

Unitarian Universalist Association
OFFICE OF CHURCH STAFF FINANCES

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CLERGY TAX STATUS

The tax status of ministers in the US, and the tax withholding and reporting responsibilities of religious organizations, can be summarized as follows:

1. Tax status of ministers:

In the US, ordained, licensed, or commissioned clergy have dual tax status under the Internal Revenue Code: they are considered to be employees for purposes of income tax, and they are considered self-employed for purposes of Social Security and Medicare taxes. (See IRS Publication 1828, *Tax Guide for Churches and Other Religious Organizations*, and also Publication 517, *Social Security and Other Information for Ministers*.)

2. Income tax for ministers:

Unless they choose the option of voluntary withholding described in #9 below, ministers must pay their own estimated income tax on their salary, and their self-employment Social Security and Medicare tax on their salary and Clergy Housing Allowance. Such tax payments are made quarterly on form 1040ES by the 15th of April, June, September, and January. For example, by January 15, 2007, all taxpayers are expected to have paid an amount for 2006 that will be equal to the lesser of 90% of their tax obligation for 2006 or 100% of their tax obligation for 2005.

3. Two forms of salary

Ordained, licensed, or commissioned clergy may receive both a cash salary as do other employees, and a second form of salary known as a Housing Allowance – also received by military officers – that is exempt from US income tax. The titles of minister, pastor, priest, rabbi, imam, or interim minister are all included in the word "clergy" in the provision in the tax code restated by Congress in the *Clergy Housing Clarification Act of 2001*. The Clergy Housing Allowance should be established by the governing board in advance each January, and should include all the bona-fide expenses of maintaining a residence such as mortgage or rent payments, property tax, insurance, utilities, repairs, and furnishings. Ministers who are married or who have domestic partners may treat 100% of the cost of maintaining the residence as a Clergy Housing Allowance regardless of the presence of other wage earners in the household.

Payments received as a Clergy Housing Allowance are exempt from US income tax but must be reported by the minister on Schedule SE of their 1040 tax return in calculating their self-employment tax for Social Security and Medicare. It is not required that employer-congregations report payments for a Clergy Housing Allowance on the W-2 form, although this may be entered in box #14 as an option. We recommend that ministers receive their monthly compensation for salary and Clergy Housing Allowance in separate checks in order to have clear documentation for tax purposes.

Earnings that are exempt from US income tax are generally also exempt from state income taxes, but individuals should check with their state department of revenue to confirm this.

4. Social Security and Medicare taxes for ministers.

The combined Social Security and Medicare tax is 15.3% of wages, with one half paid by the employer and one half paid by the employee. The term "FICA" covers this combined tax. Considering that ministers pay the full 15.3% Social Security and Medicare tax on their own, at the same rate as true self-employed professionals, many congregations try to soften the impact of this through a special payment "in lieu of employer's FICA" to the minister of one half of this obligation, or 7.65% of the combined salary and Clergy Housing Allowance. This payment "in lieu of employer's FICA" constitutes a bonus, and these extra dollars are themselves taxable for both income tax and Social Security and Medicare.

The additional 7.65% is now part of the itemized list of salary and benefits that UU congregations must identify in the process of searching for a new minister. The "in lieu..." amount should not be included in calculating retirement plan contributions and coverage for the UUA term life and long-term disability insurance policies.

5. Withholding income tax, different for clergy:

While religious organizations have the same responsibilities as other employers to withhold income and Social Security and Medicare taxes on all non-ordained employees, Congress has exempted churches, synagogues, etc. from this withholding requirement on the earnings of ordained, licensed or commissioned clergy. Employers must withhold and report both income tax and Social Security and Medicare taxes for non-ordained employees to the IRS either quarterly or monthly on IRS form 941. Information about this is available from a local IRS office or via the website www.irs.gov.

