

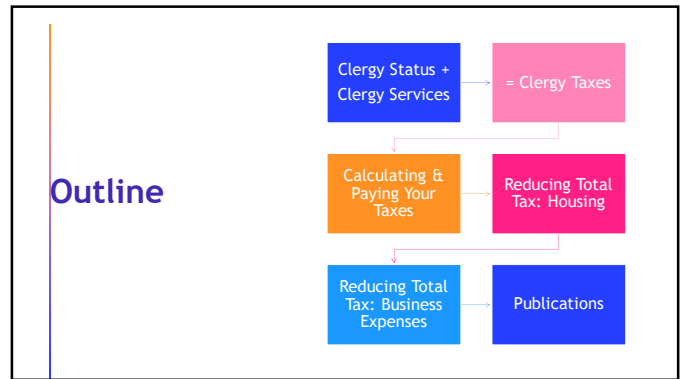
DEMYSTIFYING CLERGY TAXES

The Rev. Deb Oskin, Enrolled Agent

Handout available at:
OskinTax.com/Presentations

OSKIN TAX SERVICES
where clergy come first

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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: @ 80% Clergy Clients
- 2004: Started Teaching & Presenting Clergy Taxes!
- 2007: Earned Enrolled Agent License from Department of Treasury; 2011: NTPI Fellow: 3-yr. course in Advanced Audit Representation

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Ways To Contact Me

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**(1) CLERGY STATUS
+ (2) CLERGY SERVICES
= (3) CLERGY TAXES**

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Who Is A Minister?

- According to Congress (& IRS), a “Minister” is someone who:
 - Is duly Ordained, Commissioned, or Licensed by a religious body constituting a church or church denomination (not in reference to any particular religion)
 - This includes Ministers, Rabbis, Cantors, Imams, and Christian Science Practitioners

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Who Is A Minister?

- The “Minister” is authorized to:
 - Conduct religious worship
 - Perform sacerdotal (“priestly”) functions
 - Administer ordinances or sacraments

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What Does The Minister Do?

- Performs sacerdotal (“priestly”) functions
- Conducts religious worship
- Performs services for nonreligious organizations when assigned or designated by the minister’s church or faith community
 - If not assigned by the church, if they involve sacerdotal functions or conducting religious worship

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What Does The Minister Do?

- Writes religious books or articles
- Controls, conducts, & maintains religious organizations, boards, societies, & other integral agencies under the authority of a religious body
- Directs, manages, or promotes the organization’s activities

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What Does The Minister Do?

- Performs ministerial services at a church-related hospital or health & welfare institution
- Performs ministerial services at a private nonprofit hospital
- *Does not* include ministerial services performed at a government hospital or other government entity

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Bottom Line

IF: You Are A Minister

AND: You Provide
Ministry Services

THEN: Special Tax
Rules Apply To You!

(yes, prayer is appropriate.)



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CLERGY TAXES



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Clergy Taxes

- Pastors are not subject to some taxes that most employees are subject to:
 - FICA: Social Security & Medicare Taxes
 - Most payroll taxes
- Pastors are instead subject to 2 (two) taxes concurrently:
 - Income taxes
 - Self-Employment taxes (usually the largest tax balance due affecting Pastors)

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Clergy Tax Rules

- All ministry income is subject to self-employment tax.
- All ministry income is subject to income tax, unless properly excluded by a designated housing exclusion.
- Employers are prohibited by law from withholding & paying FICA taxes for their Pastor.
- Employers must issue a W-2 to their Pastor. A 1099-NEC can only be issued to non-employee clergy (e.g., supply preachers).

