

CLERGY TAX GUIDE

This guide has been developed to give Methodist clergy information to help them properly complete their income tax return and avoid costly mistakes.

This guide does not constitute tax advice, nor does it supply instructions about how to complete a tax return. Instead, it provides important, high-level information all Methodist clergy should know in order to properly pay their taxes.

CLERGY STATUS ACCORDING TO THE IRS

Methodist clergy are in a hybrid state when it comes to filing their income taxes. Appointed clergy (elders, deacons, associate members and local pastors) are considered church employees for income tax purposes. This means each church must provide their pastor with an IRS Form W-2 during January for the previous year's wages. **Clergy are not contractors and should not receive an IRS form 1099 MISC from their church.** If they do receive the 1099 form, clergy must inform their church that they received the incorrect form and should instead be issued a W-2 and report it as such to the IRS.

Regarding Social Security, Methodist clergy who are under appointment are considered self-employed. This means clergy are responsible for paying both the employee portion of FICA taxes and the employer's portion (7.65% is paid by employees, and 7.65% is paid by employers). Because clergy are self-employed, churches cannot pay into the Social Security trust fund for them. Clergy must do that themselves. Churches are also not allowed to give clergy cash for the purpose of offsetting self-employment taxes. Furthermore, in order to receive full Social Security and Medicare benefits at the eligible age, clergy must have worked and paid into the system for 40 quarters. In order to receive the appropriate Social Security and Medicare credit, clergy must include an IRS Form SE as a part of their tax return.

More information is available at www.socialsecurity.gov.



THE W-2 FORM

- **The name and Social Security number on the form.** If these are not correct, it will take considerable effort to ensure the taxes owed are properly received and recorded for the right person by the IRS.
- **Wages for the previous year.** Clergy need to ensure this information is correct. If not or there are questions regarding the amount, clergy should immediately talk to their church treasurer.
- **Box 12.** For clergy who have made an elective salary deferral to Wespath, this box will list that amount. Clergy should ensure this amount has been included and is correct. Code E (elective deferral to 403(b) plan) should also be selected.
- **Box 14.** There is no requirement that any information be placed in Box 14, although it is highly recommended that the church include the following in that field for the sake of transparency:
 - The amount of any housing or parsonage exclusion being claimed.
 - Any utilities the church paid on the clergyperson's behalf.
 - Any other compensation the clergyperson received from the church that was not included in wages.

CLERGY HOUSING

Clergy housing is the source of the greatest confusion for Methodist clergy trying to complete their tax returns. Housing is not subject to federal income taxation, but it is subject to self-employment taxes.

How it Works

- At the annual church conference, clergy are allowed to allocate a portion of their salary as a **housing or parsonage exclusion**. This is one of the tax benefits available to clergy when it comes to their federal income tax liability. The portion allocated is not taxable for federal income tax purposes as long as the following criteria are met:
 - That amount has been indicated at the charge conference and approved. **This approval cannot be applied retroactively.**
 - The exclusionary amount cannot exceed the fair rental value of the furnished parsonage or home, plus utilities. It is the pastor's responsibility, not the church's, to obtain the appropriate fair rental valuation. This valuation can be obtained by asking a local realtor to provide a **comparative market analysis of the fair rental value furnished** of the parsonage or home. Zillow should not be used for this purpose.
 - Clergy must spend the exclusionary amount on housing-related items (cost of repairs, lawn care, mortgage payments, rent payments, utilities the clergyperson paid, purchase of furniture, etc.). It is the clergyperson's responsibility to keep adequate records of those expenses, which means keeping receipts.
 - Any portion of the parsonage or housing exclusion not spent on housing-related expenditures must be included as income in the clergyperson's federal income tax calculation.
- Clergy must include ALL of their compensation in their self-employment tax calculation. This includes: salary, designated housing or parsonage exclusion amount, utilities provided by the church or salary-paying unit, and if living in a parsonage, the fair rental value of the home unfurnished (if the clergyperson provided the furniture re) or furnished (if the church provided the furniture).
- Here is one example to help clarify how clergy housing should be addressed:
 - Pastor Sally receives a salary of \$50,000 and is provided a parsonage. If she were renting a comparable furnished house, her monthly rent would be \$2,000. The church paid her utilities at \$200 per month. Sally claimed a housing exclusion of \$500 for the year. This means her gross salary is still \$50,000, but the \$500 is allocated for housing.
 - Box 1 of her W-2 should show \$49,500, and Box 14 should show \$500 for the parsonage exclusion. When Sally calculates her federal income taxes, her taxable income is \$49,500, as long as she can document that she spent \$500 on housing-related expenditures. If she did not, the unused portion must be included in taxable income.
 - When Sally computes the self-employment tax, her includable income should be:
 - Box 1: \$49,500 income
 - Box 14: \$500 parsonage exclusion
 - Fair rental value of the parsonage (\$2,000 x 12): \$24,000
 - Utilities (\$200 x 12): \$2,400
 - For self-employment tax purposes, Sally has an income of \$76,400.
- Here is another housing example:
 - Pastor Richard receives a salary of \$50,000 but is not provided a parsonage. Instead, he receives a housing allowance of \$2,000 per month. Richard decides he will rent an apartment at \$1,900 per month instead of purchasing a house. Because Richard doesn't think the housing allowance will cover all of his expenses, he requests, and his church conference approves, an additional housing exclusion of \$500. Richard spends \$200 per month in utilities. He also bought a new couch for \$1,000.
 - Box 1 of his W-2 should show \$49,500, and Box 14 should show \$24,500 as a housing allowance. When Richard calculates his federal income taxes, his taxable income is \$49,500. Richard spent more in housing costs than the excludable amount of \$24,500 (\$22,800 for rent, \$2,400 for utilities and \$1,000 for a couch for a total of \$26,200). There is no additional deduction for exceeding the approved exclusion amount.
 - When Richard computes his self-employment tax, his includable income should be:
 - Box 1: \$49,500 income
 - Box 14: \$24,500 housing exclusion
 - Because Richard paid his own utilities, he does not have to include it as Sally did.
 - For self-employment tax purposes, Richard has an income of \$74,000.
- These are very general examples. Much more detail is included in an actual income tax filing. **It is also imperative that clergy plan their cash flow to ensure they have enough resources to handle any unexpected tax events.**

