



Minister's Compensation Manual



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EFFECTIVELY PLANNING A MINISTER'S COMPENSATION PACKAGE

2022 Edition

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EFFECTIVELY PLANNING A MINISTER'S COMPENSATION PACKAGE

The 2018 *Minutes* of the Church of God General Assembly at *Section 68* provide detailed guidance to the local church as to what should be included in the pastor's basic compensation package. The *Minutes* state that the "basic pastoral compensation shall consist of the following based on the availability of appropriate tithe funds in the local church:



1. The compensation as designated for the appropriate membership category in *569*, entitled *Pastor's Minimum Compensation Scale*.
2. One-half of the pastor's Social Security tax (which is to be reported as taxable income...)
3. Premiums for health insurance coverage (Editor's Note: Such may now be taxable income.)
4. Contribution by the local church to the Church of God Ministers' Retirement Plan for the pastor of an amount equal to at least **10** percent of the cash compensation received by the pastor, (*changed by the 2018 General Assembly*) and
5. Adequate housing accommodations, including utilities."

In the same section, the *Minutes* go on to point out that where funds are not available to meet these minimum compensation requirements, the pastor should receive 90 percent of the gross tithe, and that the church should take up freewill offerings to increase the pastor's compensation to the minimum scale. The *Minutes* also include an encouragement for the local church to provide "automobile travel expense allowances" and other "incentives" to their pastor.

There is absolutely no question about the importance of crafting a well-designed compensation package for the pastor. The labourer is truly worthy of his reward (I Timothy 5:18).

In this manual, there will be no attempt made to cover *all* of the compensation and taxation issues that may arise in dealing with a minister. However, basic guidance will be given so that a compensation package can be created that will provide maximum tax savings for the minister and comply with the directives provided in the Church of God *Minutes* for the local church.

MINISTER'S PERSONAL BUDGET



While it may seem strange to start a discussion about a compensation package with a look at the minister's personal budget, there is really no better starting point or ending point. It is important for the minister (or pastor) to reasonably estimate his expenditures for the month – and year. Without knowing certain expenditures, especially housing costs, a well-designed compensation package cannot be created.

The *Personal Budget Worksheet* (see Attachment A) provides a basic framework for a minister – or for that matter, anyone else - to create a monthly budget. It has been said that “balancing your budget gets worse each year. It seems as though you cannot balance your net income with your gross spending habits.”

A person has only two options when it comes to having a “balanced” budget – either increase income or decrease expenditures. Simply put, you cannot plan a trip without knowing two things: where you are and where you are going. The same applies to your finances. Without getting a second job, it is extremely difficult to increase your income in the ministry, especially if you are a pastor. This is true for most professionals. Therefore, the only options become reducing your expenditures or better planning your compensation package. Since increasing income is probably not an option, decreasing expenditures must be the first avenue approached.

EXPENDITURES

Housing Costs

The largest expenditure in the average household is on housing costs, whether the costs are from owning a home or renting. Generally, 25% to 55% of a household's income is spent on providing a house and utilities. When asked how much they spend on housing, most people would say around 25% of their gross income. However, when they combine utilities and other maintenance and upkeep associated with the house, the figure begins to approach 50% of their “take home” pay. That figure is generally surprising to most.

Ministers are unique when it comes to housing costs. The costs are still the same but the way that they deal with such for tax purposes is extremely different.

Parsonage

Up until the last 25 or so years, most churches provided a parsonage for their pastor, on or near the property where the church facilities were located. In the mid-1980's, the ministerial housing allowance became more popular and many parsonages were sold or converted into other church meeting rooms.



There are both positives and negatives in regards to a church maintaining a parsonage. On the positive side, a parsonage is an attractive proposition for a young minister that does not have the resources to put towards a down payment on his own home. A parsonage also is a ready-made home, usually containing church-owned furnishings, that is available immediately for occupancy by the new pastor. Parsonages are also generally in close proximity to the church, allowing the pastor to have immediate access to the church facilities for his use. In a volatile housing market, a parsonage becomes a huge asset for a church in attracting a suitable pastor. Not to be forgotten, but since the church owns the house, the church is responsible for all maintenance and repairs. So when the roof leaks, it is the church's responsibility.

On the negative side, the church owns the parsonage. Such ownership cannot only be a source of irritation for the pastor and his family, but it also prohibits the pastor from building equity in a home. Any increase in value to the home, even though it may occur due to the efforts of the pastor, inure to the benefit of the local church rather than the pastor. Some churches have created "equity housing allowances" for their pastor when he lives in a church-owned parsonage to offset the equity that he might have gained from owning his own home. Generally, these "equity housing allowances" are taxable to the minister. To offset the taxable nature of the "equity housing allowances," instead of providing such as allowance, some churches maximize their contribution to the minister's tax-deferred retirement account.

Even if the church provides a parsonage for the minister, the church may establish a "parsonage allowance" to cover incidental costs that may occur in the normal course of the minister living in the house.

Most church leaders contend that parsonages are "horse and buggy." However, there is still a valid reason for many churches to maintain parsonages. If a church is in a remote area, or contrastingly in a very urbanized area, a parsonage may be vital in attracting a pastor.

For tax purposes, it should be remembered that the annual rental value of living in the parsonage is not considered as income to the minister for federal income tax purposes but is taxable for self-employment taxes (Social Security/Medicare).

Housing Allowance

Where a church has no parsonage, generally the church seeks to provide for the housing needs of the pastor by giving him a "ministerial housing allowance" so that he may secure his own home, either by renting or owning. Again, housing allowances have become extremely popular

over the past few years as churches have sought to shed the burden of providing a self-contained house for their pastor. If properly documented, the amount a church provides to a minister (either the senior pastor or any other credentialed minister) for housing allowance is non-taxable for federal income tax purposes, but is taxable for Social Security and Medicare purposes.

The Ministerial Housing Allowance has been the subject of much controversy over the past few years and has even been challenged on constitutional grounds of violation of church and state (*see next article*). In 2002, the Clergy Housing Allowance Clarification Act of 2002 (Public Law 107-181) was enacted to bring some clarification to this issue. The law basically provides that the ministerial housing allowance exclusion 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 church as a housing allowance;
whichever is less.

