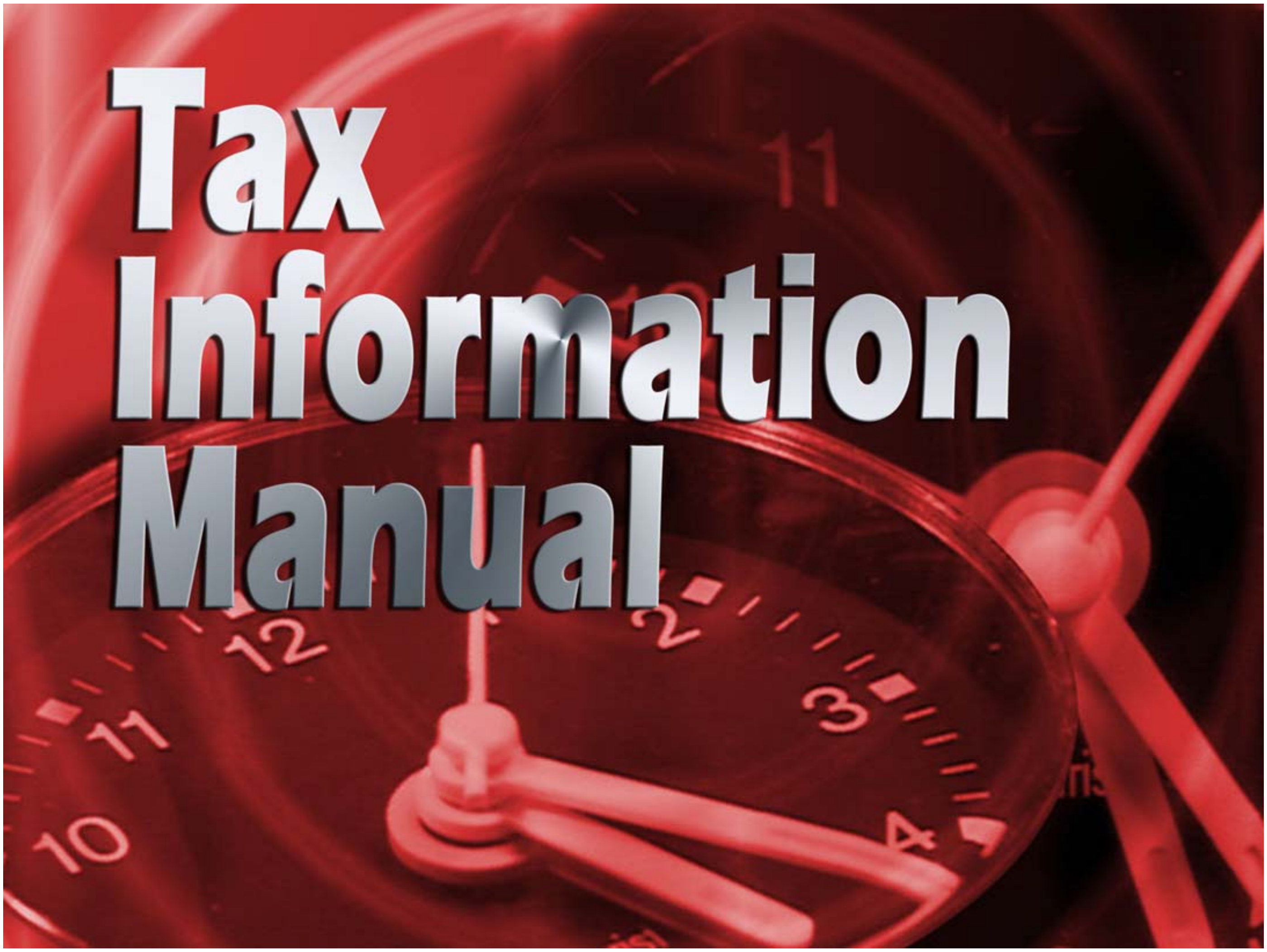

Church of God Benefits Board, Inc.
Post Office Box 4608
Cleveland, Tennessee 37320-4608
www.benefitsboard.com

Tax Information Manual - 2010
Outline

Tax Information Manual - 2010

INTRODUCTION (AND DISCLAIMER)

There is literally no way that the major tax issues impacting churches, ministers, and church-related employees can be addressed in 60 or 70 pages. The goal of this manual is not to be all-inclusive – but rather to deal with some common tax issues in a generic fashion. If you are looking for specific tax advice to deal with your once-in-a-lifetime situation, this is not the manual for you. However, if you are seeking general guidance on common tax questions, it is our hope that this manual will provide some insight.

What you will find on the following pages are articles that the Benefits Board has released on specific tax issues over the past couple of years. In addition, you will see specific questions – as well as the responses – to tax issues raised by our participants and other church-related employees.

Again, this document does not purport to be an exhaustive study on the tax laws impacting ministers, churches, or church-related employees. For that type of treatise, I would suggest Richard Hammar's *Church & Clergy Tax Guide* or Dan Busby's *Minister's Tax & Financial Guide*, both of which are updated annually to take into consideration the changing tax laws.

What follows is an easy to read and (hopefully) an easy to understand guide to help you deal with some of the most common tax issues that arise in the church setting. There is no attempt made to cover *all* of the financial and taxation issues that may confront a church. However, general information is given so that the minister, church, or church-related employee can comply with the basic tenets of the tax laws.

Neither the Board of Trustees nor the staff of the Benefits Board is engaged in rendering financial advice, legal advice, tax advice, or other financial planning services. If such advice is desired or required, the services of a competent professional should be sought.

IRS Circular 230 Notice: *United States Department of the Treasury Regulations require the Board to inform you that to the extent this communication or any attachment or link hereto concerns tax matters, it was not intended nor written to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by United States Internal Revenue Code.*

"I'm proud to be paying taxes in the U.S. The thing is, I could be just as proud for half the money." Arthur Godfrey

JUST THE (TAX) FACTS

History of Taxes

Have you ever thought about the history of taxes in this country? To this day, some contend that our current system of taxation is unconstitutional – and therefore, they refuse to pay taxes on those grounds. Of course, the government has a place for those objectors – and it is called prison.

Ken Frenke, a noted Christian financial writer and commentator, points out that in 1913, less than 1 percent of households had to pay the first income tax, which raised about $500 million. In 2004 Americans filed 239 million tax returns, including 137 million individual returns. More than $1.8 trillion dollars was collected! Our tax system has come a long way in the past 97 years.

Frenke goes on to point out where the tax revenues come from: Individuals pay 84 percent of all taxes. Income taxes account for 43 percent of that amount. Social Security and Medicare taxes total 41 percent. Corporations pay another 9 percent. Tariffs and excise taxes, upon which the federal government operated for almost 140 years, now comprise just 4 percent of federal income. Estate and gift taxes raise another 1 percent.

Of those numbers, it is most interesting that the amount collected for personal income taxes is only slightly more than the amount collected for "payroll taxes," i.e. Social Security and Medicare taxes. Over the past decade, Congress has discussed, but has never taken action to reduce the burden of the payroll tax withholdings. However, with recent news that Medicare will run out of money in the next 10-15 years unless substantial revenue sources are found, do not look for any reduction in payroll taxes in the near future.

The statistics on who pays taxes are also enlightening. Most people would contend that their tax burden has gone up recently. In his article for *Crown Ministries*, Ken Frenke states the opposite. Believe it or not, taxes on middle-income families have been falling for years. A family of four now pays the lowest percentage of their income, 7.5 percent, in federal taxes since 1965. The top 50 percent of all wage earners pay 96 percent of all income taxes. The bottom 50 percent pay just 4 percent. On the other hand, Frenke does not point out that many local jurisdictions (states, counties, and cities) have increased their tax load on individuals due to the lack of federal funds available to them.

While we do not like to admit it, paying taxes is a way for us to obtain the resources of the government to help us carry on the activities of our daily lives. Without roads, infrastructure, armies, etc. we would be open to the whims of despots. So our government serves a vital function. However, your goal should be to pay your fair share of taxes – and no more. Ministers, in particular, have ways that they can legally avoid tax liability. Those opportunities are discussed at length in this manual and in the Minister's Compensation Manual available on our web site (www.benefitsboard.com). Tax avoidance is commendable; tax evasion is not. As I always say, the difference is 20 years in prison.

Tax Facts

The following Tax Facts come from the Wall Street Journal's *SmartMoney* magazine:

- Estimated time it took to complete Form 1040 in 1997: 9 hrs. and 54 mins.
- Estimated time it took to complete Form 1040 in 2000: 13 hrs. and 1 min.
- Number of words in the current IRS Tax Code: 1.3 million
- Number of words in the King James Version of the Bible: 845,000
- Estimated amount individuals and businesses spent on tax preparation in 2000: $40 billion
- Total IRS budget for 2000: $8.3 billion

W-2 AND 1099 ISSUES

Employee or Self-Employed

If you are a pastor or employee of a Church of God church or related entity, you should receive a Form W-2 from your employer by no later than February 1. While many minister (and churches) continue to claim that the minister is "self-employed" and therefore should receive a Form 1099, the church polity of our denomination makes it almost universal that our ministers are employees of the local church for tax purposes – and thus entitled to receive a W-2 rather than a Form 1099. Based upon case law, it seems rather clear that Church of God ministers have a dual tax status – they are employees for federal tax purposes but they are self-employed for Social Security purposes. While this topic is confusing and not subject to clarification in this forum, I would recommend that you visit our web site (www.benefitsboard.com) and review the Treasurer's Manual where a more detail discussion on this issue can be found.

Completing the W-2 Form

By the end of January, the church treasurer must provide an IRS Form W-2 to the pastor and any other staff member of the church. On the other hand, IRS Form 1099s are provided to "independent contractors," such as evangelist. A line-by-line discussion of how to complete the IRS Form W-2 is included here. Completing the IRS Form W-2 should be relatively simple for the church treasurer. Additional information can be obtained from the Treasurer's Manual available at www.benefitsboard.com. Step-by-step instructions and tips follow:

- Box a – list the employee or minister's Social Security number
- Box b – list the employer/church's IRS identification number. Every church should have an Employer Identification Number. If not, the church treasurer on behalf of the church may obtain an Employer Identification Number (EIN) by completing IRS Form SS-4 or by applying on-line for an EIN number at http://www.irs.gov/businesses/small/article/0,,id=102767,00.html.
- Box c – list the name and address of the employer/church
- Box d – nothing goes in this box generally
- Box e – list the name of the employee or minister

- Box f – list the address of the employee or minister
- Box 1 – list all reportable taxable income for the employee or minister (do **not** include employer/church retirement plan contributions, amounts reduced from the employee or minister's salary through a valid salary reduction agreement, or ministerial parsonage/housing allowance).
- Box 2 – if the minister voluntarily requested that federal income taxes be withheld from his taxable compensation, including additional amounts to cover his Social Security tax liability, then list those amounts here. If there was no voluntary withholding agreement, nothing should appear in Box 2 of the minister's Form W-2. Of course, all Federal income tax withheld from an employee's compensation should be listed here.
- Box 3 through Box 6 – nothing appears in these boxes for *ministers*.
- Box 3 – for employees, the amount of compensation subject to Social Security appears here. The church treasurer should be aware that the "cap" amount subject to Social Security adjusts each year based upon inflation. The treasurer should also be aware that while salary reduction amounts withheld from a minister's income are not taxable for income tax purposes or Social Security tax purposes, salary reduction contributions for non-ministers are taxable for Social Security purposes but are not taxable for federal income tax purposes.
- Box 4 – for employees, the amount of Social Security tax withheld appears here.
- Box 5 – for employees, the amount of compensation subject to the Medicare tax appears here. There is currently no cap on how much compensation can be taxed for Medicare purposes.
- Box 6 – for employees, the amount of Medicare tax withheld appears here.
- Box 7 through Box 11 – nothing generally appears in these boxes for ministers or employees in a church setting.
- Box 12 – use the following codes and state the amount (additional codes may be applicable):
    - C – Reports cost of group term life insurance benefits in excess of $50,000 paid by the employer/church
    - E – Reports amounts contributed to a 403(b) retirement plan (like the Minister's Retirement Plan) *by salary reduction* from the employee. Please note that retirement plan contributions made by the employer are not reported anywhere on the IRS Form W-2.
    - P – Reports qualified moving expenses reimbursed to the minister or employee. If the employer/church pays the moving company directly, those costs are not reported on the Form W-2.
- Box 13 – If the minister or employee participates in the Minister's Retirement Plan, either through employer/church contributions and/or salary reduction contributions, check the box that reflects "retirement plan."
- Box 14 – Report housing allowance or fair rental value of parsonage for ministers. For example, if the minister received a housing allowance, box 14 would report "12000.00 – Minister's Housing Allowance." If the minister lives in a parsonage, box 14 would report "12000.00 – Parsonage Rental Value."
- Box 15 through Box 20 - nothing appears in these boxes generally for ministers. However, in the case of employees, the church will most likely be required to

withhold state and local taxes if applicable. If so, then the treasurer would complete these boxes as appropriate.

