

TAXATION FOR PASTORS



Survey of the unique rules that apply to the reporting of pastors' federal income and Social Security taxes



OF THE MATTER

WHY STUDY THIS? WHY DO WE CARE?

ROMANS 13:7

Pay to all what is owed to them: taxes to whom taxes are owed, revenue to whom revenue is owed, respect to whom respect is owed, honor to whom honor is owed.

“PASTOR TAX” AREAS WE WILL SURVEY

UNIQUE TAX BENEFITS AVAILABLE TO PASTORS

1. Opportunity to Opt out of Social Security
2. Housing Allowance
3. Pastor's Dual Tax Status
4. 403 (b) Retirement benefits
5. Moving Expenses
6. Taxable nature of other sources of Income

TAKE AWAY REGARDING

1. OPTING OUT OF



Pastors are the only ones who have this opportunity.

This is a “religious” decision, not a financial one!

TAKE AWAY REGARDING

2. HOUSING ALLOWANCE



HUGE TAX BENEFIT!
STUDY THE PROVISIONS!
BE PROACTIVE!

TAKE AWAY REGARDING

3. “DUAL STATUS”



REQUEST VOLUNTARY FEDERAL
WITHHOLDING FROM YOUR
CHURCH!

TAKE AWAY REGARDING

4. 403(b) RETIREMENT BENEFITS



ONLY PASTORS have the opportunity to
invest PRE-TAX DOLLARS into RETIREMENT,
AND RECEIVE BENEFITS TAX FREE.
STUDY THE PROVISIONS!
BE PROACTIVE!

WHO DOES THE IRS CONSIDER A PASTOR?

“MINISTERS” are individuals who are:

- Duly ordained, Commissioned or Licensed by a religious body constituting a CHURCH or CHURCH DENOMINATION, **AND**
- Given the authority to conduct religious worship and administer “ordinances.”

1.



A word cloud centered around the terms "Social Security" and "insurance". The words are arranged in a circular pattern around the central text. The words are in various colors including green, brown, and yellow. The words include: economy, welfare, government, old-age, benefits, income, employment, proposal, definitions, disability, unemployment, responsible, desposits, protection, retirement, patterns, families, poverty, pensions, programs, survivors, benefit, program, categories, health, fund, assistance, federal, tax, and insurance.

economy welfare
income government old-age benefits
employment proposal definitions
disability unemployment
responsible desposits
protection retirement patterns
families poverty
pensions programs
survivors benefit
program categories
health fund
assistance federal
tax

Social Security
insurance

OPTING OUT OF SOCIAL SECURITY IS TIME SENSITIVE


- Form 4361 must be filed in timely manner
 - By the due date of Tax Return for the 2nd year you had at least \$400 net earnings from SE ministerial earnings
- Must inform Church within 30 days of filing Form 4361

WHY WOULD IT BE TEMPTING TO OPT OUT OF SOCIAL SECURITY?

IMMEDIATE GRATIFICATION!

If a Pastor “Opts Out” of Social Security, his
Pastoral Income is exempt from a 15.3% Social
Security Tax

By “opting out” John would pay
approximately **\$8,500 less** in taxes!

a Employee's social security number 011-00-1111		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS website at www.irs.gov/efile	
b Employer identification number (EIN) 00-0246810				1 Wages, tips, other compensation 45000.00		2 Federal income tax withheld	
c Employer's name, address, and ZIP code First Baptist 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 Control number				9		10 Dependent care benefits	
e Employee's first name and initial Last names John E. Michaels 1040 Main Street Hometown, Texas 77099				11 Nonqualified plans		12a See instructions for box 12 E 5000.00	
				13 <input type="checkbox"/> Salaried employee <input checked="" type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay		12b	
				14 Other Housing Allowance \$16800		12c	
						12d	
f Employee's address and ZIP code							
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

2014

Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.

PASTORS CAN ONLY OPT OUT FOR RELIGIOUS REASONS

Neither personal views regarding
SOUNDNESS of Social Security,
nor economic objections to
PAYMENT of taxes,
or any other reason other than
***religious objection to acceptance of public insurance
for ministerial services***
is a valid reason.

To Opt Out, must sign Form 4361

- “I certify that***because of my religious principles I am OPPOSED TO, the ACCEPTANCE ...OF ANY PUBLIC INSURANCE*** that makes payments in the event of death, disability, old age, or retirement; or that makes payments toward the cost of, or provides services for, medical care...”
- “I certify that as a duly ordained minister...I have ***INFORMED THE ORDAINING,*** commissioning, or licensing body of my ***CHURCH.....***” (same language as the above statement)

MECHANICS OF OPTING OUT OF SOCIAL SECURITY

Exemption must be approved by the IRS

1. Pastor must file a timely Form 4361 with the IRS
2. IRS will verify you understand the grounds for exemption by mailing a statement
3. Pastor must sign and return within 90 days
4. If approved, IRS will return the Form 4361 checked “approved.”

