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Zondervan Minister's Tax & Financial Guide: 2008 Edition
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Zondervan, Grand Rapids, Michigan 49530

ISBN-10: 0-310-26218-6
ISBN-13: 978-0-310-26218-3

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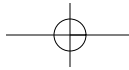
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Printed in the United States of America

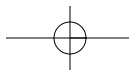
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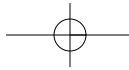




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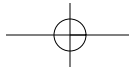
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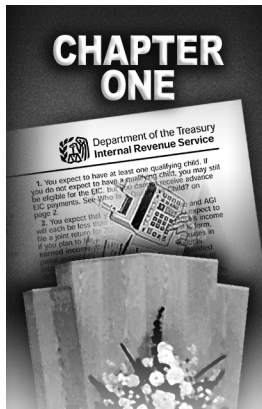
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Taxes for Ministers

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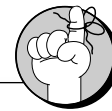
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- Social security status of ministers
- Income tax status of ministers
- Importance of the employee vs. self-employed decision
- Recommended filing status

Understanding how the various parts of the tax law fit together and apply to ministers is your primary challenge. With the big picture in mind, you can plan your tax liability instead of just letting it happen.

The key to understanding the federal tax system for ministers is to focus on tax rules that primarily benefit ministers (such as the housing allowance) and other provisions that are available to most individual taxpayers (like tax-free or tax-deferred fringe benefits).

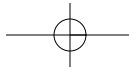
There are several special tax provisions for ministers:

- Exclusion of the housing allowance for income tax purposes and the fair rental value of a church-owned parsonage provided rent-free to clergy;
- For social security tax purposes, treatment of all clergy as self-employed as it relates to income from ministerial services;
- Exemption of clergy from self-employment social security tax under very limited circumstances;



Remember

There is some flexibility in applying certain ministerial tax provisions. For example, a minister is exempt from mandatory income tax withholding but can enter into a voluntary income tax withholding arrangement. However, if a minister qualifies for the housing allowance, he or she is subject to self-employment social security tax (using Schedule SE), not FICA—this is not optional.



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- Exemption of clergy compensation from mandatory income tax withholding;
- Eligibility for a voluntary income tax withholding arrangement between the minister-employee and the church;
- Potential “double deduction” of mortgage interest and real estate taxes as itemized deductions and as excludable housing expenses for housing allowance purposes for ministers living in minister-provided housing.

The six special tax provisions listed above apply only to individuals who

- qualify as ministers of the gospel under federal tax rules, and
- are performing services that qualify in the exercise of ministry under federal tax rules.

Ministers Serving Local Churches

You may believe you are a minister, your employer may consider you a minister, your denomination may classify you as a minister, your parachurch employer may consider you a minister, but what does the IRS consider you? For tax purposes, the opinion of the IRS is the one that counts. But even the IRS does not consistently apply the same rules in determining who is a minister in a local church setting.

Determining whether you are a minister for tax purposes is very important. It determines how you prepare your tax return for income and social security tax purposes. A qualified minister is eligible for the housing allowance. This alone can exclude thousands of dollars from income taxation. Ministers calculate self-employment social security tax on Schedule SE and pay the tax with Form 1040. Nonministers have one-half of their social security (FICA) tax withheld from salary payments, and the employer pays the other half.

How can a church determine whether to consider me a minister for tax purposes?

If you are employed by a local church, ordained, commissioned, or licensed, four tests are generally applied by the IRS to determine whether you are a minister. You

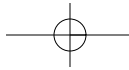
- administer sacraments (such as performing marriage and funeral services, dedicating infants, baptizing, and serving communion),
- are considered to be a religious leader by your church or parent denomination,
- conduct religious worship, and
- have management responsibility in the control, conduct, or maintenance of your local church or parent denomination.



Warning

Individuals serving local churches must meet certain tests to qualify as a minister in the eyes of the IRS. The individual must always be ordained, licensed, or commissioned.





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The IRS and the courts generally use a balancing approach to the four tests; *e.g.*, some, but not necessarily all, of the four tests must be met in determining ministerial status. This flexible approach is beneficial to many ministers because some ministers of music, education, youth, or administration will not meet all four tests.

Some individuals who are ordained, licensed, or commissioned still may not qualify for ministerial tax status. The duties performed by the individual are also important to the determination whether he or she is a duly ordained, commissioned, or licensed minister. Because religious disciplines vary in their formal procedures for these designations, whether an individual is duly ordained, licensed, or commissioned depends on a number of factors.

There is no requirement that you must be qualified to perform and actually perform every sacrament or rite of your religion. If you are qualified to perform certain sacraments and actually perform or could perform some of the sacraments on occasion, you will generally meet this test. A similar test applies to conducting religious worship and providing management services. If you currently conduct religious worship and provide management services, have done it in the past, or could do it in the future, the test will generally be met.

Job titles have little significance for tax purposes. A licensed, commissioned, or ordained minister may have a job title that implies a ministry function. However, the actual responsibilities of the position will determine if the four-factor test is met. Ministers performing services of a routine nature, such as those performed by secretaries, clerks, and janitors, generally do not qualify as ministers for tax purposes.

If your local church or parachurch organization ordains, licenses, or commissions ministers, it is very important that certain guidelines are followed. These issues are addressed in the 2008 edition of *The Zondervan Church and Nonprofit Tax & Financial Guide*.



Caution

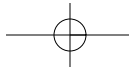
Determination of ministerial status is far from a precise matter. There has been considerable inconsistency in the position of the IRS and Tax Court on this issue across the years. Only a review of all the pertinent facts and circumstances for a particular minister will assist in determining whether an individual will qualify for ministerial tax status.

