

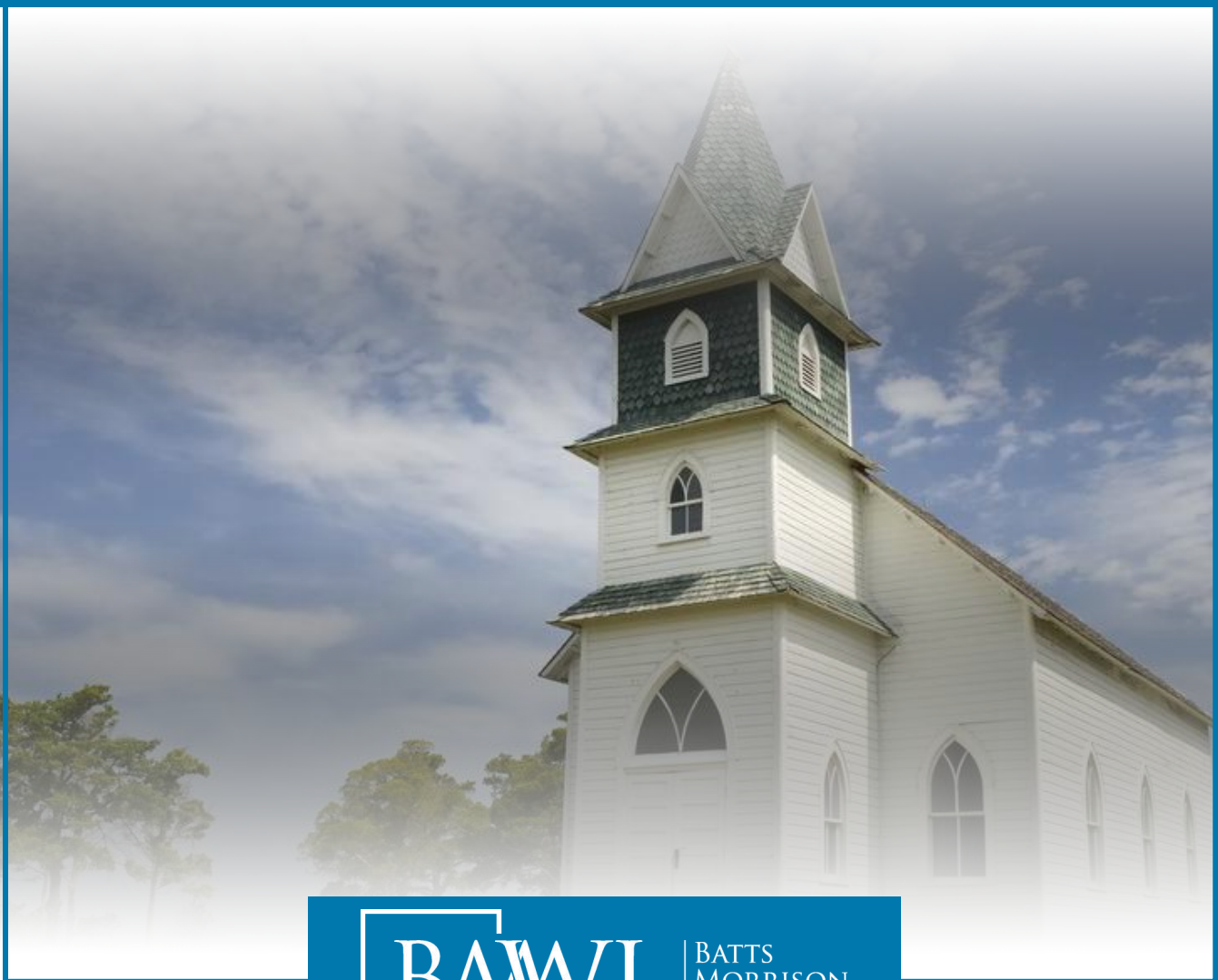
XPastor Webinar

August 11, 2021

Pastor Tax 101

Federal Tax Benefits and Rules Applicable to Ministers

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PASTOR TAX 101

FEDERAL TAX BENEFITS AND RULES APPLICABLE TO MINISTERS

A. WHO IS ELIGIBLE?

1. Duly ordained, commissioned, or licensed minister
2. For services performed in the exercise of ministry
 - a. Performance of sacerdotal functions – baptism, communion, marriages, funerals, prayer for the sick
 - b. Conduct of religious worship – depends upon the tenets and practices of the particular religious body constituting the minister’s church or church denomination
 - c. Control, conduct, and maintenance (i.e., directing, managing, or promoting the activities) of religious organizations, boards, societies, and other integral agencies that are under the authority of a church or church denomination
 - d. Services performed pursuant to a valid assignment or designation by a religious body constituting the minister’s church

