

Ministers' Tax Guide for 2018 Returns



2019

**TAX RETURN
PREPARATION
GUIDE**

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ACKNOWLEDGEMENTS

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This publication is intended to provide a timely, accurate, and authoritative discussion of tax reporting compliance and the impact of recent changes in the tax laws. It is not intended as a substitute for legal, accounting, or other professional advice. If legal, tax, or other expert assistance is required, the services of a competent professional should be sought. Although we believe this book provides accurate information, there may be changes resulting from IRS or judicial interpretations of the tax code, new tax regulations, or technical corrections that occurred after the printing of this edition that are not reflected in the text.



Welcome to the *2019 Tax Return Preparation Guide Ministers' Tax Guide for 2018 Returns*, written exclusively for pastors and other ministers by noted CPA and attorney Richard Hammar.

We are privileged as we begin this second century of service at GuideStone® to again provide this free guide.

We know that ministerial tax preparation can be complicated. While this book addresses the most commonly asked questions and most commonly used forms, you can find more extensive information on the IRS website, *IRS.gov*. For specific tax advice, you'll want to consult a tax professional who is familiar with the intricacies of ministerial taxes.

As we enter this new season advocating on behalf of pastors, ministers, churches, and ministries, this tax guide serves as a tangible reminder of our mission to honor the Lord by being a lifelong partner with our participants in enhancing their financial security. This resource is provided at no cost to our Southern Baptist and evangelical pastors and church workers. You can refer your colleagues to GuideStone.org/TaxGuide for copies of this booklet, in whole or in part, along with other helpful resources.

May the Lord richly bless you in the ministry you have received from Him!

Sincerely,

A handwritten signature in black ink, appearing to read "O.S. Hawkins". The signature is stylized with a large, looped initial "O" and a long horizontal stroke extending to the right.

O.S. Hawkins
President
GuideStone

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Special Supplement

CURRENT STATUS OF THE PARSONAGE AND HOUSING ALLOWANCE EXCLUSIONS

On November 22, 2013, U.S. District Court Judge Barbara Crabb of the District Court for the Western District of Wisconsin struck down the ministerial housing allowance as an unconstitutional preference for religion (*Freedom From Religion Foundation, Inc., v. Lew*, 983 F. Supp. 2d 1051 (W.D. Wis. 2013)). The ruling was in response to a lawsuit brought by the Freedom From Religion Foundation (FFRF) and two of its officers challenging the constitutionality of the housing allowance and the parsonage exclusion. The federal government, which defended the housing allowance since it is a federal statute, asked the court to dismiss the lawsuit on the ground that the plaintiffs lacked standing to pursue their claim in federal court.

“Standing” is a constitutional requirement of any plaintiff in a federal case and generally means that a plaintiff must have suffered some direct injury as a result of a challenged law. The Wisconsin court concluded that the plaintiffs had standing on the ground that they would have been denied a housing allowance exclusion had they claimed one on their tax return. The government appealed this ruling to a federal appeals court — the United States Court of Appeals for the Seventh Circuit in Chicago.

On November 13, 2014, the appeals court issued its ruling reversing the Wisconsin court’s decision (*Freedom From Religion Foundation, Inc., v. Lew*, 773 F.3d 815 (7th Cir. 2014)). It concluded that the plaintiffs lacked standing to pursue their challenge to the housing allowance. The plaintiffs had asserted that they had standing due to their “injury” of being denied a tax-free housing allowance should they claim one on their tax returns. But the appeals court refused to base standing on theoretical injury. It concluded: “Only a person that has been denied such a benefit can be deemed to have suffered cognizable injury. The plaintiffs here have never been denied the parsonage exemption because they have never requested it; therefore, they have suffered no injury.”

It suggested that this deficiency could be overcome if the FFRF’s officers filed tax returns claiming a housing allowance that was later rejected by the IRS in an audit: “The plaintiffs could have sought the exemption by excluding their housing allowances from their reported income on their tax returns and then petitioning the Tax Court if the IRS were to disallow the exclusion. Alternatively, they could have . . . paid income tax on their housing allowance, claimed refunds from the IRS, and then sued if the IRS rejected or failed to act upon their claims.”

The FFRF responded to the appeals court’s ruling by

designating a housing allowance for two of its officers. The officers reported their allowances as taxable income on their tax returns and thereafter filed amended tax returns seeking a refund of the income taxes paid on the amounts of their designated housing allowances. FFRF claims that in 2015 the IRS denied the refunds sought by its officers (one of whom had died and was represented by her executor).

Having endeavored to correct the standing problem, the FFRF renewed its legal challenge to the housing allowance in the U.S. District Court in Wisconsin, where the litigation began.

On October 6, 2017, Judge Crabb again ruled that the ministerial housing allowance is an unconstitutional preference for religion (*Gaylor v. Mnuchin*, (W.D. Wis. 2017)). Judge Crabb observed:

[The housing allowance] violates the establishment clause because it does not have a secular purpose or effect and because a reasonable observer would view the statute as an endorsement of religion.

The government promptly appealed this ruling to the United States Court of Appeals for the Seventh Circuit in Chicago. A ruling by the United States Court of Appeals for the Seventh Circuit ordinarily would apply only to ministers in that circuit, which includes the states of Illinois, Indiana, and Wisconsin. But Judge Crabb issued an injunction requiring the IRS to disallow the housing allowance on all tax returns filed by ministers. Judge Crabb delayed the effective date of the injunction for 180 days after a final ruling in the case. In effect, the ruling will become a national precedent if affirmed by the appellate court and U.S. Supreme Court, if applicable.

What should churches and clergy do now? Consider the following steps:

1. **Monitor developments.**
2. Many ministers will experience an immediate increase in income taxes. As a result, they should **be prepared to increase their quarterly estimated tax payments to reflect the increase in income taxes in order to avoid an underpayment penalty.** Note that there will be no effect on self-employment taxes (SECA), for which the housing allowance is not tax-exempt.
3. Many churches will want to increase ministers’ compensation to offset the adverse financial impact. Thousands of ministers have purchased a home and obtained a mortgage loan on the assumption that the housing allowance would continue to be available as it has for more than a half century. The sudden elimination of this tax benefit will immediately thrust many clergy into a dire financial

position with a mortgage loan based on a tax benefit that no longer is available. **Many church leaders will want to reduce the impact of such a predicament by increasing compensation. Such an increase could be phased out over a period of years to minimize the impact on the church.**

4. Ministers considering the purchase of a new home **should not base the amount and affordability of a home mortgage loan on the availability of a housing allowance exclusion** unless and until the courts conclusively uphold the constitutionality of the allowance.
5. **The fair rental value of church-provided parsonages remains a non-taxable benefit, for now.**

All references in this publication to line numbers on IRS forms are for the draft versions of the 2018 forms since the final forms had not been released by the IRS as of the date of publication.

HOW TO USE THIS GUIDE

This book contains the basic information you need to complete your 2018 federal income tax return. It gives special attention to several forms and schedules and the sections of each form most relevant to ministers. The companion resource — *Federal Reporting Requirements for Churches* — helps churches comply with their federal tax reporting requirements.

This guide is divided into the following sections:

- **Part 1: Introduction** — This section reviews tax highlights for 2018 and presents several preliminary questions you should consider before preparing your tax return.
- **Part 2: Special Rules for Ministers** — In this section, you learn whether or not you are a Minister for Tax Purposes, whether you are an employee or self-employed for both income tax and Social Security purposes, and how you pay your taxes.
- **Part 3: Step-by-Step Tax Return Preparation** — This section explains how to complete the most common tax forms and schedules for ministers.
- **Part 4: Comprehensive Examples and Sample Forms** — This section shows a sample tax return prepared for an active minister and spouse and for a retired minister and spouse.
- **Federal Reporting Requirements for Churches** — This resource provides assistance to churches (especially treasurers and bookkeepers) in filing federal tax forms.

TAX HIGHLIGHTS FOR 2018

1. The Tax Cuts and Jobs Act of 2017

On December 22, 2017, President Donald Trump signed into law the \$1.5 trillion, 500-page Tax Cuts and Jobs Act of 2017 (TCJA). In brief, the TCJA amends the *Internal Revenue Code* to reduce tax rates and modify credits and deductions for individuals and businesses.

With respect to individuals, the bill:

- Replaces the seven existing tax brackets (10%, 15%, 25%, 28%, 33%, 35%, and 39.6%) with seven new and lower brackets (10%, 12%, 22%, 24%, 32%, 35%, and 37%).
- Temporarily increases (through 2025) the basic standard deduction to \$24,000 for married individuals filing a joint return,

\$18,000 for head-of-household filers, and \$12,000 for all other individuals.

The significantly increased standard deduction will reduce the number of persons who are able to itemize deductions on *Schedule A (Form 1040)* from 30 percent to as few as 5 percent of all taxpayers. The result will be a significant decrease in the number of taxpayers who can claim a tax deduction for contributions they make to churches and other charities.

- Modifies section 529 plans to allow such plans to distribute **not more than \$10,000** in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a **public, private, or religious elementary or secondary school**. The new rules apply to distributions made after December 31, 2017. A section 529 plan (also known as a qualified tuition plan) is a plan operated by a state or educational institution with tax advantages and potential other incentives to make it easier to save for college and other post-secondary training for a designated beneficiary, such as a child or grandchild. The main tax advantage of a 529 plan is that earnings are not subject to federal tax and generally are not subject to state tax when used for the qualified education expenses of the designated beneficiary, such as tuition, fees, books, as well as room and board.
- Repeals both the moving expense deduction and the exclusion of employer reimbursements of moving expenses under an accountable arrangement — except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order. This provision is effective for taxable years 2018 through 2025.
- Reduces the penalty amount of the Affordable Care Act's (ACA's) individual mandate to zero. Under the ACA, individuals must be covered by a health plan that provides at least minimum essential coverage or be subject to a penalty for failure to do so (commonly referred to as the individual mandate). For 2018, the penalty could be up to \$2,085 for a family or \$695 for an individual. The TCJA reduces the penalty amount of the ACA's individual mandate to zero with respect to health coverage status for months beginning after December 31, 2018.
- Removes the deductions for personal exemptions for taxable years 2018 through 2025. Under prior law, in determining taxable income, an individual reduced adjusted gross income (AGI) by any personal exemption deductions and either the applicable standard deduction or itemized deductions. Personal exemptions generally were allowed for the taxpayer, the taxpayer's spouse, and any dependents.

- Eliminates the deductions for miscellaneous itemized deductions. Under prior law, individuals could claim itemized deductions for certain miscellaneous expenses. Certain of these expenses were not deductible unless, in aggregate, they exceeded 2 percent of the taxpayer's AGI. The deductions described below were subject to the aggregate 2 percent floor:

- Appraisal fees for a casualty loss or charitable contribution
- Casualty and theft losses from property used in performing services as an employee
- Clerical help and office rent in caring for investments
- Hobby expenses, but generally not more than hobby income
- Investment fees and expenses
- Safe deposit box rental fees, except for storing jewelry and other personal effects
- Trustee's fees for an Individual Retirement Account (IRA), if separately billed and paid
- Tax preparation expenses
- Job search expenses in the taxpayer's present occupation
- Licenses and regulatory fees
- Passport fees for a business trip
- Tools and supplies used in the taxpayer's work
- Unreimbursed employee business expenses (see below). Unreimbursed employee business expenses subject to the 2 percent AGI floor include such items as:
 - Overnight out-of-town travel
 - Local transportation
 - Meals (subject to a 50 percent AGI floor)
 - Entertainment (subject to a 50 percent AGI floor)
 - Home office expenses
 - Business gifts
 - Dues to professional societies
 - Work-related education
 - Work clothes and uniforms if required and not suitable for everyday use
 - Malpractice insurance
 - Subscriptions to professional journals and trade magazines related to the taxpayer's work
 - Equipment and supplies used in the taxpayer's work

Key Point: The IRS announced late in 2017 that for the upcoming 2018 filing season it will not accept electronically filed tax returns if the taxpayer does not

address the health coverage requirements of the Act. The IRS will not accept the electronic tax return until the taxpayer indicates whether they had coverage, had an exemption, or will make a shared responsibility payment. Returns filed on paper that do not address the health coverage requirements may be suspended pending the receipt of additional information, and any refunds may be delayed.

2. Other Tax Changes of Interest to Churches and Church Staff

There were several tax developments in 2018 that will affect tax reporting by both ministers and churches for 2018 and future years. Here is a rundown of some of the key provisions:

- You may be able to claim the earned income credit (EIC) for 2018 if (1) you do not have a qualifying child and you earned less than \$15,270 (\$20,950 if married filing jointly); (2) a qualifying child lived with you and you earned less than \$40,320 (\$46,010 if married filing jointly); (3) two qualifying children lived with you and you earned less than \$45,802 (\$51,492 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than \$49,194 (\$54,884 if married filing jointly). The maximum EIC for 2018 is (1) \$519 with no qualifying child; (2) \$3,461 with one qualifying child; (3) \$5,716 with two qualifying children; and (4) \$6,431 with three or more qualifying children.
- For contributions in 2018 to a Traditional IRA, the deduction phaseout range for an individual covered by a retirement plan at work begins at income of \$101,000 for joint filers and \$63,000 for a single person or head of household. These are 2018 amounts that increase to \$103,000 for joint filers and \$64,000 for a single person or head of household for 2019.
- The dollar limit on annual elective deferrals an individual may make to a 403(b) retirement plan is \$18,500 for 2018. It increases to \$19,000 for 2019.
- The catch-up contribution limit on elective deferrals to a 403(b) retirement plan for individuals who had attained age 50 by the end of the year was \$6,000 for 2018. It remains at \$6,000 for 2019.
- The IRS has announced that it will not issue private letter rulings addressing the question of "whether an individual is a minister of the gospel for federal tax purposes." This means taxpayers will not be able to obtain clarification from the IRS in a letter ruling on their status as a minister for any one or more of the following matters: (1) eligibility for a parsonage exclusion or housing allowance; (2) eligibility for exemption from SECA; (3) self-employed status

for Social Security; or (4) exemption of wages from income tax withholding. The IRS also has announced that it will not address “whether amounts distributed to a retired minister from a pension or annuity plan should be excludible from the minister’s gross income as a parsonage allowance.”

- The standard business mileage rate was 54.5 cents per mile for business miles driven during 2018. The standard business mileage rate for 2019 is 58 cents per mile.
- Recent tax law changes will result in lower taxes and lower estimated tax payments for many taxpayers. Be sure your estimated tax calculations or withholdings take into account the most recent tax law changes.
- Many churches employ retired persons receiving Social Security benefits. Persons younger than full retirement age may have their Social Security retirement benefits cut if they earn more than a specified amount. Full retirement age (the age at which you are entitled to full retirement benefits) for persons born in 1943–1954 is 66 years. If you are under full retirement age for the entire year, \$1 is deducted from your benefit payments for every \$2 you earn above the annual limit. For 2019 that limit is \$17,640. In the year you reach full retirement age, your monthly benefit payments are reduced by \$1 for every \$3 you earn above a different limit. For 2019 that limit is \$46,920 (\$3,910 per month), but only earnings before the month you reach full retirement age are counted.
- Will Congress give ministers another opportunity to revoke an exemption from Social Security? It does not look likely, at least for now. No legislation is pending that would provide ministers with this option.
- The housing allowance is being challenged in federal court as an unconstitutional preference for religion. This development is addressed fully at the beginning of this text.
- A provision in the comprehensive tax reform legislation enacted by Congress in 2017 (TCJA) imposes a tax (the unrelated business income tax) of 21 percent on expenses associated with benefits provided to employees through a qualified transportation fringe benefit program as defined by IRC section 132(f). These benefits include employer-provided parking, mass transit passes and commuter vans. Churches providing these benefits must file *Form 990-T* to report the costs and the related tax. The provision of parking to employees may come through payment of parking fees for employees or by provision of parking on the church’s premises. While there has been much debate over the application of the new law to on-site employer-provided parking, the current consensus is that the new tax applies to employers whose on-site parking provided to employees has value because parking in the area is provided only on

a paid basis. The protest from nonprofit organizations, including churches, has been great during 2018. Petitions have been submitted to Congress requesting repeal of the provision, and several bills have been introduced to repeal the provision. However, until Congress or the IRS provides relief, churches should prepare to comply with the new law by reporting expenses associated with qualified transportation fringe benefits on *Form 990-T* and paying the unrelated business income tax (21 percent) on this income. Future developments will be reported on *ChurchLawandTax.com*.

PRELIMINARY QUESTIONS

Below are several questions you should consider before preparing your 2018 federal tax return.

Q. Must ministers pay federal income taxes?

- A. Yes. Ministers are not exempt from paying federal income taxes.

Q. How much income must I earn to be required to file a tax return?

- A. Generally, ministers are required to file a federal income tax return if they have earnings of \$400 or more to report their SECA. Different rules apply to ministers who are exempt from SECA.

Q. Can I use the simpler Form 1040A or 1040EZ rather than the standard Form 1040?

- A. All taxpayers use the newly redesigned Form 1040 for 2018 and future years. Forms 1040A and 1040EZ no longer will be used.

Q. What records should I keep?

- A. You should keep all receipts, canceled checks, and other evidence to prove amounts you claim as deductions, exclusions, or credits.

Q. What is the deadline for filing my federal income tax return?

- A. The instructions to Form 1040 state that the deadline for filing Form 1040 for the 2018 tax year is April 15, 2019. If you live in Maine or Massachusetts, you have until April 17, 2019, because of the Patriots' Day (April 15, 2019) and Emancipation Day (April 16, 2019) holidays.

Q. What if I am unable to file my tax return by the deadline?

- A. You can obtain an automatic 6-month extension (from April 15 to October 15, 2019) to file your 2018 Form 1040 if you file Form 4868 by April 15, 2019, with the IRS service center for your area. Your Form 1040 can be filed at any time during the 6-month extension period. **An extension relieves you from only the obligation to file your return; it is not an extension of the obligation to pay your taxes.** You must make an estimate of your tax for 2018 and pay the estimated tax with your Form 4868.

Q. Should I prepare my own tax return?

- A. The answer depends on your ability and experience in working with financial information and in preparing tax returns. Keep in mind: Ministers' taxes present a number of unique rules, but these rules are not complex. Many ministers will be able to prepare their own tax returns if they understand the unique rules that apply. These rules are summarized in this document. Easily accessible tax

software will also accommodate the unique rules applicable to ministers, but it does not relieve a minister from understanding the rules in order to accurately utilize the software. On the other hand, if you experienced unusual events in 2018, such as the sale or purchase of a home or the sale of other capital assets, it may be prudent to obtain professional tax assistance. The IRS provides a service called Taxpayer Assistance, but it is not liable in any way if its agents provide you with incorrect answers to your questions. Free taxpayer publications are available from the IRS, and many of these are helpful to ministers.

► **Recommendation:** If you need professional assistance, here are some tips that may help you find a competent tax professional:

- Ask other ministers in your community for their recommendations.
- If possible, use a CPA who specializes in tax law and who is familiar with the rules that apply to ministers. A CPA has completed a rigorous educational program and is subject to strict ethical requirements. However, the tax law is broad and complicated, so it should not be assumed that all CPAs are familiar with the unique rules applicable to ministers.
- Ask local tax professionals if they work with ministers and, if so, with how many.
- Ask local tax professionals a few questions to test their familiarity with ministers' tax issues. For example, ask whether ministers are employees or self-employed for Social Security. Anyone familiar with ministers' taxes will know that ministers are self-employed for Social Security with respect to their ministerial duties. Or, ask a tax professional if a minister's church salary is subject to income tax withholding. The answer is no, and anyone familiar with ministers' taxes should be able to answer this question.

WHO IS A MINISTER FOR FEDERAL TAX PURPOSES?

Key Point: The IRS has its own criteria for determining who is a Minister for Tax Purposes. The criteria the IRS uses to determine who is a minister are not necessarily the same as those used by churches and denominations. Whether or not one qualifies as a Minister for Tax Purposes is a very important question, since special tax and reporting rules apply to ministers under federal tax law. These rules include:

- Eligibility for housing allowances
- Self-employed status for Social Security
- Exemption of wages from income tax withholding (ministers use the quarterly estimated tax procedure to pay their taxes, unless they elect voluntary withholding)
- Eligibility under very limited circumstances to exempt themselves from SECA

These special rules apply only to persons qualifying as a minister and with respect to compensation received in the exercise of ministry.

Example: Pastor J is an ordained minister employed by a church. In addition, he works a second job for a secular employer. Assume that Pastor J qualifies as a minister for federal tax purposes. Since his church duties constitute services performed in the exercise of his ministry, the church can designate a portion of his compensation as a housing allowance. However, the secular employer cannot designate any portion of Pastor J's compensation as a housing allowance, since this work would not be the exercise of ministry.

According to the IRS, ministers are individuals duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination. They are given the authority to conduct religious worship, perform sacerdotal functions, and administer ordinances or sacraments according to the tenets and practices of that church or denomination. If a church or denomination ordains some ministers and licenses or commissions others, anyone licensed or commissioned must be able to perform substantially all the religious functions of an ordained minister to be treated as a Minister for Tax Purposes. See IRS *Publication 517*.

ARE MINISTERS EMPLOYEES OR SELF-EMPLOYED FOR FEDERAL TAX PURPOSES?

Key Point: Most ministers are employees for federal income tax purposes under the tests currently used by the IRS and the courts and should receive a *Form W-2* from their church reporting their taxable income. However, ministers are self-employed for Social Security (with respect to services they perform in the exercise of their ministry).

Ministers have a **dual** tax status. For federal income taxes they ordinarily are employees, but for Social Security they are self-employed with regard to services performed in the exercise of their ministry. These two rules are summarized below:

Income taxes. For federal income tax reporting, most ministers are employees under the tests currently used by the IRS. This means that they should receive a *Form W-2* from their church at the end of each year (rather than a *Form 1099*). Formerly, it meant that they reported their employee business expenses on *Schedule A* rather than on *Schedule C*. (The deduction for employee business expenses as Miscellaneous Itemized Deductions on *Schedule A* is suspended through 2025, so employee business expenses are not deductible at this time.) A few ministers are self-employed, such as some traveling evangelists and some interim pastors. Also, many ministers who are employees of a local church are self-employed for other purposes. For example, the minister of a local church almost always will be an employee but will be self-employed with regard to guest speaking appearances in other churches and services performed directly for individual members (such as weddings and funerals).

Example: Pastor B is a minister at First Baptist Church. He is an employee for federal income tax reporting purposes with respect to his church salary. However, he is self-employed with respect to honoraria he receives for speaking in other churches and for compensation church members give him for performing personal services such as weddings and funerals. The church issues Pastor B a *Form W-2* reporting his church salary. Pastor B reports this amount as wages on line 1 of *Form 1040*. He reports his compensation and expenses from the outside self-employment activities on *Schedule C*.

Key Point: Most ministers will be better off financially being treated as employees, since the value of various

fringe benefits will be tax-free, the risk of an IRS audit is substantially lower, and reporting as an employee avoids the additional taxes and penalties that often apply to self-employed ministers audited by the IRS and reclassified as employees.

Key Point: Ministers and other church staff members should carefully review their *Form W-2* to be sure it does not report more income than was actually received or fails to report taxable benefits provided by the church. If an error was made, the church should issue a corrected tax form (*Form W-2c*).

The Tax Court test. The United States Tax Court has created a seven-factor test for determining whether a minister is an employee or self-employed for federal income tax reporting purposes. The test requires consideration of the following seven factors: (1) the degree of control exercised by the employer over the details of the work; (2) which party invests in the facilities used in the work; (3) the opportunity of the individual for profit or loss; (4) whether or not the employer has the right to discharge the individual; (5) whether the work is part of the employer's regular business; (6) the permanency of the relationship; and (7) the relationship the parties believe they are creating. Most ministers will be employees under this test.

Social Security. The tax code treats ministers as self-employed for Social Security with respect to services performed in the exercise of their ministry — even if they report their income taxes as an employee. This means that ministers must pay SECA unless they have filed a timely exemption application (*Form 4361*) that has been approved by the IRS. As noted below, few ministers qualify for this exemption.

Key Point: While most ministers are employees for federal income tax reporting purposes, they are self-employed for Social Security with respect to services they perform in the exercise of their ministry. This means that ministers are not subject to the employee's share of Social Security and Medicare taxes (FICA), even though they report their income taxes as employees and receive a *Form W-2* from their church. Rather, they pay SECA.

EXEMPTION FROM SECA

If ministers meet several requirements, they may exempt themselves from SECA with respect to their ministerial earnings. Among other things, the exemption application (*Form 4361*) must be submitted to the IRS within a limited time period. The deadline is the due date of the federal tax return for the second year in which a minister has net earnings from

self-employment of \$400 or more, any part of which comes from ministerial services. Further, the exemption is available only to ministers opposed on the basis of religious considerations to the acceptance of benefits under the Social Security program (or any other public insurance system that provides retirement or medical benefits). A minister who files the exemption application may still purchase life insurance or participate in retirement programs administered by non-governmental institutions (such as a life insurance company). Additionally, the exemption does not require a minister to revoke all rights to Social Security benefits earned through their participation in the system through secular employment.

A minister's opposition must be to accepting benefits under Social Security (or any other public insurance program) that are related to services performed as a minister. Economic or any other non-religious considerations are not a valid basis for the exemption; neither is opposition to paying SECA.

The exemption is effective only when it is approved by the IRS. Few ministers qualify for the exemption. Many younger ministers opt out of Social Security without realizing that they do not qualify for the exemption. A decision to opt out of Social Security is irrevocable. Congress did provide ministers with a brief window of time to revoke an exemption by filing *Form 2031* with the IRS. This opportunity expired in 2002 and has not been renewed.

An exemption from SECA applies only to compensation for ministerial services. Ministers who have exempted themselves from SECA must pay Social Security taxes on any non-ministerial compensation they receive. And, they remain eligible for Social Security benefits based on their non-ministerial employment, assuming that they have worked enough quarters. Generally, 40 quarters (10 years) are required. Also, the Social Security Administration (SSA) has informed the author of this text that ministers who exempt themselves from SECA may qualify for Social Security benefits (including retirement and Medicare) on the basis of their spouse's coverage if the spouse had enough credits. However, the amount of these benefits will be reduced by the so-called windfall elimination provision. Contact an SSA office for details.

Key Point: The amount of earnings required for a quarter of coverage in 2019 is \$1,360. A quarter of coverage is the basic unit for determining whether a worker is insured under the Social Security program.

Key Point: Ministers who work after they retire must continue to pay Social Security taxes on their ministerial income and wages (unless they exempted themselves from Social Security as a minister and they are employed in a ministerial capacity).

☞ **Key Point:** In 1970, the IRS ruled that ministers who exempt themselves from SECA solely on the basis of economic considerations are not legally exempt (Revenue Ruling 70-197). The IRS concluded: “The taxpayer filed the *Form 4361* solely for economic considerations and not because he was conscientiously opposed to, or because of religious principles opposed to, the acceptance of any public insurance of the type described on the form. Accordingly . . . the taxpayer did not qualify for the exemption since the *Form 4361* filed solely for economic reasons is a nullity.” Ministers wanting to revoke an exemption from SECA should discuss this ruling with a tax professional.

HOW DO MINISTERS PAY THEIR TAXES?

☞ **Key Point:** Ministers must prepay their income taxes and SECA using the estimated tax procedure, unless they have entered into a voluntary withholding arrangement with their church with respect to federal income tax only.

As noted above, ministers’ wages are exempt from federal income tax withholding. This means that a church does not have to withhold income taxes from a minister’s paycheck. And, since ministers are self-employed for Social Security with respect to their ministerial services, a church does not withhold the employee’s share of FICA from a minister’s wages. Ministers must prepay their income taxes and SECA using the estimated tax procedure, unless they enter into a voluntary withholding arrangement with their church. Estimated taxes must be paid in quarterly installments. If your estimated taxes paid for the current year are less than your actual taxes, you may have to pay an underpayment penalty. You can amend your estimated tax payments during the year if your circumstances change. For example, if your income or deductions increase unexpectedly, you should refigure your estimated tax liability for the year and amend your remaining quarterly payments accordingly or submit additional payments.

You will need to make estimated tax payments for 2019 if you expect to owe at least \$1,000 in tax for 2019 after subtracting your withholding and credits and if you expect your withholding and credits to be less than the smaller of (1) 90 percent of the tax to be shown on your 2019 tax return or (2) 100 percent of the tax shown on your 2018 tax return (110 percent if AGI exceeds \$150,000 or, if married filing separately, more than \$75,000). Your 2018 tax return must cover all 12 months.

The four-step procedure for reporting and prepaying estimated taxes for 2019 is summarized below.

Step 1. Estimated tax payments may be paid using either of the following methods:

- Obtain a copy of IRS *Form 1040-ES* for 2019 before April 15, 2019. You can obtain forms by calling the IRS toll-free forms hotline at **1-800-TAX-FORM** (1-800-829-3676) or from the IRS website (*IRS.gov*). If you paid estimated taxes last year, you should receive a copy of your 2019 *Form 1040-ES* in the mail with payment vouchers preprinted with your name, address, and Social Security number.
- Enroll in the Electronic Federal Tax Payment System (EFTPS) at *EFTPS.gov* and establish an online account to submit payments.

Step 2. Compute your estimated tax for 2019 using the *Form 1040-ES* worksheet. Ministers’ quarterly estimated tax payments should take into account both income taxes and SECA.

Step 3. Pay one-fourth of your total estimated taxes for 2019 in each of four quarterly installments as follows:

For the Period	Due Date
January 1–March 31	April 15, 2019
April 1–May 31	June 17, 2019
June 1–August 31	September 16, 2019
September 1–December 31	January 15, 2020

You must send each payment to the IRS, accompanied by one of the four payment vouchers contained in *Form 1040-ES*. If enrolled in the EFTPS system, all four payments may be pre-scheduled for automatic payment at the scheduled dates.

