

10 Fundamentals of **Clergy** Social Security



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Introduction



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Introduction

Clergy social security is one of the most complicated, confusing, and challenging issues for many clergy in the U.S. Which type of social security tax applies to clergy? Does the congregation or the minister pay the social security tax? What is the impact when a congregation pays all or a portion of a minister's social security tax? What income is subject to social security tax? Are there any deductions that may offset income subject to social security tax? These are just a few of the questions which are confounding to clergy.

This book is written to address the most basic issues surrounding clergy social security. If you understand the ten fundamentals discussed in this book, you will have a good grasp of the social security basics that are often puzzling to ministers.

Ministerial services are
subject to self-employment
type social security



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Ministerial services are subject to self-employment type social security

U.S. social security taxes are collected under two systems:

- Social security for employees. One type of social security applies to employees—those in an employee-employer relationship. The employee pays one-half of the tax through payroll withholding and the employer pays the other half. This social security system is referred to as FICA, based on the Federal Insurance Corporation Act.
- Social security for independent contractors. The second type of social security applies to independent contractors—those not in an employee-employer relationship. This social security system is based on the Self-Employment Contributions Act (SECA). The tax is calculated on schedule SE with the tax amount carried forward to Form 1040, page 2.

If an individual receives income for performing ministerial services, the income is subject to self-employment social security tax unless the individual has formally opted out of social security tax. This is true even though the individual will often be considered an employee for income tax purposes. This is referred to as clergy dual-tax status.

To say it another way, for social security purposes, ministers are self-employed, subject to SECA—they are not subject to FICA-type social security taxes—even though they report their income taxes as employees and receive a Form W-2 from their employers.

If a congregation is withholding FICA-type social security tax from a qualified minister's pay, the congregation should cease the practice and consult with a tax professional to determine appropriate steps.

In certain cases, an individual can “opt out” of paying social security. Even if the individual has opted out of social security, only the income received for ministerial services is exempt. The exemption does not apply to any other income.

Determining income from ministerial services



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Determining income from ministerial services

Income from ministerial services includes the following:

- **Most of the services performed as a minister.** These services include:
 - Performing sacerdotal functions
 - Conducting religious worship
 - Controlling, conducting, and maintaining religious organizations. (You are considered to control, conduct, and maintain a religious organization if you direct, manage, or promote the organization's activities.)
- **Services for nonreligious organizations.** Your services for a nonreligious organization may still be considered ministerial services if a church assigns or designates the services. Assigned or designated services qualify even if they do not involve performing sacerdotal functions or conducting religious worship.

If your services are not assigned or designated by a church, they are ministerial services only if they involve performing sacerdotal functions or conducting religious worship.

- **Services that are not part of your ministry.** Income from certain services may be subject to social security and Medicare tax withholding (FICA). These include services you perform as an employee that are not ministerial in nature. This income is taxed under the rules that apply to employees in general. The following are not ministerial services:
 - Services you perform for nonreligious organizations other than under an assignment (see earlier discussion).
 - Services you perform as a duly ordained, commissioned, or licensed minister while an employee of the United States government, the District of Columbia, a foreign government, or any of their political subdivisions. This is true even if you are performing sacerdotal functions or conducting religious worship. (For example, if you perform services as a chaplain in the Armed Forces of the United States, those services are not ministerial services. They are taxed under FICA.)

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- Services you perform in a government-owned and operated hospital. (These services are considered to be performed by a government employee, not by a minister as part of a ministry.) However, services that you perform at a church-related hospital or health and welfare institution, or a private nonprofit hospital, are considered to be part of the ministry and are considered ministerial services. The important difference is whether the institution is government-owned.

Determining which type of social security applies to clergy



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Determining which type of social security applies to clergy

The employer determines whether an individual qualifies for clergy tax status—not the other way around. The individual always must be ordained, licensed, or commissioned, and there may be additional requirements for clergy tax status, depending on the nature of the employer.

If the employer determines that the individual qualifies for clergy tax status, FICA-type social security tax status is not withheld from pay nor matched by the employer. Conversely, if the employer determines the individual does not qualify for clergy tax status, the employer must withhold and match FICA-type social security. This is true even if the individual opted out of social security based on previous clergy status; the employer must still withhold FICA-type social security because of the current non-clergy status.

If the individual does qualify for clergy tax status, he or she must calculate the social security tax due under the Self-Employment Contribution Act (SECA) by completing Schedule SE and carrying the calculated tax forward to Form 1040.

Example 1: An individual has received a clergy license by his or her religious denomination. However, the denomination only recognizes ordained clergy as qualifying for clergy tax status. This denomination considers all licensed ministers to be lay employees. Because of the denomination's determination of clergy tax status, the individual is subject to FICA, not SECA-type social security.

