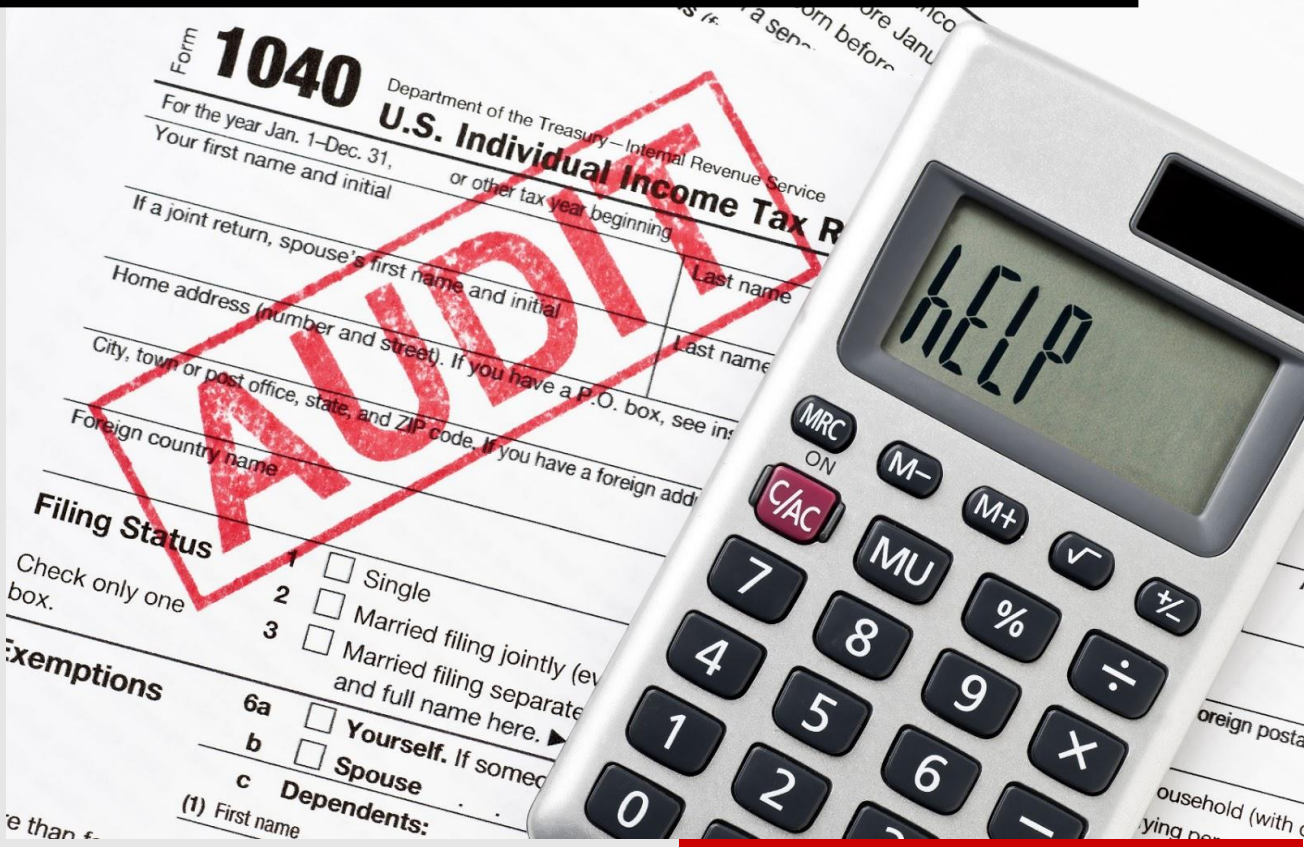
Tax Information Manual



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Tax Information Manual – 2022

Outline

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INTRODUCTION (AND DISCLAIMER)

There is literally no way that the major tax issues impacting churches, ministers, and church-related employees can be addressed in 70 or 80 pages. The goal of this manual is not to be all-inclusive – but rather to deal with some common tax issues in a generic fashion. If you are looking for specific tax advice to deal with your once-in-a-lifetime situation, this is not the manual for you. However, if you are seeking general guidance on common tax questions, it is our hope that this manual will provide some insight.

What you will find on the following pages are articles that the Benefits Board has released on specific tax issues over the past couple of years. In addition, you will see specific questions – as well as the responses – to tax issues raised by our participants and other church-related employees.

Again, this document does not purport to be an exhaustive study on the tax laws impacting ministers, churches, or church-related employees. For that type of treatise, I would suggest Richard Hammar's *Church & Clergy Tax Guide* or Dan Busby's *Minister's Tax & Financial Guide*, both of which are updated annually to take into consideration the changing tax laws.

What follows is an easy to read and (hopefully) an easy to understand guide to help you deal with some of the most common tax issues that arise in the church setting. There is no attempt made to cover *all* of the financial and taxation issues that may confront a church. However, general information is given so that the minister, church, or church-related employee can comply with the basic tenets of the tax laws.

Neither the Board of Directors nor the staff of the Benefits Board is engaged in rendering financial advice, legal advice, tax advice, or other financial planning services. If such advice is desired or required, the services of a competent professional should be sought.

IRS Circular 230 Notice: *United States Department of the Treasury Regulations require the Board to inform you that to the extent this communication or any attachment or link hereto concerns tax matters, it was not intended nor written to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by United States Internal Revenue Code.*

"I'm proud to be paying taxes in the U.S. The thing is, I could be just as proud for half the money." Arthur Godfrey

JUST THE (TAX) FACTS

History of Taxes

Have you ever thought about the history of taxes in this country? To this day, some contend that our current system of taxation is unconstitutional – and therefore, they refuse to pay taxes on those grounds. Of course, the government has a place for those objectors – and it is called prison.

Ken Frenke, a noted Christian financial writer and commentator, points out that in 1913, less than 1 percent of households had to pay the first income tax, which raised about $500 million. A 100 years later, Americans filed 237.9 million tax returns, including 145.4 million individual returns. More than $2 trillion dollars was collected! Our tax system has come a long way in the last century.

The Office of Management and Budget points out where the tax revenues come from: Individuals pay 81 percent of all taxes. Income taxes account for 47 percent of that amount. Social Security and Medicare taxes total 34 percent. Corporations pay another 9 percent. Tariffs and excise taxes, upon which the federal government operated for almost 140 years, along with estate and gift taxes, now comprise just 9 percent of federal income.

Of those numbers, it is most interesting that the amount collected for personal income taxes is only slightly more than the amount collected for "payroll taxes," i.e. Social Security and Medicare taxes. Over the past decade, Congress has discussed, but has never taken action to reduce the burden of the payroll tax withholdings. However, with recent news that Medicare will run out of money in the next 10-15 years unless substantial revenue sources are found, do not look for any permanent reduction in payroll taxes in the near future.

The statistics on who pays taxes are also enlightening. Most people would contend that their tax burden has gone up recently. In his article for *Crown Ministries*, Ken Frenke states the opposite. Believe it or not, taxes on middle-income families have been falling for years. A family of four now pays the lowest percentage of their income, 7.5 percent, in federal taxes since 1965. The top 50 percent of all wage earners pay 96 percent of all income taxes. The bottom 50 percent pay just 4 percent. On the other hand, Frenke does not point out that many local jurisdictions (states, counties, and cities) have increased their tax load on individuals due to the lack of federal funds available to them.

While we do not like to admit it, paying taxes is a way for us to obtain the resources of the government to help us carry on the activities of our daily lives. Without roads, infrastructure, armies, etc. we would be open to the whims of despots. So our government serves a vital

function. However, your goal should be to pay your fair share of taxes – and no more. Ministers, in particular, have ways that they can legally avoid tax liability. Those opportunities are discussed at length in this manual and in the Minister's Compensation Manual available on our web site (www.benefitsboard.com). Tax avoidance is commendable; tax evasion is not. As I always say, the difference is 20 years in prison.

W-2 AND 1099 ISSUES

Employee or Self-Employed

If you are a pastor or employee of a Church of God church or related entity, you should receive a Form W-2 from your employer by no later than February 1. While many minister (and churches) continue to claim that the minister is "self-employed" and therefore should receive a Form 1099, the church polity of our denomination makes it almost universal that our ministers are employees of the local church for tax purposes – and thus required to receive a W-2 rather than a Form 1099. Based upon case law, it seems rather clear that Church of God ministers have a dual tax status – they are employees for federal tax purposes, but they are self-employed for Social Security/Medicare purposes. While this topic is confusing and not subject to clarification in this forum, I would recommend that you visit our web site (www.benefitsboard.com) and review the Treasurer's Manual where a more detail discussion on this issue can be found.

Completing the W-2 Form

By the end of January, the church treasurer must provide an IRS Form W-2 to the pastor and any other staff member of the church. On the other hand, IRS Form 1099-NECs are provided to "independent contractors," such as evangelist. A line-by-line discussion of how to complete the IRS Form W-2 is included here. Completing the IRS Form W-2 should be relatively simple for the church treasurer. Additional information can be obtained from the Treasurer's Manual available at www.benefitsboard.com. Step-by-step instructions and tips follow:

- Box a – list the employee or minister's Social Security number
- Box b – list the employer/church's IRS identification number. Every church should have an Employer Identification Number. If not, the church treasurer on behalf of the church may obtain an Employer Identification Number (EIN) by completing IRS Form SS-4 or by applying on-line for an EIN number.
- Box c – list the name and address of the employer/church
- Box d – nothing goes in this box generally
- Box e – list the name of the employee or minister
- Box f – list the address of the employee or minister

- Box 1 – list all reportable taxable income for the employee or minister (do **not** include employer/church retirement plan contributions, amounts reduced from the employee or minister's salary through a valid salary reduction agreement, or ministerial parsonage/housing allowance). However, health insurance assistance paid towards an employee/ministers' *individual* policy should be included here as income.
- Box 2 – if the minister voluntarily requested that federal income taxes be withheld from his taxable compensation, including additional amounts to cover his Social Security tax liability, then list those amounts here. If there was no voluntary withholding agreement, nothing should appear in Box 2 of the minister's Form W-2. Of course, all Federal income tax withheld from an employee's compensation should be listed here.
- Box 3 through Box 6 – nothing appears in these boxes for *ministers*.
- Box 3 – for employees, the amount of compensation subject to Social Security appears here. The church treasurer should be aware that the "cap" amount subject to Social Security adjusts each year based upon inflation. The treasurer should also be aware that while salary reduction amounts withheld from a minister's income for retirement are not taxable for income tax purposes or Social Security tax purposes, salary reduction contributions for non-ministers withheld for retirement are taxable for Social Security purposes but are not taxable for federal income tax purposes.
- Box 4 – for employees, the amount of Social Security tax withheld appears here.
- Box 5 – for employees, the amount of compensation subject to the Medicare tax appears here. There is currently no cap on how much compensation can be taxed for Medicare purposes.
- Box 6 – for employees, the amount of Medicare tax withheld appears here.
- Box 7 through Box 11 – nothing generally appears in these boxes for ministers or employees in a church setting.
- Box 12 – use the following codes and state the amount (additional codes may be applicable):
    - C – Reports cost of group term life insurance benefits in excess of $50,000 paid by the employer/church
    - E – Reports amounts contributed to a 403(b) retirement plan (like the Minister's Retirement Plan) *by salary reduction* from the employee. Please note that retirement plan contributions made by the employer are not reported anywhere on the IRS Form W-2.
    - DD – Reports cost of employer-sponsored *group* health coverage. The amount reported with Code DD is not taxable.
- Box 13 – If the minister or employee participates in the Minister's Retirement Plan, either through employer/church contributions and/or salary reduction contributions, check the box that reflects "retirement plan."
- Box 14 – Report housing allowance or fair rental value of parsonage for ministers. For example, if the minister received a housing allowance, Box 14 would report

"12000.00 – Minister's Housing Allowance." If the minister lives in a parsonage, Box 14 would report "12000.00 – Parsonage Rental Value."

- Box 15 through Box 20 - nothing appears in these boxes generally for ministers. However, in the case of employees, the church will most likely be required to withhold state and local taxes if applicable. If so, then the treasurer would complete these boxes as appropriate.

The IRS provides detailed instructions on the completion of Form W-2 if such is needed beyond these cursory guidelines. In addition, the church treasurer should seek guidance and advice from a qualified tax professional if he or she is unsure on how to adequately complete the Form W-2 or the Form 1099. Seeking advice before providing the forms to the wage earner and before filing such with the IRS is much easier than the treasurer trying to correct incorrect forms already filed. A completed sample Form W-2 can be found as Attachment B to the Church Treasurer's Manual discussed above.

More W-2 Tips

A W-2 form must be issued to any employee (including ministers) who received compensation from the local church during the previous tax year. In completing the forms, here are a few tips to remember:

- The W-2 forms must be completed and issued to each employee by no later than January 31. The employer/church must then make sure that they submit to the Social Security Administration "Copy A" of each W-2 form and the W-3 transmittal form by the same date – January 31. (**NOTE** the new date for filing W-3s.)
- You can obtain blank W-2 forms from your local IRS office, your local post office, or by calling the IRS toll-free forms number (1-800-TAX-FORM).
- All dollar entries on the W-2 should be made without dollar signs and commas, but with a decimal point and cents. For example, $1,000 should read as "1000.00." If you put down 1000, the IRS scanning equipment will read that as $10.00 – so make sure that decimals and cents are used.
- If a box on the W-2 does not apply, leave it blank. Do not insert "0" or "N/A."
- Make sure that you use the correct employer identification number (EIN) for the church/employer. This is critical especially if you have more than one entity (such as a church school) operating under a similar name.
- In identifying employees on the W-2 (Box e), do not include titles, such as Rev., Mr. or Dr. Also, do not include suffixes such as Jr. or Sr.
- Make sure that the ministerial housing allowance or the fair rental value of the parsonage is not included in Box 1 wages. However, do include insurance assistance payments provided to pay *individual* healthcare policies.
- Check the retirement box in Box 13 only if the minister or church-related employee participates in a recognized retirement plan, such as the MRP.

- Make sure the ink on the W-2 is not too faint, and that the writing is legible and not too small.
- If you need additional assistance in completing the W-2 form, do not hesitate to contact the Benefits Board for general information or for specific information, you may call the IRS directly at 1-866-455-7438 for assistance.

Q: ***This year we had an appreciation day for a couple of our paid staff members (music minister & youth minister). On those days the offering from the floor was designated as a gift to these staff members. I know that this is taxable income to the individuals. What I don't know is if we are supposed to list these special offerings on their W-2s like we do offering to Pastor that individuals sometimes give or if we should just notify them that the gift should be considered taxable.***

A: You are correct - these "offerings" are taxable. The question is how was the money tabulated? If the church took the offering, counted it, and then turned it over to the staff pastors, either by giving them the cash or by cutting a church check for the amount, then the offering should be included in the pastor's W-2 as compensation. Basically, you would treat such as additional salary.

If the offering was taken and there was no accounting by the church, then the pastors should be advised that such is taxable income. Technically, under this scenario, the IRS would suggest that the pastors should advise the church of the offering amount so that it could be included in their W-2. Of course, that does not generally happen in real life.

I assume the first scenario is what happened. So yes, the amount should be included in their Box 1 reportable income on their W-2s.

Q: ***An area pastor died in the middle of this year. The church promised to pay his salary and housing allowance to his widow for the remainder of the year. How should the church report this to the widow? Would it all be reported as W-2 information? Or***

would the portion paid while the pastor was alive be reported on a W-2 and the amount paid to the spouse be reported on a 1099-R? Should the portion paid to the widow for the housing allowance be included in the 1099-R amount?

A: I think we probably need to divide your question to provide a correct answer. First of all, for salary and housing received during the life of the minister, a W-2 needs to be issued to the deceased minister listing the salary in Box 1 and the housing/parsonage allowance in Box 14. Of course, taxes would be due on the Box 1 amount and Social Security/Medicare would be due on the Box 1 amount and the Box 14 amount.

Then we move to the second issue. I have to assume that the widow performed no services for the church after the death of her husband (and I make that assumption based upon your suggestion that such income be reported as "retirement" type income by the use of a 1099-R). I also have to assume that the widow was not a credentialed or licensed minister. If these two assumptions are true, then it is my belief that any "salary" income and housing allowance (or the fair market value of the use of the parsonage) paid to the widow after the death of her husband must be counted as income to the widow. However, I would suggest that such be reported to her on a 1099-NEC, rather than on a 1099-R. I make that suggestion simply because 1099-Rs are generally reserved to denote distributions solely from pension plans. Again, if she had no ministerial licenses or credentials (with any recognizable church or denomination), then the housing allowance (or fair rental value of the parsonage) must be included as income to her on the 1099-NEC.

I would suggest that you look at Revenue Ruling 2003-12 in which "benevolent assistance" was discussed and was determined to be non-taxable in the limited situation addressed in that ruling. You might find some insight to assist your client from that ruling.

Q: ***When we have people within our congregation who need benevolence assistance and we pay out this money, are we required to give them a Form 1099 at the end of the year if it exceeds $600.00? Sometimes the check may go straight to the person but when we can, we pay the amount directly to the provider, i.e. the power company. If this person is an employee, is it treated any different? I have read in a tax book that 1099's are not supposed to be given to employees but I may be misunderstanding this. Please help.***

A: You are correct in that you should be giving non-employees a Form 1099-NEC for benevolent assistance if such is greater than $600 in a year. While there is a limited exception to this requirement, most situations do not fall into that exception. Further, whether the amount is paid directly to the non-employee or whether such is paid to a vendor (power company), it is all treated the same and should be included on the Form 1099-NEC.

If the benevolent assistance is to an employee, such is simply added to their W-2 form – and you do not give them a separate Form 1099. As you can imagine, this can mess up their withholdings and create additional tax liabilities. However, any additional amount given to an employee, regardless of what it is called, is treated as additional compensation and is fully taxable.

Tax Withholdings for Ministerial Staff

Much has been written about the "dual" tax status of ministers. In very simplistic terms, ministers are viewed by the IRS as an "employee" for federal income tax purpose but as "self-employed" for Social Security/Medicare purposes. This dual status creates heartburns for church treasurers as they try to determine whether they can withhold certain taxes from the minister's salary.

The general rule is that unless the minister request withholdings, there are to be **no** withholdings for either federal income taxes or self-employment taxes taken out of his paycheck. In this situation, the minister is responsible for filing a quarterly return to pay all his combined tax liability.

But if the minister requests such, can the church withhold taxes from his salary just like an employee of the church? The answer is both yes and no!! The church can withhold taxes but they are not withheld in the same manner as for an employee. So how can it be accomplished?

Since the minister is treated as an employee for federal income tax purposes, he or she can enter into a "voluntary withholding" arrangement with the local church by submitting a completed W-4 form. Although not required, it is generally recommended that the minister write "voluntary" across the top of the W-4 just for emphasis.

Once the W-4 is on file, the church treasurer can then withhold *income taxes* from the minister's wages. *However, since ministers are "self-employed" for Social Security purposes, the church does not withhold Social Security and Medicare taxes simply because the minister completed a W-4 form.* To have enough withheld to cover the "self-employed" taxes, the minister must request that an additional amount of income taxes be withheld to cover his expected self-employment tax liability for the year. This is done by filling in an additional amount on Step 4, line (c) of the new W-4 form. The additional withholding is reported as

additional income taxes, and becomes a credit that the minister can apply to self-employment taxes when preparing his or her tax return for the year.

The “voluntary withholding” process is generally a much better option for most ministers when compared to filing quarterly returns.