Step 4. After the close of 2018, compute your actual tax liability on *Form 1040*. Only then will you know your actual income, deductions, exclusions, and credits. If you overpaid your estimated taxes (that is, actual taxes computed on *Form 1040* are less than all of your estimated tax payments plus any withholding), you can elect to have the overpayment credited against your first 2019 quarterly estimated tax payment or spread it out in any way you choose among any or all of your next four quarterly installments. Alternatively, you can request a refund of the overpayment. If you underpaid your estimated taxes (that is, your actual tax liability exceeds the total of your estimated tax payments plus any withholding), you may have to pay a penalty.

☞ **Key Point:** Ministers who report their income taxes as employees can request that their employing church **voluntarily** withhold income taxes from their wages. Simply furnish the church with a completed *Form W-4 Employee’s Withholding Allowance Certificate* or other written authorization. Since ministers are not employees

for Social Security with respect to ministerial compensation, the church does not withhold the employee's share of FICA. However, ministers can request on *Form W-4* (line 6) that an additional amount of income tax be withheld to cover their estimated SECA liability for the year. The excess income tax withheld is a credit that is applied against the minister's SECA liability. Many churches understandably withhold FICA taxes in addition to income taxes for a minister who requests voluntary withholding. Such withholding must be reported as income tax withheld.

TAX FORMS AND SCHEDULES

This step-by-step analysis covers these forms and schedules:

Form 1040 is the basic document you will use. It summarizes all of your tax information. Details are reported on supplementary schedules and forms. Note that the IRS has unveiled a new and redesigned *Form 1040* that reflects the many tax law changes made by the TCJA. The new *Form 1040* — about half the size of the current version — replaces the current *Form 1040* as well as the *Form 1040A* and the *Form 1040EZ*. The new *Form 1040* is different from its predecessors in several ways, including the following:

1. It is half the size of the previous *Form 1040* and consists of two half-pages.
2. Health care coverage (mandatory through 2018) is reported by checking a box on page 1 (it was reported on line 61 on the 2017 form).
3. All personal exemptions were repealed after 2017, and so there is no way to claim them on the 2018 *Form 1040*.
4. Some lines have been consolidated. For example, several items of income, capital gains, rental income, etc., are consolidated now from *Schedule 1* and reported on line 6.
5. Wages are now reported on line 1 (instead of line 7 as in past years).
6. AGI is reported on line 7 and without detail on the form (instead of line 37 as in past years).
7. The standard deduction is reported on line 8 and is significantly larger than in 2017 (\$12,000 for unmarried persons and \$24,000 for married persons filing jointly).
8. Several credits are now reported on *Schedule 3* and consolidated on line 12b (they were reported on separate lines in 2017).
9. Many lines in the previous *Form 1040* have been deleted and transferred to various schedules. In fact, the 79 lines on the 2017 *Form 1040* have been reduced to 23, a reduction of more than 50 lines. For example:
 - Business income is reported on *Schedule C* as in prior years but is then posted to *Schedule 1 (Form 1040)* rather than line 12 as in prior years.
 - Adjustments to income, reported on lines 23–36 of the 2017 *Form 1040*, are now reported on lines 23–36 of *Schedule 1 (Form 1040)*.
 - *Schedule 2 (Form 1040)* lists taxes that were reported on lines 45–47 in the 2017 *Form 1040*.
 - *Schedule 3 (Form 1040)* lists “non-refundable credits”,

including credits for child and dependent care expenses and education credits, that were reported on lines 48–55 in the 2017 *Form 1040*.

- *Schedule 4 (Form 1040)* lists “other taxes”, including SECA, that were reported on lines 57–63 in the 2017 *Form 1040*.
 - *Schedule 5 (Form 1040)* lists “other payments”, including SECA, that were reported on lines 65–73 in the 2017 *Form 1040*.
-  **Key Point:** Some references in this guide are to lines in the new *Form 1040*, but others refer to lines in the new schedules. Be sure you distinguish between these terms to avoid confusion.

 **Caution:** The IRS has announced that there may be additional changes to the 2018 *Form 1040* before it is finalized.

Schedule A is for itemized deductions for medical and dental expenses, taxes, interest, certain disaster-related casualty losses, and charitable contributions.

- ✓ **New in 2018:** Beginning with tax year 2018, no miscellaneous itemized deductions that formerly were subject to a 2 percent of AGI limitation are allowed. This and other changes to *Schedule A* are addressed later in this guide.

Schedule B is for reporting dividend and interest income.

Schedule C is for reporting your income and expenses from business activities you conduct other than in your capacity as an employee. Examples would be fees received for guest speaking appearances in other churches or fees received directly from members for performing personal services, such as weddings and funerals.

Schedule SE is for reporting SECA due on your self-employment income. Ministers use this schedule since they are deemed self-employed for Social Security with respect to ministerial services (unless they have obtained an approved *Form 4361* from the IRS).

These forms and schedules, along with others, are included in the illustrated example in Part 4 of this guide. These forms and schedules are the ones most commonly used by ministers, but you may have a need for others. These forms may be obtained at certain local post offices or an IRS office. Or, you can obtain them by calling the **IRS toll-free forms hotline at 1-800-TAX-FORM (1-800-829-3676)**. They also are available on the IRS website (*IRS.gov*).

Form 1040

Step 1: Filing Status

Select the appropriate filing status from the five options listed in this section of the *Form 1040*.

In 2015, the United States Supreme Court ruled that the right of same-sex couples to marry is part of the Fourteenth Amendment's guarantees of due process and equal protection of the laws, and therefore any state law that in any way limits this right is unconstitutional and void (*Obergefell v. Hodges*, 135 S. Ct. 2584 (2015)). The effect of the Supreme Court's decision was to invalidate laws and constitutional provisions in 13 states defining marriage solely as a union between one man and one woman and to treat same-sex marriages the same as opposite-sex marriages for purposes of federal tax law.

Step 2: Name and Address

Print or type the information in the spaces provided. If you are married filing a separate return, enter your spouse's name and Social Security number on the appropriate line(s) below your name. If you filed a joint return for 2017 and you are filing a joint return for 2018 with the same spouse, be sure to enter your names and Social Security numbers in the same order as on your 2017 return.

If you plan to move after filing your return, use *Form 8822* to notify the IRS of your new address.

If you (or your spouse) changed your name because of marriage, divorce, etc., be sure to report the change to the SSA before filing your return. This prevents delays in processing your return and issuing refunds. It also safeguards your future Social Security benefits. If a name change with the SSA has not been completed, the name on file with the SSA must be used in filing your tax return.

Enter your P.O. Box number only if your post office does not deliver mail to your home.

If you want \$3 to go to the presidential election campaign fund, check the box labeled "you". If you are filing a joint return, your spouse can also have \$3 go to the fund (check "spouse"). If you check a box, your tax or refund will not change.

Step 3: Dependents

In the past, taxpayers were allowed a personal exemption for themselves and certain dependents. All personal exemptions were repealed after 2017, and so they cannot be claimed on the 2018 *Form 1040*. However, it is still necessary to determine who qualifies as dependents and include them on the return. Dependents determine various credits, such as the child tax credit,

as well as other tax-related items such as educational credits, medical expenses, child care credit, and EIC, just to name a few.

Step 4: Income

Several items of income are reported on lines 1 through 6 (including amounts carried over from *Schedule 1* lines 10–22). The most important of these (for ministers) are discussed below.

Key Point: Some items, such as the housing allowance, are not reported as income. They are called exclusions and are explained below.

Line 1. Wages, salaries, tips, etc.

As an employee, you should receive a *Form W-2* from your church reporting your wages at the end of each year. Report this amount on line 1.

Determining church wages or salary. Besides a salary, ministers' wages reported on *Form W-2* may include several other items. Some items are:

- Bonuses
- The cost of sending a minister to the Holy Land (if paid by a church)
- Most Christmas and special occasion offerings
- Retirement gifts paid by a church
- The portion of a minister's SECA paid by a church
- Personal use of a church-owned vehicle
- Purchases of church property for less than fair market value
- Business expense reimbursements under a non-accountable plan
- Imputed cost of group term life insurance coverage (including death benefits under the benefits plan) exceeding \$50,000 and cost of coverage of spouse and dependents if over \$2,000 and paid by a church
- Church reimbursements of a spouse's travel expenses incurred while accompanying a minister on a business trip (unless the spouse's presence serves a legitimate business purpose and the spouse's expenses are reimbursed under an accountable arrangement)
- Discretionary funds established by a church for a minister to spend on current needs — if the minister is allowed to distribute funds for his personal benefit
- Imputed interest from below-market interest loans of at least \$10,000 made by a church to a minister (some exceptions apply)
- Cancellation of a minister's debt to a church
- Severance pay
- Payment of a minister's personal expenses by a church
- Love gifts

☞ **Key Point:** The IRS can assess intermediate sanctions in the form of substantial excise taxes against a minister who is a “disqualified person” (meaning an officer, director, or other control party as well as relatives of such persons) and in some cases against church board members who authorize excess benefit transactions. Excess benefit transactions may occur if a church pays a minister an excessive salary, makes a large retirement or other special occasion gift to a minister, gives church property (such as a parsonage) to the minister, or sells church property to the minister at an unreasonably low price. A rebuttable presumption arises that compensation is reasonable if it is approved by an independent board on the basis of outside comparable data such as independent compensation surveys and the basis for the board’s decision is documented.

☞ **Key Point:** The IRS has ruled that disqualified persons receive automatic excess benefits resulting in intermediate sanctions, regardless of amount, if they use church assets (vehicles, homes, credit cards, computers, etc.) for personal purposes or receive non-accountable expense reimbursements (not supported by adequate documentation of business purpose), unless such benefits are reported as taxable income by the church on the disqualified person’s *Form W-2*, or by the disqualified person on his or her *Form 1040*, for the year in which the benefits are provided. The concept of automatic excess benefits directly affects the compensation practices of most churches and exposes some ministers and church board members to intermediate sanctions.

If some of these items were not reported on your *Form W-2*, they still must be reported as income. Your church should issue a corrected *Form W-2 (Form W-2c)* for the year in which one or more items of taxable income was not reported on your *Form W-2*. If you receive a *Form W-2c* and have filed an income tax return for the year shown, you may have to file an amended return. Compare amounts on *Form W-2c* with those reported on your income tax return. If the corrected amounts change your U.S. income tax, file *Form 1040X Amended U.S. Individual Income Tax Return* with *Copy B* of *Form W-2c* to amend the return you previously filed.

In addition to what is reported on *Form W-2* (or *Form W-2c*), line 1 of *Form 1040* will also report the amount of excess housing allowance calculated (the amount by which the housing allowance exceeds the lesser of the minister’s housing expenses or the fair rental value of the minister’s home (furnished, plus utilities)).

Items not reported on line 1. Some kinds of income are not taxable. These items are called **exclusions**. Most exclusions apply in computing both income taxes and SECA. The housing

allowance is an example of an exclusion that applies only to income taxes and not to SECA. Some of the more common exclusions for ministers include:

Gifts. Gifts, as defined by the *Internal Revenue Code* and the courts, are excludable from taxable income so long as they are not compensation for services. However, employers are not permitted to give tax-free gifts to employees. Likewise, the IRS and the courts have ruled that gifts ministers receive directly from members of their congregations may not always be excluded from taxable income. Before excluding gifts from taxable income, the minister should consult with a CPA or a tax attorney.

Life insurance and inheritances. Life insurance proceeds and inheritances are excludable from taxable income. Income earned before distributions of proceeds is generally taxable as income.

Employer-provided group term life insurance. Employees may exclude the cost of employer-provided group term life insurance so long as the amount of coverage does not exceed \$50,000.

Tuition reductions. School employees may exclude from their taxable income a qualified tuition reduction provided by their employer. A qualified tuition reduction is a reduction in tuition charged to employees or their spouses or dependent children by an employer that is an educational institution.

Lodging. The value of lodging furnished to a minister, i.e., a parsonage, is excluded from income. This exclusion is not available in the computation of SECA. The value of lodging furnished to a non-minister employee on an employer’s premises and for the employer’s convenience may be excludable from taxable income if the employee is required to accept the lodging as a condition of employment.

Educational assistance. Amounts paid by an employer for an employee’s tuition, fees, and books may be excludable from the employee’s taxable income if the church has adopted a written educational assistance plan. The exclusion may not exceed \$5,250 per year.

Employer-provided childcare. The value of free childcare services provided by a church to its employees is excluded from employees’ income so long as the benefit is based on a written plan that does not discriminate in favor of highly compensated employees. Other conditions apply.

Nondiscrimination rules. Many of the exclusions are not available to employees who are either highly compensated employees or key employees if the same benefit is not available on a nondiscriminatory basis to lower-paid employees.

For 2019, a highly compensated employee is an employee whose compensation for the previous year was in excess of \$125,000.

☞ **Key Point:** Some exclusions are available only to taxpayers who report their income taxes as employees and not as self-employed persons. Many, however, apply to both employees and self-employed persons.

Four other exclusions are explained below — the housing allowance, tax-sheltered annuities, qualified scholarships, and sale of a home.

Housing Allowance

☞ **Key Point:** The housing allowance is being challenged in a federal lawsuit as an unconstitutional preference for religion. The current status of this case is summarized in a special section at the beginning of this tax guide.

The most important tax benefit available to ministers who own or rent their homes is the housing allowance exclusion. Ministers who own or rent their homes do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a housing allowance, to the extent that (1) the allowance represents compensation for ministerial services; (2) it is used to pay housing expenses; and (3) it does not exceed the fair rental value of the home (furnished, plus utilities). Housing-related expenses include mortgage payments, rent, utilities, repairs, furnishings, insurance, property taxes, additions, and maintenance.

A church cannot designate a housing allowance retroactively.

Some churches fail to designate housing allowances prospectively and thereby deprive ministers of an important tax benefit.

Ministers who live in a church-owned parsonage do not pay federal income taxes on the fair rental value of the parsonage.

§ **Tax Tip:** Ministers who live in a church-owned parsonage and incur any out-of-pocket expenses in maintaining the parsonage (such as utilities, property taxes, insurance, furnishings, or lawn care) should be sure that their employing church designates in advance a portion of their annual compensation as a parsonage allowance. The amount so designated is not reported as wages on the minister's *Form W-2* at the end of the year. (If the allowance exceeds the actual expenses, the difference must be reported as income by the minister.) This is an important tax benefit for ministers living in a church-provided parsonage. Unfortunately, many of these ministers are not aware of this benefit or are not taking advantage of it.

§ **Tax Tip:** Ministers who own their homes lose the largest component of their housing allowance exclusion when they pay off their home mortgage loan. Many ministers in this position have obtained home equity loans or a conventional loan secured by a mortgage on their otherwise debt-free home and have claimed their payments under these kinds of loans as a housing expense in computing their housing allowance exclusion. The Tax Court has ruled that this is permissible only if the loan proceeds were spent on housing-related expenses.

§ **Tax Tip:** Ministers should be sure that the designation of a housing or parsonage allowance for the next year is on the agenda of the church (or church board) for one of its final meetings during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items — assuming in each case that the designation was appropriately adopted in advance by the church and supported by underlying documentation as to each minister's anticipated housing expenses.

The rental value of a parsonage and a housing allowance are exclusions only for federal income tax reporting purposes. Ministers cannot exclude a housing allowance or the fair rental value of a parsonage when computing SECA **unless they are retired**. The tax code specifies that SECA does not apply to "the rental value of any parsonage or any parsonage allowance provided after the [minister] retires."

Ministers should check their state income tax rules to determine the housing allowance rules for state income taxes.

The housing allowance is available to ministers whether they report their income taxes as employees or as self-employed (whether the church issues them a *Form W-2* or a *Form 1099*).

Housing Expenses to Include in Computing Your Housing Allowance Exclusion

Ministers who own or rent their homes should take the following expenses into account in computing their housing allowance exclusion:

- Down payment on a home (but note that a housing allowance is non-taxable only to the extent that it does not exceed the lesser of the amount designated by the church, the actual housing expenses, or the fair rental value of the minister's home (furnished, plus utilities))
- Mortgage payments on a loan to purchase or improve the minister's home (include both interest and principal)

- Rent
- Real estate taxes
- Property insurance
- Utilities (electricity, gas, water, trash pickup, landline telephone charges)
- Furnishings and appliances (purchase and repair)
- Structural repairs and remodeling
- Yard maintenance and improvements
- Maintenance items (pest control, etc.)
- Homeowners association dues

📖 **Key Point:** In 2007, the Tax Court characterized internet expenses as utility expenses. This suggests that a housing allowance may be used to pay for internet expenses (e.g., internet access, cable television). Neither the IRS nor the Tax Court has addressed this issue directly, so be sure to check with a tax professional about the application of a housing allowance to these expenses.

Please note the following:

- A housing allowance must be designated in advance. Retroactive designations of housing allowances are not effective.
- The housing allowance designated by the church is not necessarily non-taxable. It is non-taxable (for income taxes) only to the extent that it is used to pay for housing expenses and, for ministers who own or rent their homes, does not exceed the fair rental value of their homes (furnished, plus utilities).
- A housing allowance can be amended during the year if a minister's housing expenses are more than expected. However, an amendment is effective only prospectively. Ministers should notify their church if their actual housing expenses are significantly more than the housing allowance designated by their church. But note that it serves no purpose to designate a housing allowance greater than the fair rental value of a minister's home (furnished, plus utilities).
- If the housing allowance designated by the church exceeds housing expenses or the fair rental value of a minister's home (furnished, plus utilities), the excess housing allowance should be reported on line 1 of *Form 1040*.
- The housing allowance exclusion is an exclusion for federal income taxes only. Ministers must add the housing allowance as income in reporting SECA on *Schedule SE* (unless they are exempt from SECA).
- The fair rental value of a church-owned parsonage provided to a minister as compensation for ministerial services is not subject to federal income tax.

📖 **Example:** A church designated \$25,000 of Pastor D's 2018 compensation as a housing allowance. Pastor D's housing expenses for 2018 were utilities of \$4,000, mortgage payments of \$18,000, property taxes of \$4,000,

insurance payments of \$1,000, repairs of \$1,000, and furnishings of \$1,000. The fair rental value of the home (furnished) is \$19,000. Pastor D's housing allowance is non-taxable in computing income taxes only to the extent that it is used to pay housing expenses and does not exceed the fair rental value of his home (furnished, plus utilities). Stated differently, the non-taxable portion of a housing allowance is the least of the following three amounts: (1) the housing allowance designated by the church; (2) actual housing expenses; or (3) the fair rental value of the home (furnished, plus utilities). In this case, the lowest of these three amounts is the fair rental value of the home (furnished, plus utilities) (\$23,000), and so this represents the non-taxable portion of Pastor D's housing allowance. Pastor D must report the difference between this amount and the housing allowance designated by his church (\$2,000) as additional income on line 1 of *Form 1040*.

📖 **Example:** Same facts as the previous example, except the church designated \$12,000 of Pastor D's salary as a housing allowance. The lowest of the three amounts in this case would be \$12,000 (the church-designated housing allowance), and so this represents the non-taxable amount. Note that Pastor D's actual housing expenses were more than the allowance, so he was penalized because of the low allowance designated by his church.

📖 **Example:** Pastor Y owns a home and incurred housing expenses of \$12,000 in 2018. These expenses include mortgage principal and interest, property taxes, utilities, insurance, and repairs. The church designated (in advance) \$12,000 of Pastor Y's 2018 compensation as a housing allowance. Pastor Y is able to itemize expenses on *Schedule A (Form 1040)*. He is able to claim itemized deductions on *Schedule A* for both his mortgage interest and his property taxes (up to \$10,000), even though his taxable income was already reduced by these items because of their inclusion in the housing allowance. This is often referred to as the double deduction. In fact, it represents an exclusion and a deduction.

📖 **Example:** In preparing his income tax return for 2018, Pastor H discovers that his church failed to designate a housing allowance for him for 2018. He asks his church to pass a resolution retroactively granting the allowance for 2018. Such a resolution is ineffective, and Pastor H will not be eligible for any housing allowance exclusion in 2018.

📖 **Key Point:** The Sarbanes-Oxley Act makes it a crime to knowingly falsify any document with the intent to

influence “the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States . . . or in relation to or contemplation of any such matter or case,” and this provision contains no exemption for churches or pastors. It is possible that a pastor’s backdating of a board resolution to qualify for a housing allowance for the entire year is fraud and violates this provision in the Sarbanes-Oxley Act, exposing the pastor to a fine or imprisonment. Even if the pastor’s action does not violate the Act, it may result in civil or criminal penalties for tax fraud under the tax code.

§ **Tax Tip:** Ministers should be sure that the designation of a housing or parsonage allowance for the next year is on the agenda of the church board for one of its final meetings during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items — assuming in each case that the designation was duly adopted in advance by the church.

How much should a church designate as a housing allowance?

The IRS has stated that there are no limitations on how much of a minister’s compensation can be designated by his employing church as a housing allowance. However, as noted above, this means little, since the non-taxable portion of a church-designated housing allowance for ministers who own or rent their homes cannot exceed the lesser of (1) actual housing expenses or (2) the fair rental value of the home (furnished, plus utilities).

Many churches base the housing allowance on their minister’s estimate of actual housing expenses for the new year. The church provides the minister with a form on which anticipated housing expenses for the new year are reported. For ministers who own their homes, the form asks for projected expenses in the following categories: down payment, mortgage payments, property taxes, property insurance, utilities, furnishings and appliances, repairs and improvements, maintenance, and miscellaneous. Many churches designate an allowance in excess of the anticipated expenses itemized by the minister. Basing the allowance solely on a minister’s anticipated expenses penalizes the minister if actual housing expenses turn out to be higher than expected. In other words, the allowance should take into account unexpected housing costs or inaccurate projections of expenses.

🗨 **Key Point:** The housing allowance is available only if two conditions are met: (1) The recipient is a Minister for Tax Purposes (as defined above), and (2) the

allowance is compensation for services performed in the exercise of ministry.

Churches sometimes neglect to designate a housing allowance in advance of a new calendar year. For example, a church board may discover in March 2019 that it failed to designate a housing allowance for its pastor for 2019. It is not too late to act. The church should immediately designate a portion of its minister’s remaining compensation for 2019 as a housing allowance. This problem can be avoided by stipulating in each annual housing allowance designation that the allowance is for the current year **and all future years unless otherwise provided**. If such a resolution had been adopted in the December 2017 board meeting (i.e., “for 2018 and future years”) it would not matter that the church neglected to designate a minister’s 2019 allowance until March 2019, since the previous designation would have carried over. Such safety net designations are not a substitute for annual housing allowance designations (they have never been addressed or endorsed by the IRS or Tax Court). Rather, they provide a basis for claiming a housing allowance if a church neglects to designate one.

🗨 **Key Point: Remember** — churches cannot designate a housing allowance retroactively.

🗨 **Key Point:** The IRS has ruled that a retired minister is eligible for a housing allowance exclusion if the following conditions are satisfied: (1) A portion of the retired minister’s pension income is designated as a housing allowance by his church or the church pension board of a denominational pension fund; (2) the retired minister has severed his relationship with the local church and relies on the fund for a pension; and (3) the pensions paid to retired ministers “compensate them for past services to the local churches of the denomination or to the denomination.” Retired ministers who receive benefits from a denominational pension fund will be eligible in most cases to have some or all of their benefits designated in advance as a housing allowance. This is an attractive benefit for retired ministers that is not available with some other kinds of retirement plans. Retired ministers also can exclude from their gross income the rental value of a home (plus utilities) furnished to them by their church as a part of their pay for past services. A minister’s surviving spouse cannot exclude a housing allowance or rental value of a parsonage unless the allowance or parsonage is for ministerial services performed.

SECA does not apply to the rental value of a parsonage or a housing allowance provided after a minister retires.

☞ **Key Point:** Ministers who own their homes lose the largest component of their housing allowance exclusion when they pay off their home mortgage loan. Many ministers in this position have obtained home equity loans — or a conventional loan secured by a mortgage on their otherwise debt-free home — and have claimed their payments under these kinds of loans as a housing expense in computing their housing allowance exclusion. The Tax Court has ruled that this is permissible only if the loan proceeds were spent on housing-related expenses.

Section 403(b) Plans

Payments made by your church and your salary reduction contributions to a 403(b) plan are not reportable income for income tax or SECA purposes as long as the total amount credited to your retirement account does not exceed contribution limits under sections 415(c) and 402(g) of the tax code.

Contribution Limits

For 2018, total annual additions (employer, salary reduction, and tax-paid contributions) could not exceed the lesser of 100 percent of your compensation (excluding a minister's housing allowance) or \$55,000. This rule is known as the section 415(c) limit. Excess contributions can result in income tax, additional taxes, and penalties. The effect of excess contributions depends on the type of excess contribution. The distributed excess amount may not be rolled over to another 403(b) plan or to an IRA.

✓ **New in 2019:** The limit on annual additions is \$56,000 for 2019.

Minister's Housing Allowance and Contribution Limits

For 2018, the section 415(c) limit restricts 403(b) contributions to the lesser of 100 percent of compensation or \$55,000. For 2019, this amount is \$56,000. Does the term “compensation” include a minister's housing allowance? This is an important question for ministers, since the answer will determine how much can be contributed to a 403(b) plan. If the housing allowance is treated as compensation, then ministers will be able to contribute larger amounts. The tax code specifies that the term “compensation”, for purposes of applying the section 415(c) limit to a 403(b)(3) plan, “means the participant's includible compensation determined under section 403(b)(3).” Section 403(b)(3) defines “compensation” to include “the amount of compensation which is received from the employer . . . and which is includible in gross income.” Section 107 of the tax code

specifies that a minister's housing allowance (or the annual rental value of a parsonage) is not included in the minister's gross income for income tax reporting purposes. Therefore, it would appear that the definition of “compensation”, for purposes of computing the section 415(c) limit, would not include the portion of a minister's housing allowance that is excludable from gross income or the annual rental value of a parsonage. For many years the IRS website included the following question and answer addressing this issue:

Q. I am an employee minister in a local church. Each year, my church permits \$25,000 as a yearly tax-free housing allowance. I would like to use my yearly housing allowance as compensation to determine my annual contribution limits (to a TSA) under section 415(c) of the Internal Revenue Code. May I do so?

A. No. For purposes of determining the limits on contributions under section 415(c) of the *Internal Revenue Code*, amounts paid to an employee minister as a tax-free housing allowance may not be treated as compensation pursuant to the definitions of compensation under section 1.415-2(d) of the income tax regulations.

☞ **Key Point:** Churches that include the housing allowance as compensation when calculating the amount of the church's contribution to 403(b) plans must perform an additional calculation to ensure the total contributions to the plan do not exceed the maximum contribution allowed under section 415(c).

Taxation of Distributions from a 403(b) Plan

Amounts you contribute through salary reduction, and the earnings attributable to these contributions, generally cannot be withdrawn before you reach age 59½, separate from service, die, or become disabled. In some cases of financial hardship, you may withdraw your own salary reduction contributions (but not the earnings on them) prior to the occurrence of any of the above events. A 403(b) plan may make hardship distributions only if permitted by the plan.

Once amounts are distributed, they are generally taxable as ordinary income unless designated in advance as a minister's housing allowance. In addition, if amounts are distributed prior to your reaching age 59½, you will be assessed an additional tax of 10 percent of the amount which is includable in income, unless one of the following exceptions applies:

- The distributions are part of a series of substantially equal periodic payments made over your life or the lives of your beneficiaries and after you separate from service.

- The distributions are made after you separate from service in or after the year in which you reach age 55.
- The distributions do not exceed the amount of unreimbursed medical expenses that you could deduct for the current year.
- The distributions are made after your death or after you become disabled.
- The distributions are made to an alternate payee pursuant to a qualified domestic relations order.

The additional tax is computed on *Form 5329*.

Key Point: You must receive all, or at least a certain minimum, of your interest accruing after 1986 in a 403(b) plan by April 1 of the calendar year following the later of the calendar year in which you become age 70½ or the calendar year in which you retire. This required minimum is called your required minimum distribution (RMD).

Salary Reduction Contributions (Section 402(g))

In addition to the section 415(c) limit, there is an annual limit on elective deferrals. The limit applies to the total of all elective deferrals contributed (even if contributed by different employers) for the year on your behalf to a variety of retirement plans, including 403(b) plans. Generally, you cannot defer more than an allowable amount each year for all plans covering you. For 2018 the allowable limit was \$18,500. If you defer more than the allowable amount for a tax year, you must include the excess in your taxable income for that year.

✓ **New in 2019:** The dollar limit on annual elective deferrals increases to \$19,000.

Key Point: Church employees can make a special election that allows their employer to contribute up to \$10,000 for the year, even if this is more than 100 percent of your compensation. The total contributions over your lifetime under this election cannot be more than \$40,000.

The limit on elective deferrals increases for individuals who have attained age 50 by the end of the year. The additional amount that may be made is the lesser of (1) the applicable dollar amount or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year. The applicable dollar amount is \$6,000 for 2018 and 2019. Catch-up contributions are not subject to any other contribution limits and are not taken into account in applying other contribution limits.

Qualified Scholarships

Key Point: Qualified scholarships are excludable from taxable income.

Amounts received as a qualified scholarship by a candidate for a degree may be excluded from gross income. A qualified scholarship is any grant amount that, in accordance with the conditions of the grant, is used for tuition and course-related expenses. Qualified tuition and related expenses are those used for (1) tuition and fees required for the enrollment or attendance at an educational institution or (2) fees, books, supplies, and equipment required for courses of instruction at the educational institution. The scholarship need not specify that it is to be used only for qualified tuition and related expenses. All that is required is that the recipient uses the scholarship for such expenses and that the scholarship does not specify that it is to be used for non-qualified expenses (such as room and board). In addition to these requirements, the scholarship must meet the additional requirements if the recipient is an employee or a family member of an employee. Generally, the scholarship must be non-compensatory in nature and selected using non-employment-related criteria, and an independent committee must make the selection of the recipient. Additional requirements may also apply. The church should seek the advice of a CPA or tax attorney to determine the proper treatment of scholarships to employees and their children.