B. DUAL TAX STATUS

1. Generally, an employee for federal income tax purposes – receives a Form W-2
2. Self-employed for employment tax purposes (Social Security and Medicare)
 - a. Wages are not considered FICA wages (rather, they are SECA earnings)
 - b. Minister is responsible for paying the full amount of self-employment taxes (if applicable, see Section C below) on Form SE of his/her Form 1040

C. EXEMPTION FROM SOCIAL SECURITY COVERAGE

1. Must be duly ordained, commissioned, or licensed by a tax-exempt church (or convention or association of churches)
2. Must file [Form 4361](#) (in triplicate) (see provided copy)
 - a. Certifying that you are “conscientiously opposed to, or because of my religious principles I am opposed to, the acceptance (for the services I perform as a minister...) of any public insurance that makes payments in the event of death, disability, old age, or retirement; or that makes payments toward the cost of, or provides services for, medical care.” Conscientious opposition must be rooted in religious beliefs.
 - b. Must be filed by 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 derives from the performance of services in the exercise of ministry.
 - i. Generally means April 15 of the third year of ministry
3. Ordaining, commissioning, or licensing church or denomination must be notified prior to filing of Form 4361
4. IRS verification/approval is required
5. If approved, mark “Exempt – Form 4361” on the self-employment tax line of Form 1040
6. Keep approved form with all other important personal documents, and submit a copy to your employing church for your personnel file
7. Once the exemption is approved, it cannot be revoked (under current law)
8. Plan for retirement!!!!!!
 - a. 403(b) retirement plans sponsored by the church
 - b. Non-qualified deferred compensation plans sponsored by the church
 - c. Take advantage of employer matching contributions
 - d. Individual retirement accounts

D. HOUSING ALLOWANCE EXCLUSION

1. Housing Allowances

- a. Ministers may exclude the amount of their compensation that their employing church designates in writing in advance as a housing allowance, subject to certain limitations
 - i. Changes to the amount designated as housing allowance may be made during the year, but only on a prospective basis
- b. Limitations – excludible portion is limited to the lesser of:
 - i. Amount designated in writing in advance by the employing church
 - ii. Fair rental value of home (furnished, including utilities)
 - iii. The amount used for housing-related expenses
 - a) Down payment on home
 - b) Mortgage payments or rent
 - c) Utilities
 - d) Repairs
 - e) Furnishings
 - f) Insurance
 - g) Property taxes
 - h) Additions to home
 - i) Maintenance
 - j) Homeowners' association dues
- c. Exclusion is for income tax purposes only; housing allowance amount is subject to self-employment tax (if applicable, see Section C above)
- d. See provided worksheet to estimate maximum housing allowance

E. EXEMPTION FROM INCOME TAX WITHHOLDING

1. Employing church is not required to withhold income tax on ministerial wages paid
2. Minister may enter into a voluntary withholding agreement with the church to cover any income and self-employment taxes
 - a. May use Form W-4 for this purpose – amount should be entered on line 4(c) (mark other parts N/A)

- b. All amounts withheld under such agreements are reported as income tax withheld
- 3. Ministers are subject to the normal estimated tax payment rules
 - a. Must make quarterly estimated tax payments using Form 1040-ES if you expect to owe \$1,000 or more (after subtracting withholding and credits)
 - b. Estimated tax payments are based on the lesser of:
 - i. 90 percent of the tax expected to be owed for the current year, or
 - ii. 100 percent of the prior year tax (110 percent if your prior year adjusted gross income was more than \$150,000)
 - iii. Prior year tax exception is not available if no return was filed in prior year, or the return that was filed showed \$0 tax liability
 - c. Due dates for estimated tax payments – April 15, June 15, September 15, and January 15 of following year

F. HONORARIA AND MINISTER GIFTS

- 1. Generally reportable as income on Schedule C if connected to services provided as a minister
- 2. Directly related expenses can be deducted on Schedule C
 - a. Examples – travel costs incurred in connection with the performance of a special service; books or other materials used to prepare for a special service
 - b. Deason rule applies (see below)