The IRS provides detailed instructions on the completion of Form W-2 if such is needed beyond these cursory guidelines. In addition, the church treasurer should seek guidance and advice from a qualified tax professional if he or she is unsure on how to adequately complete the Form W-2 or the Form 1099. Seeking advice before providing the forms to the wage earner and before filing such with the IRS is much easier than the treasurer trying to correct incorrect forms already filed. A completed sample Form W-2 can be found as Attachment B to the Church Treasurer's Manual discussed above.

More W-2 Tips

A W-2 form must be issued to any employee (including ministers) who received compensation from the local church during the previous tax year. In completing the forms, here are a few tips to remember:

- The W-2 forms must be completed and issued to each employee by no later than January 31. The employer/church must then make sure that they submit to the Social Security Administration "Copy A" of each W-2 form and the W-3 transmittal form by no later than the end of February.
- You can obtain blank W-2 forms from your local IRS office, your local post office, or by calling the IRS toll-free forms number (1-800-TAX-FORM).
- All dollar entries on the W-2 should be made without dollar signs and commas, but with a decimal point and cents. For example, $1,000 should read as "1000.00." If you put down 1000, the IRS scanning equipment will read that as $10.00 – so make sure that decimals and cents are used.
- If a box on the W-2 does not apply, leave it blank. Do not insert "0" or "N/A."
- Make sure that you use the correct employer identification number (EIN) for the church/employer. This is critical especially if you have more than one entity (such as a church school) operating under a similar name.
- In identifying employees on the W-2 (Box e), do not include titles, such as Rev., Mr. or Dr. Also, do not include suffixes such as Jr. or Sr.
- Make sure that the ministerial housing allowance or the fair rental value of the parsonage is not included in Box 1 wages.
- Check the retirement box in Box 13 only if the minister or church-related employee participates in a recognized retirement plan, such as the MRP.
- Make sure the ink on the W-2 is not too faint, and that the writing is legible and not too small.
- If you need additional assistance in completing the W-2 form, do not hesitate to contact the Benefits Board for general information or for specific information, you may call the IRS directly at 1-866-455-7438 for assistance.

Q: ***This year we had an appreciation day for a couple of our paid staff members (music minister & youth minister). On those days the offering from the floor was designated as a gift to these staff members. I know that this is taxable income to the individuals. What I don't know is if we are supposed to list these special offerings on their W-2s like we do offering to Pastor that individuals sometimes give or if we should just notify them that the gift should be considered taxable.***

A: You are correct - these "offerings" are taxable. The question is how was the money tabulated? If the church took the offering, counted it, and then turned it over to the staff pastors, either by giving them the cash or by cutting a church check for the amount, then the offering should be included in the pastor's W-2 as compensation. Basically, you would treat such as a bonus.

If the offering was taken and there was no accounting by the church, then the pastors should be advised that such is taxable income. Technically, under this scenario, the IRS would suggest that the pastors should advise the church of the offering amount so that it could be included in their W-2. Of course, that does not generally happen in real life.

I assume the first scenario is what happened. So yes, the amount should be included in their Box 1 reportable income on their W-2s.

Q: ***An area pastor died in the middle of this year. The church promised to pay his salary and housing allowance to his widow for the remainder of the year. How should the church report this to the widow? Would it all be reported as W-2 information? Or would the portion paid while the pastor was alive be reported on a W-2 and the amount paid to the spouse be reported on a 1099-R? Should the portion paid to the widow for the housing allowance be included in the 1099-R amount?***

A: I think we probably need to divide your question to provide a correct answer. First of all, for salary and housing received during the life of the minister, I think a W-2 needs to be issued to the deceased minister listing the salary in Box 1 and the housing/parsonage allowance in Box 14. Of course, tax would be due on the Box 1 amount and Social Security would be due on the Box 1 amount and the Box 14 amount.

Then we move to the second issue. I have to assume that the widow performed no services for the church after the death of her husband (and I make that assumption based upon your suggestion that such income be reported as "retirement" type income by the use of a 1099-R). I also have to assume that the widow was not a credentialed or licensed minister. If these two assumptions are true, then it is my belief that any "salary" income and housing allowance (or the fair market value of the use of the parsonage) paid to the widow after the death of her husband must be counted as income to the widow. However, I would suggest that such be reported to her on a 1099-Misc, rather than on a 1099-R. I make that suggestion simply because 1099-Rs are generally reserved to denote distributions solely from pension plans. Again, if she had no ministerial licenses or credentials (with any recognizable church or denomination), then the housing allowance (or fair rental value of the parsonage) must be included as income to her on the 1099-Misc.

I would suggest that you look at Revenue Ruling 2003-12 in which "benevolent assistance" was discussed and was determined to be non-taxable in the limited situation addressed in that ruling. You might find some insight to assist your client from that ruling.

Tax Withholdings for Ministerial Staff

Much has been written about the "dual" tax status of ministers. In very simplistic terms, ministers are viewed by the IRS as an "employee" for federal income tax purpose but as "self-employed" for Social Security purposes. This dual status creates heartburns for church treasurers as they try to determine whether they can withhold certain taxes from the minister's salary.

The general rule is that unless the minister request withholdings, there are to be no withholdings for either federal income taxes or self-employment taxes taken out of his paycheck. In this situation, the minister is responsible for filing a quarterly return to pay all his combined tax liability.

But if the minister requests such, can the church withhold taxes from his salary just like an employee of the church? The answer is both yes and no!! The church can withhold taxes but they are not withheld in the same manner as for an employee. So how can it be accomplished?

Since the minister is treated as an employee for federal income tax purposes, he or she can enter into a "voluntary withholding" arrangement with the local church by submitting a completed W-4 form. Although not required, it is generally recommended that the minister write "voluntary" across the top of the W-4 just for emphasis.

Once the W-4 is on file, the church treasurer can then withhold *income taxes* from the minister's wages. *However, since ministers are "self employed" for Social Security purposes, the church does not withhold Social Security and Medicare taxes simply because the minister completed a W-4 form.* To have enough withheld to cover the "self-employed" taxes, the minister must request that an additional amount of income taxes be withheld to cover their expected self-employment tax liability for the year. This is done by filling in an additional amount on line 6 of the W-4 form. The additional withholding is reported as additional income taxes, and becomes a credit that the minister can apply to self-employment taxes when preparing his or her tax return for the year.

The "voluntary withholding" process is generally a much better option for most ministers when compared to having to file quarterly returns.

Tax Treatment of Retirement Plan Contributions

As for retirement contributions, whether such are reported or not on the participant's Form W-2 depends on whether the contribution was made by the church or by the pastor/staff person through salary reduction. In the ***Treasurer's Manual***, we answer this question as follows:

> *Contributions made by the church on behalf of the minister or a church-related employee are not required to be reported at all on Form W-2.* In addition, amounts contributed to the retirement plan by a salary reduction agreement are also not includible in Box 1 on the W-2 form as wages. However, on Form W-2 the "retirement plan" box should be checked in Box 13. In addition, any amount contributed by salary reduction agreement should be reported in Box 12 of the W-2 form, using the code "E". For example, if a minister reduced his salary by $5,000 to make contributions to his retirement account, that amount would not be included in Box 1 of the W-2, but "retirement plan" would be checked in Box 13 and Box 12 would report "E - 5000.00."
>
> As an additional note, church treasurers should be aware that retirement plan contributions *made by the church* are not considered wages for Social Security tax purposes. In addition, two separate Revenue Rulings (see Revenue Ruling 68-395 and Revenue Ruling 78-6) seem to suggest that even salary reduction retirement contributions *made by ministers* do not necessarily constitute self-employment earnings for purposes of determining Social Security tax liability.

Simply put, contributions made by the church are not taxed, nor are they reported on the minister or employees' W-2.

Salary reduction contributions made by a minister are not included in Box 1 income, are listed in Box 12 (E code), but are not taxed for federal income tax purposes nor are they taxed for Social Security/Medicare purposes.

Salary reduction contributions made by a church-related employee are not included in Box 1 income, are listed in Box 12 (E code), are not taxed for federal income tax purposes, but *are taxed* for Social Security/Medicare (FICA) purposes.

A simple rule to determine whether the contribution is a salary reduction contribution or an employer (church) contribution is this: If the pastor/employee is entitled to $100 salary, for example, and gets that amount, but the church makes a contribution above and beyond that of say $10 to his retirement account, the $10 contribution is a church-made contribution. Just assuming that alone, the $100 would show up in Box 1 of the person's W-2 – but the $10 contribution to the retirement plan is not required to be reported anywhere.

Further, if the person is entitled to $100 (and whether the church makes a contribution or not), he directs by a salary reduction agreement that $15 be sent to the retirement plan, then only $85 would show up in Box 1 on his W-2 form and Box 12 would show an E code with $15. The $15 is a salary reduction contribution.

For more specific directions on completing the Form W-2, please see the directions provided by the IRS with the W-2.

SOCIAL SECURITY TAX ISSUES

No Self-Employment Tax on Retirement Income from Benefits Board

At tax time, the Benefits Board gets a lot of questions about the IRS Form 1099-Rs that are sent to participants in January showing the amount of the participant's distributions for the previous year. The most common question regards whether or not the distributions are taxable for self-employment tax purposes – or in other words, is a ministerial participant required to pay Social Security on such distributions. The answer, according to Internal Revenue Code section 1402 (a)(8), is NO! In part, the Internal Revenue Code states that the self-employment tax (Social Security) does not apply to "any retirement benefit received by such an individual from a church plan… after the individual retires." This exemption applies whether or not the retired minister is able to claim the distributions as housing allowance.

Taking a step back, look at some basic tax information regarding contributions made to the Ministers' Retirement Plan:

- Participants (both ministers and non-ministers) should remember that contributions made to their MRP account by the **"employer" (or Church)** are not considered wages for income tax **or** Social Security purposes.
- However, contributions made by *salary reduction* by ***non-ministers*** are considered wages for the Social Security and Medicare tax – although not for income tax purposes.
- Contributions made by *salary reduction* by ***ministers*** do not necessarily constitute self-employment earnings for purposes of determining self-employment tax liability. See Revenue Ruling 68-395 and Revenue Ruling 78-6. However, the Benefits Board does encourage ministers to pay Social Security on their salary reduced contributions simply so their Social Security wage base will be increased for future benefit purposes.

Back to the original question, all distributions from the MRP are not taxable for Social Security purposes, regardless of whether the participant is a minister or non-minister. While the authority for ministers is cited above, in the case of non-ministers they have already paid Social Security taxes on the income that was deferred.

Q: ***I am a Youth Pastor at a Church of God. My W-2 salary was $11,700. The church agreed to pay half of my Social Security. They want me to get my taxes filled out and then see how much they owe me for Social Security. I don't believe this is the***

correct way to pay half of my Social Security. Could you tell me if this is correct or not? If not, then what is the correct way?

A: For purposes of my response, I must assume that Box 1 income on your W-2 was $11,700 - and that you had no housing allowance or any other income from the church. If that is so, and if the church agreed to pay one-half of your Social Security, they owe you 7.65% of $11,700 - or $895.05. You owe Social Security on your gross taxable income, not on your adjusted gross income. Therefore, you will owe total Social Security/Medicare taxes of $1790.10 - the church's half is $895.05.

If the church provided you with a housing allowance or provided to you a parsonage, you also owe Social Security on that amount as well, although you do not have to pay federal taxes on such.

Finally, based upon your Social Security liability, you probably should be paying quarterly to prevent the imposition of penalties and interest on the amount owed.

Q: ***I have recently started pastoring full time. I have determined that I need to pay my quarterly social security tax. Unfortunately, I cannot find the form needed to submit. Would you be able to tell me which forms to use and where to obtain them? I have tried the Social Security website, as well as trying to contact them by phone, but I keep getting the "run-a-round". Any help would be appreciated.***

A: You can obtain the estimated tax form and work sheet from the IRS web site. The specific site is http://www.irs.gov/pub/irs-pdf/f1040es.pdf. This will link you to the Form 1040-ES which is to be used by first-time filers of estimated taxes. On the form, you will find all the information you need to calculate your estimated taxes and send them in.

