

Church and Clergy Tax Issues

Biblical Foundations

- Therefore you must be subject, not only because of wrath but also for conscience' sake. For because of this you also pay taxes, for they are God's ministers attending continually to this very thing. Render therefore to all their due: taxes to whom taxes are due, customs to whom customs, fear to whom fear, honor to whom honor.
– Romans 13:5-7 NKJV

Biblical Foundations

- Teacher, we know that You are true, and teach the way of God in truth; nor do You care about anyone, for You do not regard the person of men. Tell us, therefore, what do You think? Is it lawful to pay taxes to Caesar, or not?"
- "Render therefore to Caesar the things that are Caesar's, and to God the things that are God's."
– Matthew 22:16-17; 21 NKJV

Clergy Tax Rules

- Clergy have some of the most unique and confusing tax rules
- Most ministers fail to properly calculate their taxes; some pay too much, others not enough
- Many churches leaders do not understand unique clergy tax issues
- Many tax professionals improperly prepare ministers tax returns
- Ministers tax returns have a higher audit risk than the general public (2.76% vs. 0.57%)

Who is a Minister? 5 Tests

- Ordained, Licensed, or Commissioned
 - Or member of a religious order
 - Or Christian Science Practitioner
- Performs Sacerdotal Functions
- Worship Leadership
- Church Management/Administration
- Recognized by Church/Denomination as a Minister

Who is NOT a Minister

- Armed Forces Chaplains
- Chaplains in government owned and operated hospitals
- Services performed as an employee of the USA, DC, a foreign government, or any political subdivision thereof
 - e.g. Senate chaplains or clergy employed by foreign governments in their embassy

Are Ministers Employees or Self-Employed?

- Yes – Both
- Employees for Fed. Inc. Tax purposes
- Self-Employed for Soc. Sec. Purposes
- Exceptions: Itinerant Evangelists; Pulpit Supply (including interims); Guest Speaking; Honorariums

Form W-2 or Form 1099-MISC?

- Minister Employees receive a Form W-2
- Self-Employed ministers receive Form 1099-MISC for \$600+ income from any one source
- Note: If a minister reports ministerial income as self-employed & receives only one 1099-MISC, the IRS may reclassify him/her as an employee resulting in additional taxes and penalties.

a Control number 22222		Void <input type="checkbox"/>		For Official Use Only ▶ OMB No. 1545-0008	
b Employer identification number (EIN) 00-0246910		1 Wages, tips, other compensation 31,000.00		2 Federal income tax withheld	
c Employer's name, address, and ZIP code First: United Church 1042 Main Street Hometown, Texas 77099		3 Social security wages		4 Social security tax withheld	
		5 Medicare wages and tips		6 Medicare tax withheld	
		7 Social security tips		8 Allocated tips	
d Employee's social security number 011-00-2222		9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial Last name John E. Michaels 1040 Main Street Hometown, TX 77099		11 Nonqualified plans		12a See instructions for box 12	
f Employee's address and ZIP code		13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>		12b	
		14 Other Parsonage Allowance 9,600.00 Utilities Allowance 1,200.00		12c 12d	
15 State Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** Wage and Tax Statement **2005** Department of the Treasury—Internal Revenue Service
Copy A For Social Security Administration — Send this entire page with Form W-3 to the Social Security Administration
For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D.

Calculating Income

- Salary/Wages
- Bonuses
- Special Occasion Gifts
- Social Security Tax paid by church
- Non-accountable business expense reimbursements
- “Love offerings”
- Value of personal use of church owned vehicles and cell phones

Income Exclusions

- Retirement Contributions (employee and church contributions)
- Church Paid Group Term Life Insurance Premiums (up to \$50,000 coverage)
- Business Expenses Reimbursed Under an Accountable Arraignment Plan
- Medical Insurance Premiums
- Housing Allowance

Housing Allowance

- IRC allows churches to designate a portion of a minister's salary as a tax-exempt housing allowance
- Fully taxable for Social Security (Sch. SE)
- Clergy may still deduct mortgage interest and real estate taxes on Sch A

Computing the Housing Allowance

- 2002 Clergy Housing Allowance Clarification Act
- The lesser of:
 1. Actual expenses of mortgage (rent), taxes, furnishings, utilities, and maintenance
 2. Fair Rental Value (furnished) plus utilities
 3. Amount designated by the church

Examples

- Actual Exp. - \$15,000
 - FRV+Utilities - \$15,500
 - Ch. Designated - \$14,000
- Which amount can a minister exempt from federal taxation (Form 1040)?

Examples

- Actual Exp. - \$15,500
 - FRV+Utilities - \$15,000
 - Ch. Designated - \$16,000
- Which amount can a minister exempt from federal taxation (Form 1040)?

Housing Allowance Rules

- Designated “Prospectively” never Retroactively
- Must be designated in writing and approved by the church
 - Resolution
 - Budget Line Item
 - Recorded in Minutes
 - Retain Copy for Files

Parsonages

- Fair Rental Value excluded from FIT; Included for SE tax
- Parsonage Allowance for utilities/maintenance excluded from FIT; Included for SE tax
- FRV must be consistent with other homes in the community

Retired Pastors

- May have church retirement system designate a portion (or all) of retirement withdrawals as a housing allowance.
- Follow same rules for Housing Allow.
- If home is paid off, minister can only designate amount necessary for utilities, maintenance, ins., taxes & furnishings
- Cannot use home equity loan payments unless taken to repair/improve the home

Points to Remember...

