Clergy Tax Issues
Clergy Tax Rules

- Clergy have some of the most unique and confusing tax rules
- Most ministers fail to properly report their taxes
- 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
- Performs Sacerdotal Functions
- Worship Leadership
- Church Management/Administration
- Recognized by Church/Denomination as a Minister
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?**

- Employees receive a Form W-2
- Self-Employed receive Form 1099-MISC for $600+ income from any one source
- Note: If you report your ministerial income as self-employed & you receive only one 1099-MISC, the IRS may reclassify you as an employee resulting in additional taxes and penalties.
Calculating Income

- Salary/Wages
- Bonuses
- Special Occasion Gifts
- Social Security Tax paid by church
- Non-accountable business expense reimbursements
- “Love offerings”
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
- 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 (Form SE)
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

- FRV 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 GuideStone designate a portion (or all) of retirement withdrawals as a housing allowance.
- Follow same rules for Housing Allow.
- If home is paid off, can only designate amount necessary for utilities, maintenance & 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

- Books
- Moving Expenses
- Telephone Expenses
- Professional Dues
- Office in Home
<table>
<thead>
<tr>
<th>a</th>
<th>Control number</th>
<th>22222</th>
<th>Void □</th>
</tr>
</thead>
<tbody>
<tr>
<td>b</td>
<td>Employer identification number (EIN)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>00-0246810</td>
<td>1</td>
<td>Wages, tips, other compensation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2</td>
<td>Federal income tax withheld</td>
</tr>
<tr>
<td></td>
<td></td>
<td>31,000.00</td>
<td></td>
</tr>
<tr>
<td>c</td>
<td>Employer’s name, address, and ZIP code</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>First United Church</td>
<td>3</td>
<td>Social security wages</td>
</tr>
<tr>
<td></td>
<td>1042 Main Street</td>
<td>4</td>
<td>Social security tax withheld</td>
</tr>
<tr>
<td></td>
<td>Hometown, Texas 77099</td>
<td>5</td>
<td>Medicare wages and tips</td>
</tr>
<tr>
<td></td>
<td></td>
<td>6</td>
<td>Medicare tax withheld</td>
</tr>
<tr>
<td></td>
<td></td>
<td>7</td>
<td>Social security tips</td>
</tr>
<tr>
<td></td>
<td></td>
<td>8</td>
<td>Allocated tips</td>
</tr>
<tr>
<td>d</td>
<td>Employee’s social security number</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>011-00-2222</td>
<td>9</td>
<td>Advance EIC payment</td>
</tr>
<tr>
<td>e</td>
<td>Employee’s first name and initial</td>
<td>Last name</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>John E. Michaels</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1040 Main Street</td>
<td>11</td>
<td>Nonqualified plans</td>
</tr>
<tr>
<td></td>
<td>Hometown, TX 77099</td>
<td>12a</td>
<td>See instructions for box 12</td>
</tr>
<tr>
<td></td>
<td></td>
<td>12b</td>
<td></td>
</tr>
<tr>
<td>f</td>
<td>Employee’s address and ZIP code</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>13</td>
<td>Statutory employee</td>
</tr>
<tr>
<td></td>
<td></td>
<td>14</td>
<td>Other</td>
</tr>
<tr>
<td></td>
<td></td>
<td>15</td>
<td>Parsonage Allowance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>16</td>
<td>9,600.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td>17</td>
<td>Utilities Allowance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>18</td>
<td>1,200.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td>19</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>20</td>
<td>Localis name</td>
</tr>
</tbody>
</table>

Form W-2 Wage and Tax Statement

Department of the Treasury—Internal Revenue Service

2005

For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D.
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 Reimbursement 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 Reimbursement 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; must be included on W-2
  - Failure to report non-accountable expense payments may qualify as “inurnment” & 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**
  - Church 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 requiring an overnight stay
  - Normal & Necessary Business Purpose

- Reimbursable expenses include:
  - Transportation costs
  - Lodging
  - Taxies, 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
- Combination
  - Ie., 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 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
- Taxable Salary = $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 will 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 Sch. C expenses 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
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 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”