

Introduction to Clergy Taxes



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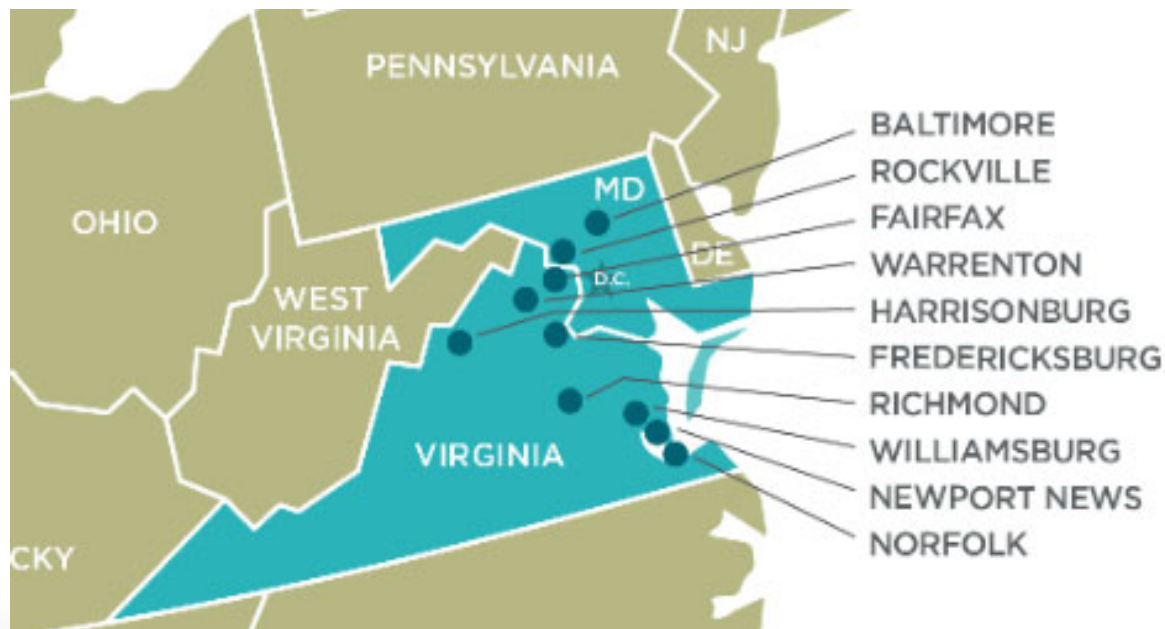


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- PBMares is ranked at 96 of the top 100 Firms
- Ed Yoder is a CPA with 22 years of public accounting experience, based in the Harrisonburg, Virginia



Disclaimer



This material is intended to provide general information about understanding the federal tax system for ministers. It is not intended as legal or tax advice. Please consult your tax attorney or accountant on specific questions related to your situation, or contact me after this seminar.

References

- [IRS Publication 517 Information for Clergy](#)
- [IRS Ministers Audit Techniques Guide](#)
- [MRT Housing Allowance for Retired Ministers](#)
- [EFCA Preparing Tax Returns for Clergy](#)

- Zondervan Minister's Tax & Financial Guide (ECFA)
- There are several other ministers guides available for free online

Special Tax Provisions for Clergy



- Exclusion of the housing allowance or a parsonage from income taxes
- Treatment of clergy as self-employed for social security taxes
- Exemption of clergy from mandatory income tax withholding
- Eligibility for a voluntary income tax withholding arrangements
- Potential “double deduction” of mortgage interest and real estate taxes as itemized deductions and as excludable housing expenses for housing allowance purposes for clergy living in clergy-owned housing
- Exemption of clergy from self-employment social security tax under very limited circumstances (must forego social security benefits during retirement)

Who Qualifies as Clergy?



Treas. Reg. Sec 1.1402(c)-5 requires - *ordained, commissioned, or licensed* by a religious body and meet the following four tests:

1. Administer the sacraments
2. Religious leader appointed by your church
3. Conduct worship services, and
4. Have management responsibility in control, conduct, and maintenance of your congregation

Income Tax Status of Clergy?



- Are clergy employees or self-employed?
- Self-Employment Contributions Act (SECA) not Federal Insurance Contributions Act (FICA)
- Generally receive Form W2
- No longer eligible to claim unreimbursed business expenses on Schedule A
- Better to have an *accountable* plan

Exclusion of Housing Allowance



- IRC Sec. 107 provides “parsonage allowance”
- Clergy Housing Allowance Clarification Act of 2002 – amended the housing allowance exclusion to limit housing allowance to *fair rental value*
- The smallest of:
 - Actual expenses to provide a home
 - Amount officially designated
 - Fair rental value

Fair Rental Value

- Responsibility of the clergy
- Facts and circumstances based on local market
- Look to what other properties are renting for in your area
- May need to adjust for furnishings and utilities

What Housing Expenses Can be Deducted?



- Most reasonable household expenses, including:
 - Down payment on home purchase
 - Principal and interest on mortgage
 - Home equity loan payments (assuming for housing)
 - Escrow payments, taxes, insurance
 - Furnishings, appliances, decoration, redecorating
 - Repairs, maintenance, remodeling, improvements
 - Yard maintenance, pest control, snow removal
 - Utilities, cable, trash pickup, local telephone

Housing Allowance is subject to Self-Employment Tax



- You must report the total compensation subject to SE Tax on Schedule SE. That would include amounts reported in box 1 of your W2, reported on a 1099, plus any amounts reported on Sch C as other SE Income plus amounts designated as housing allowance. You can however, reduce your SE Income by amounts that were deemed to be non-deductible for income tax purposes because they were related to tax-free income.

Expenses Allocable to Tax-Free Income



- IRC Sec. 265 requires business expenses to be allocated between taxable and non-taxable
- Affirmed by U.S. Tax Court *Deason v. Commissioner*, 1964
- You cannot deduct the portion of your expenses that you allocate to your tax-free housing allowance
- Referred to as the Deason adjustment

Deason Adjustment Example



- \$40,000 in earnings for ministerial services
 - \$28,000 W2 ministerial salary
 - \$2,000 honorarium for weddings and speaking
 - \$10,000 tax-free housing allowance
 - \$4,000 unreimbursed expenses (\$3,500 ministry and \$500 weddings and speaking)
 - Nondeductible portion of ministerial salary expenses, expenses are lost, consider *an accountable plan*
 - Nondeductible portion of portion to weddings
 $(\$10,000 / \$40,000) \times \$500 = \125 (Sch C)

Attach Statement to Your Return



- A list of each item for taxable ministerial income by source (wages, salary, weddings, speaking, etc)
- A list of each item of tax-free ministerial income by source (housing and utility allowance)
- How you figured the nondeductible portion of your otherwise deductible expenses
- A statement that other deductions claimed on the year are not allocable to your tax-free income

Deductions to Arrive at AGI



- HSA contributions made by a taxpayer
- Health Insurance Costs of Self-Employed Ministers
- Deduction of $\frac{1}{2}$ of Self-Employment Taxes
- Contributions to a Traditional IRA

Income Tax Withholding

- Pay-as-you-go
- Employees usually have income tax withheld
- Clergy are not subject to mandatory income tax withholding
- Estimated tax payments due
 - April 15
 - June 15
 - September 15
 - January 15

What Records Should I Keep?



- Substantiation requirement
- Prove that you spent the money with documentary evidence that can be confirmed by a third party
- Accounting Software
- Cancelled checks, account statements, credit card receipts, and invoices
- Digital Records
- Maintain for at least 7 years

Contact



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