Key Point: Amounts paid by a church for the education of a pastor or other church employee cannot be treated as a non-taxable scholarship if paid as compensation for services.

Any amount received in excess of the qualified tuition and related expenses, such as amounts received for room and board, is not eligible for this exclusion.

Any amount received that represents payment for teaching, research, or other services required as a condition for receiving a qualified scholarship cannot be excluded from gross income. In addition, amounts paid by a church for the education of a pastor or other church employee cannot be treated as a non-taxable scholarship if paid as compensation for services.

Example: First Baptist Church establishes a scholarship fund for seminary students. Robert is a church member pursuing a master's degree at a seminary. The church votes to award him a scholarship of \$2,500 for 2019. So long as Robert uses the scholarship award for tuition or other course-related expenses, he need not report it as income on his federal tax return. The better practice would be for the church to stipulate that the scholarship is to be used for tuition or other course-related

expenses (for example, fees, books, supplies) or for the church to pay the expenses directly to the educational institution. This will ensure that the scholarship does not inadvertently become taxable income because its specific use was not designated and the recipient used it for non-qualified expenses. As long as amounts are paid through a qualified scholarship plan, the church is not required to report the scholarship on *Form 1099-MISC* to the recipient.

Sale or Exchange of Your Principal Residence

A taxpayer who is an individual may exclude up to \$250,000 (\$500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the date of the sale or exchange. A taxpayer who fails to meet this requirement by reason of a change of place of employment, health, or (to the extent provided under regulations) unforeseen circumstances is able to exclude an amount equal to the fraction of the \$250,000 (\$500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met. The exclusion under this provision may not be claimed for more than one sale or exchange during any two-year period unless the special provisions for unforeseen circumstances apply.

Line 2. Interest income: attach Schedule B if more than \$1,500

Complete this line only if you had interest income. Tax-exempt interest income is reported on line 2a with taxable interest income reported on line 2b. If you had taxable interest income of more than \$1,500, complete *Schedule B*.

Line 3. Dividend income: attach Schedule B if more than \$1,500

Complete this line only if you had dividend income. If you had dividend income of more than \$1,500, complete *Schedule B*.

Lines 4a and 4b. IRA, pension, and annuity income

You should receive a *Form 1099-R* showing the total amount of your pension and annuity payments before income tax or other deductions were withheld. This amount should be shown in Box 1 of *Form 1099-R*. Pension and annuity payments include distributions from 401(k) and 403(b) plans. Do not include the following payments; instead report them on line 1:

- Disability pensions received before you reach the minimum retirement age set by your employer.

- Corrective distributions (including any earnings) of excess salary deferrals or excess contributions to retirement plans. The plan must advise you of the year(s) the distributions are includible in income.

Many denominational pension funds annually designate 100 percent of pension and disability benefits paid to retired ministers as a housing allowance. In such cases the *Form 1099-R* may show that the taxable amount of the pension income is “not determined” if you check the box on line 2b. If you are a retired or disabled minister, you may exclude all or a portion of your pension or disability income from your gross income reported on line 4 of *Form 1040* if (1) you can document that the monies were actually spent on housing-related expenses during the tax year; (2) the amount excluded does not exceed the fair rental value of the home (furnished, plus utilities); and (3) the applicable pension board designated the retirement payments as housing allowance.

IRS Publication 517 states: “If you are a retired minister, you can exclude from your gross income the rental value of a home (plus utilities) furnished to you by your church as a part of your pay for past services, or the part of your pension that was designated as a rental allowance. However, a minister’s surviving spouse cannot exclude the rental value unless the rental value is for ministerial services performed.”

- ☞ **Key Point:** A surviving spouse of a deceased minister cannot exclude any portion of the benefits received from their deceased spouse’s 403(b) account as a housing allowance.

Line 5. Social Security benefits

- ☞ **Key Point:** Individuals who receive Social Security retirement, disability, or survivor benefits may have to pay taxes on a portion of their benefits.

If you received Social Security benefits in 2018, you need to know whether or not these benefits are taxable. Here are several rules the IRS has formulated to assist Social Security beneficiaries in knowing if their benefits are taxable:

1. You should receive a *Form SSA-1099* showing in Box 3 the total Social Security benefits paid to you. Box 4 will show the amount of any benefits you repaid in 2018. If you received railroad retirement benefits treated as Social Security, you should receive a *Form RRB-1099*. Use the Social Security Benefits Worksheet in these instructions to see if any of your benefits are taxable.
2. How much, if any, of your Social Security benefits are taxable depends on your total income and marital status.

3. Generally, if Social Security benefits were your only income for 2018, your benefits are not taxable, and you probably do not need to file a federal income tax return.
4. If you received income from other sources, your benefits will not be taxed unless your modified AGI is more than the base amount for your filing status.
5. Your taxable benefits and modified AGI are computed on a worksheet in the instructions to *Form 1040*.
6. You can do the following quick computation to determine whether some of your benefits may be taxable:

First, add one-half of the total Social Security benefits you received to all your other income, including any tax-exempt interest and other exclusions from income.

Then, compare this total to the base amount for your filing status. If the total is more than your base amount, some of your benefits may be taxable.

The 2018 base amounts are:

- \$32,000 for married couples filing jointly
- \$25,000 for single, head of household, qualifying widow/widower with a dependent child, or married individuals filing separately who did not live with their spouses at any time during the year
- \$0 for married persons filing separately who lived together during the year

For additional information on the taxability of Social Security benefits, see IRS *Publication 915 Social Security and Equivalent Railroad Retirement Benefits*. *Publication 915* is available at IRS.gov.

Line 6. Total income

Report total income on this line. This is the sum of the amounts reported on lines 1–5 of *Form 1040*, plus the additional categories of income reported on lines 10–22 of *Schedule 1 (Form 1040)*. The most important of these for ministers include:

1. Line 12 (Schedule 1). Business income

Report self-employment earnings (from *Schedule C* or *Schedule C-EZ*). Self-employment earnings include:

- Compensation reported to you on a *Form 1099-MISC*
- Fees received directly from church members for performing personal services (such as weddings and funerals)
- Honoraria you received for guest speaking appearances in other churches

If you received income from any of these kinds of activities, compute your net earnings on *Schedule C* and transfer this amount to line 12 of *Schedule 1 (Form 1040)* and then to line 6 (*Form 1040*).

2. Line 13 (Schedule 1). Capital gains

Also report on line 13 capital gains or losses (attach *Schedule D*) from the sale of capital assets. These include stocks, bonds, and property. Gain or loss is reported on *Schedule D*. You also may have to file *Form 8949* (see the instructions to both forms for details). This amount, along with the other amounts reported on *Schedule 1 (Form 1040)*, is carried over to line 6 (*Form 1040*).

3. Line 21 (Schedule 1). “Other income”

“Other income” is reported on line 21 of *Schedule 1 (Form 1040)* and carried over to line 6 (*Form 1040*). Other income includes the following items:

- A canceled debt or a debt paid for you by another person (unless the person who canceled or paid your debt intended it to be a gift)
- The fair market value of a free tour you receive from a travel agency for organizing a group of tourists (in some cases this may be reported on *Schedule C*)
- Most prizes and awards
- Some taxable distributions from a Health Savings Account (HSA) or Archer MSA (see IRS *Publication 969*)
- Jury duty pay
- Taxable benefits provided by the church but not included on *Form W-2* or *Form W-2c*. (Also remember to include these benefits on *Schedule SE* for the calculation of SECA.)

Step 5: Adjustments to Income

Line 7. Adjusted gross income

You may deduct certain adjustments from total income (line 6) to compute your AGI. Report the adjustments on lines 23 through 36 of *Schedule 1 (Form 1040)*. The total amount is subtracted from line 6 to compute AGI that is reported on line 7.

If you have no adjustments to income, enter the amount from line 6 on this line.

The two most relevant adjustments for ministers are the deduction for one-half of SECA and payments to an IRA. Both are summarized below.

Schedule 1 (Form 1040) line 27. One-half of self-employment tax

- ✎ **Key Point:** Every minister who pays SECA on ministerial income qualifies for this deduction. Some are not claiming it.

All ministers are self-employed for Social Security with respect to their ministerial income. They can deduct half of their actual SECA as an adjustment on line 27 of *Schedule 1 (Form 1040)*, whether or not they are able to itemize deductions on *Schedule A*.

Schedule 1 (Form 1040) line 32. Payments to an Individual Retirement Account (IRA)

An individual retirement arrangement, or IRA, is a personal savings plan which allows you to set aside money for retirement while offering you tax advantages. You can set up different kinds of IRAs with a variety of organizations, such as a bank or other financial institution, a mutual fund, or a life insurance company.

The original IRA is referred to as a **Traditional IRA**. A Traditional IRA is any IRA that is not a Roth IRA or a SIMPLE IRA. You may be able to deduct some or all of your contributions to a Traditional IRA. You may also be eligible for a tax credit equal to a percentage of your contribution. Amounts in your Traditional IRA, including earnings, generally are not taxed until distributed to you. IRAs cannot be owned jointly. However, any amounts remaining in your IRA upon your death can be paid to your beneficiary or beneficiaries.

To contribute to a Traditional IRA, you must be under age 70½ at the end of the tax year. You, or your spouse if you file a joint return, must have taxable compensation, such as wages, salaries, commissions, tips, bonuses, or net income from self-employment. Compensation does not include earnings and profits from property, such as rental income, interest and dividend income, or any amount received as pension or annuity income or as deferred compensation.

For 2018, if you file a joint return and your taxable compensation is less than that of your spouse, the most that can be contributed for the year to your IRA is the smaller of the following two amounts: (1) \$5,500 (\$6,500 if you are age 50 or older) or (2) the total compensation includible in the gross income of both you and your spouse for the year, reduced by your spouse's IRA contribution for the year to a Traditional IRA and any contributions for the year to a Roth IRA on behalf of your spouse.

- ✓ **New in 2019:** The maximum annual dollar contribution limit for IRA contributions increases to \$6,000 for 2019. Also, the additional catch-up contribution limit for an individual who has attained age 50 before the end of the taxable year remains at \$1,000.

All IRA contributions must be made by the due date of your tax return, not including extensions. This means that your 2018 IRA contribution must be made by April 15, 2019, even if you obtain an extension for filing this return.

Your allowable deduction may be reduced or eliminated, depending on your filing status, the amount of your income, and if you or your spouse are covered by an employer-provided retirement plan. The deduction begins to decrease (phase out) when your income rises above a certain amount and is eliminated altogether when it reaches a higher amount. The amounts vary depending on your filing status. If you were covered by an employer-provided retirement plan, then the deduction for contributions to your IRA are completely phased out when AGI reaches \$121,000 (married filing jointly) or \$73,000 (single). (For 2019, the limits are \$123,000 (married filing jointly) and \$74,000 (single).) If your spouse was covered by an employer-provided retirement plan at any time during 2018 and you made contributions to your IRA, your allowable IRA deduction is completely phased out when AGI reaches \$199,000 (married filing jointly). (For 2019, the limit is \$203,000 (married filing jointly).) See IRS *Publication 590*.

The *Form W-2* you receive from your church or other employer has a box used to show whether you were covered by a retirement plan during the year. The "Retirement Plan" box should have a mark in it if you were covered. Employer retirement plans include 403(b) tax-sheltered annuities.

Figure your deduction using the worksheets in the instructions to *Form 1040* or in *Publication 590*.

Individuals who cannot claim a deduction for an IRA contribution still can make non-deductible IRA contributions, subject to the lesser of \$5,500 for 2018 (and \$6,000 for 2019) or earned income limits. Earnings on these amounts continue to accumulate on a tax-deferred basis. When distributions are made from the IRA, special rules apply in figuring the tax on the distributions when both deductible and non-deductible contributions were made to the IRA. *Form 8606* is used to designate a contribution as non-deductible and must be filed, or the full amount of future withdrawals may be taxed. Withdrawals before age 59½ are subject to a 10 percent penalty tax that also applies to deductible IRA contributions.

Distributions from a Traditional IRA are fully or partially taxable in the year of distribution. Use *Form 8606* to figure the taxable portion of withdrawals. If you made only deductible contributions, distributions are fully taxable.

Distributions made prior to age 59½ may be subject to a 10 percent additional tax. You also may owe an excise tax if you do not begin to withdraw minimum distributions by April 1 of the year after you reach age 70½.

A **Roth IRA** differs from a Traditional IRA in several respects. A Roth IRA does not permit a deduction at the time of contribution. Regardless of your age, you may be able to establish and make non-deductible contributions to a Roth IRA. However, you may be limited in the amount of non-deductible contributions you may make to your Roth IRA due to your AGI. For those filing as married filing jointly, no contribution may be made to a Roth IRA if your AGI, as modified, is \$199,000 or above (\$203,000 for 2019). For those filing as single, no contribution may be made to a Roth IRA if your AGI, as modified, is \$135,000 or above (\$137,000 for 2019).

You do not report Roth contributions on your tax return. To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is set up. Like a Traditional IRA, a Roth IRA can be set up, but there are limitations on the amount that can be contributed and the time of year that contributions can be made. You do not include in your gross income qualified distributions or distributions that are a return of your regular contributions from your Roth IRA. Refer to *Publication 590* for additional information on Roth IRAs.

For information on conversions from a Traditional IRA to a Roth IRA, refer to *Publication 590*. No further contributions to a Traditional IRA are permissible in the year you reach age 70½ or for any later year, and distributions from a Traditional IRA must generally begin by April 1 of the year following the year in which you reach age 70½. However, you must receive at least a minimum amount for each year starting with the year you reach age 70½ (your “70½ year”). If you do not (or did not) receive that minimum amount in your 70½ year, then you must receive distributions for your 70½ year by April 1 of the next year. This means that you will have two required distributions in that year.

Even if you receive a distribution from your IRA before age 59½, you may not have to pay the 10 percent penalty if the distributions are not more than your qualified education expenses or you use the distributions to buy, build, or rebuild a first home. See IRS *Publication 590-B* for an explanation of exceptions to the age 59½ rule.

Charitable contributions. An IRA owner, age 70½ or over, can directly transfer, tax-free, up to \$100,000 per year to an eligible charity. Distributions from employer-sponsored retirement plans, including SIMPLE IRA plans and simplified employee pension (SEP) plans, are not eligible. To qualify, the funds must be transferred directly by the IRA custodian to the eligible charity. Distributed amounts may be excluded from the IRA owner’s income, resulting in lower taxable income for the IRA owner. However, if the IRA owner excludes the distribution from income, no deduction, such as a charitable contribution deduction on *Schedule A*, may be taken for the distributed amount.

To report a qualified charitable distribution on your *Form*

1040 tax return, you generally report the full amount of the charitable distribution on the line for IRA distributions (line 4a, *Form 1040*). On the line for the taxable amount (line 4b, *Form 1040*), enter zero if the full amount was a qualified charitable distribution. Enter “QCD” next to this line. See the *Form 1040* instructions for additional information.

Not all charities are eligible. For example, donor-advised funds and supporting organizations are not eligible recipients.

Amounts transferred to a charity from an IRA are counted in determining whether the owner has met the IRA’s RMD.

Example: A church has a senior pastor who is 52 years old and a youth pastor who is 30 years old. The church does not participate in a retirement program for its staff. In 2019, the senior pastor can contribute \$7,000 to an IRA (maximum annual contribution of \$6,000 plus a catch-up contribution of \$1,000), and the youth pastor can contribute \$6,000.

Step 6: Tax Computation

Line 8. Itemized deduction or standard deduction

Key Point: Itemize your deductions on *Schedule A* only if they exceed the standard deduction for your filing status.

On line 8 you enter either your itemized deductions from *Schedule A* or a standard deduction amount. Itemized deductions are discussed under *Schedule A* in this guide. For 2018, the standard deduction amounts are as follows:

Filing Status	Standard Deduction Amount
Single	\$12,000
Married filing jointly or qualifying widow(er)	\$24,000
Married filing separately	\$12,000
Head of household	\$18,000

Line 9. Qualified business income deduction

Ministers who have income and expenses from business activities (conducted other than in their capacity as an employee of the church) and report their income on *Schedule C* may be entitled to a federal tax deduction of up to 20 percent of their qualified business income (QBI). This deduction is also referred to as the IRC section 199A deduction. Upon publication of this guide, it has been interpreted that the qualified business trade or business activities of a self-employed minister may be considered a “specified service trade or business”. Thus, there may be an exception to the deductibility of the QBI deduction. If a minister’s AGI (reported on line 7 of *Form 1040*) exceeds \$157,500

(\$315,000 if married filing jointly), then the deduction may be limited; if AGI exceeds \$207,500 (\$415,000 if married filing jointly), then the QBI deduction is unavailable. See *Publication 535* for additional information.

Line 11. Compute tax

Most ministers can use the tax tables to determine their income taxes. Some higher-income ministers must use the tax rate schedules (a spouse's income is considered in deciding whether or not to use the tax rate schedules).

Step 7: Credits

A credit is a direct dollar-for-dollar reduction in your tax liability. It is much more valuable than deductions and exclusions, which merely reduce taxable income. On your 2017 *Form 1040*, tax credits were reported on lines 48–55. On your 2018 *Form 1040*, these (non-refundable) credits are reported on lines 48–55 of *Schedule 3*, and the total amount for all credits is carried over to line 12b of *Form 1040* (and check the box next to line 12b). The more common and important credits for ministers are the child tax credit, the credit for child and dependent care expenses, and the retirement savings credit. Each of these is addressed below.

Line 12a. Child tax credit

The TCJA temporarily increases the child tax credit to \$2,000 per qualifying child. The credit is further modified to temporarily provide for a \$500 non-refundable credit for qualifying dependents other than qualifying children (such as aging parents). The provision generally retains the present-law definition of “dependent”.

Key Point: The child tax credit is doubled, from \$1,000 to \$2,000 per qualifying child, beginning in 2018, and a new credit of \$500 is established for non-child dependents, such as an aging parent.

However, the maximum amount refundable may not exceed \$1,400 per qualifying child (calculated and reported on lines 17b and 17 on *Form 1040* from *Schedule 8812*). Additionally, in order to receive the child tax credit (i.e., both the refundable and non-refundable portions) a taxpayer must include a Social Security number for each qualifying child for whom the credit is claimed on the tax return. For these purposes, a Social Security number must be issued before the due date for the filing of the return for the taxable year. This requirement does not apply to a non-child dependent for whom the \$500 non-refundable credit is claimed.

Further, the TCJA retains the present-law age limit for a qualifying child. As a result, a qualifying child is an individual who has not attained age 17 during the taxable year. The law also modifies

the AGI phaseout thresholds. The credit begins to phase out for taxpayers with AGI in excess of \$400,000 (for married taxpayers filing a joint return) and \$200,000 (for all other taxpayers). These phaseout thresholds are not indexed for inflation.

These new provisions are effective for taxable years beginning after December 31, 2017, and expire for taxable years beginning after December 31, 2025, unless extended by Congress.

Line 12b Schedule 3 (Form 1040) line 49. Credit for child and dependent care expenses: attach Form 2441

Complete this line if you are eligible for a credit for child or dependent care expenses. See the instructions to *Form 1040* line 12b, for details and conditions. Please check the box next to line 12b. See IRS *Publication 972* for additional information.

Line 12b Schedule 3 (Form 1040) line 51. Retirement savings contributions credit (Saver's Credit)

If you make eligible contributions to certain eligible retirement plans or to an IRA, you may be able to take a tax credit. The amount of the Saver's Credit you can get is generally based on the contributions you make and your credit rate. Refer to *Publication 590* or the instructions for *Form 8880* for more information. If you are eligible for the credit, your credit rate can be as low as 10 percent or as high as 50 percent, depending on your AGI. The lower your income, the higher the credit rate; your credit rate also depends on your filing status. These two factors will determine the maximum credit you may be allowed to take. You are not eligible for the credit if your AGI exceeds a certain amount.

The credit is available with respect to elective deferrals to a 401(k) plan, a 403(b) annuity, a SIMPLE IRA, or a SEP; contributions to a Traditional or Roth IRA; and voluntary after-tax employee contributions to a 403(b) annuity or qualified retirement plan. The amount of the credit for 2018 is described in the following table:

Adjusted Gross Income			
Joint Returns	Heads of Household	Single Filers	Amount of Credit
\$1–38,000	\$1–28,500	\$1–19,000	50% of eligible contributions up to \$2,000 (\$1,000 maximum credit)
\$38,001–41,000	\$28,501–30,750	\$19,001–20,500	20% of eligible contributions up to \$2,000 (\$400 maximum credit)
\$41,001–63,000	\$30,751–47,250	\$20,501–31,500	10% of eligible contributions up to \$2,000 (\$200 maximum credit)
over \$63,000	over \$47,250	over \$31,500	0%

For married couples filing jointly, each spouse is eligible for the credit. Enter credit from *Schedule 3* on *Form 1040* line 12b; remember to check the box next to line 12b. For more information about this credit, see *IRS Form 8880* and *Publication 590*.

Step 8: Other Taxes

On the *Form 1040* for 2017, other taxes were reported on lines 57–63. On the 2018 *Form 1040*, other taxes are reported on lines 57–63 of *Schedule 4*, and the total of all taxes is carried over to line 14 of *Form 1040*.

Line 14. Other taxes

Report the following additional taxes on this line:

- **Self-employment tax**

Ministers are self-employed for Social Security with respect to their ministerial income. They compute their SECA on *Schedule SE* and report the tax on line 57 of *Schedule 4 (Form 1040)*. They report this and other taxes on line 14 of *Form 1040*.

- **Individual responsibility payment**

For 2018, you must either:

- Check the “Full-year health care coverage or exempt” box on the front of *Form 1040* to indicate that you, your spouse (if filing jointly), and anyone you can or do claim as a dependent had qualifying health care coverage or a coverage exemption that covered all of 2018 — or a combination of qualifying health care coverage and coverage exemption(s) for every month of 2018; or
- Make a shared responsibility payment if, for any month in 2018, you, your spouse (if filing jointly), or anyone you can or do claim as a dependent didn’t have coverage and doesn’t qualify for a coverage exemption. If you can claim any part-year exemptions or exemptions for specific members of your household, use *Form 8965*. This will reduce the amount of your shared responsibility payment. For more information, see the *Form 8965* instructions. This payment is reported on line 61 of *Schedule 4 (Form 1040)* and carried over to line 14 of *Form 1040*.

Step 9: Payments

On the *Form 1040* for 2017, payments were reported on lines 64–73. On the 2018 *Form 1040*, amounts representing federal income tax withholding are reported on line 16 of *Form 1040*, and other taxes are reported on lines 66–74 of *Schedule 5 (Form 1040)*. The total of these payments is carried over to line 17 of *Form 1040*. The two most important categories of tax payments are withheld taxes and estimated tax payments, as noted below.

Line 16. Federal income tax withheld

Ministers’ wages based on the performance of ministerial services are exempt from federal income tax withholding. As a result, only those ministers who have entered into a voluntary withholding arrangement with their church will have income taxes withheld. The church should report the amount of voluntarily withheld taxes on the minister’s *Form W-2*.

Key Point: Ministers who enter into voluntary withholding arrangements will have federal and state income taxes withheld from their wages. However, a church does not withhold the employee’s share of FICA, since ministers are self-employed for Social Security with respect to ministerial compensation. Ministers can request (on *Form W-4* or through other written instructions) that their church withhold an additional amount of income taxes to cover their SECA liability. These additional withholdings must be treated as income taxes withheld (on *Forms W-2* and *941*) rather than the employee’s share of FICA. They constitute a credit that can be applied to both income taxes and SECA. Ministers still must complete *Schedule SE* to report their SECA liability.

Line 17 Schedule 5 (Form 1040) line 66. 2018 estimated tax payments

Compensation paid to ministers for ministerial duties is not subject to mandatory tax withholding. As a result, ministers must prepay their income tax and SECA using the quarterly estimated tax procedure, unless they have entered into a voluntary withholding agreement with their employing church. The estimated tax procedure is summarized in Part 2 of this guide in the section “How do ministers pay their taxes?” The total amount of estimated tax payments made to the IRS is reported as a payment of taxes on line 66 of *Schedule 5 (Form 1040)* and carried over with the other kinds of payments listed on *Schedule 5* to line 17 of *Form 1040*.

Line 17a. Earned income credit

The EIC reduces tax you owe and may give you a refund even if you do not owe any tax. A number of technical requirements must be met in order to qualify for this credit. Unfortunately, many taxpayers who qualify for the EIC do not claim it because it is so difficult to compute. In most cases, the amount of your EIC depends on (1) whether you have no qualifying child, one qualifying child, two qualifying children, or three or more qualifying children and (2) the amount of your earned income and modified AGI.

You may be able to claim the EIC for 2018 if (1) you do not have a qualifying child and you earned less than \$15,270

(\$20,950 if married filing jointly); (2) a qualifying child lived with you and you earned less than \$40,320 (\$46,010 if married filing jointly); (3) two qualifying children lived with you and you earned less than \$45,802 (\$51,492 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than \$49,194 (\$54,884 if married filing jointly). The maximum EIC for 2018 is (1) \$519 with no qualifying child; (2) \$3,461 with one qualifying child; (3) \$5,716 with two qualifying children; and (4) \$6,431 with three or more qualifying children.

You can compute the credit yourself or the IRS will compute it for you. To figure the amount of your EIC, you must use the EIC Worksheet and EIC Table in the instructions for *Form 1040* line 17. Ministers may want to consider having the IRS compute the credit for them, especially due to confusion about how the housing allowance affects the credit.

The credit is reported on line 17a of *Form 1040*.

IRS *Publication 596* is a 41-page publication that explains the EIC. The 2017 edition (the most recent available at the time of publication of this text) states: “The rental value of a home or a housing allowance provided to a minister as part of the minister’s pay generally isn’t subject to income tax but is included in net earnings from self-employment. For that reason, it is included in earned income for the EIC” except for ministers who have opted out of SECA by filing a timely *Form 4361* exemption application with the IRS.

Excerpts from *Publication 596* confirm that ministers who are employees for income tax reporting purposes and who have not exempted themselves from SECA by filing a timely *Form 4361* with the IRS include their housing allowance or the fair rental value of a parsonage in computing earned income for purposes of the EIC.

But what about ministers who have exempted themselves from SECA by filing a timely *Form 4361* with the IRS? Do they include a housing allowance or the rental value of a parsonage in computing their earned income for purposes of the EIC? As noted above, *Publication 596* explicitly states, with regard to ministers who have filed *Form 4361*, that “a nontaxable housing allowance or the nontaxable rental value of a home is not earned income.”

With respect to ministers who have filed a timely *Form 4361*, *Publication 596* states:

Whether or not you have an approved *Form 4361*, amounts you received for performing ministerial duties as an employee count as earned income. This includes wages, salaries, tips, and other taxable employee compensation. [But] if you have an approved *Form 4361*, a non-taxable housing allowance or the non-taxable rental value of a home isn’t earned income. Also, amounts you received for performing ministerial duties, but not as an employee, don’t count as

earned income. Examples include fees for performing weddings and honoraria for delivering speeches.

Ministers who are affected by this issue should consult their own tax advisor for help.

Step 10: Refund or Amount You Owe

After totaling your payments, you can calculate whether you owe the government or a refund is due you. If you owe a tax, be certain to enclose with your return a check in the amount you owe payable to the United States Treasury, or make the payment through your EFTPS account. Do not attach the check to your return, but include it with a *Form 1040-V*. If you file your return electronically, the payment may be sent in separately using the *Form 1040-V*. Include your daytime phone number and your Social Security number, and write “*Form 1040* for 2018” on the check. If you owe taxes, you also may have to pay an underpayment penalty (refer to line 23 of *Form 1040*).

If you have overpaid your taxes, you have two options: (1) Request a full refund by entering the requested amount on line 20a (and enter your bank’s direct deposit information if desired), or (2) apply the overpayment to your 2019 estimated tax on line 21.

Step 11: Sign Here

You must sign and date the return at the bottom of page 1. If you are filing a joint return, your spouse must also sign the return. In the “your occupation” space, enter your occupation — **minister**. In prior years, the signature portion of the return was on page 2 of the *Form 1040*, but the redesigned form has the signature section on page 1.

OTHER FORMS AND SCHEDULES

Schedule A

 **Key Point:** If your itemized deductions exceed your standard deduction, you should report your itemized deductions on *Schedule A (Form 1040)*. This section will summarize the itemized deductions.

Step 1: Medical and Dental Expenses (lines 1–4)

You may deduct certain medical and dental expenses (for you, your spouse, and your dependents) if you itemize your deductions on *Schedule A*, but only to the extent that your expenses exceed 7.5 percent of your AGI. You must reduce your medical expenses by the amounts of any reimbursements you receive for those expenses before applying the 7.5 percent test. Reimbursements include amounts you receive from insurance or other sources for your medical expenses (including Medicare). It does not matter if the reimbursement is paid to the patient, the doctor, or the hospital.

The following items ARE deductible as medical expenses:

- Fees for medical services
- Fees for hospital services
- Meals and lodging at a hospital during medical treatment (subject to some limits)
- Medical and hospital insurance premiums that you pay (do not include amounts paid to health sharing arrangements)
- Special equipment
- Medicare Part A premiums you pay if you are exempt from Social Security and voluntarily elect to pay Medicare Part A premiums
- Medicare Part B premiums you pay
- Medicare Part D premiums you pay
- Medicare Supplement Insurance premiums you pay (or deducted from your pension)
- Long-term care insurance premiums, subject to certain limitations on the amount that may be deducted
- Special items (false teeth, artificial limbs, eyeglasses, hearing aids, crutches, etc.)
- Transportation for necessary medical care. For 2018, the standard mileage rate for medical travel was 18 cents per mile (it increases to 20 cents per mile for 2019).
- Medicines and drugs requiring a prescription, and insulin
- The portion of a life-care fee or founder's fee paid either monthly or in a lump sum under an agreement with a retirement home that is allocable to medical care
- Wages of an attendant who provides medical care
- The cost of home improvements if the main reason is for medical care
- Program to stop smoking
- Exercise expenses (including the cost of equipment to use in the home) if required to treat an illness (including obesity) diagnosed by a physician, the purpose of the expense is to treat a disease rather than to promote general health, and the taxpayer would not have paid the expense but for this purpose

The following items are NOT deductible as medical expenses:

- Funeral services
- Health club dues (except as noted above)
- Household help
- Life insurance
- Maternity clothes
- Non-prescription medicines and drugs
- Nursing care for a healthy baby
- Toothpaste, cosmetics, toiletries
- Trip for general improvement of health
- Most cosmetic surgery

Step 2: Taxes You Paid (lines 5–7)

In the past, individuals were permitted a deduction for certain taxes paid or accrued, whether or not incurred in a taxpayer's trade or business. These taxes were:

- State and local real property taxes
- State and local personal property taxes
- State and local income taxes

At the election of the taxpayer, an itemized deduction may be taken for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes. This provision was added to address the unequal treatment of taxpayers in the seven states that do not have an income tax. Taxpayers in these states cannot take advantage of the itemized deduction for state income taxes. Allowing them to deduct sales taxes helps offset this disadvantage.