Tax Treatment of Retirement Plan Contributions

As for retirement contributions, whether such are reported or not on the participant’s Form W-2 depends on whether the contribution was made by the church or by the pastor/staff person through salary reduction. In the ***Treasurer’s Manual***, we answer this question as follows:

> *Retirement plan contributions made by the church on behalf of the minister or a church-related employee are not required to be reported at all on Form W-2.* In addition, amounts contributed to the retirement plan by a salary reduction agreement are also not includible in Box 1 on the W-2 form as wages. However, on Form W-2 the "retirement plan" box should be checked in Box 13. In addition, any amount contributed by salary reduction agreement should be reported in Box 12 of the W-2 form, using the code "E". For example, if a minister reduced his salary by $5,000 to make contributions to his retirement account, that amount would not be included in Box 1 of the W-2, but "retirement plan" would be checked in Box 13 and Box 12 would report "E - 5000.00."
>
> As an additional note, church treasurers should be aware that retirement plan contributions *made by the church* are not considered wages for Social Security tax purposes. In addition, two separate Revenue Rulings (see Revenue Ruling 68-395 and Revenue Ruling 78-6) seem to suggest that even salary reduction retirement contributions *made by ministers* do not necessarily constitute self-employment earnings for purposes of determining Social Security tax liability.

Simply put, contributions made by the church are not taxed, nor are they reported on the minister or employees’ W-2.

Salary reduction contributions made by a minister are not included in Box 1 income, are listed in Box 12 (E code), but are not taxed for federal income tax purposes nor are they taxed for Social Security/Medicare (SECA) purposes.

Salary reduction contributions made by a church-related employee are not included in Box 1 income, are listed in Box 12 (E code), are not taxed for federal income tax purposes, but *are taxed* for Social Security/Medicare (FICA) purposes.

A simple rule to determine whether the contribution is a salary reduction contribution or an employer (church) contribution is this: If the pastor/employee is entitled to $100 salary, for example, and gets that amount, but the church makes a contribution above and beyond that of

say $10 to his retirement account, the $10 contribution is a church-made contribution. Just assuming that alone, the $100 would show up in Box 1 of the person's W-2 – but the $10 contribution to the retirement plan is not required to be reported anywhere.

Further, if the person is entitled to $100 (and whether the church makes a contribution or not), he directs by a salary reduction agreement that $15 be sent to the retirement plan, then only $85 would show up in Box 1 on his W-2 form and Box 12 would show an E code with $15. The $15 is a salary reduction contribution.

For more specific directions on completing the Form W-2, please see the directions provided by the IRS with the W-2.

Churches are not Exempt from Wage and Hour Laws

Many church leaders think that the "wage and hour" laws, and particularly overtime pay rules, do not apply to churches. That could not be further from the truth. Churches and church employees are NOT exempt from the "wage and hour" laws – and failure to obey such could result in substantial penalties to the church. To try to get around these laws, many churches have "exempted" their employees from the law.

Before going further, it is important to understand the foundation of the Fair Labor Standards Act. The FLSA requires that workers be paid the federal minimum wage (or a higher wage if the local jurisdiction or state has mandated such) for the first 40 hours worked in a regular work week. Further, for any hours worked passed 40 hours in a regular work week, the FLSA requires that most employees be compensated at time and a half of their regular hourly wage.

To be exempt from this "time and a half" overtime pay rule, the employee must be classified as an executive, administrative, or professional employee - often called the "white collar" exemptions. Each category of exempt employees is defined specifically under the FLSA. However, not only do you have to meet the definition for an executive, administrative, or professional employee, but you have to be paid a salary of at least $684 a week ($35,568 for a full-year worker).

Under the rules, it is important to remember the following:

- Even a worker that meets the criteria of being designated an executive, administrative, or professional employee must be paid overtime (time and a half) if they are compensated at less than $684 a week.
- Overtime for this purpose is considered to be any hours worked over 40 hours in a regular work week.

While ministers are not statutorily exempt from FLSA requirements, several courts over the years have found that clergy are exempt under the "ministerial exemption" – in other words, ministers performing religious functions are excluded from the definition of employees under

the FLSA. Further, the Department of Labor in a 2005 opinion letter seemed to recognize this exemption.

However, should you have questions about the applicability of these rules to your employees, it is recommended that you check with a qualified employment attorney and seek professional advice regarding your particular situation immediately.

SOCIAL SECURITY TAX ISSUES

No Self-Employment Tax on Retirement Income from Benefits Board

At tax time, the Benefits Board gets a lot of questions about the IRS Form 1099-Rs that are sent to participants in January showing the amount of the participant's distributions for the previous year. The most common question regards whether or not the distributions are taxable for self-employment tax purposes – or in other words, is a ministerial participant required to pay Social Security/Medicare on such distributions. The answer, according to Internal Revenue Code section 1402 (a) (8), is NO! In part, the Internal Revenue Code states that the self-employment tax (Social Security/Medicare) does not apply to "any retirement benefit received by such an individual from a church plan… after the individual retires." This exemption applies whether or not the retired minister is able to claim the distributions as housing allowance.

Taking a step back, look at some basic tax information regarding contributions made to the Ministers' Retirement Plan:

- Participants (both ministers and non-ministers) should remember that contributions made to their MRP account by the **"employer" (or Church)** are not considered wages for income tax **or** Social Security/Medicare purposes.
- However, contributions made by *salary reduction* by ***non-ministers*** are considered wages for the Social Security and Medicare tax – although not for income tax purposes.
- Contributions made by *salary reduction* by ***ministers*** do not necessarily constitute self-employment earnings for purposes of determining self-employment tax liability. See Revenue Ruling 68-395 and Revenue Ruling 78-6. However, the Benefits Board does encourage ministers to pay Social Security on their salary reduced contributions simply so their Social Security wage base will be increased for future benefit purposes.

Back to the original question, distributions from the MRP are not taxable for Social Security/Medicare purposes, regardless of whether the participant is a minister or non-minister. While the authority for ministers is cited above, in the case of non-ministers they have already paid Social Security taxes on the income that was deferred.

Q: ***I am a Youth Pastor. My W-2 salary was $11,700. The church agreed to pay half of my Social Security. They want me to get my taxes filled out and then see how much they owe me for Social Security. I don't believe this is the correct way to pay half of my Social Security. Could you tell me if this is correct or not? If not, then what is the correct way?***

A: For purposes of my response, I must assume that Box 1 income on your W-2 was $11,700 - and that you had no housing allowance or any other income from the church. If that is so, and if the church agreed to pay one-half of your Social Security, they owe you 7.65% of $11,700 - or $895.05. You owe Social Security on your gross taxable income, not on your adjusted gross income. Therefore, you will owe total Social Security/Medicare taxes of $1790.10 (or 15.3%) - the church's half is $895.05.

If the church provided you with a housing allowance or provided to you a parsonage, you also owe Social Security/Medicare on that amount as well, although you do not have to pay federal taxes on such.

Finally, based upon your Social Security liability, you probably should be paying quarterly to prevent the imposition of penalties and interest on the amount owed.

Q: ***I have recently started pastoring full time. I have determined that I need to pay my quarterly social security tax. Unfortunately, I cannot find the form needed to submit. Would you be able to tell me which forms to use and where to obtain them? I have tried the Social Security website, as well as trying to contact them by phone, but I keep getting the "run-a-round". Any help would be appreciated.***

A: You can obtain the estimated tax form and work sheet from the IRS web site. The specific site is http://www.irs.gov/pub/irs-pdf/f1040es.pdf. This will link you to the Form 1040-ES which is to be used by first-time filers of estimated taxes. On the form, you will find all the information you need to calculate your estimated taxes and send them in.

The 1040-ES will allow you to pay your Social Security/Medicare taxes (SECA), as well as your federal income taxes, assuming that you have federal income tax liability. Simply put, it will allow you to pay either/or.

Q: ***I have been declared disable by Social Security. I receive Social Security Disability every month, plus I have Medicare Part A and Part B.***

In addition, I receive an offering of 500.00 every month from the Church which has been called a Housing Allowance. I pay $300.00 for rent plus the usual utilities, so the $500.00 amount is right on target. Now the board of the Church has approved and increased the amount to $1,200.00 per month because I need to move to a house instead of an apartment. I am not receiving any other compensation from the church. Will this housing allowance affect my status as disabled or my SSD benefits? What about if the church rents the house and make all the payments of the utilities and furniture payments and all the expenses allowed by the IRS without giving me the money? Is that better or legal?

A: From what you have written here, I think that we have to make a distinction between two very important issues: (1) what part of your income, if any, is taxable for federal income tax purposes and (2) what impact does your income have on your Social Security Disability (SSD)?

The first issue is more easily addressed. If the church determines that the amount provided you on a monthly basis (whether $500 a month or $1200 a month) is for ministerial housing expenses, based upon your reasonable estimation of those expenses, then that amount is not taxable income to you for federal income tax purposes. Even if it is the entirety of the income paid to you by the church, it could still qualify as non-taxable ministerial housing allowance, assuming that you spent such for housing. In other words, the total compensation you receive from the church can be designated as housing allowance, again assuming that you actually spend the funds on housing expenses.

However, the non-taxability applies only to federal (and State) income taxes. While ministerial housing allowance is non-taxable for federal income tax purposes, it is taxable for Social Security purposes. In other words, if you receive a housing allowance, you do not have to pay federal income taxes on that money BUT you DO have to pay Social Security and Medicare taxes on the ministerial housing allowance. This rule applies whether you are living in a parsonage or whether you are getting housing allowance and living in your own or rented home. Further, this rule applies whether the housing allowance is given to you and you pay your housing expenses OR whether the church pays the money directly to the landlord and to the utility companies. You cannot get around these rules by having the church pay the housing costs directly.

Since housing allowance is taxable for Social Security purposes, it brings us to the (2) issue involving the impact that housing allowance may have on your SSD payments. On this issue, I cannot provide a definitive answer. However, it is my understanding that SSD looks at household income. It is further my understanding that household income is based upon money coming into the home, regardless of whether it is taxable or non-taxable for federal income tax purposes. Since housing allowance is taxable for Social Security purposes, it is my belief that the Social Security Administration has a better claim that the money should be counted in determining your need for SSD. However, on this issue, I think that you need to have your caseworker look at the SSA rules concerning ministerial housing allowance and their impact on SSD.

To obtain more information on the ministerial housing allowance in general, I would suggest that you review the Ministers Compensation Manual that is available on our web site at www.benefitsboard.com.

Q: ***I have a question and would like to hear your thoughts. If cash housing allowance payments are indeed held unconstitutional; instead of paying a cash housing allowance, I would suppose that a church could pay that amount directly to the mortgage company / bank. Additionally, couldn't the church also pay the utilities directly for the affected minister?***

A: You raise a good question. However, unless the home is in the name of the church, a direct payment by the church to the mortgage company or to the rental agency would still be seen as a cash housing allowance. The same would apply for utilities. So, it would have to be a parsonage, defined as a property owned by the church, to get around this ruling.

WHAT IS TAXABLE?

"The biggest difference between tax evasion and tax avoidance is 20 years in a federal penitentiary." Art Rhodes

Tax Tips - Items NOT Considered Reportable Income for Ministers

While no one should ever hide income, there are several items that can legitimately be excluded from taxable income for ministers. One of the major items excludable from taxable income is contributions to the Ministers' Retirement Plan. *Contributions made by the church on behalf of the minister are not required to be reported at all on Form W-2.* In addition, amounts contributed to the retirement plan by a salary reduction agreement are also not includible in Box 1 on the W-2 form as wages. However, on Form W-2 the "retirement plan" box should be checked on line 13. In addition, any amount contributed by salary reduction agreement should be reported in Box 12 of the W-2 form, using the code "E". For example, if a minister reduced his salary by $5,000 to make contributions to his retirement account, that amount would not be included in Box 1 of the W-2, but "retirement plan" would be checked in Box 13 and Box 12 would report "E - $5000.00."

Additional items excluded from reportable taxable income include group term life insurance premiums for policies up to $50,000, fringe benefits (GROUP medical insurance premiums, disability insurance, etc.), business expense reimbursement under an *accountable* plan, and the minister's housing allowance (not considered as income but is taxable for self-employment taxes). None of the above-mentioned items should be included in Box 1 of the W-2 form. Keep in mind that non-ministerial employees do not receive the housing allowance benefit. If the church pays the housing costs of an employee, it is still counted as reportable income. Additionally, retirement plan contributions *made by a salary reduction agreement* for non-ministerial employees are excluded from their reportable income for tax purposes, but must be included in their income for Social Security and Medicare purposes.

Q: ***Would it be considered income for our youth pastor if the church voted to increase our youth pastor's salary, and when he was informed, he requested the money be placed in the youth funds instead of it going to him? Is that considered as the youth pastor giving to the youth account out of his personal money or the church giving additional money to the youth each month?***

A: This is an interesting question and actually the answer turns on how the church deals with the youth pastor's request. Let's consider a couple of ways this could be handled.

First, let's assume that the pastor totally renounces the raise ("I greatly appreciate your concern about increasing my salary but I prefer that the money be spent on ministry, preferably on youth ministry, and therefore I am not going to take the raise"). Under this scenario, the pastor is not entitled to the money, the church can spend it any way it likes (including on youth ministry), and therefore such is not taxable to him as income (and in the alternative, he would not get any tax deduction for renouncing such or for designating a gift to youth ministry).

Second, let's assume the pastor renounces the raise but tries to direct how the money can be spent ("I greatly appreciate your concern about increasing my salary but I want that money spent on youth ministry, and therefore I am not going to take the raise as long as you guarantee me that each month the youth budget is going to be increased by XX dollars – the amount of the raise.") Under this scenario, the minister is controlling how the money is spent by the church, much like a designated contribution taken out through salary deduction. In this case, the amount would be taxable to the minister as income but he would also be entitled to a charitable deduction for the amount given. Of course, he could also stop designating the gift and accept the raise at any time.

Thirdly, let's assume a variation of No. 2 above. The pastor could pick and choose which weeks he wanted to have the money go to the youth program and which weeks he wanted to take the raise. Again, since he is entitled to get the money each week no matter what, the amount becomes reportable income to him – and the amount given as a designated contribution becomes a part of his charitable contributions to the church.

From a tax standpoint, scenario one is the best for the pastor – simply because the money never comes into his reportable income. However, once he renounces the raise, he is completely at the mercy of the church for additional raises in the future.

Q: ***Our church had a meeting and we are now paying our Pastor a salary, reimbursement for expenses, and housing allowance. Due to the lack of finances recently, we have not been able to pay him what we normally would. I was wondering how to correctly divide his wages. Should I base it on what we were paying him and the percentage of what was going to each category? Or could I just apply what we normally would toward the reimbursement of expenses and housing allowance and if***

there is any leftover apply that toward his salary? I know this would benefit him but we want to do this correctly.

A: Since you do not have the resources to pay all, it is perfectly acceptable to reimburse the pastor for his expenses and housing first, and then let any remainder that might be available go towards salary. Proceeding in that manner would also bless the pastor because he would be getting the non-taxable portion of his total compensation first. However, I would suggest that you do this by resolution, stating the first $XX goes to Pastor's expenses, the next $XX goes towards Pastor's housing allowance, etc.

Health Savings Accounts

The Medicare bill of 2003 created new medical savings accounts, referred to as Health Savings Accounts (HSA), which became available January 1, 2004. Individuals under the age of 65 can contribute on a pretax basis to such accounts if they have a qualified health plan. The accounts can be used to pay un-reimbursed medical expenses, retiree health insurance, Medicare expenses, and prescription drugs. *NOTE: Since January 2011, over-the-counter medication cannot be paid with HSA dollars without a doctor's prescription.*

To qualify, the individual must be covered by a health plan with a high deductible of at least $1,400 for individuals and $2,800 for families. In addition, the plan must have a high cap on annual out-of-pocket expenses ($7,050 for individuals and $14,100 for families). The law allows a person to save as much as 100% of a health-plan deductible annually, to a maximum of $3,650 for self-only policies and $7,300 for family policies. In addition, for persons between 55 and 65 years of age, an additional tax-free "catch-up" contribution of as much as $1,000 can be added.

If you are less than 65 years of age, have a high deductible and high out-of-pocket cap, you should create a Health Savings Account. Money contributed to such an account is not taxed going into the account and is not taxed when it is taken out to pay legitimate and approved medical expenses. In addition, such contributions are not subject to Social Security taxes (FICA or SECA) or unemployment taxes. Health Savings Accounts can be set up at your local bank or insurance company.

Tax Liability of Cell Phones

For many years, articles and publications from the Benefits Board warned about the potential tax liability created when a minister or a church employee used a church-provided cell phone for personal use. Based upon a 1989 law and re-emphasized in a summary opinion issued by the Tax Court in 2007, the Internal Revenue Service rules and regulations required that the *personal use* of a business-provided (or church-provided) cell phone be substantiated and reported as taxable income to the user of the phone.

Many ministers and church-related employees who had cell phones provided by the church had never considered that the personal use of that cell phone created a taxable event. Under the previous law if the personal use was not "substantiated" and separated from the business use, the entire value of the cell phone service could be deemed by the IRS to be taxable to the user.

However, in the small business tax relief legislation passed by Congress in 2010 and signed by the president, business-provided cell phones were "de-listed," meaning that employers may provide employees with cell phones primarily for business use on a tax-free basis, with little requirement to document the business use versus the personal use.

The change in the tax laws concerning cell phones was effective for tax years beginning after December 31, 2009. Therefore, the requirement to keep cumbersome records to distinguish between personal and business use of each call, text message, and e-mail sent from so-called "smart" phones is no longer applicable.

Taxable Christmas Gifts

After the holidays are over, the church must sort out which "gifts" to employees and ministers were taxable and which were not. Generally, it is assumed that no "gift" is taxable. However, the Internal Revenue Service does not agree with that assumption. "Gifts," such as a church paid trip to Israel for the pastor or an all-expense paid weekend away, are taxable items to the recipient.

Smaller "gifts" often create more discussion and controversy. In a recent ruling, the IRS addressed the tax consequences of these smaller gifts. Simply put, the IRS has determined that any "de minimis fringe benefit" does not constitute taxable income. Examples of a "de minimis fringe benefit" include a ham, turkey, or gift basket as an annual holiday gift. However, the ruling goes on to point out that a "cash equivalent," such as a gift certificate, is a taxable gift. Even though the goods acquired with the gift certificate would have been a nontaxable "de minimis fringe benefit" had it been provided by the employer, the gift certificate is taxable as income.

A simple rule of thumb is that all larger gifts given by the employer/church to the minister or staff is reportable as taxable income. Smaller items given as holiday gifts may not be taxable. However, a cash gift or gift certificate, regardless of the amount, must be reported as taxable income to the recipient.

The other question on gifts that arises concerns those that are given directly to a minister or staff person by a church member. Again, the simple rule of thumb has been that if the gift is given directly to the minister/staff person by the member, it is a nontaxable gift. Whether the gift is an object or cash, this rule is no longer accepted by the IRS, even though the donor gets no charitable gift deduction on their tax return. The IRS now clearly says that, even though the "gift" was given directly to the minister or staff person, it is considered taxable compensation.

On the other hand, if the member makes a gift to the church, either of an item (a car for example) or of cash, and designates that it be given to a particular minister/staff person, the gift is clearly taxable to the recipient. However, the donor generally is also able to claim a charitable gift deduction on his or her tax return in the latter situation.

To get more details on the gift rules, please research IRS Letter Ruling 200437030.

Option to Deduct Sales Tax Made Permanent

The American Jobs Creation Act of 2004 authorized sales tax deduction as an option for those who itemize deductions, letting them choose between deductions for state and local income or sales taxes. However, it should be noted that the tax reform legislation of 2017 limited the state and local tax deduction to $10,000. (NOTE: This $10,000 limit is now the subject of debate in Congress.)

While this deduction mainly benefit taxpayers with a state or local sales tax but no income tax – Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming, to name a few states – it gives a larger deduction to any taxpayer who paid more in sales taxes than income taxes. For example, a person may have bought a new car, boosting the sales tax total, or claimed tax credits, lowering the state income tax paid. Again, the deduction is now capped at $10,000.

Taxpayers can save their receipts throughout the year and tabulate the amount actually paid, or use tables released by the IRS to compute the deduction, assuming that they are itemizing on Schedule A of the Form 1040..

