



Clergy Employment and Tax Information

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Is Your Minister an Employee or Self-Employed?

Minister or Pastor Employment Status: Below are some important facts to consider when determining if your pastor is an employee of your church or self-employed.

One of the frequently asked questions on this site is whether to issue the pastor a W-2 or 1099.

The answer always lies in determining if the minister is an employee of the church or considered self-employed.

A long time ago...all pastors and ministers were considered self-employed; however, in the mid 1980's the IRS decided to declare ministers "employees" of the church.

Most tax professionals will tell you unless the pastor has full control over the church...they should be considered an employee of the church and be issued a W-2 to report compensation.

Now remember...even though they are "employee" of the church...the IRS considers [ordained ministers to have a "dual status"](#). Which means a minister is considered an employee for federal income tax purposes and self-employed for Social Security and Medicare purposes.

That brings us to another frequently asked question: FICA or SECA?

*A church should **not** withhold and match Social Security and Medicare taxes (FICA) from a minister's wages. A minister pays his Social Security and Medicare taxes under the SECA system.*

Note: *Social security and Medicare taxes are collected under two systems. Under the Self-Employment Contributions Act (SECA), the self-employed person pays all the taxes. Under the Insurance Contributions Act (FICA), the employee and the employer each pay half of the taxes. No earnings are subject to both systems.*

Also see this page on [fringe benefits for pastors](#).

Clergy Tax

Clergy tax, also known as “minister tax”, raises some interesting questions for the church.

Is the church required to hold out federal and state income tax from a minister's paycheck?

How about Social Security and Medicare taxes? Is the church required to match the FICA tax?

A clergy's tax situation is unique and as church administrators residing in the United States, it is imperative that we know the IRS's tax laws regarding minister or clergy taxes before we write that first paycheck.

But first and foremost.....

Clergy Tax Factor 1: Determining who is a minister for tax purposes

In order to be classified a clergy for tax purposes, a minister must satisfy all five separate tests:

- Be licensed or ordained
- Administer the sacraments of the church (*weddings, funerals, baptisms, and communion, etc...*)
- Be considered a religious leader by the church
- Conduct religious worship
- Have management responsibilities in the church

The Pastor is almost always considered a clergy for tax purposes.

Clergy Tax Factor 2: What special tax treatment do clergy receive?

Clergy receive special tax treatment for the following three topics:

- Ministers pay their own self-employment tax. (*Even though ministers can be considered church employees, they are treated as self-employed for Social Security and Medicare tax purposes.*)
- Ministers can receive a *Housing Allowance* and/or live in a church provided parsonage. (*The value of both of these are excluded from a minister's calculation of income tax...but still subject to self-employment tax*)
- Churches **cannot** withhold Social Security and Medicare tax from a minister's paycheck.

Clergy Tax Factor 3: Self-employment tax

The self-employment tax consists of 12.4% for Social Security and 2.9% for Medicare (15.3% combined).

Unlike non-minister employees, the church cannot withhold half of the Social Security and Medicare tax from a minister employee's paycheck and does not have to match any FICA tax as none is held out.

Instead, a minister employee is responsible for paying his own self-employment tax. As a result, the minister employee actually pays twice as much Social Security and Medicare as a non-minister employee.

In most circumstances the amount of the minister's income that is subject to the self-employment tax includes the base salary, the housing allowance, and the fair rental value of church provided housing, if any.

An example of what a minister could expect to pay in self-employment tax :

32,000 (base salary) plus an additional \$14,400 (housing allowance)= \$46,400 times 15.3% =**\$7048** (Note: This amount does not include the minister's income tax)

Clergy Tax Factor 4: Can a clergy opt out of social security?

Yes. But he must do it by the second year in which he earned more than \$400 of ministerial income. IRS Form 4361 must be used and it must be filed on the correct basis of religious belief. If approved by the IRS, only earnings from ministerial services are exempt from self-employment tax. Form 4361 indicates that once the exemption is approved, you cannot revoke it.

Clergy Tax Factor 5: Can a church withhold tax for the clergy?

Yes. The church can withhold *income tax*, but not Social Security and Medicare tax.

A minister is responsible for paying the Social Security and Medicare tax himself. He can pay this tax by making quarterly estimated tax payment, or by requesting the church to hold out extra income tax.

The minister who is considered a church employee must complete a form W-4 and request that a specific amount be withheld from each paycheck.

For example, if a minister estimates that his combined income and self-employment tax for the year will be \$9600. He can request that the church withhold \$800 of *income tax* from each month's paycheck.

Even though the minister can only elect withholding of income taxes, he can use these tax payments against both income and self-employment tax since they are added together on his personal income tax return (Form 1040).

****Important:*** *You cannot withhold taxes from ministers' pay without the minister's authorization. Ministers are exempt from income tax withholding whether they report their income taxes as employees or self-employed; ministers who report their income taxes as an employee can request voluntary withholding by submitting a Form W-4 to the church.*

Setting Up a Housing Allowance

A housing allowance is the greatest tax benefit available to ministers. It is also one of the least understood.

A housing allowance is simply a portion of a minister's compensation that is so designated in advance by the minister's employing church.

It is very beneficial for ministers because an allowance for housing is excluded from federal income tax. However, it is not exempt from the minister's self-employment tax...more on that later.

