



MEMORANDUM

TO: Catholic Organizations Employing Members of Religious Orders

FROM: USCCB Office of General Counsel
Resource Center for Religious Institutes

RE: Compensation Paid to Members of Religious Orders

DATE: September 11, 2020

Members of religious orders¹ who provide services to Catholic organization employers (defined here to include any entity listed in *The Official Catholic Directory* [OCD; i.e., the Kenedy Directory]) may be subject to distinct tax and reporting rules, primarily as a result of their vows of poverty. This memorandum, which is issued jointly by the United States Conference of Catholic Bishops (USCCB) and the Resource Center for Religious Institutes (RCRI; formerly known as the Legal Resource Center for Religious), supersedes the memorandum dated September 11, 2006 issued by the USCCB and RCRI.

EMPLOYMENT CLASSIFICATION

Status as a member of a religious order does not automatically determine employment classification. Rather, classification of a religious as an employee of a Catholic organization employer or as an independent contractor should be made by applying the common law tests as interpreted by the Internal Revenue Service (IRS).²

This common law test as interpreted by the IRS consists of the following three-category approach to assist employers in determining proper worker classification, having applied relevant facts that fall into the following three categories. These categories apply to religious, as well:

¹ As used herein, the term "religious orders" means canonical religious institutes or societies of apostolic life that also meet the requirements of Rev. Proc. 91-20, 1991-1 C.B. 524.

² One should be aware that other statutes may apply different standards for determining covered employment.

1. Behavioral Control

Facts reviewed under the Behavioral Control analysis show whether a Catholic organization employer has a right to direct or control how the religious does the work. A religious is an employee when the Catholic organization employer has the right to direct and control the religious. The Catholic organization employer does not actually have to direct or control the way the work is done – as long as the Catholic organization employer has the right to direct and control the work.

2. Financial Control

Facts reviewed under the Financial Control analysis show whether there is a right to direct or control the business part of the work. For example, if the worker has a significant financial investment in his/her work, or is not reimbursed for some or all business expenses, or if the worker can realize a profit or incur a loss, these indicate the worker is an independent contractor.

3. Type of Relationship

These are facts that illustrate how the Catholic organization employer and the religious perceive their relationship. For example, if the religious receives benefits, or a written contract shows what the religious and the Catholic organization intend, or the expectation of a relationship to continue indefinitely, or the religious performs services that are a key aspect of the regular business of the Catholic organization, these indicate the religious is an employee. There is no single determining factor.

As a general rule, most individual workers that receive compensation (in whatever form) should be classified as employees.³ Additional tax, insurance and benefit-related risk may be incurred when employees are incorrectly identified as independent contractors. It is the Catholic organization employer that should make the classification based on its review of all the facts and circumstances; it is not up to the worker as to how he/she should be classified.⁴

Catholic organization employers should refer to IRS Publication 15-A: *Employer's Supplemental Tax Guide* for official guidance on these determinations. <https://www.irs.gov/publications/p15a>. It is revised annually. State regulations may also affect the classification of employees. In each case, it is very important to consider all the facts – no single fact provides the answer. Remember to regularly consult IRS Publication 15-A.

³ At the same time, it should be remembered that reporting and tax withholding obligations with respect to taxable religious employees differ for religious priests and non-ordained religious. Taxable priests performing ministerial services are treated as self-employed for Social Security tax purposes *even if* they are classified as employees for income tax purposes. See note 11, *infra*.

⁴ Be aware that other statutes may apply different standards for determining covered employment.

This common law test applies for purposes of FICA, FUTA, Federal income tax withholding and the Railroad Retirement Tax Act, if there is no controlling statute.

TAXATION OF COMPENSATION

No individual religious is “tax-exempt.” Tax exemption applies, if at all, to a religious order that qualifies as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code (“IRC”). Further, status as a member of a religious order does not automatically immunize from federal income and employment taxation the compensation paid to a religious who is performing services for a Catholic organization employer. Rather, the taxability of such compensation (including employee fringe benefits, if any) provided by the Catholic organization employer, is determined in accordance with the principles set forth in Rev. Rul. 77-290, 1977-2 C.B. 26. Rev. Rul. 77-290 does not provide tax exemption to individual religious.

Rev. Rul. 77-290

Under Rev. Rul. 77-290, a member of a religious order providing services to a Catholic organization employer will be considered *for tax purposes* to be an agent of his or her order and will not be liable individually for federal income or employment taxes⁵ on compensation paid by the Catholic organization employer, *provided* three criteria are met:

1. The religious must be subject to a vow of poverty;
2. The religious must be providing services for a Catholic organization employer listed in the OCD⁶ at the direction of his or her ecclesiastical superior; and
3. The religious must remit the full amount of compensation to his or her religious order, which must be exempt from federal income tax under section 501(c)(3) of the IRC.