Publication 600 (Optional State Sales Tax Tables) is available in the forms and publications section of the www.irs.gov web site to calculate the deduction.

TAX FILING ISSUES

"If the Lord had meant for us to pay income taxes, he'd have made us smart enough to prepare the return." Kirk Kirkpatrick

Most Common Mistakes on Tax Returns

If you have not yet filed your tax return, you should be aware of some common mistakes that the IRS says occurs on tax returns. These simple mistakes could delay the processing of your return or delay your expected refund. The IRS lists the following as the most common mistakes:

- Choosing the wrong filing status
- Failing to include or using incorrect Social Security numbers
- Failing to use the correct form or schedules
- Failing to sign and date the return
- Claiming ineligible dependents
- Failing to file for the Earned Income Tax Credit
- Improperly claiming the Earned Income Tax Credit
- Failing to pay and report domestic payroll taxes
- Failing to report income because it was not included on a Form W-2, Form 1099, or some other information return
- Treating employees as independent contractors
- Failing to file a return when due a refund
- Failing to check liability for the alternative minimum tax

The IRS calls this list their "dirty dozen." You can find more about common mistakes made on tax returns by visiting the IRS's web site at www.irs.gov.

Q: ***Is a credentialed "Minister of Music" eligible to receive a housing allotment? We are considering adding that to our Music Minister's package. Right now, she receives a salary which is reported on a W-2. I realize she would have to claim the housing allotment for Social Security purposes. I wasn't sure if you had to be ordained or not.***

A: Yes, a minister of music (as long as she has credentials as such) is eligible to receive a ministerial housing allowance. The credentials are the key, not ordination. And you are

right - she will be responsible for Social Security/Medicare on the housing allowance but not federal income taxes.

You can find out more about who is a minister for federal tax purposes at the following web link: http://www.churchlawandtax.com.

Tax Filing Extension

Since 2006, the Internal Revenue Service has made it easier for you to get a six-month extension on filing your individual tax return.

In previous years, you could file an IRS Form 4868 and get an automatic extension of four months, delaying your filing until August 15th. If you needed additional time, you had to file another form, providing a specific reason, to obtain an additional two-month extension. The two-step process has been eliminated. If you file a Form 4868 requesting an extension now, you will be granted an extension for six months, pushing the deadline for filing back to October 15th.

Taxpayers should remember that while the deadline for the actual filing of the return can automatically be extended now until October 15th, the taxes are due by no later than April 15th. If the taxes are not paid by April 15th, then the taxpayer will be subject to both penalties and interest on the amount owed.

Paying Your Taxes

Do you owe taxes this year? When paying your taxes to the government, make sure that you do **not** make your check payable to the Internal Revenue Service. Instead, your check should be made payable to the United States Treasury.

In addition, the IRS suggests that you write your Social Security number, your daytime telephone number, the tax year and the type of form you filed (1040 or 1040EZ) on your check, too.

Online Filing of Forms W-2 and W-3

Churches and other church-related employers, along with other businesses, may file Forms W-2 and W-3 electronically by visiting the Social Security Administrations' website at www.socialsecurity.gov/employer/. On the website, you will need to select "Business Services Online (BSO)" and register as a user. Once registered, you can upload electronic wage files or use the site's "Create Forms W-2 Online" to send electronic information to the Social Security Administration. This option allows you to create "fill-in" versions of Forms W-2 for filing with

the federal government and to print out copies of the forms for filing with state or local governments, distribution to your employees, and for your records. From the information filled in on the Form W-2s, a Form W-3 will be created for you.

Due to a change in the law in 2016 (Public Law 114-113), W-3 forms now must be transmitted to the Social Security Administration (and 1099s to the Internal Revenue Service) by the end of January, whether you are filing by paper or electronically. Therefore, all W-2s and Form 1099s must be forwarded to the individuals AND to the appropriate governmental agency by no later than January 31.

Because of this change, it is recommended that you get the W-2s and 1099s out to the individuals as early as possible so that changes, if necessary, can be made prior to the mandatory filing date of January 31.

Further, church treasurers should consider using the government's electronic filing system (www.socialsecurity.gov/employer/) to complete both their W-2s and W-3. After a simple registration process, W-2s can be completed, printed, and then filed electronically.

Just remember that if you wait to file your W-2s and 1099s with the government in February or March, you will be late. The deadline is January 31.

Who Must File a Tax Return?

Whether you have to file a tax return depends, in part, on your filing status, age, and gross income. The following is a brief guide on those who ***must*** file a tax return in 2022 for 2021 income:

- Single, under 65, and your gross income was at least $12,400.
- Single, 65 or older, and your gross income was at least $14,250.
- Married, filing a joint return, you and your spouse were both under 65, and your gross income was at least $25,100.
- Married, filing a joint return, one spouse is 65 or older, and your gross income was at least $26,450.
- Married, filing a joint return, both you and your spouse were 65 or older, and your gross income was at least $27,800.
- Married, filing a separate return, and your gross income was at least $5.00, regardless of your age.
- Head of household, under 65, and your gross income was at least $18,800.
- Head of household, 65 or older, and your gross income was at least $20,500.
- Qualifying widow or widower with a dependent child, you were under 65, and your gross income was at least $25,100.
- Qualifying widow or widower with a dependent child, you were 65 or older, and your gross income was at least $26,450.

However, if you made more than $400 in net earnings from earned income subject to the Social Security "self-employment" tax, you are required to file a tax return in order to pay the Social Security taxes due. As a note, you should remember that the distributions that a participant receives from the Minister's Retirement Plan are not subject to Social Security taxes. For more detailed clarification on whether you are required to file a tax return, you should talk with your tax professional.

Helpful Hints When Choosing a Tax Return Preparer

While most tax preparers provide excellent service to their clients, the IRS urges taxpayers to be very careful when choosing a tax preparer. You should be as careful as you would in choosing a doctor or a lawyer. It is important to know that even if someone else prepares your return, you are ultimately responsible for all the information on the tax return. The following are some helpful hints:

- Avoid tax preparers who claim they can obtain larger refunds than other preparers.
- Avoid preparers who base their fee on a percentage of the amount of the refund.
- Use a reputable tax professional who signs your tax return and provides you with a copy for your records.
- Consider whether the individual or firm will be around to answer questions about the preparation of your tax return months, or even years, after the return has been filed.
- Review your return before you sign it and ask questions on entries you don't understand.
- No matter who prepares your tax return, you (the taxpayer) are ultimately responsible for all of the information on your tax return. Therefore, never sign a blank tax form.
- Find out the person's credentials. Is he or she an Accredited Tax Preparer, Enrolled Agent, Certified Public Accountant (CPA), Licensed Public Accountant or Tax Attorney? Only attorneys, CPAs and enrolled agents can represent taxpayers before the IRS in all matters including audits, collection and appeals. Other return preparers may only represent taxpayers for audits.
- Find out if the preparer is affiliated with a professional organization that provides its members with continuing education and resources and holds them to a code of ethics.
- Ask questions. Do you know anyone who has used the tax professional? Were they satisfied with the service they received?

The IRS cautions taxpayers to be wary of claims by preparers offering larger refunds than other preparers. Check it out with a trusted tax professional or the IRS before getting involved.

Tax evasion is a risky crime, a felony, punishable by five years imprisonment and a $250,000 fine.

MISCELLANEOUS TAX TIPS

Gift Tax Exclusion

A taxpayer can currently give up to $16,000 a year to a child or anyone else without triggering the gift tax. In addition, married couples can give one person up to $32,000 a year. So as a part of your estate planning, consider making a gift now – while you can watch the person enjoy it.

Refund

While you as a taxpayer would be better off to lower your withholdings rather than giving the government the equivalent of an interest free loan, many over withhold as a forced “savings plan.” Others over withhold out of sheer fear of the IRS. In recent years, the trend has been around 70% of taxpayers are entitled to a tax refund.

So, tax time may not be such a dreaded time of the year in your household. Get your return filed and look for the “check in the mail.”

Deducting Your Diet

You may not be able to reduce your weight, but trying to may reduce your taxes, according to a regulation issued by the Internal Revenue Service in 2002. For the first time, the agency agreed that obesity is a disease and that the costs of being treated for it qualify as deductible medical expenses. Until that time, such a program was deductible only if it was prescribed to help treat a specific disease, such as hypertension or diabetes. But, since the IRS now says that obesity is a disease, if a doctor says someone is obese that taxpayer may qualify for the deduction. Thus, a taxpayer who is obese but otherwise healthy may qualify for the deduction.

But before rushing to stock up on low-calorie treats, taxpayers should note that the ruling and the law contain significant restrictions. First, weight-loss costs associated with an effort simply to look better -- rather than to treat a disease -- still are not deductible. Neither is most diet food. A deduction would be allowed for special food only "if (1) the food alleviates or treats an illness, (2) it is not part of the normal nutritional needs of the taxpayer, and (3) the need for the food is substantiated by a physician," the IRS said. Special food that is simply a substitute for what the taxpayer normally consumes is not deductible. Food is food, the IRS said, and you don't get a deduction for eating.

But most significantly, medical expenses of all types, including weight-loss programs, may be deductible only if they are not reimbursed by insurance, and the deduction applies only to

unreimbursed expenses that exceed 10 percent of adjusted gross income. This means that most taxpayers would have to run up thousands of dollars in unreimbursed weight-reduction costs before any of them would be deductible.

So, for all of us who have participated in one to many chicken dinners, the IRS is offering at least a glimmer of hope. Happy dieting!!

Audit Tips

Your chances of being audited by the Internal Revenue Service are going up, but only slightly. For example, in 2001 the IRS audited 732,000 individual returns compared to only 618,000 in 2000. In 2019, only 771,095 tax returns were audited, but those audits brought in an additional $17.3 billion in recommended additional tax.

It should be noted that there are certain "triggers" that can spark the IRS to take a second look, or at least request additional information, about your tax return. These "triggers" can range from simple mathematical mistakes on your return to certain deductions that you claim. According to the IRS, the most common "triggers" are:

- sudden spikes (drops or increases) in income
- missing forms or undocumented income
- an unsigned return
- missing Social Security numbers for the taxpayer or dependents
- filing a Schedule C – self-employed taxpayers are three times more likely than wage earners to be audited
- deductions that exceed the norm for your income
- taking the home office deduction
- casualty losses to your home

None of these "triggers" should keep you from filing an accurate tax return. However, if you are claiming such, you should make sure that you have complete and documented information to back up your claim.

Tax Reporting for Church Schools

If your church operates or controls a private school, you are required to file a Certificate of Racial Nondiscrimination for a Private School Exempt From Federal Income Tax (IRS Form 5578) each year. This form must be filed with the Internal Revenue Service by the 15th day of the fifth month following the end of the organization's fiscal year. Of course, for schools that use the calendar year as their fiscal year, this form must be filed by no later than May 15. It should be noted that if, for some other reason, the organization must file a Form 990 with the IRS, the certification of nondiscrimination must be completed on Schedule A to the Form 990.

Completing the Form 5578 is rather simple. However, it is imperative that all "private" schools complete such annually. In the directions to the Form 5578, the IRS defines a "private" school as "an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The term includes primary, secondary, preparatory, or high schools and colleges and universities, whether operated as a separate legal entity or as an activity of a church or other organization described in Code section 501(c)(3). The term also includes preschools and any other organization that is a school as defined in Code section 170(b)(1)(A)(ii)." Basically, any private school for any age is covered under this definition.

The policy of nondiscrimination requires, as provided for in the instructions to Form 5578, that the school "admits the students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at that school and that the school does not discriminate on the basis of race in the administration of its educational policies, admissions policies, scholarship and loan programs, and other school-administered programs."

Since the Form 5578 requires that an official of the church certify, under penalty of perjury, that a nondiscrimination policy is in place, a church that operates a school should seek legal assistance to assure that the school's policies are in compliance with the law. Further, you should make sure that the certification form is filed timely each year.

Tax Housekeeping Issues

Have you noticed how quickly the year seems to be moving? It is amazing how fast time seems to be passing. However, that brings me to the question that I must ask – Is your "tax house" in order for the year? Is the ministerial housing allowance designation by the church/employer current? Are you properly accounting for and substantiating all accountable expenses? Did the church adopt a new accountable expense plan for the year?

While such decisions cannot be made retroactive, at any time a church can prospectively make changes to such things as the minister's housing allowance or accountable expense plan. For example, assume that a pastor moves to a different house in February and his housing costs go

up several hundred dollars a month. The pastor may request that the church reconsider his compensation package at that time to take into consideration his additional housing costs. So, for the remainder of the year, based upon the church's approval, an additional amount of the pastor's salary can be designated as housing. While the church cannot go back and deal with January and February issues retroactive, they can change the future allocations to cover the expense that will be incurred for the remainder of the year.

So, make sure that your "tax house" is in order. Making changes now could drastically impact your tax liability for the year. For more direction on such issues, you may review the Minister's Compensation Manual at www.benefitsboard.com.

Tax Tips

During the holiday season in years past, each taxpayer would receive a package in the mail from their favorite uncle. Yes, "Uncle Sam" use to send a package immediately after Christmas that contains your tax forms for filing your income taxes. As of December 2010, the IRS stopped sending out those tax forms, primarily because of the costs associated with such and the increasing number of tax filers who are using electronic filing. Even though you are not getting a tax package from Uncle Sam with all the forms and instructions, you should always read the instructions carefully because, as in most years, a few things change each year. If you use a tax preparer, you should begin immediately to get your documentation together to present to them. Here are just a few tips:

- ***W-2 vs. 1099*** - If you are a pastor or employee of a Church of God church or related entity, you should receive a Form W-2 from your employer before February 1. While many ministers (and churches) continue to claim that the minister is "self-employed" and therefore should receive a Form 1099-NEC, the church polity of our denomination provides that our ministers are employees of the local church – and thus entitled to receive a W-2 rather than a Form 1099. Based upon case law, it seems rather clear that Church of God ministers have a dual tax status – they are employees for federal tax purposes but they are self-employed for Social Security purposes. While this topic is confusing and not subject to clarification in this brief forum, I would recommend that you visit our web site (www.benefitsboard.com) and review the Treasurer's Manual or the Minister's Compensation Manual where a more detail discussion on this issue can be found.
- ***Saver's Credit*** - If you made contributions to a retirement plan (such as the Ministers' Retirement Plan), you may be eligible for a tax credit, called the "saver's credit." This credit could reduce the federal income taxes you pay dollar-for-dollar. The amount of the credit you can get is based on the contributions you make and your "credit rate". The "credit rate" can be as low as 10% or as high as 50%, depending on your adjusted gross income – the lower your income, the higher the credit rate. The credit rate also depends on

your filing status. To obtain more information on the Saver's Credit, visit the Forms section of our web site (www.benefitsboard.com).

Understanding the "Valuation" Process

Many participants in the equity (or stock) accounts offered by the Ministers' Retirement Plan may not fully understand the process of how they make money – or lose money – in their equity accounts. While it is rather simple to understand the earned interest concept for the Trustees' Fund, the idea of net asset value (NAV) and volatility is more difficult to understand when trying to determine how your equity account moves in value.

Hopefully, a brief explanation of the "valuation" process with a few simple examples will be helpful in better understanding how equity funds are valued.

Within the Ministers' Retirement Fund, valuation occurs at least weekly whether you sell, buy, or hold your funds. For example, assume that you contribute $100 and the entirety of that amount is attributed to the Large Capitalization Equity Fund. On the day that you made the contribution, assume that the net asset value (NAV) was $10 per share. With your $100 dollars, 10 shares will be purchased for your account. Further, let's assume that a week, a month, or even a year or more later, you are looking at your fund and the NAV has decreased due to market volatility. You still have 10 shares (assuming no additional purchases or transfers out), but the NAV is now, say, $9.75 per share. In other words, your 10 shares, purchased at $100, are now only worth $97.50. Of course, that same process works the opposite way as the NAV rises.

Using this very simplistic example, if you sold your shares (or transferred your funds out of that asset class which would require a sell of your shares) when the NAV was $9.75, you would have a loss of $0.25 per share. If you did nothing and just held on to the shares, your account balance would show an unrealized (or paper loss) of the same $0.25 per share. Of course, the NAV could increase and recover your lost value or it could decline further, depending upon the overall economic conditions and movement of that asset class.

So why does the net asset value (NAV) move? The NAV moves based upon the underlying value of the stocks in the pool of assets you have invested in. For example, the Ministers' Retirement Plan's Large Capitalization Equity Fund may have as many as 80-100 different companies' stocks included in the portfolio. The value of a single company's stock may move upwards or downwards based upon a number of things, including the overall need for that company's products, expansion efforts of the company into new markets, the closing of certain markets to the company's products, a competitor coming out with a better product, changes in leadership of the company, profit margins above the actual cost to produce the product, and a thousand other reasons.

As in sports, though, there are always winners and losers – and both may be contained in the same Large Capitalization portfolio for example. Take for instance the run up in the price of Apple stock over the past few years or so. With the release of new I-Phones and I-Pads, as well as other products, Apple surged to be a leader in the technology sector of the market. However, while Apple gobbled up market share, other technology companies, like Dell and H-P, suffered. A Large Capitalization portfolio might contain all three companies in the same portfolio. The hope, of course, is that the "gainers" always out-weight the "losers."

Stock investing is not for everyone, especially the faint of heart. One day the stock market can make you look like a genius and the very next day make you look like a dunce. The goal is to maintain a long-term view and hope that over an extended period of time you will have substantial gains from your investment in growing and prospering companies through your equity investment.

Happy investing!!!

CHARITABLE CONTRIBUTIONS

Charitable Acknowledgement

As a pastor, clerk, or church treasurer, you should make sure that any person who contributed more than $250 to your church within the year in a single gift gets a letter of acknowledgement from your church at least by the end of January of the following year. The acknowledgement should be on church letterhead and should be signed by the treasurer and/or the pastor. It should include the amount of the gift(s), and whether or not the person received anything in return for the gift. If there was nothing given in return, you should add a provision that says that "no goods or services were provided in return for the contribution other than intangible religious benefits, but such benefits are not valued for tax purposes."

Other points to consider concerning acknowledgements for charitable contributions:

- Aggregate contributions that total more than $250 are not required to be acknowledged by the church. For example, if a member of your church gave a check of $200 each week, the church is not required under IRS regulations to provide acknowledgement even though the contributions for the year would total over $10,000. However, **we recommend that all contributions be acknowledged by the church**. If there is no acknowledgement, cancels checks can be used for contributions less than $250. But again, make it simple for people to give to your church – give them a yearly (or maybe even quarterly) list of their contributions.
- Sample contribution letters can be found on the Benefits Board's web site at www.benefitsboard.com under the Treasurer's Manual and in the forms section. Samples can also be found in IRS Publication 1771 at www.irs.gov.

- A donor cannot claim a tax deduction for charitable contributions over $250 (single gift) unless he has written acknowledgement of the gift. The acknowledgement must be in his possession **prior** to the filing of his tax return for him to be able to claim the deduction.
- According to IRS publications, acknowledgement can be provided by the church to the donor electronically, i.e. by e-mail.

The church should always seek to make sure that its donors are provided sufficient information to comply with the tax laws of our country.

Charitable Gifts under $250 to Churches

Most church treasurers and donors are familiar with the current law concerning substantiation of gifts given to churches. If a donor gives any one gift that is in excess of $250, the church must provide a receipt to the donor for the gift before the donor can claim such as a charitable contribution on his or her tax return. The receipt can be provided contemporaneous with the gift or the church can provide a regular accounting of all gifts over $250 (as well as other gifts) once a year or once a quarter. For gifts under $250, prior to January 1, 2007, the church was not required to provide substantiation of the gift, even if the combination of all the gifts exceeded $250. For gifts under $250, the donor was able to use their own records to substantiate those gifts. However, effective January 1, 2007, substantiation of gifts under $250 changed.