The 1040-ES will allow you to pay your Social Security/Medicare taxes (SECA), as well as your federal income taxes, assuming that you have federal income tax liability. Simply put, it will allow you to pay either/or.

Q: ***I have been declared disable by Social Security. I receive Social Security Disability every month, plus I have Medicare Part A and Part B.***

In addition, I receive an offering of 500.00 every month from the Church which has been called a Housing Allowance. I pay $300.00 for rent plus the usual utilities, so the 500.00 amount is right on target. Now the board of the Church has approved and increased the amount to $1,200.00 per month because I need to move to a house instead of an apartment. I am not receiving any other compensation from the church. Will this housing allowance affect my status as disabled or my SSD benefits? What about if the church rents the house and make all the payments of the utilities and furniture payments and all the expenses allowed by the IRS without giving me the money? Is that better or legal?

A: From what you have written here, I think that we have to make a distinction between two very important issues: (1) what part of your income, if any, is taxable for federal income tax purposes and (2) what impact does your income have on your Social Security Disability (SSD)?

The first issue is more easily addressed. If the church determines that the amount provided you on a monthly basis (whether $500 a month or $1200 a month) is for ministerial housing expenses, based upon your reasonable estimation of those expenses, then that amount is not taxable income to you for federal income tax purposes. Even if it is the entirety of the income paid to you by the church, it could still qualify as non-taxable ministerial housing allowance, assuming that you spent such for housing. In other words, the total compensation you receive from the church can be designated as housing allowance, again assuming that you actually spend the funds on housing expenses.

However, the non-taxability applies only to federal (and State) income taxes. While ministerial housing allowance is non-taxable for federal income tax purposes, it is taxable for Social Security purposes. In other words, if you receive a housing allowance, you do not have to pay federal income taxes on that money BUT you DO have to pay Social Security taxes on the ministerial housing allowance. This rule applies whether you are living in a parsonage or whether you are getting housing allowance and living in your own or rented home. Further, this rule applies whether the housing allowance is given to you and you pay your housing expenses OR whether the church pays the money directly to the landlord and to the utility companies. You can not get around these rules by having the church pay the housing costs directly.

Since housing allowance is taxable for Social Security purposes, it brings us to the (2) issue involving the impact that housing allowance may have on your SSD payments. On this issue, I can not provide a definitive answer. However, it is my understanding that SSD looks at need, based upon household income. It is further my understanding that household income is based upon money coming into the home, regardless of whether it is taxable or non-taxable for federal income tax purposes. Since housing allowance is taxable for Social Security purposes, it is my belief that the Social Security Administration has a better claim that the money should be counted in determining your need for SSD. However, on this issue, I think that you need to have your caseworker look at the SSA rules concerning ministerial housing allowance and their impact on SSD.

To obtain more information on the ministerial housing allowance in general, I would suggest that you review the [Ministers Compensation Manual]() that is available on our web site at [www.benefitsboard.com]().

WHAT IS TAXABLE?

"The biggest difference between tax evasion and tax avoidance is 20 years in a federal penitentiary." Art Rhodes

Tax Tips - Items NOT Considered Reportable Income for Ministers

While no one should ever hide income, there are several items that can legitimately be excluded from taxable income for ministers. One of the major items excludable from taxable income is contributions to the Ministers' Retirement Plan. *Contributions made by the church on behalf of the minister are not required to be reported at all on Form W-2.* In addition, amounts contributed to the retirement plan by a salary reduction agreement are also not includible in Box 1 on the W-2 form as wages. However, on Form W-2 the "retirement plan" box should be checked on line 13. In addition, any amount contributed by salary reduction agreement should be reported in Box 12 of the W-2 form, using the code "E". For example, if a minister reduced his salary by $5,000 to make contributions to his retirement account, that amount would not be included in Box 1 of the W-2, but "retirement plan" would be checked in Box 13 and Box 12 would report "E - $5000.00."

Additional items excluded from reportable taxable income include group term life insurance premiums for policies up to $50,000, fringe benefits (medical insurance, disability insurance, etc.), qualified reimbursement of moving expenses, business expense reimbursement under an *accountable* plan, and the minister's housing allowance (not considered as income but is taxable for self-employment taxes). None of the above-mentioned items should be included in Box 1 of the W-2 form. Keep in mind that non-ministerial employees do not receive the housing allowance benefit. If the church pays the housing of the employee, it is still counted as reportable income. Additionally, retirement plan contributions *made by a salary reduction agreement* for non-ministerial employees are excluded from their reportable income for tax purposes, but must be included in their income for Social Security and Medicare purposes.

Q: ***Would it be considered income for our youth pastor if the church voted to increase our youth pastor's salary, and when he was informed, he requested the money be placed in the youth funds instead of it going to him? Is that considered as the youth***

pastor giving to the youth account out of his personal money or the church giving additional money to the youth each month?

A: This is an interesting question and actually the answer turns on how the church and the pastor deal with the pastor's request. Let's consider a couple of ways this could be handled.

First, let's assume that the pastor totally renounces the raise ("I greatly appreciate your concern about increasing my salary but I prefer that the money be spent on ministry, preferably on youth ministry, and therefore I am not going to take the raise"). Under this scenario, the pastor is not entitled to the money, the church can spend it any way it likes (including on youth ministry), and therefore such is not taxable to him as income (and in the alternative, he would not get any tax deduction for renouncing such or for designating a gift to youth ministry).

Second, let's assume the pastor renounces the raise but tries to direct how the money can be spent ("I greatly appreciate your concern about increasing my salary but I want that money spent on youth ministry, and therefore I am not going to take the raise as long as you guarantee me that each month the youth budget is going to be increased by XX dollars – the amount of the raise.") Under this scenario, the minister is controlling how the money is spent by the church, much like a designated contribution taken out through salary deduction. In this case, the amount would be taxable to the minister as income but he would also be entitled to a charitable deduction for the amount given. Of course, he could also stop designating the gift and accept the raise at any time.

Thirdly, let's assume a variation of No. 2 above. The pastor could pick and chose which weeks he wanted to have the money go to the youth program and which weeks he wanted to take the raise. Again, since he is entitled to get the money each week no matter what, the amount becomes reportable income to him – and the amount given as a designated contribution becomes a part of his charitable contributions to the church.

From a tax standpoint, scenario one is the best for the pastor – simply because the money never comes into his reportable income. However, once he renounces the raise, he is completely at the mercy of the church for additional raises in the future.

Q: ***Our church had a meeting and we now paying our Pastor a salary, reimbursement for expenses, and housing allowance. Due to the lack of finances recently, we have not been able to pay him what we normally would. I was wondering how to correctly divide his wages. Should I base it on what we where paying him and the percentage of what was going to each category? Or could I just apply what we normally would toward the***

reimbursement of expenses and housing allowance and if there is any left over apply that toward his salary? I know this would benefit him but we want to do this correctly.

A: Since you do not have the resources to pay all, it is perfectly acceptable to reimburse the pastor for his expenses and housing first, and then let any remainder that might be available go towards salary. Proceeding in that manner would also bless the pastor because he would be getting the non-taxable portion of his total compensation first.

Health Savings Accounts

The Medicare bill of 2003 created new medical savings accounts, referred to as Health Savings Accounts, which became available January 1, 2004. Individuals under the age of 65 can contribute on a pretax basis to such accounts if they have a qualified health plan. The accounts can be used to pay un-reimbursed medical expenses, retiree health insurance, Medicare expenses, and prescription drugs.

To qualify, the individual must be covered by a health plan with a high deductible of at least $1,000 for individuals and $2,000 for families. In addition, the plan must have a high cap on annual out-of-pocket expenses ($5,000 for individuals and $10,000 for families). The law allows a person to save as much as 100% of a health-plan deductible annually, to a maximum of $2,600 for self-only policies and $5,150 for family policies. In addition, for persons between 55 and 65 years of age, an additional tax-free “catch-up” contribution of as much as $1,000 can be added.

If you are less than 65 years of age, have a high deductible and high out-of-pocket cap, you should create a Health Savings Account. Money contributed to such an account is not taxed going into the account and is not taxed when it is taken out to pay legitimate and approved medical expenses. In addition, such contributions are not subject to Social Security taxes (FICA or SECA) or unemployment taxes. Health Savings Accounts can be set up at your local bank or insurance company.

Church-Provided Cell Phones

While ministers and church-related employees are very familiar with the substantiation rules relating to mileage traveled in the course of business, few are aware that similar rules apply to the use of cell phones. The tax code, along with IRS rules and regulations, require that the personal use of a business-provided cell phone be substantiated and reported as taxable income to the user of the phone. This procedure was confirmed by a recent Tax Court decision.

The substantiation requirement mandates the user to document what calls were made for business and what calls were purely personal in nature. Using the information, the costs of the cell phone service is then pro-rata assigned to business or personal use, with the personal use portion being reported as taxable income. Many ministers argue that such is absurd, simply because the personal use is using up minutes that are already paid for as a part of the bundled package - and would go unused if not used for personal use. However, the Tax Court has specifically ruled that the personal use creates a taxable benefit to the employee and must be reported as taxable income.

For church leaders, if such personal use is not reported as taxable income, the IRS may consider the value of such to be an “automatic excess benefit” triggering what the IRS calls “intermediate sanctions” which are substantial excise taxes that may be charged if the impacted employee is an officer or director (or a relative of such a person). The “intermediate sanctions” excise tax could be as high as 225%.

Since most ministers and church-related employees do not want to take the time and effort to substantiate whether each call made was either personal or business, many churches have simply moved to providing a “cell phone allowance.” The allowance is simply added to the salary package and becomes fully taxable income to the recipient. By far, this is the easiest way to deal with the complicated rules imposed by the Internal Revenue Service.

Church-Provided Cell Phones - Revisited

No article ever included in a Benefits Board publication has generated as much discussion and questions as the article above dealing with business and personal use of a church-provided cell phone. In summary, the article above notes that the tax code, along with IRS rules and regulations, require that the *personal use* of a business-provided (or church-provided) cell phone be substantiated and reported as taxable income to the user of the phone.

Many ministers and church-related employees who have cell phones provided by the church have never considered that the personal use of that cell phone is a taxable event. However, if the personal use is not “substantiated” and separated from the business use, the entire value of the cell phone service may be deemed by the IRS to be taxable to the user.

In a summary opinion issued in early 2007, the Tax Court again noted the “substantiation” requirement. In Soholt v. Commissioner, T.C. Summary Opinion 2007-49, the court notes “strict substantiation requires the taxpayer to generally introduce records or evidence showing the amount of the expense, the time and place of the expense, the business purpose of the expense, and the business relationship to the taxpayer of the persons involved in the expense…Expenses subject to strict substantiation may not be estimated…” The Tax Court in the *Soholt* case went on to say that “cellular phones are….subject to the strict substantiation requirements.”

Not only did the *Soholt* case reinforce the Internal Revenue Service’s prior interpretation, it also cleared up any doubt about whether you could estimate business and personal use. The Court specifically noted that “any approximation or estimation of cell phone expenses attributable to business use is prohibited under section 274(d)” of the Internal Revenue Code.

Therefore, as noted in the previous article, the substantiation requirement mandates the user to document which calls were made for business and which calls were purely personal in nature. Using the information, the costs of the cell phone service is then pro-rata assigned to business or personal use, with the personal use portion being reported as taxable income. Many ministers argue that such is absurd, simply because the personal use is using up minutes that are already paid for as a part of the bundled package - and would go unused if not used for personal use. However, the Tax Court has specifically ruled that the personal use creates a taxable benefit to the employee and must be reported as taxable income.

IRS Takes on Tax Liability of Cell Phones

For the past several years, articles and publications from the Benefits Board have warned about the potential tax liability created when a minister or a church employee uses a church-provided cell phone for personal use. Based upon a 1989 law and re-emphasized in a summary opinion issued by the Tax Court in 2007, the current Internal Revenue Service rules and regulations require that the *personal use* of a business-provided (or church-provided) cell phone be substantiated and reported as taxable income to the user of the phone.

Many ministers and church-related employees who have cell phones provided by the church have never considered that the personal use of that cell phone is a taxable event. However, under current law if the personal use is not “substantiated” and separated from the business use, the entire value of the cell phone service may be deemed by the IRS to be taxable to the user.

Over the years businesses and churches have flaunted this law, basically ignoring the requirement to keep the cumbersome records necessary to distinguish between personal and business use. To comply with the current law, records must not only be kept concerning each call but also each text message and e-mail sent from so-called “smart” phones.