G. THE DEASON RULE

- 1. Business expenses (reportable on Schedule C) incurred in connection with ministerial earnings are nondeductible for federal income tax purposes to the extent that they are allocable to tax-exempt housing allowances.
- 2. Steps for computing nondeductible portion:
 - a. Determine a minister's total ministry income, including the housing allowance
 - b. Divide the housing allowance by the total ministry income to determine the nontaxable percentage
 - c. Multiply the ministerial business expenses by the nontaxable percentage to determine the nondeductible portion
 - d. Subtract the nondeductible portion from the total expenses to determine the amount deductible on Schedule C

H. HELPFUL IRS PUBLICATIONS

1. [IRS Publication 517](#) – Social Security and Other Information for Member of the Clergy & Religious Workers
2. [IRS Publication 463](#) – Travel, Entertainment, Gift, and Car Expenses

This outline is provided for general information purposes. It does not constitute professional advice. It is a generic document that is not specifically designed for your personal tax situation. We have provided it as a matter of professional courtesy for you to consider, together with your legal and tax counsel, along with other sample documents and other sources of information as you determine are appropriate for your situation.

**Application for Exemption From Self-Employment Tax
 for Use by Ministers, Members of Religious Orders
 and Christian Science Practitioners**

**File Original
 and Two Copies**

File original and two copies and attach supporting documents. This exemption is granted only if the IRS returns a copy to you marked "approved."

Please type or print	1 Name of taxpayer applying for exemption (as shown on Form 1040)	Social security number
	Number and street (including apt. no.)	Telephone number (optional)
	City or town, state, and ZIP code	
2 Check one box: <input type="checkbox"/> Christian Science practitioner <input type="checkbox"/> Ordained minister, priest, rabbi <input type="checkbox"/> Member of religious order not under a vow of poverty <input type="checkbox"/> Commissioned or licensed minister (see line 6)	3 Date ordained, licensed, etc. (Attach supporting document. See instructions.)	
4 Legal name of ordaining, licensing, or commissioning body or religious order		
Number, street, and room or suite no.	Employer identification number	
City or town, state, and ZIP code		

5 Enter the first 2 years after the date shown on line 3 that you had net self-employment earnings of \$400 or more, any of which came from services as a minister, priest, rabbi, etc.; member of a religious order; or Christian Science practitioner ▶

6 If you apply for the exemption as a licensed or commissioned minister and your denomination also ordains ministers, please indicate how your ecclesiastical powers differ from those of an ordained minister of your denomination. Attach a copy of your denomination's bylaws relating to the powers of ordained, commissioned, and licensed ministers.

7 I certify that I am conscientiously opposed to, or because of my religious principles I am opposed to, the acceptance (for services I perform as a minister, member of a religious order not under a vow of poverty, or Christian Science practitioner) of any public insurance that makes payments in the event of death, disability, old age, or retirement; or that makes payments toward the cost of, or provides services for, medical care. (Public insurance includes insurance systems established by the Social Security Act.)

I certify that as a duly ordained, commissioned, or licensed minister of a church or a member of a religious order not under a vow of poverty, I have informed the ordaining, commissioning, or licensing body of my church or order that I am conscientiously opposed to, or because of religious principles I am opposed to, the acceptance (for services I perform as a minister or as a member of a religious order) of any public insurance that makes payments in the event of death, disability, old age, or retirement; or that makes payments toward the cost of, or provides services for, medical care, including the benefits of any insurance system established by the Social Security Act.

I certify that I have never filed Form 2031 to revoke a previous exemption from social security coverage on earnings as a minister, member of a religious order not under a vow of poverty, or Christian Science practitioner.

I request to be exempted from paying self-employment tax on my earnings from services as a minister, member of a religious order not under a vow of poverty, or Christian Science practitioner, under section 1402(e) of the Internal Revenue Code. I understand that the exemption, if granted, will apply only to these earnings. Under penalties of perjury, I declare that I have examined this application and to the best of my knowledge and belief, it is true and correct.

Signature ▶ _____ **Date ▶** _____

Caution: Form 4361 is **not proof** of the right to an exemption from federal income tax withholding or social security tax, the right to a parsonage allowance exclusion (section 107 of the Internal Revenue Code), assignment by your religious superiors to a particular job, or the exemption or church status of the ordaining, licensing, or commissioning body, or religious order.

For Internal Revenue Service Use

Approved for exemption from self-employment tax on ministerial earnings
 Disapproved for exemption from self-employment tax on ministerial earnings

By _____ (Director's signature) _____ (Date)

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Purpose of form. File Form 4361 to apply for an exemption from self-employment tax if you have ministerial earnings (defined later) and are:

- An ordained, commissioned, or licensed minister of a church;
- A member of a religious order who has not taken a vow of poverty; or
- A Christian Science practitioner.

