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# ACCOUNTING POLICIES

## Payroll Processing

**Policy:** A payroll system will readily provide the following information:

- 1) Current period earnings, by employee
- 2) Quarterly and Annual earnings, by employee
- 3) Current, quarterly, and annual totals for taxes withheld from employees
- 4) Distribution of these expenditures to the appropriate accounts

**Rationale:** The Internal Revenue Service requires the maintenance of records and the filing of reports that reflect the remuneration paid to each employee performing services for the parish.

## Procedures

### Compensation

- a) **Employee:** The IRS defines an employee as “anyone who performs services subject to the will and control of the employer both as to what will be done and how it shall be done” and receives some type of remuneration for the services. Most regular staff members will be considered employees (office staff, custodians, housekeepers, etc.)
- b) **Independent Contractor:** All individuals or unincorporated organizations receiving payment for services for the parish and who are not considered employees are generally independent contractors. See p. for the factors to be considered in determination of independent contractor status.

### Payroll Taxes and Withholdings

- a) **Employee:** Wages are subject to Federal and State Income Tax withholding and Social Security and Medicare contributions. These taxes and contributions are reported:
  - 1) Quarterly on Federal Form 941 and Illinois Form 941.
  - 2) Annually on Form W-2.
- b) **Independent Contractors:** Payments will be made by check without any deductions because they are not subject to withholdings. Payments are reported annually on a Form 1099 if total payments are \$600.00 or more to an individual or organization.
- c) **Diocesan Priests:** Payments will be made by check according to the current Clergy Remuneration Schedule. Priests are self-employed for Social Security tax purposes. Therefore, priests cannot have FICA taxes withheld.

Withholding for income taxes is at the option of the individual priest. (Consult INCOME TAX FOR PRIESTS ONLY By Wayne Lenell for details on the reporting of taxes withheld.) Payments are reported annually on a Form W-2 as a non-statutory employee.

- d) **Religious Men and Women:** Stipends for members of religious communities (Priests, Sisters and Brothers) will be paid by check made out to the order or jointly to the order and individual. No payroll deductions or withholdings are made. A Form W-2 or 1099 is not issued.

### Accounting Withholding Procedures

- a) Taxes withheld are a liability to the parish. Amounts may also be withheld for the 403b Retirement Plan and insurance; these withholdings are a liability to the parish. The gross payroll is charged to the proper payroll expense account; withheld taxes, the 403b Retirement Plan, and insurance to the liability accounts; and net pay to the cash account.

ACCT. #		DEBIT	CREDIT
_____	SALARIES	1,000	
_____	FICA TAXES PAYABLE		75
_____	FEDERAL INCOME TAXES PAYABLE		150
_____	STATE INCOME TAX PAYABLE		50
_____	403b RETIREMENT PLAN PAYABLE		20
_____	MEDICAL INSURANCE PAYABLE		50
_____	CASH		655

TO RECORD LAY EMPLOYEE SALARIES.

- b) The employer's share of FICA and 403b Retirement Plan is charged to the appropriate expense accounts.

ACCT. #		DEBIT	CREDIT
_____	FICA TAX EXPENSE	75	
_____	403b RETIREMENT PLAN EXPENSE	10	
_____	FICA TAXES PAYABLE		75
_____	403b RETIREMENT PLAN PAYABLE		10

TO RECORD EMPLOYER'S SHARE OF FICA TAXES AND THE 403b RETIREMENT PLAN.

## Accounting for Payment of Payroll Taxes, 403b Retirement, Insurance

Taxes due to the IRS, payments to the 403b Retirement Plan, and insurance payments are remitted as required:

ACCT. #		DEBIT	CREDIT
<u>          </u>	FICA TAXES PAYABLE	150	
<u>          </u>	FEDERAL INCOME TAXES PAYABLE	150	
<u>          </u>	CASH		300
	TO RECORD PAYMENT OF FICA AND FEDERAL INCOME TAXES.		
<u>          </u>	ILLINOIS STATE TAXES PAYABLE	25	
<u>          </u>	CASH		25
	TO RECORD PAYMENT OF ILLINOIS INCOME TAXES		
<u>          </u>	403b RETIREMENT PLAN PAYABLE	30	
<u>          </u>	CASH		30
	TO RECORD PAYMENT TO 403b RETIREMENT A		
<u>          </u>	MEDICAL INSURANCE PAYABLE (amt withheld)		50
<u>          </u>	MEDICAL INSURANCE EXPENSE (amt parish pays)		50
<u>          </u>	CASH		100
	TO RECORD PAYMENT OF MEDICAL INSURANCE.		