If any Rev. Rul. 77-290 criterion fails to be met, the religious is taxable individually on compensation received.

Rev. Rul. 77-290 does not purport to determine the employment status of religious providing services for Catholic organization employers, and does not preclude classification of a religious as an employee of a Catholic organization employer or the provision of customary employee benefits to religious who are employees.

Verifying Rev. Rul. 77-290 Requirements

Each Catholic organization employer has the responsibility to determine whether a member of a religious order meets all three criteria of Rev. Rul. 77-290 before suspending its general withholding and reporting obligations under the Internal Revenue Code. Thus, the Catholic organization employer should verify that an individual is a member of a section 501(c)(3) religious

⁵ For purposes of Rev. Rul. 77-290, “employment taxes” refers to FICA and Medicare taxes.

⁶ This also includes asterisked (*domestic* non-Group Ruling) listings in the OCD, since they are subject to the same standards of relationship to the Church as are ordinary Group Ruling listings in the OCD.

order subject to a vow of poverty recognized by the Church⁷ and that the individual's services have been authorized by his or her religious superior. These first two issues can be resolved in any reasonable manner, e.g. by correspondence with the member's religious order.

Section 501(c)(3) status should be verified by reference to the OCD. The Catholic organization employer should also verify that the full amount of compensation paid to the religious will be remitted to the religious order. This can be accomplished in one of several ways, listed below in order of preference:

1. By direct deposit to a bank account bearing the name and employer identification number ("EIN") of the religious order;
2. By check payable to the religious order; or
3. By check payable jointly to the religious order and the individual religious.

As a general rule, compensation paid directly to an individual religious will be taxable to the individual religious. However, in limited circumstances a Catholic organization employer may be justified in treating such compensation as qualifying under Rev. Rul. 77-290. In these circumstances, the Catholic organization employer should determine that there exists a significant impediment to the payment of compensation to the religious order directly as outlined above.⁸ In addition, the Catholic organization employer should obtain appropriate written documentation from the superior of the religious order certifying that compensation paid directly to the individual religious will be remitted to the religious order in accordance with the requirements of Rev. Rul. 77-290. This supporting documentation should be updated annually.

NOTE: As religious increasingly come to the United States from religious institutes outside the country, special care must be taken to review and confirm payment for services to the criteria identified *supra*. If the foreign religious institute is not exempt from taxes by inclusion in the OCD, any payment must usually be made under an ordinary and taxable employment relationship.

A Catholic organization employer can avoid withholding on payments made or deemed made to a religious institute outside the United States pursuant to Rev. Rul. 77-290 if the foreign religious institute furnishes a withholding certificate (Form W-8) and either: (i) a favorable IRS determination letter regarding its tax exempt status, or, if it has no determination letter; (ii) an opinion of U.S. counsel (or of any other person the IRS may prescribe in published guidance) that is acceptable to the withholding agent which concludes that the organization is described in section 501(c).⁹

⁷ Any questions that arise concerning the nature or validity of the vow of poverty taken by a particular individual can be referred to a canon lawyer specializing in the field of religious life.

⁸ For example, mere insistence that compensation must be paid directly to the individual religious would not satisfy this requirement. In practice, such situations will be rare.

⁹ Treas. Reg. § 1.1441-9(b)(2).

Accessing Information on Religious Institutes and other IRC Section 501(c)(3) Tax-Exempt Organizations

The OCD includes the names and addresses of the agencies and instrumentalities and the educational, charitable, and religious institutions operated by the Roman Catholic Church in the United States, its territories, and possessions that are subordinate organizations under the group tax exemption of the USCCB. Each subordinate organization listed in the OCD is recognized as exempt under section 501(c)(3) of the IRC under the USCCB general exemption number.

Subordinate organizations under a group exemption do not receive individual exemption letters nor are they separately listed in Publication 78 or the EO Business Master File. Verification of a subordinate organization having been included in the group exemption of the USCCB is achieved by consulting the OCD. The IRS does not verify the inclusion of subordinate organizations under the USCCB group exemption.

Each subordinate organization covered in a group exemption should have its own Employer Identification Number ("EIN"). Each subordinate organization must use its own EIN, not the EIN of the USCCB, in all filings with IRS. As noted *supra*, an organization that is listed in the OCD with an asterisk indicates the organization has its own individual IRS determination letter and therefore is not included in the USCCB Group Ruling.