The TCJA allows taxpayers to claim an itemized deduction of up to \$10,000 (\$5,000 for married taxpayer filing a separate return) for the aggregate of:

- State and local property taxes
- State and local income taxes (or sales taxes in lieu of income taxes) paid or accrued in the taxable year

The new rules apply to taxable years 2018 through 2025.

Step 3: Interest You Paid (lines 8–10)

As a general rule, personal interest is not deductible. Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations. Qualified residence interest means interest paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness. A qualified residence means the taxpayer's principal residence and one other residence of the taxpayer, selected to be a qualified residence. A qualified residence can be a house, condominium, cooperative, mobile home, house trailer, or boat.

Acquisition indebtedness is indebtedness incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer and that secures the residence. The maximum amount treated as acquisition indebtedness is \$1 million (\$500,000 in the case of a married person filing a separate return). Acquisition indebtedness also includes indebtedness from the refinancing of other acquisition indebtedness but only to the extent of the amount (and term) of the refinanced indebtedness. For example, if the taxpayer incurs \$200,000 of acquisition indebtedness to acquire a principal residence and pays down the debt to \$150,000, the taxpayer's acquisition indebtedness with respect to the residence cannot thereafter be increased above \$150,000 (except by indebtedness incurred to substantially improve the residence).

Home equity indebtedness is indebtedness (other than acquisition indebtedness) secured by a qualified residence. In order for interest related to home equity indebtedness to be considered as qualified residence interest, the proceeds must be used to buy, build, or substantially improve the residence that secures the loan. (Prior law did not restrict the use of the proceeds, but limited the total debt to \$100,000.)

The TCJA provides that, in the case of taxable years beginning after December 31, 2017, and beginning before January 1, 2026, a taxpayer may treat no more than \$750,000 as qualified residence loans, including acquisition indebtedness and qualifying home equity indebtedness (\$375,000 in the case of married taxpayers filing separately). In the case of acquisition indebtedness incurred before December 15, 2017, this limitation is \$1,000,000 (\$500,000 in the case of married taxpayers filing separately).

The term “points” is sometimes used to describe certain charges paid by a borrower. They are also called loan origination fees, maximum loan charges, or premium charges. If the payment of any of these charges is **only** for the use of money, it ordinarily is interest paid in advance and must be deducted in installments over the life of the mortgage (not deducted in full in the year of payment). However, points are deductible in the year paid if the following requirements are satisfied:

1. Your loan is secured by your main home. (Your main home is the one you ordinarily live in most of the time.)
2. Paying points is an established business practice in the area where the loan was made.
3. The points paid were not more than the points generally charged in that area.
4. You use the cash method of accounting. This means you report income in the year you receive it and deduct expenses in the year you pay them. Most individuals use this method.
5. The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
6. The funds you provided at or before closing, plus any points the seller paid, were at least as much as the points charged. The funds you provided are not required to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds you paid at or before closing for any purpose. You cannot have borrowed these funds from your lender or mortgage broker.
7. You use your loan to buy or build your main home.
8. The points were computed as a percentage of the principal amount of the mortgage.
9. The amount is clearly shown on the settlement statement (such as the *Settlement Statement, Form HUD-1*)

as points charged for the mortgage. The points may be shown as paid from either your funds or the seller's.

Step 4: Gifts to Charity (lines 11–14)

Cash contributions to churches, schools, and most other public charities, which are U.S. organizations, are deductible up to 60 percent of AGI. Contributions of property are subject to different limitations. See IRS *Publication 526*. Contributions of cash or checks are reported on line 11, while contributions of non-cash property are reported on line 12. If you do not itemize deductions, you cannot deduct any of your charitable contributions.

The value of personal services is never deductible as a charitable contribution, but unreimbursed expenses incurred in performing services on behalf of a church or other charity may be. For example, if you drive to and from volunteer work on behalf of a charity, you may deduct the actual cost of gas and oil or you may claim the standard charitable mileage rate of 14 cents for each substantiated mile (for 2018 and 2019). Unreimbursed travel expenses incurred while away from home (whether within the United States or abroad) in the course of donated services to a tax-exempt religious or charitable organization are deductible as a charitable contribution. There are two ways to do this.

An individual performing the charitable travel can keep track of his or her travel expenses and then claim a charitable contribution for the total on *Schedule A*. (A letter acknowledging the individual's service should be obtained from the charity.) Or, the individual could provide his or her church or charity with a travel report substantiating all travel expenses. In such a case, the church or charity could issue the individual a charitable contribution receipt for the total amount of the substantiated travel expenses. Travel expenses that can be receipted include airfare, lodging, meals, and incidental expenses.

No charitable deduction is allowed for travel expenses incurred while away from home in performing services for a religious or charitable organization unless there is no significant element of personal pleasure, recreation, or vacation involved in the travel.

 **Example:** Pastor J goes on a trip to Europe. He is in Europe for 10 days and conducts one-hour worship services on two of those days. Pastor J will not be able to claim a charitable contribution deduction for the travel expenses that he incurs in making this trip. The same rule would apply if Pastor J's spouse or children go along on the trip.

Charitable contributions must be claimed in the year they are delivered. One exception is a check that is mailed to a charity — it is deductible in the year the check is mailed (and

postmarked), even if it is received early in the next year.

Charitable contributions generally are deductible only to the extent they exceed the value of any premium or benefit received by the donor in return for the contribution.

There are limits on the amount of a contribution that can be deducted. Generally, cash contributions to churches, schools, and other public charities are deductible up to a maximum of 60 percent of AGI. In some cases, contributions that exceed these limits can be carried over and claimed in future years. Some charitable contributions are limited to 20 percent or 30 percent of AGI, depending on the recipient and the form of the contribution.

Designated contributions are those made to a church with the stipulation that they be used for a specified purpose. If the purpose is an approved project or program of the church, the designation will not affect the deductibility of the contribution. An example is a contribution to a church building fund. However, if a donor stipulates that a contribution be spent on a designated individual, no deduction is allowed unless the church exercises full administrative control over the donated funds to ensure that they are being spent in furtherance of the church's exempt purposes. Designated contributions that ordinarily are not deductible include contributions to church benevolence or scholarship funds that designate a specific recipient. Contributions to benevolence or scholarship funds ordinarily are deductible if the donor does not earmark a specific recipient.

Contributions to a church or missions board that specify a particular missionary may be tax-deductible if the church or missions board exercises full administrative and accounting control over the contributions and ensures that they are spent in furtherance of the church's mission. Direct contributions to missionaries, or any other individual, are not tax-deductible, even if they are used for religious or charitable purposes.

Charitable contributions must be properly substantiated. Individual cash contributions of less than \$250 may be substantiated by a canceled check or a receipt from the charity. Special rules govern the substantiation of individual contributions of cash or property of \$250 or more. The donor must substantiate these contributions with a qualifying receipt from the charity including a listing of the contributions and a statement that there were no goods or services provided in exchange for the contributions. These rules are further explained in the supplement to this guide entitled *Federal Reporting Requirements for Churches*.

If you contribute property that you value at \$500 or more, you must include a completed *Form 8283* with your *Form 1040*. Complete only Section A if the value claimed is \$500 or more but less than \$5,000. If you claim a deduction of more than \$5,000 for a contribution of non-cash property (other than publicly

traded securities), then you must obtain a qualified appraisal of the property and include a qualified appraisal summary (Section B of *Form 8283*) with your *Form 1040*.

Special rules apply to donations of cars, boats, and planes. See the instructions to IRS *Form 1098-C* for details.

Key Point: The Tax Court ruled that a donor who contributed property worth more than \$10,000 to a church was not eligible for a charitable contribution deduction, even though there was no dispute as to the value of the property, because he failed to attach a qualified appraisal summary (*Form 8283*) to the tax return on which the contribution was claimed.

Step 5: Casualty and Theft Losses (line 15)

Under prior law, a taxpayer could claim an itemized deduction for any loss sustained during the taxable year, not compensated by insurance or otherwise. For individual taxpayers, deductible losses had to be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Personal casualty or theft losses were deductible only if they exceeded \$100 per casualty or theft. In addition, aggregate net casualty and theft losses were deductible only to the extent they exceeded 10 percent of an individual taxpayer's AGI.

The TCJA temporarily modifies the deduction for personal casualty and theft losses. Taxpayers may claim a personal casualty loss (subject to the limitations described above) only if the loss was attributable to a disaster declared by the president of the United States under the *Disaster Relief and Emergency Assistance Act*.

The above-described limitation is effective for losses incurred in taxable years 2018 through 2025.

NOTE: Job Expenses and Most Other Miscellaneous Deductions

Under prior law, individuals could claim itemized deductions for certain miscellaneous expenses. Certain of these expenses were not deductible unless, in aggregate, they exceeded 2 percent of the taxpayer's AGI. The deductions described below were subject to the aggregate 2 percent floor:

- Appraisal fees for a casualty loss or charitable contribution
- Casualty and theft losses from property used in performing services as an employee
- Clerical help and office rent in caring for investments
- Hobby expenses, but generally not more than hobby income
- Investment fees and expenses

- Safe deposit box rental fees, except for storing jewelry and other personal effects
- Trustee's fees for an IRA, if separately billed and paid
- Tax preparation expenses
- Unreimbursed employee business expenses (see below)
- Job search expenses in the taxpayer's present occupation
- Licenses and regulatory fees
- Passport fees for a business trip
- Tools and supplies used in the taxpayer's work

Unreimbursed employee business expenses subject to the 2 percent AGI floor included such items as:

- Overnight out-of-town travel
- Local transportation
- Meals (subject to a 50 percent AGI floor)
- Entertainment (subject to a 50 percent AGI floor)
- Home office expenses
- Business gifts
- Dues to professional societies
- Work-related education
- Work clothes and uniforms if required and not suitable for everyday use
- Malpractice insurance
- Subscriptions to professional journals and trade magazines related to the taxpayer's work
- Equipment and supplies used in the taxpayer's work

The TCJA suspends all miscellaneous itemized deductions subject to the 2 percent floor under present law. As a result, taxpayers may not claim the above-listed items as itemized deductions for the taxable years to which the suspension applies.

This provision is effective for taxable years 2018 through 2025 unless extended by Congress.

The elimination of an itemized deduction for most expenses, including unreimbursed employee business expenses, will hit some clergy hard. Some have suggested that this impact can be minimized if a church reimburses employee business expenses under an accountable expense reimbursement arrangement. To be accountable, a church's reimbursement arrangement must comply with all four of the following rules:

- Expenses must have a business connection — that is, the reimbursed expenses must represent expenses incurred by an employee while performing services for the employer.
- Employees are reimbursed only for expenses for which they provide an adequate accounting within a reasonable period of time (not more than 60 days after an expense is incurred).

- Employees must return any excess reimbursement or allowance within a reasonable period of time (not more than 120 days after an excess reimbursement is paid).
- The income tax regulations caution that in order for an employer's reimbursement arrangement to be accountable, it must meet a "reimbursement requirement" in addition to the three requirements summarized above. The reimbursement requirement means that an employer's reimbursements of an employee's business expenses come out of the employer's funds and not by reducing the employee's salary.

The basis for this workaround is that while the TCJA eliminated "all miscellaneous itemized deductions that are subject to the 2 percent floor under present law" (including unreimbursed employee business expenses), it did not modify or repeal section 62(a)(2)(A) of the tax code, which excludes from tax employer reimbursements of employee business expenses under an accountable plan (defined above).

Schedule B

Schedule B is used to report taxable interest income and dividend income of more than \$1,500.

Step 1: Interest Income (lines 1–4)

List (on line 1) the name of each institution or individual that paid you taxable interest if you received more than \$1,500 of taxable interest in 2018. Be sure the interest you report on line 1 corresponds to any *Forms 1099-INT* you received from such institutions. Do not include tax-exempt interest. Interest income is carried over to line 2b of *Form 1040*.

Step 2: Dividend Income (lines 5–6)

List (on line 5) the name of each institution that paid you dividends if you received more than \$1,500 in dividends in 2018. Be sure the dividends you report on line 5 correspond to any *Forms 1099-DIV* you received from such institutions. Dividend income is carried over to line 3b of *Form 1040*.

Step 3: Foreign Accounts and Foreign Trusts (lines 7–8)

Be sure to complete this part of the schedule if you had more than \$1,500 of either taxable interest or dividends.

Schedule C

- 📌 **Key Point:** Most ministers who serve local churches or church agencies are employees for federal income tax purposes with respect to their church salary. They

report their church salary on line 1 of *Form 1040* and receive a *Form W-2* from the church. They do not report their salary as self-employment earnings on *Schedule C*.

- 🗨️ **Key Point:** Use *Schedule C* to report income and expenses from ministerial activities you conduct other than in your capacity as a church employee. Examples would be fees for guest speaking in other churches and fees received directly from church members for performing personal services, such as weddings and funerals.
- **Recommendation:** Some ministers are eligible to use the simpler *Schedule C-EZ*.

Step 1: Introduction

Complete the first several questions on *Schedule C*. Ministers should list code 541990 on line B, since this is the code the IRS uses in a clergy tax illustration in *Publication 517*. Some ministers who report their church compensation as self-employed point to this code as proof that ministers serving local churches can report as self-employed. This is not so. This code applies to the incidental self-employment activities of ministers who report their church salaries as employees. It also applies to those few ministers who are self-employed, such as traveling evangelists.

Step 2: Income (lines 1–7)

Report on line 1 your gross income from your self-employment activity.

Step 3: Expenses (lines 8–27)

- ▲ **Warning:** Many ministers continue to report their income taxes as self-employed. One perceived advantage of doing so is the ability to deduct business expenses on *Schedule C* (and avoid the non-deductibility of unreimbursed and non-accountable reimbursed employee business expenses as itemized deductions on *Schedule A*). This advantage is often illusory. Most ministers, if audited by the IRS, would be reclassified as employees and their *Schedule C* deductions disallowed. This could result in substantial additional taxes, penalties, and interest. The best way for ministers to handle their business expenses is through an accountable expense reimbursement arrangement as an employee of the church.

Report any business expenses associated with your self-employment earnings on lines 8 through 27. For example, if you incur transportation, travel, or other expenses in the course of performing self-employment activities, you deduct these expenses on lines 8 through 27 of *Schedule C*. Self-employed

persons can deduct only 50 percent of business meals and meals associated with entertainment.

- 🗨️ **Key Point:** The TCJA provides that no deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement, or recreation; (2) membership dues with respect to any club organized for business, pleasure, recreation, or other social purposes; or (3) a facility or portion thereof used in connection with any of the above items. Thus, the provision repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50 percent limit to such deductions). Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel). For amounts incurred and paid after December 31, 2017, and until December 31, 2025, the TCJA expands this 50 percent limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for de minimis fringe benefits and for the convenience of the employer. This new law does not affect the taxation of reimbursement of entertainment expenses. As long as the church has adopted and followed an accountable expense reimbursement plan, the minister does not include reimbursement of entertainment expenses in his taxable income.

Since self-employed ministers list only their net self-employment earnings (that is, after deducting all business and professional expenses) as a component of gross income on line 6 of *Form 1040* (line 7 if claiming adjustments), they in effect are able to deduct 100 percent of their business and professional expenses even though they cannot deduct business expenses as an itemized deduction on *Schedule A*.

- 🗨️ **Key Point:** In the past, one of the reasons the audit rate was higher for self-employed taxpayers was that only 30 percent of all taxpayers had sufficient itemized expenses to use *Schedule A*. If the IRS could reclassify taxpayers from self-employed to employee status, it generated more tax dollars since only 30 percent of taxpayers could itemize deductions on *Schedule A*. Business expenses that could have been claimed by a self-employed taxpayer on *Schedule C* were lost if a taxpayer was reclassified as an employee and had insufficient expenses to itemize on *Schedule A*.

Report self-employment income from *Schedule C* on *Schedule 1 (Form 1040)* line 12, and carry over this and other items of additional income reported on *Schedule 1 (Form 1040)* to line 6 of *Form 1040* (line 7 if you are claiming adjustments).

Schedule C-EZ

The IRS has released a simpler form of *Schedule C* that can be used by some people with self-employment earnings. *Schedule C-EZ* can be used instead of *Schedule C* if you meet all of these requirements:

- You had business expenses associated with your trade or business of \$5,000 or less in 2018.
- You use the cash rather than the accrual method of accounting.
- You did not have an inventory at any time during the year.
- You did not have a net loss from your trade or business.
- You had only one business as a sole proprietor.
- You had no employees.
- You do not use *Form 4562* to compute a depreciation deduction with regard to your trade or business.
- You do not claim a deduction for the business use of your home.

Many ministers who report their church compensation as employees will be able to use this form to report small amounts of self-employment earnings they receive during the course of a year as honoraria for occasional guest speaking in other churches or as fees received directly from church members for services rendered on their behalf (for example, weddings and funerals).

Schedule SE

 **Key Point:** Use *Schedule SE* to report Social Security taxes on any income you earned as a minister if you have not applied for and received IRS approval of an exemption application (*Form 4361*). Remember, ministers (except for some chaplains) are self-employed for Social Security with respect to their ministerial services. They pay SECA and not FICA with respect to compensation from such services.

 **Key Point:** Ministers who have received IRS approval of an application for exemption from SECA (*Form 4361*) do not pay SECA on compensation received for their ministerial services.

Step 1: Section A (line 2)

Most ministers use the short *Schedule SE* rather than the long *Schedule SE*. This means that they complete Section A on page 1

of the schedule rather than Section B on page 2.

Ministers report their net self-employment earnings on line 2 of Section A. This amount is computed as follows:

Add the following to your church salary:

- Other items of church income (including taxable fringe benefits)
- Fees you receive for weddings, funerals, etc.
- Self-employment earnings from outside businesses
- Annual rental value of a parsonage, including utilities paid by the church (unless you are retired)
- A housing allowance (unless you are retired)
- Business expense reimbursements (under a non-accountable plan)
- The value of meals served on the church's premises for the convenience of the employer
- Any amount the church pays toward your income tax or SECA

And then deduct the following:

- Most income tax exclusions, other than meals or lodging furnished for the employer's convenience, and the foreign earned income exclusion
- Annual fair rental value of a parsonage provided to you after you retire
- Housing allowance provided to you after you retire
- Contributions by your church to a tax-sheltered annuity plan set up for you, including any salary reduction contributions (elective deferrals) that are not included in your gross income
- Pension payments or retirement allowances you receive for your past ministerial services

Unreimbursed and non-accountable reimbursed expenses. The clear implication of the tax code and IRS Revenue Ruling 80-110 is that unreimbursed business expenses, and reimbursed business expenses under a non-accountable plan, are deductible by pastors in computing their SECA liability even if they are not able to deduct these expenses in computing their income tax liability. This understanding is clearly reflected in IRS *Publication 517*. This position is also reflected in the following statement in the instructions to *Schedule SE*:

If you were a duly ordained minister who was an employee of a church and you must pay SE [SECA] tax, the unreimbursed business expenses that you incurred as a church employee are not deductible as an itemized deduction for income tax purposes. However, when figuring SE tax, subtract on line 2 the allowable expenses from your self-employment earnings and attach an explanation.

Step 2: Section A (line 4)

Ministers (and other taxpayers who are self-employed for Social Security) can reduce their taxable earnings by 7.65 percent, which is half the FICA paid by employers and employees. To do this, multiply net earnings from self-employment times 0.9235 on line 4. SECA is paid on the reduced amount.

Step 3: Section A (line 5)

SECA for 2018 is computed on this line. The SECA rate for 2018 is 15.3 percent, which consists of the following two components:

1. A Medicare hospital insurance tax of 2.9 percent
2. An old-age, survivor and disability (Social Security) tax of 12.4 percent

For 2018, the 2.9 percent Medicare tax applied to all net earnings from self-employment regardless of amount. The 12.4 percent Social Security tax applied to only the first \$128,400 of net self-employment earnings.

Form 2106

 **Key Point:** In the past *Form 2106* was used by employees to compute employee business expenses claimed on *Schedule A*. For most taxpayers this form is now obsolete because of the suspension of an itemized deduction for employee business expenses on *Schedule A*. *Form 2106* is now used only by Armed Forces reservists, qualified performing artists, fee-basis state or local government officials, and employees with impairment-related work expenses.

Example One: Active Minister

Note: This example is based on an illustrated example contained at the end of IRS *Publication 517*. Because the 2018 version of IRS *Publication 517* was not available as of the date of printing and due to the major changes to tax law effective for the 2018 tax year, this example may be somewhat different than the example in IRS *Publication 517*.

Rev. John Michaels is the minister of the First Baptist Church. He is married and has one child. The child is considered a qualifying child for the child tax credit. Mrs. Michaels is not employed outside the home. Rev. Michaels is a common-law employee of the church, and he has not applied for an exemption from SECA tax. The church paid Rev. Michaels a salary of \$45,000. In addition, as a self-employed person, he earned \$4,000 during the year for weddings, baptisms, and honoraria. He made estimated tax payments during the year totaling \$12,000. He taught a course at the local community college, for which he was paid \$3,400. Rev. Michaels owns a home next to the church. He makes a \$1,125 per month mortgage payment of principal and interest only. His utility bills and other housing-related expenses for the year totaled \$1,450, and the real estate taxes on his home amounted to \$1,750 for the year. The church paid him \$1,400 per month as his parsonage allowance. The home's fair rental value is \$1,380 per month (furnished, utilities already included).

The parts of Rev. and Mrs. Michaels' income tax return are explained in the order they are completed. They are illustrated in the order that Rev. Michaels will assemble the return to send it to the IRS.

Because of tax reform, certain schedules prepared by Rev. Michaels in the prior tax year are not prepared for this example. First, because unreimbursed business expenses are no longer deductible as itemized deductions for purposes of federal income tax, *Schedule 2106-EZ* is not prepared. Additionally, because the \$14,535 remaining available itemized deductions (comprised of state and local sales taxes of \$1,175, real estate taxes of \$1,750, home mortgage interest of \$6,810, and cash contributions of \$4,800) are less than the new \$24,000 standard deduction for married couples filing jointly, *Schedule A* is not prepared.

Form W-2 from Church

The church completed *Form W-2* for Rev. Michaels as follows:

Box 1. The church entered Rev. Michaels' \$45,000 salary.

Box 2. The church left this box blank because Rev. Michaels did not request federal income tax withholding.

Boxes 3 through 6. Rev. Michaels is considered a self-employed person for purposes of FICA tax withholding, so the church left these boxes blank.

Box 14. The church entered Rev. Michaels' total parsonage allowance for the year and identified it.

TurboTax® Tip: Listed below are tips for ministers who use TurboTax to complete their returns. We have listed our recommended responses to some of the questions asked by the software when entering your *Form W-2* from your church. These tips should not be construed as an endorsement or recommendation of the TurboTax software.

1. "Do any of these apply to this *Form W-2*?"

Be sure to check the box that says, "Religious employment — This income was for religious employment (clergy, nonclergy, religious sect)."

2. "About your religious employment."

Please note that ministers fall under the category of clergy employment.

3. "Tell us about your clergy housing." TurboTax then asks for the parsonage or housing allowance, as well as the amount of qualifying expenses.

The amount you should enter for qualifying expenses is the lesser of your actual housing expenses, the annual fair rental value of your home (furnished, plus utilities), or the amount of your pay that was designated as ministerial housing allowance by your church.

4. "How would you like us to calculate clergy self-employment tax?"

Please note that self-employment tax should be paid on wages and housing allowance. See *Schedule SE TurboTax Tip* for additional information.

Form W-2 from College

The community college gave Rev. Michaels a *Form W-2* that showed the following:

Box 1. The college entered Rev. Michaels' \$3,400 salary.

Box 2. The college withheld \$272 in federal income tax on Rev. Michaels' behalf.

Boxes 3 and 5. As an employee of the college, Rev. Michaels is subject to FICA withholding on his full salary from the college.

Box 4. The college withheld \$210.80 in Social Security taxes.

Box 6. The college withheld \$49.30 in Medicare taxes.

Schedule C-EZ (Form 1040)

Some of Rev. Michaels' entries on *Schedule C-EZ* are explained here.

Line 1. Rev. Michaels reports the \$4,000 from weddings, baptisms, and honoraria.

Line 2. Rev. Michaels reports his expenses related to the line 1 amount. The total consisted of \$87 for marriage and family booklets and \$251 for 461 miles of business use of his car, mainly in connection with honoraria. Rev. Michaels used the standard mileage rate to figure his car expense. He multiplied the standard mileage rate of 54.5 cents by 461 miles for a total of \$251. These expenses total \$338 (\$251 + \$87). However, he cannot deduct the part of his expenses allocable to his tax-free parsonage allowance. He attaches the required statement, *Attachment 1* (shown later), to his return showing that 25 percent (or \$85) of his business expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the \$85 from the \$338 and enters the \$253 difference on line 2.

Line 3. He enters his net profit of \$3,747 both on line 3 and on *Schedule 1 (Form 1040)* line 12.

Lines 4 through 8b. Rev. Michaels fills out these lines to report information about his car.

TurboTax Tip: TurboTax does not appear to calculate the non-deductible portion of the expenses that should be allocated to the tax-free portion of the housing allowance. The taxpayer will need to adjust the expenses (as shown in *Attachment 1*) and input the reduced figure into the software.

Schedule SE (Form 1040)

After Rev. Michaels prepares *Schedule C-EZ*, he fills out *Schedule SE (Form 1040)*. He reads the chart on page 1 of the schedule, which tells him he can use Section A—Short Schedule SE to figure his self-employment tax. Rev. Michaels is a minister, so his salary from the church is not considered church employee income. Thus, he does not have to use Section B—Long Schedule SE. He fills out the following lines in Section A:

Line 2. Rev. Michaels attaches a statement (see *Attachment 2*, later) that explains how he figures the amount (\$63,826) he enters here. The calculation in *Attachment 2* includes unreimbursed business expenses from his work for the church. Although unreimbursed business expenses are clearly no longer

deductible on *Schedule A* as itemized deductions for federal income tax purposes, there is still some ambiguity as of the date of this writing as to whether these expenses remain deductible for self-employment tax purposes. The author has prepared this example, based on rulings and other information, assuming unreimbursed business expenses are deductible against self-employment earnings. Ministers should consult with their personal tax advisors regarding the deductibility of these expenses for purposes of self-employment tax on their 2018 *Form 1040*, in light of the developing nature of guidance in this area as of the date of this writing. Rev. Michaels' records show that he drove 2,600 miles. He multiplies miles driven by the mileage rate of 54.5 cents. The combined result is \$1,417. Additionally, Rev. Michaels paid \$219 for professional publications and booklets in connection with his work for the church. The total unreimbursed business expenses were \$1,636. After including the \$85 of *Schedule C-EZ* expenses allocable to tax-free income, the total deductions against self-employment income are \$1,721.

Line 4. He multiplies \$63,826 by .9235 to get his net earnings from self-employment (\$58,943).

Line 5. The amount on line 4 is less than \$128,400, so Rev. Michaels multiplies the amount on line 4 (\$58,943) by .153 to get his self-employment tax of \$9,018. He enters that amount here and on *Schedule 4 (Form 1040)* lines 57 and 64.

Line 6. Rev. Michaels multiplies the amount on line 5 by .50 to get his deduction for the employer-equivalent portion of self-employment tax of \$4,509. He enters that amount here and on *Schedule 1 (Form 1040)* line 27.

TurboTax Tip: The software asks about self-employment tax on clergy wages. The taxpayer should check the box to pay self-employment tax on wages and housing allowance (assuming, as shown in this example, that the minister has not applied for exemption from the SECA tax). Please note that the software does not appear to automatically reduce self-employment wages by the business expenses allocated to tax-free income. The taxpayer will need to adjust net self-employment income (as shown in *Attachment 2*) and input the reduced figure into the software. This can be done by going into the "Business Taxes" section and selecting "Self-Employment Tax". Choose "Make Adjustments", and enter in the "Ministerial Business Expenses" item the additional expenses that were allocable to tax-free income (\$1,721 in this example — see *Attachment 2*).

Form 1040, Schedule 1 (Form 1040), Schedule 4 (Form 1040), and Schedule 5 (Form 1040)

After Rev. Michaels prepares the above schedules, he fills out *Form 1040*, along with *Schedules 1* through *5* to the extent required. He files a joint return with his wife. First he fills out *Form*

1040, Page 1 and completes the appropriate lines for his filing status and exemptions. Then, he fills out the rest of the forms as follows:

Form 1040, Page 2, line 1. Rev. Michaels reports \$48,640. This amount is the total of his \$45,000 church salary, \$3,400 college salary, and \$240, the excess of the amount designated and paid to him as a parsonage allowance over the lesser of his actual expenses and the fair rental value of his home (furnished, plus utilities). The two salaries were reported to him in Box 1 of the *Forms W-2* he received.

