



HOW DO MINISTERS GET PAID?

THE REV. DEB OSKIN, ENROLLED AGENT
HANDOUT AVAILABLE AT:
OskinTax.com/Presentations

TUESDAY
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2022

DESCRIPTION

- Do W-2s and 1099s confuse you? This session, led by a clergy tax expert, will answer the complex question: How do ministers get paid? Learn about the differences between employees and self-employed workers and why those differences matter. Finally figure out what the designated housing exclusion is. Attendees will leave this session ready to use rules regarding health insurance, business expenses, and employer reimbursements to lower their minister's taxable income, and learn tips on how to double-check the W-2 to make sure it was prepared correctly.

OUTLINE

- Independent Contractors vs. Employees
- Clergy Income, Clergy Taxes, & Checking the W-2
- Designated Housing Exclusion
- Health Insurance: Section 105 & QSEHRAs
- Business Expenses & Employer Reimbursements: Non-Accountable & Accountable Plans
- Publications
- Integrated Annual Ministry Agreement Training

BUT FIRST, ABOUT ME

- 1989: Adventures with Clergy taxes began! (husband was ordained; I was ordained in 2004).
- 2000-2011: H&R Block Master Tax Advisor & Certified Advanced Instructor at a Premium Office; On my own since 2011: @ 85% Clergy Clients.
- 2004: Started Teaching & Presenting on Clergy Taxes!
- 2007: Earned Enrolled Agent License from Department of Treasury; 2011: NTPI Fellow: 3-yr. course in Advanced Audit Representation.

WAYS TO CONTACT ME

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APPOINTMENTS
are free!

INDEPENDENT CONTRACTORS VS. COMMON-LAW EMPLOYEES

WHY DOES IT MATTER?

- Employers are required to treat Independent Contractors & Common-Law Employees differently:
 - Employers are not required to withhold or pay any taxes on their payments to Independent Contractors.
 - Employers are required to withhold & pay Income, Social Security, Medicare, & Unemployment Taxes on wages paid to an Employee.

WHY DOES IT MATTER?

- Employers will be held liable for Employment Taxes, plus interest & penalties, if a worker is incorrectly classified as an Independent Contractor.
- All evidence of control & independence in the relationship between employer & worker will be considered.
- This evidence falls into 3 categories: Behavioral Control, Financial Control, & Type of Relationship.

HOW IRS DECIDES

- Behavioral Control
 - How the work is to be done (is this communicated via instructions, training, or other means).
- Financial Control
 - Financial & business aspects of the job (can the worker have unreimbursed business expenses; realize a profit or incur a loss; invest in the facilities used in performing services, etc.).

HOW THE IRS DECIDES

- Type of Relationship
 - How the parties perceive their relationship (what does their contract say; can the worker receive employee-type benefits; is the worker available to work for other similar businesses; etc.).
- Within these 3 broad categories, IRS applies the "20-Factor Test" (listed on IRS Form SS-8) to each situation individually.

CLERGY: "HYBRID" EMPLOYEES

- Pastors are Common-Law Employees of the Congregation:
 - for Federal Income Tax & Benefit Plans
 - but not for FICA or Unemployment Taxes
 - but who must pay Self-Employment Taxes on their total ministerial income
- So: Pastors are Employees of the Congregation who are exempt from FICA but subject to SECA (but who are NOT independent contractors).

CLERGY INCOME, TAXES, & CHECKING THE W-2

CLERGY INCOME

- There are actually 3 types of Clergy income. The first two are reported by the Congregation:
 - Salary . . .
reported on the W-2 in Box 1
 - Housing Exclusion . . .
reported on the W-2 in Box 14
- The third is reported by the Pastor:
 - Self-Employment or Honoraria . . .
reported on Schedule C (Form 1040)

CLERGY INCOME

- The following income is subject to Clergy Tax Rules:
 - Salaries & fees for ministry services (not including royalties from publishing).
 - Offerings received for marriages, baptisms, funerals, masses, etc.
 - Any "gross-up" amount the Congregation pays the Pastor toward their federal income tax or self-employment tax (not including amounts withheld from the Pastor's salary).