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Clergy W-2

a. Employer's social security number 000-00-0000		Safe, accurate, FAST! Use efile Visit the IRS website at www.irs.gov/efile	
b. Employer identification number (EIN) 00-0000000		1. Wages, tips, other compensation \$18,000.00	2. Federal income tax withheld \$7,065.78
c. Employer's name, address, and ZIP code Happy Valley Congregation 1 Happy Drive Happy Valley, STATE 00000		3. Social security wages	4. Social security tax withheld
d. Control number		5. Medicare wages and tips	6. Medicare tax withheld
e. Employer's first name and initial Last name Happy Valley Minister 50 Valley Avenue Happy Valley, STATE 00000		7. Social security tips	8. Allocated tips
f. Employer's address and ZIP code ST		9	10. Dependent care benefits
15. State Employer's state ID number		11. Nonqualified plans	12a. See instructions for box 12
16. State wages, tips, etc. \$18,000.00		12b. <input checked="" type="checkbox"/> Retirement <input type="checkbox"/> Health <input type="checkbox"/> Life <input type="checkbox"/> Other	12c. <input type="checkbox"/> E <input type="checkbox"/> \$2,000.00
17. State income tax		13. Rollover <input type="checkbox"/> Distribution <input checked="" type="checkbox"/> Withdrawal <input type="checkbox"/> Other	14. Other
18. Local wages, tips, etc. \$18,000.00		15. HOUS EXCL \$13,692 PARS ADJ \$16,308 TOTAL HOUS \$30,000	16. Local income tax
19. Local income tax		20. Locality name HAPVAL	

Form **W-2** Wage and Tax Statement **2022** 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.

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1099-NEC

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0116	
PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		Form 1099-NEC (Rev. January 2022) For calendar year 20	
PAYER'S TIN	RECIPIENT'S TIN	1. Nonemployee compensation \$	Copy B For Recipient This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
RECIPIENT'S name	2. Payer made direct sales totaling \$5,000 or more of consumer products to recipient for resale <input type="checkbox"/>	3	
Street address (including apt. no.)	4. Federal income tax withheld \$	5. State tax withheld \$	
City or town, state or province, country, and ZIP or foreign postal code	6. State Payer's state no.	7. State income \$	
Account number (see instructions)		8. State tax withheld \$	

Form **1099-NEC** (Rev. 1-2022) (keep for your records) www.irs.gov/Form1099NEC Department of the Treasury - Internal Revenue Service

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Table: Active Pastor

	Subject to Income Tax?	Subject to Self-Employment Tax?	Subject to FICA Taxes?
SE Income (Honoraria)	Yes	Yes	No
Employee Salary	Yes	Yes	No
Housing Exclusion FRV of Parsonage	Maybe No	Yes	No

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CALCULATING
& PAYING
YOUR TAXES



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Employer Withholding

- The easiest way for Pastors to pay their taxes is by having the employer withhold taxes from the employee's paycheck before the employee receives it.
- Employers are required to withhold income (& FICA) taxes from their regular employees.
- However, Pastors, as you know, are a class unto themselves! Employers are not required to withhold income taxes from their Pastor employees, although they may do so if requested.

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Employer Withholding

- If there are other employees, then the employer is already involved in withholding procedures & should be willing to withhold for their Pastor as well.
- The Pastor should submit IRS Form W-4 to the employer to give them information they need to withhold taxes properly.
- Of course, Pastors fill out Form W-4 differently than everyone else!

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Form W-4 Instructions

- Form W-4 looks scary, but there are very few entries actually required.
- Step 1: Personal Information
 - (a) Name & Address
 - (b) Social Security Number
 - (c) Filing Status. I recommend that every minister check the 1st box: "Single or Married Filing Separately." This has no effect on how you actually file your tax return; it just tells your employer to maximize the amount of income tax withheld.

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Form W-4

Employee's Withholding Certificate
OMB No. 1545-0074
2023

Form **W-4**
Department of the Treasury
Internal Revenue Service

Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.
Give Form W-4 to your employer.
Your withholding is subject to review by the IRS.

Step 1: Enter Personal Information

(a) First name and middle initial _____ Last name _____
Address _____
City or town, state, and ZIP code _____

(b) Social security number _____

Does your name match the name on your social security card? If not, to ensure you get credit for your earnings, contact SSA at 800-772-1213 or go to www.ssa.gov.

☐ Single or Married filing separately
☐ Married filing jointly or Qualifying surviving spouse
☐ Head of household (Check only if you're unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)

Complete Steps 2-4 ONLY if they apply to you; otherwise, skip to Step 5. See page 2 for more information on each step, who can claim exemption from withholding, other details, and privacy.

Step 2: Multiple Jobs or Spouse Works

Complete this step if you (1) hold more than one job at a time, or (2) are married filing jointly and your spouse also works. The correct amount of withholding depends on income earned from all of these jobs.
Do only one of the following:
(a) Reserved for future use.
(b) Use the Multiple Jobs Worksheet on page 3 and enter the result in Step 4(c) below; or
(c) If there are only two jobs total, you may check this box. Do the same on Form W-4 for the other job. This option is generally more accurate than (b) if pay at the lower paying job is more than half of the pay at the higher paying job. Otherwise, (b) is more accurate. ☐

TIP: If you have self-employment income, see page 2.