## Payroll Reporting

The following is a listing and description of the most frequently used payroll tax forms:

### FORM W-4: EMPLOYEE'S WITHHOLDING ALLOWANCE CERTIFICATE (IL W-4 FOR ILLINOIS WITHHOLDING)

This form indicates the number of withholding exemptions to be used in calculating the amount of income tax to be withheld from an employee's paycheck. The form is completed when an employee is initially hired and when an employee changes the number of exemptions. The employer keeps these on file with the other payroll information.

### FORM 941: EMPLOYER'S QUARTERLY FEDERAL TAX RETURN (IL-941 FOR ILLINOIS)

This form is a summary of wages paid and taxes due from employee federal income tax and FICA withholding and is to be filed by the month end following each calendar quarter. Due dates are April 30, July 31, October 31, and January 31. Substantial penalties will be assessed by the government for late filings or for non-compliance.

### FORM W-2: WAGE AND TAX STATEMENT

This form summarizes by calendar year the total wages paid along with federal income tax, FICA tax and 403b Retirement Plan withheld for each employee. It must be issued to the employee by January 31 of the following calendar year. Additionally one copy is to be sent to the Social Security Administration and one to the state taxing authorities. Substantial penalties apply when they are filed late or improperly.

### FORM 1099: STATEMENT OF NON-EMPLOYEE COMPENSATION

This form is to be issued to all individuals and unincorporated organizations that performed services for the parish and who received \$600 or more during the calendar year. Additionally, copies of 1099's must be filed with the IRS by February 28 of the following calendar year.

### **Additional Suggested Payroll Related Policies**

1. Employees and independent contractors will always be paid by check, not cash. Employees may also be paid by electronic funds transfer (EFT) if the system provides it.
2. Employees will be paid based upon time sheets which specify when work was performed. Time sheets will be signed by authorized parish staff members before being processed for payment.
3. Regarding gifts and bonuses to employees, volunteers, or independent contractors, the IRS draws a strict line over taxability. Generally speaking, gifts like a turkey or ham are not taxable. Any other gifts, whether cash, gift certificates, etc. are all considered taxable income subject to withholding by the parish.
4. Taxes withheld from employees pay checks are to be deposited with the respective federal and state agencies. Failure to make timely deposits will be subject the parish to substantial penalties.
5. A personnel file is to be kept for each employee and will contain such items as original application for work, signed W-4 (Employees Withholding Allowance Certificate) and any other forms required by the government (e.g. work permits for non-US citizens).
6. Refer to page for retention of payroll records.
7. Outside processing of payroll may be an alternative for some parishes and institutions. Most payroll processing companies provide EFT for employees, make all tax payments, and prepare and file all reports.

## Cash Receipts Processing

**POLICY:** All receipts of cash will be properly recorded in the parish internal accounting system. An accounting entry includes a debit to the appropriate checking or savings account and a corresponding credit to a revenue or receivable account.

**RATIONALE:** Accounting records provide accurate control of parish finances and information for timely reports to the pastor, finance council, and parishioners.

**PROCEDURE:** The following are examples of parish inflows of cash and the appropriate ledger entries:

ACCT. #		DEBIT	CREDIT
_____	CASH (CHECKING)	5,000	
_____	SUNDAY COLLECTION		4,200
_____	FUEL COLLECTION		500
_____	MISSION SUNDAY COLL PAYABLE		300

TO RECORD \$5,000 DEPOSIT OF COLLECTIONS: \$4,200 SUNDAY COLLECTION, \$500 FUEL COLLECTION, AND \$300 MISSION SUNDAY COLLECTION.

_____	CASH (CHECKING)	500	
_____	RENTAL INCOME		200
_____	MEMORIALS		300

TO RECORD \$500 DEPOSIT: \$200 FOR RENTAL OF PARISH HALL AND \$300 FOR MEMORIALS.

_____	CASH (CHECKING)	300	
_____	INTEREST - DIOCESAN AID, NFP		300

TO RECORD INTEREST CHECK RECEIVED FROM DIOCESAN AID.

_____	CASH (SAVINGS)	100	
_____	INTEREST - SAVINGS		100

TO RECORD \$100 INTEREST ADDED TO YOUR SAVINGS ACCOUNT.