Simply put, in looking at the three qualifiers above, you must use the least of the three. 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.*

It is the responsibility of the church to establish the amount of the housing allowance, in cooperation with the minister, based on his or her actual housing expenses. The church in conference, or by action of the Pastor's Council, should set that amount each year. In determining his housing allowance, the minister may include (but is not limited to) the following expenses:

- Mortgage payments/rent
- Property taxes
- Homeowners insurance
- Furniture, appliances, etc.
- Decorating/carpet/lamps
- Repairs and upkeep
- Improvements
- Utilities/basic cable TV
- Lawn care, snow removal, shrubbery

To accurately report his expenses to the local church body, the minister should complete an *Estimate of Housing Allowance* form (see Attachment B) and submit the same to the governing

body of the church for adoption prior to any designation of housing allowance being made. In other words, the church's governing body has to adopt the housing allowance before the minister can claim such. Further, a housing allowance cannot be made retroactively.

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 recent decision, can be found at <https://www.benefitsboard.com/housing-allowance>.

Reporting Housing Allowance

As mentioned earlier, if properly set up, the housing allowance is non-taxable for federal income tax purposes but is taxable for Social Security and Medicare purposes for the minister. There are three basic ways that the housing allowance is handled for tax purposes:

Actual Exclusion Method – (Best, most accurate, most difficult, but preferred method by the IRS)

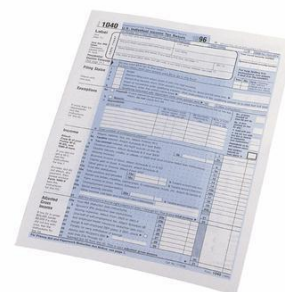
- a. Minister provides estimate for next year's housing expenses
- b. Church designates a housing allowance.
- c. Minister substantiates actual housing expenses.
- d. Church computes actual housing allowance exclusion.
- e. Minister's W-2 is reduced by the actual exclusion.

Estimated Exclusion Method

- a. Minister provides estimate of next year's housing expenses
- b. Church designates a housing allowance.
- c. Minister's W-2 reduced by church-designated housing allowance.
- d. Minister reports any "excess housing allowance" as taxable income.

Non-accountable Method – (Though probably the most common method, this is the least desirable and least accurate method)

- a. Minister requests housing allowance with no estimate of housing expenses.
- b. Church designates a housing allowance.
- c. Minister's W-2 reduced by church-designated housing allowance.
- d. Minister reports any "excess housing allowance" as taxable.



The Actual Exclusion Method is the most difficult because it requires the minister to have all his housing receipts in to his local church's treasurer before the end of January following the year in which the expenses were incurred so that his IRS Form W-2 may be reduced by the actual amount used for housing, as long as such is under the limit set by the church and does not exceed fair rental value. The "actual" method also creates problems because it places the church treasurer in the position of determining whether or not an expenditure actually qualifies as a legitimate housing cost. While the IRS would prefer that the "actual" exclusion method be used, their examples primarily use the "estimated" exclusion method. Generally, the estimated exclusion method is going to be the best way for the church and the pastor to deal with reporting his housing allowance. The non-accountable method is just that – non-accountable. It should not be used under any circumstances, simply because it places the amount that the minister receives as housing subject to tax liability.

Tax Planning Steps

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 (See Attachment B).
- 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. For 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 (for example) 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. These limitations are included in the *Exclusion Worksheet* (see Attachment C).
- The minister must pay federal income taxes on any “excess housing allowance.” On the dotted line next to Line 1 (IRS Form 1040), enter “Excess Allowance” and the amount.
- The minister must pay self-employment tax (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. In other words, 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 free from income taxes.

Tax Reporting

As noted, the housing allowance is not included in income for federal income tax purposes but is taxable for Social Security and Medicare purposes. Therefore, it is recommended that the ministerial housing allowance be properly reported on the minister’s Form W-2. IRS instructions

for the Form W-2 notes that the ministerial housing allowance may be reported in Box 14 of the minister's W-2. 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." However, the ministerial housing allowance is **not** included in Box 1 on the Form W-2.

Business Expenses

Business expenses place more ministers in the "cross hairs" of the Internal Revenue Service than any other issue. Claiming excessive business mileage is probably the number one reason that ministers are audited.



Since ministers (especially those in a pastoral role) are W-2 employees, they can no longer claim unreimbursed business expenses on Schedule A after the 2017 tax reform act. On the other hand, a great audit risk is created by ministers who claim to be self-employed so that they can file Schedule C and get a direct deduction.

To avoid both the Schedule C audit problem and the new prohibition against claiming unreimbursed business expenses on Schedule A for employees, the church should adopt an "accountable plan" for their minister. Simply put, under an accountable plan the minister accounts for his business expenses to the local church entity and they reimburse him for those business expenses. To have an accountable plan, the governing body of the church must approve and adopt the "accountable plan" prior to the minister submitting expenses. 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).

Expenses covered under an accountable plan would include auto expenses, entertainment, conventions and conferences, professional books and magazines, travel expenses (air, motel, etc.), and a variety of other expenses incurred in the regular course of the minister carrying out his duties.

Usually, churches will adopt an accountable plan that provides full reimbursement for all professional business expenses or provides reimbursement up to a specified annual limit. Even if a limit is placed on the accountable reimbursement account, it should be viewed as an annual limit. It is also better not to break down the different categories of the limit, such as so much for mileage, so much for conventions, etc. An overall limit works best. For example, assume that the church sets an accountable reimbursement limit of \$500 a month. That amount should be considered as an overall amount, with the minister submitting receipts to show how the money was spent that month. In one month, mileage may be a big factor while travel may be the overriding factor in another month. The annual limit allows for those deviations and also allows the pastor to spend \$1000 in one month to attend a convention while only spending

\$200 or so in other months. Again, the monthly limits can be used for the local church to track the budgetary impact but the \$500 a month used in the example should be viewed as a \$6,000 annual limit. An estimate of accountable reimbursement expenses is helpful for planning purposes. The *Estimate of Accountable Reimbursement Expenses* form allows for such planning (see Attachment D).

If the accountable plan meets all the requirements of the IRS regulations as set out earlier, the amounts paid under the arrangement are excluded from the minister's gross income and are not required to be reported on his Form W-2. On the other hand, if the plan does not meet IRS standards, then the payments are included as gross wages and are taxable.

The IRS makes very clear that a salary reduction arrangement which "reimburses" the minister for business expenses by reducing his salary does not qualify as an accountable plan. They apply this rule whether the amount varies by pay period or is a specific amount. As long as the minister is entitled to receive the full amount of annual compensation, regardless of whether or not business expenses are incurred during the year, the arrangement does not meet the "accountable plan" provisions.