Complete Steps 3-4(b) on Form W-4 for only ONE of these jobs. Leave those steps blank for the other jobs. (Your withholding will be most accurate if you complete Steps 3-4(b) on the Form W-4 for the highest paying job.)

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Form W-4 Instructions

- Step 2: Multiple Jobs or Spouse Works
 - Skip this section, even if it applies to you
- Step 3: Claim Dependents
 - Enter "0" (zero) on the far right column. Remember, the idea is to maximize the income taxes withheld from the paycheck, so Pastors don't face a balance due at the end of the year. If the employer thinks you'll have a credit reducing your taxes, they'll withhold less.

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Form W-4 Instructions

- Step 4 (optional): Other Adjustments
 - (a) Other income (not from jobs)
 - Skip this section
 - (b) Deductions
 - Skip this section
 - (c) Extra Withholding
 - This is the most critical entry on this form! This entry allows Pastors to withhold enough federal income tax to cover their expected self-employment tax bill.

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Form W-4

Step 3: If your total income will be \$200,000 or less (\$400,000 or less if married filing jointly):

Claim Dependent and Other Credits

Multiply the number of qualifying children under age 17 by \$2,000 \$

Multiply the number of other dependents by \$500 \$

Add the amounts above for qualifying children and other dependents. You may add to this the amount of any other credits. Enter the total here 3 \$

Step 4 (optional): Other Adjustments

(a) **Other income (not from jobs).** If you want tax withheld for other income you expect this year that won't have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income 4(a) \$

(b) **Deductions.** If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use the Deductions Worksheet on page 3 and enter the result here 4(b) \$

(c) **Extra withholding.** Enter any additional tax you want withheld each pay period 4(c) \$

Step 5: Sign Here

Under penalties of perjury, I declare that this certificate, to the best of my knowledge and belief, is true, correct, and complete.

Employee's signature (This form is not valid unless you sign it.) Date

Employers Only

Employer's name and address First date of employment Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 3. Cat. No. 102093 Form W-4 (2023)

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Form W-4 Instructions

- The first step is to calculate your total self-employment tax for the year.
 - Step 1: Calculate your total ministry compensation by adding together your salary, housing &/or parsonage FRV, & any honoraria expected.
 - Step 2: Multiply total pastoral compensation by 0.9235
 - Step 3: Multiply the result of Step 2 by 0.153. This amount is the total self-employment (SE) tax due for the year on total ministry compensation.

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Form W-4 Instructions

- Step 4: Figure the number of remaining paychecks you will receive for the year:
 - Employees who are paid every other week receive 26 paychecks in a year
 - Employees who are paid twice a month receive 24 paychecks in a year
 - Employees who are paid once a month receive 12 paychecks in a year (etc.)
- Step 5: Divide the result of Step 3 (total SE tax) by the result of Step 4 (paychecks remaining in the calendar year), & enter the result on Line 4(c).

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Form W-4 Instructions

- Having this additional amount withheld helps ensure that enough withholding occurs to cover the Pastor's self-employment tax.
- This amount is a goal!
- Pastors should consider their personal budgets & cash flow to make sure they can have this amount of money withheld from every paycheck & still make ends meet.

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Estimated Tax Payments

- If the Pastor's employer isn't willing or able to withhold income & additional taxes for them, they must make estimated tax payments.
- Commonly called "quarterly taxes," the due dates for estimated taxes are NOT quarterly! They are due on the 15th (or the following Monday):
 - Voucher 1: (04) April 15th
 - Voucher 2: (06) June 15th
 - Voucher 3: (09) September 15th
 - Voucher 4: (01) January 15th

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Estimated Tax Payments

- How much should be paid?
 - Start by calculating the total self-employment tax due for the year (see instructions for Form W-4, Steps 1-3)
 - Next, check the prior year tax return to add any income tax amount owed that year
 - Pastors can also use the estimated tax worksheets, but should use "0" (zero) for all allowance amounts in the worksheets
 - Add these amounts together & divide by 4.