In order to confirm an organization bearing an asterisk – or an organization not listed in the OCD – is recognized as exempt under section 501(c)(3) of the IRC, Catholic employer organizations should consider consulting the Tax Exempt Organization Search (TEOS) of the IRS, which replaced the EO Select Check in 2018. The TEOS online tool may be found <https://www.irs.gov/charities-non-profits/tax-exempt-organization-search>.

The Exempt Business Master File Extract (EO BMF) of the IRS is also a helpful online tool which includes cumulative information on exempt organizations. The data is extracted monthly and is available by state and region. Utilizing the search feature of a web browser for a unique term in the organization's title should provide quick results. The EO BMF online tool may be found at <https://www.irs.gov/charities-non-profits/exempt-organizations-business-master-file-extract-EO-bmf>

NOTE: When Catholic organization employers consult the listings of religious institutes of men and of women that appear at the end of a diocesan listing in the OCD, indicating the various religious institutes which minister in that particular diocese, the Catholic organization should also note the corresponding P.J. Kenedy bracketed identification number that precedes the listing of the religious institute. This corresponding bracketed number should then be utilized in referring to the Index of religious institutes of men and of women that appears in the Religious Institute Section of the OCD.

This Index contains the general headquarters, provinces, provincialates, a summary of legal titles and holdings taken from the individual archdioceses and dioceses within the OCD, various forms of ministry and works, statistical data of personnel, and representation in the U.S. dioceses and archdioceses. Foreign religious institutes are not included in the USCCB Group Ruling.

REPORTING COMPENSATION

The manner of reporting compensation of religious performing services for Catholic employers depends on the taxability of that compensation. If the criteria of Rev. Rul. 77-290 are satisfied and compensation is not taxable to the individual religious, *no reporting on Form W-2 or Form 1099 is required*.¹⁰

On the other hand, if the criteria of Rev. Rul. 77-290 have **not** been satisfied, e.g., if the Catholic organization employer has been unable to verify that the full amount of compensation will be remitted to the religious order, compensation is taxable to the individual religious and should be reported in the ordinary course. Thus, if the religious is taxable and is classified as an employee of the Catholic organization, compensation must be reported on Form W-2.¹¹ If the religious is taxable and is classified as an independent contractor of the Catholic organization employer, compensation must be reported on Form 1099. No withholding is required with respect to independent contractors unless an independent contractor is a nonresident alien for federal tax purposes. To be covered under the self-employment tax provisions (SECA), individuals generally must be citizens or resident aliens of the United States. Nonresident aliens are not covered under SECA unless a social security agreement in effect between the United States and the foreign country determines that they are covered under the U.S. social security system.¹² See IRS Publication 519: *U.S. Tax Guide for Aliens* to determine alien status. <https://www.irs.gov/pub/irs-pdf/p519.pdf>.

¹⁰ Some Catholic organization employers may currently report compensation paid to nontaxable religious pursuant to Rev. Rul. 77-290 generally in one of two ways: (1) issuance of a Form 1099 bearing the religious order's EIN; or (2) issuance of a \$000 Form W-2 bearing the SSN of the religious employee. The first practice is unnecessary, particularly when the religious order is a corporation. The second practice is also unnecessary and may trigger IRS scrutiny. Although commercial payroll providers often initially insist on issuance of a Form W-2 or Form 1099, with persistence and determination they can be persuaded to modify their computer programs to accommodate the special needs of Catholic employers with respect to Rev. Rul. 77-290.

¹¹ Reporting and tax withholding obligations with respect to taxable religious employees differ for religious priests and non-ordained religious. The compensation of a taxable religious priest employee who is performing ministerial services should be reported in the same manner as that of diocesan priest employees. Under Treas. Reg. §1.107-1(a), ministerial services include: (a) performance of sacerdotal functions; (b) conduct of religious worship; (c) administration and maintenance of religious organizations and their integral agencies; and (d) performance of teaching and administrative duties at theological seminaries. Note that taxable priests performing ministerial services are treated as self-employed for Social Security tax purposes *even if* they are classified as employees for income tax purposes. They are liable for SECA tax under section 1402 of the Code. No FICA taxes should be withheld. The compensation of a taxable religious priest employee who is *not* performing ministerial services, or of a taxable non-ordained religious employee, should be reported in the same manner as that of lay employees of the Catholic employer, with income and FICA tax withheld.

¹² IRS Publication 517, *Social Security and Other Information for Members of the Clergy and Religious Workers* (2019), p. 4.