Mileage



Documentation of expenses is vital to an acceptable accountable reimbursement plan. As earlier mentioned, 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 non-deductible 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 business 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.

Effective January 1, 2022, the standard mileage rate for the use of a car for business purposes is **58.5 cents a mile** for all business miles driven.

Dues vs. Contributions

Some ministers contend that since they are “required” to pay tithe, that such amounts to “dues,” and therefore should be deductible as a business expense. The IRS clearly refutes this effort at tax evasion. Tithes for a minister are treated just like anyone else that pays tithes – they are a charitable contribution that can potentially be deducted on Schedule A.



Records Required

The Internal Revenue Service requires that any expenditure over \$75 (or any amount spent on lodging) included in an accountable reimbursement plan must be documented by a receipt. However, the local church can require receipts for a lesser amount if they so desire. The best policy is to require receipts for **all** expenditures except for incidental expenses such as tolls.

It is important to note that a credit card bill is not a sufficient receipt. The actual receipt from the point of transaction must be used and not the monthly statement from American Express, VISA, etc.

Creating an Accountable Plan



The following steps should be taken to create 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.”

This resolution should be 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* (see Attachment E) 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.

A historical note is in order at this point in relationship to compensation paid to Church of God ministers. Prior to General Assembly action in 1992, the Church of God salary structure was divided into two separate categories – salary and expenses. Basically, the *Minutes* assumed that every pastor in the same category incurred the same expenses on a weekly basis. The Internal Revenue Service raised questions about this structure on two major grounds. First, they contended that a blanket designation of expenses was incorrect because some ministers may have more expenses than others. For example, a minister pastoring a rural church would generally incur more mileage expenses than a pastor in a “city” church. Second, under the approach taken in the *Minutes*, the IRS correctly pointed out that the pastor was not required to “account” for his expenses. The *Minutes* had just assumed that he had such expenses – and therefore had designated such. The IRS basically advised the church that such created a “non-accountable” reimbursement plan and that they would more than likely rule that the expense designation was income – and therefore taxable to the minister.

To deal with this issue, the 1992 General Assembly combined the two (salary and expenses) into what is now known as the “minimum compensation scale.” Based upon interviews with those that were involved in this proposal, it was the intention of the General Assembly to create one big “pot” that the minister could use in setting up an accountable plan. If he could

justify more expenses, then he could have more of his weekly “compensation” designated as expenses, thereby reducing his tax burden.

In creating a valid accountable reimbursement plan, let us assume that a pastor is entitled to minimum compensation of \$1,000.00 per week – or \$52,000.00 per year. As a part of his planning, the minister estimates that his weekly expenses will be \$200.00 (\$10,400.00 per year). According to the *Minutes* and IRS guidelines, the church governing body (either the Council or the church as a whole) should designate \$10,400.00 as an accountable reimbursement plan and designate \$41,600.00 as salary. If the minister substantiates, documents, and reports expenses up to \$10,400, that amount would not be taxable for either income taxes or SECA taxes. The remainder (\$41,600) would be taxable income for all purposes.

This process differs from salary reduction. Under this type of arrangement, the “total” compensation scale is used to determine what expenses, if any, the minister will incur. In addition, an amount is set in advance as to how much is expenses and how much is “taxable salary.” Again, from a historical review, it was anticipated that the “minimum compensation scale” would cover *both* taxable compensation **and** expenses. This is made evident by the list of elements that are included in the basic compensation package of the pastor as found in Section 68 of the *Minutes*.

Some pastors contend that expenses are *in addition to* the “minimum compensation scale” found in Section 69 of the *Minutes*. These ministers use paragraph III of Section 68 to justify their position: “Therefore, all churches are encouraged to provide automobile travel expense allowances and to provide incentives such as higher percentages of retirement, annuity, and insurance plans, and so forth, based on increases in finances, pastoral responsibility, pastoral effectiveness, and longevity.” If the local church is financially able to provide the minimum compensation scale as taxable income **plus** an accountable expense allowance in addition, that would be a wonderful blessing to the pastor. However, the “minimum” income for the pastor should be the compensation scale contained in Section 69 of the *Minutes*, which would include his accountable reimbursable expenses and his taxable income.



From a church bookkeeping standpoint, the local church does not have to cut the pastor a separate check each week for expenses. He can be given one check that includes his taxable compensation, his accountable reimbursement expense funds, his housing allowance, and any other compensation or reimbursement for which he is entitled. Those differences can be noted in the ledger – and should be dealt with on the minister’s Form W-2 as well.

It must be remembered that any amounts paid under a valid accountable plan is not considered income to the minister and does not appear on his Form W-2.

Any amounts in excess of those to cover substantiated expenses must be returned to the church. For example, at the end of the year the minister has documented and substantiated expenses to the church treasurer of \$8,000. However, each week he has received \$200 for expenses from the church in advance – or \$10,400 for the year. The minister must return the

\$2,400 difference to the church or the plan is deemed by the IRS to be a nonaccountable plan. Even if the church decides to give the \$2,400 to the pastor as a gift, the IRS requires that it must be returned by the minister to show a paper trail that the accountable plan is separate from the gift. Of course, if the \$2,400 is given as a gift, it becomes taxable to the minister as income.

A valid accountable plan for business expenses is as important as having a housing resolution in place. If an accountable plan is not provided for the minister, it is almost a certainty that the minister will pay too much in income taxes.

Tax Reporting

If an accountable reimbursement plan is set up properly, any amounts paid to the minister under the plan do not appear on his Form W-2, nor does the minister have to claim these expenses as a deduction. On the other hand, if the minister does not have an accountable reimbursement plan that was adopted by the church, all funds paid to the minister as reimbursement for expenses are treated as ordinary income – and are included as compensation in Box 1 on the minister's Form W-2.



Fringe Benefits

Another key component of a minister's compensation package involves "fringe benefits." Usually by the time the minister and the church get the housing allowance and the accountable expense plan worked out, they have little or no energy left to deal with any other aspects of the compensation package. Not creating a fringe benefits package can be devastating to the minister in the long run. The fringe benefits package can contain many different elements but most often deals with retirement accounts, health insurance, and reimbursement of half of the minister's Social Security payments.

Tax-deferred Retirement Account

As cited above, the *Minutes* of the Church of God General Assembly state that the local church should make contributions "to the Church of God Ministers' Retirement Plan for the pastor of an amount equal to at least 10 percent of the cash compensation received by the pastor." The Ministers' Retirement Plan is a 403(b)(9) retirement plan set up under the auspices of the Internal Revenue Service. The Ministers' Retirement Plan, or MRP, is administered for the Church of God by the Benefits Board, Inc. The MRP operates almost identically to a 401(k) plan.