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Demystifying Clergy Taxes

Presenter: Deb Oskin, EA

Sponsored by the Office of Ministry Annual Conference Equipping Session

Estimated Tax Payments

1040-ES Department of the Treasury Internal Revenue Service **2023 Estimated Tax** **Payment Voucher 1** OMB No. 1545-0074

File only if you are making a payment of estimated tax by check or money order. Mail this voucher with your check or money order payable to "United States Treasury." Write your social security number and "2023 Form 1040-ES" on your check or money order. Do not send cash. Enclose, but do not staple or attach, your payment with this voucher.

Calendar year—Due April 15, 2023
Amount of estimated tax you are paying by check or money order.

Pay online at www.irs.gov/efpay
Simple, Fast, Secure.

Print or type

Your first name and middle initial	Your last name	Your social security number
If joint payment, complete for spouse		
Spouse's first name and middle initial	Spouse's last name	Spouse's social security number
Address (number, street, and apt. no.)		
City, town, or post office. If you have a foreign address, also complete spaces below.	State	ZIP code
Foreign country name	Foreign province/county	Foreign postal code

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Form 1040-ES (2023)

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Making Payments Online at IRS.GOV

IRS

Help | News | English | Charities & Nonprofits | Tax Pro

File Pay Refunds Credits & Deductions Forms & Instructions

Helping people understand and meet their tax responsibilities

How can we help you?

- File Your Taxes for Free
- Sign In to Your Account
- Get Your Refund Status
- Make a Payment**
- Get Your Tax Record
- Find Forms & Instructions
- Check Your Federal Tax Withholding
- Get Answers to Your Tax Questions
- Apply for an Employer ID Number (EIN)

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Making Payments Online at IRS.GOV

IRS

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File Pay Refunds Credits & Deductions Forms & Instructions

Make a Payment

English | Spanish | 中文(简体) | 中文(繁體) | 日本語 | Français | Italiano

Bank Account (Direct Pay) We accept full and partial payments, including payments toward a payment plan (including installment agreements). Penalties and interest will continue to grow until you pay the full balance.

Debit or Credit Card **Pay Now**

Your Online Account You'll need to confirm your identity before making a payment using any new options. Make a payment today, or schedule a payment, without signing up for an IRS Online Account. Pay from your bank account, your debit or credit card, or even with a check.

Business Tax Payment (EFTPS) **Pay from Your Bank Account**

Penalties For individuals only. No registration required. No fees from IRS. Schedule payments up to a year in advance.

Interest **Pay Now with Direct Pay**

Tax Withholding **Pay by Debit Card, Credit Card or Digital Wallet (e.g., PayPal)**

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Making Payments Online at IRS.GOV

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File Pay Refunds Credits & Deductions Forms & Instructions

Direct Pay With Bank Account

English | Spanish | 中文(简体) | 中文(繁體) | 日本語 | Français | Italiano

Bank Account (Direct Pay) Use this secure service to pay your taxes for **Form 1040 series, estimated taxes** or **after account setup** directly from your checking or savings account at no cost to you. You can easily keep track of your payment by signing up for email notifications about your tax payment, each time you use IRS Direct Pay.

Debit or Credit Card You can easily keep track of your payment by signing up for email notifications about your tax payment, each time you use IRS Direct Pay.

Your Online Account • Email notification will contain the confirmation number you receive at the end of a payment transaction. • The IRS continues to monitor requests to match not for www.irs.gov/efpay. You will only receive an email from IRS Direct Pay if you've requested the service.

Business Tax Payment (EFTPS) If you have already made a payment through Direct Pay, you can use your confirmation number to access the look up a payment feature. However, you must wait 24 hours before making a payment and two business days before the payment date. You can also check your payment history by accessing your online account with the IRS.

Penalties **Make a Payment**

Interest **Look Up Payment**

Tax Withholding Foreign Electronic Payments

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Making Payments Online at IRS.GOV

IRS

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File Pay Refunds Credits & Deductions Forms & Instructions

Direct Pay

Have questions or need additional information? | Español

Step 1 of 5

Tax Information Select the appropriate payment type and reason for your payment. Information about payment types can be found by clicking the help icon (?). If you are making more than one type of payment or making payments for more than one tax year, submit each of them separately.

Business Taxes? All business tax payments should be made through the Electronic Federal Tax Deposit System (EFTDS).

Reason for Payment Estimated Tax

Apply Payment To 1040ES (for 1040, 1040A, 1040EZ)

Tax Period for Payment 2023

CONTINUE

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Making Payments Online at IRS.GOV

IRS

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File Pay Refunds Credits & Deductions Forms & Instructions

Direct Pay

Have questions or need additional information? | Español

Step 2 of 5

Verify Identity All fields with * are required.