_____	CASH (CHECKING)	5,000	
_____	LOAN PAYABLE (DIOC. AID)		5,000

TO RECORD A \$5,000 LOAN RECEIVED FROM DIOCESAN AID, NFP.

## Disbursement Processing

**POLICY:** All payments of cash will be properly recorded in the parish internal accounting system. An accounting entry includes a debit to the appropriate expense or liability account and a corresponding credit to a parish checking account.

**RATIONALE:** Accounting records provide accurate monitoring of expenses with budgeted amounts and provide timely reports for the pastor, finance council, and parishioners.

**PROCEDURE:** The following are examples of parish outflows of cash and the appropriate ledger entries:

ACCT. #		DEBIT	CREDIT
	OFFICE SUPPLIES	50	
	CASH (CHECKING)		50
	PAID \$50 FOR OFFICE SUPPLIES.		
	TELEPHONE - CHURCH	75	
	TELEPHONE - SCHOOL	50	
	CASH (CHECKING)		125
	PAID \$125 TELEPHONE BILL: \$75 CHURCH; \$50 SCHOOL.		
	LOAN PAYABLE	500	
	INTEREST EXPENSE		35
	CASH (CHECKING)		535
	PAID \$500 ON PRINCIPAL AND \$35 INTEREST ON NOTE FROM DIOCESAN AID, NFP.		
	CATHOLIC POST PAYABLE (from parishioners) 150		
	CATHOLIC POST EXPENSE (from parish)		50
	CASH (CHECKING)		200
	PAID \$200 CATHOLIC POST SUBSCRIPTION BILL: \$150 COLLECTED FROM PARISHIONERS AND \$50 PAID BY PARISH		
	RICE BOWL COLLECTION	200	
	CASH (CHECKING)		200
	REMITTED \$200 TO THE DIOCESE FOR THE RICE BOWL COLLECTION.		



## Cash Account Exchanges

**POLICY:** All deposits and withdrawals from one cash account to another cash account will be properly recorded in the parish internal accounting system. An accounting entry will be made to debit the account in which cash is being deposited and a corresponding credit to the account from which cash is being withdrawn.

**RATIONALE:** This transaction is a simple exchange from one parish account to another and represents neither an increase nor a decrease of total parish cash, revenue or expense. Recording the transaction keeps an accurate record of the amount in each cash account and facilitates the month end reconciliation of the account with the bank or the diocese loan fund account.

**PROCEDURE:** The following are examples of exchanges:

ACCT. #		DEBIT	CREDIT
	CASH (CHECKING)	10,000	
	CASH (SAVINGS)		10,000
TRANSFERRED \$10,000 FROM A PARISH SAVINGS ACCOUNT TO A CHECKING ACCOUNT TO PAY MONTHLY BILLS.			
	CASH (SAVINGS)	7,000	
	CASH (CHECKING)		7,000
TRANSFERRED \$7,000 FROM A PARISH CHECKING ACCOUNT TO A SAVINGS ACCOUNT.			
	DIOCESAN AID	5,000	
	CASH (SAVINGS)		5,000
TRANSFERRED \$5,000 FROM A PARISH SAVINGS ACCOUNT TO DIOCESAN AID, NFP FOR INVESTMENT.			
	CASH (CHECKING)	3,000	
	DIOCESAN AID		3,000
TRANSFERRED \$3,000 FROM THE DIOCESAN AID, NFP TO A PARISH CHECKING ACCOUNT.			

## Tuition Payments for Students

**POLICY:** Tuition payments will be recorded on the financial report for the school.

**RATIONALE:** Receipts for tuition are revenue for the operation of the school. They are not tax deductible for the donor.

**PROCEDURE:** The following is an example of a tuition receipt recorded on the school books:

ACCT. #		DEBIT	CREDIT
_____	CASH (CHECKING)	\$1,000	
_____	TUITION		\$1,000

## Income Tax

The following section outlines income tax issues that churches and related organizations deal with. This information is provided by the United States Conference of Catholic Bishops (USCCB).