Note. If you are a commissioned or licensed minister of a religious denomination or church that ordains its ministers, you may be treated in the same manner as an ordained minister if you perform substantially all the religious functions within the scope of the tenets and practices of your religious denomination or church.

This application must be based on your religious or conscientious opposition to the acceptance (for services performed as a minister, member of a religious order not under a vow of poverty, or Christian Science practitioner) of any public insurance that makes payments for

death, disability, old age, or retirement; or that makes payments for the cost of, or provides services for, medical care, including any insurance benefits established by the Social Security Act.

If you are a duly ordained, commissioned, or licensed minister of a church or a member of a religious order not under a vow of poverty, prior to filing this form you must inform the ordaining, commissioning, or licensing body of your church or order that, on religious or conscientious grounds, you are opposed to the acceptance of public insurance benefits based on ministerial service.

Ministerial service, in general, is the service you perform in the exercise of your ministry, in the exercise of the duties required by your religious order, or in the exercise of your profession as a Christian Science practitioner. Ministerial earnings are the self-employment earnings that result from such service. See Pub. 517 for details.

Do not file Form 4361 if:

- You ever filed Form 2031, Revocation of Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders, and Christian Science Practitioners; or
- You belong to a religious order and took a vow of poverty. You are automatically exempt from self-employment tax on earnings for services you perform for your church or its agencies. No tax exemption applies to earnings for services you perform for any other organization.

Additional information. See Pub. 517, Social Security and Other Information for Members of the Clergy and Religious Workers.

When to file. File Form 4361 by the due date, including extensions, of your tax return for the second tax year in which you had at least \$400 of net earnings from self-employment, any of which came from ministerial services.

Effective date of exemption. An exemption from self-employment tax is effective for all tax years ending after 1967 in which you have net self-employment earnings of \$400 or more if you receive any of it from ministerial services. For example, if you had qualified net earnings of \$400 or more in 2008 and not again until 2010, a valid Form 4361 filed by April 15, 2011, would apply to 2008 and all later years. See Pub. 517 to find out if you are entitled to a refund of self-employment tax paid in earlier years.

Where to file. Mail the original and two copies of this form to: Department of the Treasury, Internal Revenue Service Center, Philadelphia, PA 19255-0733.

Approval of application. Before your application can be approved, the IRS must verify that you are aware of the grounds for exemption and that you want the exemption on that basis. When your completed Form 4361 is received, the IRS will mail you a statement that describes the grounds for receiving an exemption under section 1402(e). You must certify that you have read the statement and seek exemption on the grounds listed on the statement. The certification must be made by signing a copy of the statement under penalties of perjury and mailing it to the IRS not later than 90 days after the date the statement was mailed to you. If it is not mailed by that time, your exemption will not be effective until the date the signed copy is received by the IRS.

If your application is approved, a copy of Form 4361 will be returned to you marked "approved." Keep this copy of Form 4361 for your permanent records. Once the exemption is approved, you cannot revoke it.

Exempt earnings. Only earnings from ministerial services (ministerial earnings) are exempt from self-employment tax.

Conducting religious worship services or ministering sacerdotal functions are ministerial services whether or not performed for a religious organization.

Ministerial services also include controlling, conducting, and maintaining religious organizations (including religious boards,

societies, and other agencies integral to these organizations) under the authority of a church or church denomination.

If your church assigns or designates you to perform services for an organization that is neither a religious organization nor an integral agency of a religious organization, you are performing ministerial services even though they may not involve conducting religious worship or ministering sacerdotal functions. Your services are ordinarily not considered assigned or designated by your church if any of the following is true.

- The organization for which you perform the services did not arrange with your church for your services.
- You perform the same services for the organization as other employees not designated as you were.
- You perform the same services before and after the designation.

Nonexempt earnings. Exemption from self-employment tax does not apply to earnings from services that are not ministerial.

Earnings from the following entities are not exempt even if religious services are conducted or sacerdotal functions are ministered: the United States; a state, territory, or possession of the United States; the District of Columbia; a foreign government; or a subdivision of any of these bodies. For example, chaplains in the U.S. Armed Forces are considered commissioned officers, not ministers. Similarly, chaplains in state prisons or universities are considered civil servants.