The Pension Protection Act of 2006, among other things, provided that no charitable deduction is allowed after January 1, 2007 for **any** contribution unless the donor maintains as a record of such contribution a bank record or a written receipt from the church showing the name of the church organization, the date of the contribution, and the amount of the contribution. Simply stated, this provision does not change the substantiation requirement for contributions in excess of $250. Those gifts must still be substantiated by an appropriate receipt from the church, and a cancelled check is not sufficient. However, for gifts less than $250, for the donor to be able to claim such as a charitable contribution, he or she must have a cancelled check or a written receipt from the church denoting the gift.

Because of this change, instead of placing a few dollars in the collection plate, donors may want to write a check even for their smaller donations. The other option is for the local church to record by donor all cash contributions made through the church “envelope” system. Of course, this places more pressure on churches to maintain accurate records of contributions of all sizes, not just those over $250. Again, this provision is effective for all contributions made after January 1, 2007.

Saving Tithe Envelopes

There are always many questions about how long tithe envelopes should be saved by a church. The general rule is that churches should save tithe envelopes for at least three and a half years. However, if you place the donors on notice that you are destroying those records, you may be able to get rid of them earlier. It is suggested that when the church sends out the charitable receipts that a note be added that says something to the effect of "all contributions contained herein were recorded off of your checks or tithes envelopes. If you find mistakes, please advise us immediately because the tithe envelopes will be destroyed in 90 days from the date of this statement." Then it is suggested that the church hold the envelopes for well past the 90 days – and then destroy them. By taking this approach, the church has given the donor notice of their charitable contributions, the church has held the envelopes for a period of time to validate the contributions, the church has given the donor notice that it is going to destroy the envelopes, and then the church has done just as promised.

It is suggested that you create a policy manual that contains the church's process for disposing of these old tithe envelopes, based upon this or a similar system – and then the church follow it. As long as your "system" is reasonable and you follow your own system, the church should not have any troubles with the Internal Revenue Service.

Q: ***If a person pays $50.00 a plate for a Royal Rangers fund raiser (steak dinner and entertainment), does that person get a full charitable deduction or should I as treasurer get a fair price for the meal, deduct that, then give them credit for the remaining as a donation?***

In like manner our choir had a golf tournament where the golfers paid $40 but got 18 rounds of golf plus a free dinner. Do I deduct a fair cost then give them credit?

A: The answer is simply that the donor is entitled to claim a charitable deduction to the extent that the amount given exceeds the value of the goods or services provided in exchange for the gift. If tickets are printed up for such events, it is generally a good idea to list on the ticket the amount that can be claimed as a charitable donation. Regardless, it is much better to determine in advance how much is a donation and how much is for payment of the goods or services – than afterwards.

Sample receipt forms on how to deal with such gifts can be found under the Treasurer's form section of the Benefits Board's web site at www.benefitsboard.com.

Non-Cash Charitable Gifts

Over the past few years, many churches have become the recipients of non-cash gifts. While accounting for cash gifts are rather simple for the church, the giving of items other than cash is unique and therefore most non-cash gifting should be completed only after consulting a tax professional. For more information on how to report non-cash charitable contributions, you should review the instructions for IRS Form 8283.

Tax-Deductible Contributions for a Short-term Mission Trip

During the summer months, many churches and organizations sponsor short-term mission trips. On these trips, students and adults alike visit places both domestically and internationally to share the Good News of Jesus Christ. Some trips involve evangelization efforts while others primarily concentrate on manual labor. Regardless of the purpose, all short-term mission trips have something in common - the need to raise money to defer the cost of such an endeavor.

Instead of having car washes and bake sales, the simplest way to raise funds for a short-term mission trip is to request donations from individuals. The question then arises as to whether the donations are tax deductible for the donor. For donations to be tax deductible, a few simple rules should be followed:

- The church should preauthorize the trip as meeting the church's mission and statement of purpose. This preauthorization should be accomplished before accepting donations.
- While a donor may express a "preference" that his or her donation be used to assist a particular trip recipient, the donor should not restrict the donation to only be used by the particular recipient. If so, the gift becomes earmarked for the specified individual and it is no longer qualified as a tax deductible charitable contribution. If the church cannot exercise complete control over the gift, it loses its ability to be a tax-deductible gift.
- Contributions should be made to the church (and not the individual) and should be receipted by the church as charitable contributions.
- All expenses for the mission trip should be paid out of the church's designated account from funds raised for the trip or from other church resources.
- The trip should have no significant element of personal pleasure, recreation, or vacation. If so, not only may the gifts given for such not qualify as tax deductible donations but the amounts spent on the "mission trip" participants may become income to them for tax purposes. If the trip looks more like a vacation than a mission trip, those giving will not get a tax deduction and those going on the trip may find that their "mission trip" has caused them to have tax liability.

- A church should not refund contributions made in “preference” for a person who later decided not to go on the trip. Refunding these gifts is a strong indication that the church did not have adequate discretion or control over the gifts to begin with.

Short-term mission trips can be a great blessing to the participants, as well as the church that sends them. Following a few simple safeguards will also assure that donors who assist the mission trip participants will adequately receive tax-deductible credit for their contributions and also assure that the participants on the trip are not taxed for trying to do good. Enjoy your short-term mission trip! It will revolutionize your life.

Gifts Designated for Pastor

Responding to an inquiry by a constituent of then U.S. Senator Johnny Isakson (D-GA), the Internal Revenue Service in 2009 addressed the tax consequences of a church member's contribution to his local church when the donor designated the contribution to help pay for the pastor's health bills. After noting that the church "must have full control of the donated funds and discretion as to their use" for a contribution to be deductible, the IRS cited a 1979 Revenue Ruling which held that payments to a religious organization that were earmarked for particular students were not deductible charitable contributions.

Following that line of thought, the IRS in their response to Senator Isakson contended that an individual's contribution that is designated for the medical bills of his pastor is not deductible under the Internal Revenue Code (Section 170) as a charitable contribution. The IRS's response became public in INFO 2009-0038. At this link you can read the IRS's complete response, only with the constituent's name redacted.

Most troubling about the response is that the IRS seemed to answer a question that was not asked, i.e. are all offerings designated for a pastor, given through the local church, considered to be non-deductible charitable contributions? The only question in controversy involved the deductibility of a contribution given to a church to help pay a minister's bill for previous health expenses, not a simple situation where a gift was given to the church just to bless the pastor. However, the IRS's response seems to be a broad sweep that covers any designated gift through the church to a pastor.

Dan Busby, former President of the Evangelical Council on Financial Accountability, in an article on this subject following the release of the IRS letter noted that this interpretation may effectively limit all designated contributions to pastors from being deductible charitable contributions. Mr. Busby, a noted Certified Public Accountant and the author of the *Zondervan Minister's Tax Guide*, suggests that a church member who wishes to provide funds for a pastor should be encouraged to make the gift directly to the pastor. He notes that efforts to "run gifts for pastors through the church" are the basis for headaches for both the church and the pastor.

We will continue to closely watch to see if the Internal Revenue Service offers additional clarification on this issue.

Q: ***I understand if we take up an offering and it goes straight to the church's general benevolence fund, those donating can use their donations as a charitable tax deduction, but if they ear mark their contribution to an individual then it is not. Am I correct on this?***

A: There are two issues for consideration. First, does the donor making the gift get a tax deduction for the gift? Second, does the recipient of the gift have to pay taxes on the amount received?

As to the first question, a donor cannot use a nonprofit entity, or a church, to pass through gifts to an individual, even if such is for a worthwhile cause. If the gift is just a pass through, the donor cannot get a charitable credit for their gifts BUT the gift is also not taxable to the recipient. It would be just like me giving you $20 for your birthday.

On the other hand, if a donor gives a gift to a benevolent fund at a church and such is not specifically for an individual, the donor is entitled to a charitable deduction for such. If the church has full control over the gift, it is a charitable gift - even though the church's benevolence committee may decide to give all the funds to one person in need.

Secondly, the tax consequences to the recipient again depends on how the money is given to them. If the church simply acts as the pass through and all funds are turned over to the recipient, checks are made to the recipient and not the church, and the church does not record who gave what, there probably is no tax consequences. This goes back to my direct birthday gift scenario.

However, if the church makes an allocation from church funds to the person, based upon recent IRS letter rulings the amount is most likely taxable to the recipient and the church should issue a Form 1099 if the amount is over $600 in one year.

Tax Treatment of Minister's Tithes - Ministers Should Not Deduct Tithes Pre-Tax

Following guidance given in an unpublished Tax Court decision from 1992, some ministers continue to contend that the tithes they pay to the local church should be treated as a business expense rather than as a charitable deduction. If a minister is allowed to treat tithing as a business expense, the minister would then be able to deduct his tithes from his compensation

before taxes (both federal income taxes and SECA taxes) were calculated. Such would allow for substantial tax savings to the minister.

In the 1992 tax court case mentioned above, *Forbes v. Commissioner*, T.C. Sum. Op. 1992-167 (unpublished), the local church had adopted a "tithing policy" that mandated that every minister and employee of the church had to pay a tithe of 10 percent of their total compensation back to the church. In a review of the church's policy, the court found that several employees had been terminated for failing to comply with the tithing policy. The court found that "ordinary and necessary expenses" incurred in carrying out a business can be claimed as business expenses. Since a minister or church-employee for this local church could not retain their position unless they paid the "mandatory" tithe, the court reached the conclusion that the tithe was a business expense - and therefore, could be deducted pre-taxes.

In trying to make the *Forbes* case applicable to ministers in the Church of God, it should be noted that the 2018 General Assembly *Minutes* at S21 provides that "all ministers are required to pay tithes to retain their license." Although historical data may reveal that ministers in times past were "disbanded from the fellowship" for failure to pay their tithes to the local church, it might be difficult to prove the mandatory nature of tithing by Church of God ministers today. While the *Minutes* seem to create a mandatory requirement, the enforcement of the "tithing policy" probably would prove to be problematic.

Most importantly, the issue of whether charitable contributions made by a minister may be treated as deductible business expenses is addressed directly by the IRS. The Internal Revenue Service "audit guidelines" for ministers clearly address this issue in a section entitled Dues vs. Contributions:

> **Dues versus Contributions.** Ministers often pay a small annual renewal fee to maintain their credentials, which constitutes a deductible expense. *However, ministers' contributions to the church are not deductible as business expenses.* They may argue that they are expected to donate generously to the church as part of their employment. This is not sufficient to convert charitable contributions to business expenses. The distinction is that charitable contributions are given to a qualifying organization (such as a church) for the furtherance of its charitable activities. Dues, on the other hand, are usually paid with the expectation that a financial benefit will result to the individual, as in a realtor's multi-list dues or an electrician's union dues. A minister's salary and benefits are not likely to directly depend on the donations made to the church. They may still be deducted as contributions on Schedule A but may not be used as a business expense to reduce self-employment tax.

While every tax liability can be challenged, the "audit guidelines" seem to provide more applicable guidance than the Tax Court's decision in the *Forbes* case. Although we have reviewed the holding in the *Forbes* case here, it should be noted that the *Forbes* case cannot be cited as legal precedent in a hearing before the IRS or the Tax Court. Because the participants in the *Forbes* case used an expedited procedure to get a determination, the case is unpublished

and cannot be cited in a legal argument. No other court has adopted the *Forbes* decision and it seems to be in contradiction to ever official position taken by the IRS, including the "audit guidelines" as quoted above. If a minister chooses to follow the guidance given in *Forbes*, he or she should be well aware that they are taking a risky position that most likely will be challenged by the IRS - and such may result in penalties, back taxes, and interest.

Note: While a pastor should not deduct his tithe to the local church pre-tax, the pastor can request that his tithes be withheld from his paycheck on a regular basis, just as he might have a portion of his salary set aside to go into a savings account. This does not reduce his salary (he still is taxed on his whole salary amount, including what goes back to the church as tithe and what might go to his savings account) but it does keep him from having to cut a check each week for tithes. The pastor's W-2 would report the total amount and the treasurer would also need to give the pastor a charitable gift receipt for his contributions (even though they were withheld), assuming that they were over $250 each. For gifts under $250, the pastor's paycheck stub could serve as a contemporary "bank record" for charitable deduction purposes, assuming that such was clearly delineated.

Notice to Donors of the Local Church

To avoid jeopardizing the tax deductibility of charitable contributions, churches should advise donors at the end of the year (or the beginning of the New Year) not to file their income tax returns until they have received a written acknowledgement of their contributions from the church. This communication should be in writing.

Richard Hammar in the *Church Treasurer Alert* suggests that the following notice be placed in a letter to donors or in the church bulletin:

> ***Important Notice:*** *To ensure the deductibility of your church contributions, do not file your income tax return until you have received a written acknowledgment of your contributions from the church. Some of your contributions may not be tax-deductible if you file your tax return before receiving a written acknowledgement of your contributions from the church.*

The IRS rules basically prohibit a taxpayer from claiming a charitable deduction for any single gift over $250 unless the taxpayer/donor has written acknowledgement from the church (or charity) receiving the gift. For gifts under $250, the donor must have bank records (cancelled checks, etc.) or a written acknowledgement from the church (or charity) before such can be claimed as a deductible charitable contribution. The Benefits Board suggests that churches provide written acknowledgement of all gifts, regardless of the amount, to all donors on at least an annual basis. To get suggestions on how to draft gift receipts, the church treasurer may visit the Benefits Board's web site.

Tips from the IRS for Deducting Charitable Contributions

The Internal Revenue Service, along with *Christianity Today* magazine, has released a list of helpful tips when it comes to claiming a charitable contribution as a tax deduction. The following are a few of those tips:

1. To be deductible, a contribution must be made to a "qualified" tax exempt organization, which would include churches. Contributions made to a specific individual, political organization, or political candidate, even though such was given for a charitable cause, cannot be claimed as a charitable contribution.
2. A person cannot claim a charitable deduction based upon the value of their time or personal services performed. Therefore, a lawyer who donates her time to do legal work for a church cannot claim the value of that service as a charitable donation to the church.
3. If you get something from the charity in return for your donation, you can deduct only the amount that exceeds the fair market value of the benefit you received. For example, if you give $100 to a television ministry and receive a $25 Bible in return for the donation, you can only claim a $75 charitable contribution deduction.
4. If you donate stock or other property, the value of the donation is determined at the time of the gift, regardless of what you paid for the stock or property. Assume that you paid $10,000 for a piece of property and it is now worth $50,000. If you sold the property yourself, you would owe taxes on the $40,000 gain. However, if you donated that property to the church, you get to claim a charitable contribution deduction for the entire $50,000, not just the $10,000 cost basis that you have in the property.
5. Clothing and household items can be claimed as charitable donations but only if they are "in good used condition." These items must be itemized to be deductible. Just saying "bag of used clothes - $50" is not sufficient.
6. For *all* contributions, you can only claim a charitable deduction if you maintain a bank record or a written communication from the charitable organization that contains the name of the organization, the date of the contribution, and the amount of the contribution.
7. In addition, if the contribution is $250 or more, you must obtain a written acknowledgment from the charitable organization showing the amount of the contribution, the date of the contribution, and whether the charitable organization provided any goods or services in exchange for the gift. Simply having bank records is not sufficient for gifts over $250.
8. If you give more than $500 in non-cash gifts to any charity, you must attach IRS Form 8283 (Non-Cash Charitable Contributions) to your tax return. If you give more than $5,000 in non-cash gifts, an appraisal must also be attached to the IRS Form 8283.
9. Churches should voluntarily provide tax receipts to donors at least once a year. Examples of receipts can be found on our web site by clicking here.

While we do not give gifts to charitable organizations or churches solely to receive a tax deduction, it is an added benefit that is provided under the tax code. Therefore, you should take advantage of the opportunity to claim every deduction that you are entitled to under the law.

It should be noted that following the tax reform legislation of late 2017 and the increase in the standard deduction, fewer and fewer people will be itemizing deductions and therefore charitable deductions may become less important. There is a concern that this tax law change could cause donors to be less generous in their giving to churches and other charitable organizations. However, it still is too early to tell what the impact on charitable giving may be.

RETIREE TAX ISSUES

Important Tax Information for Retirees

If you are receiving benefits from the old Aged Ministers' Fund, you will not receive an IRS Form 1099 from Lincoln National Life Insurance Company or the Church of God International Office. They will not send you anything - just a check every month.

On the other hand, the Benefits Board will send you a Form 1099-R if you withdrew funds from your Ministers' Retirement Plan account during the previous year. Your Form 1099-R will reflect how much money you drew from the Benefits Board during the year. You should take the amount on the Form 1099 provided by the Benefits Board **plus** the amount that you receive from Lincoln National (or the Church of God International Office) and put that amount in Line **5a** on the new Form 1040 (your tax return). If you are a minister, you may then subtract out your housing cost and place the difference on Line **5b** of the Form 1040.

For example, let's assume you are a minister and that you draw $200 a month from Lincoln National (or $2400 a year). In addition, the 1099-R you receive from the Benefits Board states that you drew $500 a month ($6000 a year) from the Benefits Board. On line 5a of your Form 1040, you would add the two accounts and show that you had pension and annuity income of $8400 (this example assumes you have no other pension income other than Social Security). If your housing costs for the year were $8400 or more, you would show $0 in Line 5b on the Form 1040. If your housing costs were $5000, assuming the same pension income, you would show $3400 on Line 5b of Form 1040.

No Annual Interest Statement from Board

Each year as participants begin to get all their tax information together, they realize that they have not received a Form 1099-INT from the Benefits Board showing the amount of interest they earned on their retirement account during the previous year. Since the participant receives a Form 1099-INT from their banking institutions, they assume that they should get such a form from the Benefits Board. However, that is incorrect.

Since funds invested in the Ministers' Retirement Plan are tax-deferred, there is no annual requirement to report the interest or earnings on your account at the Benefits Board. All contributions, earnings, and interest will be reported once you begin to take distributions (withdrawals) from your account. All those who take distributions in retirement or by early withdrawal receive a Form 1099-R from the Benefits Board.

Anyone receiving a distribution from the Board should receive their Form 1099-R in late January of the next year.

Working after Retirement Age

The Social Security retirement age is now on a sliding scale based upon your year of birth. Therefore, to receive full benefits from Social Security you must wait until you reach your "full retirement age" which is between 65 and 67, again depending upon when you were born. If you take "early" Social Security benefits, the amount of wages you may earn without your Social Security benefits being reduced is limited. For 2022, a person taking early benefits will have their Social Security retirement benefits reduced by $1 for every $2 of earned income in excess of $19,560.

For persons who reach full retirement age during 2022, their Social Security retirement benefits will be reduced by $1 for every $3 earned over $51,960 until the worker reaches full retirement age. After reaching full retirement age, employees can receive their full Social Security retirement benefits amount no matter how much they earn.

It should be remembered that regular distributions/withdrawals from the Ministers' Retirement Plan do not count against this "earnings limit" for Social Security. Only "earned" income is used for the calculation.

Further, Social Security "full retirement age" only applies to Social Security benefits. You may begin withdrawing from your retirement account at the Benefits Board after you have reached 59½ years of age, regardless of your "full retirement age." However, the Benefits Board would encourage you to leave your retirement account intact without making withdrawals until you have officially retired. Such allows your account to continue to grow tax free.

Housing Allowance for Retired Ministers

Under the Internal Revenue Service guidelines, the Church of God Benefits Board designates up to 100% of the retired minister's annual distributions from the Benefits Board as housing allowance. However, the minister is **not automatically** entitled to exclude 100% of his distributions as housing allowance. To qualify, the minister must actually spend for housing the amount of money that he claims as an exclusion when filing his federal income taxes on Form 1040. The total amount excluded may not exceed the total cost to rent or to provide a retirement home. It should also be noted that church-related employees do not get to claim the housing allowance provision in retirement – just as they did not get to claim such during their work years for a church organization.