### USCCB Group Tax Exemption Ruling

Annually since 1946, the Internal Revenue Service (IRS) has issued to the United States Conference of Catholic Bishops and its predecessor organization, a group tax exemption ruling with respect to the Catholic organizations listed in *The Official Catholic Directory* (OCD) for a particular year ("Group Ruling"). The Group Ruling establishes (1) that organizations included in the OCD are exempt from federal income tax under section 501(c)(3) of the Code and from federal unemployment tax; and (2) that contributions to such organizations are deductible for federal income, gift, and estate tax purposes. The current Group Ruling is available on the USCCB website at [www.usccb.org/ogc](http://www.usccb.org/ogc). At that website there is also a full explanation of what the group ruling provided as well as application forms for including newly formed organizations in the OCDD. Inclusion in the Group Ruling has no effect on an organization's liability for any federal excise taxes, nor does it automatically establish an organization's exemption from state or local income, sales, or property taxes. For more information on the Group Ruling, see the annual Group Ruling explanatory memo issued by OGC.

### Income Tax Issues

The following is intended to provide general information about income tax issues.

#### Deductibility/Substantiation of Contributions

In order to be deductible, a payment must first qualify as a *gift*, which is defined as a voluntary transfer of money or property without receipt of or expectation of a commensurate return benefit. Thus, for example, the payment of tuition, whether made directly to a school or to a church operating the school, is not deductible. In addition, payments made in various fundraising contexts may or may not be deductible, depending on whether goods or services are received in return. For example, payment for a purchase at a charity auction will be deductible only to the extent the payment exceeds the fair market value (FMV) of goods or services received in return. Payments for charity raffle tickets are not deductible, since the amount paid is not a gift, but rather payment for the chance to win whatever prize is being offered.

In response to abuses with respect to charitable contributions, in 1993 Congress enacted enhanced substantiation rules applicable to contributions of \$250 or more. Section 170(f)(8) provides that no contribution of \$250 or more will be deductible unless the donor obtains, prior to filing his or her tax return, written acknowledgment from the donee charity verifying the amount of the contribution and whether any goods or services were received in return. If so, such goods or services must be identified and must be valued by the donee charity. If the benefits received consist solely of intangible religious benefits, a statement to that effect must be included. Although the burden of requesting appropriate acknowledgment is placed on the

donor and not imposed on the donee charity, charities that knowingly provide false written substantiation statements may be subject to penalties for aiding and abetting an understatement of tax liability under section 6701.

Effective January 1, 2007, Congress amended the IRS code to require that donors retain written documentation for all money donations in the form of a cancelled check, bank record or receipt from the donee organization showing the name of the donee organization, the date of the contribution and the amount of the contribution. This will make it important that donors use checks or contribution envelopes.

Certain payments are considered *quid pro quo* contributions—namely, they are made partly as a gift and partly in consideration for goods or services furnished to the donor. An exception is provided for payments made to an exclusively religious organization in return for which the donor receives solely intangible religious benefits. Under section 6115, charitable organizations must inform donors in writing that *quid pro quo* contributions in excess of \$75 are deductible only to the extent that they exceed the value of any goods or services provided by the charitable organization in return, and the organizations must provide a good-faith estimate of the value of such goods or services. This disclosure must be made either at the time of solicitation or upon receipt of the *quid pro quo* contribution. Penalties are imposed on any charity that fails to make appropriate disclosure under section 6115 at \$10 per contribution, capped at \$5,000 per particular fundraising event or mailing. Typical *quid pro quo* contribution situations include charity golf tournaments, auctions, dinner dances, and so forth, where part of the payment constitutes a contribution. In such situations, the disclosure statement may be placed in solicitation materials, in event programs or brochures, or on the face of event tickets—i.e., in any reasonable manner likely to come to the attention of the donor.

Additional substantiation requirements are imposed with respect to certain contributions. Most non-cash contributions require that the donor receive a receipt from the charitable organization showing the name of the charitable organization, the date and location of the contribution and a reasonable description of the item(s) donated. Items dropped off at collection boxes and valued at less than \$250 do not require a receipt however the items donated must be in “good condition”, with no guidance provided on what constitutes “good condition”. Contributors of non-cash gifts valued at \$500 or more must complete Form 8283 and attach it to Form 1040. Contributors of non-cash gifts valued at \$5,000 or more (other than gifts of publicly traded securities) must

- Obtain a qualified appraisal and submit an appraisal summary with the Form 8283 attached to Form 1040, *and*
- Have the donee charity complete and return to the donor the "Donee Acknowledgment Section" (in doing so, the donee charity is *not* vouching for the appraised value)

The donee charity is required to report to the IRS on Form 8282 if such contributions are subsequently sold or otherwise disposed of within two years of receipt.