CLERGY INCOME

- The following income is subject to Clergy Tax Rules:
 - Fair Rental Value of a Parsonage provided for the Pastor (including furnished utilities) or Parsonage Adjustment (in lieu of parsonage) paid to the Pastor.
 - Value of Meals & Lodging provided for the Pastor & family for the Congregation's convenience.

"GIFTS" VS. SALARY

- "Gifts" vs. Salary:
 - While the Pastor continues to serve, Courts have decided that most "Gifts" or special offerings are actually compensation for services.
 - "Retirement Gifts" to departing Pastor are usually gifts (per the Courts), as there's no expectation of services in the future.
 - "Gifts" from individual members of the Congregation to the Pastor might be gifts; each situation could be different.

"FREE MINISTERS"

- "Free Minister" with no compensation from the Congregation:
 - If not reimbursed under an Accountable Plan, Clergy expenses are cash charitable contributions (regular Schedule A rules apply).
- "Free Minister" with no compensation from the Congregation, but living in the Parsonage:
 - FRV of Parsonage = Clergy compensation. Letter from Congregation with FRV amount can substitute for \$0 (Box 1) W-2.

NOT CLERGY INCOME

- The following income is not subject to Clergy Tax Rules:
 - Offerings made to the Congregation by others.
 - Contributions by the Congregation to a tax-sheltered annuity plan (403(b)) set up for the Pastor, including salary reduction contributions made by the Pastor (usually found on the W-2 Box 12 Code E).

CLERGY TAXES

- Pastors are not subject to taxes that most employees are subject to:
 - FICA: Social Security & Medicare Taxes
 - Payroll Taxes: Unemployment
- Pastors are, however, subject to 2 other taxes:
 - Federal Income Tax
 - Self-Employment Tax: this is usually the largest tax balance-due affecting Pastors.

CLERGY TAX RULES: EMPLOYERS

- Congregations are prohibited by law from withholding FICA taxes for their Pastor.
- Congregations may withhold Federal Income Taxes for their Pastor if requested.
- Congregations must issue a W-2 to their Pastor.
- Congregations can only issue a 1099-MISC to non-employee Clergy (e.g., Supply Preachers).

CLERGY TAX RULES: CLERGY

- All Clergy income is subject to Self-Employment Tax.
- All Clergy income is subject to Federal Income Tax – unless properly excluded by an officially designated Housing Exclusion.

CLERGY INCOME & TAX TABLE

Types/Sources of Clergy Income:	Income Tax?	Self-Employment Tax?	FICA Tax?
Self-Employment Income (Honoraria)	Yes	Yes	No
Employee Salary	Yes	Yes	No
<u>Housing Exclusion</u> Fair Rental Value of Parsonage	<u>Maybe</u> No	Yes	No

EMPLOYER "GROSS-UP"

- "Gross-Up"
 - Congregation can pay their Pastor extra to help pay Pastor's self-employment tax bill.
 - IRS Pub. 15-A Ch. 4 gives a formula for "grossing-up" these payments to Pastors, so that when federal income taxes are taken on the increased amount, the Pastor still receives the amount the Congregation intended.
 - Gross-Up amount is added to W-2 Box 1.

CLERGY W-2

a Employee's social security number		Safe, accurate, FAST! Use Visit the IRS website at www.irs.gov/efile	
b Employer identification number (EIN)		1 Wages, tips, other compensation \$ 13,800.00	2 Federal income tax withheld \$ 4,039.31
c Employer's name, address, and ZIP code		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 name Suffix		11 Nonqualified plans	12a See instructions for box 12
		13 Statutory employee <input type="checkbox"/> Retirement plan <input checked="" type="checkbox"/> Third-party sick pay <input type="checkbox"/>	12b E \$ 1,200.00
		14 Other HOUS EXCL \$15,000 PARS ADJ \$16,308	12c
f Employee's address and ZIP code		15 State wages, tips, etc.	16 Local wages, tips, etc.
15 State Employer's state ID number OH		\$ 13,800.00	\$ 15,000.00
		17 State income tax	18 Local income tax
			19 Locality name CITY

Form **W-2** Wage and Tax Statement **2021** 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.