In late 2009, the IRS presented for discussion and comments three options to simplify the documentation requirements involving business-provided cell phones. The three potential options offered by the IRS were as follows:

1.) The employer could deem 75 percent of the usage as related to work and the remaining 25 percent would be deemed to be for personal use. The employee would then be taxed on the value of the personal use.
2.) The employee would have to provide proof that he or she had a personal cell phone to use during work hours and that they used their work cell phone for “minimal personal use.” If so, there would be no tax consequences.
3.) The employer could use a statistical sampling to determine the average workers’ usage of the business-provided cell phone for personal calls. The employee would then be taxed on the value of the average of personal usage.

Within days of offering these three possible solutions to the cumbersome record-keeping requirements of the current rules and regulations, the IRS Commissioner requested that Congress totally repeal the 20-year-old law “to ensure that neither companies nor workers will be subject to taxes for employees’ personal use of work cell phones.”

Even though the IRS Commissioner has called for the repeal of the law, Congress has not acted nor has the IRS withdrawn its three proposals. The IRS still plans to collect comments on their proposals and entertain ideas on how employers should account for personal call made by employees on work cell phones. The formal IRS comment period closed on September 4, 2009.

Until the IRS finalizes a new policy and possibly selects one of the three options listed above ***or*** Congress repeals the law, the current Internal Revenue Service policy in place now requires the *personal use* of a business-provided (or church-provided) cell phone to be substantiated and reported as taxable income to the user of the phone. There are no exceptions or exclusions.

When, or if, this policy is changed by the IRS, we will provide information to you so that you can stay in compliance with the tax laws of our nation. You should be aware that since the IRS is addressing this issue, it means that this has come to the forefront of their enforcement efforts. While personal cell phone usage has only been an inquiry in audits brought on for other reasons, you might expect this issue to be the primary reason for potential audits in the future.

Gifts Designated for Pastor

Responding to an inquiry by a constituent of U.S. Senator Johnny Isakson (D-GA), the Internal Revenue Service in 2009 addressed the tax consequences of a church member's contribution to his local church when the donor designated the contribution to help pay for the pastor's health bills. After noting that the church "must have full control of the donated funds and discretion as to their use" for a contribution to be deductible, the IRS cited a 1979 Revenue Ruling which held that payments to a religious organization that were earmarked for particular students were not deductible charitable contributions.

Following that line of thought, the IRS in their response to Senator Isakson contended that an individual's contribution that is designated for the medical bills of his pastor is not deductible under the Internal Revenue Code (Section 170) as a charitable contribution. The IRS's response recently became public in INFO 2009-0038. At this link you can read the IRS's complete response, only with the constituent's name redacted.

Most troubling about the response is that the IRS seemed to answer a question that was not asked, i.e. are all offerings designated for a pastor, given through the local church, considered to be non-deductible charitable contributions? The only question in controversy involved the deductibility of a contribution given to a church to help pay a minister's bill for previous health expenses, not a simple situation where a gift was given to the church just to bless the pastor. However, the IRS's response seems to be a broad sweep that covers any designated gift through the church to a pastor.

Dan Busby, President of the Evangelical Council on Financial Accountability, in an article on this subject following the release of the IRS letter noted that this interpretation may effectively limit all designated contributions to pastors from being deductible charitable contributions. Mr. Busby, a noted Certified Public Accountant and the author of the *Zondervan Minister's Tax Guide*, suggests that a church member who wishes to provide funds for a pastor should be encouraged to make the gift directly to the pastor. He notes that efforts to "run gifts for pastors through the church" are the basis for headaches for both the church and the pastor.

We will continue to closely watch to see if the Internal Revenue Service offers additional clarification on this issue.

Taxable Christmas Gifts

After the holidays are over, the church must sort out which “gifts” to employees and ministers were taxable and which were not. Generally, it is assumed that no gift is taxable. However, the Internal Revenue Service does not agree with that assumption. “Gifts,” such as a church paid trip to Israel for the pastor or an all expense paid weekend away, are taxable items to the recipient.

Smaller “gifts” often create more discussion and controversy. In a recent ruling, the IRS addressed the tax consequences of these smaller gifts. Simply put, the IRS has determined that any “de minimis fringe benefit” does not constitute taxable income. Examples of a “de minimis fringe benefit” include a ham, turkey, or gift basket as an annual holiday gift. However, the ruling goes on to point out that a “cash equivalent,” such as a gift certificate, is a taxable gift. Even though the goods acquired with the gift certificate would have been a nontaxable “de minimis fringe benefit” had it been provided by the employer, the gift certificate is taxable as income.

A simple rule of thumb is that all larger gifts given by the employer/church to the minister or staff is reportable as taxable income. Smaller items given as holiday gifts may not be taxable. However, a cash gift or gift certificate, regardless of the amount, must be reported as taxable income to the recipient.

The other question on gifts that arises concerns those that are given directly to a minister or staff person by a church member. Again, the simple rule of thumb is that if the gift is given directly to the minister/staff person by the member it is a nontaxable gift. This general rules applies whether the gift is an object or cash. The donor gets no charitable gift deduction on their tax return. On the other hand, if the member makes a gift to the church, either of an item (a car for example) or of cash, and designates that it be given to a particular minister/staff person, the gift is then taxable to the recipient. Of course, the donor generally is also able to claim a charitable gift deduction on his or her tax return.

To get more details on the gift rules, please research IRS Letter Ruling 200437030.

Tax Law has Option to Deduct Sales Tax

The American Jobs Creation Act of 2004 authorized a new sales tax deduction as an option for those who itemize deductions, letting them choose between deductions for state and local income or sales taxes.

While this deduction will mainly benefit taxpayers with a state or local sales tax but no income tax – in Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming – it may give a larger deduction to any taxpayer who paid more in sales taxes than income taxes. For example, a person may have bought a new car, boosting the sales tax total, or claimed tax credits, lowering the state income tax paid.

Taxpayers can save their receipts throughout the year and tabulate the amount actually paid, or use tables released recently to compute the deduction.

Publication 600 (Optional State Sales Tax Tables) is available in the forms and publications section of the www.irs.gov web site to calculate the deduction. Please note that this provision is set to expire.

TAX FILING ISSUES

"If the Lord had meant for us to pay income taxes, he'd have made us smart enough to prepare the return." Kirk Kirkpatrick

Most Common Mistakes on Tax Returns

If you have not yet filed your tax return, you should be aware of some common mistakes that the IRS says occurs on tax returns. These simple mistakes could delay the processing of your return or delay your expected refund. The IRS lists the following as the most common mistakes:

- Choosing the wrong filing status
- Failing to include or using incorrect Social Security numbers
- Failing to use the correct form or schedules
- Failing to sign and date the return
- Claiming ineligible dependents
- Failing to file for the Earned Income Tax Credit
- Improperly claiming the Earned Income Tax Credit
- Failing to pay and report domestic payroll taxes
- Failing to report income because it was not included on a Form W-2, Form 1099, or some other information return
- Treating employees as independent contractors
- Failing to file a return when due a refund
- Failing to check liability for the alternative minimum tax

The IRS calls this list their "dirty dozen." You can find more about common mistakes made on tax returns by visiting the IRS's web site at www.irs.gov.

***Q:* Is a credentialed "Minister of Music" eligible to receive a housing allotment? We are considering adding that to our Music Minister's package. Right now, she receives a salary which is reported on a W-2. I realize she would have to claim the housing allotment for Social Security purposes. I wasn't sure if you had to be ordained or not.**

A: Yes, a minister of music (as long as she has credentials as such) is eligible to receive a ministerial housing allowance. The credentials are the key, not ordination. And you are right - she will be responsible for Social Security on the housing allowance but not federal income taxes.

You can find out more about who is a minister for federal tax purposes at the following web link: http://www.churchlawtoday.com/newminlesson.php?136

Tax Filing Extension

Since 2006, the Internal Revenue Service has made it easier for you to get a six month extension on filing your individual tax return.

In previous years, you could file an IRS Form 4868 and get an automatic extension of four months, delaying your filing until August 15th. If you needed additional time, you had to file another form, providing a specific reason, to obtain an additional two month extension. The two step process has been eliminated. If you file a Form 4868 requesting an extension now, you will be granted an extension for six months, pushing the deadline for filing back to October 15th.

Taxpayers should remember that while the deadline for the actual filing of the return can automatically be extended now until October 15th, the taxes are due by no later than April 15th. If the taxes are not paid by April 15th, then the taxpayer will be subject to both penalties and interest on the amount owed.

Paying Your Taxes

Do you owe taxes this year? When paying your taxes to the government, make sure that you do **not** make your check payable to the Internal Revenue Service. Instead, your check should be made payable to the United States Treasury.

In addition, the IRS suggests that you write your Social Security number, your daytime telephone number, the tax year and the type of form you filed (1040, 1040A, or 1040EZ) on your check, too.

Online Filing of Forms W-2 and W-3

Churches and other church-related employers, along with other businesses, may file Forms W-2 and W-3 electronically by visiting the Social Security Administrations' website at www.socialsecurity.gov/employer/. On the website, you will need to select "Business Services Online (BSO)" and register as a user. Once registered, you can upload electronic wage files or use the site's "Create Forms W-2 Online" to send electronic information to the Social Security Administration. This option allows you to create "fill-in" versions of Forms W-2 for filing with the federal government and to print out copies of the forms for filing with state or local governments, distribution to your employees, and for your records. From the information filled in on the Form W-2s, a Form W-3 will be created for you.

Normally, the Form W-3 has to be filed by the end of February. However, when you file electronically, you receive an extra month to file because electronically filed W-2s aren't due until March 31st. Once you submit your W-3 electronically, you will receive an acknowledgement receipt.

So if you need a little extra time to submit your Form W-3, using the electronic system is the way to go. In addition, it is simple, convenient, and quick.

Who Must File a Tax Return?

Whether you have to file a tax return depends, in part, on your filing status, age, and gross income. The following is a brief guide on those who ***must*** file a tax return in 2010 for 2009 income (*please note that these numbers change each year*):

- Single, under 65, and your gross income was at least $9,350.
- Single, 65 or older, and your gross income was at least $10,750.
- Married, filing a joint return, you and your spouse were both under 65, and your gross income was at least $18,700.
- Married, filing a joint return, one spouse is 65 or older, and your gross income was at least $19,800.
- Married, filing a joint return, both you and your spouse were 65 or older, and your gross income was at least $20,900.
- Married, filing a separate return, and your gross income was at least $3,650, regardless of your age.
- Head of household, under 65, and your gross income was at least $12,000.
- Head of household, 65 or older, and your gross income was at least $13,400.
- Qualifying widow or widower with a dependent child, you were under 65, and your gross income was at least $15,050.
- Qualifying widow or widower with a dependent child, you were 65 or older, and your gross income was at least $16,150.

However, if you made more than $400 in net earnings from earned income subject to the Social Security "self-employment" tax, you are required to file a tax return in order to pay the Social Security taxes due. As a note, you should remember that the distributions that a participant receives from the Minister’s Retirement Plan are not subject to Social Security taxes. For more detailed clarification on whether you are required to file a tax return, you should talk with your tax professional.

Helpful Hints When Choosing a Tax Return Preparer

While most tax preparers provide excellent service to their clients, the IRS urges taxpayers to be very careful when choosing a tax preparer. You should be as careful as you would in choosing a doctor or a lawyer. It is important to know that even if someone else prepares your return, you are ultimately responsible for all the information on the tax return. The following are some helpful hints:

- Avoid tax preparers who claim they can obtain larger refunds than other preparers.
- Avoid preparers who base their fee on a percentage of the amount of the refund.
- Use a reputable tax professional who signs your tax return and provides you with a copy for your records.
- Consider whether the individual or firm will be around to answer questions about the preparation of your tax return months, or even years, after the return has been filed.
- Review your return before you sign it and ask questions on entries you don't understand.
- No matter who prepares your tax return, you (the taxpayer) are ultimately responsible for all of the information on your tax return. Therefore, never sign a blank tax form.
- Find out the person’s credentials. Is he or she an Accredited Tax Preparer, Enrolled Agent, Certified Public Accountant (CPA), Licensed Public Account or Tax Attorney? Only attorneys, CPAs and enrolled agents can represent taxpayers before the IRS in all matters including audits, collection and appeals. Other return preparers may only represent taxpayers for audits.
- Find out if the preparer is affiliated with a professional organization that provides its members with continuing education and resources and holds them to a code of ethics.
- Ask questions. Do you know anyone who has used the tax professional? Were they satisfied with the service they received?

The IRS cautions taxpayers to be wary of claims by preparers offering larger refunds than other preparers. Check it out with a trusted tax professional or the IRS before getting involved.

Tax evasion is a risky crime, a felony, punishable by five years imprisonment and a $250,000 fine.