Schedule 1 (Form 1040) line 12. He reports his net profit of \$3,747 from *Schedule C-EZ* line 3. Since no other amounts are reported on *Schedule 1 (Form 1040)* lines 1–21, he also reports this amount on line 22 and carries the figure to the blank space on *Form 1040*, Page 2, line 6.

Form 1040, Page 2, line 6. Rev. Michaels adds *Form 1040*, Page 2, line 1 and the amount reported on the blank space on *Form 1040*, Page 2, line 6 and enters the total (\$52,387) on line 6.

Form 1040, Page 2, line 7. Because Rev. Michaels has reported deductible self-employment tax on *Schedule 1 (Form 1040)* line 27, Rev. Michaels goes to *Schedule 1 (Form 1040)* and completes the bottom section of the form. Since there are no other amounts listed on lines 23–33, Rev. Michaels reports \$4,509 on line 36 and subtracts this amount from the amount reported on *Form 1040*, Page 2, line 6. The result (\$47,878) is entered on *Form 1040*, Page 2, line 7. This is his AGI.

Form 1040, Page 2, line 8. He enters the standard deduction for married couples filing jointly (\$24,000) on line 8.

Form 1040, Page 2, line 9. He enters \$749 on line 9. (Note: Because the Michaels' line 7 AGI is less than \$315,000, Rev. Michaels is eligible for the qualified business income deduction equal to 20 percent of his *Schedule C-EZ* net profit of \$3,747.)

Form 1040, Page 2, line 10. Rev. Michaels subtracts line 8 from line 7. This is his taxable income.

Form 1040, Page 2, lines 11a and 11. Rev. Michaels uses the tax tables in the 2018 *Form 1040* instructions to determine his applicable tax and enters the amount (\$2,394) on the space provided on lines 11a and 11.

Form 1040, Page 2, line 12a. The Michaels can take the child tax credit for their daughter, Jennifer. Rev. Michaels figures the credit by completing the Child Tax Credit Worksheet (not shown) contained in the *Form 1040* general instructions. He enters the \$2,000 credit. (Note: The Michaels are not required to attach *Schedule 8812* to claim the child tax credit since they are not eligible for the additional child tax credit and their daughter does not have an individual taxpayer identification number (ITIN). The IRS issues ITINs to foreign nationals and others who have federal tax reporting or

filing requirements and do not qualify for Social Security numbers (SSNs). Since Jennifer has an SSN, she is not required to obtain an ITIN and therefore *Schedule 8812* is not applicable.)

Form 1040, Page 2, line 14 and Schedule 4 (Form 1040). Rev. Michaels completes *Schedule 4 (Form 1040)*. Since the only amount reported on *Schedule 4 (Form 1040)* is his self-employment tax from *Schedule SE*, he reports the amount (\$9,018) on *Schedule 4 (Form 1040)* line 64 and on *Form 1040*, Page 2, line 14.

Form 1040, Page 2, line 16. He enters the federal income tax shown in Box 2 of his *Form W-2* from the college.

Form 1040, Page 2, line 17 and Schedule 5 (Form 1040). Rev. Michaels enters the \$12,000 estimated tax payments he made for the year on *Schedule 5 (Form 1040)* line 66. Since there are no other amounts reported on *Schedule 5 (Form 1040)*, he reports the amount on *Schedule 5 (Form 1040)* line 75 and also enters the amount on the blank space provided beside "Add any amount from Schedule 5" on line 17 and on line 17 itself.

		a Employee's social security number 011-00-1111		OMB No. 1545-0008		Safe, accurate, FAST! Use				Visit the IRS website at www.irs.gov/efile	
b Employer identification number (EIN) 00-0246810				1 Wages, tips, other compensation 45000.00		2 Federal income tax withheld					
c Employer's name, address, and ZIP code First Baptist Church 1042 Main Street Hometown, Texas 77099				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					
d Control number				9 Verification code		10 Dependent care benefits					
e Employee's first name and initial Last name Suff. John E. Michaels 1040 Main Street Hometown, Texas 77099				11 Nonqualified plans		12a See instructions for box 12					
				13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>		12b					
				14 Other Parsonage Allowance \$16800		12c					
						12d					
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	
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Form **W-2** Wage and Tax Statement

2018

Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.

Sample: from church

a Employee's social security number 011-00-1111		OMB No. 1545-0008		Safe, accurate, FAST! Use				Visit the IRS website at www.irs.gov/efile		
b Employer identification number (EIN)				1 Wages, tips, other compensation 3400.00		2 Federal income tax withheld 272.00				
c Employer's name, address, and ZIP code Hometown College 40 Honor Road Hometown, Texas 77099				3 Social security wages 3400.00		4 Social security tax withheld 210.80				
				5 Medicare wages and tips 3400.00		6 Medicare tax withheld 49.30				
				7 Social security tips		8 Allocated tips				
d Control number				9 Verification code		10 Dependent care benefits				
e Employee's first name and initial Last name Suff. John E. Michaels 1040 Main Street Hometown, Texas 77099				11 Nonqualified plans		12a See instructions for box 12				
				13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>		12b				
				14 Other		12c				
						12d				
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

2018

Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.

Sample: from college

Filing status: Single Married filing jointly Married filing separately Head of household Qualifying widow(er)

Your first name and initial: **John E.** Last name: **Michaels** Your social security number: **0 1 1 0 0 1 1 1 1**

Your standard deduction: Someone can claim you as a dependent You were born before January 2, 1954 You are blind

If joint return, spouse's first name and initial: **Susan R.** Last name: **Michaels** Spouse's social security number: **0 1 1 0 0 2 2 2 2**

Spouse standard deduction: Someone can claim your spouse as a dependent Spouse was born before January 2, 1954 Full-year health care coverage or exempt (see inst.)

Spouse is blind Spouse itemizes on a separate return or you were dual-status alien

Home address (number and street). If you have a P.O. box, see instructions. **1040 Main Street** Apt. no. **Presidential Election Campaign (see inst.)** You Spouse

City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule 6. **Hometown, Texas 77099** If more than four dependents, see inst. and here

Dependents (see instructions):		(2) Social security number	(3) Relationship to you	(4) <input checked="" type="checkbox"/> if qualifies for (see inst.):	
(1) First name	Last name			Child tax credit	Credit for other dependents
Jennifer	Michaels	0 1 1 0 0 3 3 3 3	Daughter	<input checked="" type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>

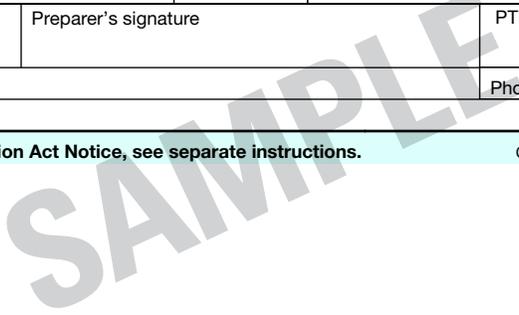
Sign Here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature <i>John E. Michaels</i>	Date 3/15/19	Your occupation Minister	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
Spouse's signature. If a joint return, both must sign. <i>Susan R. Michaels</i>	Date 3/15/19	Spouse's occupation Homemaker	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparer Use Only

Preparer's name	Preparer's signature	PTIN	Firm's EIN	Check if:
Firm's name ▶		Phone no.		<input type="checkbox"/> 3rd Party Designee
Firm's address ▶				<input type="checkbox"/> Self-employed



Attach Form(s) W-2. Also attach Form(s) W-2G and 1099-R if tax was withheld.

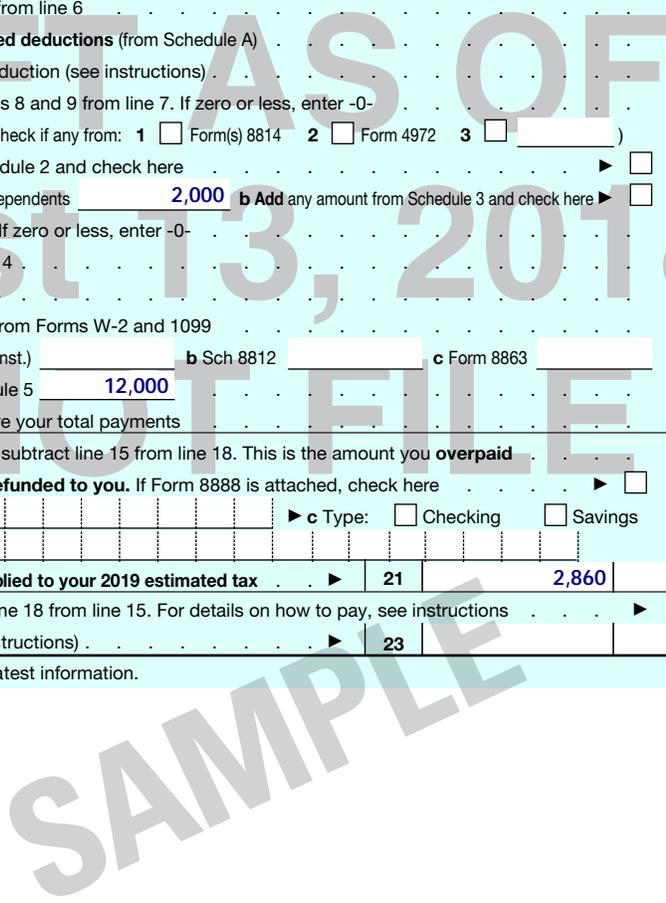
Standard Deduction for —

- Single or married filing separately, \$12,000
- Married filing jointly or Qualifying widow(er), \$24,000
- Head of household, \$18,000
- If you checked any box under Standard deduction, see instructions.

1	Wages, salaries, tips, etc. Attach Form(s) W-2	1	48,640
2a	Tax-exempt interest	2a	
3a	Qualified dividends	3a	
4a	IRAs, pensions, and annuities	4a	
5a	Social security benefits	5a	
6	Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22 3,747	6	52,387
7	Adjusted gross income. If you have no adjustments to income, enter the amount from line 6; otherwise, subtract Schedule 1, line 36, from line 6	7	47,878
8	Standard deduction or itemized deductions (from Schedule A)	8	24,000
9	Qualified business income deduction (see instructions)	9	749
10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-	10	23,129
11	a Tax (see inst) 2,394 (check if any from: 1 <input type="checkbox"/> Form(s) 8814 2 <input type="checkbox"/> Form 4972 3 <input type="checkbox"/>)	11	2,394
	b Add any amount from Schedule 2 and check here <input type="checkbox"/>		
12	a Child tax credit/credit for other dependents 2,000 b Add any amount from Schedule 3 and check here <input type="checkbox"/>	12	2,000
13	Subtract line 12 from line 11. If zero or less, enter -0-	13	394
14	Other taxes. Attach Schedule 4	14	9,018
15	Total tax. Add lines 13 and 14	15	9,412
16	Federal income tax withheld from Forms W-2 and 1099	16	272
17	Refundable credits: a EIC (see inst.) b Sch 8812 c Form 8863		
	Add any amount from Schedule 5 12,000	17	12,000
18	Add lines 16 and 17. These are your total payments	18	12,272
19	If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you overpaid	19	2,860
20a	Amount of line 19 you want refunded to you . If Form 8888 is attached, check here <input type="checkbox"/>	20a	
b	Routing number	c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
d	Account number		
21	Amount of line 19 you want applied to your 2019 estimated tax	21	2,860
22	Amount you owe . Subtract line 18 from line 15. For details on how to pay, see instructions	22	
23	Estimated tax penalty (see instructions)	23	

Refund

Direct deposit? See instructions.



SCHEDULE 1
(Form 1040)

Additional Income and Adjustments to Income

OMB No. 1545-0074

2018
Attachment
Sequence No. **01**

Department of the Treasury
Internal Revenue Service

▶ **Attach to Form 1040.**

▶ **Go to www.irs.gov/Form1040 for instructions and the latest information.**

Name(s) shown on Form 1040

John E. & Susan R. Michaels

Your social security number

011-00-1111

Additional Income					
1-9b	Reserved			1-9b	
10	Taxable refunds, credits, or offsets of state and local income taxes			10	
11	Alimony received			11	
12	Business income or (loss). Attach Schedule C or C-EZ			12	3,747
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>			13	
14	Other gains or (losses). Attach Form 4797			14	
15a	Reserved			15b	
16a	Reserved			16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17	
18	Farm income or (loss). Attach Schedule F			18	
19	Unemployment compensation			19	
20a	Reserved			20b	
21	Other income. List type and amount ▶			21	
22	Combine the amounts in the far right column. If you don't have any adjustments to income, enter here and include on Form 1040, line 6. Otherwise, go to line 23			22	3,747
Adjustments to Income					
23	Educator expenses	23			
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	24			
25	Health savings account deduction. Attach Form 8889	25			
26	Moving expenses for members of the Armed Forces. Attach Form 3903	26			
27	Deductible part of self-employment tax. Attach Schedule SE	27	4,509		
28	Self-employed SEP, SIMPLE, and qualified plans	28			
29	Self-employed health insurance deduction	29			
30	Penalty on early withdrawal of savings	30			
31a	Alimony paid b Recipient's SSN ▶	31a			
32	IRA deduction	32			
33	Student loan interest deduction	33			
34	Reserved	34			
35	Reserved	35			
36	Add lines 23 through 35	36			4,509

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71479F

Schedule 1 (Form 1040) 2018

**SCHEDULE 4
(Form 1040)**

Other Taxes

OMB No. 1545-0074

Department of the Treasury
Internal Revenue Service

▶ **Attach to Form 1040.**

2018
Attachment
Sequence No. **04**

▶ **Go to www.irs.gov/Form1040 for instructions and the latest information.**

Name(s) shown on Form 1040

John E. & Susan R. Michaels

Your social security number

011-00-1111

**Other
Taxes**

57	Self-employment tax. Attach Schedule SE	57	9,018
58	Unreported social security and Medicare tax from: Form a <input type="checkbox"/> 4137 b <input type="checkbox"/> 8919	58	
59	Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required	59	
60a	Household employment taxes. Attach Schedule H	60a	
b	Repayment of first-time homebuyer credit from Form 5405. Attach Form 5405 if required	60b	
61	Health care: individual responsibility (see instructions)	61	
62	Taxes from: a <input type="checkbox"/> Form 8959 b <input type="checkbox"/> Form 8960 c <input type="checkbox"/> Instructions; enter code(s)	62	
63	Section 965 net tax liability installment from Form 965-A	63	
64	Add the amounts in the far right column. These are your total other taxes . Enter here and on Form 1040, line 14	64	9,018

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71481R

Schedule 4 (Form 1040) 2018

SCHEDULE 5
(Form 1040)

Other Payments and Refundable Credits

OMB No. 1545-0074

2018
Attachment
Sequence No. **05**

Department of the Treasury
Internal Revenue Service

▶ **Attach to Form 1040.**

▶ **Go to www.irs.gov/Form1040 for instructions and the latest information.**

Name(s) shown on Form 1040

John E. & Susan R. Michaels

Your social security number

011-00-1111

Other Payments and Refundable Credits	65	Reserved	65		
	66	2018 estimated tax payments and amount applied from 2017 return	66	12,000	
	67a	Reserved	67a		
	b	Reserved	67b		
	68-69	Reserved	68-69		
	70	Net premium tax credit. Attach Form 8962	70		
	71	Amount paid with request for extension to file (see instructions)	71		
	72	Excess social security and tier 1 RRTA tax withheld	72		
	73	Credit for federal tax on fuels. Attach Form 4136	73		
	74	Credits from Form: a <input type="checkbox"/> 2439 b <input type="checkbox"/> Reserved c <input type="checkbox"/> 8885 d <input type="checkbox"/>	74		
75	Add the amounts in the far right column. These are your total other payments and refundable credits . Enter here and include on Form 1040, line 17.	75	12,000		

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71482C

Schedule 5 (Form 1040) 2018

DRAFT AS OF JANUARY 2018
DO NOT FILE

SAMPLE

**SCHEDULE C-EZ
(Form 1040)**

Department of the Treasury
Internal Revenue Service (99)

Name of proprietor

John E. Michaels

Net Profit From Business

(Sole Proprietorship)

▶ Partnerships, joint ventures, etc., generally must file Form 1065.
▶ Attach to Form 1040, 1040NR, or 1041. ▶ See instructions on page 2.

OMB No. 1545-0074

2018
Attachment
Sequence No. **09A**

Social security number (SSN)

011-00-1111

Part I General Information

**You may use
Schedule C-EZ
instead of
Schedule C
only if you:**

- Had business expenses of \$5,000 or less,
- Use the cash method of accounting,
- Did not have an inventory at any time during the year,
- Did not have a net loss from your business,
- Had only one business as either a sole proprietor, qualified joint venture, or statutory employee,

And you:

- Had no employees during the year,
- Do not deduct expenses for business use of your home,
- Do not have prior year unallowed passive activity losses from this business, and
- Are not required to file **Form 4562**, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, to find out if you must file.

A Principal business or profession, including product or service Minister	B Enter business code (see page 2) 5 4 1 9 9 0
C Business name. If no separate business name, leave blank.	D Enter your EIN (see page 2)
E Business address (including suite or room no.). Address not required if same as on page 1 of your tax return. 1042 Main Street City, town or post office, state, and ZIP code Hometown, Texas 77099	
F Did you make any payments in 2018 that would require you to file Form(s) 1099? (see the Instructions for Schedule C) <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
G If "Yes," did you or will you file required Forms 1099? <input type="checkbox"/> Yes <input type="checkbox"/> No	

Part II Figure Your Net Profit

1 Gross receipts. Caution: If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see <i>Statutory employees</i> in the instructions for Schedule C, line 1, and check here <input type="checkbox"/>	1	4,000	
2 Total expenses (see page 2). If more than \$5,000, you must use Schedule C	2	253	*
3 Net profit. Subtract line 2 from line 1. If less than zero, you must use Schedule C. Enter on both Schedule 1 (Form 1040), line 12 , and Schedule SE, line 2 , or on Form 1040NR, line 13 , and Schedule SE, line 2 (see page 2). (Statutory employees do not report this amount on Schedule SE, line 2.) Estates and trusts, enter on Form 1041, line 3 .	3	3,747	

Part III Information on Your Vehicle. Complete this part **only** if you are claiming car or truck expenses on line 2.

4 When did you place your vehicle in service for business purposes? (month, day, year) ▶ 7/15/11

5 Of the total number of miles you drove your vehicle during 2018, enter the number of miles you used your vehicle for:

a Business 461 **b** Commuting (see page 2) 0 **c** Other 7,478

6 Was your vehicle available for personal use during off-duty hours? Yes No

7 Do you (or your spouse) have another vehicle available for personal use? Yes No

8a Do you have evidence to support your deduction? Yes No

b If "Yes," is the evidence written? Yes No

Instructions

Future developments. For the latest information about developments related to Schedule C-EZ (Form 1040) and its instructions, such as legislation enacted after they were published, go to www.irs.gov/ScheduleCEZ.



Before you begin, see General Instructions in the 2018 Instructions for Schedule C.

You can use Schedule C-EZ instead of Schedule C if:

- You operated a business or practiced a profession as a sole proprietorship or qualified joint venture, or you were a statutory employee, and
- You have met all the requirements listed in Schedule C-EZ, Part I.

For more information on electing to be taxed as a qualified joint venture (including the possible social security benefits of this election), see *Qualified Joint Venture* in the Instructions for Schedule C. You can also go to www.irs.gov/QJV.

Line A

Describe the business or professional activity that provided your principal source of income reported on line 1. Give the general field or activity and the type of product or service.

Line B

Enter the six-digit code that identifies your principal business or professional activity. See the Instructions for Schedule C for the list of codes.

Line D

Enter on line D the employer identification number (EIN) that was issued to you and in your name as a sole proprietor. If you are filing Form 1041, enter the EIN issued to the estate or trust. Do not enter your SSN. Do not enter another taxpayer's EIN (for example, from any Forms 1099-MISC that you received). **If you do not have an EIN, leave line D blank.**

You need an EIN only if you have a qualified retirement plan or are required to file an employment, excise, alcohol, tobacco, or firearms tax return, are a payer of gambling winnings, or are filing Form 1041 for an estate or trust. If you need an EIN, see the Instructions for Form SS-4.

Single-member LLCs. If you are the sole owner of an LLC that is not treated as a separate entity for federal income tax purposes, enter on line D the EIN that was issued to the LLC (in the LLC's legal name) for a qualified retirement plan, to file employment, excise, alcohol, tobacco, or firearms returns, or as a payer of gambling winnings. **If you do not have such an EIN, leave line D blank.**

Line E

Enter your business address. Show a street address instead of a box number. Include the suite or room number, if any.

Line F

See the instructions for Schedule C, line I, to help determine if you are required to file any Forms 1099.

Line 1

Enter gross receipts from your trade or business. Include amounts you received in your trade or business that were properly shown on Form 1099-MISC. If the total amounts that were reported in box 7 of Forms 1099-MISC are more than the total you are reporting on line 1, attach a statement explaining the difference. You must show all items of taxable income actually or constructively received during the year (in cash, property, or services). Income is constructively received when it is credited to your account or set aside for you to use. Don't offset this amount by any losses.

Line 2

Enter the total amount of all deductible business expenses you actually paid during the year. Examples of these expenses include advertising, car and truck expenses, commissions and fees, insurance, interest, legal and professional services, office expenses, rent or lease expenses, repairs and maintenance, supplies, taxes, travel, the allowable percentage of business meals and entertainment, and utilities (including telephone). For details, see the instructions for Schedule C, Parts II and V. You can use the optional worksheet below to record your expenses. Enter on lines **b** through **f** the type and amount of expenses not included on line **a**.

If you claim car or truck expenses, be sure to complete Schedule C-EZ, Part III.

Line 3

Nonresident aliens using Form 1040NR should also enter the total on Schedule SE, line 2, if you are covered under the U.S. social security system due to an international social security agreement currently in effect. See the Instructions for Schedule SE for information on international social security agreements.

Line 5b

Generally, commuting is travel between your home and a work location. If you converted your vehicle during the year from personal to business use (or vice versa), enter your commuting miles only for the period you drove your vehicle for business. For information on certain travel that is considered a business expense rather than commuting, see the instructions for Schedule C, line 44b.

Optional Worksheet for Line 2 (keep a copy for your records)

a	Deductible meals (see the instructions for Schedule C, line 24b)	a		
b	-----	b		
c	-----	c		
d	-----	d		
e	-----	e		
f	-----	f		
g	Total. Add lines a through f . Enter here and on line 2	g		

**SCHEDULE SE
(Form 1040)**

Self-Employment Tax

OMB No. 1545-0074

2018
Attachment
Sequence No. **17**

Department of the Treasury
Internal Revenue Service (99)

► Go to www.irs.gov/ScheduleSE for instructions and the latest information.
► Attach to Form 1040 or Form 1040NR.

Name of person with self-employment income (as shown on Form 1040 or Form 1040NR)

Social security number of person with self-employment income ►

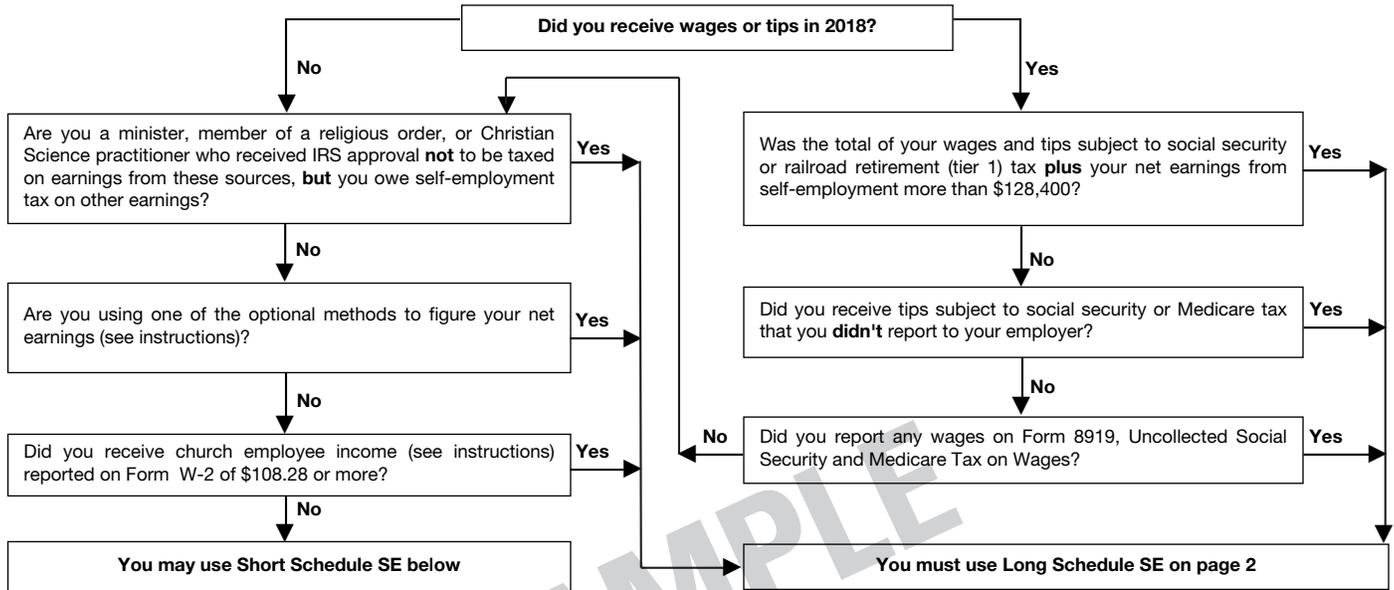
011-00-1111

John E. Michaels

Before you begin: To determine if you must file Schedule SE, see the instructions.

May I Use Short Schedule SE or Must I Use Long Schedule SE?

Note: Use this flowchart **only** if you must file Schedule SE. If unsure, see *Who Must File Schedule SE* in the instructions.



Section A—Short Schedule SE. Caution: Read above to see if you can use Short Schedule SE.

1a	Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A		
1b	If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code AH	()
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report		63,826 *
3	Combine lines 1a, 1b, and 2		63,826
4	Multiply line 3 by 92.35% (0.9235). If less than \$400, you don't owe self-employment tax; don't file this schedule unless you have an amount on line 1b. ►		58,943
5	Self-employment tax. If the amount on line 4 is: • \$128,400 or less, multiply line 4 by 15.3% (0.153). Enter the result here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55 • More than \$128,400, multiply line 4 by 2.9% (0.029). Then, add \$15,921.60 to the result. Enter the total here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55		9,018
6	Deduction for one-half of self-employment tax. Multiply line 5 by 50% (0.50). Enter the result here and on Schedule 1 (Form 1040), line 27, or Form 1040NR, line 27	6	4,509

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 11358Z

Schedule SE (Form 1040) 2018

*See Attachment on page 52.

Name of person with **self-employment** income (as shown on Form 1040 or Form 1040NR)

Social security number of person with **self-employment** income ▶

Section B—Long Schedule SE

Part I Self-Employment Tax

Note: If your only income subject to self-employment tax is **church employee income**, see instructions. Also see instructions for the definition of church employee income.

A If you are a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361, but you had \$400 or more of **other** net earnings from self-employment, check here and continue with Part I

1a Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A. Note: Skip lines 1a and 1b if you use the farm optional method (see instructions)	1a	
b If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code AH	1b ()
2 Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report. Note: Skip this line if you use the nonfarm optional method (see instructions)	2	
3 Combine lines 1a, 1b, and 2	3	
4a If line 3 is more than zero, multiply line 3 by 92.35% (0.9235). Otherwise, enter amount from line 3 Note: If line 4a is less than \$400 due to Conservation Reserve Program payments on line 1b, see instructions.	4a	
b If you elect one or both of the optional methods, enter the total of lines 15 and 17 here	4b	
c Combine lines 4a and 4b. If less than \$400, stop ; you don't owe self-employment tax. Exception: If less than \$400 and you had church employee income , enter -0- and continue ▶	4c	
5a Enter your church employee income from Form W-2. See instructions for definition of church employee income	5a	
b Multiply line 5a by 92.35% (0.9235). If less than \$100, enter -0-	5b	
6 Add lines 4c and 5b	6	
7 Maximum amount of combined wages and self-employment earnings subject to social security tax or the 6.2% portion of the 7.65% railroad retirement (tier 1) tax for 2018	7	128,400
8a Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) and railroad retirement (tier 1) compensation. If \$128,400 or more, skip lines 8b through 10, and go to line 11	8a	
b Unreported tips subject to social security tax (from Form 4137, line 10)	8b	
c Wages subject to social security tax (from Form 8919, line 10)	8c	
d Add lines 8a, 8b, and 8c	8d	
9 Subtract line 8d from line 7. If zero or less, enter -0- here and on line 10 and go to line 11 ▶	9	
10 Multiply the smaller of line 6 or line 9 by 12.4% (0.124)	10	
11 Multiply line 6 by 2.9% (0.029)	11	
12 Self-employment tax. Add lines 10 and 11. Enter here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55	12	
13 Deduction for one-half of self-employment tax. Multiply line 12 by 50% (0.50). Enter the result here and on Schedule 1 (Form 1040), line 27, or Form 1040NR, line 27	13	

Part II Optional Methods To Figure Net Earnings (see instructions)

Farm Optional Method. You may use this method **only** if (a) your gross farm income¹ wasn't more than \$7,920, or (b) your net farm profits² were less than \$5,717.

14 Maximum income for optional methods	14	5,280
15 Enter the smaller of: two-thirds (2/3) of gross farm income ¹ (not less than zero) or \$5,280. Also include this amount on line 4b above	15	

Nonfarm Optional Method. You may use this method **only** if (a) your net nonfarm profits³ were less than \$5,717 and also less than 72.189% of your gross nonfarm income,⁴ and (b) you had net earnings from self-employment of at least \$400 in 2 of the prior 3 years. **Caution:** You may use this method no more than five times.

16 Subtract line 15 from line 14	16	
17 Enter the smaller of: two-thirds (2/3) of gross nonfarm income ⁴ (not less than zero) or the amount on line 16. Also include this amount on line 4b above	17	

¹ From Sch. F, line 9, and Sch. K-1 (Form 1065), box 14, code B.