CLERGY W-2

- The Pastor's W-2 only shows payments to the Pastor which are subject to Federal Income Tax.
- The W-2 prepared by the Congregation shows the Pastor's non-Housing Exclusion compensation in Box 1, & notes the amount of the officially designated Housing Exclusion in Box 14.

CLERGY W-2

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- The W-2 prepared by the Congregation shows the Pastor's non-Housing Exclusion compensation in Box 1, & notes the amount of the officially designated Housing Exclusion, & the FRV of a provided Parsonage or the amount of the Parsonage Adjustment in Box 14.

CLERGY W-2

- Congregations are required by the IRS to issue W-2s (not 1099-NECs) to their Pastors. This is true even if there is no federal income tax withholding.
- Another benefit of using a W-2 (over a 1099-NEC) is that the Housing amounts appear in Box 14.
- However, if the Pastor has \$0 (zero) in Box 1, no W-2 is required. In this case, the Congregation issues a letter on their letterhead detailing the compensation paid to the Pastor.

CLERGY W-2

- Finally, since Pastors are exempt from FICA & unemployment tax withholding, no payroll returns need to be filed for them unless income tax is being withheld.
- If income tax is being withheld for other employees, this option should be offered to Pastors as well. Otherwise, Pastors are required to make estimated tax payments totaling thousands of dollars each year.

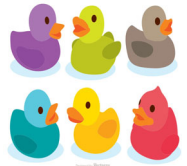
CHECKING THE CLERGY W-2

- Total Pastor's Compensation as reported on W-2 = Box 1 (salary) + Box 12 (pension Code E) + Box 14 (officially designated housing exclusion).
- Confirm that the Housing Exclusion amount listed in Box 14 is correct (check contract & payment records).
- Confirm that there are no entries for Boxes 3-6 (FICA wages & FICA withholding).

DESIGNATED HOUSING EXCLUSION

HOUSING EXCLUSION

- The Housing Exclusion is called by many names, yet they all represent the same thing: the mechanism by which Pastors are permitted to exclude some of their income from being subject to (or taxed by) federal income tax.
 - Housing allowance or exclusion
 - Rental allowance or exclusion
 - Parsonage allowance or exclusion
 - Utilities allowance or exclusion



HOUSING EXCLUSION

- Ordained, Commissioned, or Licensed Ministers performing ministerial services **should** designate **all or part** of their total compensation from their Congregation as Housing Exclusion.
- This allows the amount so designated to be excluded from their income for federal income tax purposes (subject to certain rules).

HOUSING EXCLUSION

- However, remember that all ministry income is subject to self-employment tax, including both the designated Housing Exclusion &/or the Fair Rental Value (FRV) of a provided Parsonage & the cost of all Utilities paid by the congregation.



TYPICAL HOUSING EXPENSES

HOUSING EXPENSES:

rent/mortgage payments (in full)
real estate taxes (in full)
renter's/homeowner's insurance
homeowner's assn./condo fees
repairs & maintenance
furnishings & decorations
lawn care & snow removal
cleaning services
(26 CFR §1.107-1(c)(3))
(etc.)

UTILITIES:

electricity
heating oil
natural gas
pest control
water/sewer/trash
security systems
internet/cable/tv
land-line phone OR
personal use cell phone
(etc.)