In 2022, the regular contribution limit to the Ministers' Retirement Plan is \$61,000 or the amount of the minister's (or church-related employees') taxable ministerial income, *whichever is less*. Of that amount, no more than \$20,500 in 2022 can be contributed by salary reduction. The remainder of the limit must come from the church's contribution.

In addition to the regular contribution limit, anyone that is 50 years of age or older during 2022 can contribute an additional \$6,500 for the year, either through salary reduction or by the employer, as a catch-up contribution.

As ministers approach the retirement years, they become much more interested in preparing for retirement. However, then it is often too late to save enough to provide for the standard of living that they desire in retirement. Therefore, planning for retirement is important for ministers of all ages. Money saved in a retirement account as a young person has many more opportunities to compound than money saved in the last few years of a person's working career.

While a young minister may not see a retirement account as a valuable fringe benefit, it should be included in his package at least at the ten percent level recommended by the *Minutes*. A more reasonable figure would be to set aside 15% of the minister's cash compensation for contribution to the Ministers' Retirement Plan. The church should take the position that they are not only providing for the minister now – but also in his retirement years.

If the church includes payments to the Ministers' Retirement Plan in their compensation package, a resolution should be entered on the local church records to memorialize such.

It should be noted that the Ministers' Retirement Plan is the only tax-deferred plan recognized by the Church of God, and therefore, the only retirement plan that a church can make contributions to on behalf of a minister.

Tax Reporting of Retirement Plan Contributions

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."

As an additional note, it should be pointed out 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.

Health Insurance

The cost of health insurance for all Americans has become outrageous. Recognizing the need for health insurance, the *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 tax-free reimbursement of such premiums by the church except in very 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. 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 if the employer offers 1) a *group* health insurance plan or 2) falls under the “one employee” exception.

Further, more 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 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: In some situations, recent legislation has eliminated this penalty.]

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 potentially 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 (IRS 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 tax-free, 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.

Tax Reporting of Health Insurance Premiums

Simply put, the payment of health insurance premiums for the minister under an *individual* policy are now completely taxable – and therefore must be included as a part of Box 1 income on the minister's IRS Form W-2. Such can only be considered a fringe benefit if premium payments are made towards a *group* health insurance plan or if the person falls under the "one-employee" exception.

Health Reimbursement Arrangements

Even under the best insurance plans, there are going to be some charges not covered either because they do not fall under the coverage of the policy or because they are subject to a deductible or a co-payment provision in the insurance policy. These costs can be substantial after a major surgery or dental procedure. While medical costs can be claimed on Schedule A, only the amount that exceeds 10% of the minister's adjusted gross income actually becomes a deduction. Therefore, these costs come out of the pocket of the minister.

To fill this void on unreimbursed expenses, some churches have set up Health Reimbursement Arrangements (HRA) as a fringe benefit to provide assistance to their employees who fall in this gap. HRA are a technical creation of the IRS and are set up under Section 105(b) of the Internal Revenue Code. Professional assistance from a CPA or an attorney is not only advisable but is critical in creating such a plan. The *Zondervan Minister's Tax & Financial Guide* by Dan Busby is an informative source of information on health reimbursement arrangements.

As a general rule now under the Affordable Care Act, employer/churches may **only** offer a Health Reimbursement Arrangement if the HRA is integrated with a *group* health insurance plan (and not with *individual* insurance plans). [NOTE: Legislation has been offered to hopefully address this issue.] Further, a valid HRA requires a written plan or procedures manual, all employees must be allowed to participate in such (not just the pastor if there are other employees, although it seems probable that a distinction could be made between full and part-time employees), the HRA must provide a maximum dollar amount of coverage (for example, \$2,500 a year), the church/employer must fund the HRA and not the employee through salary reduction, and the plan document may allow for money not used in one year to carry forward to the next. However, if a person has the right to receive cash under the plan without such being a reimbursement, the entire HRA is disqualified and all benefits paid out of such becomes taxable.

HRAs offer additional benefits in that they can be used to reimburse expenses not normally covered under health insurance policies, such as laser eye surgery, chiropractic care, or the extra cost of a private hospital room.

While a Health Reimbursement Arrangement is not for every minister or every church, if the church has a *group* health insurance plan, it is a fringe benefit that can be of great benefit to a minister and other church-related employees.

Tax Reporting on Health Reimbursement Arrangements

If the Health Reimbursement Arrangement is properly created and administered in conjunction with a *group* health insurance plan, reimbursements from such are not considered wages for federal income tax purposes or for Social Security purposes. Therefore, such do not appear on the minister's IRS Form W-2.

Health Savings Accounts

If you have a high-deductible health insurance plan (HDHP), the Tax Code allows you to have a Health Savings Account (or "HSA"). Funds placed into a HSA can come from the employee and/or the employer (while contributions to the Health Reimbursement Arrangements discussed above come solely from the employer). Funds contributed to an HSA are made with pre-tax dollars and further, there are no taxes owed when the funds are spent, as long as they are spent on qualified health expenses that appear on the IRS approved list.

If Health Savings Account funds are spent on non-approved items, you are not only responsible for the tax on the amount spent but you will be subject to a 20% penalty as well.

While a Health Savings Account can only be used by those ministers with a high-deductible health insurance plan, the accounts can be a substantial benefit.

Tax Reporting on Health Savings Account

If paired with a high-deductible health insurance plan, and if expenditures from such are made on qualified health expenses, the contributions to an HSA and the payments from such are made without tax consequences. However, it should be noted that there is a tax reporting of Health Savings Account – and such accounts should be set up with assistance from a reputable provider.

Social Security/Medicare Reimbursement

As mentioned earlier in our analysis, a minister has dual tax status: he is an employee for federal income tax purpose, but he is self-employed for Social Security/Medicare purposes. Further discussion on this issue is found elsewhere in this document. Due to the minister's status as self-employed for Social Security/Medicare purposes, he is required to pay the self-employment tax of 15.3% on his wages. In a regular employment relationship, the employer would pay half (7.65%) and the employee would pay half (7.65%) through withholdings.

