessary. The form W-4 is used by employees to claim withholding allowances, which determines the correct amount of income tax that should be withheld. Employees who change their marriage status or have children during the year may need to update their withholding allowances.

Ministers, who are treated as employees for federal tax reporting, are exempt from federal tax withholding. However, if they would like to have federal taxes voluntarily withheld by the church, they should fill out a W-4 form.

Housing Allowance Designations.

Ministers (as defined by the IRS) are eligible for several benefits, including a housing allowance. However, this benefit is only for those ministers that meet the criteria set by the IRS.

A minister's housing allowance should be adopted and documented in the minutes of a church board meeting held prior to the beginning of the calendar year for which the allowance is to be paid. A minister's housing allowance must be designated by the board in advance of the allowance being paid – retroactive designations are not permitted. So, if a board fails to adopt a housing allowance for a minister until February 1 of the year, the designation can only apply to the minister's pay after that date and not before. The housing allowance may be adopted as a yearly, monthly or weekly fixed dollar amount or could be adopted as a percentage of the minister's total pay.

There is no limit on the amount that can be designated as a housing allowance, but the amount the minister can actually exclude is limited to the lowest

of these three items: the approved designation, the minister's actual housing expenses, or the fair rental value of the home.

A copy of the board-approved housing allowance should be maintained in the employee's payroll file. For tax reporting purposes, each minister should be able to provide documentation that their housing allowance was properly approved by the church board. Without it, the IRS could disallow the housing allowance—which could leave the minister liable for unpaid taxes and penalties.

Other Governance Issues.

The end of year is also a good time for the board to perform some housekeeping and review important items that may get overlooked during the year. For example:

- Review staff compensation. The IRS requires compensation provided to ministers to be reasonable. As you create your budget and review compensation packages, one way to determine reasonableness is to consult independent compensation surveys for comparison.
 - › Richard Hammar's *2012-2013 Compensation Handbook for Church Staff* can be purchased from the [AG webstore](#). This survey covers a wide range of churches and denominations.
 - › The Southern Baptist Convention publishes a compensation survey related to their Baptist churches on the [Lifeway website](#).

Each of these surveys can provide compensation ranges based on several factors and demographics. Further, the surveys include all components of ministerial compensation such as salary, housing allowance, social security

Continued on next page...

Year-End Reporting: What Churches Need to Know (cont.)

add-on, retirement benefits paid by the church and health insurance paid by the church.

Richard Hammar, Legal Counsel for the Assemblies of God, suggests that if you find your compensation package is significantly more than the highest 25% for comparable positions, you should obtain an opinion from an experienced tax attorney confirming that the amount is not “unreasonable.” This may help avoid exposing the minister and the board to penalties called intermediate sanctions. See his [complete article](#) here at the ChurchLawandTax.com website.

- Review and update authorized signers on bank accounts. As new board members are elected, or staff hired, there may be a need to change who is authorized to sign checks and other documents on behalf of the church.
- Change access codes. Similarly, it is a good idea to regularly review who has access to the safe combination, or building access codes. This information should be restricted to only those who absolutely need it. It may be necessary to change these codes on an annual basis.
- Perform a key inventory. A master log of who has keys to the buildings and vehicles should be maintained, and an annual check performed to see if those people still have the keys in their possession. If many keys are missing or unaccounted for, it may be necessary to re-key the locks.

- Review insurance needs. The board should review their current insurance coverage to determine if it is still adequate. New construction, extensive remodeling, and major furniture or equipment purchases during the year could cause your coverage to be undervalued. Connect with your insurance agent annually to see if your coverage is adequate and up to date. For more information on insurance, AG Financial Services has a wealth of information on their [insurance website](#).

* * *

About the Authors:

Rollie Dimos is the Internal Audit Director at the AG National Leadership and Resource Center. As an auditor in the government and nonprofit sectors, Rollie has been helping leaders assess the strength of their organizational controls for over 20 years.

Michella Duque is a staff auditor at the AG National Leadership and Resource Center. Michella has assisted churches and ministers with their bookkeeping, payroll and tax reporting for over 20 years. She and her husband are also US missionary church planters.

* * *

If you have a question about this article, you can contact the authors at 417-862-2781, or by email at rdimos@ag.org, or mduque@ag.org.