HOUSING EXPENSES

- 26 CFR § 1.107-1 Rental value of parsonages
- (c) . . . "Circumstances under which a rental allowance will be deemed to have been used to rent or provide a home will include cases in which the allowance is expended (1) for rent of a home, (2) for purchase of a home, and (3) for expenses directly related to providing a home. **Expenses for food and servants are not considered for this purpose to be directly related to providing a home."**

PARSONAGES

- Rules for Pastors Living in Parsonages:
 - The FRV of the Parsonage (including utilities) is automatically excluded from income before federal income tax is calculated
 - The FRV of the Parsonage (including utilities) is automatically included in income before self-employment tax is calculated

PARSONAGES

- Rules for Pastors Living in Parsonages:
 - The FRV must be reasonable for its location, but it benefits the Pastor's taxes if it is on the low end of the range of rentals in the area.
 - Ask a realtor for up-to-date FRV comps.
 - Pastors should also designate a Housing Exclusion to cover the **stuff** that goes inside the parsonage.

HOUSING EXCLUSION RULES

- The amount officially designated as Housing Exclusion must be specified in writing, in an official document of the Congregation, before any Housing Exclusion payment is made.
 - *It can be a dollar amount or a percentage.*
 - *It can be time limited ("for calendar year 2022") or in perpetuity ("until further notice").*

HOUSING EXCLUSION RULES

- The amount must be used to provide or rent the home (IRC: "provide a dwelling for the minister").
- The amount cannot be more than reasonable pay for Clergy services.
 - *It can be 100% of the Pastor's unspent compensation.*

HOUSING EXCLUSION RULES

- If the designated housing exclusion is 100% of the Pastor's "unspent" compensation, a few other items must be taken out first:
 - Any tax withholding to Federal, state, or local
 - Pastor's pension contributions
 - Pastor's payments for Eder Insurances
 - Pastor's payments for non-Eder Insurances
- The remaining cash salary amount can then be designated as the housing exclusion amount.

HOUSING EXCLUSION RULES

- IF there was no:
 - tax withholding to IRS, state, or local; or
 - pastor's pension contributions;

THEN no W-2 is issued.
- A letter on congregational letterhead details the date the officially designated housing exclusion was approved & total housing exclusion payments to the pastor.

HOUSING EXCLUSION RULES

- Note about pension contributions:
 - "Section 415(c) Limit": Under some specific circumstances, the combined contributions from both the employer and employee cannot exceed \$10,000 in a single year. Be careful to add the contribution amounts together to be sure you are not exceeding this value.

CALCULATING THE EXCLUSION

- The amount that can be excluded from income before federal income tax is calculated is the smallest of the following 3 amounts:
 - The amount officially designated in writing as the Housing Exclusion (always start here)
 - The amount actually spent to provide a home
 - The Fair Rental Value (FRV) of the home, including utilities, furnishings, etc. (basically, everything in the home except food & clothing!)

SUPPLY PREACHERS

- Rules for Clergy Serving as Supply Preachers:
 - The official designation of a Housing Exclusion amount can be made by the Congregation who holds the minister's membership.
 - This is also true for pension payments if not designated by the pension plan.
 - Language can include something similar to: "100% of all income received from Ministerial Services is designated as Housing Exclusion, until further notice."

MOVING EXPENSES

- Due to the "Tax Cuts & Jobs Act," moving expenses are no longer deductible for anyone outside the U.S. Armed Forces. In fact, those expenses paid by the employer become taxable income to the employee & are reported in Box 1.
- I strongly recommend that the costs of moving the Pastor's household **stuff** (not the people) be designated as a special Housing Exclusion before the move occurs & payments are made. That moves these expenses from Box 1 to Box 14.