In order to qualify for the exclusion from federal income tax, two very important conditions must be satisfied:

- The housing allowance must be board approved before it was paid (*A housing allowance is NEVER retroactive*)
- The minister actually spent the allowance on eligible housing expenses during the year

Your church must make sure the amount they are going to pay as an allowance for housing is determined before it is paid. It should be included in a board approved resolution and properly documented in the church records. Most of the time, it is reviewed and adjusted at the beginning of each new budget year.

Here is an example of [housing allowance worksheet](#) your minister can use to figure his housing expenses.

Your church does not have anything to do with the second condition. The minister has the responsibility of tracking actual housing expenses and determining the fair rental value of the housing.

What types of expenses are included in a allowance for housing?

It may be used for any expense relating to renting a home, purchasing a home, and maintaining a home. Some of the eligible expenses are:

- mortgage payments/rent
- utilities
- mortgage interest and insurance
- home insurance
- property tax

What about taxes on a church provided parsonage?

If a minister lives in a church provide parsonage, the minister is not subject to income taxes on the use of the parsonage.

However, the fair rental value of the parsonage is added when figuring his self-employment tax. (*The minister is responsible for determining the fair rental value of the parsonage.*)

What if the minister does not spend all of the allowance on housing?

The church does not have any responsibility in making sure that the minister spends all of his allowance on housing expenses.

Instead it is the minister's responsibility to report any excess funds as taxable income. The church should never know, and has no right to know, what the minister does with his housing allowance.

How does the church report this tax benefit?

The church is not required to report the minister's allowance for housing to the IRS. However some churches choose to report it in Box 14 of the minister's W-2 (which is labeled "Other") as a courtesy to the minister.

Or, churches can just include the amount of the allowance in a separate letter to the minister. *(This separate letter should not be sent to the IRS and will not be included or attached to the minister's personal tax return.)*

Are the allowance payments exempt from all taxes?

No. Housing allowance payments are exempt from federal income taxes, but not from self-employment taxes (Social Security).

A minister who receives such an allowance must report the lesser of the following amounts on a SE schedule on their personal income tax return:

- The amount actually spent on eligible housing expenses.
- The fair market rental value plus furnishings and utilities.
- The amount officially designated in advance as housing allowance.

Are the allowance for housing payments exempt from state taxes also?

Generally, housing allowance payments are exempt from most state's income tax.

Housing Allowance Resolution: Examples of Minutes Required

How do you establish a housing allowance?

You will need to include the following example in the minutes of any business meeting of the church or board. The names of the individuals making the motion and seconding it should be included.

If the church does not provide a parsonage and pay the utilities, then the second paragraph is to be omitted.

The housing allowance cannot apply to expenses paid before the date of these minutes. *A housing allowance is never retroactive.*

1. It was discussed that under the tax law a minister of the gospel is not subject to federal income tax on the "housing allowance paid to him as part of his compensation to the extent used by him to rent or provide a home."
2. The parsonage owned by the church has a rental value of \$_____ and is provided for the convenience of the church. Actual utility expenses will be paid by the church and they will amount to approximately \$_____ for the year.
3. After considering the statement "Pastor's Estimate of Home Expenses" prepared by _____, a motion was made and seconded and passed to adopt the following resolution:
4. Resolved that Pastor _____ is to receive a total cash remuneration of \$_____ (salary) for the year 20___. Of this amount, \$_____ (housing expenses paid from salary) is hereby designated as housing allowance.
5. Resolved that as long as Pastor _____ is our employee the above amount of housing/parsonage allowance shall apply to all future years until modified.

Date _____ Signed _____

A Housing Allowance Worksheet or Pastor's Estimate of Home Expenses

Should a church have their minister fill out a housing allowance worksheet?

Yes. A completed worksheet should be included in the church's housing allowance minutes. Title it what you want and make sure it is completely filled out by your qualifying minister before your church board meeting.

How does a pastor estimate his housing expenses?

Your pastor can use the following form to estimate his housing allowance. The housing allowance can be amended in midyear, but the housing allowance is never retroactive.

Name of church _____

Position held _____

Housing allowance for the coming year of 20____. I expect to incur the following expenses to rent or otherwise provide a home.

Rent or payments on purchase of a house including down payment, principal payments, interest, taxes, and improvements: \$ _____

Furnishings and appliances: \$ _____

Utilities : \$ _____

Other housing expenses (cleaning supplies, etc.): \$ _____

Miscellaneous repairs: \$ _____

Total: \$ _____

Signature _____ Date _____

Housing Allowance Expenses

The housing allowance may be used for any expense relating to renting a home or purchasing a home. Some of the eligible cost or expenses are:

- Down payment on a home
- Home Mortgage payments, including both interest and principal
- Real estate taxes
- Personal property tax
- Fire and homeowners liability insurance
- Rental payments
- Cost of acquiring a home (i.e. legal fees, bank fees, title fees, etc.)

The housing allowance can also be used for maintaining a home. Some of the eligible cost or expenses are:

- Home improvements
- Minor repairs
- Utilities
- Furnishings and appliances ((dishwasher, TV, refrigerator, pool table, vacuum cleaner, personal computer, etc.)
- Home decor (rugs, curtains, plants, knick knacks, wallpaper, paint, towels, bedding, etc.)
- Lawn care (lawnmower, garden hose, sod, landscape tools, etc.)
- Basic telephone Services
- Cable TV
- Internet Service
- Pest Control
- Miscellaneous (light bulbs, cleaning supplies, carper cleaning, etc.)

Examples of expenses which are not eligible are:

- Foods
- Servants
- Cleaning service or expenses for a person to clean your house
- Groceries
- personal toiletries
- CDs and DVDs
- Personal computer software