Under the Clergy Housing Allowance Clarification Act of 2002 (Public Law 107-181), the amount excludable by a retired minister as housing allowance cannot exceed**:**

- the fair rental value of the furnished house, plus the cost of utilities,
- the actual expenses of operation of the home, or
- the amount designated by the Benefits Board as a housing allowance;

whichever is less.

Ministers that are retired (or those who are considering retirement) should remember the following facts when looking at the housing allowance:

- A minister can have only one housing allowance. If the minister is receiving a full housing allowance from his church, he cannot claim pension distributions as housing allowance as well.
- Distributions from the Ministers' Retirement Plan must initially be set up to occur over a period 10 years or longer for such to qualify as housing allowance.
- In order for you to maximize this special benefit, you must maintain diligent documentation of all housing related cost. *Good record keeping cannot be over emphasized.* The liability for determining the appropriate amount of housing allowance that can be excluded *is the responsibility of the retired minister.*
- If the minister's house is paid for, he can claim utilities, taxes, insurance, maintenance, repair work, etc. He cannot claim a "rental amount." Only actual expenditures are claimable.
- The retired minister should report the total amount received from the Benefits Board on Line **5A** of the IRS Form 1040. The amount reported on Line **5A** should correspond with the 1099-R form received from the Board in late January. Qualified housing costs should then be subtracted from the amount received from the Benefits Board (reported on Line **5A),** with the difference – the taxable amount - reported on Line **5B**.
- The minister does not have to provide documentation to the IRS of his housing allowance when he files his taxes. However, such documentation should be kept in his personal records with a copy of his tax return in case the IRS ever questions his housing allowance deductions.

- A large down payment or doubling up on mortgage payments may not be excludable as housing allowance if such exceeds the fair rental value of the property. For example, assume that a minister pays $50,000 down and in payments during a year on his house. Further assume that the fair rental value of the house fully furnished with all utilities paid would be $24,000 a year and the participant draws $25,000 a year from his pension plan at the Benefits Board. Using the three-prong test stated above, the participant could only exclude $24,000 from his income for housing allowance (the lesser of the three). The additional $1,000 received from the pension plan would have to be reported on line **5B** of the IRS 1040 as taxable income, even though the participant spent much more on his actual housing costs.
- Pension distributions can only be designated as ministerial housing allowance by qualified church pension plans set up under Section 403 (b) (9) of the Internal Revenue Code. The Ministers' Retirement Plan, administered by the Benefits Board, meets that criterion.
- Again, only credentialed ministers are eligible to claim the ministerial housing allowance.

Without a doubt, the ministerial housing allowance is one of the best benefits available to both active and retired ministers. However, its implementation is often difficult and confusing.

Social Security Benefits Statements are Now Available Online

The Social Security Administration is now providing online statements for individuals to view the estimated benefits that person will receive when they retire, replacing the paper statements the agency use to mail to everyone each year a couple months prior to your birthday. The yearly statements told what your benefits would be if you retired at age 62, 66 or 70. Now the statements will be mailed only on milestone birthdays (55, 60, etc.). With the free online statements, workers 18 and older can go to www.ssa.gov and create a secure account to view their earnings and benefit information.

In announcing the online statements, the Commissioner of Social Security stated, "Our new online Social Security statement is simple, easy-to-use and provides people with estimates they can use to plan for their retirement." The online statements include a history of taxable earnings for each year so people can check for any mistakes, as well as the total amount of Social Security and Medicare taxes paid over the lifetime of the worker. They also provide estimates of monthly benefits based on current earnings and when a worker may plan on retiring. Early Social Security retirement benefits can be claimed starting at age 62 and full benefits are currently available at age 66, but gradually increasing to 67 for those born in 1960 or later. However, if workers wait until 70 to apply for Social Security, they can receive even higher benefits.

To get a personalized online statement, anyone 18 and older must provide information about themselves that match the information Social Security already has on file. They must provide their identifying personal information and answer a few security questions in order to pass the verification process. Once verified, a person can create a "My Social Security" account with a unique user name and password to access their statement.

Overall, the new online statements are a part of a larger government effort to use new technologies to communicate with taxpayers and distribute benefits. The federal government has phased out paper checks for all benefit programs, including Social Security. For more information about the online statements, go to http://www.ssa.gov/mystatement/.

Q: ***We need clarification on the tax-free housing allowance paid to our pastor at retirement. Specifically, what is the "board designated" housing allowance for calculating the minimum of fair rental value, actual home operating expenses or board designated housing allowance? It is our understanding that our retired pastor's actual housing allowance will be the lower of these three calculations.***

A: The Board will designate 100% of the amount that the minister draws in retirement as housing, subject to him using such for housing and subject to the IRS regulations. Basically, the same rules for housing apply whether the minister is active or retired. He will be limited to claim his actual housing costs, the amount received from the Benefits Board designated as housing (i.e. 100% of his distribution), or the fair rental value of his housing, **whichever is less**. Generally, the fair rental value criterion is not an issue. So, assume that his actual housing expenses were $1500 a month on average and his distribution was $2000 a month - he would report $500 a month ($6000 a year) on line **5B** of the 1040 as taxable distribution from his pension (assuming this was the only pension account he had).

Q: ***When reporting my income each year, will there be some statement from the Benefits Board declaring a portion of my withdrawals as Ministerial Housing Allowance?***

A: See answer to previous question. If you use 100% for housing, then you will have 0% reportable income. You would simply list the amount you received from the Benefits Board on line **5A** of the 1040 Form and then on line **5B** (the taxable amount of **5A**) you would list $0. If you do not use it all for housing, then **5B** would be the difference between what you received and the amount used for housing.

The Benefits Board will provide you with a Form 1099-R showing how much you drew from your retirement account during the previous year. However, it will be up to you to determine how much was used for housing - and thus not taxable.

HOUSING ALLOWANCE TAX ISSUES

Creating a Valid Ministerial Housing Allowance

The following simple steps should be taken to assure that the ministers' housing allowance is created properly:

- The minister should determine his yearly housing costs by using the *Estimate of Housing Allowance* form (may be obtained at www.benefitsboard.com).
- The *Estimate* should be submitted to, and adopted, by the governing body of the local church (either Church Council or full church business meeting) prior to the beginning of the new year for which estimate is based on. However, it can be done after the start of the year but only may be applied prospectively, not retroactive. As an example, the resolution should state that "*the Anytown Church of God, through this action of the Church Council, does hereby create a housing allowance for Pastor Phil Pulpit. The church agrees to pay to Pastor Pulpit $1,000 each and every month to secure and maintain a residence. This resolution shall be good and valid for the upcoming fiscal year and all years afterward unless changed by this body*."
- The minister should keep careful records of all housing costs for the year.
- The minister should remember that he can receive a housing allowance for only *one* home.
- The minister's housing allowance is limited to the *least* of the (1) amount designated by the church as housing allowance, (2) the amount actually used to provide a home, or (3) the fair rental value of the home, including furnishings and utilities.
- The minister must pay federal income taxes on any "excess housing allowance," which is reported on line 1 of the minister's IRS Form 1040.

- The minister must pay self-employment taxes (Social Security and Medicare) on the entirety of the housing allowance.
- A housing allowance provision has to be adopted by the church before the minister can claim such. As noted earlier, the housing allowance cannot be made retroactive.

Even though a minister's home mortgage interest and real estate taxes have been paid with money excluded from income as a housing allowance, he may still claim itemized deductions for these same items on Schedule A of his tax return. This practice is commonly referred to as "double-dipping," but is permissible under the IRS guidelines.

The ministerial housing allowance is by far the best tax advantage that a minister has available to him. If the allowance is crafted properly, a good portion of the "income" available to the minister will be tax-free. *(Note: More information on the Minister's Housing Allowance can be obtained from the Minister's Compensation Manual, available without costs on the Benefits Board's web site at www.benefitsboard.com.)*

Tax Reporting and the Housing Allowance

Although the IRS instructions for Form W-2 do not require that the "fair rental value" of the parsonage be reported on the W-2, the Board joins the IRS (Instructions for Form W-2) in recommending that Box 14 be used to record this amount. Putting the "parsonage fair rental value" or "ministerial housing allowance" on the W-2 is a great way of maintaining a record of the amount designated as such.

If the pastor is living in a parsonage, the amount that is reported is the fair rental value of the house, plus any utilities and furnishings that are provided by the church. To get the fair rental value, it is suggested that you ask a local realtor to provide the church with a written estimate of how much a house similar to the parsonage in size and location would rent for on the open market. The church treasurer should then take that amount and add to it a "fair rental amount" for any furnishings that the church provides, plus utility costs if the church also provides utilities. This total amount would be reported on the W-2 in Box 14 as, for example, "12000.00 - Ministerial Parsonage Allowance." If the minister received a housing allowance, Box 14 would report, for example, "12000.00 - Minister's Housing Allowance."

It should always be remembered that while the pastor does not have to pay federal income tax on this amount, he is required to pay SECA taxes (Medicare and Social Security taxes) on the housing amount. Further, it should be noted that only licensed or credentialed ministers are entitled to a parsonage allowance or a housing allowance. If a non-minister is given either a housing allowance or allowed to live in the parsonage, the entire value becomes taxable to the non-minister for both federal income tax purposes, as well as Medicare/Social Security tax purposes.

Parsonage / Housing Allowances - IRS's Perspective

The following article is directly reprinted from the Internal Revenue Service's *Tax Guide for Churches and Religious Organizations* (Publication 1828). You may access the entire publication by clicking here:

"Generally, a minister's gross income does not include the fair rental value of a home (parsonage) provided, or a housing allowance paid, as part of the minister's compensation for services performed that are ordinarily the duties of a minister.

A minister who is furnished a *parsonage* may exclude from income the fair rental value of the parsonage, including utilities. However, the amount excluded cannot be more than the reasonable pay for the minister's services.

A minister who receives a *housing allowance* may exclude the allowance from gross income to the extent it is used to pay expenses in providing a home. Generally, those expenses include rent, mortgage payments, utilities, repairs, and other expenses directly relating to providing a home. If a minister owns a home, the amount excluded from the minister's gross income as a housing allowance is limited to the least of the following: (a) the amount actually used to provide a home, (b) the amount officially designated as a housing allowance, or (c) the fair rental value of the home. The minister's church or other qualified organization must designate the housing allowance pursuant to official action taken *in advance* of the payment. If a minister is employed and paid by a local congregation, a designation by a national church agency will not be effective. The local congregation must make the designation. A national church agency may make an effective designation for ministers it directly employs. If none of the minister's salary has been officially designated as a housing allowance, the full salary must be included in gross income.

The fair rental value of a parsonage or housing allowance is excludable from income only for income tax purposes. These amounts are *not* excluded in determining the minister's net earnings from self-employment for SECA tax purposes. Retired ministers who receive either a parsonage or housing allowance are not required to include such amounts for SECA tax purposes."

Ministers' Housing Allowance Under Attack Again

Ministers across the country cheered in June 2011 when the plaintiffs in a California lawsuit voluntarily dismissed their challenge to the ministerial housing allowance. However, the celebration was a little premature in that the housing allowance quickly came under attack again from two separate fronts.

First, the Freedom From Religion Foundation and three of its officers filed a new lawsuit in federal court in Wisconsin in October 2011, contending that the ministerial housing allowance, for both active and retired ministers, was unconstitutional. The plaintiffs contended that they receive housing allowance but such was taxed as income to them. On the other hand, ministers who receive housing allowance are able to exempt such from taxation. The plaintiffs contended also that this difference created unconstitutional discrimination that benefits religious organizations and not others. The complaint alleged that because employees of secular organizations are not allowed these tax preferences, secular groups incur comparatively greater compensation costs, placing them at a "competitive disadvantage."

The Wisconsin lawsuit requested that the ministerial housing allowance be found in violation of the "Establishment Clause" of the First Amendment of the Constitution. They further requested that the court prohibit the use of the ministerial housing allowance under federal law. The district court ruled in their favor, holding the housing allowance unconstitutional. However, the ruling was reversed by the appellate court on a technicality. However, a new case was filed in April 2016. *See next article.*

Secondly, Senator Charles Grassley (R-Iowa), working in conjunction with the Evangelical Council for Financial Accountability (ECFA) and other non-profit religious organizations, formed the "Commission on Accountability and Policy for Religious Organizations" to look into a variety of issues involving the financial practices of religious groups. The Commission is chaired by Michael Batts, the managing partner of an Orlando-based accounting firm that serves non-profit organizations. In their review, the Commission continues to look into a variety of issues including:

- Whether churches should file the same highly-detailed annual information return (Form 990) that other non-profits must file.
- Whether the income tax exclusion for housing allowance paid to clergy should be limited in some manner.
- Whether legislation is needed to remove uncertainty about the taxability of "love offerings' paid by church attendees to ministers through a church.

The initial Commission report, issued in December 2012, also raised concerns about the constitutionality of the housing allowance. The Commission continues its work.

Ministerial Housing Allowance Held **Constitutional**

The Freedom From Religion Foundation filed a lawsuit on April 6, 2016, challenging the constitutionality of the ministerial housing allowance under section 107 of the Internal Revenue Code. This lawsuit followed a similar lawsuit, filed in the same federal court in the Western District of Wisconsin, where the judge ruled that the housing allowance (not the parsonage provision) was unconstitutional. Fortunately, the earlier decision was overturned by the Seventh Circuit Court of Appeals in November 2014 on a technicality.

As a part of the Seventh Circuit's earlier decision, the opinion went on for page after page telling the plaintiffs how they would have to refile their case and the steps they would need to take to keep from having their case dismissed in the future. The Freedom From Religion Foundation, and their officers, took that advice to heart and did exactly what the court suggested they would have to do to have a viable case.

On October 6, 2017, the federal district court judge ruled in the new case that the ministerial housing allowance again violated the Constitution. Judge Barbara Crabb held that Section 107(2) of the Tax Code, the provision that specifically addresses the "cash" ministerial housing allowance, violated the Establishment Clause of the First Amendment, simply because it did not have a secular purpose or effect, and because it singled out "ministers of the Gospel" for special tax treatment not available to others.

Due to an earlier decision by the court, the ruling only dealt with the housing allowance where ministers are provided cash to rent or purchase a home, and left fully intact, at least for now, the tax-free use of parsonages.

Although Judge Crabb ruled that the ministerial housing allowance was unconstitutional, she did not immediately implement a ruling as to what was supposed to happen next. In a follow-up order dated December 13, 2017, Judge Crabb issued an injunction that prohibited the government from enforcing Section 107(2) of the Tax Code. Simply stated, the injunction prohibited the Internal Revenue Service from allowing ministers to claim the housing allowance as an exclusion from income. However, as expected, the judge "stayed" the injunction until "180 days after the conclusion of any appeals." The judge noted that the additional time would allow Congress, the IRS and affected individuals and organizations to adjust to the change.

The unconstitutional decision by the lower court was appealed to the Seventh Circuit Court of Appeals in Chicago where the different parties to the case filed position briefs with the court. On April 26, 2018, the Church of God denomination and the Church of God Benefits Board filed a "friend of the court" brief in the matter, along with other similar organizations and denominations.

Oral arguments were presented before the appellate court on October 24, 2018.

Some six months later (March 15, 2019) in a surprising unanimous decision, the Seventh Circuit Court of Appeals held that the ministerial housing allowance did not violate the U.S. Constitution. While Court observers were divided on their predictions about what the court's final decision might be, the unanimous decision upholding the "cash" housing allowance took almost everyone by surprise.

From the Court's opinion, it was evident that the Seventh Circuit looked very closely at the laws supporting the ministerial housing allowance that have been in place for more than 60

years. They also looked closely at the impact that disregarding that legal precedent would have on both active and retired ministers of the Gospel.

For all ministers, the Court's finding that the cash ministerial housing allowance was constitutional was a huge win.

Additional information on the litigation involving the ministerial housing allowance, along with a copy of the court's decision, can be found at https://www.benefitsboard.com/housing-allowance.

Multiple Homes and the Ministerial Housing Allowance

It is not unusual for a minister to own two homes. He may be living in one home and buying another for retirement purposes or he may have lived in one home for a particular pastorate and bought another home when he assumed a new pastorate. In addition, a pastor may be living in the church-provided parsonage while buying his own home.

The question that arises is whether the minister can claim a ministerial housing allowance (or parsonage allowance) for *both* homes. Section 107 of the Internal Revenue Code answers this question with an emphatic no!! In plain English, the tax code prohibits a minister from claiming the housing allowance on any home other than the house that he occupies as his "dwelling place." A close review of the tax code and the regulations surrounding the ministerial housing allowance singularly support the conclusion that the allowance can only be applied to the expenses associated with one home – and one home only.

Therefore, a minister living in his own home as a pastor of a local church, while at the same time buying another home to serve as his retirement home, could only claim the housing expenses associated with the home he is living in towards the exclusion for ministerial housing allowance. Any expenses associated with the retirement home could not be used in calculating the ministerial housing allowance.

Further, if the church provides the minister with a parsonage, he cannot also claim the expenses from his own home under the ministerial housing allowance. While it would be helpful in the latter years of ministry if you could live in a parsonage and also began to outfit and operate your soon-to-be retirement home by claiming the expenses under the ministerial housing allowance, the IRS "one home" rule prohibits such.

While some ministers have tried to get around the "one home" rule by claiming that they have two "duty stations," the IRS has never officially recognized this practice. Simply stated, the IRS rules and regulations make it abundantly clear that for purposes of the ministerial housing allowance a minister can only claim one house and that he must use that house as his dwelling place. There is no gray area for a more open interpretation.

"Driscoll" Decision on Two Homes

In a December 2010 decision, the United States Tax Court, in a case involving a Cleveland, Tennessee minister, took a totally different approach in dealing with a minister's assertion that he could claim two homes under the ministerial housing allowance provision of the Internal Revenue Code. In Driscoll vs. Commissioner (135 T.C. No. 27), the Tax Court, in a divided opinion, held that the minister/taxpayer could claim the ministerial housing allowance for two homes under Section 107 of the tax code. However, that decision was later reversed.

In the Driscoll case, the minister had one home in Cleveland that was his primary residence and another residence that the Tax Court called a "second home" on the Ocoee River just outside of Cleveland. When the minister initially claimed the ministerial housing allowance on both homes, the IRS rejected the exemption on the "second home." However, the Tax Court held that the IRS had no authority under Section 107 of the Tax Code to reject the minister's claim and therefore ruled that the minister was eligible to have the ministerial housing allowance on both homes.

When the initial decision was handed down, it was noted that the Driscoll decision could do more harm than good in the long run when it came to maintaining the ministerial housing allowance. It was noted that not only were exorbitant amounts claimed by Driscoll for housing allowance, but also that the majority of ministers do not have the ability to own two homes. It was noted that opponents of the ministerial housing allowance could use the amounts claimed in the Driscoll case and the discussion of a "second" or "vacation" home to turn public opinion against those who have tried to follow the letter of the law over the years.

Realizing that the Driscoll decision was an overstatement of what most people had considered to be settled principles of law, the Internal Revenue Service appealed the decision in the Driscoll case. In early February 2012, a three-judge panel from the U.S. 11th Circuit Court of Appeals in Atlanta overturned the Tax Court's decision in the Driscoll case.

The decision by the Appeals Court hinged on whether "a home" as used in the housing allowance provision of Section 107 of the Tax Code also includes "homes." The Appeals Court concluded that 'a' maintains a singular connotation in the context of Section 107 and was meant to deal with one home, rather than multiple homes. The Appeals Court clearly stated their holding by noting that *"the consistent use of the singular in this legislative history — "a dwelling house," "a home," and "the home"— demonstrate that Congress intended for the parsonage allowance exclusion to apply to only one home."*

After a request by legal counsel for Driscoll for a full hearing of this matter before an en banc panel of the 11th Circuit Court of Appeals, the three-judge panel's decision overturning the Tax Court was allowed to stand, thus limiting the ministerial housing allowance to only one home. Further, a request to have the matter heard by the U.S. Supreme Court was also denied.