CONSEQUENCES OF OPTING OUT OF SOCIAL SECURITY



Once approved, the exemption is generally
IRREVOCABLE.

CONSEQUENCES OF OPTING OUT OF SOCIAL SECURITY

Pastor will need to set aside significant funds to replace Social Security **BENEFITS** which cover:

- Retirement
- Survivor's Insurance
- Disability Insurance
- Medicare-type Medical Insurance

AND AGAIN,
To Opt Out Pastor must sign
Form 4361

“I certify that ...
because of my religious *principles*
I am OPPOSED TO,
the *ACCEPTANCE*
...OF ANY PUBLIC INSURANCE”

WHAT I WANT YOU TO REMEMBER ABOUT OPTING OUT OF



- Pastors are the only ones who have this option.
- This is a “religious” decision, not a financial one!
- It is likely an irrevocable decision.
- Seek the help of a Tax Planner if you decide to opt out.

2. HOUSING ALLOWANCE EXCLUSION

**Most Important Tax Benefit
Available to Ministers**



WHY IS THE HOUSING ALLOWANCE SO BENEFICIAL???

- Pastors can EXCLUDE the church designated Housing Allowance from Income for FEDERAL INCOME TAX purposes!
- However... must remember, the Housing Allowance IS TAXABLE FOR SOCIAL SECURITY purposes.

HOW DOES THE HOUSING ALLOWANCE WORK?

Pastors are responsible to estimate their annual housing expenses AND report them to the Church.

WHAT IS INCLUDED?

ALLOWABLE HOUSING EXPENSES:

- Down payment, and other purchase costs
- Mortgage Payment (interest and principle)
- Real Estate taxes
- Home Insurance
- Utilities - heat, electric, basic telephone, water, etc.
- Furnishings and other decorating items...
- Repairs and Remodeling
- Yard and other home maintenance
- Home Association Dues, and other costs to maintain a home

HOW IS EXEMPT AMOUNT DETERMINED?

1. Pastors may exclude from income, the **SMALLEST** of :
 - Amount actually used to provide home
 - Amount officially designated as Housing Allowance
 - The Fair Rental value of their furnished home including utilities
2. Pastors must report ANY excess Housing Allowance as Taxable Income on 1040,line 7

LET'S WORK THROUGH AN EXAMPLE

Church agrees to pay Pastor John \$61,800 in Compensation.

Church proposes to split his compensation paying him \$45,000 in wages and \$16,800 in Housing Allowance.

JOHN accepted their offer in 2014, but after attending this seminar John feels comfortable proposing a different split based on his Housing Allowance Worksheet calculation.

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1. Pastors may exclude from income, the **SMALLEST** of :
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WORKSHEET CALCULATION

Based on our **Worksheet Calculation**, John petitions the Church to rearrange his compensation to:

HOUSING ALLOWANCE \$36,800

TAXABLE WAGES 25,000

SAME TOTAL = \$61,800

TAX SAVINGS?? (\$20,000 x TAX RATE OF 15%?) = \$3,000.

AND IF TAX BRACKET IS 28%, SAVINGS ALMOST DOUBLE !!



THE IRS WILL NOT ACCEPT A RETROACTIVE HOUSING ALLOWANCE

The church board must designate, through “official”
action AND IN ADVANCE OF PAYMENT the amount
of the pastor’s housing allowance.

OTHERWISE IT WILL BE “TAXABLE INCOME”

HOMEOWNER'S HOUSING ALLOWANCE



Pastors who own their own home may **ALSO**
deduct mortgage interest and real estate taxes
on Schedule A, **EVEN THOUGH**
they exclude those amounts from income as
Housing Allowance.

WHAT I WANT YOU TO REMEMBER ABOUT HOUSING ALLOWANCE



HUGE TAX BENEFIT!
MAX OUT YOUR HOUSING ALLOWANCE!
STUDY PROVISIONS!
BE PROACTIVE!

3. PASTORS DUAL STATUS



PASTORS ARE BOTH EMPLOYEES AND SELF-EMPLOYED



- Pastors are considered “Employees” of the Church and receive W-2 forms
- BUT for purposes of Social Security Taxes, they are considered Self-Employed

IMPLICATIONS OF DUAL STATUS

- Because Pastors are treated as Self-Employed for SS, they are liable for SECA instead of FICA
- SECA treats the taxpayer as BOTH the EMPLOYEE AND THE EMPLOYER
- Therefore the SECA rate is 2xs the FICA Rate
@ 15.3%

IMPLICATIONS OF DUAL STATUS

Even though pastors are liable for Social Security Taxes and Federal Income Taxes, the
CHURCH DOES NOT WITHHOLD
SECA OR FEDERAL INCOME TAXES
FROM PASTORS' PAY,
UNLESS REQUESTED!