Example 2: An individual is ordained clergy and the employing church recognizes this person as qualifying for clergy tax status. He or she requests the employer to withhold FICA-type social security from his or her pay. The employing congregation has no basis to withhold FICA and should not do so. To improperly withhold and match FICA-type tax would result in passing through a tax-free benefit (the employer's FICA match) to the individual, since any matching of social security for clergy is a fully taxable event.

Computing clergy self-employment tax



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Computing clergy self-employment tax

The net earnings for self-employment tax purposes include gross income earned from services performed in the exercise of ministry.

The following are subject to self-employment taxes on Schedule SE:

- clergy compensation reported on Form W-2, Box 1 (the designated housing allowance should have been excluded from this box)
- housing allowance excluded from Form W-2, Box 1
- the net profit or loss from Schedule C or C-EZ relating to clergy income (for example, received for conducting marriages, baptisms, and funerals)
- the fair rental value of employer-provided housing

- amounts that were erroneously omitted from Form W-2, Box 1, such as:
 - business expense reimbursements made under a nonaccountable plan
 - self-employment social security tax reimbursement or allowance
 - any amount an employer pays toward your income tax (other than withholding)
 - love offerings facilitated by the employer

Amounts not included in determining self-employment net earnings are:

- Contributions by the employer to a tax-sheltered annuity plan that the employer set up, including any salary reduction contributions (elective deferrals) that are not included in gross income
- Pension payments or retirement allowances received for past ministerial services
- The rental value of a parsonage or a parsonage allowance provided after retirement

Unreimbursed business expenses are deductible in determining the income subject to SECA. Clergy may deduct unreimbursed business expenses even if the deductions were not itemized on Form 1040 by filing a Schedule A.

Moving expenses do not qualify as business expenses. Therefore, moving expenses are not deductible when computing self-employment tax.

Example: Salary from a church is \$50,000, of which the housing allowance is \$12,000; net Schedule C-EZ income related to special speaking engagements, weddings, and funerals is \$1,350; and Schedule A employee business expense is \$1,800.

Your self-employment income is:

Salary from church	\$38,000
Church-designated housing allowance	12,000
Schedule C-EZ net earnings	1,350
Employee business expenses eligible for deduction on Schedule A	(1,800)
Total claimed as income:	<u>\$49,550</u>

SECA tax can be paid
in two different ways



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SECA tax can be paid in two different ways

Clergy self-employment social security tax (SECA), as well as federal income tax, is generally paid in one of two ways:

- Form 1040-ES is filed quarterly with payments of estimated taxes.
- Or, under a voluntary withholding agreement, a minister asks the church to withhold an amount to cover self-employment taxes (and perhaps enough to cover federal, state, and local income taxes). This is not a mandatory withholding concept.

Under such an arrangement, the church must report all amounts withheld as federal income taxes on Forms 941 and W-2.

Example: A minister projected that he will owe \$1,000 in federal income tax and \$3,000 in self-employment social security tax for a total tax obligation of \$4,000. The minister and his spouse do not have withholding from nonchurch employment. They do not qualify for the earned income tax credit. The minister could enter into a voluntary withholding agreement whereby the church would withhold federal income taxes from each paycheck so that by the end of the tax year, the entire \$4,000 had been withheld (and reported on Form W-2, Box 2). No FICA-type social security tax is withheld from the minister's pay since he is subject to the SECA-type social security. Or, instead of these withholdings, the minister could file Forms 1040-ES on April 15, June 15, September 15, and January 15, submitting payments of \$1,000 per filing (or payments that totaled \$4,000).

Deductions available in calculating social security taxes



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Deductions available in calculating social security taxes

Clergy, as self-employed individuals, can take a deduction equal to one-half of the amount of self-employment tax. The deduction is claimed against gross income on Form 1040, page 1.

Clergy also may deduct a portion of their self-employment tax liability in calculating self-employment tax. This deduction is made on Schedule SE.

These deductions equalize the taxes paid by (and for) persons with equivalent income, whether they are employees or self-employed.

Employer reimbursements
of social security taxes are
fully taxable



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Employer reimbursements of social security taxes are fully taxable

Some clergy are reimbursed for the SECA tax they have to pay. The reimbursements may offset a portion or all of the self-employment tax. The employer sometimes calls the payments “allowances,” but they amount to income and must be claimed as income in the year in which they are received.

Example 1: A minister pays \$3,000 in SECA social security for Year 1, as calculated on Form 1040, Schedule SE. The employing church decides to provide a 50 percent allowance starting in Year 2, so it pays her \$1,500. The allowance is fully taxable for the minister, both for income and for social security (SECA) tax purposes and should be reported on Form W-2, Box 1 for Year 2.

