TO: Catholic Organizations Employing Members of Religious Orders
FROM: USCCB Office of General Counsel
       Legal Resource Center for Religious
RE: Compensation Paid to Members of Religious Orders
DATE: September 11, 2006

Background. Members of religious orders¹ who provide services to Catholic organization employers 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 Legal Resource Center for Religious ("LRCR"), supercedes the memorandum dated November 6, 1987 issued by the United States Catholic Conference [now USCCB] and the Office of Legal Services, CMSM/LCWR/NATRI [now LRCR].

Confusion continues to exist among Catholic organization employers about the application and scope of Rev. Rul. 77-290, 1977-2 C.B. 26. This memorandum is intended to clarify the standards for determining the employment status of religious performing services for Catholic organization employers, as well as the taxability and reporting obligations with respect to compensation paid for such services.

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. Rev. Rul. 77-290 does not purport to determine the employment status of religious providing services for Catholic

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.

organization employers, and in no way precludes classification of religious as employees\(^3\) of Catholic organization employers or the provision of customary employee benefits to religious who are employees.

**Taxation of Compensation.** No individual religious is “tax exempt.” Tax exemption applies, if at all, to a religious order that qualifies as tax exempt under section 501(c)(3) of the Code. 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 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.

*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 taxes\(^4\) 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 OCD\(^5\) 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 Code. If any Rev. Rul. 77-290 criterion fails to be met, the religious is taxable individually on compensation received.

**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 order subject to a vow of poverty recognized by the Church\(^6\), 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 superior. 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. Compensation can be paid: (1) by direct deposit to a bank account bearing the name and employer identification number ("EIN") 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.

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\(^3\) In fact, Rev. Rul. 77-290 presumes that the religious are employees of the entities described therein, since neither FICA nor income tax withholding would have been at issue in the absence of status as an employee.

\(^4\) For purposes of Rev. Rul. 77-290, “employment taxes” refers to FICA and Medicare taxes.

\(^5\) This also includes asterisked (domestic non-Group Ruling) listings in the OCD, since these are subject to the same standards of relationship to the Church as are ordinary Group Ruling listings in the OCD.

\(^6\) 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.
As a general rule, compensation paid directly to an individual religious will be taxable to the individual religious. However, there are limited circumstances in which Catholic organization employers 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. 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.

**Reporting Compensation.** The manner of reporting compensation of religious performing services for Catholic organization 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.

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 employer, compensation must be reported on Form W-2. 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.

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7 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.

5 Some Catholic organization employers may currently report compensation paid to nontaxable religious, 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 services 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.

9 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 1401 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 organization employer, with income and FICA tax withheld.