Direct Pay verifies your identity using information from your 1040 filing history. Please provide the following information from a 1040 tax return you filed for one of the years listed in the Tax Year for Verification step above.

Note: The Tax Year for Verification you enter here does not have to match the tax year for your payment.

Tax Year for Verification * 2022 2021 2020 2019 2018 2017

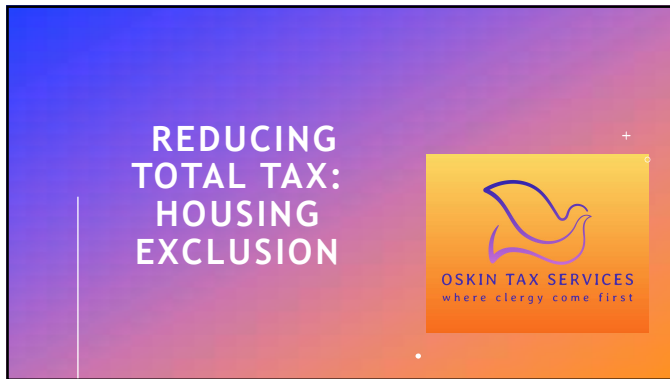
First Name * Last Name *

CONFIRMING AND PAYING

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Housing Exclusion

- The Pastor's designated housing exclusion is called by many names, yet each represents 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
- Parsonage allowance or exclusion
- Rental allowance or exclusion
- Utilities allowance or exclusion



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Housing Exclusion

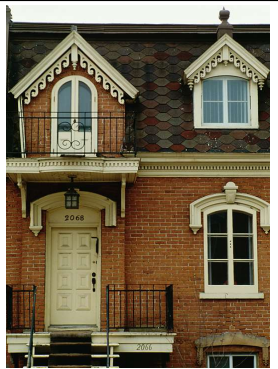
- Ordained, commissioned, or licensed ministers performing ministry services **should** designate **all or part** of their total compensation from their employer as designated housing exclusion.
- This allows the amount so designated to be excluded from their income for federal income tax purposes (subject to certain rules).

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Housing Exclusion

- However, remember that all ministry income is subject to self-employment tax, including both the officially designated housing exclusion, the parsonage adjustment amount, &/or the fair rental value (FRV) of a provided parsonage.



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Typical Housing Expenses

HOUSING EXPENSES	UTILITIES EXPENSES
Rent/Mortgage Payments (in full)	Electricity
Real Estate Taxes (in full)	Heating Oil
Renter's/Homeowner's Insurance	Natural Gas
Homeowner's Assn./Condo Fees	Pest Control
Repairs & Maintenance	Water/Sewer/Trash
Furnishings & Decorations	Security Systems
Lawn Care & Snow Removal	Internet/Cable/TV
Cleaning Supplies & Cleaning Services	Landline Phone —OR—
(26 CFR §1.107-1(c)(3))	Personal Use Cell Phone
(etc.)	

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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." *(emphasis added)*

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Pastors Living in Parsonages

- The fair rental value (FRV) of the parsonage (including utilities if paid by the congregation) is automatically **EXCLUDED** from income before federal income tax is calculated
- The fair rental value (FRV) of the parsonage (including utilities if paid by the congregation) is automatically **INCLUDED** in income before self-employment tax is calculated

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Pastors Living in Parsonages

- The FRV must be reasonable for its location & its condition. Ask a realtor for up-to-date FRV comps.
 - Setting the FRV on the low end of the range benefits the Pastor's tax bill now (lower self-employment taxes)
 - Setting the FRV on the high end of the range benefits the Pastor's social security benefits later (higher reported earnings)
- Pastors need a designated housing exclusion to cover the cost of the **stuff** that goes inside the parsonage.

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Housing Exclusion Rules

- The amount officially designated as housing exclusion must be specified in writing, in an official document of the congregation, before the designated housing exclusion payment is made.
 - *It can be a dollar amount or a percentage*
 - *It can be time limited ("calendar year 2023") or in perpetuity ("until further notice")*
 - *It can be changed at any time with approval in writing by the church board/leadership team*
 - *All changes are prospective, not retroactive*

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Housing Exclusion Rules

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

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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.