Recognizing the inequity of the dual tax status, the *Minutes* of the Church of God General Assembly encourages the local church to pay at least "one-half of the pastor's Social Security tax." These payments basically put the minister in the same position as any other employee. There is one exception – the payments are taxable for income and Social Security tax purposes whether they are paid directly to the minister or to the Internal Revenue Service. Therefore, an allowance to cover half of the minister's self-employment Social Security/Medicare tax provides absolutely no tax benefit since the amount is fully taxable. However, paying at least a portion of the minister's Social Security/Medicare tax is important so this amount can be properly shown as a fringe benefit for compensation analysis purposes.

Tax Reporting on Social Security/Medicare Reimbursement

Any payments made by the church for reimbursement of any portion of the minister's Social Security/Medicare tax liability, whether they are paid directly to the minister or to the IRS, are taxable for federal income tax purposes and Social Security/Medicare tax purposes. Although such payments are considered a "fringe benefit," they are included in the minister's taxable compensation. Therefore, they are included in Box 1 income on the minister's IRS Form W-2.

WORKSHEET ON MINISTER'S COMPENSATION

The entire discussion on minister's compensation began with a discussion of the minister's personal budget. A good compensation package from the employer/church should also benefit the minister on his personal budgeting. The minister's entire compensation can be summarized on one form – the *Worksheet for Minister's Compensation* (see Attachment F). By using this simple form, the minister can determine quickly and accurately what his tax liability will be for the year. This information is absolutely essential for the minister who files estimated tax payments quarterly.

The first part of the *Worksheet on Minister's Compensation* includes all that goes into a compensation package – salary, parsonage or housing allotment, accountable reimbursements, and other fringe benefits. The total derived here determines exactly how much it will cost the employer/church to have the minister on staff. This number is essential to the church in planning and budgeting for a new year.



The second part of the *Worksheet on Minister's Compensation* allows the minister to determine how much of his compensation package will be taxable. While this information is not as important to the employer/church, it is vitally important to the minister as he tries to insure that he is meeting his tax liability obligations. Also, this analysis allows the minister to determine what amounts he can contribute to his retirement plan through a salary reduction agreement.

REPORTING MINISTER'S COMPENSATION

As previously noted, most ministers are employees of the church for federal income tax purposes. However, the Internal Revenue Code places the pastor and other ministerial staff in a “dual tax status”. This dual status means that while the pastor and other ministers are employees for income tax purposes, they are self-employed for Social Security tax purposes with respect to ministerial income. This dual tax status creates a unique tax withholding or payment situation for ministers.

According to the Internal Revenue Code [IRC 3401(a)(9)], it is unlawful for a church to withhold income tax or FICA taxes on a minister. However, the minister can voluntarily have the employer/church withhold income taxes. In addition, due to the minister's status as self-employed for Social Security/Medicare purposes, he does not pay FICA taxes – but rather pays self-employment taxes (or SECA taxes).

The employer/church **does not** withhold self-employment taxes (SECA) from the minister's salary. The minister is responsible for the payment of these taxes on a quarterly basis. However, the minister may voluntarily have the church withhold extra income taxes to cover the amount owed for self-employment taxes. Entering into a voluntary agreement with the church to withhold income taxes, and an additional amount for self-employment taxes, is by far the easiest way for the minister to meet his tax liability obligations. IRS Form W-4 can be used for this purpose (*see Attachment G*).

For Social Security/Medicare purposes, self-employment earnings include pastoral salary, the fair rental value of a parsonage or a housing allowance, Social Security reimbursement, and business expenses (except where the church has an “accountable reimbursement” plan in place for business expenses). The current rate for self-employment taxes is 15.3%. The self-employment tax is computed by using IRS Form 1040 Schedule SE quarterly.

7171 ☐ VOID ☐ CORRECTED

PAVER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

Anytown Church of God
123 Praise Street
Anytown, TN 45678

OMB No. 1545-0116
2021
Form **1099-NEC**
Nonemployee Compensation

Copy A
For Internal Revenue Service Center
File with Form 1096.
For Privacy Act and Paperwork Reduction Act Notice, see the 2021 General Instructions for Certain Information Returns.

PAVER'S TIN 98-7654321	RECIPIENT'S TIN 123-45-6789	1 Nonemployee compensation \$ 800.00
RECIPIENT'S name Phil B. Pulpit		2 Payer made direct sales totaling \$5,000 or more of consumer products to recipient for resale <input type="checkbox"/>
Street address (including apt. no.) 123 Broad Street		3
City or town, state or province, country, and ZIP or foreign postal code Cleveland, TN 37320		4 Federal income tax withheld \$ 100.00
Account number (see instructions)	2nd TIN not <input type="checkbox"/>	5 State tax withheld \$ 6 State/Payer's state no. \$ 7 State income \$

Form **1099-NEC** Cat. No. 72500N www.irs.gov/form1099-NEC Department of the Treasury - Internal Revenue Service
Do Not Cut or Separate Forms on This Page – Do Not Cut or Separate Forms on This Page

Due to the minister's status as an employee of the church, he should receive a Form W-2 each year before February 1 to reflect his wages for the previous year (*see Attachment H*). Non-employees of the employer/church should receive a Form 1099-NEC, if they received income in excess of \$600 during the year (*see Attachment I*). Evangelist should receive a Form 1099-NEC, rather than a Form W-2. It should be noted that a church does not have to provide an incorporated ministry (Phil Pulpit Evangelistic Ministries, Inc.) with a Form

1099 if the revival receipts/love offerings were made payable to that incorporated ministry.

NOTE: Based upon an IRS proposal, all Form 1099 rules are scheduled to change. Information on these changes will be forthcoming from the Internal Revenue Service once Congress adopts such.

Reportable Income for the Minister

Ministers and churches often find it difficult to determine or agree upon what is or is not reportable income for the minister.

Simply put, it is unlawful for a minister (or anyone else) to try to “hide” income by calling it something else. The following are clearly income to a minister:

- salary
- bonuses
- Additional salary payments to assist in payment of health insurance costs
- love offerings (Christmas or Pastor’s Appreciation offerings from the church)
- gifts that are run through the church for tax credit
- trips given to the pastor as a gift (i.e. Holy land trips)
- Social Security paid by the church for the minister
- business expense reimbursement under a *non-accountable* plan
- Personal use of church-provided automobile, and
- honoraria given for weddings and funerals (*list is not inclusive*)

While this is not an exhaustive list, it provides a good framework for the employer/church to determine what items should be included on the minister’s W-2 form. Suffice it to say, the IRS will scrutinize the minister’s income very carefully should he or she be audited. Good records are essential for preventing penalties and interest on unpaid taxes from unreported income.