PAYING INTO SOCIAL SECURITY “SECA”


Pastors have the option of paying in by either:

Making Quarterly Estimated Payments


OR

Requesting Voluntary Federal Tax Withholding
from their employer

W-2 FOR NON-MINISTER SERVICES

a Employee's social security number 011-00-1111		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS website at www.irs.gov/efile	
b Employer identification number (EIN) 00-1357913				1 Wages, tips, other compensation 3400.00		2 Federal income tax withheld 272.00	
c Employer's name, address, and ZIP code Hometown College 40 Honor Road Hometown, Texas 77099				3 Social security wages 3400.00		4 Social security tax withheld 210.80	
				5 Medicare wages and tips 3400.00		6 Medicare tax withheld 49.30	
				7 Social security tips		8 Allocated tips	
d Control number				9		10 Dependent care benefits	
e Employee's first name and initial Last names John E. Michaels 1040 Main Street Hometown, Texas 77099				11 Nonqualified plans		12a See instructions for box 12	
				13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>		12b	
				14 Other		12c	
						12d	
f Employee's address and ZIP code							
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	

W-2 FOR MINISTER SERVICES

a Employee's social security number 011-00-1111		OMB No. 1545-0008		Safe, accurate, FAST! Use				Visit the IRS website at www.irs.gov/efile					
b Employer identification number (EIN) 00-0246810				1 Wages, tips, other compensation 45000.00		2 Federal income tax withheld							
c Employer's name, address, and ZIP code First Baptist Church 1042 Main Street Hometown, Texas 77099				3 Social security wages		4 Social security tax withheld							
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				7 Social security tips		8 Allocated tips							
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				13 14 15 <input type="checkbox"/> 13a <input checked="" type="checkbox"/> 13b <input type="checkbox"/> 13c <input type="checkbox"/> 13d <input checked="" type="checkbox"/> 13e <input type="checkbox"/> 13f		12b							
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TAKE AWAY REGARDING “DUAL STATUS”



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WITHHOLDING FROM YOUR
CHURCH!

4. 403(b) RETIREMENT PLAN



403(b) PLAN TAX ADVANTAGES

- 403(b) Contributions made by **your church**
AVOID Tax
- 403(b) Contributions made by **you** through
salary reduction AVOID Tax
- Plan Earnings are tax deferred
- Up to 100% of Plan Distributions after age
59½ can be tax-free housing if so designated

TAKE AWAY REGARDING 403(b)



PASTORS have the opportunity to invest
PRE-TAX DOLLARS into RETIREMENT, AND
RECEIVE BENEFITS TAX FREE.
STUDY THE PROVISIONS!
BE PROACTIVE!

5. MOVING EXPENSES



ARE MOVING EXPENSES TO NEW JOB DEDUCTIBLE?

If expenses are within one year of the new job and meet the following tests:

1. Move must be closely related, time and place to the start of work at new job
2. Distance Test – new job must be 50 miles further from your former home than old job
3. Time Test – must work full-time 39 wks of first 12 months

WHAT EXPENSES ARE DEDUCTIBLE?

1. Moving your household goods and personal effects, including storing & insuring during the 30 days since goods were moved from home
2. Travel expenses - cost of transportation and lodging for you and members of your household during one trip to the new home

WHAT IF SOME OF MY MOVING EXPENSES ARE REIMBURSED BY MY CHURCH?

- If allowable expenses are reimbursed under an accountable arrangement, then reimbursements are NOT TAXABLE to you
- Any allowable expenses NOT reimbursed can be deducted on Form 3903
- Excess Reimbursements are Taxable Income

TAKE AWAY FOR MOVING EXPENSES



- DOCUMENT EXPENSES
- REQUEST REIMBURSEMENT WHEN YOU NEGOTIATE EMPLOYMENT
- COMPLETE FORM 3903 IN TAX YEAR OF THE MOVE

6. COMMON MISUNDERSTANDINGS





LOVE OFFERINGS



- LOVE Gifts for the pastor, that are processed through the Church are typically considered taxable income to the pastor
- Encourage church members' to give any pastor gifts directly to the pastor eliminating the church's involvement in the collection, distribution and taxation.

INTEREST-FREE LOANS



- If the church makes a below market interest loan of more than \$10,000 to an employee, it would have to report the "foregone interest" as taxable income to the employee.
- If the same loan is \$10,000 or less, they are not required to report the foregone interest as taxable income

RESOURCE LINKS

ARTICLE ON PASTORS' CHALLENGES IN COMPLYING WITH THE IRS - even the comments are insightful.

<http://www.churchlawandtax.com/blog/2013/october/neglecting-to-render-unto-caesar.html>

I Opting out of Social Security - Form 4361 and instructions

<http://www.irs.gov/pub/irs-pdf/f4361.pdf>

II Housing Allowance

<http://www.iksynod.org/resources/housingallowanceworksheet.pdf>

<http://www.ecfa.org/Documents/TheMinistersHousingAllowance.pdf>

III Generally covers all areas

<http://www.guidestone.org/LearningCenter/Ministry/MinistersTaxGuide.aspx>

<http://www.guidestoneretirement.org/ToolsandEducation/ChurchBudgetPlanning> Compensation link

<http://www.irs.gov/pub/irs-pdf/p517.pdf>