HEALTH INSURANCE

affordable care act

- Before the ACA, "Applicable Small Employers" (fewer than 50 FTE [Full Time Equivalent] employees) used medical insurance premium reimbursements to help their employees afford medical insurance.
- However, the 2010 Affordable Care Act changed that practice. Many congregations could no longer provide a pre-tax health insurance reimbursement to their employees.

aca exceptions / sec. 105

- There are two exceptions to the prohibition against Medical Insurance Premium Reimbursement under the Affordable Care Act (post June 30, 2015, & without the excise tax penalty of \$100 per day per employee).
- These "one person plans" are now called "Section 105 Plans" & can be implemented with or without plan administration documents.

aca exceptions / sec. 105

- If the Congregation has only one employee ("fewer than two employees") in the plan;
- If the Congregation has only Retirees in the plan.

aca exceptions / sec. 105

- One-Employee Plans
 - IF the Congregation has only one employee who works more than 25 hours per week, on average;
 - THEN the Congregation can reimburse that employee's health insurance under a medical reimbursement plan, pre-tax.

aca exceptions / sec. 105

- Retirees-Only Plans
 - The Congregation can reimburse their retired employees' health insurance under a medical reimbursement plan, pre-tax.
 - There can be any number of retirees in the plan.
 - However: Assume that having a One-Employee Plan means the Congregation cannot also have a Retirees-Only Plan, & vice versa.

qsehra

- If Congregations are unable to take advantage of a Section 105 Plan, there is another option.
- In December 2016, The 21st Century Cures Act created the QSEHRA (Qualified Small Employer Health Reimbursement Arrangement).
- A QSEHRA allows certain small employers to give their employees pre-tax dollars to pay for premiums & other medical expenses, so long as the QSEHRA meets certain standards.

qsehra

- Small employers can offer HRAs on a stand-alone basis to employees, & employees may use funds in qualifying HRAs to buy individual health insurance.
- Maximum annual employer contribution for 2022 (must be prorated per month of coverage):
 - \$5,450 per year for an HRA covering only the employee
 - \$11,050 for an HRA covering the employee & their family

QSEHRA

- Employees cannot contribute to the HRA.
- Employer must provide payment or reimbursement for medical expenses, which can include copays & premiums for individual health insurance, Medicare Supplemental insurance, & Medicare Parts A, B, C, & D.
- Employees must provide documentation in the form of receipts for medical expenses or health insurance premiums paid.

QSEHRA

- 2022 pre-tax reimbursements from a QSEHRA cannot exceed \$5,450 per year for single coverage, or \$11,050 a year for family coverage.
- Amounts above this limit become taxable income to the employee.
- Setting up a QSEHRA requires specific plan documents addressing particular requirements of the law. A professional benefits advisor should be consulted when setting up a QSEHRA.

BUSINESS EXPENSES & EMPLOYER REIMBURSEMENTS

BUSINESS EXPENSES

- In IRS Publication 463, "Travel, Entertainment, Gift, and Car Expenses" (p. 2), IRS defines business expenses as "ordinary & necessary business-related expenses."
- An ordinary expense is one that is common & accepted in the trade or business.
- A necessary expense is one that is helpful & appropriate for the business. An expense doesn't have to be required to be considered necessary.



TYPICAL CLERGY EXPENSES

- Business Mileage
- **Books !** & Subscriptions
- Computer & Internet
- Religious Material; Anointing Oil
- Education (Seminars & Conferences)
- Robes, Vestments, Collars, etc. (& dry cleaning)
- Office Supplies
- **Portion of Cell Phone Bill Used for Ministry**

EMPLOYER REIMBURSEMENT

- Due to the changes to unreimbursed employee business expenses, Congregations should immediately set up a method by which "ordinary & necessary" expenses incurred by Pastors for the benefit of the Congregation are reimbursed to the Pastor.
- It's not an enormous amount to the Congregation, but it's certainly helpful to the Pastor!

EMPLOYER REIMBURSEMENT

- There are many ways Congregations can reimburse Pastors for these expenses. They tend to end up in two categories with vastly different tax consequences for the Pastors:
 - Non-Accountable (~~bad~~) Reimbursement Plans
 - Accountable (**good**) Reimbursement Plans

NON-ACCOUNTABLE PLANS

- Congregations prepare budgets which often include their Pastors' anticipated expenses. Budgets are an essential financial management tool.
- "Allowances" (e.g., car allowance, education allowance, travel allowance, etc.) are based on the Congregation's budget for these expenses.
- Once the expenses are budgeted for, it seems simple enough just to pay it to the Pastor as part of their regular paycheck.