A simple rule of thumb is if a person has reason to believe that they can claim their gift as a charitable deduction, it is taxable to the recipient. In times past, a person who gave the minister a \$20 bill on the way out of church was said to have given the minister a “gift,” creating no

charitable contribution deduction for the giver and no tax liability for the recipient. However, the IRS has recently taken the position that such a “gift” is actually additional compensation for the minister – and therefore taxable to him, although the donor probably does not get a charitable deduction since it was not recorded and made through the church. On the other hand, had the person written a check to the Anytown Church of God for \$20 and designated such as “pastor love offering,” the person now has a reasonable expectation that the “gift” is a charitable contribution and can claim a deduction for such. In addition, the “gift” becomes a taxable item to the minister.



Items Not Considered Reportable Income for Ministers

Lawyers often jokingly state that there is a simple distinction between *tax evasion* and *tax avoidance* – twenty years in federal prison. Hiding income is tax evasion and punishable by imprisonment upon conviction. However, there are several items mentioned within this document that can legitimately be excluded from taxable income for ministers. Since these items are dealt with at length elsewhere, only a brief mention of each will be noted here. The primary items not considered as reportable taxable income for ministers are:

- Retirement Plan Contributions – It should be noted that *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 IRS Form W-2, but "retirement plan" would be checked in Box 13 and Box 12 would report "E - \$5000.00."
- 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 – which is 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. Further, the employer/church should be aware that non-ministerial employees do not receive the housing allowance benefit. If the church pays the housing of the 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. For ministers, salary reduction contributions are excluded for both tax purposes and Social Security purposes.

Completing Form W-2

Completing the minister's IRS Form W-2 should be relatively simple for the employer/church. Step-by-step instructions and tips follow:

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b Employer identification number (EIN) 98-7654321			1 Wages, tips, other compensation 40000.00							
c Employer's name, address, and ZIP code Anytown Church of God 123 Prairie Street Anytown, TN 45678			2 Federal income tax withheld 0.00							
			3 Social security wages							
			4 Social security tax withheld							
			5 Medicare wages and tips							
			6 Medicare tax withheld							
			7 Social security tips							
d Control number			8 Allocated tips							
			9 Dependent care benefits							
e Employer's first name and initial P. D.		f Last name Puppt	10 Nonqualified plans							
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- Box a – list the 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 at
<http://www.irs.gov/businesses/small/article/0,,id=102767,00.html>.

- 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 minister
- Box f – list the address of the minister
- Box 1 – list all reportable taxable income for the minister (do not include employer/church retirement plan contributions or amounts reduced from the minister's salary through a valid salary reduction agreement)
- 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.
- Box 3 through Box 11 – nothing generally appears in these boxes for ministers
- 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
 - DD – Reports cost of employer-sponsored *group* health coverage. The amount reported with Code DD is not taxable.
- Box 13 – If the minister 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 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 generally appears in these boxes unless state and local withholding is required by law.

The IRS provides detailed instructions on the completion of Form W-2 if such is needed beyond these cursory guidelines.

SUMMARY

As stated earlier, this guide is not meant to be exhaustive. There are some subjects that have not been covered because professional, legal, or accounting assistance is needed to address your specific circumstances. This “manual” is primarily made available so that ministers (and churches) will be familiar with most of the components of a well-defined compensation package. There has been absolutely no attempt to cover every single aspect of a minister’s compensation package or to discuss every possible tax implication of a particular financial decision.

As a minister reads through this “manual,” he or she will find things that they are doing “right” and things that they are doing “differently.” It has been our attempt to present items in a way that meet the requirements of the Internal Revenue Code. That is not to say, however, that the way that you are doing something would not pass the muster of the IRS. The Service issues hundreds of opinions per year and often even those opinions differ on ways that particular issues should be handled. While we would all like to have clear “black and white” interpretations when it comes to tax laws, that is often not the case. However, the matters dealt with here come from Internal Revenue Service publications and the recommended course of action found in this document comes from the IRS itself.

It is the hope of the Benefits Board that this “manual” will serve you well in providing for the local pastor or leader of your congregation. He is God’s choice servant and should be treated as such.

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.*

The Board of Directors, or the staff of the Benefits Board, is not engaged in rendering financial advice, legal advice, or other financial planning services. If such advice is desired or required, the services of a competent professional should be sought.

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PERSONAL BUDGET WORKSHEET

Income

Salary _____
Pension Income _____
Social Security _____
Interest _____
Other _____
Other _____
Other _____

Gross Income per Month _____

Less

Taxes (Fed., State, FICA) _____
Tithes _____
Savings _____

NET AVAILABLE INCOME _____

Expenditures

Housing

Mortgage/Rent _____
Insurance _____
Real Estate Taxes _____
Electricity _____
Gas _____
Water/Sewer/Garbage _____
Cable TV _____
Telephone _____
Repairs/Upkeep _____
Furnishings/Appliances _____
Lawn Care _____
Total _____

Food

Groceries _____
Dining Out _____
Total _____

Automobile

Payment _____
Gas & Oil _____
Auto Insurance _____
Auto Taxes and Fees _____
Maintenance _____
Total _____

Insurance

Life _____
Medical _____
Other _____
Total _____

Debts

Consumer Loans _____
Credit Cards _____
Total _____

Entertainment and Recreation

Vacation _____
Trips _____
Health/Fitness Club _____
Baby Sitters _____
Other _____
Total _____

Clothing

Husband _____
Wife _____
Children _____
Total _____

Medical Expenses (Un-reimbursed)

Doctor _____
Dentist _____
Drugs _____
Other _____
Total _____

School/Child Care

Tuition/Fees _____
Supplies _____
Total _____

Investments

Retirement Plan _____
Stocks/bonds/etc. _____
Other _____
Total _____

Miscellaneous

Toiletry, cosmetics _____
Beauty, barber _____
Laundry, cleaning _____
Newspaper/magazines _____
Gifts _____
Cash _____
Other _____
Other _____
Total _____

TOTAL EXPENSES _____

INCOME vs. EXPENSES

Net Available Income _____
Less Total Expenses _____
Equals Surplus Income* _____

Surplus income should be designated to savings or investments. It should not be spent just because it is available.



