

Clergy – Religious Workers

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Ministers

Ministers are individuals duly ordained, commissioned, or licensed by a church. "Church" is used generically and does not refer to any particular religion. Most ministers who receive compensation are treated as dual-status taxpayers—employees for income tax purposes but not for Social Security and Medicare tax. Many ministers also receive a parsonage allowance. See *Parsonage Allowance*, later.

Ministerial income. Total ministerial income includes church wages, gross self-employment income from ministerial service, and tax-exempt allowances.

Employee income and expenses. The minister receives Form W-2 from the church employer.

- The minister's wage income is reported in box 1, Form W-2.
- Social Security and Medicare taxes (FICA) are not withheld. The wages will be included in the minister's self-employment tax computation.
- Ministers are not subject to federal income tax withholding. A minister and employer may agree to voluntary withholding.
- Parsonage or housing allowances are reported in box 14, Form W-2.
- Employee expenses are allowed as itemized deductions on Schedule A, Form 1040, subject to the 2% AGI limitation, and prorated to the extent the minister has tax-exempt income from a parsonage allowance.

Self-employment income and expenses. Amounts received by a minister for performing marriages, baptisms, funerals, etc., are generally self-employment income, even if no Form 1099-MISC is received by the minister.

- Self-employment income is reported on Schedule C, *Profit or Loss from Business*, Form 1040.

- Self-employment expenses are deductible on Schedule C, prorated to the extent the minister has tax-exempt income from a parsonage allowance.

Expense reduction for tax-exempt income. A minister who receives tax-exempt income (such as a parsonage allowance) as part of compensation must reduce deductions for Schedule A employee expenses and Schedule C self-employment expenses as follows.

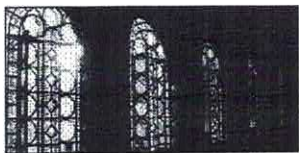
$$\frac{\text{Tax-exempt income}}{\text{Total ministerial income}} = \text{Reduction percentage}$$

Example: Patrick is a minister who receives a housing allowance of \$15,000. His total ministerial income including the housing allowance is \$60,000. Since the housing allowance is not subject to regular income tax, Patrick must reduce his allowable expenses for purposes of computing itemized deductions by 25% ($\$15,000 \div \$60,000 = 25\%$). Assume Patrick's ministerial expenses are \$4,000. For purposes of itemized deductions, Patrick can claim only \$3,000 ($\$4,000 \times 25\% = \$1,000$ reduction). Since Patrick's housing allowance is subject to self-employment tax, he can deduct the entire \$4,000.

Minister's self-employment tax. A minister reports income subject to self-employment tax on Schedule SE, *Self-Employment Tax*, Form 1040.

The following income is included as self-employment income on Schedule SE.

- Church wages from box 1, Form W-2, less associated employee expenses in full.
- Gross Schedule C income from ministerial services, less associated self-employment expenses in full.
- Entire amount of parsonage allowance, including utilities, whether received in the form of allowances or provided in-kind to the minister. If housing and utilities are provided, include the fair rental value of the home and cost of utilities.



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Do not include any of the following.

- Expense reduction due to tax exempt income.
- Housing and housing allowance, including utilities, provided to retired ministers.

Earned Income Credit. For purposes of the Earned Income Credit, a minister's earned income includes:

- Net earnings from self-employment from Schedule SE, including parsonage allowance (line 2, Section A or line 2, Section B), *minus*:
- The portion of SE tax deducted on line 27, Form 1040, *plus*
- Non-ministerial wages.

Parsonage Allowance

A church or congregation may provide for a minister's residence in the form of a parsonage or a housing allowance. The value of a parsonage, plus utilities, if paid by the church, and housing allowances are subject to self-employment tax but may generally be excluded from income tax.

Parsonage provided to a minister:

Income tax. The value of the home, including utilities, is excluded from income. The exclusion cannot be more than reasonable pay for the minister's services.

Self-employment tax. The fair rental value of the home, including the cost of utilities, is included in gross income when calculating self-employment tax.

Housing allowance paid to a minister:

Income tax. A minister can exclude from income the smallest of:

- 1) The amount officially designated by the employer as housing allowance. Amounts must be designated as housing allowance before payment is made.
- 2) The amount actually used to provide a home. Include amounts paid in the tax year for rent, mortgage payments, furnishings, appliances, repairs, utilities, and down payments. Do not include food, entertainment, servants, or home equity loan payments for items unrelated to the home. Mortgage interest and property tax used in this calculation are also allowed as itemized deductions on Schedule A, Form 1040.

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- 3) The fair rental value of the home, including furnishings, utilities, garage, etc.
- 4) The minister's reasonable pay.

Employers typically report housing allowances in box 14, Form W-2. Housing allowances are not included in taxable wages in box 1. If the excludable amount is less than the housing allowance, include the excess as income on line 7, Form 1040.

Self-employment tax. The entire housing allowance, including utilities, is included in gross income when calculating self-employment tax.

Retired Ministers

Income tax. Retired ministers can exclude from taxable income:

- The value of housing and utilities provided to them, or
- The part of a pension officially designated as housing allowance. The amount excluded is limited to actual expenses or fair rental value of the home. See (2) and (3) above.

Self-employment tax for retired ministers. Housing provided to retired ministers and housing allowances paid to retired ministers are not subject to SE tax.

Surviving spouses. A minister's surviving spouse cannot exclude a parsonage allowance from income unless it is received for ministerial services he or she performs or performed.

Court Case: The IRS appealed a Tax Court ruling permitting an ordained minister to use his parsonage allowance to provide both a principal and second home. The Circuit Court determined that Congress intended for the parsonage allowance exclusion to apply to only one home, reversing the Tax Court ruling. The parsonage allowance was excludable only to the extent used for the taxpayer's main home. (*Driscoll*, 135 T.C. 557 and *Driscoll*, 11th Cir., February 8, 2012)

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of \$5,000.