CLERGY PENSION

One-way clergy can limit their income tax liability is to have their church make a pre-tax contribution from their salary to their UMPIP account with Wespeth. This has two benefits: it provides additional funds for retirement and reduces income tax liability.

- Although many clergy don't often think about retirement, it is a life change that happens for all clergy. It is critical that each clergyperson begin a discipline of saving as early in their ministry as possible in order to have adequate financial resources when retirement comes.
- Taking money out before taxes reduces the tax liability. Consider Pastor Sally again. She earns \$50,000 each year in gross income. Let's assume she puts \$100 per month, or \$1,200 per year, into her UMPIP account before taxes (meaning that the taxes are actually deferred until she retires). With no other adjustments, she would be in the 12% marginal tax bracket. Mathematically it works out that she is saving $.12 \times \$1,200$ or \$144. An alternative way of looking at it is to say she is taking \$1,200 from her paycheck, but it is only costing her \$1,056 ($\$1,200 - \144).

PAYMENT OF TAXES

There are three ways clergy can pay their taxes to the IRS:

- **Quarterly estimated tax payments.** This requires clergy to estimate to the best of their ability their income tax liability for each quarter and remit that amount to the IRS by the quarterly tax due date. It will also require clergy to save a portion of their paycheck in order to have the necessary funds to pay the estimated amount. These can be paid by check and mailed to the IRS or paid through the option below – EFTPS.
- **Electronic payments through EFTPS (Electronic Federal Tax Payment System).** This is a secure way for clergy to send money to the IRS as soon as they get paid. The money is sent from the clergyperson's bank account to the IRS on the date indicated by the clergyperson. Signing up for EFTPS is simple and can be done online.
- **Clergy can make their payment to the church, and then the church remits the money to the IRS for the pastor.** This method is not advisable because it can easily create some confusion as to who is paying and how is it being reported.

GETTING HELP

This guide by itself is not sufficient for clergy to complete and file their federal income taxes. It is strongly recommended that all clergy consult with a certified financial planner, a certified public accountant or a licensed tax attorney to determine what is best for them.

For the best advice, clergy should ensure that the professional they choose is fully aware of the tax rules related to Methodist clergy. Otherwise, clergy may end up paying significant back taxes, interest or penalties, especially if mistakes have been made over a number of years. Mistakes might also make clergy ineligible for Social Security and Medicare if they don't file properly.

Other helpful references include:

- IRS Publication 517 at <https://www.irs.gov/forms-pubs/about-publication-517>
- <https://www.irs.gov/pub/irs-pdf/p1828.pdf>
- <https://www.churchlawandtax.com/topics/understand-taxes/clergy/>

Contact us for more information.