² From Sch. F, line 34, and Sch. K-1 (Form 1065), box 14, code A—minus the amount you would have entered on line 1b had you not used the optional method.

³ From Sch. C, line 31; Sch. C-EZ, line 3; Sch. K-1 (Form 1065), box 14, code A; and Sch. K-1 (Form 1065-B), box 9, code J1.

⁴ From Sch. C, line 7; Sch. C-EZ, line 1; Sch. K-1 (Form 1065), box 14, code C; and Sch. K-1 (Form 1065-B), box 9, code J2.

Attachment 1. Computation of expenses, allocable to tax-free ministerial income, that are non-deductible

		Taxable	Tax-Free	Total
Salary as a minister		\$ 45,000		\$ 45,000
Parsonage allowance:				
Amount designated and paid by church (\$1,400 x 12)	\$ 16,800			
Actual expenses				
(Mortgage \$1,125 x 12, Utilities/other \$1,450, Real estate taxes \$1,750)	16,700			
Fair rental value of home (furnished, plus utilities) (\$1,380 x 12)	16,560			
Taxable portion of allowance				
(excess of amount designated & paid over lesser of actual expenses or fair rental value)	<u>\$ 240</u>	240		240
Tax-free portion of allowance (lesser of amount designated, actual expenses or fair rental value)			16,560	16,560
Gross income from weddings, baptisms, and honoraria		<u>4,000</u>		<u>4,000</u>
Ministerial income		<u>\$ 49,240</u>	<u>\$ 16,560</u>	<u>\$ 65,800</u>
% of non-deductible expenses: \$16,560/\$65,800 = 25%				

Schedule C-EZ Deduction Computation

Marriage and family booklets		\$ 87
Business use of car:		
461 miles x 54.5¢		<u>251</u>
Unadjusted <i>Schedule C-EZ</i> expenses Minus:		338
Non-deductible part of <i>Schedule C-EZ</i> expenses (25% x \$338)		<u>(85)</u>
<i>Schedule C-EZ</i> deductions (line 2)		<u>\$ 253</u>

Attachment 2. Attachment to Schedule SE (Form 1040)

Church wages		\$ 45,000
Parsonage allowance		16,800
Net profit from <i>Schedule C-EZ</i>		<u>3,747</u>
		65,547
Less:		
<i>Schedule C-EZ</i> expenses allocable to tax-free income		\$ 85
Ministerial employee unreimbursed business expenses		
Car expenses for church business:		
2,600 miles x 54.5¢		1,417
Publications and booklets		219
Net self-employment income		(1,721)
<i>Schedule SE</i> , Section A, line 2		<u>\$ 63,826</u>

SAMPLE

Example Two: Retired Minister

Rev. William K. Green is a retired minister. He is 69 years old. He is married to Sarah J. Green. She is 65 years old and is also retired. For 2018, Rev. Green received \$15,000 in annuity income, all of which was designated in advance by GuideStone as a housing allowance. Rev. Green had housing expenses of \$13,000. The home's fair rental value is \$1,200 per month (furnished, plus utilities). Housing allowances for retired ministers are not taxable in computing federal income tax to the extent that they do not exceed the lesser of actual housing expenses or the annual fair rental value of the home (furnished, plus utilities). Retirement benefits, whether or not designated in advance as a housing allowance, are not subject to self-employment taxes.

Rev. Green received \$12,000 of Social Security benefits in 2018, and his wife received \$6,000. None of this income is taxable, however, because the Greens' income is not enough to expose their Social Security benefits to tax.

In 2018, Rev. Green received \$2,000 from occasional guest preaching engagements. He incurred \$590 in expenses as a result of these activities (\$436 of travel expenses and \$150 of meal expenses). Note that Rev. Green will pay self-employment tax on this income (see *Schedule SE*), since it represents compensation from active ministry.

The parts of Rev. and Mrs. Green's income tax return are explained in the order they are completed. They are illustrated in the order that Rev. Green will assemble the return to send it to the IRS.

Form 1099-R from GuideStone

GuideStone completed *Form 1099-R* for Rev. Green as follows:

Box 1. The \$15,000 pension income Rev. Green receives from GuideStone.

Box 2a. Taxable amount not determined. GuideStone designated in advance 100 percent of pension income as a housing allowance. It is not taxable to the extent that it does not exceed the lesser of actual housing expenses or the annual fair rental value of the home (furnished, plus utilities).

Box 7. Rev. Green's pension income is a normal distribution.

Schedule C-EZ (Form 1040)

Some of Rev. Green's entries on *Schedule C-EZ* are explained here.

Line 1. Rev. Green reports the \$2,000 from occasional guest preaching engagements.

Line 2. Rev. Green reports his expenses related to the line 1 amount. He drove 800 miles of business use of his car in connection with guest preaching. Rev. Green used the standard business mileage rate to figure his car expense. He multiplied the standard mileage rate of 54.5 cents by 800 miles for a total of \$436. He also incurred \$75 (\$150 x 50 percent non-deductible) in business meal expenses (i.e., non-entertainment-related, see bold note below) in connection with the guest preaching for total expenses of \$511. However, he cannot deduct the part of his expenses allocable to his tax-free parsonage allowance. He attaches the required statement, *Attachment 1* (shown later), to his return showing that 76 percent (or \$388) of his business expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the \$388 from the \$511 and enters the \$123 difference on line 2. **Note: Due to changes in the tax law as a result of recent tax reform, there are certain scenarios where food and beverage expenses incurred in connection with entertainment may not be deductible. Business-related meal expenses remain 50 percent deductible. In this example, the author has assumed the meal expenses incurred in connection with the guest preaching were 50 percent deductible business meal expenses. As of the date of this writing, the IRS is in the process of drafting formal guidance to clarify when food and beverage expenses would be considered entertainment expenses and therefore not deductible by taxpayers. Interim guidance has been provided in IRS Notice 2018-76. Taxpayers should consult with their personal tax advisors regarding the deductibility of food and beverage expenses on Schedule C-EZ in light of recent tax reform.**

Line 3. He enters his net profit of \$1,877 both on line 3 and on *Schedule 1 (Form 1040)* line 12.

Lines 4 through 8b. Rev. Green fills out these lines to report information about his car.

TurboTax Tip: Listed below are tips for ministers who use TurboTax to complete their returns. These tips should not be construed as an endorsement or recommendation of the TurboTax software.

TurboTax does not appear to calculate the non-deductible portion of the expenses that should be allocated to the tax-free portion of the housing allowance. The taxpayer will need to adjust the expenses (as shown in *Attachment 1*) and input the reduced figure into the software.

Schedule SE (Form 1040)

After Rev. Green prepares *Schedule C-EZ*, he fills out *Schedule SE (Form 1040)*. He reads the chart on page 1 of the schedule, which tells him he can use Section A—Short Schedule SE to figure his self-employment tax. Ministers are not church employees under this definition. He fills out the following lines in Section A:

Line 2. Rev. Green attaches a statement (see *Attachment 2*, later) that calculates his net profit of \$1,489, and he enters that amount here.

Line 4. He multiplies the \$1,489 by .9235 to get his net earnings from self-employment (\$1,375).

Line 5. The amount on line 4 is less than \$128,400, so Rev. Green multiplies the amount on line 4 (\$1,375) by .153 to get his self-employment tax of \$210. He enters that amount here and on *Schedule 4 (Form 1040)* line 57.

Line 6. Rev. Green multiplies the amount on line 5 by .50 to get his deduction for the employer-equivalent portion of self-employment tax of \$105. He enters that amount here and on *Schedule 1 (Form 1040)* line 27.

TurboTax Tip: The software does not appear to reduce self-employment wages by the business expenses allocated to tax-free income. The taxpayer will need to adjust net self-employment income (as shown in *Attachment 2*) and input the reduced figure into the software.

Form 1040, Schedule 1 (Form 1040), and Schedule 4 (Form 1040)

After Rev. Green prepares *Schedule C-EZ* and *Schedule SE*, he fills out *Form 1040*, along with *Schedules 1* through *5* to the extent required. Rev. Green files a joint return with his wife. First he fills out *Form 1040*, Page 1 and completes the appropriate lines for his filing status, including checking the appropriate boxes indicating that he and his wife were born before January 2, 1954. Then, he fills out the rest of the form as follows:

Form 1040, Page 2, lines 4a and 4b. Rev. Green reports his total annuity income of \$15,000 on line 4a. He reports the taxable amount (\$2,000) as computed on *Attachment 1* (shown later) on line 4b.

Form 1040, Page 2, lines 5a and 5b. Rev. Green reports \$18,000 of Social Security benefits on line 5a (the sum of his \$12,000 of Social Security benefits and his wife's \$6,000 of Social Security benefits). He reports \$0.00 on line 5b.

Schedule 1 (Form 1040) line 12. He reports his net profit of \$1,877 from *Schedule C-EZ* line 3. Since no other amounts

are reported on *Schedule 1 (Form 1040)* lines 1–21, he also reports this amount on line 22 and carries the figure to the blank space on *Form 1040*, Page 2, line 6.

Form 1040, Page 2, line 6. Rev. Green adds *Form 1040*, Page 2, line 4b and the amount reported on the blank space on *Form 1040*, Page 2, line 6 and enters the total (\$3,877) on line 6.

Form 1040, Page 2, line 7. Because Rev. Green has reported deductible self-employment tax of \$105 on *Schedule 1 (Form 1040)* line 27, Rev. Green goes to *Schedule 1 (Form 1040)* and completes the bottom section of the form. Since there are no other amounts listed on lines 23–33, Rev. Green reports \$105 on line 36 and subtracts this amount from the amount reported on *Form 1040*, Page 2, line 6. The result (\$3,772) is entered on *Form 1040*, Page 2, line 7. This is his AGI.

Form 1040, Page 2, line 8. Rev. Green enters his standard deduction of \$26,600, which takes into consideration that he and his wife were born before January 2, 1954.

Form 1040, Page 2, line 9. He enters \$375 on line 9. (Note: Because the Greens' line 7 AGI is less than \$315,000, Rev. Green is eligible for the qualified business income deduction equal to 20 percent of his *Schedule C-EZ* net profit of \$1,877.)

Form 1040, Page 2, line 10. Rev. Green has no taxable income.

Form 1040, Page 2, line 14 and Schedule 4 (Form 1040). Rev. Green completes *Schedule 4 (Form 1040)*. Since the only amount reported on *Schedule 4 (Form 1040)* is his self-employment tax from *Schedule SE*, he reports the amount (\$210) on *Schedule 4 (Form 1040)* line 64 and on *Form 1040*, Page 2, line 14.

Form 1040, Page 2, line 16. Rev. Green did not have any income tax withheld from his pension.

Form 1040, Page 2, line 22. Amount Rev. Green owes to the IRS.

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and phone no. GuideStone Financial Resources 5005 LBJ Freeway Ste 2200 Dallas, Texas 75244-6152 888-984-8433			1 Gross distribution \$ 15000.00		OMB No. 1545-0119 2018 Form 1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
			2a Taxable amount \$ 0.00			
PAYER'S TIN 75-0939949			RECIPIENT'S TIN 202-20-2002		2b Taxable amount not determined <input checked="" type="checkbox"/> Total distribution <input type="checkbox"/>	
RECIPIENT'S name William K. Green			3 Capital gain (included in box 2a) \$		4 Federal income tax withheld \$	
Street address (including apt. no.) 787 Adams Street			5 Employee contributions/ Designated Roth contributions or insurance premiums \$		6 Net unrealized appreciation in employer's securities \$	
City or town, state or province, country, and ZIP or foreign postal code Anytown, NY 10002			7 Distribution code(s) 7		8 Other \$ %	
			IRA/SEP/SIMPLE <input type="checkbox"/>			
10 Amount allocable to IRR within 5 years \$			11 1st year of desig. Roth contrib.		9a Your percentage of total distribution %	
FATCA filing requirement <input type="checkbox"/>			12 State tax withheld \$		9b Total employee contributions \$	
Account number (see instructions)			Date of payment		13 State/Payer's state no.	
			15 Local tax withheld \$		14 State distribution \$	
			16 Name of locality		17 Local distribution \$	

Copy B
Report this income on your federal tax return. If this form shows federal income tax withheld in box 4, attach this copy to your return.

This information is being furnished to the IRS.

Form 1099-R

www.irs.gov/Form1099R

Department of the Treasury - Internal Revenue Service

SAMPLE

Filing status: Single Married filing jointly Married filing separately Head of household Qualifying widow(er)

Your first name and initial: **William K.** Last name: **Green** Your social security number: **2 0 2 2 0 2 0 0 2**

Your standard deduction: Someone can claim you as a dependent You were born before January 2, 1954 You are blind

If joint return, spouse's first name and initial: **Sarah J.** Last name: **Green** Spouse's social security number: **3 0 3 3 0 3 0 0 3**

Spouse standard deduction: Someone can claim your spouse as a dependent Spouse was born before January 2, 1954 Full-year health care coverage or exempt (see inst.)

Spouse is blind Spouse itemizes on a separate return or you were dual-status alien

Home address (number and street). If you have a P.O. box, see instructions. **787 Adams Street** Apt. no. **Presidential Election Campaign (see inst.)** You Spouse

City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule 6. **Anytown, New York 10002** If more than four dependents, see inst. and here

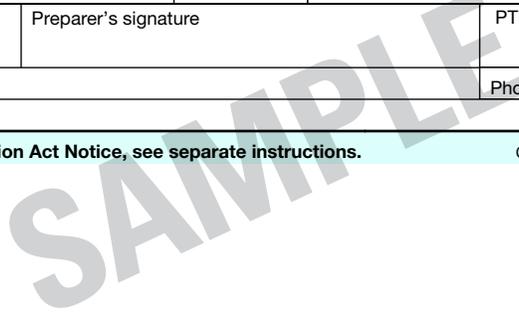
Dependents (see instructions):		(2) Social security number	(3) Relationship to you	(4) <input checked="" type="checkbox"/> if qualifies for (see inst.):	
(1) First name	Last name			Child tax credit	Credit for other dependents
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>

Sign Here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.	Your signature <i>William K. Green</i>	Date 3/15/19	Your occupation Retired Minister	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
	Spouse's signature. If a joint return, both must sign. <i>Sarah J. Green</i>	Date 3/15/19	Spouse's occupation Retired	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparer Use Only

Preparer's name	Preparer's signature	PTIN	Firm's EIN	Check if: <input type="checkbox"/> 3rd Party Designee <input type="checkbox"/> Self-employed
Firm's name ▶		Phone no.		
Firm's address ▶				



Attach Form(s) W-2. Also attach Form(s) W-2G and 1099-R if tax was withheld.

Standard Deduction for —

- Single or married filing separately, \$12,000
- Married filing jointly or Qualifying widow(er), \$24,000
- Head of household, \$18,000
- If you checked any box under Standard deduction, see instructions.

1	Wages, salaries, tips, etc. Attach Form(s) W-2	1	
2a	Tax-exempt interest	2a	
3a	Qualified dividends	3a	
4a	IRAs, pensions, and annuities	4a	15,000
5a	Social security benefits	5a	18,000
6	Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22	6	1,877
7	Adjusted gross income. If you have no adjustments to income, enter the amount from line 6; otherwise, subtract Schedule 1, line 36, from line 6	7	3,772
8	Standard deduction or itemized deductions (from Schedule A)	8	26,600
9	Qualified business income deduction (see instructions)	9	375
10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-	10	0
11	a Tax (see inst) <u>0</u> (check if any from: 1 <input type="checkbox"/> Form(s) 8814 2 <input type="checkbox"/> Form 4972 3 <input type="checkbox"/>)	11	0
	b Add any amount from Schedule 2 and check here <input type="checkbox"/>	12	0
12	a Child tax credit/credit for other dependents b Add any amount from Schedule 3 and check here <input type="checkbox"/>	13	0
13	Subtract line 12 from line 11. If zero or less, enter -0-	14	210
14	Other taxes. Attach Schedule 4	15	210
15	Total tax. Add lines 13 and 14	16	
16	Federal income tax withheld from Forms W-2 and 1099	17	
17	Refundable credits: a EIC (see inst.) b Sch 8812 c Form 8863	18	0
	Add any amount from Schedule 5	19	
18	Add lines 16 and 17. These are your total payments	20a	
19	If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you overpaid	21	
20a	Amount of line 19 you want refunded to you . If Form 8888 is attached, check here <input type="checkbox"/>	22	210
21	Amount of line 19 you want applied to your 2019 estimated tax	23	
22	Amount you owe . Subtract line 18 from line 15. For details on how to pay, see instructions		
23	Estimated tax penalty (see instructions)		

Refund

Direct deposit? See instructions.

b Routing number **c** Type: Checking Savings

d Account number

Go to www.irs.gov/Form1040 for instructions and the latest information.

SAMPLE

SCHEDULE 1
(Form 1040)

Additional Income and Adjustments to Income

OMB No. 1545-0074

2018
Attachment
Sequence No. **01**

Department of the Treasury
Internal Revenue Service

▶ **Attach to Form 1040.**

▶ **Go to www.irs.gov/Form1040 for instructions and the latest information.**

Name(s) shown on Form 1040

William K. & Sarah J. Green

Your social security number

202-20-2002

Additional Income	1-9b	Reserved		1-9b		
	10	Taxable refunds, credits, or offsets of state and local income taxes		10		
	11	Alimony received		11		
	12	Business income or (loss). Attach Schedule C or C-EZ		12	1,877	
	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>		13		
	14	Other gains or (losses). Attach Form 4797		14		
	15a	Reserved		15b		
	16a	Reserved		16b		
	17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17		
	18	Farm income or (loss). Attach Schedule F		18		
	19	Unemployment compensation		19		
	20a	Reserved		20b		
	21	Other income. List type and amount ▶		21		
	22	Combine the amounts in the far right column. If you don't have any adjustments to income, enter here and include on Form 1040, line 6. Otherwise, go to line 23		22	1,877	
	Adjustments to Income	23	Educator expenses	23		
		24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	24		
		25	Health savings account deduction. Attach Form 8889	25		
		26	Moving expenses for members of the Armed Forces. Attach Form 3903	26		
		27	Deductible part of self-employment tax. Attach Schedule SE	27	105	
		28	Self-employed SEP, SIMPLE, and qualified plans	28		
		29	Self-employed health insurance deduction	29		
		30	Penalty on early withdrawal of savings	30		
31a		Alimony paid b Recipient's SSN ▶	31a			
32		IRA deduction	32			
33	Student loan interest deduction	33				
34	Reserved	34				
35	Reserved	35				
36	Add lines 23 through 35	36		105		

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71479F

Schedule 1 (Form 1040) 2018

**SCHEDULE 4
(Form 1040)**

Other Taxes

OMB No. 1545-0074

Department of the Treasury
Internal Revenue Service

▶ **Attach to Form 1040.**

2018
Attachment
Sequence No. **04**

▶ **Go to www.irs.gov/Form1040 for instructions and the latest information.**

Name(s) shown on Form 1040

William K. & Sarah J. Green

Your social security number

202-20-2002

**Other
Taxes**

- 57** Self-employment tax. Attach Schedule SE
- 58** Unreported social security and Medicare tax from: Form **a** 4137 **b** 8919
- 59** Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required
- 60a** Household employment taxes. Attach Schedule H
- b** Repayment of first-time homebuyer credit from Form 5405. Attach Form 5405 if required
- 61** Health care: individual responsibility (see instructions)
- 62** Taxes from: **a** Form 8959 **b** Form 8960
c Instructions; enter code(s)
- 63** Section 965 net tax liability installment from Form 965-A **63**
- 64** Add the amounts in the far right column. These are your **total other taxes**. Enter here and on Form 1040, line 14

57		210	
58			
59			
60a			
60b			
61			
62			
63			
64		210	

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71481R

Schedule 4 (Form 1040) 2018

SAMPLE

**SCHEDULE C-EZ
(Form 1040)**

Department of the Treasury
Internal Revenue Service (99)

Name of proprietor

William K. Green

Net Profit From Business

(Sole Proprietorship)

▶ Partnerships, joint ventures, etc., generally must file Form 1065.
▶ Attach to Form 1040, 1040NR, or 1041. ▶ See instructions on page 2.

OMB No. 1545-0074

2018
Attachment
Sequence No. **09A**

Social security number (SSN)

202-20-2002

Part I General Information

You may use Schedule C-EZ instead of Schedule C only if you:

- Had business expenses of \$5,000 or less,
- Use the cash method of accounting,
- Did not have an inventory at any time during the year,
- Did not have a net loss from your business,
- Had only one business as either a sole proprietor, qualified joint venture, or statutory employee,

And you:

- Had no employees during the year,
- Do not deduct expenses for business use of your home,
- Do not have prior year unallowed passive activity losses from this business, and
- Are not required to file **Form 4562**, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, to find out if you must file.

A Principal business or profession, including product or service Minister	B Enter business code (see page 2) 5 4 1 9 9 0
C Business name. If no separate business name, leave blank.	D Enter your EIN (see page 2)
E Business address (including suite or room no.). Address not required if same as on page 1 of your tax return. 787 Adams Street City, town or post office, state, and ZIP code Anytown, New York 10002	
F Did you make any payments in 2018 that would require you to file Form(s) 1099? (see the Instructions for Schedule C)	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
G If "Yes," did you or will you file required Forms 1099?	<input type="checkbox"/> Yes <input type="checkbox"/> No

Part II Figure Your Net Profit

1 Gross receipts. Caution: If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see <i>Statutory employees</i> in the instructions for Schedule C, line 1, and check here <input type="checkbox"/>	1	2,000	
2 Total expenses (see page 2). If more than \$5,000, you must use Schedule C	2	123	*
3 Net profit. Subtract line 2 from line 1. If less than zero, you must use Schedule C. Enter on both Schedule 1 (Form 1040), line 12 , and Schedule SE, line 2 , or on Form 1040NR, line 13 , and Schedule SE, line 2 (see page 2). (Statutory employees do not report this amount on Schedule SE, line 2.) Estates and trusts, enter on Form 1041, line 3.	3	1,877	

Part III Information on Your Vehicle. Complete this part **only** if you are claiming car or truck expenses on line 2.

4 When did you place your vehicle in service for business purposes? (month, day, year) ▶ 7/15/2011

5 Of the total number of miles you drove your vehicle during 2018, enter the number of miles you used your vehicle for:

a Business 800 **b** Commuting (see page 2) 0 **c** Other 12,682

6 Was your vehicle available for personal use during off-duty hours? Yes No

7 Do you (or your spouse) have another vehicle available for personal use? Yes No

8a Do you have evidence to support your deduction? Yes No

b If "Yes," is the evidence written? Yes No

Instructions

Future developments. For the latest information about developments related to Schedule C-EZ (Form 1040) and its instructions, such as legislation enacted after they were published, go to www.irs.gov/ScheduleCEZ.



Before you begin, see General Instructions in the 2018 Instructions for Schedule C.

- You can use Schedule C-EZ instead of Schedule C if:
- You operated a business or practiced a profession as a sole proprietorship or qualified joint venture, or you were a statutory employee, and
 - You have met all the requirements listed in Schedule C-EZ, Part I.
- For more information on electing to be taxed as a qualified joint venture (including the possible social security benefits of this election), see *Qualified Joint Venture* in the Instructions for Schedule C. You can also go to www.irs.gov/QJV.

Line A

Describe the business or professional activity that provided your principal source of income reported on line 1. Give the general field or activity and the type of product or service.

Line B

Enter the six-digit code that identifies your principal business or professional activity. See the Instructions for Schedule C for the list of codes.

Line D

Enter on line D the employer identification number (EIN) that was issued to you and in your name as a sole proprietor. If you are filing Form 1041, enter the EIN issued to the estate or trust. Do not enter your SSN. Do not enter another taxpayer's EIN (for example, from any Forms 1099-MISC that you received). **If you do not have an EIN, leave line D blank.**

You need an EIN only if you have a qualified retirement plan or are required to file an employment, excise, alcohol, tobacco, or firearms tax return, are a payer of gambling winnings, or are filing Form 1041 for an estate or trust. If you need an EIN, see the Instructions for Form SS-4.

Single-member LLCs. If you are the sole owner of an LLC that is not treated as a separate entity for federal income tax purposes, enter on line D the EIN that was issued to the LLC (in the LLC's legal name) for a qualified retirement plan, to file employment, excise, alcohol, tobacco, or firearms returns, or as a payer of gambling winnings. **If you do not have such an EIN, leave line D blank.**

Line E

Enter your business address. Show a street address instead of a box number. Include the suite or room number, if any.

Line F

See the instructions for Schedule C, line I, to help determine if you are required to file any Forms 1099.

Line 1

Enter gross receipts from your trade or business. Include amounts you received in your trade or business that were properly shown on Form 1099-MISC. If the total amounts that were reported in box 7 of Forms 1099-MISC are more than the total you are reporting on line 1, attach a statement explaining the difference. You must show all items of taxable income actually or constructively received during the year (in cash, property, or services). Income is constructively received when it is credited to your account or set aside for you to use. Don't offset this amount by any losses.

Line 2

Enter the total amount of all deductible business expenses you actually paid during the year. Examples of these expenses include advertising, car and truck expenses, commissions and fees, insurance, interest, legal and professional services, office expenses, rent or lease expenses, repairs and maintenance, supplies, taxes, travel, the allowable percentage of business meals and entertainment, and utilities (including telephone). For details, see the instructions for Schedule C, Parts II and V. You can use the optional worksheet below to record your expenses. Enter on lines **b** through **f** the type and amount of expenses not included on line **a**.

If you claim car or truck expenses, be sure to complete Schedule C-EZ, Part III.

Line 3

Nonresident aliens using Form 1040NR should also enter the total on Schedule SE, line 2, if you are covered under the U.S. social security system due to an international social security agreement currently in effect. See the Instructions for Schedule SE for information on international social security agreements.

Line 5b

Generally, commuting is travel between your home and a work location. If you converted your vehicle during the year from personal to business use (or vice versa), enter your commuting miles only for the period you drove your vehicle for business. For information on certain travel that is considered a business expense rather than commuting, see the instructions for Schedule C, line 44b.

Optional Worksheet for Line 2 (keep a copy for your records)

a	Deductible meals (see the instructions for Schedule C, line 24b)	a		
b	-----	b		
c	-----	c		
d	-----	d		
e	-----	e		
f	-----	f		
g	Total. Add lines a through f . Enter here and on line 2	g		

**SCHEDULE SE
(Form 1040)**

Self-Employment Tax

OMB No. 1545-0074

2018
Attachment
Sequence No. **17**

Department of the Treasury
Internal Revenue Service (99)

▶ Go to www.irs.gov/ScheduleSE for instructions and the latest information.
▶ Attach to Form 1040 or Form 1040NR.

Name of person with self-employment income (as shown on Form 1040 or Form 1040NR)

Social security number of person
with self-employment income ▶

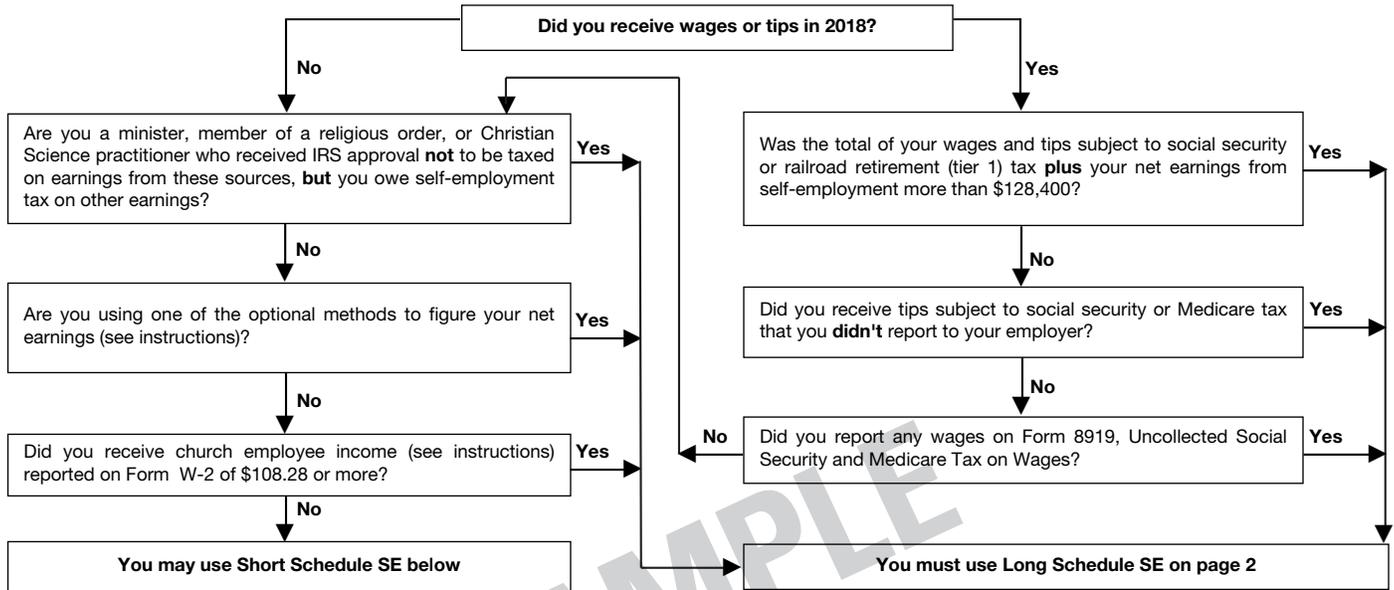
William K. Green

202-20-2002

Before you begin: To determine if you must file Schedule SE, see the instructions.

May I Use Short Schedule SE or Must I Use Long Schedule SE?

Note: Use this flowchart **only** if you must file Schedule SE. If unsure, see *Who Must File Schedule SE* in the instructions.



Section A—Short Schedule SE. Caution: Read above to see if you can use Short Schedule SE.