MISCELLANEOUS TAX TIPS

Gift Tax Exclusion

A taxpayer can currently give up to $13,000 a year to a child or anyone else without triggering the gift tax. In addition, married couples can give one person up to $26,000 a year. So as a part of your estate planning, consider making a gift now – while you can watch the person enjoy it.

Refund

While you as a taxpayer would be better off to lower your withholdings rather than giving the government the equivalent of an interest free loan, many over withhold as a forced “savings plan.” Others over withhold out of sheer fear of the IRS. In recent years, the trend has been around 70% of taxpayers are entitled to a tax refund.

So tax time may not be such a dreaded time of the year in your household. Get your return filed and look for the “check in the mail.”

Deducting Your Diet

You may not be able to reduce your weight, but trying to may reduce your taxes, according to a regulation issued by the Internal Revenue Service in 2002. For the first time, the agency agreed that obesity is a disease and that the costs of being treated for it qualify as deductible medical expenses. Until that time, such a program was deductible only if it was prescribed to help treat a specific disease, such as hypertension or diabetes. But, since the IRS now says that obesity is a disease, if a doctor says someone is obese that taxpayer may qualify for the deduction. Thus, a taxpayer who is obese but otherwise healthy may qualify for the deduction.

But before rushing to stock up on low-calorie treats, taxpayers should note that the ruling and the law contain significant restrictions. First, weight-loss costs associated with an effort simply to look better -- rather than to treat a disease -- still are not deductible. Neither is most diet food. A deduction would be allowed for special food only "if (1) the food alleviates or treats an illness, (2) it is not part of the normal nutritional needs of the taxpayer, and (3) the need for the food is substantiated by a physician," the IRS said. Special food that is simply a substitute for what the taxpayer normally consumes is not deductible. Food is food, the IRS said, and you don't get a deduction for eating.

But most significantly, medical expenses of all types, including weight-loss programs, may be deductible only if they are not reimbursed by insurance, and the deduction applies only to unreimbursed expenses that exceed 7.5 percent of adjusted gross income. This means that most taxpayers would have to run up thousands of dollars in unreimbursed weight-reduction costs before any of them would be deductible.

So, for all of us who have participated in one to many chicken dinners, the IRS is offering at least a glimmer of hope. Happy dieting!!

Audit Tips

Your chances of being audited by the Internal Revenue Service are going up, but only slightly. For example, in 2001 the IRS audited 732,000 individual returns compared to only 618,000 in 2000. In addition to the regular increase in 2002, the IRS was mandated to randomly audit at least 50,000 extra returns. While those numbers seem high, your risk of being audited remains relatively low considering that approximately 129 million individual returns were filed in 2002.

It should be noted that there are certain "triggers" that can spark the IRS to take a second look, or at least request additional information, about your tax return. These "triggers" can range from simple mathematical mistakes on your return to certain deductions that you claim. According to the IRS, the most common "triggers" are:

- sudden spikes (drops or increases) in income
- missing forms or undocumented income
- an unsigned return
- missing Social Security numbers for the taxpayer or dependents
- filing a Schedule C – self-employed taxpayers are three times more likely than wage earners to be audited
- deductions that exceed the norm for your income
- taking the home office deduction
- casualty losses to your home

None of these "triggers" should keep you from filing an accurate tax return. However, if you are claiming such, you should make sure that you have complete and documented information to back up your claim.

Tax Reporting for Church Schools

If your church operates or controls a private school, you are required to file a Certificate of Racial Nondiscrimination for a Private School Exempt From Federal Income Tax (IRS Form 5578) each year. This form must be filed with the Internal Revenue Service by the 15th day of the fifth month following the end of the organization's fiscal year. Of course, for schools that use the calendar year as their fiscal year, this form must be filed by no later than May 15. It should be noted that if, for some other reason, the organization has to file a Form 990 with the IRS, the certification of nondiscrimination must be completed on Schedule A to the Form 990.

Completing the Form 5578 is rather simple. However, it is imperative that all "private" schools complete such annually. In the directions to the Form 5578, the IRS defines a "private" school as "an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The term includes primary, secondary, preparatory, or high schools and colleges and universities, whether operated as a separate legal entity or as an activity of a church or other organization described in Code section 501(c)(3). The term also includes preschools and any other organization that is a school as defined in Code section 170(b)(1)(A)(ii)." Basically, any private school for any age is covered under this definition.

The policy of nondiscrimination requires, as provided for in the instructions to Form 5578, that the school "admits the students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at that school and that the school does not discriminate on the basis of race in the administration of its educational policies, admissions policies, scholarship and loan programs, and other school-administered programs."

Since the Form 5578 requires that an official of the church certify, under penalty of perjury, that a nondiscrimination policy is in place, a church that operates a school should seek legal assistance to assure that the school's policies are in compliance with the law. Further, you should make sure that the certification form is filed timely each year.

Tax Housekeeping Issues

Have you noticed how quickly the year seems to be moving? It is amazing how fast time seems to be passing. However, that brings me to the question that I must ask – Is your "tax house" in order for the year? Is the ministerial housing allowance designation by the church/employer current? Are you properly accounting for and substantiating all accountable expenses? Did the church adopt a new accountable expense plan for the year?

While such decisions can not be made retroactive, at any time a church can prospectively make changes to such things as the minister's housing allowance or accountable expense plan. For example, assume that a pastor moves to a different house in February and his housing costs go up several hundred dollars a month. The pastor may request that the church reconsider his compensation package at that time to take into consideration his additional housing costs. So for the remainder of the year, based upon the church's approval, an additional amount of the pastor's salary can be designated as housing. While the church can not go back and deal with January and February issues retroactive, they can change the future allocations to cover the expense that will be incurred for the remainder of the year.

So make sure that your "tax house" is in order. Making changes now could drastically impact your tax liability for the year. For more direction on such issues, you may review the Minister's Compensation Manual at www.benefitsboard.com.

Tax Tips

Each year during the holiday season, each taxpayer also receives another package in the mail from their favorite uncle. Yes, "Uncle Sam" sends you a package immediately after Christmas that contains your tax forms for filing your income taxes. As always, you should read the instructions carefully because, as in most years, a few things change each year. If you use a tax preparer, you should begin immediately to get your documentation together to present to them. Here are just a few tips:

- ***W-2 vs. 1099*** - If you are a pastor or employee of a Church of God church or related entity, you should receive a Form W-2 from your employer before February 1. While many ministers (and churches) continue to claim that the minister is "self-employed" and therefore should receive a Form 1099, the church polity of our denomination makes it almost universal that our ministers are employees of the local church – and thus entitled to receive a W-2 rather than a Form 1099. Based upon case law, it seems rather clear that Church of God ministers have a dual tax status – they are employees for federal tax purposes but they are self-employed for Social Security purposes. While this topic is confusing and not subject to clarification in this brief forum, I would recommend that you visit our web site (www.benefitsboard.com) and review the Treasurer's Manual or the Minister's Compensation Manual where a more detail discussion on this issue can be found.
- ***Saver's Credit*** - If you made contributions to a retirement plan (such as the Ministers' Retirement Plan), you may be eligible for a tax credit, called the "saver's credit." This credit could reduce the federal income tax you pay dollar-for-dollar. The amount of the credit you can get is based on the contributions you make and your "credit rate". The "credit rate" can be as low as 10% or as high as 50%, depending on your adjusted gross income – the lower your income, the higher the credit rate. The credit rate also depends on your filing status. To obtain more information on the Saver's Credit, visit the Forms section of our web site (www.benefitsboard.com).

CHARITABLE CONTRIBUTIONS

Charitable Acknowledgement

As a pastor, clerk, or church treasurer, you should make sure that any person who contributed more than $250 to your church within the year in a single gift gets a letter of acknowledgement from your church at least by mid-January of the following year. The acknowledgement should be on church letterhead and should be signed by the treasurer and/or the pastor. It should include the amount of the gift(s), and whether or not the person received anything in return for the gift. If there was nothing given in return, you should add a provision that says that "no goods or services were provided in return for the contribution other than intangible religious benefits, but such benefits are not valued for tax purposes."

Other points to consider concerning acknowledgements for charitable contributions:

- Aggregate contributions that total more than $250 are not required to be acknowledged by the church. For example, if a member of your church gave a check of $200 each week, the church is not required under IRS regulations to provide acknowledgement even though the contributions for the year would total over $10,000. However, **we recommend that all contributions be acknowledged by the church**. If there is no acknowledgement, cancels checks can be used for contributions less than $250. But again, make it simple for people to give to your church – give them a yearly (or maybe even quarterly) list of their contributions.

- Sample contribution letters can be found on the Benefits Board's web site at www.benefitsboard.com under the Treasurer's Manual and in the forms section. Samples can also be found in IRS Publication 1771 at www.irs.gov.
- A donor can not claim a tax deduction for charitable contributions over $250 (single gift) unless he has written acknowledgement of the gift. The acknowledgement must be in his possession **prior** to the filing of his tax return for him to be able to claim the deduction.
- According to recent IRS publications, acknowledgement can now be provided by the church to the donor electronically, i.e. by e-mail.

The church should always seek to make sure that its donors are provided sufficient information to comply with the tax laws of our country.

Charitable Gifts under $250 to Churches

Most church treasurers and donors are familiar with the current law concerning substantiation of gifts given to churches. If a donor gives any one gift that is in excess of $250, the church must provide a receipt to the donor for the gift before the donor can claim such as a charitable contribution on his or her tax return. The receipt can be provided contemporaneous with the gift or the church can provide a regular accounting of all gifts over $250 (as well as other gifts) once a year or once a quarter. For gifts under $250, prior to January 1, 2007, the church was not required to provide substantiation of the gift, even if the combination of all the gifts exceeded $250. For gifts under $250, the donor was able to use their own records to substantiate those gifts. However, effective January 1, 2007, substantiation of gifts under $250 changed.

The Pension Protection Act of 2006, among other things, provided that no charitable deduction is allowed after January 1, 2007 for **any** contribution unless the donor maintains as a record of such contribution a bank record or a written receipt from the church showing the name of the church organization, the date of the contribution, and the amount of the contribution. Simply stated, this provision does not change the substantiation requirement for contributions in excess of $250. Those gifts must still be substantiated by an appropriate receipt from the church, and a cancelled check is not sufficient. However, for gifts less than $250, for the donor to be able to claim such as a charitable contribution, he or she must have a cancelled check or a written receipt from the church denoting the gift.

Because of this change, instead of placing a few dollars in the collection plate, donors may want to write a check even for their smaller donations. The other option is for the local church to record by donor all cash contributions made through the church "envelope" system. Of course, this places more pressure on churches to maintain accurate records of contributions of all sizes, not just those over $250. Again, this provision is effective for all contributions made after January 1, 2007.

Q: ***If a person pays $50.00 a plate for a Royal Rangers fund raiser (steak dinner and entertainment), does that person get full credit deduction or should I as treasurer get a fair price for the meal, deduct that, then give them credit for the remaining as a donation?***

In like manner our choir had a golf tournament where the golfers paid $40 but got 18 rounds of golf plus a free dinner. Do I deduct a fair cost then give them credit?

A: The answer is simply that the donor is entitled to claim a charitable deduction to the extent that the amount given exceeds the value of the goods or services provided in exchange for the gift. If tickets are printed up for such events, it is generally a good idea to list on the ticket the amount that can be claimed as a charitable donation. Regardless, it is much better to determine in advance how much is a donation and how much is for payment of the goods or services – than afterwards.

Sample receipt form on how to deal with such gifts can be found under the Treasurer's form section of the Benefits Board's web site at www.benefitsboard.com.

Non-Cash Charitable Gifts

Over the past few years, many churches have become the recipients of non-cash gifts. While accounting for cash gifts are rather simple for the church, the giving of items other than cash is unique and therefore most non-cash gifting should be completed only after consulting a tax professional. For more information on how to report non-cash charitable contributions, you should review the instructions for IRS Form 8283.

Tax-Deductible Contributions for a Short-term Mission Trip

During the summer months, many churches and organizations sponsor short-term mission trips. On these trips, students and adults alike visit places both domestically and internationally to share the Good News of Jesus Christ. Some trips involve evangelization efforts while others primarily concentrate on manual labor. Regardless of the purpose, all short-term mission trips have something in common - the need to raise money to defer the cost of such an endeavor.