NON-ACCOUNTABLE PLANS

- Allowances are "Non-Accountable Plans." Here are some of their characteristics:
 - Employee is not required to give the employer receipts or other documentation
 - Employee is not required to return any amount of an advance not used for business expenses
 - Employer pays the employee regardless of whether the employer reasonably expects the employee to have business expenses.

NON-ACCOUNTABLE PLANS

- Payments from an Non-Accountable Plan are income to the employee.
- These payments are wages & are subject to withholding & payment of Income, Social Security, Medicare, & Unemployment Taxes.
- Non-Accountable Plans hit Pastors especially hard!
- When Allowances show up on the Pastor's W-2 in Box 1 as salary, that income becomes subject to both federal income tax & self-employment tax.

ACCOUNTABLE PLANS

- "Accountable Plans" are easy to set up. Here are the requirements:
 - Expenses must be business-related
 - Employee expenses must be adequately accounted to employer (receipts provided) in a reasonable & timely fashion (within 120 days)
 - Any excess reimbursement must be returned to employer within a reasonable amount of time (within 120 days)

ACCOUNTABLE PLANS

- Payments from an Accountable Plan are not income to the employee.
- Which means these payments are not wages & are not subject to withholding & payment of Income, Social Security, Medicare, & Unemployment Taxes.
- And they are not taxable income to Pastors!

ACCOUNTABLE PLANS

- However, be careful:
 - If, at the end of the year, there is still money left in the budget in any of these expense categories, & the Congregation decides to give the balance to the Pastor without documented expenses . . .
 - The entire plan for the entire year becomes a Non-Accountable Plan, turning all Accountable Plan reimbursements for the entire year into taxable wages for **every** employee. *Notooooo!!!*

PUBLICATIONS

PUBLICATIONS

- Batts, Michael E. 2019. Church Finance: The Church Leader's Guide to Financial Operations. 2nd ed. Carol Stream IL: Christianity Today Intl. www.ChurchLawAndTaxStore.com
- Laue, Vonna. 2013. Essential Guide to Church Financial Health. Ver. 1.0. Carol Stream IL: Christianity Today. www.ChristianityToday.org
- Newsletters from ChurchLawAndTax.com:
 - Church Finance Update Newsletter
 - Church Law & Tax Update Newsletter

PUBLICATIONS

- Pub 517, Social Security & Other Information For Members Of The Clergy & Religious Workers
 - Pub 15-A, Employer's Supplemental Tax Guide, Ch. 4, "Religious Exemptions & Special Rules For Ministers"
 - Pub 1828, Tax Guide For Churches & Religious Organizations
 - Ministers Audit Techniques Guide (04/2009)
- All pubs & forms can be found at www.irs.gov

PUBLICATIONS

- Pub 15 (Circular E), Employer's Tax Guide
- Pub 463, Travel, Entertainment, Gift, & Car Expenses
- Pub 526, Charitable Contributions
- Pub 535, Business Expenses
- Pub 15-B, Employer's Tax Guide To Fringe Benefits

All pubs & forms can be found at www.irs.gov

agreement TRAINING DATES

- | | | |
|-------------|----------|---------------------|
| • Monday | 09/26/22 | 8:00pm – 10:00pm ET |
| • Wednesday | 09/28/22 | 7:00pm – 9:00pm ET |
| • Tuesday | 10/04/22 | 8:00pm – 10:00pm ET |
| • Thursday | 10/06/22 | 7:00pm – 9:00pm ET |
| • Saturday | 10/22/22 | 11:00am – 1:00pm ET |
| • Saturday | 10/22/22 | 3:00pm – 5:00pm ET |

Each Zoom training will be exactly the same.
Choose whichever time works best for you.