Therefore, any minister who relied on the Tax Court decision in the earlier Driscoll case to apply a housing allowance to more than one home should immediately consult with your tax professional about amending your previous tax returns.

Home Office Deduction vs. Ministerial Housing Allowance

Many ministers have an office in their home. For the costs of a home office to be deductible as a business expense for a taxpayer on his or her tax return, the office must be used exclusively and regularly in the taxpayer's trade or business. But in the case of a minister who is receiving a housing allowance (either as an active minister or as a retired minister), can the expenses associated with a home office be deductible as a business expense on his or her tax return?

The answer seems to be NO.

In Deason v. Commissioner, 41 T.C. 465 (1964), the Tax Court ruled that section 265 of the Internal Revenue Code denied a deduction for any expense allocable to tax-exempt income. Although the Deason decision involved transportation costs, the principle of the case is thought to apply to the home office expenses of a minister. In other words, the Deason case is interpreted to prohibit a minister who is claiming a housing allowance from being entitled to the home office deduction.

The Internal Revenue Service Audit Guidelines for Minister clearly denies this deduction, while noting in the alternative that "double dipping" for mortgage interest and taxes is allowable:

> *The church often provides an office on the premises for the minister, so the necessity of an office in the home should be questioned closely. Furthermore, since the total cost to provide the home is used in computing the exempt housing allowance, home office deductions for taxes, insurance, mortgage interest, etc. would be duplications. (Note that itemized deductions are allowable for mortgage interest and taxes. IRC § 265(a)(6), and Rev. Rul. 87-32, 1987-1 C.B. 131).*

Simply put, if you are getting a ministerial housing allowance, you should not be claiming a home office deduction. A minister can claim one or the other. Due to the "recapture" provision relative to the home office deduction and the scrutiny that the home office deduction still comes under from the IRS, it seems to be a rather simple decision – the minister will get much more savings generally out of the housing allowance than from the home office deduction. The housing allowance is basically a tax credit while the home office deduction is just that – a tax deduction. Credits are generally much better than a deduction.

However, should the housing allowance go away in the future, the minister can then seek to claim the home office deduction.

The Earned Income Tax Credit

The question arises as to whether or not a minister's housing allowance or the fair rental value of the parsonage is earned income for purposes of calculating the earned income tax credit, or EIC.

The tax code is clear that ministerial housing, whether a housing allowance or a parsonage provided by the church, is excluded from a minister's *federal taxable income* if such is set up under an approved housing allowance designated by the church. On the other hand, the minister is required to pay SECA (Social Security/Medicare) taxes on the housing allowance or the "fair rental value" of the parsonage. Simply put, a housing/parsonage allowance is not taxable for income tax purposes but it is taxable for Social Security/Medicare tax purposes.

Based upon that distinction, one could reasonably assume that the housing allowance or "fair rental value of the parsonage" would not count as income in calculating the "earned income credit." However, that is **NOT** the case. The Internal Revenue Service, in Publication 596 - Earned Income Credit (EIC) – clearly points out that ministerial housing *is included* in determining the earned income tax credit. At page 7 of Publication 596, the following is found:

> **Minister's housing.** The rental value of a home or a housing allowance provided to a minister as part of the minister's pay generally is not subject to income tax but is included in net earnings from self-employment. For that reason, **it is included in earned income for the EIC** (except in certain cases described in Approved Form 4361 or Form 4029).

The exception noted regarding an approved Form 4361 deals with ministers who have opted out of Social Security on their ministerial income. In a strange twist of the law that has not yet been corrected by Congress, ministers **who have <u>not</u> opted out** of Social Security (i.e. have not exempted themselves from self-employment taxes by filing Form 4361) must treat their housing allowance or fair rental value of their parsonage as earned income in calculating the earned income credit. On the other hand, ministers **who have opted out** of Social Security should **<u>not</u>** treat their housing allowance as earned income in computing the earned income credit.

This interpretation by the IRS creates an illogical and confusing situation. However, there seems to be no better interpretation. In a recent edition of the **Church & Clergy Tax Guide**, Richard Hammar spent more than five pages trying to explain this confusion.

Q: ***Our church hired a youth pastor that did not have credentials. As his compensation, the church allowed the youth pastor to live in the parsonage and the church paid all the utilities. The youth pastor is now getting credentials. How do we treat the housing allowance for the youth pastor on his W-2 form? At what point does he become a minister and is eligible for ministerial housing allowance?***

A: This is a great question and one not easily answered. Before your youth pastor had ministerial credentials, he was not seen as a "minister" by the IRS. While the church and the community may have seen him as a minister, the IRS says that to even be considered as a minister you must be "ordained, commissioned, or licensed." In other words, you must have some type of official designation that you are a minister – and in our church that is Exhorter, Ordained Minister, and Ordained Bishop, as well as Minister of Education and Minister of Music licensing.

Therefore, before the youth pastor received his ministerial credentials, the value of the parsonage (fair rental value), plus any utilities paid by the church, becomes **Box 1** reportable income to him on **Form W-2**. Since a non-minister is not entitled to the ministerial housing allowance, the value of such is pure taxable income.

However, after the youth pastor receives his ministerial credentials, he is entitled to the ministerial housing allowance. So for the time during which he had ministerial credentials, the value of the parsonage (fair rental value), plus any utilities paid by the church, should be reported in **Box 14** (the "Other" box) as **"Ministerial Parsonage Allowance - $XXXXX".**

Theoretically, if the youth pastor received his ministerial credentials mid-year, the housing allowance for the first part of the year would be reported in Box 1, while the remainder of the year after the minister received credentials would be reported in Box 14 on the Form W-2.

Q: ***So if a "minister" is only eligible for the ministerial housing allowance once he becomes a "minister," the question is when is a minister considered a "minister for tax purposes" according to the IRS? Is he a "minister" when he passes his Exhorter test?***

A: According to the credentialing steps for the Church of God, passing of the examination is only one small part of the credentialing process. Other criteria that must be met include: marital status approval, CAMS completion, local church endorsement ("setting forth"), background check, etc. Therefore, it seems that the person cannot be

considered a minister in the Church of God until the date that he is formally issued a ministerial certificate and a ministerial file number by the denomination. It is only at that point that all the steps to reaching credentialing have been confirmed. NOTE: For other denominations, this process may differ.

Q: ***Our church has always had a Parsonage for our Senior Pastor and Youth Pastor. However, we sold our youth parsonage mid-year. The council then voted to put the Youth Pastor on a housing allowance. How do I show both the parsonage allowance and the housing allowance on the Youth Pastor's W-2 form?***

A: The housing allowance and the parsonage allowance are basically treated the same on the W-2. Both are listed in Box 14 on the W-2. The parsonage allowance on the W-2 is the "fair rental value" of the house as provided to the pastor (or youth pastor). Such would include the rental value of the home plus utilities and furnishings if those are provided. To get the fair rental value of the home itself, the IRS would prefer that you have a real estate professional in your area provide you with a written estimate of such.

On the other hand, the housing allowance is the amount designated by the church as such. It should be noted that the housing allowance is the amount "designated" by the church and not necessarily the additional amount given by the church to the pastor for housing. For example, assume that for the senior pastor, the Minutes set his salary at $40,000 a year plus the church decided to give an additional $10,000 on top of that for housing. His total compensation package at this point would be $50,000. If the pastor submitted an estimate to the church that his housing expenses for the upcoming year was going to be $15,000 and the church designated such as housing, his income in Box 1 would be $35,000 and Box 14 would note "15000.00 - Ministerial Housing Allowance." More info on total compensation planning can be found in the Ministers' Compensation Manual on our web site at www.benefitsboard.com.

To answer your question simply, I would list the parsonage allowance and housing allowance separately in Box 14 on the youth pastor's W-2. For example, "10000.00 - Ministerial Parsonage Allowance; 2000.00 - Ministerial Housing Allowance."

One final note - for the youth pastor to receive a housing/parsonage allowance, he must be a credentialed minister. If he does not have credentials from the COG or some other recognized religious organization, all the "housing" amounts are taxable to him and included in Box 1 as income.

Q: ***I am an associate pastor and my local church is giving me a 1099 and I was wondering where on the 1099 should the housing allowance be listed. Or should they give me a W-2? I have credentials with the Church of God. I have a job outside the church and being paid by a church is new to me.***

A: As a minister, you should be receiving a W-2 from the church and not a 1099. You are an employee for tax purposes (and thus entitled to a W-2) while you are self-employed for Social Security purposes. Again, the Minister's Compensation Manual on our web site (www.benefitsboard.com) goes into great depth about this dual status.

On the W-2, assuming that you only received housing allowance, nothing would go in any of the numerical boxes except Box 14. There the amount received would be listed. For example, "5000.00 - Ministerial Housing Allowance."

Q: ***Our church has hired a part time associate pastor. The new associate is full time employed by another company. My question is can we allow his salary that we pay him to go toward housing?***

A: If your new associate has credentials or licenses as a minister, then the answer is yes - his entire church salary can be designated as housing. He should submit to the church an estimate of annual housing costs and then the church's governing body (council or church as a whole) should adopt a resolution designating the amount as housing. For more information on this, please review the Ministers' Compensation Manual available without costs on our web site (www.benefitsboard.com).

Q: ***I pastor a small church and if the funds are there, I receive $200.00 a week; if not, I do not. However, I do not have to depend upon the church for my livelihood; I am retired from a secular job. However, I would like to try to do my taxes using TurboTax. The question is how do I put the money down that I receive from the church; they call it a house allotment and phone bill, utility and so forth. I would really like to do my own taxes but not at the expense of going to jail.***

A: Before I give you an answer, I have several questions:

Has the church's governing body (church council or whole church in conference) set up and approved a housing allowance for you?

Has the church's governing body approved an accountable reimbursement expense plan? And do you regularly (at least within 60 days) provide an accounting to the church of how the "expense" money is spent?

Simply put, if the church has created a housing allowance for you, then the $200 a week that you are getting may be totally tax-free (although you are required to pay Social Security taxes on housing allowance). If they designate the entire amount as housing, and you spend $200 or more a week on housing (payment, interest, utilities, furnishings, repairs, taxes, upkeep, insurance, etc.), then the amount would be non-taxable for federal income tax purposes.

The church should be giving you a W-2 each year showing that amount as housing. The W-2 would be extremely simple with nothing showing in Box 1 (the income box), but Box 14 would note the amount of housing - for example "10400.00 - Ministerial Housing Allowance." Again, if it is designated as housing and used as housing, there is no reportable income for federal tax purposes.

The same rules apply for expenses. You just have to document any expenses that you incur in the "course of business" back to the church within no more than 60 days of incurring those expenses.

You can find an in-depth discussion on these issues in the "Treasurer's Manual" and in the "Ministers' Compensation Manual" available on our web site at www.benefitsboard.com.

But to answer your ultimate question, I believe that you can use Turbo Tax to do your taxes and I have little fear that you will go to jail. Of course, if I am wrong, you could always start a new jail ministry.

Q: ***I pastor a small church that averages about 15 on Sunday morning. I'm given $200.00 a week for a housing allotment most week; some weeks I get nothing because it is just not there. The church also put $200.00 a month in the retirement system for me. Is this legal and if it is how should I show this on my W-2.***

A: Assuming what is listed here is all your compensation for a year from the church, you have a relatively simple tax issue. If the church provides you no salary, nothing goes in Box 1 on the IRS Form W-2. In Box 14 (the OTHER box), we would suggest that you put "Ministerial Housing Allowance – 10400.00" - that assumes that you got the $200 each week for 52 weeks. If the amount is different, you simply adjust the amount.

The $200 a month that the church puts in your retirement account is not reported on your W-2 and therefore, it does not show up anywhere, nor does it have to be reported to the IRS as long as the church is making those contributions. On the other hand, if you reduce your salary to make retirement contributions, you would check box 13 that you have a retirement plan (that box needs to be checked even if the church makes the contributions) and then in Box 12, you would put as the code "E" and the amount - $2,400 ($200 x 12).

Q: ***Who is responsible for determining the fair rental value of the parsonage - the church, the pastor, or a professional (realtor or appraiser)? Is more at stake than the "more a person pays into Social Security the more he draws"?***

A: The "fair rental value" comes into play in dealing with both the parsonage allowance and the housing allowance. Under the parsonage allowance, the fair rental value is the amount that is added to the minister's income for Social Security purposes (such is tax-exempt for Federal income tax purposes). According to the IRS directives, the fair rental value of the parsonage should be determined by an impartial third party (i.e. a realtor) and provided to the church in writing. The fair rental value should be based upon how the house is provided to the pastor. If it is furnished with all utilities paid, the fair rental value should be of a comparable house in your community furnished with all utilities paid. Getting a realtor to provide such an estimate is often difficult in some areas. Some churches have resorted to the "1% of value" theory - meaning that they claim that 1% of the value of the house is the monthly fair rental value. For example, if the parsonage is worth $100,000, then the monthly fair rental value is $1,000. The IRS does not approve of this method but it is often used.

In a housing allowance situation, the fair rental value becomes a cap at which the church or the minister cannot exceed each month. In other words, the rules say that you can claim housing allowance up to the amount designated by the church, the amount actually spent by the minister for housing, or the fair rental value of the house, whichever of the three is less. Generally, the fair rental value is the highest and becomes a cap. For example, let's assume the minister receives a housing allowance of $12,000 a year from his church. In the year in question, he had to put a roof on his house in

addition to his payments and he paid out $16,000 towards his housing costs. Further, the house he lives in, fully furnished with all utilities paid, would rent for $2,000 a month ($24,000 a year). In this example, the most the minister could exclude from his income would be $12,000 – the amount designated by the church as housing allowance since it is the least of the three. Assuming the same example, but with the fact that the minister paid out only $8,000 for actual housing costs in the year, the housing exclusion would be limited to $8,000, again the least of the three qualifiers. *Just because the church designates a certain amount does not automatically make that amount excludable from the minister's income.*

Again, the fair rental value of the housing allowance needs to be determined by an independent, unbiased third party.

In both cases (parsonage allowance or housing allowance), we recommend that such be reported in Box 14 (the other box) on the minister's W-2 form. While not required by the IRS (but recommended), it makes a simple place to place the housing/parsonage allowance for the calculation of Social Security taxes.

So, I would suggest that there is much more to the fair rental value than just "the more one pays, the more he draws" philosophy.

Q: ***I am a full-time pastor and have always lived in a parsonage. My wife and I have just purchased a piece of property and we are putting a manufactured home on the property to serve as our primary residence.***

Could you guide us in the best way to set up the payments and other moving expenses for tax and other purposes? For example, should I reduce my salary by the payment and claim housing allowance or just pay the payments and file on 1040?

A: First of all, congratulations on your new home. You will soon learn that having a home of your own, rather than living in a parsonage, is a true delight.

I am assuming that the church is going to use the parsonage for some other purpose, such as Sunday School classes, a home for an associate pastor, or rent it out – and that they are supportive of you obtaining your own home. With that being the assumed case, the best way to go is to have the church establish for you a housing allowance to cover the costs of your new home.

While establishing a housing allowance sounds like it will be more costs to the church, it does not have to be. Let's use a very simplistic example. Let's assume that the church is

paying you $20,000 a year now as salary and benefits. Also, let's assume that your housing costs are estimated to be $1000 a month or $12,000 a year. The church council (or the governing body in the church), based upon your estimated housing costs, can designate as housing $12,000 a year of your $20,000 salary. This has not costs the church another penny. However, it saves you from having to pay federal income taxes on the $12,000 designated as housing (although you still have to pay Social Security on the housing amount). In effect, you are getting the same money each week but a portion has been designated as housing, thus reducing your tax liability.

Of course, if the church so desires, they can certainly give you money above and beyond your salary to cover the costs of your housing. Such is actually recommended in S68 of the General Assembly Minutes.

Having a housing allowance is by far a much better method than just being able to claim the mortgage interest deduction on Schedule A on your 1040 Form.

To learn more about Ministerial Housing Allowance and to get a copy of a resolution to create such and an estimation form for housing expenses, you can go to our web site at www.benefitsboard.com and look at the manual entitled Minister's Compensation. You will find all kind of helpful ideas in that manual.

Q: ***Can our pastor roll a portion of his 403(b) contract to an IRA or another 403(b) at retirement and still qualify for the tax free housing allowance assuming he takes distributions from the portion left with the Benefit Board (qualified church pension plan) over a period longer than 10 years?***

A: All distributions from the MRP account will be designated as housing as long as the minister retains credentials with the COG. However, any amounts moved from the plan cannot be designated as housing unless they are moved to a church plan as specified in the ERISA legislation. However, some of the funds could be moved to an IRA, for instance, and lose their ability to be designated as housing, while the remaining funds could stay in the MRP and be designated as housing upon distribution. I would note that once funds leave the "church plan" by rollover, they can never be re-designated as "church plan" assets again if they are rolled back to the MRP unless they are held in a "conduit" account in the interim.

Q: ***Since I no longer receive any retirement from the Church of God Benefits Board, can I still deduct housing allowance from our income when reporting to the IRS?***

A: If you receive distributions from the old Aged Ministers' Fund, you can continue to claim your housing costs against that income. In addition, if you have "ministerial income" from pastoring, filling in, or evangelizing, you may be able to offset your "ministerial income" by claiming your housing costs.

To be able to claim the housing allowance, you would need the church you are pastoring or filling in at to designate a portion of your income as housing. If you are evangelizing, your "evangelistic ministerial organization" that you set up for evangelizing, would need to make that designation or you would have to claim such as a Schedule C deduction.

On the other hand, if you just have income from investments or other non-ministerial related income, you cannot offset that income with the ministerial housing allowance exclusion. Of course, you still could claim any taxes or mortgage interest allowable to all itemizing taxpayers on Schedule A.

REIMBURSEMENT TAX ISSUES

Mileage

Documentation of expenses is vital to an acceptable accountable reimbursement plan. Mileage driven in the course of business is generally the minister's greatest expense. Some ministers have contended that every mile they travel is in the furtherance of their business – and thus reimbursable. Their contention is based upon the fact that they never stop being a minister and technically are "on call" at all times. The IRS has not accepted this argument, just as they have declined similar claims by doctors and other professionals. Commuting, going to the grocery store, or the local department store are miles that are not ministerial in nature and thus cannot be claimed for reimbursement. In their publications, the IRS clearly agrees that trips to the hospital or nursing home, or to attend conferences or other church meetings are business miles and can be deducted. However, they go on to point out that trips to and from the church are considered nondeductible commuting expenses.

A minister should carefully document his business mileage by the use of a daily (or trip) log. The log should contain the odometer reading at the beginning of the trip and the end of the trip, the date, and the purpose of the trip. Stopping by the grocery store on the way home does not take the trip out of the business expense category, as long as the stop was incidental. The log should be used to calculate your mileage for submission to the church and should be retained long term to document such expenses if ever questioned by the IRS.

The IRS standard mileage rate for the use of a car for business purposes changes yearly. Please contact the Benefits Board at info@benefitsboard.com to get the latest IRS rate.

Q: ***Is having to get a replacement vehicle an accountable expense for a pastor? What about repairs to the pastor's vehicle?***

A: If an employee/pastor is using an accountable plan, the costs of a replacement vehicle or the costs of repairs to a vehicle are **not** accountable expenses. For automobile expenses under an accountable plan, the minister is paid a per mile reimbursement. For 2022 the IRS has set the rate at **58.5 cents per mile**. That per mile reimbursement is supposed to cover fuel, oil, repairs, payment on the vehicle, etc. Any amount paid above and beyond the per-mile cost set by the IRS would be strictly additional salary – and would be taxable to the minister. Even if the church decided to pay 60 cents a mile currently, the amount over the IRS set rate (currently **58.5 cents** per mile) would be considered as taxable income.

