

FAQ Series: Clergy Taxes
August 2015

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Topic: Clergy Tax Status?

Question: Ministerial compensation is quite confusing. What do congregations and clergy need to know about clergy taxes?

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 Members of the Clergy and Religious Workers*.)

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

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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 this is not true for some states. Individuals should check with their state department of revenue to confirm their state requirements.

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 also be included in calculating coverage for the UUA term life and long-term disability insurance policies and may be included (provided the congregation has elected to do so in their UUA Retirement Plan participation Agreement) for calculating retirement plan contributions.

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 regularly, who receive benefits, and whose work activities are 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

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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.

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. Detailed instructions for completing W-2 forms for clergy and non-clergy staff are available in a separate FAQ document.

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.

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.

For more detailed information see:

- [IRS Publication 1828, Tax Guide for Churches and Religious Organizations](#), and
- [Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers](#)

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.

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