Attachment B

(HSG710)

Estimate of Housing Allowance for 20____

I, _____, certify that I am a licensed/credentialed minister of the gospel, and I estimate my housing cost for the calendar year of 20____ as follows:

- | | |
|---|----------|
| 1. Rent | \$ _____ |
| 2. Mortgage (including down payment) | \$ _____ |
| 3. Real Estate Tax | \$ _____ |
| 4. Insurance (home and contents) | \$ _____ |
| 5. Repairs, Improvements, and Maintenance | \$ _____ |
| 6. Household Furnishings and Appliances | \$ _____ |
| 7. Decorator items (drapes, carpet, pictures, etc.) | \$ _____ |
| 8. Utilities (electricity, gas, water, and sewage) | \$ _____ |
| 9. Lawn Maintenance, Landscape, and Pest Control | \$ _____ |
| 10. Any other allowance expense (Specify) | \$ _____ |

Estimated Total Annual Housing \$ _____

Allowance Amount per Month (1/12 of yearly total) \$ _____

I understand that the total allowance permitted is limited to 1) the fair market rental value of my home plus the cost of utilities and furnishings, 2) the amount I actually spend on housing, or 3) the amount designated by the church as ministerial housing allowance, WHICHEVER IS LESS.

Signature _____ Date _____

Adopted by the Board on _____

Attachment C

(HSG750)

Housing/Parsonage Allowance Exclusion Worksheet

A. Housing Allowance

Home Owned or Rented

The exclusion is limited to the least of:

1. Amount designated as housing allowance by Church _____

2. Amount actually used to provide a home:

Rent _____
House Payments _____
Furnishings _____
Repairs _____
Insurance, Taxes _____
Utilities _____
Other expenses _____
(include down payment, interests, etc., but not food or servants or entertainment)

3. Fair rental value of home, including furniture, utilities, and garage _____

B. Parsonage

Parsonage Provided

Fair Rental Value of Parsonage _____

Based on the above figures (either A or B), the amount of the minister's housing allowance excludible from income tax liability is _____.

The entire designated ministerial housing allowance is subject to self-employment tax unless the minister has "opted out" of Social Security or the minister is retired.



Attachment D

(TRS310)

Estimate of Accountable Reimbursement Expenses

NAME _____

YEAR _____

EMPLOYER _____

POSITION _____

(Please list only ministry related expenses)

- | | | |
|-----|--|----------|
| 1. | Car Miles _____ @ _____ cents | \$ _____ |
| 2. | Parking Fees and Tolls | \$ _____ |
| 3. | Meals and Entertainment | \$ _____ |
| 4. | Dues and Publications | \$ _____ |
| 5. | Office Expense | \$ _____ |
| 6. | Telephone Calls | \$ _____ |
| 7. | Business Gifts | \$ _____ |
| 8. | Depreciation on Equipment | \$ _____ |
| 9. | Conventions and Seminars | \$ _____ |
| 10. | Insurance on Professional Items | \$ _____ |
| 11. | Travel – Airline, Motels, Etc. | \$ _____ |
| 12. | Repairs to Equipment | \$ _____ |
| 13. | Audio and Video Cassettes | \$ _____ |
| 14. | Advertising – calling cards, ads, etc. | \$ _____ |
| 15. | Interest on Business Debts | \$ _____ |
| 16. | Other _____ | \$ _____ |

Estimated Total Yearly Business Expenses \$ _____

Allowance Amount per Month (1/12 of yearly total) \$ _____

I understand that all expenses, when submitted, must be substantiated as to the date, amount, and business purpose within 60 days after they are incurred and that any excess reimbursement must be refunded to the church within 120 days after expenses are paid or incurred.

Signature _____ Date _____

Adopted by the Board on _____



Attachment E

(TRS300)

Accountable Reimbursement Plan Ministry Related Expense Form

NAME _____

YEAR _____

POSITION _____

MONTH ENDING _____

(Please list only ministry related expenses)

- | | | |
|-----|--|----------|
| 1. | Car Miles _____ @ _____ cents | \$ _____ |
| 2. | Parking Fees and Tolls | \$ _____ |
| 3. | Meals and Entertainment | \$ _____ |
| 4. | Dues and Publications | \$ _____ |
| 5. | Office Expense | \$ _____ |
| 6. | Telephone Calls | \$ _____ |
| 7. | Business Gifts | \$ _____ |
| 8. | Depreciation on Equipment | \$ _____ |
| 9. | Conventions and Seminars | \$ _____ |
| 10. | Insurance on Professional Items | \$ _____ |
| 11. | Travel – Airline, Motels, Etc. | \$ _____ |
| 12. | Repairs to Equipment | \$ _____ |
| 13. | Audio and Video Cassettes | \$ _____ |
| 14. | Advertising – calling cards, ads, etc. | \$ _____ |
| 15. | Interest on Business Debts | \$ _____ |
| 16. | Other _____ | \$ _____ |

(Mileage log, receipts, etc. must be attached.)

Total Ministry related expense

For the month of _____ \$ _____

Signed by: _____ Date _____

I. Church Office Use Only

Reimbursed by: _____

Check #: _____

Date: _____



Attachment F

(TRS110)

Worksheet for Minister's Compensation

NAME OF CHURCH		PASTOR	Actual (Current Year)	DATE Proposed (Next Year)
I.	PASTOR'S MINIMUM COMPENSATION (See <i>Minutes</i> for Scale)		\$ _____	\$ _____
II.	PARSONAGE / HOUSING ALLOTMENT (Include additions to salary only - or fair rental value of parsonage)		\$ _____	\$ _____
III.	ACCOUNTABLE REIMBURSEMENTS (Include amounts that are designated for ministry-related expenses in addition to salary)		\$ _____	\$ _____
IV.	FRINGE BENEFITS			
	1. Retirement Plan Contributions		\$ _____	\$ _____
	2. Medical Insurance Assistance		\$ _____	\$ _____
	3. Social Security Reimbursement		\$ _____	\$ _____
	4. Other _____		\$ _____	\$ _____
	5. Other _____		\$ _____	\$ _____
V.	SUMMARY:			
	Total Compensation Package		\$ _____	\$ _____

TAXABLE COMPENSATION

Total Compensation		\$ _____	\$ _____
LESS: Housing Allowance (Minister must complete Estimate of Housing Allowance and a resolution must be adopted by church)		\$ _____	\$ _____
LESS: Accountable Reimbursements (Minister must complete Accountable Reimbursement Plan Expense Form and a resolution must be adopted by church)		\$ _____	\$ _____
LESS: Fringe Benefits (Exclude Social Security and Medical Insurance Assistance on a non-group plan)		\$ _____	\$ _____
Total Reportable Compensation		\$ _____	\$ _____
LESS: Retirement Plan Contributions (By Salary Reduction Agreement)		\$ _____	\$ _____
TAXABLE COMPENSATION (Reported in Box 1 on Form W-2)		\$ _____	\$ _____

