

# Chapter 7

## Reporting to Tax Authorities

Life would be much simpler if we did not have to make reports! But, as with all Christian service, accountability is part of your ministry. You already know that you are accountable to the governance authority and the congregation. You also are accountable to the civil government. In Chapter 5 we discussed the various reports you make to the governance authority and to the congregation. In this chapter, we will discuss how you report to the IRS and Social Security Administration.

In addition to these federal agencies, most states have quarterly and annual payroll filing requirements. Contact the state department of revenue and the district office for guidance in this area.

Be sure to keep payroll records until the statute of limitations runs out on them. See **Appendix E** for the period of time you must keep payroll records.

## Payroll Records and Tax Reports

Certain areas of church tax handling and reporting are often misunderstood:

- Payroll records
- Tax deposit requirements
- Filing requirements to report wages

Much of the confusion is because the pastor is in an unusual category. Clergy have a different reporting system than others who file income tax returns.

As you discovered in Chapter 6, the pastor has a dual status under the tax laws. Social Security covers services that he performs under the Self-Employment Contributions Act (SECA). Accordingly, he must pay self-employment taxes on his earnings as a minister. The church's non-clergy employees (i.e. secretary or custodian) must pay their portion of the Federal Insurance Contributions Act (FICA) tax and the church must pay the employer's portion of the tax.

For **income tax purposes**, the IRS considers the pastor to be an employee. Wages paid to the pastor are reported on Form W-2. When you complete a W-2 for the pastor, leave the section for FICA wages blank.

## Payroll Tax Deposits

You should get IRS Publication 1 (Circular E) for the church. This is the IRS handbook for employers. The IRS should send it to the church automatically each year after you receive the church's federal identification number. Two sections will help you most: tax withholding and tax payments.

If the church has non-clergy employees, you need to have them complete Form W-4, the **Employee's Withholding Allowance Certificate**. On it, they indicate the number of exemptions they will claim. Based on the number of exemptions they claim on the W-4, you determine how much income tax to withhold from their paycheck. You will find this in the tax withholding tables in **Circular E**. You also must withhold FICA taxes. You can find instructions for calculating them in **Circular E**.

You must send payroll taxes to the government. You make these payments quarterly, or more frequently if the amount is large. **Circular E** tells you when these payments are due. In general:

- Quarterly payments are filed on Form 941 (discussed below). There are places on Form 941 for you to record the amounts you have already paid.
- More frequent payments can be made at a local bank. Send these with Form 8109, **Payroll Tax Deposit Coupon** that the IRS provides. A completed example of this form and additional instructions is available.

The IRS does not require you to withhold federal taxes from the pastor's wages. Instead, he makes quarterly estimated payments for his income and self-employment taxes himself. However, he may ask the church to withhold taxes from his paycheck, just as you do for non-clergy employees. If he chooses this latter option, have him complete a W-4 and report the amount you withhold as *federal income tax withheld*. Most state laws follow the federal law, which is they do not require you or the pastor to withhold state income taxes. A few states *do* require such withholding, even where the IRS doesn't require it for federal purposes. You should check the laws in your state.

## Quarterly Reports

Form 941 is a quarterly report to the IRS of the wages that were paid and taxes withheld. It must be filed on or before the last day of the month *following* the close of a quarter. For example, you must file the report for January through March by April 30. In completing Form 941, everything you report quarterly you will ultimately report on Form W-2, which is filed annually. Amounts you report on Form 941 **must** agree with your payroll earnings records. A completed example of Form 941 and more instructions is available.

## Annual Reports

You must file W-2 forms annually to report earnings of the pastor and other employees to:

- Social Security Administration
- State tax authorities
- Local tax authorities

You must provide W-2 forms for the preceding calendar year to all the church's employees by January 31.

Use a **Transmittal Form W-3** to send your W-2s to the Social Security Administration. You must send these by February 28. Complete the forms and send them according to the IRS

instructions. Samples of a completed W-2 and W-3 are available. It also has instructions for some of the boxes.

The IRS also requires you to report some other payments. You must report payments to *non-employees* for services they provided if your total payments to them are \$600 or more for the year. This requirement includes payments for services, but not for “goods” (actual items) paid to individuals or partnerships. Payments to companies that are incorporated are also excluded except for health providers and lawyers. Report these on Form 1099. Complete the form and give it to the non-employee by January 31 (for the previous calendar year). You must file it with the IRS by February 28. Use transmittal form 1096 to send 1099s to the IRS. Completed examples of forms 1096 and 1099 are available.

Some churches treat individuals as independent contractors. They may do this so the church is not responsible for payroll taxes. However, be **warned** if you do this. Apply the *common law employee test* described in the income tax regulations. From it, you can determine how to classify a person working in the church for federal tax purposes. (Note that some states have different tests for determining whether a worker is an employee.) According to the federal test,

*generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done, but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services.*

IRS Form SS-8 contains a checklist of twenty criteria. They can help you determine whether to classify a person as an employee or as self-employed. A checklist is available.

The most common example of this question in your church is the custodian. Often, churches consider the custodian as an employee. This is because the church usually directs what, where, how and when the janitor works. Suppose, however, your church *contracts* a person to clean the church. You have a written, signed contract with the person that states the person is an independent contractor and responsible for applicable payroll taxes. The contract also should cover as many of the twenty criteria as are relevant, indicating that the person meets the criteria for an independent contractor. The contracted janitor decides when and how to clean the church and the janitor uses his or her own equipment. In this situation, you may consider the janitor as an independent contractor.

There is one other consideration about the 1099 form. This involves *itinerant ministers*, such as traveling evangelists. They depend on the honoraria that they receive from many churches for their support. Therefore, they do not have just one church that serves as their employer. This prevents them from taking advantage of the specific tax laws that benefit employees. However,

the church may designate a portion of its gift to that minister as housing allowance. You may do so only if your church writes an agreement with the evangelist to designate a portion of his honorarium as housing allowance. Do not include the amount of the designated housing allowance in the amount that you report on the minister's 1099 form.

## Conclusion

Working with payroll and payroll taxes can be confusing. Don't get discouraged! Start by keeping good payroll records. Then just follow the instructions on the forms.