

## **Tax Questions and Answers For Active Ministers**

### **1. What's the most important thing an ordained minister should know when preparing taxes?**

The single most important thing an ordained minister should know is that he/she has a "dual status" when filing a tax return. Ordained Presbyterian clergy are – in most cases – considered:

- *Employees* for Federal Income Tax purposes, and
- *Self-employed* for Social Security tax purposes. This means that the minister must pay the full amount of any Self-Employment Contribution Act (SECA) tax due at the higher self-employed rate.

Given that most clergy are considered employees for Federal Income tax purposes, their churches must report clergy income to the IRS on form W-2, not form 1099. Form 1099 is used only for consultants and independent contractors.

Clergy serving in non-parish situations, and those in interim, stated supply, or tent-making ministries, may have unique factual situations which require consultation with a tax advisor familiar with clergy tax matters.

Remember, with regard to the Clergy Housing Allowance:

- Only an employer may designate a housing allowance,
- It may be excluded from calculation of Federal Income taxes; however,
- It must be included for calculating Social Security taxes, and
- Ministers who are independent contractors *may not* exclude 1099 income under section 107 of the tax code.

The employment status of clergy is further detailed on the Internal Revenue Service Web site; or you may read more about this in the annual *Tax Guide for Ministers & Churches* published by the Board of Pensions.

### **2. Is there any danger pastors will lose the clergy housing allowance? Also, is it available to me when I retire?**

It is impossible to know what Congress, the courts or the IRS might do in the future, so any particular tax matter is always subject to change. However, the adoption of the 2002 Clergy Housing Allowance Clarification Act by Congress limits the IRS's ability to eliminate the exclusion.

Under current federal law, the Clergy Housing Allowance is also available to retired ministers *if* a church pension board (such as the Board of Pensions) annually designates retirement income as Housing Allowance subject to the IRS rules. Currently, the Board does designate retirement pension payments, disability payments, and/or distributions from the Board-sponsored 403(b)(9) Retirement Savings Plan as 100 percent clergy housing allowance, to the extent the recipient can justify that designation.

### **3. How do I determine the Fair Rental Market Value of my residence and furnishings? Are there differences for interims and non-parish clergy, from Called and Installed pastors?**

To date, the IRS has not given specific guidance on how to determine Fair Rental Market Value. But according to tax expert Richard Hammar, one way to determine Fair Rental Market Value is to consult with real estate experts.

For example, obtain the current fair rental value of your home (or manse) from a local realtor or someone in the residential rental business who will give you a quote in writing. At a minimum, find and keep comparable rental listings in your neighborhood from the newspaper, Craig's List or another independent sources of reference. It is important to document your basis for making the determination.

As to the rental value of furnishings, you can add an additional minimal amount to the rental value, or you might consider consulting a local or national furniture rental company for what it would cost to rent appropriate furniture for your home. Again, document your numbers in writing in the event you are audited in the future.

In terms of any differences in treatment of clergy related to the housing allowance based on their particular call, a key requirement is that the work be ministry-related, i.e., either a call approved by the presbytery or a validated ministry. Who the employer is may also play a role as well as the job function. ***Consult a tax professional to determine your status.***

### **4. What items can be considered for “furnishing” and “maintaining” a residence for the housing allowance? (Manse v. own residence)**

There are no detailed IRS guidelines for what expenditures qualify for exclusion under the clergy housing allowance. However, in the Board's annual *Tax Guide for Ministers & Churches*, tax expert Richard Hammar offers a list of items which qualify.

Examples of furnishings that qualify are linens, kitchen utensils, and furniture as well as appliances. Items and supplies related to maintaining the home, such as a lawn mower (and the gas to run it), repairs, and improvements to the house or grounds also qualify.

### **5. Can I take a tax write off for cell phones, laptop computers, internet/cable, home offices, and other similar items?**

Cell phones, laptops and personal computers fall into a category the IRS calls “listed property.” There are strict rules on how to document business use of these items (as distinguished from personal use). You can find more information on the subject of “listed property” in the IRS Code, Section 280F.

However, in the December 2007 Tax Tips Teleconference, Mr. Hammar stated the rules related to cell phones are so complex and burdensome he recommends simply increasing the salary of the minister (or other church employee) by the amount the church is willing to reimburse rather than attempting to follow the IRS documentation rules. Similarly complex rules relate to laptops and personal computers.

In terms of internet access and cable TV, Mr. Hammar also noted in the same Tax Tips Teleconference that recent rulings now classify internet access and cable TV as “utilities.” That means they clearly **can** be excluded under the Clergy Housing Allowance rules.

Clergy who take advantage of the Clergy Housing Allowance do *not* qualify for the “home office” deduction. Assuming you are already excluding the cost of your housing and utilities under the Clergy Housing Allowance, a home office cannot be deducted a second time.

