

Amazing Grace & Taxes



The Unmerited Favor of Uncle Sam

Welcome

Today's Objective is to HELP YOU

- Identify the basic tax issues facing campus ministers
- Understand what records you need to keep
- Help your qualified tax professional / financial advisor

DIY DANGER

- This area of the tax law is one of the most complex – requires extensive study, experience and expertise
- This area of the tax law is one of the most dynamic
 - In 1996, Rick Warren, author of *This Purpose Driven Life*, was audited by the IRS
 - The IRS disallowed his “parsonage exemption”
 - Rick Warren appealed in Tax Court, and won
 - The IRS appealed to the US Court of Appeals, 9th Circuit (a court sympathetic to the IRS)
 - With miraculous speed, Congress **unanimously** passed *The Clergy Housing Allowance Clarification Act of 2002* which was promptly signed by George W. Bush
 - The issues facing the US Tax Court Case immediately became moot

DIY DANGER (continued)

- This area of the tax law is one of the most dynamic
 - Challenges by both the “left” and “right”
 - Federal district court ruled that the “parsonage exemption” was unconstitutional
 - November 13, 2014, a federal appeals court struck down that ruling saying the parties did not have “standing”
 - In order to achieve standing, they would need to claim the parsonage exemption, wait to get audited by the IRS, have the IRS disallow the exemption, and then, and only then, would they have sufficient “standing” to litigate the constitutional question

For DIY'ers - Free Sermons & a Prayer

BEFORE you begin, please call me for:

- Please specify the number of weeks needed for free sermons and/or Bible lessons
- Prayer for peace, wisdom and understanding

REMEMBER:

- The 3rd Commandment – “Do not take the Lord’s name in vain” while preparing your income tax return or reading the IRS instructions
- While some are called to the “ministry of the gospel” – others called to the “ministry of accounting”

You Might Get the Words Right – But Still Sing the Wrong Tune!



- Since the verses of Amazing Grace use “common meter” (8, 6, 8, 6), they are easily adapted to countless tunes
- Andy Andrews sings the words using the tunes of:
 - Ghost Riders in the Sky
 - House of the Rising Sun
 - The Ballad of Gilligan's Isle
- <https://youtu.be/2cINrWlfCPI>
- Over 20 different tunes recorded with this song
- Guinness Book of Word Records – most recorded song
- Amazing Grace written by John Newton in 1772
- Former captain of a slave ship, once a slave himself
- Considered his spiritual autobiography

Unmerited Favor - A Long History

- Constantine, Emperor of Rome, granted the Christian church a complete exemption from all forms of taxation in 312 AD
- US churches were tax exempt since the country's founding
- In 1894, US churches received an official federal income tax exemption
- All 50 states & the DC exempt churches from property tax
- As of 2011, US churches owned \$300-\$500 billion in untaxed property

Unmerited Favor – Pro's & Cons

■ Pro's

- Keeps the government out of church finances
- Upholds the separation of Church and State
- Churches are deserving since provide countless social services

■ Con's

- Violates the separation of Church and State through indirect subsidies
- Lost tax revenue – property tax, income tax, sales tax, etc.

Clergy are Caught in the Middle – Major Issues

- Income Tax
- Social Security & Medicare Tax (FICA & SECA)
- Parsonage or Housing Allowance
- Ministry-Related Expenses (Reimbursed vs. Unreimbursed vs. Charitable Gifts)
- Need for Additional Retirement & Disability
- Health Care

Clergy are Caught in the Middle – Minor Issues

- Lack of Unemployment Benefits
- Lack of Workers' Compensation (by State)
- Non-Ministerial Income
- Foreign Earned Income and Housing Exclusions
- Interaction of Income Tax and Self-Employment Tax with Tax Credits

Who Qualifies as “Clergy”?

- IRC Section 107 – Rental Value of Parsonage - specifically mentions “minister of the gospel”
- Does this include ... ?
 - Catholic Priest or Nun
 - Christian Science Practitioner or Reader
 - Jewish Rabbi or Hazzan (Cantor)
 - Iman or Ayatollah

Who Qualifies as “Clergy”?