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Housing Exclusion Rules

- If there was no tax withholding or Pastor's pension contributions, then no W-2 is issued.
- A letter on congregational letterhead lists the date the officially designated housing exclusion was approved & the total housing exclusion payments to the Pastor.

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Calculating The Exclusion

- The amount that can be excluded from income before federal income tax is calculated is the smallest of the following 3 (three) 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, which includes utilities, furnishings, decorations—basically, everything in the home except food, clothing, & personal care items!

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Fair Rental Values

- For purposes of calculating the excludable housing amount, calculating the FRV of the home you rent or own is very different than calculating the FRV of a parsonage.
- The FRV of a parsonage is calculated based on an empty building, yard, garage, & any utilities paid by the congregation on the Pastor's behalf.
- A realtor can give a good range of rental values for the location & condition of the parsonage.

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Fair Rental Values

- The FRV of the home you own or rent is calculated based on the home, yard, garage, & utilities—but with everything still in it (except food, clothing, & personal care items)!
- Look around your house & really see all the **stuff** inside. What would it cost to rent it all? There is no accepted way to calculate this FRV amount.
- Since underestimating the FRV of your home can cost you significant tax savings, here's my rule:

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Fair Rental Values

**Never allow the FRV
of your home
to be the smallest
of those 3 amounts!**

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Calculating The Exclusion

- If the amount that was officially designated in writing as the housing exclusion is the smallest of these 3 amounts:
 - Amount officially designated
 - Amount actually spent
 - FRV of the home (never the smallest number!)
- Then that amount can be excluded from income before federal income tax can be calculated.

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Calculating The Exclusion

- If the amount that was officially designated in writing as the housing exclusion is NOT the smallest of these 3 amounts,
 - Then
 - The excess of the designated housing exclusion
 - Over the smallest of these 3 amounts (it had better not be the FRV of the home!)
 - Must be added back into wages before federal income tax is calculated.

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Calculating The Exclusion

- Ideally, the officially designated housing exclusion should always be a little higher than the Pastor's actual expenses.
- This way the Pastor can take advantage of any unexpected expenses (e.g., repairs, furniture, disasters) to further reduce their income before federal income tax is calculated.
- If designated correctly, the Pastor will have a small amount of "excess housing" added back into wages each year.

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Calculating The Exclusion: Example

- \$25,000 Designated Housing Exclusion
- \$24,700 Amount Actually Spent on Housing
- \$30,000 FRV of Home, including furnishings, decorative items, & utilities

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Calculating The Exclusion: Example

- \$25,000 Designated Housing Exclusion
- \$24,700 Amount Actually Spent on Housing
- \$30,000 FRV of Home, including furnishings, decorative items, & utilities
- The smallest amount is not the Designated Housing Exclusion, instead it's the Amount Actually Spent: so the difference (\$300) between the Housing Exclusion (\$25,000) & the Amount Actually Spent (\$24,700) is added back into wages & labeled "Excess Housing."

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Supply Preachers

- The official designation of a housing exclusion amount can be made by the congregation who holds the Minister's membership & to whom the Minister is accountable.
- Language can include something similar to:
 - "100% of all income received from ministry services is designated as housing exclusion until further notice."
- No IRS reporting is required. A dated copy of this statement should be kept in the Minister's files.

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Office In Home

- Only available for Schedule C business filers.
- Area must be used regularly & exclusively for business. IRS is serious about this.
- When all housing expenses have been used by exclusion, no expenses remain to be used for an office in home deduction (except depreciation).
- When there are housing expenses that were not used by the housing exclusion, those can be used for an office in home deduction.

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Office In Home

- Cautions:
 - Carefully track which expenses were used for housing exclusion & which expenses were used for office in home deduction
 - Reduce mortgage interest & real estate taxes taken on Schedule A by the amounts permitted on Form 8829 (Office in Home).

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Business Expenses

- In IRS Publication 463, Travel, Gift, & Car Expenses,” IRS defines business expenses as “ordinary & necessary business-related expenses.”
- An ordinary expense is one that is common & accepted in your trade or business.
- A necessary expense is one that is helpful & appropriate for your business. An expense doesn’t have to be required to be considered necessary.



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Typical Pastor’s Business Expenses

- **Books!** & Subscriptions
- Business Mileage (LOG!) & Travel
- Cell Phone Bill (Business Use Portion)
- Clothing (Robes, Vestments, etc. & Dry Cleaning)
- Conferences, Seminars, & Education
- Meals (parishioners, colleagues, while traveling)
- Office Supplies
- Religious Supplies (Anointing Oil, etc.)