Instead of having car washes and bake sales, the simplest way to raise funds for a short-term mission trip is to request donations from individuals. The question then arises as to whether the donations are tax deductible for the donor. For donations to be tax deductible, a few simple rules should be followed:

- The church should preauthorize the trip as meeting the church's mission and statement of purpose. This preauthorization should be accomplished before accepting donations.
- While a donor may express a "preference" that his or her donation be used to assist a particular trip recipient, the donor should not restrict the donation to only be used by the particular recipient. If so, the gift becomes earmarked for the specified individual and it is no longer qualified as a tax deductible charitable contribution. If the church can not exercise complete control over the gift, it loses its ability to be a tax deductible gift.
- Contributions should be made to the church (and not the individual) and should be receipted by the church as charitable contributions.
- All expenses for the mission trip should be paid out of the church's designated account from funds raised for the trip or from other church resources.
- The trip should have no significant element of personal pleasure, recreation, or vacation. If so, not only may the gifts given for such not qualify as tax deductible donations but the amounts spent on the "mission trip" participants may become income to them for tax purposes. If the trip looks more like a vacation than a mission trip, those giving will not get a tax deduction and those going on the trip may find that their "mission trip" has caused them to have tax liability.
- A church should not refund contributions made in "preference" for a person who later decided not to go on the trip. Refunding these gifts is a strong indication that the church did not have adequate discretion or control over the gifts to begin with.

Short-term mission trips can be a great blessing to the participants, as well as the church that sends them. Following a few simple safeguards will also assure that donors who assist the mission trip participants will adequately receive tax-deductible credit for their contributions and also assure that the participants on the trip are not taxed for trying to do good. Enjoy your short-term mission trip! It will revolutionize your life.

Gifts Designated for Pastor

Responding to an inquiry by a constituent of U.S. Senator Johnny Isakson (D-GA), the Internal Revenue Service in 2009 addressed the tax consequences of a church member's contribution to his local church when the donor designated the contribution to help pay for the pastor's health bills. After noting that the church "must have full control of the donated funds and discretion as to their use" for a contribution to be deductible, the IRS cited a 1979 Revenue Ruling which held that payments to a religious organization that were earmarked for particular students were not deductible charitable contributions.

Following that line of thought, the IRS in their response to Senator Isakson contended that an individual's contribution that is designated for the medical bills of his pastor is not deductible under the Internal Revenue Code (Section 170) as a charitable contribution. The IRS's response recently became public in INFO 2009-0038. At this link you can read the IRS's complete response, only with the constituent's name redacted.

Most troubling about the response is that the IRS seemed to answer a question that was not asked, i.e. are all offerings designated for a pastor, given through the local church, considered to be non-deductible charitable contributions? The only question in controversy involved the deductibility of a contribution given to a church to help pay a minister's bill for previous health expenses, not a simple situation where a gift was given to the church just to bless the pastor. However, the IRS's response seems to be a broad sweep that covers any designated gift through the church to a pastor.

Dan Busby, President of the Evangelical Council on Financial Accountability, in an article on this subject following the release of the IRS letter noted that this interpretation may effectively limit all designated contributions to pastors from being deductible charitable contributions. Mr. Busby, a noted Certified Public Accountant and the author of the *Zondervan Minister's Tax Guide*, suggests that a church member who wishes to provide funds for a pastor should be encouraged to make the gift directly to the pastor. He notes that efforts to "run gifts for pastors through the church" are the basis for headaches for both the church and the pastor.

We will continue to closely watch to see if the Internal Revenue Service offers additional clarification on this issue.

Tax Treatment of Minister's Tithes - Ministers Should Not Deduct Tithes Pre-Tax

Following guidance given in an unpublished Tax Court decision from 1992, some ministers continue to contend that the tithes they pay to the local church should be treated as a business expense rather than as a charitable deduction. If a minister is allowed to treat tithing as a business expense, the minister would then be able to deduct his tithes from his compensation before taxes (both federal income taxes and SECA taxes) were calculated. Such would allow for substantial tax savings to the minister.

In the 1992 tax court case mentioned above, *Forbes v. Commissioner*, T.C. Sum. Op. 1992-167 (unpublished), the local church had adopted a "tithing policy" that mandated that every minister and employee of the church had to pay a tithe of 10 percent of their total compensation back to the church. In a review of the church's policy, the court found that several employees had been terminated for failing to comply with the tithing policy. The court found that "ordinary and necessary expenses" incurred in carrying out a business can be claimed as business expenses. Since a minister or church-employee for this local church could not retain their position unless they paid the "mandatory" tithe, the court reached the conclusion that the tithe was a business expense - and therefore, could be deducted pre-taxes.

In trying to make the *Forbes* case applicable to ministers in the Church of God, it should be noted that the General Assembly *Minutes* at S56 provides that "since we do not license or ordain applicants for the ministry unless they pay tithes, they are required to pay tithes to retain their license." Although historical data may reveal that ministers in times past were "disbanded from the fellowship" for failure to pay their tithes to the local church, it might be difficult to prove the mandatory nature of tithing by Church of God ministers today. While the *Minutes* seem to create a mandatory requirement, the enforcement of the "tithing policy" probably would prove to be problematic.

Most importantly, the issue of whether charitable contributions made by a minister may be treated as deductible business expenses is addressed directly by the IRS. The Internal Revenue Service "audit guidelines" for ministers clearly address this issue in a section entitled Dues vs. Contributions:

> **Dues versus Contributions.** Ministers often pay a small annual renewal fee to maintain their credentials, which constitutes a deductible expense. *However, ministers' contributions to the church are not deductible as business expenses.* They may argue that they are expected to donate generously to the church as part of their employment. This is not sufficient to convert charitable contributions to business expenses. The distinction is that charitable contributions are given to a qualifying organization (such as a church) for the furtherance of its charitable activities. Dues, on the other hand, are usually paid with the expectation that a financial benefit will result to the individual, as in a realtor's multi-list dues or an electrician's union dues. A minister's salary and benefits are not likely to directly depend on the donations made to the church. They may still be deducted as contributions on Schedule A but may not be used as a business expense to reduce self-employment tax.

While every tax liability can be challenged, the "audit guidelines" seem to provide more applicable guidance than the Tax Court's decision in the *Forbes* case. While we have reviewed the holding in the *Forbes* case here, it should be noted that the *Forbes* case can not be cited as legal precedent in a hearing before the IRS or the Tax Court. Because the participants in the *Forbes* case used an expedited procedure to get a determination, the case is unpublished and can not be cited in a legal argument. No other court has adopted the *Forbes* decision and it seems to be in contradiction to ever official position taken by the IRS, including the "audit guidelines" as quoted above. If a minister chooses to follow the guidance given in *Forbes*, he or she should be well aware that they are taking a risky position that most likely will be challenged by the IRS - and such may result in penalties, back taxes, and interest.

Note: While a pastor should not deduct his tithe to the local church pre-tax, the pastor can request that his tithes be withheld from his paycheck on a regular basis, just as he might have a portion of his salary set aside to go into a savings account. This does not reduce his salary (he still is taxed on his whole salary amount, including what goes back to the church as tithe and what might go to his savings account) but it does keep him from having to cut a check each week for tithes. The pastor's W-2 would report the total amount and the treasurer would also need to give the pastor a charitable gift receipt for his contributions (even though they were withheld), assuming that they were over $250 each. For gifts under $250, the pastor's paycheck stub could serve as a contemporary "bank record" for charitable deduction purposes, assuming that such was clearly delineated.

Notice to Donors of the Local Church

To avoid jeopardizing the tax deductibility of charitable contributions, churches should advise donors at the end of the year (or the beginning of the New Year) not to file their income tax returns until they have received a written acknowledgement of their contributions from the church. This communication should be in writing.

Richard Hammar in the *Church Treasurer Alert* suggests that the following notice be placed in a letter to donors or in the church bulletin:

> ***Important Notice:*** *To ensure the deductibility of your church contributions, do not file your income tax return until you have received a written acknowledgment of your contributions from the church. Some of your contributions may not be tax-deductible if you file your tax return before receiving a written acknowledgement of your contributions from the church.*

The IRS rules basically prohibit a taxpayer from claiming a charitable deduction for any single gift over $250 unless the taxpayer/donor has written acknowledgement from the church (or charity) receiving the gift. For gifts under $250, the donor must have bank records (cancelled checks, etc.) or a written acknowledgement from the church (or charity) before such can be claimed as a deductible charitable contribution. The Benefits Board suggests that churches provide written acknowledgement of all gifts, regardless of the amount, to all donors on at least an annual basis. To get suggestions on how to draft gift receipts, the church treasurer may visit the Benefits Board's web site.

Tips from the IRS for Deducting Charitable Contributions

The Internal Revenue Service, along with *Christianity Today* magazine, has released a list of helpful tips when it comes to claiming a charitable contribution as a tax deduction. The following are a few of those tips:

1. To be deductible, a contribution must be made to a "qualified" tax exempt organization, which would include churches. Contributions made to a specific individual, political organization, or political candidate, even though such was given for a charitable cause, can not be claimed as a charitable contribution deduction.
2. A person can not claim a charitable deduction based upon the value of their time or personal services performed. Therefore, a lawyer who donates her time to do legal work for a church can't claim the value of that service as a charitable donation to the church.
3. If you get something from the charity in return for your donation, you can deduct only the amount that exceeds the fair market value of the benefit you received. For example, if you give $100 to a television ministry and receive a $25 Bible in return for the donation, you can only claim a $75 charitable contribution deduction.
4. If you donate stock or other property, the value of the donation is determined at the time of the gift, regardless of what you paid for the stock or property. Assume that you paid $10,000 for a piece of property and it is now worth $50,000. If you sold the property

yourself, you would owe taxes on the $40,000 gain. However, if you donated that property to the church, you get to claim a charitable contribution deduction for the entire $50,000, not just the $10,000 cost basis that you have in the property.

5. Clothing and household items can be claimed as charitable donations but only if they are "in good used condition". These items must be itemized to be deductible. Just saying "bag of used clothes - $50" is not sufficient.
6. For *all* contributions, you can only claim a charitable deduction if you maintain a bank record or a written communication from the charitable organization that contains the name of the organization, the date of the contribution, and the amount of the contribution.
7. In addition, if the contribution is $250 or more, you must obtain a written acknowledgment from the charitable organization showing the amount of the contribution, the date of the contribution, and whether the charitable organization provided any goods or services in exchange for the gift. Simply having bank records is not sufficient for gifts over $250.
8. If you give more than $500 in non-cash gifts to any charity, you must attach IRS Form 8283 (Non-Cash Charitable Contributions) to your tax return. If you give more than $5,000 in non-cash gifts, an appraisal must also be attached to the IRS Form 8283.
9. Churches should voluntarily provide tax receipts to donors at least once a year. Examples of receipts can be found on our web site by clicking here.

While we do not give gifts to charitable organizations or churches solely to receive a tax deduction, it is an added benefit that is provided under the tax code. Therefore, you should take advantage of the opportunity to claim every deduction that you are entitled to under the law.

RETIREE TAX ISSUES

Important Tax Information for Retirees

If you are receiving benefits from the old Aged Ministers' Fund, you will not receive an IRS Form 1099 from Lincoln National Life Insurance Company or the Church of God International Office. They will not send you anything - just a check every month.

On the other hand, the Benefits Board will send you a Form 1099-R if you withdrew funds from your Ministers' Retirement Plan account during the previous year. Your Form 1099-R will reflect how much money you drew from the Benefits Board during the year. You should take the amount on the Form 1099 provided by the Benefits Board **plus** the amount that you receive from Lincoln National (or the Church of God International Office) and put that amount in Line 16**A** on the Form 1040 (your tax return). If you are a minister, you may then subtract out your housing cost and place the difference on Line 16 **B** of the Form 1040.

For example, let's assume you are a minister and that you draw $200 a month from Lincoln National (or $2400 a year). In addition, the 1099-R you receive from the Benefits Board states that you drew $500 a month ($6000 a year) from the Benefits Board. On line 16A of your Form 1040, you would add the two accounts and show that you had pension and annuity income of

$8400 (this example assumes you have no other pension income other than Social Security). If your housing costs for the year were $8400 or more, you would show $0 in Line 16B on the Form 1040. If your housing costs were $5000, assuming the same pension income, you would show $3400 on Line 16B of Form 1040.

No Annual Interest Statement from Board

Each year as participants begin to get all their tax information together, they realize that they have not received a Form 1099-INT from the Benefits Board showing the amount of interest they earned on their retirement account during the previous year. Since the participant receives a Form 1099-INT from their banking institutions, they assume that they should get such a form from the Benefits Board. However, that is incorrect.

Since funds invested in the Ministers' Retirement Plan are tax-deferred, there is no annual requirement to report the interest or earnings on your account at the Benefits Board. All contributions, earnings, and interest will be reported once you begin to take distributions (withdrawals) from your account. All those who take distributions in retirement or by early withdrawal receive a Form 1099-R from the Benefits Board.