- Depends on the specific facts of the situation
- Duly ordained, commissioned or licensed by a religious body constituting a church or church denomination
- Given the authority to
 - Conduct religious worship
 - Perform sacerdotal functions
<http://www.merriam-webster.com/dictionary/sacerdotal>
 - Administer ordinances or sacraments according to tenets and practices of that church or denomination

Who Qualifies as “Clergy”?

- Does this include ... ?
 - Song Leader
 - Girls Life Minister (Limited role of women conducting service)
 - Deaf Minister
 - Retired Ministers (special category)
 - Someone who has taken a vow of poverty (special category)
 - Church Employees i.e. secretary, janitor, deacon, etc.
- Full-Time vs. Part-Time; does it matter?

Income

- IRC Section 61 - ... Gross income means all income from whatever source derived ...
- Included, unless specifically excluded

- Uncle Sam has a DUAL tax system
 - Income tax system – a progressive tax
 - Social Security & Medicare tax system (FICA & SECA) – a flat tax

When Receive Income

- Is it included or excluded?
 - For income tax purposes
 - For Social Security or Medicare purposes
- If included
 - How much reported?
 - Where reported?
 - How pay tax on it?
 - When pay tax on it?

Income Tax

Money Paid to Clergy by a Church

- If Clergy is an Employee
Then wages reported on Form W-2
- If Clergy is **NOT** an Employee
Then nonemployee compensation reported on 1099-MISC

How decide if an employee or not?

Income Tax

Employee vs. Non-Employee

The 7-Factor Test used by the US Tax Court

1. The degree of control exercised by the employer over the details of the work
2. Which party invests in the facilities used in the work
3. The opportunity of the individual for profit or loss
4. Whether or not the employer has the right to discharge the individual
5. Whether the work is part of the employer's regular business
6. The permanency of the relationship
7. The relationship the parties believe they are creating

Income Tax

Employees & Withholding

- Most clergy qualify as “employees” under this test
- Thus, the church issues a Form W-2 reporting their church salary as wages
- But, clergy are exempt from federal income tax withholding requirements
- Therefore, clergy should make estimated tax payments like self-employed taxpayers unless other voluntary arrangements have been made with their church
- This also means that any **unreimbursed** business expenses will be reported on Schedule A, if itemize

Income Tax

Other Ministry-Related Income

- Amounts – not wages – received directly for
 - Baptisms
 - Funerals
 - Honoria
 - Other similar types of income
- Should be reported on Schedule C as self-employment income
- Consequently, most clergy are now disqualified from filing a Form 1040EZ or Form 1040A

Social Security & Medicare Tax

- Social Security program (OASDI) – “Insurance” coverage for taxpayer, spouse & children
 - Old age
 - Survivors (spouse & children until 18)
 - Disability
- Medicare’s Hospital Insurance (HI)
- Collected through
 - FICA (Federal Insurance Contributions Act)–paid by employees
 - SECA (Self Employed Contributions Act)–paid by non-employees

Social Security & Medicare Tax

IRS Form 4361 – Electing Out

- If meet several requirements, Clergy may exempt **MINISTRY-RELATED** earnings from Social Security & Medicare Tax
- The exemption is only available to clergy who are “conscientiously opposed” to accepting benefits
- Economic or nonreligious reasons do not qualify for the election
- The election must be made at time of ordination
- The election is only effective once approved by the IRS – don’t exclude until receive appropriate paperwork from IRS
- This election is **IRREVOCABLE**
- Other restrictions apply – See IRS Publication 517

Social Security & Medicare Tax

IRS Form 4361 – Electing Out (continued)

- This decision should be deliberately, thoughtfully & prayerfully made
- My personal recommendation is to **NOT** elect out – based on the following economic reasons
 - Private alternatives are expensive & time-consuming
 - Coverage provides survivor benefits to the taxpayer's family
 - Coverage provides disability benefits to the taxpayer
- Various denominations encourage their clergy to participate

Social Security & Medicare Tax Electing In – How Pay For It?