The IRS has issued special rules for the claiming of deductions for donated vehicles. In general, the deduction will be limited to the actual sales price the charity receives for the vehicle. Donors may claim a deduction for the fair market value under the following circumstances:

- The charity makes a significant intervening use of the vehicle, such as using it to deliver meals on wheels.
- The charity makes a material improvement to the vehicle, i.e., major repairs that significantly increase its value and not mere painting or cleaning.
- The charity donates or sells the vehicle to a needy individual at a significantly below-market price, if the transfer furthers the charitable purpose of helping a poor person in need of a means of transportation.

Sales of donated vehicles are reported to the IRS and to donors on form 1098 C. Copy A must be filed with the IRS. Copies B and C must be furnished to the donor (for donor's records and for attachment to his or her tax return) not later than 30 days after the date of sale if box 4a is checked, or 30 days after the date of the contribution if box 5a or 5b is checked. Form 1098-C is available on the IRS website at [www.irs.gov](http://www.irs.gov) under Forms and Publications.

Finally, diocesan entities often benefit from contributed services. A parishioner may volunteer to clean the church every week, or a carpenter may replace the windows and only charge for materials. These acts of charity are welcomed, but often the volunteer asks for a tax receipt for the contributed services. After all, the volunteer saved the church hundreds of dollars in labor costs, and the volunteer could have been making money elsewhere had he or she not been volunteering.

While it is permissible to write a letter thanking the volunteer for donating his or her time that saved the church \$500 in labor costs, it is not permissible to give the volunteer a tax receipt or include the value of the services on the volunteer's annual contribution statement. The value of contributed personal labor is *not deductible*. However, unreimbursed out of pocket expenditures are deductible.

## School Tuition vs. Donation

The following section outlines school tuition and donations issues. This information is provided by the United States Conference of Catholic Bishops (USCCB).

Payments made to a parish by parents of children enrolled in a Catholic school may qualify as deductible contributions if they are gifts, *i.e.*, if they are voluntary transfers of funds made with no expectation of obtaining commensurate benefit. Specifically, enrollment in the school must in no manner be contingent on making the payment; the payment must not be made pursuant to a plan (whether express or implied) to convert nondeductible tuition into charitable contributions; and the receipt of the benefit (schooling or reduced tuition payments) must not otherwise be dependent upon making the payment. Rev. Rul. 83-104, 1983-2 C.B. 46, cites the following factors as creating a presumption that a payment is NOT a charitable contribution:

1. The existence of a contract (express or implied) whereby a taxpayer (*i.e.*, parents, etc.) agrees to make a "contribution" and which insures school admission for the taxpayer's child;
2. A plan allowing taxpayers either to pay tuition or make "contributions" in exchange for schooling;
3. The earmarking of contributions for the direct benefit of a particular individual;
- or
4. The otherwise unexplained denial of admission/readmission of children of taxpayers who are financially able but who do not contribute.

Additional adverse factors include:

5. the absence of a significant tuition charge;
6. Substantial or unusual (different from that applied to non-parents) pressure applied to parents of children attending school;
7. Contribution appeals made as part of the admissions or enrollment process;
8. The absence of significant school revenue sources other than parent contributions; and
9. Other factors suggesting a contribution policy created as a means of avoiding characterization of payments as tuition.

Situation 6 of Rev. Rul. 83-104 sanctions differential tuition for parishioners and non-parishioners in certain limited circumstances. The parish received contributions from all its members. These contributions are available to support all parish activities, a substantial portion of which are unrelated to the school. The parish has full control over the use of the contributions it receives. Most parish members do not have children in the school. The methods of soliciting contributions from parishioners with children in the school are the same as the methods of

soliciting members without children in the school. No tuition is charged to parishioners, but non-parishioners are charged tuition. In this situation, IRS concluded that the contributions made by parishioners with children in the school are ordinarily deductible, unless there is a showing that contributions by parishioners with children in the school are significantly larger than those of other parishioners.

The IRS has indicated in other rulings that it will compare parental giving levels to non-parental giving levels in evaluating deductibility of payments.

Any attempt to link school enrollment or tuition reductions/benefits to parish contribution or level of parish contribution jeopardizes the deductibility of contributions by parishioners who benefit from such practices. Various labels given to parish contributions, e.g., sacrificial giving, tithing, negotiated tuition, stewardship, minimum giving, etc., are not determinative of deductibility. Further, parishes cannot qualify under Situation 6 by defining parish "membership" (or otherwise qualifying for reduced or no tuition) according to level of contribution. All such practices undercut parish claims that parish contributions are "gifts", the *sine qua non* of charitable deductibility.