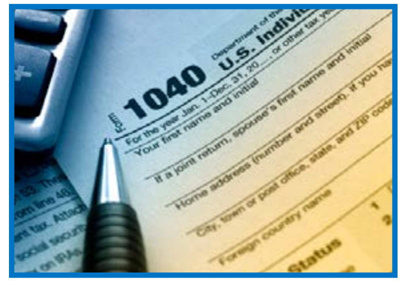
Properly Reporting Fringe Benefits

By Rollie Dimos



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As the calendar year winds down, several year-end deadlines are quickly approaching for churches and nonprofits. Some of these requirements include tax form submissions, annual donor giving statements and employee compensation reporting. This is also the time when certain fringe benefits may need to be included as income.

IRS FORM W-2

Before we discuss the proper handling of various fringe benefits, let's review some facts about reporting income on the IRS Form W-2, Wage and Tax Statement. As a reminder, employers are required to withhold federal income taxes and Social Security taxes from their employees wages, deposit these taxes with the IRS, file quarterly tax returns (Form 941), and issue W-2 forms to employees.

However, special rules and exceptions exist for ministerial staff, so here are some key points to remember when completing W-2 forms.

- Properly include all wages and taxable income in box 1. This includes taxable fringe benefits.

- 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 may have the housing allowance amount reported in box 14 of the W-2, although this is not required. The housing allowance amount should not exceed the amount authorized by the board at the beginning of the year.

- The W-2 form must be provided to the employee by January 31.

FRINGE BENEFITS

Here are some common fringe benefits that should be included in taxable income.

Personal Use of Company Automobile

Personal use of a company-owned automobile is taxable income and includes commuting to and from work. The IRS provides four different methods to value this benefit: a general valuation rule and three special valuation rules (cents-per-mile, commuting or lease value). You can use the general valuation rule or one of the special rules if you meet the required criteria.

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Group-Term Life Insurance
Employer-paid premiums for group-term life insurance whose benefit is greater than $50,000 is taxable income for the amount that exceeds $50,000. Employer-paid life insurance policies are excludable from income as long as the amount of coverage does not exceed $50,000.

Special Occasion Cash and Gift Cards
Cash gifts to employees, whether for Christmas, birthdays or pastor appreciation, are taxable income and should be included on the W-2.

Gift cards are considered cash equivalents and should always be included in income. There is no minimum value or *de minimis* rule for cash or gift cards.

Retirement Gifts
Retirement gifts are taxable compensation for services rendered and are included in taxable income.

Benevolence Payments to Employees
Many churches have a benevolence program to help members of the congregation or community. However, any benevolence payments made to employees will be considered taxable income. This also includes payments made on behalf of the employee, like making a payment directly to a utility company or landlord.

Cell Phones for Spouses and Family
Church provided cell phones for employees will not result in taxable income if the cell phone has a *substantial business need*. According to the IRS, a substantial business need includes the following:

- An employer needs to contact the employee at all times for work-related emergencies.
- An employee must be available to speak with clients when away from the office.

However, if the church provides a cell phone for a non-employee spouse or family member, it will result in taxable income if it doesn't meet the substantial business need criteria. The church can add the value to the employee's W-2 or send an IRS Form 1099-misc to the family member.

Tours to Israel or other Holy Lands
Many churches may send their pastor or staff member on a trip to Israel. While beneficial for ministry, the IRS generally does not consider the cost of these trips as valid business expenses. Whether the church pays for the pastor's trip, or takes an offering to help subsidize the trip the value of the trip will result in taxable income for the church employee.

Spouse and Dependent Travel
When non-employee spouses travel with church employees, the amounts paid or incurred for the spouse are considered personal expenses. If the church pays for those expenses, the amounts are taxable to the employee unless the spouse has a bona fide business purpose.

If the spouse has a bona fide business purpose, the employee must substantiate those expenses under an accountable arrangement.

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Sabbatical Expense Allowance

Some churches have authorized a sabbatical policy for its pastor and will provide an expense allowance during the sabbatical. The sabbatical expense allowance will be taxable to the pastor unless there is a valid business justification associated with the expense and substantiated under an accountable arrangement.

Unaccountable Allowances or Expense Accounts

Monthly allowances or stipends could result in taxable income for the employee. These would include a stipend or allowance for ministry resources, cell phone expenses, automobile expenses, or health expenses. If these expenses are not properly accounted for under an accountable arrangement, it will result in taxable income.

NON-TAXABLE FRINGE BENEFITS

Here are some types of fringe benefits that are excluded from taxable income, if handled appropriately:

De Minimis Gifts of Tangible Personal Property

The IRS allows occasional gifts to employees of *de minimis* tangible personal property to be excluded from income. This would include a gift of a turkey or fruitcake during the holidays. The IRS doesn't put a value on what is considered *de minimis,* but it would seem reasonable, that while a turkey is excludable from income, an expensive watch would not be excludable.

Achievement Awards

Some employers give achievement awards to employees, such as length of service or safety awards. Awards that consist of tangible personal property (other than cash or gift certificates) can be excluded from income. The amount excluded can be up to $1,600 per recipient, if the organization has a "qualified plan."

A qualified plan includes giving the award as part of an established written plan or program that does not favor highly compensated employees [which includes those earning $115,000 or more in 2012]. Further, the award can't be offered more often than every 5 years.

Employer-Paid Health Insurance

Employer-paid premiums for employee health insurance policies are excludable from income.

Employer-Paid Moving Expenses

Employer-paid moving expenses can be excluded from income in certain circumstances. In order to be excluded, the employer-paid moving expenses must be paid under an accountable plan and meet the following three requirements:

- Expenses must have a business connection.
- Expenses must be adequately accounted for within a reasonable time.
- Excess reimbursements or allowances must be returned within a reasonable time.

Additionally, the employer must pay the moving company directly. If the employer reimburses the employee for moving expenses, these reimbursements must be reported on the employee's W-2 as taxable income.

Health Savings Account Contributions

Health Savings Account contributions made by

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the employer on behalf of employees are excludable for income purposes. Maximum dollar limits apply, which are $3,250 for an individual and $6,450 for family coverage (2013 tax year). These limits can be increased by $1,000 if the qualified individual is 55 or older during the year.

CONSEQUENCES

It is very important to properly handle these fringe benefits and include them as income, when necessary. If these are not accumulated properly, the employee is subject to back taxes plus penalties and interest on the unreported income.

Further, the church and its leaders are exposed to significant fines and penalties, called intermediate sanctions. For example:

- If the employee is an officer or director, the employee is subject to additional excise taxes up to 225% of the amount because this would be characterized as an automatic excess benefit.
- Any board member who approved the excess benefit is subject to an excise tax equal to 10% of the excess benefit amount—up to a maximum of $20,000 collectively.

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About the Author:

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