Anyone receiving a distribution from the Board should receive their Form 1099-R in mid January of the next year.

Working after Retirement Age

The Social Security retirement age is now on a sliding scale based upon your year of birth. Therefore, to receive full benefits from Social Security you must wait until you reach your "full retirement age" which is between 65 and 67, again depending upon when you were born. If you take "early" Social Security benefits, the amount of wages you may earn without your Social Security benefits being reduced is limited. For 2010, a person taking early benefits will have their Social Security retirement benefits reduced by $1 for every $2 of earned income in excess of $14,160.

For persons who reach full retirement age during 2010, their Social Security retirement benefits will be reduced by $1 for every $3 earned in excess of $3,140 each month until the month they reach full retirement age. After reaching full retirement age, employees can receive their full Social Security retirement benefits amount no matter how much they earn.

It should be remembered that regular distributions/withdrawals from the Ministers' Retirement Plan do not count against this "earnings limit" for Social Security. Only "earned" income is used for the calculation.

Further, Social Security "full retirement age" only applies to Social Security benefits. You may begin withdrawing from your retirement account at the Benefits Board after you have reached 59½ years of age, regardless of your "full retirement age." However, the Benefits Board would encourage you to leave your retirement account intact without making withdrawals until you have officially retired. Such allows your account to continue to grow tax free.

Housing Allowance for Retired Ministers

Under the Internal Revenue Service guidelines, the Church of God Benefits Board has designated up to 100% of the retired minister's annual distributions from the Benefits Board as housing allowance. However, the minister is **not automatically** entitled to exclude 100% of his distributions as housing allowance. To qualify, the minister must actually spend for housing the amount of money that he claims as an exclusion when filing his federal income taxes on Form 1040 or 1040A. The total amount excluded may not exceed the total cost to rent or to provide a retirement home. It should also be noted that church-related employees do not get to claim the housing allowance provision in retirement – just as they did not get to claim such during their work years for a church organization.

Under the Clergy Housing Allowance Clarification Act of 2002 (Public Law 107-181), the amount excludable by a retired minister as housing allowance cannot exceed**:**

- the fair rental value of the furnished house, plus the cost of utilities,
- the actual expenses of operation of the home, or
- the amount designated by the Benefits Board as a housing allowance;

whichever is less.

Ministers that are retired (or those who are considering retirement) should remember the following facts when looking at the housing allowance:

- A minister can have only one housing allowance. If the minister is receiving a full housing allowance from his church, he can not claim pension distributions as housing allowance as well.
- Distributions from the Ministers' Retirement Plan must initially be set up to occur over a period 10 years or longer for such to qualify as housing allowance.
- In order for you to maximize this special benefit, you must maintain diligent documentation of all housing related cost. *Good record keeping cannot be over emphasized.* The liability for determining the appropriate amount of housing allowance that can be excluded *is the responsibility of the retired minister.*
- If the minister's house is paid for, he can claim utilities, taxes, insurance, maintenance, repair work, etc. He can not claim a "rental amount." Only actual expenditures are claimable.
- The retired minister should report the total amount received from the Benefits Board on Line 16**A** of the IRS Form 1040 (or line 12A on the Form 1040A). The amount reported on Line 16A should correspond with the 1099-R form received from the Board in late January. Qualified housing costs should then be subtracted from the amount received from the Benefits Board (and reported on Line 16**A),** with the difference – the taxable amount - reported on Line 16**B** (or line 12B on the Form 1040 A).
- The minister does not have to provide documentation to the IRS of his housing allowance when he files his taxes. However, such documentation should be kept

in his personal records with a copy of his tax return in case the IRS ever questions his housing allowance deductions.

- A large down payment or doubling up on mortgage payments may not be excludable as housing allowance if such exceeds the fair rental value of the property. For example, assume that a minister pays $50,000 down and in payments during a year on his house. Further assume that the fair rental value of the house fully furnished with all utilities paid would be $24,000 a year and the participant draws $25,000 a year from his pension plan at the Benefits Board. Using the three prong test stated above, the participant could only exclude $24,000 from his income for housing allowance (the lesser of the three). The additional $1,000 would have to be reported on line 16B of the IRS 1040 as taxable income, even though the participant spent much more on his actual housing costs.
- Pension distributions can only be designated as ministerial housing allowance by qualified church pension plans set up under Section 403 (b) (9) of the Internal Revenue Code. The Ministers' Retirement Plan, administered by the Benefits Board, meets that criterion.
- Again, only credentialed ministers are eligible to claim the ministerial housing allowance.

Without a doubt, the ministerial housing allowance is one of the best benefits available to both active and retired ministers. However, its implementation is often difficult and confusing.

Q: ***We need clarification on the tax free housing allowance paid to our pastor at retirement. Specifically, what is the "board designated" housing allowance for calculating the minimum of fair rental value, actual home operating expenses or board designated housing allowance? It is our understanding that our retired pastor's actual housing allowance will be the lower of these three calculations.***

A: The Board will designate 100% of the amount that the minister draws in retirement as housing, subject to him using such for housing and subject to the IRS regulations. Basically, the same rules for housing apply whether the minister is active or retired. He will be limited to claim his actual housing costs, the amount received from the Benefits Board designated as housing (i.e. 100% of his distribution), or the fair rental value of his housing, **whichever is less**. Generally, the fair rental value criterion is not an issue. So assume that his actual housing expenses were $1500 a month on average and his distribution was $2000 a month - he would report $500 a month ($6000 a year) on line 16B of the 1040 as taxable distribution from his pension (assuming this was the only pension account he had).

Q: ***When reporting my income each year, will there be some statement from the Benefits Board declaring a portion of my withdrawals as Ministerial Housing Allowance?***

A: See answer to previous question. If you use 100% for housing, then you will have 0% reportable income. You would simply list the amount you received from the Benefits Board on line 16A of the 1040 Form and then on line 16B (the taxable amount of 16A) you would list $0. If you do not use it all for housing, then 16B would be the difference between what you received and the amount used for housing.

The Benefits Board will provide you with a Form 1099-R showing how much you drew from your retirement account during the previous year. However, it will be up to you to determine how much was used for housing - and thus not taxable.

HOUSING ALLOWANCE TAX ISSUES

Creating a Valid Ministerial Housing Allowance

The following simple steps should be taken to assure that the ministers' housing allowance is created properly:

- The minister should determine his yearly housing costs by using the *Estimate of Housing Allowance* form (may be obtained at www.benefitsboard.com).
- The *Estimate* should be submitted to, and adopted, by the governing body of the local church (either Church Council or full church business meeting) prior to the beginning of the new year for which estimate is based on. However, it can be done after the start of the year but only may be applied prospectively, not retroactive. As an example, the resolution should state that "*the Anytown Church of God, through this action of the Church Council, does hereby create a housing allowance for Pastor Phil Pulpit. The church agrees to pay to Pastor Pulpit $1,000 each and every month to secure and maintain a residence. This resolution shall be good and valid for the upcoming fiscal year and all years afterward unless changed by this body*."
- The minister should keep careful records of all housing costs for the year.
- The minister should remember that he can receive a housing allowance for only *one* home.
- The minister's housing allowance is limited to the *least* of the (1) amount designated by the church as housing allowance, (2) the amount actually used to

provide a home, or (3) the fair rental value of the home, including furnishings and utilities.

- The minister must pay federal income taxes on any "excess housing allowance," which is reported on line 21 of the minister's IRS Form 1040.
- The minister must pay self-employment tax (Social Security) on the entirety of the housing allowance.
- A housing allowance provision has to be adopted by the church before the minister can claim such. As noted earlier, the housing allowance can not be made retroactive.

Even though a minister's home mortgage interest and real estate taxes have been paid with money excluded from income as a housing allowance, he may still claim itemized deductions for these same items on Schedule A of his tax return. This practice is commonly referred to as "double-dipping" but is permissible under the IRS guidelines.

The ministerial housing allowance is by far the best tax advantage that a minister has available to him. If the allowance is crafted properly, a good portion of the "income" available to the minister will be tax-free. *(Note: More information on the Minister's Housing Allowance can be obtained from the Minister's Compensation Manual, available without costs on the Benefits Board's web site at www.benefitsboard.com.)*

Tax Reporting and the Housing Allowance

Although the IRS instructions for Form W-2 do not require that the "fair rental value" of the parsonage be reported on the W-2, the Board joins the IRS (Publication 517) in recommending that Box 14 be used to record this amount. Putting the "parsonage fair rental value" or "parsonage allowance" on the W-2 is a great way of maintaining a record of the amount designated as such.

If the pastor is living in a parsonage, the amount that is reported is the fair rental value of the house, plus any utilities and furnishings that are provided by the church. To get the fair rental value, it is suggested that you ask a local realtor to provide the church with a written estimate of how much a house similar to the parsonage in size and location would rent for on the open market. The church treasurer should then take that amount and add to it a "fair rental amount" for any furnishings that the church provides plus utility costs if the church also provides utilities. This total amount would be reported on the W-2 in Box 14 as, for example, "12000.00 - Ministerial Parsonage Allowance." If the minister received a housing allowance, Box 14 would report, for example, "12000.00 - Minister's Housing Allowance."

It should always be remembered that while the pastor does not have to pay federal income tax on this amount, he is required to pay SECA taxes (Medicare and Social Security taxes) on the housing amount. Further, it should be noted that only licensed or credentialed ministers are entitled to a parsonage allowance or a housing allowance. If a non-minister is given either a housing allowance or allowed to live in the parsonage, the entire value becomes taxable to the non-minister for both federal income tax purposes, as well as Medicare/Social Security tax purposes.

Parsonage / Housing Allowances - IRS's Perspective

The following article is directly reprinted from the Internal Revenue Service's *Tax Guide for Churches and Religious Organizations* (Publication 1828). You may access the entire publication by clicking here:

"Generally, a minister's gross income does not include the fair rental value of a home (parsonage) provided, or a housing allowance paid, as part of the minister's compensation for services performed that are ordinarily the duties of a minister.

A minister who is furnished a *parsonage* may exclude from income the fair rental value of the parsonage, including utilities. However, the amount excluded cannot be more than the reasonable pay for the minister's services.

A minister who receives a *housing allowance* may exclude the allowance from gross income to the extent it is used to pay expenses in providing a home. Generally, those expenses include rent, mortgage payments, utilities, repairs, and other expenses directly relating to providing a home. If a minister owns a home, the amount excluded from the minister's gross income as a housing allowance is limited to the least of the following: (a) the amount actually used to provide a home, (b) the amount officially designated as a housing allowance, or (c) the fair rental value of the home. The minister's church or other qualified organization must designate the housing allowance pursuant to official action taken *in advance* of the payment. If a minister is employed and paid by a local congregation, a designation by a national church agency will not be effective. The local congregation must make the designation. A national church agency may make an effective designation for ministers it directly employs. If none of the minister's salary has been officially designated as a housing allowance, the full salary must be included in gross income.

The fair rental value of a parsonage or housing allowance is excludable from income only for income tax purposes. These amounts are *not* excluded in determining the minister's net earnings from self-employment for SECA tax purposes. Retired ministers who receive either a parsonage or housing allowance are not required to include such amounts for SECA tax purposes."

New Legal Challenge to Ministers' Housing Allowance

In mid October 2009, the Freedom from Religion Foundation (FFRF) filed a federal lawsuit in California challenging the income tax exclusion of the ministerial housing allowance. This issue was last the subject of major litigation in 2002 when author and pastor Rick Warren's ministerial housing allowance was brought to the attention of the Internal Revenue Service. The case involving the Saddleback Church's pastor was ultimately resolved by specific legislation being introduced and passed by Congress that made the lawsuit moot.

Although there have been rumors that a new lawsuit would be filed, the current case caught many by surprise since it was filed with little advance notice and hardly any fanfare. The lawsuit, brought by the Freedom from Religion Foundation and twenty-one named plaintiffs, seeks a declaration that, on their face and as administered, tax code provisions allowing housing benefits for "ministers of the gospel" violate the Establishment Clause of the First Amendment to the U.S. Constitution. Not only are the plaintiffs asking that the ministerial housing allowance be declared unconstitutional, they are also asking that the court immediately enjoin any use of such tax benefits for ministerial housing allowance under both federal and state law. The named defendants in the lawsuit are the U.S. Secretary of Treasury, the Commissioner of the Internal Revenue Service, and the director of the California Franchise Tax Board.

The argument advanced by the plaintiffs in this lawsuit is that employees of secular organizations are not allowed these same tax benefits, therefore putting secular organizations in a situation where they "incur comparatively greater compensation costs" and thus putting them at a "competitive disadvantage."