Example 2: Same facts as Example 1 except the employing church pays the social security tax allowance to the clergy quarterly during Year 1. In this instance, the \$1,500 allowance should be should be reported on Form W-2, Box 1 for Year 1.

Clergy rarely qualify to opt out of social security



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Clergy rarely qualify to opt out of social security

All clergy are automatically covered by SECA-type social security for services in the exercise of ministry. However, the IRS may approve an exemption based on the filing of Form 4361.

To claim the exemption from self-employment tax, one must

- file Form 4361;
- be conscientiously opposed to public insurance, with respect to services performed as a minister (which includes insurance systems established by the Social Security Act that helps pay for or provides services for medical care, such as Medicare) because of your individual religious considerations (not because of your general conscience), or because of the principles of your religious denomination (either opposition must be based on religious belief);

- file for other than economic reasons (there is no basis to opt out of social security if you believe it is not financially advantageous to participate in social security);
- inform the ordaining, commissioning, or licensing body of your church or order that you are opposed to public insurance if you are a minister;
- establish that the religious organization that ordained, commissioned, or licensed you is a church or a convention or association of churches; and
- sign and return the statement the IRS mails to you to verify that you are requesting an exemption based on the grounds listed in the statement.

Form 4361 must be filed by the date your income tax return is due, including extensions, for the second tax year in which you have net earnings (gross earnings less related expenses) of at least \$400 from self-employment. This is true if any part of your net earnings from each of the two years came from clergy services. The two years do not have to be consecutive tax years.

Example 1: Rev. Samuel Smith, a minister ordained in 2012, has net self-employment earnings of \$450 in 2012 and \$500 in 2013. He must file his application for exemption by the due date, including extensions, for his 2013 income tax return. However, if Rev. Smith does not receive IRS approval for an exemption by April 15, 2014, his self-employment tax for 2013 is due by that date.

Example 2: Rev. Samantha Crowell has \$300 in net self-employment earnings as a minister in 2012, but earned more than \$400 in 2011 and expects to earn more than \$400 in 2013. She must file her application for exemption by the due date, including extensions, for her 2013 income tax return. However, if she does not receive IRS approval for an exemption by April 15, 2014, her self-employment tax for 2013 is due by that date.

The IRS will return a copy of your Form 4361 to you indicating whether your exemption has been approved. If it is approved, keep that copy in your permanent records.

Opting back into social security



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Opting back into social security

A special window to opt back into social security has periodically been provided by Congress. However, there is currently no formal method available for ministers to opt back into social security until Congress provides another window of opportunity.

If a minister who has opted out of social security begins to voluntarily pay self-employment social security tax, the minister should be aware that the IRS could require payment of the social security tax for all the years open under the statute of limitations—generally three years.

Applying for social security benefits



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Applying for social security benefits

The earliest age you can begin getting social security retirement benefits is 62.

You should apply for benefits no more than four months before the date you want your benefits to start. Benefits are paid the month after they are due. If your benefits start in April, you will receive your first benefit payment in May.

If you are not getting social security and you are not ready to retire, you should still sign up for Medicare four months before your 65th birthday.

The age for collecting your full social security benefit used to be 65—but no longer. Full retirement gradually increases from age 65 to 67.

Here, by year of birth, is the age at which you can expect to collect your full social security retirement benefit:

Year of Birth	Age for Collecting Full Retirement Benefit
Before 1938	65
1938	65 and two months
1939	65 and four months
1940	65 and six months
1941	65 and eight months
1942	65 and ten months
1943-1954	66
1955	66 and two months
1956	66 and four months
1957	66 and six months
1958	66 and eight months
1959	66 and ten months
1960 and later	67

Income taxes on benefits. Social security benefits are income-tax free for the majority of beneficiaries. However, those with high total incomes must include up to 85% of their benefits as income for federal income tax purposes. Special step-rate “thresholds” determine the amount on which you may be taxed:

- Single persons: \$25,000 to \$34,000
- Married couples filing a joint return: \$32,000 to \$44,000

Working after you reach retirement age. If you are below full retirement age (FRA), you lose \$1 of social security benefits for every \$2 you earn over a certain limit, which increases annually (\$14,640 in 2012). Once you reach FRA, you can earn as much as you like with no cut in benefits. The earnings test takes into account only money you earn from a job or self-employment, not income from investments or other sources. However, dollars from income excluded because of the housing allowance are included in the earnings test.