6. What is an "employee?"

A minister's employee status is not abrogated by the fact that the minister has a signed contract with the congregation, may work less than full-time, or by the fact that the minister may be serving in an interim ministry for less than one year. The IRS has a very detailed list of criteria for what constitutes an employee: generally, an employee is a worker over whom the employer exerts some degree of control in regard to the nature of the work and how it is performed. Also, employees can be hired or fired, and they usually work in a setting provided by the employer, and they usually receive benefits. Also, if the employer has paid all or a portion of a worker's moving expenses, that is further verification of employee status.

Ministers who serve the same congregation each week, who receive benefits, and whose work is subject to the direction of the congregation or governing board meet the test of being employees for tax purposes, even if they consider themselves as other-than-employees for professional or religious purposes. Itinerant preachers or evangelists that operate their own businesses, preaching to different groups for their livelihood, may meet the test of being self-employed independent contractors.

Employers who misclassify employees as self-employed independent contractors usually do so to avoid paying the employer's share of Social Security and Medicare taxes. These employers are out of compliance with the tax code and are subject to fines and penalties by the IRS, although the IRS has tended to penalize religious employers only in cases of flagrant and egregious violation.

7. W-2 forms for ministers:

Since in almost all circumstances, ministers who serve local congregations are considered to be employees for purposes of income taxes, the minister's salary should be reported on form W-2, as are the earnings of all other employees. W-2 forms must be given to employees by February 1 and sent to the Social Security Administration by March 1 of each year.

On the minister's W-2 form, in box #1 "wages," enter the amount paid as cash salary, the "in lieu of employer's FICA" payment, plus any overages in moving allowances, the imputed value of an employer-owned auto, or payments for business expenses made in a "non-accountable plan" where the minister did not substantiate the expenses. In box #2 where it asks for income tax withheld, write the word "clergy" unless income taxes have been withheld by the employer-congregation and paid to the IRS, in which case enter that amount.

Health, dental, and term life insurance premiums paid by employers as personnel benefits are not reported on the W-2 form, except the amount of life insurance premiums for more than \$50,000 of face value. Monies reimbursed from Accountable Professional Expense Allowances are also not taxable as income to ministers or other employees, and do not appear on the W-2. This is the same as for employees of all other organizations.

8. Independent contractors and Form 1099:

An independent contractor is a self-employed person who provides a service for hire, who works independently, and over whom the employing organization exerts little or no control. Examples are attorneys, auditors, accountants, and consultants. Independent contractors pay their own business expenses such as travel costs and insurance premiums that are deductible on Schedule C or C-EZ.

Annual earnings of \$600 or more by independent contractors must be reported on form 1099 by the firms that have used their services. Musicians whose work for a church is incidental to their regular employment, who receive payment only for their Sunday performances, and who do not receive benefits might be considered self-employed independent contractors; their income would be reported on Form 1099.

9. The option of voluntary withholding for ministers

At the mutual agreement of the church and the minister, the employer-congregation may withhold taxes from the minister's cash salary and submit the amount to the IRS monthly with IRS form 941, as if the minister were a non-ordained employee such as a religious educator, secretary, administrator, custodian, etc. The amount withheld from the minister's salary is designated for income tax, but it should be sufficient to cover both the income tax and the Social Security and Medicare tax obligation. Most ministers pay 15% or 28% income tax on their cash salary, and 15.3% self-employment tax on their cash salary and clergy housing allowance.

This option saves the minister having to submit tax payments with a Form 1040ES every quarter, but it does not reduce the total tax obligation. Ministers are taxed at the same rate as other taxpayers on taxable income. Conversely, the advantage of the minister paying his or her taxes directly is that if the funds are retained in a savings account until due, she/he can earn interest on the money until it is paid out.

10. Additional information

We recommend that congregations purchase a copy of "*The Church & Clergy Tax Guide*", from Church Law and Tax Report, www.churchlawtoday.com, 800/222-1840. This annually updated volume answers almost all tax questions relevant to religious bodies and ordained clergy. The organization also publishes a monthly newsletter entitled "*Church Treasurer Alert*" with new tax information.

While we understand the above information to be correct, the staff of the UUA Office of Church Staff Finances are not certified tax professionals, and we encourage congregations to seek the services of their own tax experts in dealing with unusual cases or individual circumstances.