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Clergy Business Expenses

- Income & expenses need to be kept together when Pastors do their taxes. That is, expenses need to be attributed to the income they are related to.
- The following slide shows where each type of income and expense is reported.

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Clergy Business Expenses

- Pastors have 3 (three) types of income:
 - Salary (W-2, Box 1)
 - Housing (W-2, Box 14)
 - Self-Employment or Honoraria (Schedule C)
- So their expenses need to be reported as follows:
 - Salary (Clergy Worksheet 3, Line 6)
 - Housing (Clergy Worksheet 1 & Schedule A)
 - Self-Employment or Honoraria (Schedule C)

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Clergy Business Expenses

- Some expenses are shared expenses; that is, they’re used both for salary (parish work) & for self-employment or honoraria (weddings & funerals).
- Shared expenses are prorated according to the proportion of total ministry income represented by the W-2 & Schedule C, respectively:

$$\frac{\text{Income Subject to Income Tax}}{\text{Total Ministry Income}}$$

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Clergy Business Expenses

- How the Pastor's expenses are deducted from income:
 - For Self-Employment Tax: Because all ministry income is subject to self-employment tax, deduct all expenses.
 - For Federal Income Tax: Because not all ministry income is subject to federal income tax, deduct only the portion of expenses that are attributable to taxable income (per Deason Rule).

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Clergy Business Expenses

- Reduce all expenses by the proportion (percent) of non-taxable housing exclusion to total ministry income, as follows:

$$\frac{\text{Non-Taxable Housing Exclusion}}{\text{Total Ministry Income}}$$

Use the Clergy Worksheets
at the end of IRS Publication 517
to calculate these amounts!

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IRS Clergy Worksheets

- Worksheet 1. Figuring the Percentage of Tax-Free Income
- Worksheet 2. Figuring the Allowable Deduction for Schedule C Expenses
- Worksheet 3. Figuring Net Self-Employment Income for Schedule SE (Form 1040)

(see the actual worksheets at end of handout)

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Unreimbursed Business Expenses

- The "Tax Cuts & Jobs Act" of 2017 (effective in 2018) eliminated deductions for unreimbursed employee business expenses from federal income for all employees.
- However, Pastors can deduct their unreimbursed employee business expenses against their federal self-employment income, using the Clergy Worksheets at the end of IRS Publication 517: Worksheet 3, Line 6, "Total unreimbursed employee business expenses."

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Employer Reimbursement Plans

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

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Accountable Reimbursement Plans

- Accountable plans are easy to set up. Here are the requirements:
 - Expenses must be business-related
 - Employee must have paid or incurred deductible expenses while performing services as an employee. The reimbursement or advance must be paid for that expense.
 - Employee must substantiate the expense (provide a receipt) to the employer within a reasonable period of time (within 120 days)

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Accountable Reimbursement Plans

- Employee must return any amounts in excess of substantiated expenses within a reasonable period of time (within 120 days)
- 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, FICA, & payroll taxes
- And they are not taxable income to Pastors!

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Accountable Reimbursement Plans

- But be careful:
 - If, at the end of the year, there is still money left in the budget in any expense category, & the employer decides to give the balance to the employee without documented expenses . . .
 - The IRS could disqualify the accountable plan, meaning all accountable plan reimbursements for every year would become taxable wages for every employee, plus amendments, taxes, & penalties.

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PUBLICATIONS



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Publications

- Hammar, Richard R. (updated yearly). Church & Clergy Tax Guide. Carol Stream IL: Christianity Today. www.ChurchLawAndTaxStore.com
- Sommerville, Elaine L. (2021). Church Compensation: From Strategic Plan to Compliance. 2nd Ed. Carol Stream IL: Christianity Today International. www.ChurchLawAndTaxStore.com

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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

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Publications

- Pub 15 (Circular E), Employer's Tax Guide
- Pub 463, Travel, 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

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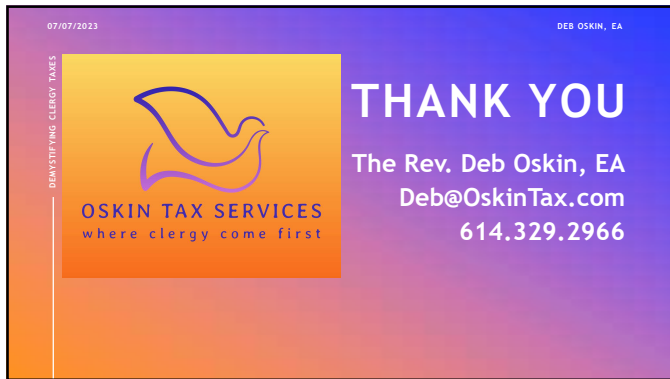
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Worksheets

These worksheets are provided to help you figure your taxable ministerial income, your allowable deductions, and your net self-employment income.