On the other hand, if the church sets a specific amount – say $50 a week – for automobile costs, and requires no substantiation by the minister that he or she actually used that amount for auto expenses (either by submitting mileage, tolls, parking, etc.), then the $50 a week becomes taxable income. There must be substantiation of the expenses to make it non-taxable under an accountable reimbursement plan.

Travel Expenses for a Spouse

When a pastor or church staff person travels on business for the church, the spouse of that person often travels with them. For example, a pastor may attend a conference on behalf of the church and the pastor's wife may accompany him to the conference. If the local church reimburses the pastor for all travel expenses associated with the conference, the question arises as to whether such can be treated as a non-taxable event.

Clearly, assuming the rules for an accountable reimbursement plan are met, the pastor's expenses can be reimbursed without creating tax liability. However, what about the reimbursement of the expenses solely attributable to the pastor's wife?

Most churches just automatically assume that the pastor and wife are treated as one - and therefore, any expenses reimbursed for either would be non-taxable. The IRS regulations do not make such an automatic assumption. Instead, the regulations point out that at least three stringent rules must be in place before the spouse's travel expenses qualify as "nontaxable working condition fringe benefits:"

- The amount reimbursed cannot be treated by the church as compensation to the pastor or spouse,
- The spouse's presence on the business trip must be for a "legitimate business purpose," and
- The reimbursement must be substantiated under an accountable reimbursement arrangement.

The second point - the "legitimate business purpose" - is the one that generally causes the most concern. If the spouse does not substantially participate in the "business" activities, it is highly unlikely that this portion of the test is met. While attending Camp Meeting or General Assembly with her husband probably meets this test, going to Orlando with her husband to attend a conference but visiting Disney World while he attends business meetings would probably not meet the test.

Even if the spouse's activities are not business related, it does not mean that the total expenses are just split in half – with half being nontaxable business reimbursement and the other half being taxable income. Instead, the amount that is taxable to the minister would be the travel expenses directly attributable to the spouse's travel. For example, if the minister traveled by car, there would be no additional charges and generally there would be no additional charges

for the hotel room to have another person in the room. However, food charges and other things directly attributable to the spouse would become taxable to the minister.

Some churches promote the spouse's travel with the minister for accountability purposes. If the church follows this policy, the policy should be in writing and consistently followed to keep the spouse's travel expenses in the nontaxable category.

Finally, it should be noted that if the spouse's taxable travel expenses are not reported as income to the minister, the IRS could determine that such amounted to an "automatic excess benefit" which could result in "intermediate sanction" - meaning that the IRS potentially could levy a substantial excise tax against the pastor and possibly even church board members who had approved the payment for such expenses.

Reimbursement of travel expenses for a pastor's spouse is another area where advice from a competent local certified public accountant is vital.

Health Insurance

The cost of health insurance for all Americans has become outrageous. Recognizing the need for health insurance, the Church of God *Minutes* point out that the local church should provide the funds to pay for the minister's premiums for health insurance coverage. According to the IRS regulations that have been in effect for more than fifty years prior to 2014, payments by the church directly to the insurance carrier or to the minister based upon substantiation of the health care costs **were** considered to be a tax-free benefit to the minister. If such payments were not made by the church and the minister had to pay his own health insurance premiums, he could only claim such on Schedule A of the 1040 tax form – and the minister could only get a deduction if those expenses exceed 10% of his adjusted gross income.

However, the Affordable Care Act (often called the "ACA" or "ObamaCare") changed this process by 1) making payments made by the church towards individual health insurance premiums taxable and 2) prohibiting the reimbursement of such premiums by the church, except in limited circumstances. See the following article on these specific topics.

No REIMBURSEMENT of Certain Health Insurance Policies with Pre-Tax or After-Tax Dollars

While most churches thought that they were exempt from the major impacts of the Affordable Care Act (often called "ACA" or "ObamaCare"), a seemingly innocuous Internal Revenue Service notice, issued in September 2013, has been interpreted to place many churches and businesses in the crossfire of the Affordable Care Act.

According to IRS Notice 2013-54, employers may no longer reimburse employees for, or directly pay, the cost of *individual* health insurance policy premiums and exclude such amounts from the employee's gross income, except in limited circumstances. Effective January 1, 2014, these "employer payment plans" must be paid with "after tax" dollars, rather than with "pre-tax" dollars, and cannot be a "reimbursement." The employer is only allowed to use "pre-tax" dollars to pay for health insurance premiums 1) if the employer offers a *group* health insurance plan or 2) falls under the "one employee" exception (explained in next article).

Further, more recent guidance suggested that "reimbursement" by an employer of an *individual* health insurance policy premium creates a non-compliant health care plan under the Affordable Care Act – and therefore potentially subjects the employer to a **$100 per day penalty**, per employee. According to this recent guidance, an employer/church who reimburses a pastor or staff member for their individual health insurance policy premium, *even if such is subject to taxes*, has violated the Affordable Care Act and is subject to $36,500 a year in penalties, per employee. [*NOTE: Legislation has passed that would eliminate this penalty in certain situations*.]

While an employer/church can increase an employee's salary to cover the costs of that employee's individual insurance policy – and can even increase the amount to cover additional taxes, it should not be noted as reimbursement of the employee's individual health insurance policy premiums, nor should the employer/church request verification of the insurance premium costs. If the insurance premium notice is requested or provided, the U.S. Department of Labor's recent guidance suggests that such creates a non-compliant group health plan and triggers the penalties mentioned above.

Since an IRS revenue ruling in 1961, churches and businesses have been able to structure compensation plans where employees could obtain their own individual health care plan, provide documentation and substantiation of such to the employer, and the employer could reimburse the employee for, or directly pay, the cost of the individual health insurance policy premiums and such amounts were excluded from the employee's gross income. Under IRS Notice 2013-54, the Affordable Care Act no longer allows such an arrangement to occur with pre-tax dollars or even with after-tax dollars if such is deemed reimbursement. In very limited situations, an employer can still withhold funds and transmit those to pay the premiums on the individual health insurance policy, as a convenience to the employee, but the amounts must come from after-tax funds and cannot be reimbursements.

Consider the following examples:

1.) A local church agrees to pay a pastor $40,000 a year salary, plus pay another $10,000 a year towards the pastor's individual health insurance premium. According to IRS Notice 2013-54, the pastor would have taxable income of $50,000 in the year in question. It should be noted that the amount designated for insurance must be taxed whether the pastor has secured the health insurance independently or through the government-operated Health Care Exchange. Further, the pastor should not submit nor should the

church require documentation of the pastor's individual health insurance premium costs.

2.) A pastor's wife has health insurance through a *group* plan at her employment and her company pays the entirety of her premium. Such amounts paid by her company are not taxable income to her since she is covered by a *group* plan that meets the requirements of the Affordable Care Act. In addition, her company offers full family coverage but the employee must pay the difference between the company provided employee group coverage and the family coverage premium. If the pastor's church offers to pay the additional $500 per month to cover the pastor and the pastor's children, the $500 per month is taxable income to the pastor. If documentation of the costs is requested or submitted, the church may be subject to the penalties discussed earlier.

As noted above, IRS Notice 2013-54 took effect January 1, 2014 (but implementation was delayed until July 1, 2015). Therefore, currently any additional amounts paid by a church to a pastor or staff member for that person's individual health insurance plan must be treated as taxable income. Treating such amounts as taxable income means that the amounts are subject to federal income taxes, state income taxes, and self-employment taxes (Social Security and Medicare taxes). Using example one above, and assuming a 20% federal income tax bracket, the pastor would be subject to federal income taxes on the additional $10,000 paid towards his health insurance of $2,000, plus SECA taxes of $1,530, as well as any state income taxes.

Because the Affordable Care Act has converted the policy premium payments from pre-tax to after-tax funds for individual health insurance plans, a minister stands to lose forty or so percent of this benefit that was previously considered a fringe benefit, assuming state taxes are due.

As these rules took effect, the conversations with Congress, the U.S. Department of Treasury, the U.S. Department of Labor, and the Internal Revenue Service continued as we tried to eliminate this onerous burden created by the Affordable Care Act. However, those efforts have been unsuccessful, and in fact, the most recent guidance has made the impact of the Act even more challenging. The Internal Revenue Service continues to contend that the new procedure is necessary to prevent "double dipping" from a person receiving insurance premiums paid with pre-tax dollars and also claiming the new "premium tax credit" available under the Affordable Care Act.

Therefore, the bottom line is that churches may no longer reimburse employees for, or directly pay, the cost of *individual* health insurance policy premiums with either pre-tax or after-tax dollars. If the church wants to assist a pastor or staff member in paying for their individual health insurance policy costs, the church may raise the person's salary, the church may not request or receive documentation of the premium costs, and the church must include such additional compensation in the employee's gross income.

"Group Plan" Exception

Although there was much discussion about eliminating such, employers (and churches) are still allowed to provide a group health insurance plan for all employees and pay the premiums for such, without creating tax liability for the employees. For such not to create tax liability for the employee, the group health plan must be offered to all qualified employees. An employee may decline coverage because of coverage elsewhere but the group plan must be offered to all.

If the group plan is offered to all employees, premiums paid for the health insurance by the employer are not taxable income to the employee, creating an exception to the rules of the Affordable Care Act.

"Group of One" Exception

The original notice dealing with the Affordable Care Act (Notice 2013-54) contained an interesting exception to the prohibition against reimbursing *individual* health insurance premiums under an employer payment plan, dealing with an employer/church which has "less than two employees." Many refer to this exception as the "group of one" exception.

Under the "group of one" exception, if an employer/church has only **one employee**, the church can continue reimbursing health care premiums on a **pre-tax** basis. If the church qualifies for this exception, the church may still reimburse the employee's health care premiums and the reimbursement may continue to be a pre-tax benefit and not included in the employee's W-2 compensation. It is as though the church has a group plan for just one person.

Since the provision creates an exception if the employer/church has "less than two employees," the issue has been raised regarding the applicability of this exception if the church has a full time pastor, and a part-time secretary or a part-time janitor. While there is no clear guidance on this issue, it seems logical that one full-time person and a part-time person would be "less than two employees." However, if in this situation health insurance was reimbursed for the full-time pastor and not for the part-time secretary, it is assumed that such would create a discriminatory violation under the law that could bring other penalties. Therefore, without specific guidance from a benefits specialist well versed in the applicability of the Affordable Care Act, it is suggested that the "group of one" exception only be used if you have ONLY one employee.

Health Insurance Now

In the *Minutes* previously discussed, churches are encouraged to pay the entire premium for the minister's health insurance. While the Affordable Care Act now prohibits the church from making such payments directly or reimbursing the pastor for such (unless the pastor is a part of a group plan or fits under the "group of one" exception), the church may still increase the

pastor's salary with an additional amount to provide "assistance" to him in securing insurance. However, if the resources are not available in the local church to increase the pastor's salary to cover all his insurance costs, the church should consider increasing the pastor's salary as much as possible to assist him in providing insurance for the pastor and his family.

While the church may take into consideration the pastor's insurance costs in setting his total compensation, the church should not seek documentation from the pastor of those costs nor should the pastor provide to the church documentation of those costs. As with any salary increase, a resolution should be entered on the local church records to memorialize such, but such should only state, at the most, that the pastor's salary is being increased to "assist" him and his family in obtaining health insurance. There should be absolutely no mention of reimbursement of health insurance premiums.

Medical expenses of the pastor may be deductible on Schedule A as an itemized deduction. Of course, medical expenses that are reimbursed under a health insurance plan cannot be deducted as medical expenses on an individual's tax return.

Qualified Small Employer Health Reimbursement Arrangements Allowed

On December 13, 2016, President Obama signed into law the 21st Century Cures Act ("Act"). This Act includes a section allowing qualified small employers to offer a new type of health reimbursement arrangement ("HRA") to employees effective January 1, 2017. Two requirements of the Affordable Care Act previously prohibited most stand-alone HRAs. The new arrangement is called a qualified small employer health reimbursement arrangement (or a "QSEHRA").

Only employers who employ fewer than 50 full-time equivalent employees and do not offer a group health plan to any employee will be allowed to reimburse an employees' eligible medical care expenses through a QSEHRA. The QSEHRA must:

- be provided on the same terms to **all** eligible employees of the eligible employer (variation is allowed in the pricing of a policy based on age and number of family members),
- be funded solely by the employer (no employee salary reduction contributions are allowed),
- provide for the payment or reimbursement of eligible medical care expenses incurred by the employee or family members (including premiums for individual health coverage) only after the employee provides proof of health coverage, and
- ensure that, in 2022, annual payment or reimbursement does not exceed $5,450 for singles – or $11,050 if family members are covered under the HRA. (These amounts could change in future years.)

An eligible employer funding a QSEHRA must provide a notice to eligible employees not later than 90 days before the beginning of the year or the date the eligible employee is first eligible to participate in the QSEHRA. The Act describes the specific information that must be included in the notice.

A few additional points to note – the employee must have minimum essential coverage (as defined under the Affordable Care Act) in order for the payment or reimbursement to be tax-free. Reimbursement amounts may reduce the amount of premium tax credit subsidies available to eligible employees, and if the QSEHRA provides "affordable coverage" (as defined under the Affordable Care Act), employees will not be eligible for a marketplace subsidy. The employer must report QSEHRA reimbursement amounts on employees' Forms W-2.

NOTE: *Regulations and policies concerning QSEHRAs, and a new HRA, called Individual Coverage Health Reimbursement Arrangements (ICHRAs), are still being developed.*

Q: ***If the pastor has a secular job where he receives health insurance coverage on his family through payroll deduction, can this amount be treated as a health insurance reimbursement by the church? In other words, can we specify that a portion of his salary is reimbursement for health insurance premiums and reduce his W-2 income in Box 1 by this amount?***

A: If the pastor has a secular job and health insurance is offered to him (and his family) through that employer, the church can contribute towards the pastor's health insurance costs as a *taxable* "fringe benefit." The church may not include the health insurance premiums in the pastor's accountable reimbursement package – and no documentation of such premiums can be requested or provided. Doing so could subject the church to a penalty of $100 per day per employee.

Q: ***Pastor asked me to contact you regarding the recent law changes regarding the taxation of health care benefits for pastors. As we understand it, any health care that the church has paid for after June 30, 2015 that was NOT part of a group plan, will be considered regular income to the pastor. Is that correct? If so, where does this dollar amount belong on the W2?***

A: Yes. You are correct, unless the church has ONLY one employee, any payments made by an employer since June 30, 2015 for an employee's health care plan who is not a part of a group plan is considered a part of the employee's taxable income. This amount should be reported as additional salary and included in Box 1 on his W-2 form. Of course, such is taxable for not only income tax purposes but also for SECA tax purposes in the case of a minister and FICA taxes in the case of a non-minister.

Further, based upon recent guidance, going forward there should be no connection where this payment looks like a reimbursement for healthcare costs. If so, it could subject the church to penalties of up to $100 a day.

Q: ***I read on the Benefits Board website that if the church reimburses me for my health insurance expenses they are now subject to a fine. I recently became senior pastor and they give me a check for my health insurance that is labeled for health insurance and is the exact amount of my bill, but they also pay Social Security as income to me. If I am reading this right it would appear they are doing this wrong and should just give me a raise to cover costs of healthcare and not label this separately and pay taxes as normal income.***

A: If the church "reimburses" you for your insurance premium payments for an *individual* healthcare policy, you are correct in stating that the church could now be subject to a fine/penalty. This change does not prohibit the church from giving you additional money to cover your health care costs, you just cannot present to them your premium notice nor can they demand a copy of your statement for insurance costs - and then "reimburse" you for that amount. They could actually give you the same amount as your insurance costs but there should be no records where such is deemed to be a reimbursement. So if the church voted to "reimburse" you for your health care costs, those minutes need to be revised to state that they are giving you a salary increase of $XX dollars to help assist you in obtaining medical insurance. Any reference or documentation that makes such look like reimbursement could be a problem.

Creating an Accountable Reimbursement Plan

Only at tax time do many ministers find out that their "accountable reimbursement plan" is not really "accountable" under the rules of the IRS. Included here is an excerpt from the Church Treasurers' Manual, available at www.benefitsboard.com without charge, which should be helpful in creating a valid "accountable" plan:

The church governing body (Church Council or the church as a whole operating in a business meeting) should adopt a resolution creating an accountable reimbursement plan. The resolution could be very simple, for example:

"The Anytown Church of God, through this action of the Church Council, does hereby create an accountable reimbursement plan for Pastor Phil Pulpit. The church agrees to designate $500.00 per month of the pastor's compensation to cover all necessary and proper business expenses incurred by him during the normal course of conducting business on behalf of the Anytown Church of God. Expenses must be substantiated to the church treasurer as to the date, amount, and purpose within 30 days after they are incurred. Any excess reimbursement must be refunded to the church within 60 days after expenses are paid or incurred. This resolution shall be good and valid for the upcoming fiscal year and all years afterward unless changed by this body."

It is the responsibility of the church treasurer to make sure that this resolution is reviewed and examined each year. However, the last sentence of the resolution keeps such active in case the church fails to place a new resolution in the records.

Disbursement of the "expense" money can be made on a regular basis, either in advance or upon submission of the receipts. If expenses are paid upon submission of expense receipts, there is no problem of "excess" expenses that has to be returned at year-end. However, many ministers would rather receive their "expense" money in advance so that they do not have to use their personal funds to "float" the expenses of the church for a month or so. Advancing expenses is perfectly fine. However, the minister still must provide receipts to the church treasurer. While the IRS regulations require that receipts must be submitted within 60 days of incurring the expense, the church can demand that receipts be submitted more often – say every 30 days (or by the first of the month). A shorter time period generally helps assure that proper receipts are presented. The *Accountable Reimbursement Plan Ministry Related Expense Form* can be used by the minister to submit his expenses to the church treasurer, whether he is getting payment in advance or if he is receiving payment upon receipt of proper documentation.

The minister should maintain a detailed log of all mileage traveled for business purposes. The log should be used to calculate the mileage claimed on the Accountable Reimbursement Plan Ministry Related Expense Form. In addition, the minister should save the logs for at least seven years to respond to any inquiry that might be raised by the Internal Revenue Service.

The church should **not** use a salary reduction arrangement to pay for the minister's business expenses. Under this type of plan, the minister's "salary" check would be reduced weekly or monthly by the amount of expenses he submitted. Such arrangement is nonaccountable and any "reimbursement" must be counted as income to the minister.

End of Year Reconciliation of an Accountable Reimbursement Plan

Every year questions are raised about the reconciliation of an accountable reimbursement plan. Since 1992, the *Church of God Minutes* (S.69) has listed only one amount in the Pastor's Minimum Compensation Scale. Previously, the amount had been broken into salary and expenses. A discussion on why this change occurred can be found in the financial manuals published by the Board.

Assuming that the "scale" lists the pastor's compensation at $500 a week, the pastor in conjunction with the governing body of the church can designate a portion of that amount, say $100 a week, as expenses under an accountable plan. To qualify under the IRS regulations, an accountable plan must be for business expenses and have a business connection, the minister must substantiate the expenses within a reasonable time (within 60 days of the expense) to the church, and the minister must return any amounts in excess of substantiated expenses within a reasonable time (generally within 120 days).

The problem occurs at year-end when the pastor or staff member has not provided documentation to substantiate all the "expense" money they have received during the year. The IRS rules are clear that if the pastor or staff person does not return the "excess" expense money the entire amount paid for the year as expenses must be included as taxable income on the person's W-2.

However, the pastor will contend that he is entitled to the "excess" amount because the *Minutes* say that such is his compensation. Generally, the pastor will ask that the "excess" reimbursement be included on his W-2 as taxable income – and that he will just keep the money rather than returning it to the church. The IRS prohibits this practice.

To keep the plan accountable, the pastor must return the excess reimbursement to the church and such must be documented. The question then arises as to whether the church can then cut the pastor a taxable check for the same amount that he just returned as excess reimbursement which would make him receive the total compensation provided for in the *Minutes*. The simple answer is no.