1a	Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A		
1b	If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code AH	()
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report	1,489	*
3	Combine lines 1a, 1b, and 2	1,489	
4	Multiply line 3 by 92.35% (0.9235). If less than \$400, you don't owe self-employment tax; don't file this schedule unless you have an amount on line 1b. ▶	1,375	
5	Self-employment tax. If the amount on line 4 is: • \$128,400 or less, multiply line 4 by 15.3% (0.153). Enter the result here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55 • More than \$128,400, multiply line 4 by 2.9% (0.029). Then, add \$15,921.60 to the result. Enter the total here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55 . . .	210	
6	Deduction for one-half of self-employment tax. Multiply line 5 by 50% (0.50). Enter the result here and on Schedule 1 (Form 1040), line 27, or Form 1040NR, line 27 . . .		
		6	105

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 11358Z

Schedule SE (Form 1040) 2018

*See Attachment on page 64.

Name of person with **self-employment** income (as shown on Form 1040 or Form 1040NR)

Social security number of person with **self-employment** income ▶

Section B—Long Schedule SE

Part I Self-Employment Tax

Note: If your only income subject to self-employment tax is **church employee income**, see instructions. Also see instructions for the definition of church employee income.

A If you are a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361, but you had \$400 or more of **other** net earnings from self-employment, check here and continue with Part I

1a Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A. Note: Skip lines 1a and 1b if you use the farm optional method (see instructions)	1a	
b If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code AH	1b ()
2 Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report. Note: Skip this line if you use the nonfarm optional method (see instructions)	2	
3 Combine lines 1a, 1b, and 2	3	
4a If line 3 is more than zero, multiply line 3 by 92.35% (0.9235). Otherwise, enter amount from line 3 Note: If line 4a is less than \$400 due to Conservation Reserve Program payments on line 1b, see instructions.	4a	
b If you elect one or both of the optional methods, enter the total of lines 15 and 17 here	4b	
c Combine lines 4a and 4b. If less than \$400, stop ; you don't owe self-employment tax. Exception: If less than \$400 and you had church employee income , enter -0- and continue ▶	4c	
5a Enter your church employee income from Form W-2. See instructions for definition of church employee income	5a	
b Multiply line 5a by 92.35% (0.9235). If less than \$100, enter -0-	5b	
6 Add lines 4c and 5b	6	
7 Maximum amount of combined wages and self-employment earnings subject to social security tax or the 6.2% portion of the 7.65% railroad retirement (tier 1) tax for 2018	7	128,400
8a Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) and railroad retirement (tier 1) compensation. If \$128,400 or more, skip lines 8b through 10, and go to line 11	8a	
b Unreported tips subject to social security tax (from Form 4137, line 10)	8b	
c Wages subject to social security tax (from Form 8919, line 10)	8c	
d Add lines 8a, 8b, and 8c	8d	
9 Subtract line 8d from line 7. If zero or less, enter -0- here and on line 10 and go to line 11 ▶	9	
10 Multiply the smaller of line 6 or line 9 by 12.4% (0.124)	10	
11 Multiply line 6 by 2.9% (0.029)	11	
12 Self-employment tax. Add lines 10 and 11. Enter here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55	12	
13 Deduction for one-half of self-employment tax. Multiply line 12 by 50% (0.50). Enter the result here and on Schedule 1 (Form 1040), line 27, or Form 1040NR, line 27	13	

Part II Optional Methods To Figure Net Earnings (see instructions)

Farm Optional Method. You may use this method only if (a) your gross farm income ¹ wasn't more than \$7,920, or (b) your net farm profits ² were less than \$5,717.		
14 Maximum income for optional methods	14	5,280
15 Enter the smaller of: two-thirds (² / ₃) of gross farm income ¹ (not less than zero) or \$5,280. Also include this amount on line 4b above	15	
Nonfarm Optional Method. You may use this method only if (a) your net nonfarm profits ³ were less than \$5,717 and also less than 72.189% of your gross nonfarm income, ⁴ and (b) you had net earnings from self-employment of at least \$400 in 2 of the prior 3 years. Caution: You may use this method no more than five times.		
16 Subtract line 15 from line 14	16	
17 Enter the smaller of: two-thirds (² / ₃) of gross nonfarm income ⁴ (not less than zero) or the amount on line 16. Also include this amount on line 4b above	17	

¹ From Sch. F, line 9, and Sch. K-1 (Form 1065), box 14, code B.

² From Sch. F, line 34, and Sch. K-1 (Form 1065), box 14, code A—minus the amount you would have entered on line 1b had you not used the optional method.

³ From Sch. C, line 31; Sch. C-EZ, line 3; Sch. K-1 (Form 1065), box 14, code A; and Sch. K-1 (Form 1065-B), box 9, code J1.

⁴ From Sch. C, line 7; Sch. C-EZ, line 1; Sch. K-1 (Form 1065), box 14, code C; and Sch. K-1 (Form 1065-B), box 9, code J2.

Attachment 1. Computation of expenses, allocable to tax-free ministerial income, that are non-deductible

% of Non-deductible Expenses				
		Taxable	Tax-Free	Total
Parsonage allowance:				
Ministerial retirement benefits designated as housing allowance	\$ 15,000			
Actual expenses	\$ 13,000			
Fair rental value of home (furnished, plus utilities) (\$1,200 x 12)	<u>\$ 14,400</u>			
Taxable portion of allowance (excess of amount designated & paid over lesser of actual expenses or fair rental value)	\$ 2,000	\$ 2,000		\$ 2,000
Tax-free portion of allowance (lesser of amount designated, actual expenses or fair rental value)			13,000	13,000
Gross income from occasional guest preaching engagements		2,000		2,000
Ministerial income		<u>\$ 4,000</u>	<u>\$ 13,000</u>	<u>\$ 17,000</u>
% of non-deductible expenses: \$13,000/\$17,000 =				

Schedule C-EZ Deduction Computation	
Business use of car: 800 miles x 54.5¢	\$ 436
Meal expenses (\$150 less 50% reduction)	<u>75</u>
Unadjusted <i>Schedule C-EZ</i> expenses	\$ 511
Non-deductible part of expenses \$511 X 76%	<u>(388)</u>
<i>Schedule C-EZ</i> deductions, line 2	<u>\$ 123</u>
None of the other deductions claimed in the return are allocable to tax-free income.	

Attachment 2. Computation of net earnings from self-employment

Computation for Schedule SE (Form 1040)	
Gross income from <i>Schedule C-EZ</i>	\$ 2,000
Less: Unadjusted <i>Schedule C-EZ</i> expenses	<u>(511)</u>
Net self-employment income, <i>Schedule SE</i> , line 2	<u>\$ 1,489</u>

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2019

FEDERAL REPORTING **REQUIREMENTS** *for Churches*

Richard R. Hammar, J.D., LL.M., CPA
Senior Editor, *Church Law & Tax Report*



GuideStone®

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This publication is intended to provide a timely, accurate, and authoritative discussion of tax reporting compliance and the impact of recent changes in the tax laws. It is not intended as a substitute for legal, accounting, or other professional advice. If legal, tax, or other expert assistance is required, the services of a competent professional should be sought. Although we believe this book provides accurate information, there may be changes resulting from IRS or judicial interpretations of the tax code, new tax regulations, or technical corrections that occurred after the printing of this edition that are not reflected in the text.

Introduction

The most important federal reporting obligation for most churches is the withholding and reporting of employee income taxes and Social Security taxes. These payroll reporting requirements apply, in whole or in part, to almost every church. Yet many churches do not fully comply with them for various reasons, including the following:

- The church treasurer is elected by the congregation and does not remain in office long enough to understand the application of the payroll tax reporting rules to churches.
- Church leaders assume that churches are exempt from the payroll tax reporting requirements. This is a false assumption. The courts have rejected the argument that the application of the payroll tax reporting rules to churches violates the constitutional guaranty of religious freedom.
- There are a number of special payroll tax reporting rules that apply to churches, and these often are not clearly understood by church staff members. These special rules include the following:
 - While most ministers are employees for federal income tax reporting, they are self-employed for Social Security with respect to compensation they receive for ministerial services. This means that they pay the self-employment tax (SECA) rather than the employee's share of Social Security and Medicare taxes (FICA) — even if they report their federal income taxes as a church employee. It is a common mistake for churches to treat ministers as employees for Social Security and to withhold the employee's share of FICA from their wages.
 - Wages paid to a minister as compensation for ministerial services are exempt from income tax withholding whether the minister reports income taxes as an employee or as self-employed. Ministers use the estimated tax procedure to pay their federal taxes, unless they have entered into a voluntary withholding agreement with their employing church (explained below).
 - Some churches are exempt from the employer's share of FICA because they filed a timely exemption application. For most churches, this exemption had to be filed before October 31, 1984. The exemption does not excuse the church from income tax withholding, filing *Form 941*, or issuing *Forms W-2* to church employees. The non-minister employees of a church that filed this exemption application are treated as self-employed for Social Security and must pay SECA if they are paid \$108.28 or more during the year.

▲ **Warning:** Federal law specifies that any corporate officer, director, or employee who is responsible for withholding taxes and paying them over to the government may be liable for a penalty in the amount of 100 percent of such taxes if they are either not withheld or not paid over to the government. This penalty is of special relevance to church leaders, given the high rate of non-compliance by churches with the payroll reporting procedures.

MAXIMIZING TAX BENEFITS FOR YOUR MINISTER

Housing Allowance (and Parsonage Allowance)

▲ **Caution:** The housing allowance is being challenged in federal court as an unconstitutional preference for religion. See the discussion of this case, including its possible impact, in a special section at the beginning of the companion booklet on ministers' tax preparation.

The most important tax benefit available to ministers who own or rent their home is the housing allowance exclusion. Unfortunately, many churches fail to designate a portion of their minister's compensation as a housing allowance and thereby deprive the minister of an important tax benefit.

A housing allowance is simply a portion of a minister's compensation that is so designated in advance by the minister's employing church. For example, in December 2018 a church agrees to pay its pastor total compensation of \$45,000 for 2019 and designates \$15,000 of this amount as a housing allowance (the remaining \$30,000 is salary). This costs the church nothing. It is simply a matter of designating part of a minister's salary as a housing allowance.

The tax code specifies that the housing allowance of a minister who owns or rents a home is non-taxable in computing federal income taxes to the extent that it is (1) declared in advance, (2) used for housing expenses, and (3) does not exceed the fair rental value of the minister's home (furnished, plus utilities).

☞ **Key Point:** Under no circumstances can a church designate a housing allowance retroactively.

☞ **Key Point:** Although repayments of principal and interest on a home mortgage loan qualify as a housing expense to which a housing allowance can be applied, costs associated with refinancing a principal residence or a home equity loan qualify only if the proceeds are used for housing expenses.

Ministers who live in a church-owned parsonage provided rent-free as compensation for ministerial services do not include

the annual fair rental value of the parsonage as income in computing their federal income taxes. The annual fair rental value is not deducted from the minister's income. Rather, it is not reported as additional income on *Form 1040* (as it generally would be by non-clergy workers). Ministers who live in a church-provided parsonage do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a parsonage allowance, to the extent that the allowance represents compensation for ministerial services and is used to pay parsonage-related expenses such as utilities, repairs, and furnishings.

Note that the housing allowance and fair rental value of a parsonage are non-taxable only when computing federal income taxes. Ministers must include their housing allowance and fair rental value of a parsonage as taxable income when computing their SECA (except for retired ministers). In addition, any housing provided to a minister that is excludable from taxable income pursuant to IRC §119 (relating to housing provided on an employer's premises "for the convenience of the employer") also must be included in a minister's taxable income when computing self-employment income.

- ☞ **Key Point:** Be sure that the designation of a housing allowance for the following year is on the agenda of the church or church board for its last meeting of the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations in employment contracts and budget line items — assuming that the church duly adopted the designation and it is reflected in a written document.

Accountable Reimbursements

The elimination of an itemized deduction for most expenses, including unreimbursed employee business expenses, will hit some clergy hard. But many tax professionals are encouraging the use of accountable reimbursement plans as a means of easing the negative tax impact. The basis for this idea is that while the Tax Cuts and Jobs Act of 2017 eliminated "all miscellaneous itemized deductions that are subject to the 2 percent floor under present law" (including unreimbursed employee business expenses), it did not modify or repeal section 62(a)(2)(A) of the tax code, which excludes from tax employer reimbursements of employee business expenses under an accountable plan.

To be accountable, a church's reimbursement arrangement must comply with all four of the following rules:

- Expenses must have a business connection — that is, the reimbursed expenses must represent expenses incurred by an employee while performing services for the employer.

- Employees are reimbursed only for expenses for which they provide an adequate accounting within a reasonable period of time (not more than 60 days after an expense is incurred).
- Employees must return any excess reimbursement or allowance within a reasonable period of time (not more than 120 days after an excess reimbursement is paid).
- The income tax regulations caution that in order for an employer's reimbursement arrangement to be accountable, it must meet a reimbursement requirement in addition to the three requirements summarized above. The reimbursement requirement means that an employer's reimbursements of an employee's business expenses come out of the employer's funds and not by reducing the employee's salary.

- ☞ **Key Point:** Reimbursements of business expenses under an accountable arrangement are not reported as taxable income on an employee's *Form W-2* or *Form 1040*, and there are no deductions to claim. In effect, the employee is reporting to the church rather than to the IRS. This often translates into significant tax savings for the employee.

An accountable reimbursement arrangement should be established by the church board or congregation in an appropriate resolution. In adopting a resolution, pay special attention to the following rules:

1. Condition the reimbursement of any expense on adequate substantiation. This will include written evidence for all expenses and receipts for expenses of \$75 or more. For most expenses, the evidence must substantiate the amount, date, place, and business nature of each expense. The key point is this: A church must require the same degree of substantiation as would be required for a deduction on the minister's income tax return.
2. Expenses must be substantiated, and excess reimbursements returned to the church, within a reasonable time. Expenses will be deemed substantiated within a reasonable time if they are substantiated within 60 days. Excess reimbursements will be deemed to be returned to the employer within a reasonable time if they are returned within 120 days.

Churches occasionally reimburse ministers for **non-business** expenses. Such reimbursements, though they require an accounting, ordinarily must be included in the minister's wages for income tax reporting purposes, and they are not deductible by the minister. Instead, the entire amount of these reimbursements must be reported as taxable income on the minister's *Form W-2* and *Form 1040*.

Flexible Spending Accounts

A health Flexible Spending Arrangement (FSA) allows employees to be reimbursed for medical expenses. FSAs are usually funded through voluntary salary reduction agreements with one's employer. No payroll taxes are deducted from employee contributions. The employer also may contribute.

Key Point: Unlike Health Spending Arrangements (HSAs), which must be reported on *Form 1040*, FSA contributions are not reported on the employee's *Form 1040*.

FSAs have several benefits, including the following: (1) Employer contributions can be non-taxable; (2) no payroll taxes are deducted from employee contributions; (3) withdrawals may be tax-free if used to pay qualified medical expenses; (4) employees can withdraw funds from an FSA to pay qualified medical expenses even if they have not placed the funds in the account.

Generally, distributions from a health FSA must be paid to reimburse the employee for qualified medical expenses. Qualified medical expenses are those incurred by an employee, the employee's spouse, and certain dependents (including a child under age 27 at the end of the year).

Employees must be able to receive the total amount they have elected to contribute for the year at any time during the year, regardless of the amount they have actually contributed.

FSAs are "use-it-or-lose-it" plans. This means that amounts in the account at the end of the plan year cannot be carried over to the next year. However, the plan can provide for a grace period of up to two and one-half months after the end of the plan year. If there is a grace period, any qualified medical expenses incurred in that period can be paid from any amounts left in the account at the end of the previous year. An employer is not permitted to refund any part of the balance to the employee.

Key Point: An employer, at its option, may amend its cafeteria plan document to provide for the carryover to the immediately following plan year of up to \$500 of any amount remaining unused as of the end of the plan year in a health FSA. The carryover of up to \$500 may be used to pay or reimburse medical expenses under the health FSA incurred during the entire plan year to which it is carried over. For this purpose, the amount remaining unused as of the end of the plan year is the amount unused after medical expenses have been reimbursed at the end of the plan's run-out period for the plan year. In addition to the unused amounts of up to \$500 that a plan may permit an individual to carry over to the next year, the plan may permit the individual to also elect up to the maximum allowed salary reduction

amount (\$2,650 for 2018). Thus, the carryover of up to \$500 does not count against or otherwise affect the \$2,650 salary reduction limit applicable to each plan year. Although the maximum unused amount allowed to be carried over in any plan year is \$500, the plan may specify a lower amount as the permissible maximum (and the plan sponsor has the option of not permitting any carryover at all).

A plan adopting this carryover provision is not permitted to also provide a grace period with respect to health FSAs.

The maximum amount available for reimbursement of incurred medical expenses of an employee and the employee's dependents under a health FSA cannot exceed \$2,650 for 2018 or \$2,700 for 2019.

Note that the Affordable Care Act (ACA) prohibits employers from using an FSA to pay for, or reimburse, the cost of individually owned health insurance policies with pretax dollars.

Key Point: Non-prescription medicines (other than insulin) do not qualify as an expense for FSA purposes.

Section 403(b) Retirement Plans

A 403(b) plan, also known as a tax-sheltered annuity or retirement income account, is a retirement plan for certain employees of churches and other tax-exempt organizations. These plans have the following tax benefits: (1) Employees do not pay income tax on allowable tax-deferred contributions until they begin making withdrawals from the plan, usually after they retire. Note, however, that lay employees must pay FICA on their contributions to a 403(b) plan, including those made under a salary reduction agreement. (2) Earnings and gains on amounts in an employee's 403(b) account are not taxed until they are withdrawn. (3) Employees may be eligible to claim the retirement savings contributions credit (Saver's Credit) for elective deferrals contributed to a 403(b) account.

There are limits on the amount of contributions that can be made to a 403(b) account each year. If contributions made to a 403(b) account are more than these contribution limits, penalties may apply. Generally, annual contributions to a 403(b) plan cannot exceed either the limit on annual additions or the limit on elective deferrals. See IRS *Publication 571* for details.

COMPLYING WITH FEDERAL PAYROLL TAX REPORTING OBLIGATIONS

Step 1. Obtain an Employer Identification Number (EIN) from the federal government if this has not been done.

This number must be reported on some of the returns listed below and is used to reconcile a church's deposits of withheld taxes with the *Forms W-2* it issues to employees. The EIN is a nine-digit number that looks like this: 00-0246810. If your church does not have an EIN, you may apply for one online. Go to the IRS website at *IRS.gov* for information. You may also apply for an EIN by calling 1-800-829-4933, or you can fax or mail *Form SS-4* to the IRS. You should have only one EIN.

Key Point: An EIN is not a tax exemption number and has no relation to your nonprofit corporation status. It merely identifies you as an employer subject to tax withholding and reporting and ensures that your church receives proper credit for payments of withheld taxes. You can obtain an EIN by submitting a *Form SS-4* to the IRS.

Step 2. Determine whether each church worker is an employee or self-employed.

In some cases, it is difficult to determine whether a particular worker is an employee or is self-employed. If in doubt, churches should treat a worker as an employee, since substantial penalties can be assessed against a church for treating a worker as self-employed whom the IRS later reclassifies as an employee. In general, a self-employed worker is not subject to the control of an employer with respect to how a job is done. Further, a self-employed person typically is engaged in a specific trade or business and offers his or her services to the general public.

The IRS and the courts have applied various tests to assist in classifying a worker as an employee or self-employed. Factors that tend to indicate employee status include the following:

- The worker is required to follow an employer's instructions regarding when, where, and how to work.
- The worker receives on-the-job training from an experienced employee.
- The worker is expected to perform the services personally and not use a substitute.
- The employer rather than the worker hires and pays any assistants.
- The worker has a continuing working relationship with the employer.
- The employer establishes set hours of work.
- The worker is guaranteed a regular wage amount for an hourly, weekly, or other period of time.
- The worker is expected to work full time.
- The work is done on the employer's premises.
- The worker must submit regular oral or written reports to the employer.

- The worker's business expenses are reimbursed by the employer.
- The employer furnishes the worker's tools, supplies, and equipment.
- The worker does not work for other employers.
- The worker does not advertise his or her services to the general public.

Not all of these factors must be present for a worker to be an employee. But if most of them apply, the worker is an employee. Once again: If in doubt, treat the worker as an employee.

Key Point: For 2019, churches must withhold 24 percent of the compensation paid to a self-employed person who fails to provide his or her Social Security number to the church. This is referred to as backup withholding and is designed to promote the reporting of taxable income.

Key Point: Some fringe benefits are non-taxable only when received by employees.

Step 3. Obtain the Social Security number for each worker.

After determining whether a worker is an employee or self-employed, you must obtain the worker's Social Security number. A worker who does not have a Social Security number can obtain one by filing *Form SS-5*. This is a Social Security Administration (SSA) form, not an IRS form. If a self-employed worker performs services for your church (and earns at least \$600 for the year), but fails to provide you with his or her Social Security number, then the church is required by law to withhold a specified percentage of compensation as backup withholding. The backup withholding rate is 24 percent for 2019.

A self-employed person can stop backup withholding by providing the church with a correct Social Security number.

The church will need the correct number to complete the worker's *Form 1099-MISC* (discussed later).

Churches can be penalized if the Social Security number they report on a *Form 1099-MISC* is incorrect, unless they have exercised due diligence. A church will be deemed to have exercised due diligence if it has self-employed persons provide their Social Security numbers using *Form W-9*. It is a good idea for churches to present self-employed workers (e.g., guest speakers, contract laborers) with a *Form W-9* and to backup withhold unless the worker returns the form. The church should retain each *Form W-9* to demonstrate its due diligence.

All taxes withheld through backup withholding must be reported to the IRS on *Form 945*. The *Form 945* for 2018 must be filed with the IRS by January 31, 2019. However, if you made

deposits on time in full payment of the taxes for the year, you may file the return by February 11, 2019.

Step 4. Have each employee complete a *Form W-4*.

These forms are used by employees to claim withholding allowances. A church will need to know how many withholding allowances each non-minister employee claims in order to withhold the correct amount of federal income tax. Ministers need not file a *Form W-4 Employee's Withholding Allowance Certificate* unless they enter into a voluntary withholding arrangement with their employing church. A withholding allowance lowers the amount of tax that will be withheld from an employee's wages. Allowances generally are available for the employee, the employee's spouse, each of the employee's dependents, and in some cases for itemized deductions.

Ask all new employees to give you a signed *Form W-4* when they start work. If an employee does not complete such a form, then the church must treat the employee as a single person without any withholding allowances or exemptions. Employers must put into effect any *Form W-4* that replaces an existing certificate no later than the start of the first payroll period ending on or after the 30th day after the day on which you received the replacement *Form W-4*. Of course, you can put a *Form W-4* into effect sooner, if you wish. Employers are not responsible for verifying the withholding allowances that employees claim.

§ **Tax Tip:** The Withholding Calculator found on the IRS website (*IRS.gov*) can help employees determine the proper amount of federal income tax withholding.

Step 5. Compute each employee's taxable wages.

The amount of taxes that a church should withhold from an employee's wages depends on the amount of the employee's wages and the information contained on his or her *Form W-4*. A church must determine the wages of each employee that are subject to withholding. Wages subject to federal withholding include pay given to an employee for services performed. The pay may be in cash or in other forms. Measure pay that is not in money (such as property) by its fair market value. Wages often include a number of items in addition to salary. (There is a comprehensive list of examples in Step 10.)

Step 6. Determine the amount of income tax to withhold from each employee's wages.

The amount of federal income tax the employer should withhold from an employee's wages may be computed in a number of ways. The most common methods are the wage bracket method and the percentage method.

Wage bracket method. Under the wage bracket method, the employer simply locates an employee's taxable wages for the applicable payroll period (that is, weekly, biweekly, monthly) on the wage bracket withholding tables in IRS *Publication 15 (Circular E), Employer's Tax Guide* and determines the tax to be withheld by using the column headed by the number of withholding allowances claimed by the employee. You can obtain a copy of IRS *Publication 15* at any IRS office or by downloading a copy from the IRS website (*IRS.gov*).

Percentage method. Under the percentage method, the employer multiplies the value of one withholding allowance (derived from a table contained in *Publication 15*) by the number of allowances an employee claims on *Form W-4*, subtracts the total from the employee's wages, and determines the amount to be withheld from another table. This method works for any number of withholding allowances an employee claims and any amount of wages.

- **Recommendation:** Be sure to obtain a new IRS *Publication 15* in January 2019. It will contain updated tables for computing the amount of income taxes to withhold from employees' 2019 wages and other helpful information.

Both of these methods are explained in detail in IRS *Publication 15*. Each year, a church should obtain a copy of *Publication 15* to ensure that the correct amount of taxes is being withheld.

Wages paid to a minister as compensation for ministerial services are exempt from income tax withholding. However, ministers who report their income taxes as employees can enter into a voluntary withholding arrangement with their church. Under such an arrangement, the church withholds federal income taxes from the minister's wages as if the minister's wages are not exempt from withholding. Some ministers find voluntary withholding attractive since it avoids the often difficult task of budgeting for four significant tax payments.

A minister initiates voluntary withholding by providing the church with a completed IRS *Form W-4*. The filing of this form is deemed to be a request for voluntary withholding.

Voluntary withholding arrangements may be terminated at any time by either the church or minister or by mutual consent.

The tax code specifies that ministers are self-employed for Social Security with respect to services performed in the exercise of ministry. Therefore, a church whose minister elects voluntary withholding is obligated to withhold only the minister's federal income taxes. The minister is still required to use the estimated tax procedure to report and prepay SECA. However, ministers electing voluntary withholding can indicate on line 6 of *Form W-4* that they want an additional amount of income taxes to be withheld from each pay period that will be sufficient to pay the estimated SECA liability by the end of the year. This additional

withholding of income taxes becomes a credit that can be applied against a minister's SECA on *Form 1040*. It is reported by the church as additional income taxes withheld on its quarterly *Form 941*. Many churches incorrectly report these additional withholdings as FICA.

Since any tax paid by voluntary withholding is deemed to be timely paid, a minister who pays SECA using this procedure will not be liable for any underpayment penalty (assuming that a sufficient amount of taxes is withheld).

Step 7. Withhold FICA from non-minister employees' wages.

Employees and employers each pay FICA equal to 7.65 percent of an employee's wages. The 7.65 percent tax rate is comprised of two components: (1) a Medicare hospital insurance (HI) tax of 1.45 percent and (2) an old age, survivor and disability (Social Security) tax of 6.2 percent. There is no maximum amount of wages subject to the HI tax. For 2018, the maximum wages subject to the Social Security tax (the 6.2 percent amount) was \$128,400. It increases to \$132,900 for 2019.

Beginning in 2013, the ACA increased the employee portion of the HI tax by an additional tax of 0.9 percent on wages received in excess of a threshold amount. However, unlike the general 1.45 percent HI tax on wages, this additional tax is on the combined wages of the employee and the employee's spouse, in the case of a joint return. The threshold amount is \$250,000 in the case of a joint return or surviving spouse and \$200,000 for single persons. The \$250,000 and \$200,000 amounts are not adjusted for inflation and remain the same for 2019.

The Social Security tax rates for 2018 and 2019 are shown in the following table:

Year	Tax on Employee	Tax on Employer	Combined Tax
2018	7.65%	7.65%	15.3%
2019	7.65%	7.65%	15.3%

Key Point: Federal law allowed churches that had non-minister employees as of July 1984 to exempt themselves from the employer's share of FICA by filing a *Form 8274* with the IRS by October 30, 1984. Many churches did so. The exemption was available only to those churches opposed for religious reasons to the payment of Social Security taxes. The effect of such an exemption is to treat all non-minister church employees as self-employed for Social Security purposes. Such employees must pay SECA if they are paid \$108.28 or more for the year. Churches hiring their first non-minister employee after 1984 have until the day before the due date for their first quarterly *Form 941* to file the exemption application. Churches can revoke their

exemption by filing a *Form 941* accompanied by full payment of FICA for that quarter. Many churches have done so, often inadvertently.

Step 8. The church must deposit the taxes it withholds.

Churches accumulate three kinds of federal payroll taxes:

- Income taxes withheld from employees' wages
- The employees' share of FICA (withheld from employees' wages)
- The employer's share of FICA

Most employers must deposit payroll taxes on a monthly or semiweekly basis. An employer's deposit status is determined by the total taxes reported in a four-quarter lookback period. For 2019, the lookback period will be July 1, 2017, through June 30, 2018.

Monthly depositor rule. Churches that reported payroll taxes of \$50,000 or less in the lookback period will deposit their withheld taxes for 2019 on a monthly basis. Payroll taxes withheld during each calendar month, along with the employer's share of FICA, must be deposited by the fifteenth day of the following month.

Semiweekly depositor rule. Churches that reported payroll taxes of more than \$50,000 in the lookback period must deposit their withheld taxes on a semiweekly basis. This means that for paydays falling on Wednesday, Thursday, or Friday, the payroll taxes must be deposited on or by the following Wednesday. For all other paydays, the payroll taxes must be deposited on the Friday following the payday.

Payment with return rule. If you accumulate less than a \$2,500 tax liability during the current or previous quarter, you may make a payment with *Form 941* instead of depositing monthly. See *IRS Publication 15* for more information.

Key Point: All deposits must be made using the Electronic Federal Tax Payment System (EFTPS). There are penalties for depositing late or for mailing payments directly to the IRS that are required to be deposited, unless you have reasonable cause for doing so. To enroll in EFTPS, call 1-800-555-4477, or to enroll online, visit EFTPS.gov. If you do not want to use EFTPS, you can arrange for your tax professional, financial institution, payroll service, or other trusted third party to make deposits on your behalf.

Step 9. All employers subject to income tax withholding, FICA, or both must file *Form 941* quarterly.

Form 941 reports the number of employees and amount of FICA and withheld income taxes that are payable. *Form 941* is due on the last day of the month following the end of each calendar quarter.