(Revised 01/15)



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Attachment G

Sample Form W-4

W-4 Form (Rev. December 2020) Department of the Treasury Internal Revenue Service		Employee's Withholding Certificate		OMB No. 1545-0074
		Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay. ▶ Give Form W-4 to your employer. ▶ Your withholding is subject to review by the IRS.		2021
Step 1: Enter Personal Information	(a) First name and middle initial Phil B	Last name Pulpit		(b) Social security number
	Address 123 Broad Street			▶ Does your name match the name on your social security card? If not, to ensure you get credit for your earnings, contact SSA at 800-772-1213 or go to www.ssa.gov .
	City or town, state, and ZIP code Cleveland, TN 373212			
	(c) <input type="checkbox"/> Single or Married filing separately <input checked="" type="checkbox"/> Married filing jointly or Qualifying widow(er) <input type="checkbox"/> Head of household (Check only if you're unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)			
Complete Steps 2-4 ONLY if they apply to you; otherwise, skip to Step 5. See page 2 for more information on each step, who can claim exemption from withholding, when to use the estimator at www.irs.gov/W4App, and privacy.				
Step 2: Multiple Jobs or Spouse Works	Complete this step if you (1) hold more than one job at a time, or (2) are married filing jointly and your spouse also works. The correct amount of withholding depends on income earned from all of these jobs. Do only one of the following. (a) Use the estimator at www.irs.gov/W4App for most accurate withholding for this step (and Steps 3-4); or (b) Use the Multiple Jobs Worksheet on page 3 and enter the result in Step 4(c) below for roughly accurate withholding; or (c) If there are only two jobs total, you may check this box. Do the same on Form W-4 for the other job. This option is accurate for jobs with similar pay; otherwise, more tax than necessary may be withheld ▶ <input type="checkbox"/> TIP: To be accurate, submit a 2021 Form W-4 for all other jobs. If you (or your spouse) have self-employment income, including as an independent contractor, use the estimator.			
Complete Steps 3-4(b) on Form W-4 for only ONE of these jobs. Leave those steps blank for the other jobs. (Your withholding will be most accurate if you complete Steps 3-4(b) on the Form W-4 for the highest paying job.)				
Step 3: Claim Dependents	If your total income will be \$200,000 or less (\$400,000 or less if married filing jointly): Multiply the number of qualifying children under age 17 by \$2,000 ▶ \$ 4,000.00 Multiply the number of other dependents by \$500 ▶ \$ Add the amounts above and enter the total here 3 \$ 4,000.00			
Step 4 (optional): Other Adjustments	(a) Other income (not from jobs). If you want tax withheld for other income you expect this year that won't have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income			4(a) \$ 1,000.00
	(b) Deductions. If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use the Deductions Worksheet on page 3 and enter the result here			4(b) \$
	(c) Extra withholding. Enter any additional tax you want withheld each pay period			4(c) \$ 90.00
Step 5: Sign Here	Under penalties of perjury, I declare that this certificate, to the best of my knowledge and belief, is true, correct, and complete. Phil B. Pulpit ▶ Employee's signature (This form is not valid unless you sign it.) ▶ 01/01/2021 Date			
Employers Only	Employer's name and address Anytown Church of God 123 Praise Street Anytown, TN 45678	First date of employment 01/01/2021	Employer identification number (EIN) 98-7654321	

For Privacy Act and Paperwork Reduction Act Notice, see page 3.

Cat. No. 10220Q

Form **W-4** (2021)



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Attachment H

Sample Form W-2

22222		VOID <input type="checkbox"/>	a Employee's social security number 123-45-6789		For Official Use Only ▶ OMB No. 1545-0008	
b Employer identification number (EIN) 98-7654321			1 Wages, tips, other compensation 40000.00		2 Federal income tax withheld	
c Employer's name, address, and ZIP code Anytown Church of God 123 Praise Street Anytown, TN 45678			3 Social security wages		4 Social security tax withheld	
			5 Medicare wages and tips		6 Medicare tax withheld	
			7 Social security tips		8 Allocated tips	
			9		10 Dependent care benefits	
d Control number						
e Employee's first name and initial Phil B.		Last name Pulpit		Suff.		11 Nonqualified plans
123 Broad Street Cleveland, TN 37320						12a See instructions for box 12 E 6000.00
						13 Statutory employee <input type="checkbox"/> Retirement plan <input checked="" type="checkbox"/> Third-party sick pay <input type="checkbox"/>
						14 Other 12000.00 Minister's Housing Allowance
						12b
f Employee's address and ZIP code						
15 State Employer's state ID number		16 State wages, tips, etc.		17 State income tax		18 Local wages, tips, etc.
						19 Local income tax
						20 Locality name

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

2021

Department of the Treasury—Internal Revenue Service

Copy A—For Social Security Administration. Send this entire page with Form W-3 to the Social Security Administration; photocopies are not acceptable.

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 10134D

Do Not Cut, Fold, or Staple Forms on This Page



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Attachment I

Sample Form 1099-NEC

7171

☐ VOID

☐ CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. Anytown Church of God 123 Praise Street Anytown, TN 45678		OMB No. 1545-0116 2021 Form 1099-NEC		Nonemployee Compensation
PAYER'S TIN 98-7654321	RECIPIENT'S TIN 123-45-6789	1 Nonemployee compensation \$ 800.00		
RECIPIENT'S name Phil B. Pulpit		2 Payer made direct sales totaling \$5,000 or more of consumer products to recipient for resale <input type="checkbox"/>		Copy A For Internal Revenue Service Center File with Form 1096. <small>For Privacy Act and Paperwork Reduction Act Notice, see the 2021 General Instructions for Certain Information Returns.</small>
Street address (including apt. no.) 123 Broad Street		3		
City or town, state or province, country, and ZIP or foreign postal code Cleveland, TN 37320		4 Federal income tax withheld \$ 100.00		
Account number (see instructions)		5 State tax withheld \$	6 State/Payer's state no. \$	
2nd TIN not <input type="checkbox"/>		7 State income \$		

Form **1099-NEC**

Cat. No. 72590N

www.irs.gov/Form1099NEC

Department of the Treasury - Internal Revenue Service

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