Worksheet 1. Figuring the Percentage of Tax-Free Income

Note. For each line, enter the appropriate amount in **all** boxes that aren't shaded.

	Source of Income		(a) Taxable	(b) Tax-free	(c) Total
1	W-2 salary as a minister (from box 1 of Form W-2)	1			
2	Gross income from weddings, baptisms, writing, lecturing, etc. (from line 1 of Schedule C)	2			
Note. Complete either lines 3a through 3e or lines 4a through 4i. • If your church provides you with a parsonage, complete lines 3a through 3e. • If, instead of providing a parsonage, your church provides you with a rental or parsonage allowance, complete lines 4a through 4i.					
3a	FRV* of parsonage provided by church	3a			
b	Utility allowance, if any	3b			
c	Actual expenses for utilities	3c			
d	Enter the smaller of line 3b or 3c	3d			
e	Excess utility allowance (subtract line 3d from line 3b)	3e			
4a	Parsonage or rental allowance	4a			
b	Utility allowance, if separate	4b			
c	Total allowance (add lines 4a and 4b)	4c			
d	Actual expenses for parsonage	4d			
e	Actual expenses for utilities	4e			
f	Total actual expenses for parsonage and utilities (add lines 4d and 4e)	4f			
g	FRV* of home, plus the cost of utilities	4g			
h	Enter the smaller of line 4c, 4f, or 4g	4h			
i	Excess allowance (subtract line 4h from line 4c)	4i			
5	Ministerial income (for columns (a), (b), and (c), add lines 1 through 4i)	5			
6	Percentage of tax-free income: $\frac{\text{Total tax-free income (line 5(b)) \$}}{\text{Total income (line 5(c)) \$}}$			=	%**
* FRV (Fair Rental Value): As determined objectively and between unrelated parties, what it would cost to rent a comparable home (including furnishings) in a similar location. ** This percentage of your ministerial expenses won't be deductible. Use Worksheets 2 and 3 to figure your allowable deductions.					

Worksheet 2. Figuring the Allowable Deduction for Schedule C Expenses

1	Percentage of expenses that are nondeductible (from Worksheet 1, line 6): _____ %		
2	Business use of car for entire year: _____ miles x 58.5 cents (\$0.585) before July 1, 2022 and 62.5 cents (\$0.625) on or after July 1, 2022	2	
3	Meals: \$ _____ x 100% (1.00)	3	
4	Other expenses (list item and amount)		
a		4a	
b		4b	
c		4c	
d		4d	
e		4e	
f	Total other expenses (add lines 4a through 4e)	4f	
5	Total Schedule C expenses (add lines 2, 3, and 4f)	5	
6	Nondeductible part of Schedule C expenses (multiply line 5 by the percent in line 1)	6	
7	Deduction allowed.* Subtract line 6 from line 5. Enter the result here and on Schedule C, line 27a.	7	

* None of the other deductions claimed in this return are allocable to tax-free income.

Worksheet 3. Figuring Net Self-Employment Income for Schedule SE (Form 1040)

1	W-2 salary as a minister (from box 1 of Form W-2)	1	
2	Net profit from Schedule C, line 31	2	
3a	Parsonage or rental allowance (from Worksheet 1, line 3a or 4a)	3a	
b	Utility allowance (from Worksheet 1, line 3b or 4b)	3b	
c	Total allowance (add lines 3a and 3b)	3c	
4	Add lines 1, 2, and 3c	4	
5	Schedule C expenses allocable to tax-free income (from Worksheet 2, line 6)	5	
6	Total unreimbursed employee business expenses	6	
7	Total business expenses not deducted in lines 1 and 2 above (add lines 5 and 6)	7	
8	Net self-employment income. Subtract line 7 from line 4. Enter here and on Schedule SE (Form 1040), line 2.	8	