

Ministers and Taxes

By Bob Young

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Introduction

Tax Day is past for another year! I have always done my own taxes. (After all, I am a mathematician!) Although I have never hung my shingle out as a tax preparer, for a number of years, I did seminars and consultations to help those involved in ministry with their taxes. Now is the time to understand those things that influence the amount of taxes paid and to take appropriate steps to minimize next year's tax bill. There are a number of things churches and ministers can do to make certain the amount of taxes paid is accurate—that the right amount of taxes is being paid without overpaying. Tax evasion is illegal. Tax planning is wise. The information here is provided only as a general guideline to suggest areas to be studied, and is not intended to provide legal counsel.

Getting Started

The first factor that must be understood in ministerial remuneration is that the government considers ministers as employees for income tax purposes, but as self-employed for social security purposes. This dual status is quite confusing, but must be understood to maximize the ministerial pay package and to minimize taxes. (There are some exceptions—those who minister in unique situations should study the tax code carefully to make certain whether they are employees.)

This dual status helps one understand why ministers have the option of excluding themselves from Social Security when the exclusion is based on biblical and conscientious objections. Ministers considering this matter should carefully read the statement to be signed and also consider the financial implications. I am a participant in Social Security and I recommend that ministers, except those who clearly have conscientious objections as reflected in the statement, participate in Social Security. Ministers and churches who have conscientious objections much develop alternate plans to meet emergency, retirement, and future medical needs. Churches and ministers must make certain that the employing church is a recognized 501(c)3 organization, and that the minister's status is correctly identified. These are essential for using the housing allowance and for participating in qualified retirement plans.

In general, churches can provide four kinds of remuneration to ministers.

First, churches provide salary or personal support. Churches should provide sufficient income to meet the needs of the minister and his family. While the minister as employee can agree with the church to withhold funds due as taxes (income and FICA), such funds are income to the minister due to his self-employed status and are included in his income, not as a benefit or employee cost to the employer. I recommend that ministers escrow the required funds and make quarterly payments.

Second, churches can provide the minister housing and/or a housing allowance. If the church provides the minister a parsonage, the value of the housing must be included in the remuneration package and the minister is to pay FICA taxes on the value. (Both housing and the housing allowance are not taxable earned income but are subject to FICA taxes.) A minister

who lives in a house provided by the church should also have a housing allowance to cover the housing expenses not provided by the church. In recent years, more and more ministers have had the opportunity to purchase their own housing, using a housing allowance provided by the church. The housing allowance is limited by the amount designated, the amount actually spent, the fair market or fair rental value of the housing, and the minister's income. Ministers should study the tax code carefully to make certain they are taking full advantage of this provision but are not abusing it.

Third, the church can pay employee expenses. A few churches may use an open-ended reimbursement plan and reimburse whatever expenses the minister incurs in the activities of ministry. More often, churches want to limit such expenses. In fact, many churches develop a total amount to be paid for ministry, and ministers must determine how much of that amount should be designated as reimbursable expenses. Only reimbursable expense plans meet the government requirements—the old income reduction approach does not. A disadvantage of a reimbursable expense plan is that the amount designated must be spent on expenses or it remains with the church (or must be returned if it has been advanced in equal weekly amounts). The rules for churches and ministers in this area are not different from those of other employers and employees, and any good tax book will provide guidance.

Fourth, the church can provide benefits to the minister and his family, e.g. health insurance, life insurance, disability insurance, and retirement. In this area, as in the area of expenses, the rules for the church and minister are not different from those governing other employer and employee relationships, and good information is available in understandable form in various tax preparation books. This area has a number of excellent opportunities for the church to help meet the needs of the minister, but is also complex with cafeteria plans, HSAs, 403bs, and various qualified instruments. There are also non-discrimination rules. The church and minister will do well to receive legal counsel in setting up complex arrangements in this area.

For Church Leaders

Church leaders should help ministers take full legal advantage of the tax advantages available. This is good stewardship. Church leaders should attempt to understand the unique situation in which the minister finds himself.

Church leaders can help the members of the church understand the minister's pay package and can avoid conflicts and questions with a few simple steps. Most churches simply lump all of the above items into a budget item labeled minister's salary. This is a source of great confusion to church members as they try to understand why the minister makes so much. Those who operate businesses know that the expenses and benefits often add at least 25-33% to a basic pay package. In addition, most people are accustomed to thinking of "take-home" pay and do not understand that the amount the minister is receiving includes the taxes he must pay for himself—often a sizeable sum that he sends to the government in quarterly payments (in my experience, as much as \$8000-10000 annually).

A helpful approach to budgeting the minister's salary package is to list expenses as expenses—not as ministerial income. Likewise, employee benefits and costs can be listed as such. Some churches even distinguish the minister's gross check (as reflected in a regular paycheck) from the net amount which is communicated to the congregation, taking into consideration the

minister's responsibility to pay his own income taxes and Social Security/FICA with quarterly payments.

For example, consider a church whose total financial package for the minister is \$50000. Of that amount, \$5000 is designated reimbursable expenses, \$5000 is used to pay the minister's health insurance premium, and \$5000 is paid to a qualified retirement plan. The minister receives a \$10000 housing allowance. In this example, the minister will pay FICA taxes of 15.3% on \$35000 and will have \$25000 taxable income before deductions. He will probably pay the government at least \$6000 annually in his quarterly payments. He receives a gross weekly check for about \$700 but his "take-home" is actually slightly less than \$600/week.

The church in this example, instead of having a \$50000 items labeled "minister's salary" could include the expenses as an expense item, the benefits as an employee benefits expense, and show that the minister takes home \$29000, but also receives funds customarily withheld from the members' paychecks, in this example \$6000, since he pays his own withholding and FICA directly.

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Note: I will try to answer questions or suggest good resources related to the above for those who contact me. While I will try to answer questions personally, individual responses may not be possible and some questions may be answered in future articles.

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