Once you have elected to participate in Social Security & Medicare tax

- FICA method – Clergy may enter into a voluntary withholding arrangement with their church
- SECA method – Without such an arrangement, the Clergy should make quarterly estimated payments

Dates to Remember

- 1st Quarter payments due April 15th
- 2nd Quarter payments due June 15th
- 3rd Quarter payments due September 15th
- 4th Quarter payments due January 15th

NOTE: Taxpayers that live in States with an income tax and itemize their deductions, You may want to make the 4th Quarter estimated payment for your State before December 31st – but not required

Things to Provide Your Accountant-# 1

- Quarterly
 - Provide most recent pay-stub showing wages and housing allowance
 - Provide a detailed list of money received for other ministry-related services i.e. baptism, funerals, honoraria, book income, etc.
- Annually
 - Provide a copy of your IRS Form W-2
 - Provide a copy of all IRS Form 1099-MISC's
 - Provide a copy of all other income not reported above

Parsonage or Housing Allowance

Example #1

- Clergy receives \$10,000 for Parsonage Allowance
- IRC Code 61 – Income unless specifically excluded
- IRC Code 107 – Specifically excludes the Fair Rental Value (FRV) of the home from income tax
- REMEMBER: DUAL tax system
 - Income tax – EXCLUDED
 - Self-Employment tax – INCLUDED; If retired - EXCLUDED

Parsonage or Housing Allowance Includable Housing Expenses

- Rent
- Down payment on a home
- Mortgage payments to purchase or improve (include both interest & principal)
- Real estate taxes
- Property insurance

Parsonage or Housing Allowance Includable Housing Expenses (continued)

- Utilities (electricity, gas, water, trash pickup, security, internet, cable TV, local telephone charges)
- Maintenance items (pest control, etc.)
- Homeowners' association dues
- Furnishings and appliances (purchase and repairs)
- Structural repairs and remodeling

Parsonage or Housing Allowance “Gotcha’s”

- Must be designated in advance; church should pass a resolution for housing allowance for the current year, **and all future years unless otherwise provided.**
- Allowance may be amended during the year, but it is NOT effective retroactively
- If actual “housing expenses” below allowance, then excess is included as income

Parsonage or Housing Allowance “Gotcha’s” (continued)

- FRV (fair rental value) includes furnished, plus utilities
- If actual “housing expense” exceed FRV, then no tax benefit to clergy
- Don’t forget to include deductible housing expense on Schedule A (mortgage interest, real estate taxes, etc.)
- Housing allowance is only excluded from income tax, not self-employment tax, unless retired (some restrictions apply)

Things to Provide Your Accountant-#2

- Quarterly
 - Provide a detailed lists of your housing expenses
 - Provide an estimate of any future housing expenses
- Annually
 - Provide a detailed list of your total housing expenses for the year
 - Determine the Fair Rental Value (FRV) of your residence
 - Estimate your Parsonage or Housing Allowance for the next year
 - Inform your accountant if your are considering retirement

Job Expenses

Defined as “ordinary and necessary” expenses incurred while performing your job

Such expenses can be:

- Not reported on tax return since reimbursed by the church (i.e. expense report)
- Reported on the tax return
 - Schedule A as unreimbursed employee business expense
 - Schedule A as charitable contributions
 - Schedule C as deductible business expenses

Job Expenses Gotcha's

- If you receive a parsonage or housing allowance that is exempt from income tax, you must allocate a portion of those expenses to your tax-free income
- Many consumer-grade tax software packages do not properly calculate this amount; so you must manually override their calculations
- You cannot deduct that portion of your expenses allocated to your tax-free income
- See IRS Publication 517 for more information

Job Expenses Example

- Rev. Charles Ashford received earnings of \$40,000 for ministerial services as follows:
 - \$28,000 – for salary as an employee
 - \$2,000 – for weddings, baptisms as a self-employed person
 - \$10,000 – for a tax-free parsonage allowance
- The non-deductible allocation is 25.0% ($\$10,000 \div \$40,000$)
- With unreimbursed business expenses of \$3,000, \$750 is not deductible ($\$3,000 \times 25.0\%$)
- With \$1,000 of expenses as a self-employed person, \$250 is not deductible ($\$1,000 \times 25.0\%$)

Things to Provide Your Accountant-#3

- Annually
 - Provide a detailed list of your reimbursed job expenses
 - Provide a detailed list of your unreimbursed job expenses
 - Provide a detailed list of your expenses incurred as a self-employed person

Together, with your accountant, you can make some beautiful music!