Indicating exemption on Form 1040. If the IRS returns your application marked "approved" and your only self-employment income was from ministerial services, enter "Exempt—Form 4361" on the self-employment tax line in the *Other Taxes* section of Form 1040. If you had other self-employment income, see Schedule SE (Form 1040).

Specific Instructions

Line 3. Enter the date you were ordained, commissioned, or licensed as a minister of a church; became a member of a religious order; or began practice as a Christian Science practitioner. Do not file Form 4361 before this date. Attach a copy of the certificate (or, if you did not receive one, a letter from the governing body of your church) that establishes your status as an ordained, commissioned, or licensed minister; a member of a religious order; or a Christian Science practitioner.

Line 4. If you are a minister or belong to a religious order, enter the legal name, address, and employer identification number of the denomination that ordained, commissioned, or licensed you, or the order to which you belong. Get the employer identification number from your church or order.

You must be able to show that the body that ordained, commissioned, or licensed you, or your religious order, is exempt from federal income tax under section 501(a) as a religious organization described in section 501(c)(3). You must also be able to show that the body is a church (or convention or association of churches) described in section 170(b)(1)(A)(i). To assist the IRS in processing your application, you can attach a copy of the exemption letter issued to the organization by the IRS. If that is not

available, you can attach a letter signed by an individual authorized to act for the organization stating that the organization meets both of the above requirements.

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. We need this information to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax. Applying for an exemption from self-employment tax is voluntary. However, providing the requested information is mandatory if you apply for the exemption. Our legal right to ask for the information requested on this form is Internal Revenue Code sections 1402(e), 6001, 6011, 6012(a), and 6109 and their regulations. Code section 6109 requires that you provide your social security number on what you file. If you fail to provide all or part of the information requested on Form 4361, your application may be denied. If you provide false or fraudulent information, you may be subject to penalties.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law.

Generally, tax returns and return information are confidential, as stated in section 6103. However, section 6103 allows or requires the Internal Revenue Service to disclose or give the information shown on your tax return to others as described in the Code. We may disclose this information to the Social Security Administration for administration of the exemption, to the Department of Justice to enforce civil and criminal tax laws, and to cities, states, the District of Columbia, and U.S. commonwealths or possessions to administer their tax laws. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal nontax criminal laws, and to federal law enforcement and intelligence agencies to combat terrorism.

Please keep this notice with your records. It may help you if we ask you for other information. If you have any questions about the rules for filing and giving information, please call or visit any Internal Revenue Service office.

The average time and expenses required to complete and file this form will vary depending on individual circumstances. For the estimated averages, see the instructions for your income tax return.

If you have suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Avenue, NW, IR-6526, Washington, DC 20224. Do not send the form to this address. Instead, see *Where to file* on this page.

WORKSHEET TO ESTIMATE MAXIMUM HOUSING ALLOWANCE (For Ministers Who Own or Rent Their Home)

Minister's Name: _____

Church Name: _____

Calculation for the year 20____ or the period _____ TO _____ # of Months _____

FAIR RENTAL VALUE (Including Furnishings and Utilities)

1. What is the monthly market rental value of your home? (If you rent your home, apartment, etc., enter monthly rent.) (See instructions on reverse.)		
2. What is the monthly rental value of your furniture, appliances and other furnishings? Estimate if necessary. (See instructions on reverse.)		
3. How much is your average monthly utility bill (electric, gas, water, sewer, garbage, etc.)?		
4. Enter the total of lines 1-3.	-	
5. Multiply line 4 by 12. This is the estimated fair rental value for one year (including furnishings and utilities). (If period of calculation is less than one year, multiply by the appropriate number of months.)	-	
	\$	-

COSTS INCURRED TO PROVIDE A HOME		Estimate (Complete in advance)	Actual* (Complete after year-end)
6. If you own your home, enter expected mortgage payments (both principal and interest) for the year or other applicable period, if less than 1 year. (Include insurance and taxes paid as part of monthly payments or paid separately.) Also include any extra mortgage payments to be made, down payments to be made, real estate commissions to be paid, etc.	Note: Certain home equity loan payments may not be included in these costs. Consult your tax advisor for help.		
7. If you rent, enter total rent for the year or other applicable shorter period. (Include renter's insurance premiums, if any.)			
8. What is the estimated cost of maintenance and repairs, including lawn maintenance, pest control, painting, etc. for the year or applicable shorter period?			
9. Enter the amount you expect to pay for furnishings, appliances, decorator items, cleaning supplies, etc. for the year or applicable shorter period.			
10. Estimated utilities cost for the year or applicable shorter period (Line 3 multiplied by the appropriate number of months [12 if for a year]).		-	
11. Enter the total of lines 6-10 above. This is total of costs to provide a home.		\$ -	\$ -
SALARY			
12. Enter your annual total compensation, including salary and housing allowance for the year or applicable shorter period.			
13. Enter the amount on line 5, 11 or 12 whichever is least. This is your estimated maximum tax-free housing allowance for the period.			