- Housing allowance must be designated in advance
- Cannot exceed FRV (furnished) plus utilities & maintenance
- Excluded from FIT calculation, but not SE tax
- Add back to AGI for EITC calculation

Business Expenses

- Transportation
- Travel
- Entertainment
- Business Gifts
- Subscriptions
- Continuing Ed.
- Books
- Moving Expenses
- Telephone Expenses
- Professional Dues
- Office in Home
- NOT Tithes!!!

Reimbursed or Unreimbursed

- Unreimbursed employee business expenses may be tax deductible for filers who itemize
- Reimbursed employee business expenses are excluded from income provided they are reimbursed under an “accountable” reimbursement plan
- “Non-accountable” reimbursements are fully taxable; expenses are itemized deductions

Accountable vs. Non-Accountable Reimbursements Plans

- Accountable Plans
 - Timely & adequate accounting for employee business expense (provided within 60 days)
 - Excess reimbursements returned within 120 days
 - Excess reimbursements not returned must be included on W-2 as taxable income
 - Failure to report retained excess reimbursements may expose the church to intermediate sanctions and excise taxes & penalties for the minister

Accountable vs. Non-Accountable Reimbursements Plans

- Non-Accountable Plans
 - Minister is given a flat sum each month
 - Minister is not required to substantiate expenses with records and receipts to the church
 - Payments are fully taxable (FIT & SE); must be included on W-2
 - Failure to report non-accountable expense payments may qualify as “inurement” & expose the church to intermediate sanctions and excise tax; Minister will have additional taxes and penalties

Transportation Expenses

- Local Business Travel
- Normal & Necessary Business Purpose
- Record Date, Place, & Business Purpose
 - Records must be written and contemporary
- Commuting is ALWAYS a personal expense
 - Value of Church-owned vehicles used for commuting must be reported as income
- Two Methods of Calculation
 - Standard Mileage & Actual Expenses

Travel Expenses

- Business travel outside of tax home area generally requiring an overnight stay
 - Normal & Necessary Business Purpose
- Reimbursable expenses include:
 - Transportation costs
 - Lodging
 - Taxis, buses, subways
 - Tips & Gratuities
 - Meals & Entertainment
 - Other incidentals like laundry services

Travel Expenses

- Two Methods of Reimbursement
- Actual Costs
 - Must have receipts for all expenses \$75+
- Per Diem
 - IRS/Fed rates for lodging, meals, & incidentals
 - High-Low rates may apply
- Combination
 - I.e., Actual cost for lodging & per diem for MI&E

Form 2106

- Used to account for most unreimbursed & partially reimbursed employee expenses
- Can only itemize the amount of unreimbursed expense that exceed 2% AIG
 - AIG = \$40,000; 2% = \$800
 - Can only deduct expenses exceeding \$800
- Must apply the “Deason” Rule

Deason Rule

- Must reduce ministerial business expenses by the percentage of clergy income designated as Housing Allowance
- Gross Salary = \$40,000
 - Taxable Salary = \$30,000
 - Housing Allowance \$10,000
- Must reduce business expenses by 25%

Applying Deason Rule

- Gross Salary = \$40,000
- Housing Allowance \$10,000
- AGI = \$30,000
- Form 2106 = \$6,000 total expenses
- Allowable Expenses:
 - \$6,000 - 25% = \$4,500
 - \$4,500 – 2% AGI = \$3,900
- Apply Deason Rule to Schedule C expenses

Too Complicated?

- Have the church adopt an accountable reimbursement plan
- No need to file Form 2106
- No need to report reimbursements on taxes

Office in Home (OIH)

- Tax deduction for portion of home used for an office
- Must be used regularly & exclusively for business purposes; no element of personal use allowed
- Must be for the convenience of the Employer
- OIH deduction NOT allowed if receiving Housing Allowance
- May trigger “recapture” rules if home is sold

Self-Employment Tax

- Ministers are ALWAYS considered self-employed for Social Security tax (SECA)
- Ministers who have not filed a timely request for exemption from Social Security tax (Form 4361) must pay both the employer & employee share of Social Security (15.3%) as a Self-Employment tax using Schedule SE
- WARNING: Exemption from paying into Social Security may also deny the minister Medicare unless qualified by some other secular employment

Calculating SE Tax

- Gross Ministerial Salary From W-2, Line 1
- Plus Housing Allowance
- Plus Net Income from Self Employment (Sch C)
- Minus 100% Form 2106 expenses
- Minus remainder of Sch. C expenses previously excluded by the Deason Rule
- Enter resulting calculation on Sch. SE, Line 2 and perform the remaining calculations

Too Complicated?

- Too bad!
- All ministers **MUST** file Schedule SE unless they have an approved Form 4361

Requesting SE Exemption

- File Form 4361 by the due date of the tax return (including ext.) for the second year of \$400+ ministerial self employment earnings
- Be religiously opposed to public insurance; not economically opposed
- Inform the ordaining body; must be tax a exempt religious body
- Members of certain religious sects use Form 4029 (Amish/Mennonites)

Schedule C-EZ

- Use Schedule C or C-EZ to calculate net income from self employment
 - Honorariums from Weddings/Funerals
 - Revivals, Supply Preaching, Interims
- Use to calculate expenses associated with earning the above income
 - Deason Rule applies!

Estimated Tax Payments

- Ministers and other Self Employed people must estimate their yearly tax and make quarterly payments
- Form 1040-ES
 - April 15
 - June 15
 - Sep 15
 - Jan 15
- Penalties apply for inaccurate reporting or failing to make timely payments

“Safe Haven” Rule

- 100% of previous year’s tax obligation
- 90% if current year’s tax obligation

Got Questions?

- Refer to IRS Publication 517 “Social Security and Other Information for Members of the Clergy and Religious Workers”