What about licensed or commissioned ministers?

Some religious groups ordain, license, and commission ministers. Other groups only ordain, only commission, or only license and ordain ministers or provide some other combination of the three types of special recognition of ministers.

Will you be treated as a minister by the IRS if you are only licensed or commissioned? Perhaps. Your status with the IRS will depend on all the facts and circumstances; *e.g.*, the validity of the licensing or commissioning process, and the extent to which you administer the sacraments, are considered to be a religious leader by your church, conduct worship services, and have management responsibility in the control, conduct, and maintenance of your church.





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Example: Rev. Smith is an ordained minister who serves as a minister of counseling at his church. He does not preach or conduct worship services and never administers sacraments. He has management responsibility for the operation of a counseling center in the local church. He occasionally makes hospital visits. While he qualifies under the “control, conduct, and maintenance of the church” test, he does not administer sacraments or conduct worship services. With professional advice, the church must decide whether he qualifies as a minister for tax purposes.

Evangelists and Missionaries

The qualifications for itinerant evangelists for the special ministerial tax provisions are generally the same as for ministers serving local churches.

Most evangelists are self-employed both for income tax and self-employment social security tax purposes. An exception is an evangelist who has formed a corporation and is an employee of the corporation. In this instance, the evangelist is an employee for income tax purposes but remains self-employed for social security tax purposes.

Missionaries are also subject to the same rules to qualify for ministerial status for tax purposes (see pages 26-29). Qualifying for benefits such as a housing allowance is often not so important for a minister-missionary because of the foreign-earned income exclusion. However, the issue of ministerial tax status is vitally important to determine if the minister is subject to social security as an employee or as a self-employed person.

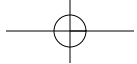
A missionary may qualify for the foreign-earned income exclusion (Form 2555) whether or not the missionary qualifies for ministerial tax treatment. The foreign-earned income exclusion affects income tax but not social security tax.

Members of Religious Orders

Members of religious orders qualify for certain tax provisions afforded to ministers. The IRS has developed stringent characteristics to determine whether an organization is a religious order. They are as follows:

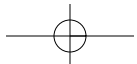
- The organization is described in section 501(c)(3) of the Internal Revenue Code.
- The members of the organization, after successful completion of the organization's training program and probationary period, make a long-term commitment to the organization (normally more than two years).
- The organization is, directly or indirectly, under the control and supervision of a church or convention or association of churches or is significantly funded by such an entity.
- The members of the organization normally live together as part of a community

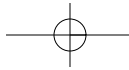




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Special Tax Provisions	Application to Religious Order Members
<ul style="list-style-type: none"> ● Exemption of members from self-employment social security tax in very limited circumstances. ● Treatment of members (who do not elect social security exemption) as self-employed for social security tax purposes for income from the religious order. ● Exemption of member compensation from mandatory income tax withholding. ● Eligibility for a voluntary income tax withholding arrangement between the member-employee and the religious order. ● Exclusion for income tax purposes of the housing allowance and the fair rental value of religious-order-owned housing provided rent-free to a member. 	<ul style="list-style-type: none"> ● The rules apply to religious order members and to clergy. ● The rules apply to religious order members and to clergy. ● The rules apply to religious order members and to clergy. ● The rules apply to religious order members and to clergy. ● If a member is required to live on the immediate premises of the order “for the convenience of the employer,” the rental value of the housing is generally tax-free for income tax purposes. If a member does not live on the immediate premises of the order, the following guidelines generally apply: Lay members. The rental value of religious-order-provided housing or a housing allowance is generally subject to income tax. Ordained, licensed, or commissioned members. If the religious order is a church or an integral agency of a church or a church denomination, the rental value of religious-order-provided housing or a housing allowance is generally tax-free for income tax purposes. If the religious order is not a church, an integral agency of a church, or a church denomination, the rental value of religious-order-provided housing or a housing allowance is generally tax-free for income tax purposes only if the work performed by the member includes sacerdotal functions.





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and are held to a significantly stricter level of moral and spiritual discipline than that required of church lay members.

- The members of the organization work or serve full-time on behalf of the religious, educational, or charitable goals of the organization.
- The members of the organization participate regularly in activities such as public or private prayer, religious study, teaching, care of the aging, missionary work, or church reform or renewal.

Housing for members of religious orders generally falls into the following categories:

- Housing provided by the religious order on its premises and the member is required to live in the housing.
- Member does not live on the immediate premises of the religious order.
 - ❑ For lay members, the rental value of religious-order-provided housing or a housing allowance is generally subject to income tax.
 - ❑ For members who are ordained, licensed, or commissioned, the taxability of religious-order-provided housing or a housing allowance generally depends on whether the religious order is a church or an integral agency of a church or a church denomination.



Warning

There are two types of members of religious orders:

1. members who are ordained, licensed, or commissioned by a church that is separate from the religious order, or by the religious order, if authorized by its organizing documents; and
2. lay members who are not ordained, licensed, or commissioned.

Ministers in Denominational Service, on Church Assignment, and Other Service

Ordained, commissioned, or licensed ministers not serving local churches may qualify as “ministers” for federal tax purposes in the following situations:

Denominational service

This category encompasses the administration of religious denominations and their integral agencies, including teaching or administration in parochial schools, colleges, or universities that are under the authority of a church or denomination.

The IRS uses the following criteria to determine if an institution is an integral agency of a church:

- Did the church incorporate the institution?