However, the church governing body can decide to give the pastor a year-end or Christmas bonus with available funds on hand. That amount could be the same as returned, greater than or less than the amount returned. Regardless, the decision by the church's governing body should be totally separate and distinct from the return of the excess contribution. The pastor also takes the risk that the governing body will not be generous at all.

This discussion clearly points out the need for the pastor to accurately project what his business and professional expenses will be for the coming year – and for the pastor to actually substantiate all the expenses that he incurs throughout the year. An accountable reimbursement plan that is accurately projected and substantiated will be a wonderful blessing

to the minister in tax savings since the reimbursement is not taxable for income tax purposes or Social Security (SECA) tax purposes.

RETIREMENT PLAN ISSUES

Accounting for Losses

For those who participate in the Benefits Board's equity (stock) accounts, you may suffer a loss in any particular year. We are sometimes asked if you can claim, or deduct, that loss on your tax return. The answer is simply NO! Since your accounts at the Benefits Board are a part of a tax-sheltered investment vehicle (specifically, a 403(b) account), you cannot deduct losses that you suffered in the stock market. Just as you are not required to claim the gains (or interest earned on your account), you cannot deduct losses. Other than the tremendous tax advantages of contributing to a tax-sheltered account, your account with the Benefits Board has no tax consequences until you start making withdrawals from the account.

Rolled In Accounts

Many participants express interest in rolling other retirement funds into their account at the Benefits Board. Those transfers are allowed and the Board will be glad to work with the participant to effectuate the transfer of funds. However, there are several important factors that must be remembered about transferring funds from one account to another:

- While there is no tax consequences associated with such a transfer, the current custodian of your funds may charge a withdrawal fee if their contract with you allows for such. This fee may be as high as 15%.
- Funds rolled into an account at the Benefits Board do not become available for disbursement as housing allowance. Such accounts are disbursed as taxable amounts just like they would have been by the prior custodian.
- All funds transferred to the Benefits Board are placed in sub-accounts. Therefore, if your account number is 12345, your rolled-in account will be designated as 12345-a (or some similar designation). This separate designation is made so that we can track all rolled-in funds and apply whatever new rules the IRS may apply at some point in the future. If no new rules are applied by the IRS, the rolled-in funds will be treated as taxable amounts just like they would have been by the prior custodian.

Contributing to Retirement Fund when all Income is Designated as Housing

Statistics show that approximately 70% of Church of God ministers are bi-vocational. Most bi-vocational pastors do not depend on the church for their primary source of income but only as a supplement to their secular income. In some situations, the pastor may only be receiving a housing allowance from the church – and no other income whatsoever.

When the minister's entire income is designated as housing, he has no taxable income, but he is required to pay self-employment taxes (Social Security and Medicare) on the housing allowance.

Even though the minister is receiving a check each week for housing, he cannot contribute to his retirement account through salary reduction since he has no taxable income, assuming the entire amount is designated as ministerial housing allowance. The IRS rules say that in 2022 you can contribute up to $20,500 **or** an amount equal to your "taxable income," whichever is less, through salary reduction to your Ministers' Retirement Plan account. Additional limits apply if the church is making contributions and if you are entitled to certain catch-up contribution limits. Again, if the minister's compensation is totally designated as housing allowance, he has no taxable income and therefore can make no contribution through salary reduction to his MRP account.

To get around this prohibition, the minister could request that his housing allowance be reduced and a portion of his compensation be designated as salary. This action would have to be approved by the church's governing body (the finance committee, church council, or full church).

For example, assume that the pastor is currently receiving $500 a month as housing allowance ($6,000 a year) as total compensation from the church. For discussion purposes, the pastor could request that $400 a month be designated by the church as housing ($4,800 a year) and the other $100 a month could be designated by the pastor as a salary reduction retirement contribution. Interestingly enough, such a plan would actually lower the pastor's overall tax liability. Using this example, currently the pastor is required to pay self-employment taxes on the $6,000 housing allowance (but no federal income taxes). Under the revised plan, the pastor would pay self-employment taxes on the $4,800 amount for housing – but would pay neither self-employment taxes nor federal income taxes on the $1,200 deferred into the pension plan since he is a minister of the Gospel.

The Minister's Compensation Manual available on our web site at www.benefitsboard.com can provide more direction on compensation planning.

Deferred Taxation on Traditional Account Contributions

In regard to contributions made to the traditional before-tax retirement accounts, the participant does not pay federal income taxes on the contributions, whether the contributions were made by the participant's employer or by the participant through a salary reduction agreement. All taxes are deferred until benefits (distributions) are paid to the participant (or the participant's beneficiary), generally in retirement. In many situations, the taxes paid in retirement will be less than those paid while fully employed.

For ministers, contributions to a traditional account, whether made by the employer or through a salary reduction agreement, are not subject to federal income taxes **or** subject to Social Security/Medicare taxes. However, if the minister does not pay Social Security taxes on the contributions, they are also not creditable towards his or her Social Security earnings.

For the church-related *employee* (non-credentialed), contributions made by the employer are not subject to federal income taxes nor subject to Social Security taxes. However, contributions to a traditional account made by salary reduction are not subject to federal income taxes *but are* subject to Social Security taxes.

State and local taxation issues vary by jurisdiction. You should contact your tax advisor to determine your state and local tax liability on deferred income. It should be noted that at least one state does not defer state taxation on certain contributions that are considered tax deferred for federal tax purposes. Because of the constant changing of state laws, your local tax advisor should be consulted for advice on state and local taxation issues.

Taxation on Roth Contributions

Since contributions made by a minister or church-related employee to a designated Roth account are made with after-tax income, those contributions are subject immediately to federal income taxes, Social Security and Medicare taxes, and state income taxes, if applicable.

Paying Taxes on Amounts Withdrawn Early from Pension Funds

Some participants question whether they have to include money that is withdrawn early from their pension account as income in the year that it is withdrawn. The answer is simply yes IF the withdrawal comes from your traditional 403(b) account. You must include as a part of your income the total amount of your distribution from the Ministers' Retirement Plan. The Benefits Board will report to you the exact amount of the distribution on a Form 1099-R. You should receive the Form 1099-R in late January following the year of withdrawal.

If you make a lump sum withdrawal, the Benefits Board is required to withhold 20% as prepayment of taxes. You should include the federal income taxes withheld on the appropriate line of your federal tax return along with any other federal income taxes you paid.

In addition, if you took the distribution before age 59½, you may be required to pay a 10 percent penalty tax on early distributions from qualified retirement plans unless you meet one of the exceptions in IRS Publication 575, *Pension and Annuity Income*. While the 20% tax discussed above counts as prepayment of taxes owed, the 10% penalty tax is just that – a penalty, and does not apply against your tax liability. Due to the almost universal applicability of the 10% "penalty" tax, such should be figured into the realized amount when contemplating an early withdrawal.

Tax Reporting of Retirement Plan Contributions made by Chaplains and Evangelists

Chaplains and evangelists are the only participants in the Ministers' Retirement Plan who can make direct contributions by personal checks to their retirement accounts. All others must make their contributions by salary reduction or by employer contributions by the way of an employer (or church) check. Again, the Board can accept personal checks only from chaplains and evangelists.

IRS Publication 571 goes into great detail discussing contributions to a 403(b) retirement account. The publication notes that generally *employer contributions* to your 403(b) account are not reported on the employer-provided W-2 form. Your employer, however, should report *salary reduction* amounts on your W-2 in Box 12 while checking "retirement plan" in Box 13. Again, contributions above and beyond your salary made by the employer (the church) to your account, as noted above, do not have to be reported at all on the W-2.

For evangelists (the IRS calls evangelists "self-employed ministers"), Publication 571 states that you must report your total contributions to your 403(b) plan as a deduction on your tax return by deducting them on **line 16** of the Schedule 1 (Form 1040.)

On the other hand, Publication 571 notes that chaplains should take a deduction for their contributions on **line 24g** on the Schedule 1 (Form 1040) and deduct their contributions on that line.

Since **lines 16 and 24g** are both in the adjustment schedule of the 1040 tax return, noting the contributions on either line 16 for evangelists or line 24g for chaplains allows the minister to be able to deduct the contributions from his income just as though he were in an employment situation as a pastor or staff member of a church and such was deducted from his W-2 Box 1 income.

Please remember that these special rules only apply to evangelists or chaplains. For more information on this issue, please review IRS Publication 571.

Q: ***I have been serving as an evangelist and missionary evangelist for some time now and have made no contributions to my retirement account. I was not aware that I was able to make contributions to my account and now I understand that I may pay in contributions by personal checks. What are my options and what can I do to increase my income for retirement?***

A: As an evangelist, you can make deposits into your account by personal check. IRS Publication 571 (Page 3) goes into great detail on how you (as a self-employed minister, i.e. evangelist) can make contributions to a 403(b) retirement account and how you account for those contributions when you file your tax return. You may access a copy of Publication 571 from the IRS web site (www.irs.gov).

If you are over 50 years of age, you may also contribute towards the "over-50" catch-up provision. The contribution amount for this limit potentially changes each year.

You may print copies of MRP Contribution vouchers off our web site (www.benefitsboard.com) to make your contributions.

Q: ***I am a 27 year-old COG-licensed minister with interest in the Minister's Retirement Plan. Is the main difference between the Benefits Board Plan and a Roth IRA the housing exemption for ministers provided by the Plan? Does an IRA provide more flexibility for early withdrawals than the Plan if they are for the purchase of a new home, children's college education, etc.?***

A: The plan offered by the Benefits Board is the Ministers' Retirement Plan (MRP), a church retirement plan created under Section 403(b) of the Internal Revenue Code. The MRP is more in line with a 401(k) plan offered by an employer than an Individual Retirement Account (IRA) that you create individually. IRAs come in two forms – (1) Traditional IRA – those to which you make contributions with before tax dollars and (2) Roth IRAs – those to which you make contributions with after tax dollars.

So the MRP (before tax contributions) and the Roth IRA (after tax contributions) are really totally different. The MRP is closer aligned with Traditional IRAs – but still there are several huge differences. With IRAs (Roth or Traditional), your annual giving limit is limited to $6,000 (since you are under the age of 50), while your contribution limit to a 401 or 403 employer provided plan is $61,000 in 2022. Further, in a 403 plan, your employer (the Church) and you individually can make contributions to your retirement account while contributions to an IRA (Roth or Traditional) are limited to your "individual" contributions - and employer contributions are not allowed.

Further, as you noted, distributions from your MRP account in retirement can be designated as ministerial housing allowance, subject to you using such for housing, and thus may be tax free. Distributions from a Traditional IRA, on the other hand, will be taxable in retirement – and cannot be designated as housing allowance. While Roth IRA distributions in retirement are generally non-taxable, you do have to pay taxes on the money before it goes into the Roth IRA.

With the MRP, as a minister, your contributions and those of the Church go into the plan before taxes; your account grows without tax liability; and in retirement, as much of your distribution that is used for housing is non-taxable. That is a rather nice benefit for ministers.

And the MRP provides as much flexibility as an IRA in terms of withdrawal options, such as for purchasing a home, etc.

Probably the biggest difference between the MRP and an IRA would be the investment selections. Most IRAs offer dozens of investment choices while the Ministers' Retirement Plan only offers four choices. However, statistics show that most investors choose to invest in only two or three options anyway. We feel that our choices are sufficiently broad to allow for solid diversification, especially since our investments are socially screened.

Q: ***After reading information on the Savers Tax Credit, I was wondering what IRS Tax Form you would use to get this credit?***

A: You have to complete IRS Form 8880 - and then put the credit on line 4 of the IRS Schedule 3 (Form 1040.) *(Subject to Congressional approval, this credit may not be available in future years.)*

Q: ***Will our pastor be required to take required minimum distributions (RMD) from his 403(b) at age 72 or has he been grandfathered because of the age of his contract?***

A: No. Since the Ministers' Retirement Plan is an "employer" provided plan, he will not have to take RMD at 72 if he is still working for a church or church-sponsored entity. The IRS says that how he reports to his "overseeing" body determines whether he is retired or not. If he reports he is retired, then he would have to take RMD at 72. If he reports he is not retired, the RMD are tolled until the April 1 following his actual retirement. We have some who are in their late 70, still contributing, still active, and still tolling the RMD. (*NOTE: The age for RMD changed from 70½ to 72 by law signed on Dec. 20, 2019, effective Jan. 1, 2020.)*

Q: ***What are the investment options available to participants in addition to the trustees' fund?***

A: We currently offer three equity accounts (Large Cap, Small Cap, and International), in addition to the Trustees Fund. You can review the performance of each of those funds on our website under Services (Investments) at www.benefitsboard.com.

Q: ***If I die, does my wife have to withdraw the remaining funds from my Benefits Board account and place those funds in some other deposit since she is not a credentialed minister?***

A: No. Your wife can continue to draw from the account just like you have been doing - or she can start all over with all the options available to her again just like they were to you when you set up your distributions. Generally, the surviving spouse just continues to draw as before since they have become use to the monthly amount coming in. The only difference is that your spouse will not be able to claim the amount as ministerial housing since she does not have credentials. We feel that she should be able to claim such as housing but the IRS disagrees. So, in summary, she can continue to draw,

doesn't have to do anything other than give us a copy of your death certificate, but the withdrawals cannot be designated as housing since she is not credentialed.

Q: ***Will I get something like a W-2 to report the income that I receive from the Benefits Board each year after I start taking withdrawals?***

A: Yes. You will get a Form 1099-R from us towards the end of January each year listing your distributions from the previous year. The box "taxable amount not determined" will be checked on the form. That means that the Benefits Board has designated up to 100% of the amount as housing, subject to you using such for housing under the applicable IRS rules and regulations.

Q: ***Will I continue to get statements from the Benefits Board even after I start taking withdrawals?***

A: Yes. You will continue to get quarterly statements (either by mail or available on our electronic portal) from the Board just as you did when you were contributing.

Q*: If interest rates rise, will those receiving monthly distribution checks get an increase in their retirement checks?*

A: Yes. If rates go up, all those in distributions get an increase. Of course, the same works in reverse – if rates should go down, you could see a decrease.

TAX WITHHOLDING ISSUES

Q: ***If a minister wants to have taxes voluntarily withheld from his paycheck, how does he complete the IRS W-4 form?***

A: I generally lean towards the minister just completing a W-4 and requesting the amount to be withheld in Step 4, line (c) - the extra withholding line. Attachment G in the Minister's Compensation Manual shows that example. However, since the W-4 is for the employer's use (and only in limited circumstances is ever provided to the IRS), I see no problem in allowing the minister to just list his dependents, etc. in Step 3.

The reason that most ministers would want to list the number of dependents in Step 3 rather than put an amount in Step 4, line (c) is that they do not know what their tax liability is or will be. They want you (or someone) to figure it out for them and take it out. They don't want to say take out $90 a pay period and then realize later that $90 was either too much or not enough. They are seeking to take the simple road.

Again, I don't see any problem in allowing the minister to use either Step 3 or Step 4, line (c) – or both.

I would note that if the minister chooses to go with Step 3 listing of deductions, I would request that he either note on the W-4 that he is "voluntarily requesting withholding" or that he write a letter to the church clerk/bookkeeper voluntarily requesting withholding.

Further, you can withhold additional amounts to cover Social Security liability but on the year-end W-2 all the withholding must be reported under Box 2 tax withholdings. The minister must then use the Form 1040 (Schedule SE) to allocate the amounts to taxes and Social Security/Medicare when he files his tax return.

Employer Identification Number

The church treasurer should insure that the church has a valid Employer Identification Number, commonly called an EIN. If there is no EIN, the treasurer should apply for such by using IRS Form SS-4. The treasurer should be aware that the EIN is not a tax exemption number. It merely identifies your church as an employer subject to tax withholding and reporting, and ensures that your church receives proper credit for payments of withheld taxes. The EIN is also used to reconcile a church's deposits of withheld taxes with the W-2 forms it issues to employees. Without an EIN, tax deposits cannot be made.

The Internal Revenue Service allows churches (and other businesses) to obtain identification numbers directly online. After the appropriate representative (generally the church treasurer)

completes an application form online, the system issues an employer identification number (EIN) that may be used immediately. The web-based application process eliminates the need to send paperwork to the IRS as well as the delay in issuing a number that may result from an incomplete application form. Once a church has its EIN, it can file tax returns and may enroll in the Electronic Federal Tax Payment System to handle its payments most efficiently.

Q: ***How do I obtain an employer identification number (EIN) for my church?***

A: To get an employer identification number (EIN), you need to file an IRS SS-4 form. You can now do that on-line, and get an immediate number. To access the on-line EIN application form, you may go directly to the IRS website.

You should remember that the EIN is simply an identification number for your church with the IRS. Further, your EIN number should not be "shared" with another church, nor should you be using the state/regional office's EIN. Each church should have their own EIN. It is also important to understand that the EIN is not a tax-exempt number. If your state offers exemption to churches/non-profits from the state's sales taxes, you must obtain a state tax exempt number from the state's Department of Revenue or state Tax Commission. The EIN does not cover the state tax exemption.

Employer Identification Number – IRS Form 8822-B

Every church is required to have an Employer Identification Number (EIN) to open a bank account, put on IRS Form W-2 for their pastor and employees, and to transact other business. To get an EIN number for the church, assuming that you do not have one, a "responsible party" must complete a Form SS-4 or use the IRS electronic application form discussed above.

Since 2010, the application for an EIN number has required the name and Social Security number of the "responsible party" making the application. A "responsible party" is defined as a person who has a level of control over the funds or assets of the entity. For a church, a "responsible party" would be the pastor, church treasurer, or maybe even a board member.

As you might imagine, the "responsible party" often changes in a church situation due to a number of reasons, including resignation and death – and further, prior to 2010, the IRS did not have information about a "responsible party" listed on the EIN applications. To address this issue and to maintain a contact person – or a "responsible party" – for each EIN issued, the Internal Revenue Service has adopted an entirely new requirement to alleviate this problem.

Beginning January 1, 2014, any entity with an EIN must file Form 8822-B to report the latest change to its "responsible party." Form 8822-B must be filed **within 60 days** of the change. If the change in the identity of the "responsible party" occurred before 2014, and the church has not previously notified the IRS of the change, you should file Form 8822-B immediately.

The following suggestions are offered:

1.) Any church that received an EIN number prior to 2010 should complete a Form 8822-B *immediately* so that the IRS has a "responsible party" on file for the church.
2.) Any church who obtained an EIN since 2010 and has had a change in the "responsible party" should file a Form 8822-B *immediately* to name a new "responsible party."
3.) Any church, regardless of when you received your EIN and you do not know if a "responsible party" was listed, should file a Form 8822-B *immediately* to name a new "responsible party."
4.) If you believe that a former pastor may have been the "responsible party" listed on the EIN application, you should file a Form 8822-B *immediately* to name a new "responsible party."

It actually may be good practice to consider filing a Form 8822-B going forward every time that your church has a pastoral change. Again, going forward, the Form 8822-B must be filed within 60 days of a change in the "responsible party."

There is currently no penalty for not updating the name of the "responsible party." However, if the Internal Revenue Service does not have proper contact information, the church may not receive timely notices of deficiencies or demands for taxes from the IRS, and such may lead to penalties and additional interest charges.

While completing the Form 8822-B is a new requirement from the Internal Revenue Service, following through with such should keep the church adequately informed about tax matters impacting them.

CONCLUSION

This manual is not intended to be an all-inclusive tax guide. There are many areas that have not been addressed and many others that have only been mentioned in passing. If you have any questions regarding tax issues on specific matters, you should contact a tax lawyer, a Certified Public Accountant, or some other tax professional. In providing this manual, the Board's desire is to provide general, non-specific information about generic tax issues that ministers, churches, and church-related employees face on a regular basis.

The information in this Manual is provided as a service by the Church of God Benefits Board, Inc. For more information, you may contact the Benefits Board as follows:

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