(SEE INFORMATION ON REVERSE)

*Note: This column is for use after year-end as described on reverse.

NOTE: PRESENT THIS TO THE BOARD FOR RATIFICATION IN ADVANCE OF THE PERIOD TO WHICH IT APPLIES. SUBMIT REVISED ESTIMATES IF ANY OF THE ESTIMATED AMOUNTS CHANGE SIGNIFICANTLY DURING THE YEAR. IF THE HOUSING ALLOWANCE GRANTED TO YOU EXCEEDS YOUR ACTUAL HOUSING COSTS FOR THE YEAR, THE EXCESS MUST BE RECOGNIZED AS INCOME BY YOU ON YOUR TAX RETURN.

(Use the ACTUAL column on the front of this worksheet after the year is over to determine your actual costs of providing a home for the year.)

Instructions To Line 1:

1. If you own your home, the best method of determining this amount is to have an appraiser or rental real estate specialist provide you with a written estimate of the monthly rental value. If this is not feasible, you should estimate the fair rental value using some reasonable method.

Instructions To Line 2:

2. The amount on this line should be your estimate of the amount that the monthly rental value of your home would increase if the home were furnished. There are no specific rules providing guidance in this area, but a reasonable estimate should be made.

BOARD APPROVAL:

THIS AFFIRMS THAT THE BOARD OF DIRECTORS HAS APPROVED THE DESIGNATION OF \$_____ OF THE SALARY OF
(Minister's Name)_____ AS A TAX-FREE HOUSING ALLOWANCE FOR THE PERIOD _____,
AND AN EQUIVALENT ANNUAL AMOUNT THEREAFTER UNTIL FUTURE NOTICE.

SIGNED: _____
Secretary

DATE: _____

This sample document is provided for general information purposes and should be used only under the guidance of a qualified professional tax advisor. It does not constitute legal, accounting, tax or professional advice of any type.

TODAY'S PRESENTER



Michele M. Wales, CPA

National Director of Tax Services – Batts Morrison Wales & Lee

Michele Wales is a partner and the national director of tax services for BMWL. She has supervisory responsibility for the firm's tax practice, with expertise in federal, state, and local tax issues affecting nonprofit organizations and their affiliates. She is responsible for training members of the firm who specialize in this area of taxation. Michele has more than 20 years of experience in public accounting, and has also served as chief financial officer for a large nonprofit social services agency and controller for an airplane manufacturing company. She is licensed or authorized to practice as a Certified Public Accountant in multiple states and is also a Chartered Global Management Accountant. She has been a conference speaker on nonprofit taxation issues at both the local and national levels. Michele is a contributing editor of BMWL's nonprofit feature articles and special alerts, which provide news related to current developments and perspective on issues impacting nonprofits and their leaders. Michele previously served on the board of directors of a charter school in Seminole County, Florida, and of PPP of Orlando, Inc. (the local chapter of the Partnership for Philanthropic Planning). Her community activities include serving as a religious education teacher, Eucharistic minister, and ministry team member for her church. Michele graduated with honors from the University of Florida, receiving her bachelor of accounting and master of accounting degrees.



KEEPING WATCH FOR NONPROFITS ACROSS THE UNITED STATES®

AUDIT & ASSURANCE | TAX SERVICES | STRATEGIC ADVISORY

— DISCOVER THE BMWL DIFFERENCE —

We understand you want to protect the financial health and reputation of your organization. Our entire service model is built around that very idea.

MAXIMIZE TAX
EXEMPTIONS

PROTECT YOUR
EXEMPT STATUS

PRODUCE HIGHLY
EFFECTIVE
FINANCIAL
REPORTS

PROVIDE
BOARD MEMBER
GOVERNANCE,
ORIENTATION, AND
TRAINING

PROTECT
YOUR MISSION

STRATEGICALLY
BUDGET
FOR IMPROVED
FINANCIAL
CONDITION

SIMPLIFY YOUR
FINANCIAL
ADMINISTRATION

IMPROVE OVERALL
RISK MANAGEMENT

MAINTAIN STRONG
DONOR TRUST