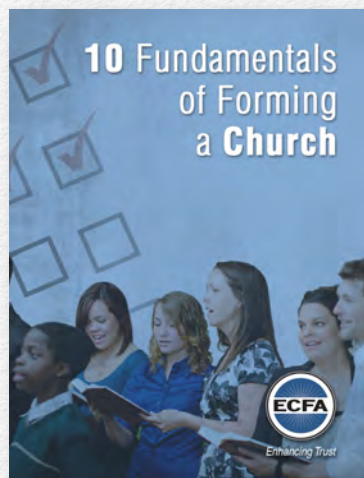
Checking on your benefits. Complete a Request for Earnings and Benefit Estimate Statement (Form SSA-7004) every three years. You can order a free copy of the form at <http://www.ssa.gov/online/ssa-7004.html>.

Complete the form and the SSA will mail you a statement of your earnings along with a projection of your future benefits. Notify the SSA of any discrepancies.

And don’t overlook the possibility of errors in your church retirement plan, either. Get a summary plan description from your church pension board, and look over your annual statement summary.

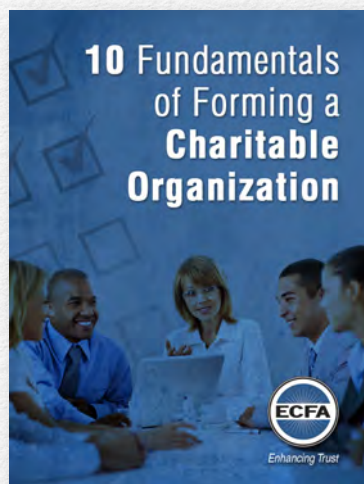


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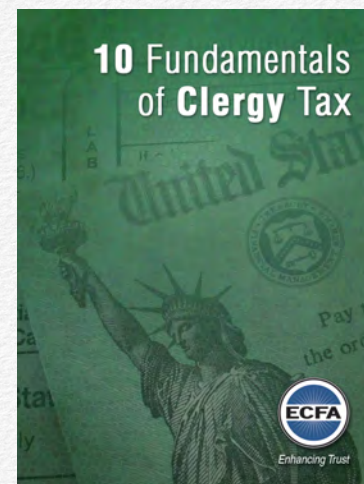
10 Fundamentals of Forming a Church

Churches form to give followers of Christ the opportunity to worship together, grow in faith, and meet the needs of the local community. Although churches are formed for spiritual purposes, there are also practical legal and financial consequences that arise when organizing a church. This book provides an overview of the ten most fundamental issues to consider when starting a new church.



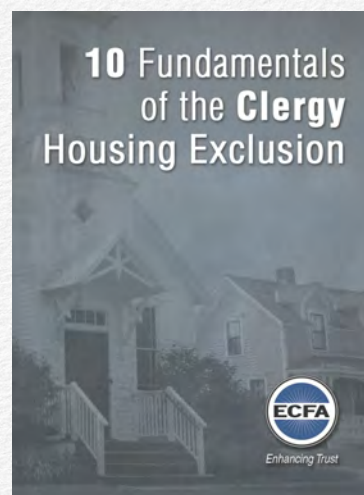
10 Fundamentals of Forming a Charitable Organization

Tens of thousands of new nonprofits are formed each year. Of those applying for tax-exempt status with the IRS, about three out of four applications are approved. When forming a new nonprofit, there are some fundamental issues to consider before starting the process. This book provides an easy-to-read guide to the ten fundamental issues related to starting a new nonprofit organization.



10 Fundamentals of Clergy Tax

This book provides a cogent overview of the ten most basic fundamentals of clergy tax. Clergy who understand these ten fundamentals will have a better understanding of the Federal tax issues impacting them. Some of these crucial issues include the clergy housing allowance, expense reimbursements, social security tax and more.



10 Fundamentals of the Clergy Housing Exclusion

The clergy housing exclusion provides an income tax advantage to nearly every member of the clergy—in some instances ministers can save thousands of dollars per year using this tax provision. Maximizing this benefit requires coordination with the church, keeping good records of housing expenses, and applying the housing exclusion limits provided in the tax law. If you understand the ten fundamentals

discussed in this book, you will have a sound understanding of the housing exclusion basics for clergy.

Watch for future books which will be published soon.

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Notes

This text is provided with the acknowledgment that the authors and the publisher are not engaged in rendering legal, accounting, or other professional advice or service. Professional advice on specific issues should be sought from an accountant, lawyer or other professional.

Clergy who are members of a religious order are subject to special rules not listed herein. Additionally, this information does not relate to churches and qualified church-controlled organizations that are opposed to the payment of social security and Medicare taxes for religious reasons and have elected to exclude all their employees from FICA coverage.

Resources

- IRS Publication 517 Social Security and Other Information for Members of the Clergy and Religious Workers
- *The Zondervan Minister's Tax & Financial Guide* by Dan Busby and John Van Drunen, revised annually

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