Amazing Grace by Wintley Phipps



- Founder of the US Dream Academy
- He has performed for American Presidents Jimmy Carter, Ronald Reagan, George H.W. Bush, Bill Clinton, George W. Bush and Barack Obama
- He has sung at Billy Graham's crusades for over 30 years
- https://youtu.be/DMF_24cQqT0
(Song begins @ 5:00 min., Words @ 6:25 min.)

For More Information or Questions Regarding Tax Planning & Other Issues

- Equity Allowance - additional housing allowance for renters
- Additional Retirement Options
- Additional Disability Options
- Other Ministerial Income such as Book Sales
- And, more

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IRS Resources

- IRS Publication 517 (search for current year)
<http://www.irs.gov/pub/irs-pdf/p517.pdf> (PDF version)
<http://www.irs.gov/publications/p517/index.html> (1st page of HTML version)
- IRS Tax Topic 417 – Earnings for Clergy
<http://www.irs.gov/taxtopics/tc417.html> (online only)
- IRS Minister Audit Technique Guide (published April 2009)
<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Minister-Audit-Technique-Guide>

Other Resources

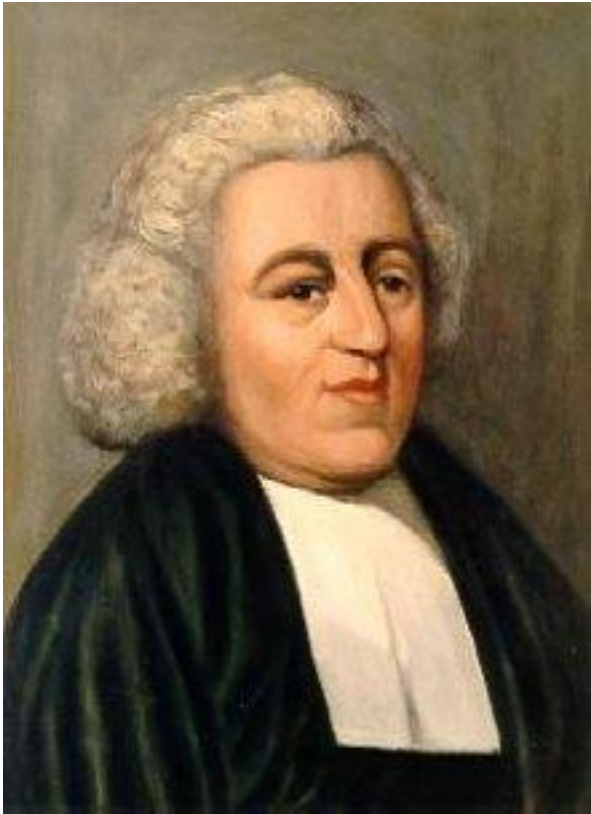
- United Methodist Church: Clergy Tax Packet
<http://www.umc.org/gcfa/tax-packet>
- The Board of Pensions of the Presbyterian Church (U.S.A.) – Available Resources / Books and Publications
<http://www.pensions.org/AvailableResources/BookletsandPublications/Pages/default.aspx>
- 2015 Church and Clergy Tax Guide by Richard Hammar
<http://www.churchlawandtax.com/>

Articles of Interest

- New York Times: Religion-Based Tax Breaks: Housing to Paychecks to Books (October 11, 2006)
http://www.nytimes.com/2006/10/11/business/11religious.html?_r=2&pagewanted=print
- The Nation: Rick Warren's Clout (January 15, 2009)
<http://www.thenation.com/article/rick-warrens-clout#>

Amazing Grace

Other Notable Performances



- Celtic Woman (26+ million views)
https://youtu.be/HsCp5LG_zNE
- Royal Scots Dragoon Guards
<https://youtu.be/jkLXOWimMY8>
- Judy Collins and the Choir
<https://youtu.be/AtteRD5bBNQ>