Quarter	Ending	Due Date of <i>Form 941</i>
1st (January–March)	March 31	April 30
2nd (April–June)	June 30	July 31
3rd (July–September)	September 30	October 31
4th (October–December)	December 31	January 31

If any due date for filing shown above falls on a Saturday, Sunday, or legal holiday, you may file your return on the next business day.

Form 941 may be filed electronically. For more information, visit the IRS website at *IRS.gov* or call 1-866-255-0654.

Key Point: *Form 944* replaces *Form 941* for eligible small employers. The purpose of the new *Form 944* is to reduce the burden on the smallest employers by allowing them to file their employment tax returns annually and, in most cases, pay the employment tax due with their return. Generally, you are eligible to file this form only if your payroll taxes for the year are \$1,000 or less. Do not file *Form 944* unless the IRS has sent you a notice telling you to file it.

Step 10. Prepare a *Form W-2* for every employee, including ministers employed by the church.

Key Point: Congress has enacted legislation requiring that *Forms W-2, W-3, 1099-MISC, and 1096* be filed by January 31 and eliminating the extended due date (March 31) for electronically filed *Forms W-3 and 1096*.

A church reports each employee's taxable income and withheld income taxes as well as FICA on this form. A church should furnish *Copies B, C, and 2* of the 2018 *Form W-2* to each employee by January 31, 2019. File *Copy A* with the SSA by January 31, 2019. Send all *Copies A* with *Form W-3 Transmittal of Wage and Tax Statements*. If you file electronically, the due date remains January 31, 2019.

Key Point: Be sure to add cents to all amounts. Make all dollar entries without a dollar sign and comma, but with a decimal point and cents. For example, \$1,000 should read "1000.00". Government scanning equipment assumes that the last two figures of any amount are cents. If you report \$40,000 of income as "40000", the scanning equipment would interpret this as 400.00 (\$400)!

You may need some assistance with some of the boxes on the *Form W-2*. Consider the following:

Box a. Report the employee's Social Security number. Insert "applied for" if an employee does not have a Social Security number but has applied for one. If you do not provide the correct employee name and Social Security number on *Form W-2*, you may owe a penalty unless you have reasonable cause.

Box b. Insert your church's federal EIN. This is a nine-digit number assigned by the IRS. If you do not have one, you can obtain one by submitting a completed *Form SS-4* to the IRS. Some churches have more than one EIN. For example, some churches that operate a private school have a number for both the church and the school. Be sure that the EIN listed on an employee's *Form W-2* is the one associated with the employee's actual employer.

Box c. Enter your church's name, address, and ZIP code. This should be the same address reported on your *Form 941*.

Box d. You may use this box to identify individual *Forms W-2*. You are not required to use this box.

Box e. Enter the employee's name.

Box f. Enter the employee's address and ZIP code.

Box 1. Report all wages paid to workers treated as employees for federal income tax reporting purposes. This includes:

- Salary, bonuses, prizes, and awards.
- Taxable fringe benefits (including cost of employer-provided group term life insurance coverage that exceeds \$50,000).
- The value of the personal use of an employer-provided car.
- Most Christmas, birthday, anniversary, and other special occasion gifts paid by the church.
- Business expense reimbursements paid under a non-accountable plan (one that does not require substantiation of business expenses within a reasonable time, or does not require excess reimbursements to be returned to the church, or reimburses expenses out of salary reductions). Also note that such reimbursements are subject to income tax and Social Security withholding if paid to non-minister employees.
- If you reimburse employee travel expenses under an accountable plan using a per diem rate, include in Box 1 the amount by which your per diem rate reimbursements for the year exceed the IRS-approved per diem rates. Also note that such excess reimbursements are subject to income tax and Social Security withholding if paid to non-minister employees or ministers who have elected voluntary tax withholding. Use code L in Box 12 to report the amount equal to the IRS-approved rates.
- If you reimburse employee travel expenses under an accountable plan using a standard business mileage rate in excess of

the IRS-approved rate (**54.5 cents per mile for 2018; 58 cents per mile for 2019**), include in Box 1 the amount by which your mileage rate reimbursements for the year exceed the IRS-approved rates. Also note that such excess reimbursements are subject to income tax and Social Security withholding if paid to non-minister employees or ministers who have elected voluntary tax withholding. Use code L in Box 12 to report the amount equal to the IRS-approved rates.

- Non-qualified moving expenses and expense reimbursements (except for reimbursements of the travel expenses of members of the U.S. Armed Forces on active duty).
- Any portion of a minister's SECA paid by the church.
- Amounts includible in income under a non-qualified deferred compensation (NQDC) plan because of section 409A.
- Designated Roth contributions made under a section 403(b) salary reduction agreement.
- Church reimbursements of a spouse's travel expenses incurred while accompanying a minister on a business trip represent income to the minister unless the spouse's presence serves a legitimate and necessary business purpose and the spouse's expenses are reimbursed by the church under an accountable plan.
- Churches that make a below-market loan to a minister of at least \$10,000 create taxable income to the minister (some exceptions apply). A below-market loan is a loan on which no interest is charged or on which interest is charged at a rate below the applicable federal rate.
- Churches that forgive a minister's debt to the church create taxable income to the minister.
- Severance pay.
- Payment of a minister's personal expenses by the church.
- Employee contributions to a Health Savings Account (HSA), if reasonable to be included in the income of the employee.
- Employer contributions to an HSA if includable in the income of the employee.
- "Love gifts" from the church to a pastor.

For ministers who report their income taxes as employees, do not report in Box 1 the annual fair rental value of a parsonage or any portion of a minister's compensation that was designated (in advance) as a housing allowance by the church. Also, some contributions made to certain retirement plans out of an employee's wages are not reported.

▲ Caution: Taxable fringe benefits not reported as income in Box 1 may constitute an automatic excess benefit transaction, exposing the recipient and members of the church board to intermediate sanctions in the form of substantial excise taxes.

🗨 Key Point: Churches should not include in Box 1 the annual fair rental value of a parsonage or a housing allowance provided to a minister as compensation for ministerial services.

Box 2. List all federal income taxes that you withheld from the employee's wages. The amounts reported in this box (for all employees) should correspond to the amount of withheld income taxes reported on your four *Forms 941*.

Box 3. Report an employee's wages subject to the Social Security component (the 6.2 percent rate for 2018) of FICA. Box 3 should not list more than the maximum wage base for the Social Security component of FICA (\$128,400 for 2018; \$132,900 for 2019). This box usually will be the same as Box 1, but not always. For example, certain retirement contributions are included in Box 3 that are not included in Box 1. To illustrate, contributions to a 403(b) plan by salary reduction agreement may be excludable from income and not reportable in Box 1, but they are subject to FICA, and accordingly they represent Social Security and Medicare wages for non-minister employees. For ministers, this box should be left blank.

🗨 Key Point: Remember that ministers (including those who report their income taxes as employees) are self-employed for Social Security with respect to their ministerial services, and so they pay SECA rather than the employee's share of FICA.

Churches that filed a timely *Form 8274* exempting themselves from the employer's share of FICA do not report the wages of non-minister employees in this box since such employees are considered self-employed for Social Security purposes.

Box 4. Report the Social Security component (6.2 percent) of FICA that you withheld from a non-minister employee's wages. This tax is imposed on all wages up to a maximum of \$128,400 for 2018 and \$132,900 for 2019. Do not report the church's portion (the employer's share) of FICA. Ministers who report their income taxes as employees are still treated as self-employed for Social Security with respect to compensation from the performance of ministerial services. For ministers, this box should be left blank.

Box 5. Report a non-minister employee's current and deferred (if any) wages subject to the HI component (1.45 percent) of FICA. This will be an employee's entire wages regardless of amount. There is no ceiling. For persons earning less than the annual maximum earnings subject to the 6.2 percent Social Security tax (\$128,400 for 2018 and \$132,900 for 2019), Boxes 3 and 5 should show the same amount. If you pay more than \$128,400 in 2018 or \$132,900 in 2019 to a non-minister employee, Box 3 should show \$128,400 in 2018 or \$132,900 in

2019, and Box 5 should show the full amount of wages paid. For ministers, this box should be left blank.

Box 6. Report the HI component of FICA that you withheld from the non-minister employee's wages. This tax is imposed on all wages, current and deferred (if any), regardless of amount. For ministers, this box should be left blank.

Box 10. Show the total dependent care benefits under a dependent care assistance program (section 129) paid or incurred by you for your employee. Include the fair market value of employer-provided daycare facilities and amounts paid or incurred for dependent care assistance in a section 125 cafeteria plan. Report all amounts paid or incurred, including those in excess of the \$5,000 exclusion. Include any amounts over \$5,000 in Boxes 1, 3, and 5. For more information, see IRS *Publication 15-B*.

Box 11. The purpose of Box 11 is for the SSA to determine if any part of the amount reported in Box 1 or Box 3 or 5 was earned in a prior year. The SSA uses this information to verify that they have properly applied the Social Security earnings test and paid the correct amount of benefits. Report distributions to an employee from a non-qualified plan in Box 11. Also report these distributions in Box 1. Under non-qualified plans, deferred amounts no longer subject to a substantial risk of forfeiture are taxable even if not distributed. Report these amounts in Boxes 3 (up to the Social Security wage base) and 5. Do not report in Box 11 deferrals included in Box 3 or 5 and deferrals for current-year services (such as those with no risk of forfeiture).

If you made distributions and are reporting any deferrals in Box 3 or 5, do not complete Box 11. See IRS *Publication 957*.

Unlike qualified plans, non-qualified plans do not meet the qualification requirements for tax-favored status. Non-qualified plans include those arrangements traditionally viewed as deferring the receipt of current compensation, such as a rabbi trust. Welfare benefit plans and plans providing termination pay, or early retirement pay, are not generally non-qualified plans.

For additional information, see IRS *Publications 15* and *957*.

Box 12. Insert the appropriate code and dollar amount in this box. Insert the code letter followed by a space and then insert the dollar amount on the same line within the box. Do not enter more than three codes in this box. If more are needed, use another *Form W-2*. Use capital letters for the codes, and remember not to use dollar signs or commas. For example, to report a \$3,000 contribution to a section 403(b) tax-sheltered annuity, you would report "E 3000.00" in this box. The codes are as follows:

- A — This will not apply to church employees.
- B — This will not apply to church employees.
- C — You (the church) provided your employee with more than \$50,000 of group term life insurance. Report the cost

of coverage in excess of \$50,000. It should also be included in Box 1 (and in Boxes 3 and 5 for non-minister employees). See page 11 for additional information.

D — Generally not applicable to churches.

E — The church made contributions to a 403(b) plan pursuant to a salary reduction agreement on behalf of the employee. Report the amount of the contributions. While this amount ordinarily is not reported in Box 1, it is included in Boxes 3 and 5 for non-minister employees since it is subject to FICA with respect to such workers.

F — Generally not applicable to churches.

G — Generally not applicable to churches.

H — Generally not applicable to churches.

J — You (the church) are reporting sick pay. Show the amount of any sick pay that is not includable in the employee's income because he or she contributed to the sick pay plan.

K — Generally not applicable to churches.

L — You (the church) reimbursed the employee for employee business expenses using the standard mileage rate or the per diem rates, and the amount you reimbursed exceeds the amounts allowed under these methods. Enter code L in Box 12, followed by the amount of the reimbursements that equal the allowable standard mileage or per diem rates. Any excess should be included in Box 1. For non-minister employees, report the excess in Boxes 3 (up to the Social Security wage base) and 5 as well. Do not include any per diem or mileage allowance reimbursements for employee business expenses in Box 12 if the total reimbursements are less than or equal to the amount deemed substantiated under the IRS-approved standard mileage rate or per diem rates.

M, N — Generally not applicable to churches.

Q — Generally not applicable to churches.

R — Report employer contributions to a medical savings account on behalf of the employee. Any portion not excluded from the employee's income also should be included in Box 1.

S — Report employee salary reduction contributions to a SIMPLE retirement account. However, if the SIMPLE account is part of a 401(k) plan, use code D.

T — Report amounts paid (or expenses incurred) by an employer for qualified adoption expenses furnished to an employee under an adoption assistance program.

V — Generally not applicable to churches.

W — Report employer contributions to an HSA. Include amounts the employee elected to contribute using a cafeteria plan.

Y — It is no longer necessary to report deferrals under a section 409A NQDC plan in Box 12 using code Y.

Z — Report all amounts deferred (including earnings on

deferrals) under a NQDC plan included in income under section 409A of the tax code because the NQDC fails to satisfy the requirements of section 409A. Do not include amounts properly reported on *Forms 1099-MISC* or *W-2* for a prior year. Also, do not include amounts considered to be subject to a substantial risk of forfeiture for purposes of section 409A. The amount reported in Box 12 using code Z is also reported in Box 1.

AA — Generally not applicable to churches.

BB — Report designated Roth contributions under a section 403(b) salary reduction agreement. Do not use this code to report elective deferrals under code E.

DD — The ACA requires employers to report the cost of coverage under an employer-sponsored group health plan. IRS *Notice 2011-28* provided relief for smaller employers filing fewer than 250 *Forms W-2* by making the reporting requirement optional for them until further guidance is issued by the IRS. The reporting under this provision is for information only; the amounts reported are not included in taxable wages and are not subject to new taxes.

EE — Generally not applicable to churches.

Box 13. Check the appropriate box.

- **Statutory employee.** Churches rarely if ever have statutory employees. These include certain drivers, insurance agents, and salespersons.
- **Retirement plan.** Mark this checkbox if the employee was an active participant (for any part of the year) in any of the following: (1) a qualified pension, profit-sharing, or stock bonus plan described in section 401(a) (including a 401(k) plan); (2) an annuity contract or custodial account described in section 403(b); (3) a simplified employee pension (SEP) plan; or (4) a SIMPLE retirement account.
- **Third-party sick pay.** Churches generally will not check this box.

Box 14. This box is optional. Use it to provide information to an employee. Some churches report a church-designated housing allowance in this box. The IRS uses Box 14 for this purpose in a comprehensive minister tax example in the current edition of its *Publication 517*, but this is not a requirement.

§ Tax Tip: The IRS has provided the following suggestions to reduce the discrepancies between amounts reported on *Forms W-2*, *W-3*, and *941*: First, be sure the amounts on *Form W-3* are the total amounts from *Forms W-2*. Second, reconcile *Form W-3* with your four quarterly *Forms 941* by comparing amounts reported for: (1) income tax withholding (Box 2); (2) Social Security and Medicare wages (Boxes 3, 5, and 7); and (3) FICA (Boxes 4 and 6). Amounts reported on *Forms*

W-2, *W-3*, and *941* may not match for valid reasons. If they do not match, you should determine that the reasons are valid.

Step 11. Prepare a *Form 1099-MISC* for every self-employed person receiving non-employee compensation of \$600 or more.

By January 31, 2019, churches must furnish *Copy B* of *Form 1099-MISC Miscellaneous Income* to any self-employed person to whom the church paid non-employee compensation of \$600 or more in 2018. This form (rather than a *W-2*) should be provided to clergy who report their federal income taxes as self-employed, since the Tax Court and the IRS have both ruled that a worker who receives a *W-2* rather than a *1099-MISC* is presumed to be an employee rather than self-employed. Other persons to whom churches may be required to issue a *1099-MISC* include evangelists, guest speakers, contractors, and part-time custodians.

Churches must send *Copy A* of *Forms 1099-MISC*, along with *Form 1096*, to the IRS by January 31, 2019, if non-employee compensation is reported in Box 7. If you file electronically, the due date for filing *Copy A* with the IRS is also January 31, 2019, if you are reporting non-employee compensation in Box 7. Otherwise the deadline is February 28 if you file on paper or April 1 if you file electronically.

Form 1099-MISC is designed to induce self-employed persons to report their full taxable income.

Self-employment earnings include compensation paid to any individual other than an employee. Examples include ministers who report their income as self-employed for income tax reporting purposes, some part-time custodians, and certain self-employed persons who perform miscellaneous services for the church (plumbers, carpenters, lawn maintenance providers, etc.) and who are not incorporated.

To illustrate, if a guest speaker visited a church in 2018 and received compensation from the church in an amount of \$600 or more (net of any housing allowance or travel expenses reimbursed under an accountable plan), then the church must issue the person *Copy B* of *Form 1099-MISC* by January 31, 2019.

Exceptions apply. For example, a church need not issue a *Form 1099-MISC* to a corporation or to a person who will be receiving a *Form W-2* for services rendered to the church. Also, travel expense reimbursements paid to a self-employed person under an accountable reimbursement plan do not count toward the \$600 figure.

To complete *Form 1099-MISC*, the church will need to obtain the recipient's name, address, and Social Security number. Churches should obtain this information at the time of the person's visit, since it often can be difficult to obtain the

necessary information at a later date. IRS *Form W-9* can be used to obtain this information. If a self-employed person who is paid \$600 or more during the course of a year by a church refuses to provide a Social Security number, then the church is required to withhold a percentage of the person's total compensation as backup withholding. See Step 2 above. The backup withholding rate is 24 percent for 2019.

OTHER IMPORTANT REQUIREMENTS FOR CHURCHES

Reporting Group Term Life Insurance

You must include in the income of employees an imputed cost of employer-provided group term life insurance coverage (including death benefits under the benefits plan) that exceeds \$50,000. You must also include the imputed cost of all employer-provided group term life insurance on the life of a spouse or dependent if the coverage provided exceeds \$2,000. The imputed cost can be determined according to the following table:

Cost Per \$1,000 of Protection for One-month Period	
Age Brackets	Cost
Under 25	5 cents
25–29	6 cents
30–34	8 cents
35–39	9 cents
40–44	10 cents
45–49	15 cents
50–54	23 cents
55–59	43 cents
60–64	66 cents
65–69	\$1.27
70 and above	\$2.06

 **Example:** Church A pays the premiums on a \$70,000 group term life insurance policy on the life of Pastor B with B's wife as beneficiary. Pastor B is 29 years old. Church A also pays the premium on a \$5,000 group term life policy, which covers Pastor B's wife, who is 30 years old. The church would have to report \$19.20 as the imputed cost of the insurance provided to Pastor B and his wife. This amount is computed as follows: (1) For Pastor B, the table shows the cost per month for each \$1,000 of group term life insurance in excess of \$50,000. To compute the cost for Pastor B, take 6 cents x 12 months = 72 cents x 20 (corresponding to \$20,000 of group term life insurance in excess of \$50,000) = \$14.40. (2) In addition, the cost of the entire \$5,000

of insurance provided to Pastor B's wife would have to be computed. Take 8 cents x 12 months = 96 cents x 5 = \$4.80. Combine this amount with the cost of Pastor B's excess insurance to obtain the taxable amount of \$19.20. Church A should include this amount with wages in Box 1 of *Form W-2*. This amount should also be reported in Box 12 and labeled code C. Any includable amount is subject to income tax as well as FICA withholding for non-minister church employees.

Form I-9

All employers are responsible for verifying employees' identity and eligibility to work in the United States. As employers, churches must complete an *Employment Eligibility Verification* form for each new employee. This form is better known as *Form I-9*.

Form I-9 is not an IRS form and is not filed with any government agency. However, it is important for churches to be familiar with this form because they can be assessed fines for failing to comply with the requirements summarized below.

Churches should:

- Ensure that each new employee completes Section 1 of the *Form I-9* on or before his or her first day of compensated work. Review the employee's documents and fully complete Section 2 of the *Form I-9* within three business days of the hire. Collect a *Form I-9* for all employees, including ministers, hired after November 6, 1986, even if the church has no doubt that someone is a U.S. citizen. An employee signs part of the form and the employer signs part of the form. The form's instructions list documents employees may show to verify their identity and eligibility to work in the United States.
- Review the United States Citizenship and Immigration Services website ([USCIS.gov](http://uscis.gov)) for instructions that will assist you in completing the *Form I-9*. You can also download *Form I-9* from the USCIS website.
- Collect forms from new employees only, not from all applicants. When extending job offers, churches should clarify that employment is conditioned on completion of a *Form I-9*. Employers should remind new employees to bring their documents the first day of work. Forms should be completed no later than the end of the employee's third day at work.
- Accept documents that appear to be genuine and relate to the employee. If churches act reasonably when deciding that a document is genuine, they will not be held responsible for a mistake. Churches may keep photocopies of original identification and verification documents with each employee form. This is not required by law but may be helpful in case there is ever a question about whether a document was genuine.

- Employers must retain an employee's completed *Form I-9* for as long as the individual works for the employer. Once the individual's employment has terminated, the employer must determine how long after termination the *Form I-9* must be retained, which is either three years after the date of hire or one year after the date employment is terminated, whichever is later. *Forms I-9* can be retained either on paper or microform or electronically.
- Upon request, show completed forms to authorized officials of the Department of Homeland Security (DHS), Department of Labor (DOL), or the Justice Department's Office of Special Counsel for Unfair Immigration-Related Employment Practices (OSC). Officials will give a minimum of three days' notice before inspection.
- Churches, like any employer, can be penalized for failing to comply with the *I-9* requirement. If you fail to complete, retain, or make available for inspection a *Form I-9* as required by law, you may face a civil penalty for each violation. There are additional penalties for knowingly hiring unauthorized aliens.
- Providing an employee's Social Security number on *Form I-9* is voluntary for all employees unless an employer participates in the USCIS E-Verify program.

Annual Certification of Racial Nondiscrimination

Churches and other religious organizations that operate, supervise, or control a private school must file a certificate of racial nondiscrimination (*Form 5578*) each year with the IRS. The certificate is due by the fifteenth day of the fifth month following the end of the organization's fiscal year. This is May 15 of the following year for organizations that operate on a calendar-year basis. For example, the *Form 5578* for 2018 is due May 15, 2019.

A private school is defined as an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly conducted. The term includes primary, secondary, preparatory, or high schools, and colleges and universities, whether operated as a separate legal entity or an activity of a church.

Key Point: The term "school" also includes preschools, and this is what makes the reporting requirement relevant for many churches. As many as 25 percent of all churches operate a preschool program.

Key Point: Independent religious schools not affiliated with a church or denomination and that file *Form 990* do not file *Form 5578*. Instead, they make their annual certification of racial nondiscrimination directly on *Schedule E (Form 990)*.

Form 5578 is easy to complete. A church official simply identifies the church and the school and certifies that the school has "satisfied the applicable requirements of sections 4.01 through 4.05 of Revenue Procedure 75-50." This reference is to the following requirements:

- The school has a statement in its charter, bylaws, or other governing instrument, or in a resolution of its governing body, that it has a racially nondiscriminatory policy toward students.
- The school has a statement of its racially nondiscriminatory policy toward students in all its brochures and catalogs dealing with student admissions, programs, and scholarships.
- The school makes its racially nondiscriminatory policy known to all segments of the general community served by the school through the publication of a notice of its racially nondiscriminatory policy at least annually in a newspaper of general circulation or through utilization of the broadcast media. However, such notice is not required if one or more exceptions apply. These include the following: (1) During the preceding three years, the enrollment consists of students at least 75 percent of whom are members of the sponsoring church or religious denomination, and the school publicizes its nondiscriminatory policy in religious periodicals distributed in the community. (2) The school draws its students from local communities and follows a racially nondiscriminatory policy toward students and demonstrates that it follows a racially nondiscriminatory policy by showing that it currently enrolls students of racial minority groups in meaningful numbers.
- The school can demonstrate that all scholarships or other comparable benefits are offered on a racially nondiscriminatory basis.

Filing the certificate of racial nondiscrimination is one of the most commonly ignored federal reporting requirements. Churches that operate a private school (including a preschool), as well as independent schools, may obtain *Form 5578* from the IRS website (*IRS.gov*) or by calling the IRS forms number (1-800-829-3676).

Charitable Contribution Substantiation Rules

Several important rules apply to the substantiation of charitable contributions, including the following:

Cash contributions. All cash contributions, regardless of amount, must be substantiated by either a bank record (such as a cancelled check) or a written communication from the charity showing the name of the charity, the date of the contribution, and the amount of the contribution. The recordkeeping requirements **may not be satisfied by maintaining other written**

records. In the past, donors could substantiate cash contributions of less than \$250 with “other reliable written records showing the name of the charity, the date of the contribution, and the amount of the contribution” if no cancelled check or receipt was available. This is no longer allowed. As noted below, additional substantiation requirements apply to contributions (of cash or property) of \$250 or more, and these must be satisfied as well.

Substantiation of contributions of \$250 or more. Donors will not be allowed a tax deduction for any individual cash (or property) contribution of \$250 or more unless they receive a written acknowledgment from the church containing the following information:

- Name of the church
- Name of the donor (a Social Security number is not required)
- Date of the contribution
- Amount of any cash contribution
- For contributions of property (not including cash) valued by the donor at \$250 or more, the receipt must describe the property. No value should be stated.
- The receipt must contain one of the following: (1) a statement that no goods or services were provided by the church in return for the contribution; (2) a statement that goods or services a church provided in return for the contribution consisted entirely of intangible religious benefits; or (3) a description and good faith estimate of the value of goods or services other than intangible religious benefits that the church provided in return for the contribution.
- The church may either provide separate acknowledgments for each single contribution of \$250 or more or one acknowledgement to substantiate several single contributions of \$250 or more. Separate contributions are not aggregated for purposes of measuring the \$250 threshold.
- The written acknowledgment must be received by the donor on or before the earlier of the following two dates: (1) the date the donor files a tax return claiming a deduction for the contribution or (2) the due date (including extensions) for filing the return.

Quid pro quo contributions of more than \$75. If a donor makes a quid pro quo contribution of more than \$75 (that is, a payment that is partly a contribution and partly a payment for goods or services received in exchange), the church must provide a written statement to the donor that satisfies two conditions:

- The statement must inform the donor that the amount of the contribution that is tax-deductible is limited to the excess of the amount of any money (or the value of any property other than money) contributed by the donor over the value of any goods or services provided by the church or other charity in return.

- The statement must provide the donor with a good faith estimate of the value of the goods or services furnished to the donor.

A written statement need not be issued if only **token goods or services** are provided to the donor.

For 2018, token goods or services were those having a value not exceeding the lesser of \$109 or 2 percent of the amount of the contribution. This amount is adjusted annually for inflation. In addition, the rules do not apply to contributions in return for which the donor receives solely an intangible religious benefit that generally is not sold in a commercial context outside the donative context.

Gifts of property. Several additional rules apply to the substantiation of contributions of non-cash property valued by the donor at \$500 or more. Donors who claim a deduction over \$500 but not over \$5,000 for a non-cash charitable contribution must retain certain records and complete the front side (Section A, Part I and Part II if applicable) of IRS *Form 8283* and enclose the completed form with the *Form 1040* on which the charitable contribution is claimed.

Special rules apply to donations of cars, boats, and planes valued by the donor at more than \$500. The church must provide the donor with a written acknowledgment and send a *Form 1098-C* to the IRS containing required information about the donation. *Form 1098-C* can be used as the written acknowledgment that must be issued to a donor. See the instructions to *Form 1098-C* for more information.

For contributions of non-cash property valued at more than \$5,000 (\$10,000 for privately held stock), a donor must obtain a qualified appraisal of the donated property from a qualified appraiser, complete a qualified appraisal summary (Section B of *Form 8283*), and have the summary signed by the appraiser and a church representative. The completed *Form 8283* is then enclosed with the *Form 1040* on which the charitable contribution deduction is claimed. The appraisal must be enclosed for contributions of property (other than inventory and publicly traded securities) in excess of \$500,000.

ACA Reporting

The ACA imposes the most significant reporting obligations since the introduction of *Form W-2* in 1943. In fact, the new reporting obligations are similar to *Form W-2* in that forms must be issued to individual employees and a transmittal form sent to the IRS along with copies of all the forms issued to employees. And, as with *Form W-2*, the IRS can assess penalties for failure to comply with the new reporting obligations.

Because of the similarities of the new reporting requirements to *Form W-2*, some are calling them the “health care *W-2s*”. Of course, the analogy is not perfect. The *Form W-2*

reports compensation and tax withholding, while the new forms report health insurance information. The reporting requirements consist of the following forms:

- Providers of minimum essential coverage are required to file *Forms 1094-B* and *1095-B*. These forms are used to report certain information to the IRS and to employees about individuals covered by minimum essential coverage and therefore aren't liable for the individual shared responsibility payment penalty. These forms must be filed by February 28, 2019 (April 1, 2019, if filed electronically).
- Applicable large employers, generally employers with 50 or more full-time employees (including full-time equivalent employees) in the previous year, must file one or more *Forms 1094-C* (including a *Form 1094-C* designated as the Authoritative Transmittal, whether or not filing multiple *Forms 1094-C*) and must file a *Form 1095-C* for each employee who was a full-time employee of the employer for any month of the calendar year. Generally, the employer is required to furnish a copy of the *Form 1095-C* (or a substitute form) to the employee. These forms must be filed by February 28, 2019 (April 1, 2019, if filed electronically). The information reported on *Forms 1094-C* and *1095-C* is used to determine whether an employer owes a payment under the Employer Shared Responsibility Provision of the ACA (the employer mandate or play or pay provision).

See the instructions to these forms on the IRS website ([IRS.gov](https://www.irs.gov)) for more information.

 **Key Point:** Churches with fewer than 50 full-time employees and an insured group health plan generally have no reporting obligation. They are not required to file *Forms 1094-C* and *1095-C* since they have fewer than 50 employees, and their group plan insurer files the *Forms 1094-B* and *1095-B*.

HELPFUL NUMBERS AND RESOURCES

1-800-TAX-FORM or 1-800-829-3676

To request IRS forms

IRS.gov

IRS home page

GuideStone.org/TaxGuide

GuideStone's helpful resources about ministerial tax issues and frequently asked questions about minister's housing allowance

ChurchLawandTax.com

A *Christianity Today* website featuring Richard Hammar and a host of other professionals who provide information on church law, tax, finance, and risk management

ChurchLawandTaxStore.com

Christianity Today's online store with church management resources to keep your church safe, legal, and financially sound

Church & Ministry Tax Guide

Richard Hammar's comprehensive tax guide published annually by Christianity Today International




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