## **6. What are the tax advantages of the 403(b)(9) Retirement Savings Plan for clergy?**

a) Contributions, via salary deferral, save both Federal Income Taxes and Social Security taxes for clergy. (Lay persons save on Federal Income Taxes only.) This means a contribution to a 403(b)(9) Plan could mean a tax deferral from 10 to 25 percent, or more.

b) The Board’s 403(b)(9) Plan has no fees for set up or account maintenance, and all investments are “no-load” (no sales charges).

c) Investments grow tax-deferred while in your account.

d) Investment options include a variety of mutual funds (and two proprietary funds), and thus reduce your investment risk versus investing in individual stocks or bonds. Remember, *all* investments carry some level of risk.

e) A church or employing organization can also put money into your 403(b)(9). To the extent it is a “match” under rules recently adopted by the Board of Pensions, that match is *not* included in your Effective Salary and thus not subject to Plan dues.

f) Distributions to clergy may be considered Housing Allowances to the extent the funds are used in compliance with the IRS rules for Clergy Housing Allowances.

g) The 403(b)(9) account is easy to set up by the church or employing organization. Once set up, the employer or church pays a monthly invoice.

h) There is 24/7 account access via the internet or phone through Fidelity Investments. Your account information is confidential.

## **7. What are the IRS implications for honoraria, “love offerings,” and fees received separately from compensation?**

For the most part, any income received in exchange for services rendered is taxable income for both Federal Income Tax and Social Security Tax, regardless of how it was received. The only exceptions are income paid for certain employer-provided benefits and housing allowances.

If income comes through a source other than your employing organization, and it is more than \$600 from one source in a calendar year, it needs to be reported at year-end on a

Form 1099-MISC by the organization which paid this money to you. Any additional income that you received from your church or employer must be reported on your W-2.

Regarding what are called “love offerings,” according to tax expert Richard Hammar, co-author of the Board’s annual *Tax Guide for Ministers & Churches* and *Federal Reporting Requirements for Churches*, there are several tax decisions one can draw upon regarding special occasion gifts.

One criterion to determine whether the gift is taxable or nontaxable is *the intent with which the money is given*. If the donor wants to provide additional compensation to his/her minister in recognition of services rendered, similar to a bonus, then the contribution ordinarily will be taxable compensation rather than a tax-free gift. If the contribution “proceeds from a detached and disinterested generosity” and is offered out of sincere affection, respect and admiration, not out of a desire to compensate the pastor more fully for services rendered, it *might* qualify as a gift.

In all cases, the contribution must be made directly to the pastor, not the church, and the donor must *not* take a tax deduction for the gift.

One of the examples in the tax guide is that of a Christmas gift offering. The offering is announced, and members are told to make their gifts directly to the pastor. They are told contributions will not be receipted through the church and will not be tax-deductible. The church collected the offering and gave it to the pastor, so he/she would report it as taxable income.

If it is viewed as taxable income, the pastor would be liable in an audit because the church is not required to withhold payroll taxes for clergy and ***misrepresenting income on a W-2 Form could jeopardize the church’s own tax status.***

**8. What are the tax implications when the church pays a portion of the Self-employment Contribution Act (SECA) tax? If they do, why do I need to pay Social Security and Federal tax on it, too? How does this affect my Effective Salary reporting to the Board of Pensions?**

By law, clergy are considered “self-employed” for Social Security (Self Employment Contribution Act) purposes, and therefore *cannot* have any of their SECA tax paid for them on a tax-favored basis. If you receive any allowance or SECA “offset,” unfortunately it will be subject to Federal Income Tax and added to your SECA tax base.

To the extent that any such SECA allowance is ½ or less of the estimated amount due in any given year, the employer does not need to include the allowance in the Effective Salary reported to the Board or pay Plan dues on that amount.

Amounts over ½ of the estimated SECA amount are reportable and subject to Plan dues. This dues adjustment is designed to treat clergy and lay persons--who have ½ of their Social Security tax (FICA) paid by the employer on a non-dues-bearing basis--equally.

## 9. How can I use the clergy housing allowance to maximum benefit when purchasing a home? What are the basic rules related to the Clergy Housing Allowance?

It is possible to exclude the down payment and other home purchase costs in calculating the amount of your allowable Clergy Housing Allowance. However, you cannot exceed the total amount of such an allowance the IRS will allow in any given year. The maximum amount you can exclude for Clergy Housing Allowance in any year is the *smallest* of the following:

- Fair rental value of your primary residence, furnished, including appurtenances such as a garage, plus the actual annual cost of utilities.
- Amount designated in advance by your Church or Session; or
- Amount you actually spent.

With regard to clergy entering a retirement facility, in the December 2007 Tax Tips Teleconference Mr. Hammar commented that admission fees to retirement communities may be included in your calculation of the Clergy Housing Allowance. However, it must be included all in one year and cannot be pro-rated over several years.

In addition, your monthly “maintenance fees” in such a community often include housing costs, which may be broken-out for you by the facility’s administration.

**Important note:** The admission and maintenance fees cannot be excluded unless your employer designated the amount as a housing allowance in advance of your earning the income, i.e., entering the retirement community in January versus December.

You may obtain copies of the Board’s tax-related resources, including this annual guide, at [www.pensions.org](http://www.pensions.org) or by calling 800-773-7752.