While most expected that any lawsuit involving the ministerial housing allowance would be brought by the law professor who handled the former case against Rick Warren, the plaintiffs in this case are represented by Michael Newdow. Newdow, an atheist, is widely known for having brought the California case on behalf of his daughter regarding the Pledge of Allegiance. The U.S. Supreme Court ultimately found that Newdow's daughter did not have standing to bring a lawsuit challenging the mention of God in the Pledge of Allegiance.

The ministerial housing allowance lawsuit has been filed in United States District Court in Sacramento, California. You can read a copy of the complaint by going to the FFRF website at http://ffrf.org/news/2009/CAlawsuit.pdf.

Multiple Homes and the Ministerial Housing Allowance

It is not unusual for a minister to own two homes. He may be living in one home and buying another for retirement purposes or he may have lived in one home for a particular pastorate and bought another home when he assumed a new pastorate. In addition, a pastor may be living in the church-provided parsonage while buying his own home.

The question that arises is whether the minister can claim a ministerial housing allowance (or parsonage allowance) for *both* homes. Section 107 of the Internal Revenue Code answers this question with an emphatic no!! In plain English, the tax code prohibits a minister from claiming the housing allowance on any home other than the house that he occupies as his “dwelling place.” A close review of the tax code and the regulations surrounding the ministerial housing allowance singly support the conclusion that the allowance can only be applied to the expenses associated with one home – and one home only.

Therefore, a minister living in his own home as a pastor of a local church, while at the same time buying another home to serve as his retirement home, could only claim the housing expenses associated with the home he is living in towards the exclusion for ministerial housing allowance.

Any expenses associated with the retirement home could not be used in calculating the ministerial housing allowance.

Further, if the church provides the minister with a parsonage, he can not also claim the expenses from his own home under the ministerial housing allowance. While it would be helpful in the latter years of ministry if you could live in a parsonage and also began to outfit and operate your soon-to-be retirement home by claiming the expenses under the ministerial housing allowance, the IRS "one home" rule prohibits such.

While some ministers have tried to get around the "one home" rule by claiming that they have two "duty stations," the IRS has never officially recognized this practice. Simply stated, the IRS rules and regulations make it abundantly clear that for purposes of the ministerial housing allowance a minister can only claim one house and that he must use that house as his dwelling place. There is no gray area for a more open interpretation.

Housing Allowance for Retired Ministers

Under the Internal Revenue Service guidelines, the Church of God Benefits Board has designated up to 100% of the retired minister's annual distributions from the Benefits Board as housing allowance. However, the minister is **not automatically** entitled to exclude 100% of his distributions as housing allowance. To qualify, the minister must actually spend for housing the amount of money that he claims as an exclusion when filing his federal income taxes on Form 1040 or 1040A. The total amount excluded may not exceed the total cost to rent or to provide a retirement home. It should also be noted that church-related employees do not get to claim the housing allowance provision in retirement – just as they did not get to claim such during their work years for a church organization.

Under the Clergy Housing Allowance Clarification Act of 2002 (Public Law 107-181), the amount excludable by a retired minister as housing allowance cannot exceed**:**

- the fair rental value of the furnished house, plus the cost of utilities,
- the actual expenses of operation of the home, or
- the amount designated by the Benefits Board as a housing allowance;

whichever is less.

Ministers that are retired (or those who are considering retirement) should remember the following facts when looking at the housing allowance:

- A minister can have only one housing allowance. If the minister is receiving a full housing allowance from his church, he can not claim pension distributions as housing allowance as well.
- Distributions from the Ministers' Retirement Plan must initially be set up to occur over a period 10 years or longer for such to qualify as housing allowance.
- In order for you to maximize this special benefit, you must maintain diligent documentation of all housing related cost. *Good record keeping cannot be over emphasized.* The liability for determining the appropriate amount of housing allowance that can be excluded *is the responsibility of the retired minister.*

- If the minister's house is paid for, he can claim utilities, taxes, insurance, maintenance, repair work, etc. He can not claim a "rental amount." Only actual expenditures are claimable.
- The retired minister should report the total amount received from the Benefits Board on Line 16**A** of the IRS Form 1040 (or line 12A on the Form 1040A). The amount reported on Line 16A should correspond with the 1099-R form received from the Board in late January. Qualified housing costs should then be subtracted from the amount received from the Benefits Board (and reported on Line 16**A),** with the difference – the taxable amount - reported on Line 16**B** (or line 12B on the Form 1040A).
- The minister does not have to provide documentation to the IRS of his housing allowance when he files his taxes. However, such documentation should be kept in his personal records with a copy of his tax return in case the IRS ever questions his housing allowance deductions.
- A large down payment or doubling up on mortgage payments may not be excludable as housing allowance if such exceeds the fair rental value of the property. For example, assume that a minister pays $50,000 down and in payments during a year on his house. Further assume that the fair rental value of the house fully furnished with all utilities paid would be $24,000 a year and the participant draws $25,000 a year from his pension plan at the Benefits Board. Using the three prong test stated above, the participant could only exclude $24,000 from his income for housing allowance (the lesser of the three). The additional $1,000 would have to be reported on line 16B of the IRS 1040 as taxable income, even though the participant spent much more on his actual housing costs.
- Pension distributions can only be designated as ministerial housing allowance by qualified church pension plans set up under Section 403(b)(9) of the Internal Revenue Code. The Ministers' Retirement Plan, administered by the Benefits Board, meets that criterion.
- Again, only credentialed ministers are eligible to claim the ministerial housing allowance.

Without a doubt, the ministerial housing allowance is one of the best benefits available to both active and retired ministers. However, its implementation is often difficult and confusing. Please contact the Benefits Board for additional assistance and guidance concerning the housing allowance if such is needed.

The Earned Income Tax Credit

The question arises as to whether or not a minister's housing allowance or the fair rental value of the parsonage is earned income for purposes of calculating the earned income tax credit, or EIC.

The tax code is clear that ministerial housing, whether a housing allowance or a parsonage provided by the church, is excluded from a minister's *federal taxable income* if such is set up under an approved housing allowance designated by the church. On the other hand, the minister is required to pay SECA (Social Security/Medicare) taxes on the housing allowance or the “fair rental value” of the parsonage. Simply put, a housing/parsonage allowance is not taxable for income tax purposes but it is taxable for Social Security/Medicare tax purposes.

Based upon that distinction, one could reasonably assume that the housing allowance or “fair rental value of the parsonage” would not count as income in calculating the “earned income credit.” However, that is **NOT** the case. The Internal Revenue Service, in Publication 596 - Earned Income Credit (EIC) – clearly points out that ministerial housing *is included* in determining the earned income tax credit. At page 10 of Publication 596, the following is found:

> **Minister’s housing.** The rental value of a home or a housing allowance provided to a minister as part of the minister’s pay generally is not subject to income tax but is included in net earnings from self-employment. For that reason, **it is included in earned income for the EIC** (except in certain cases described in Approved Form 4361 or Form 4029).

The exception noted regarding an approved Form 4361 deals with ministers who have opted out of Social Security on their ministerial income. In a strange twist of the law that has not yet been corrected by Congress, ministers **who have <u>not</u> opted out** of Social Security (i.e. have not exempted themselves from self-employment taxes by filing Form 4361) must treat their housing allowance or fair rental value of their parsonage as earned income in calculating the earned income credit. On the other hand, ministers **who have opted out** of Social Security should **<u>not</u>** treat their housing allowance as earned income in computing the earned income credit.

This interpretation by the IRS creates an illogical and confusing situation. However, there seems to be no better interpretation. In the recent edition of the **Church & Clergy Tax Guide**, Richard Hammar spent more than five pages trying to explain this confusion.

> ***Q:** Our church has always had a Parsonage for our Senior Pastor and Youth Pastor. However, we sold our youth parsonage mid year. The council then voted to put the Youth Pastor on a housing allowance. How do I show both the parsonage allowance and the housing allowance on the Youth Pastor’s W-2 form?*
>
> ***A:*** The housing allowance and the parsonage allowance are basically treated the same on the W-2. Both are listed in Box 14 on the W-2. The parsonage allowance on the W-2 is the "fair rental value" of the house as provided to the pastor (or youth pastor). Such would include the rental value of the home plus utilities and furnishings if those are provided. To get the fair rental value of the home itself, the IRS would prefer that you have a real estate professional in your area provide you with a written estimate of such.
>
> On the other hand, the housing allowance is the amount designated by the church as such. It should be noted that the housing allowance is the amount "designated" by the church and not necessarily the additional amount given by the church to the pastor for housing. For example, assume that for the senior pastor, the Minutes set his salary at $40,000 a

year plus the church decided to give an additional $10,000 on top of that for housing. His total compensation package at this point would be $50,000. If the pastor submitted an estimate to the church that his housing expenses for the upcoming year was going to be $15,000 and the church designated such as housing, his income in Box 1 would be $35,000 and Box 14 would note "15000.00 - Ministerial Housing Allowance." More info on total compensation planning can be found in the Ministers' Compensation Manual on our web site at www.benefitsboard.com.

To answer your question simply, I would list the parsonage allowance and housing allowance separately on the youth pastor's W-2. For example, "10000.00 - Ministerial Parsonage Allowance; 2000.00 - Ministerial Housing Allowance."

One final note - for the youth pastor to receive a housing/parsonage allowance, he must be a credentialed minister. If he does not have credentials from the COG or some other recognized religious organization, all the "housing" amounts are taxable to him and included in Box 1 as income.

Q: ***I am an associate pastor and my local church is giving me a 1099 and I was wondering where on the 1099 should the housing allowance be listed. Or should they give me a W-2? I have credentials with the Church of God. I have a job outside the church and being paid by a church is new to me.***

A: As a minister, you should be receiving a W-2 from the church and not a 1099. You are an employee for tax purposes (and thus entitled to a W-2) while you are self-employed for Social Security purposes. Again, the Minister's Compensation Manual on our web site (www.benefitsboard.com) goes into great depth about this dual status.

On the W-2, assuming that you only received housing allowance, nothing would go in any of the numerical boxes except Box 14. There the amount received would be listed. For example, "5000.00 - Ministerial Housing Allowance."

Q: ***Our church has hired a part time associate pastor. The new associate is full time employed by another company. My question is can we allow his salary that we pay him to go toward housing?***

A: If your new associate has credentials or licenses as a minister, then the answer is yes - his entire church salary can be designated as housing. He should submit to the church an estimate of annual housing costs and then the church's governing body (council or church as a whole) should adopt a resolution designating the amount as housing. For more information on this, please review the Ministers' Compensation Manual available without costs on our web site (www.benefitsboard.com).

Q: ***I pastor a small church and if the funds are there, I receive $200.00 a week; if not, I do not. However, I do not have to depend upon the church for my livelihood; I am retired from a secular job. However, I would like to try to do my taxes using TurboTax. The question is how do I put the money down that I receive from the church; they call it a house allotment and phone bill, utility and so forth. I would really like to do my own taxes but not at the expense of going to jail.***

A: Before I give you an answer, I have several questions:

1.) Has the church's governing body (church council or whole church in conference) set up and approved a housing allowance for you?
2.) Has the church's governing body approved an accountable reimbursement expense plan? And do you regularly (at least within 60 days) provide an accounting to the church of how the "expense" money is spent?

Simply put, if the church has created a housing allowance for you, then the $200 a week that you are getting may be totally tax-free (although you are required to pay Social Security taxes on housing allowance). If they designate the entire amount as housing, and you spend $200 or more a week on housing (payment, interest, utilities, furnishings, repairs, taxes, upkeep, insurance, etc), then the amount would be non-taxable for federal income tax purposes.

The church should be giving you a W-2 each year showing that amount as housing. The W-2 would be extremely simple with nothing showing in Box 1 (the income box), but Box 14 would note the amount of housing - for example "10400.00 - Ministerial Housing Allowance". Again, if it is designated as housing and used as housing, there is no reportable income for federal tax purposes.

The same rules apply for expenses. You just have to document any expenses that you incur in the "course of business" back to the church within no more than 60 days of incurring those expenses.

You can find an in-depth discussion on these issues in the "Treasurer's Manual" and in the "Ministers' Compensation Manual" available on our web site at www.benefitsboard.com.

But to answer your ultimate question, I believe that you can use Turbo Tax to do your taxes and I have little fear that you will go to jail. Of course, if I am wrong, you could always start a new jail ministry.

Q: ***I pastor a small church that averages about 15 on Sunday morning. I'm given $200.00 a week for a housing allotment most week; some weeks I get nothing because it is just not there. The church also put $200.00 a month in the retirement system for me. Is this legal and if it is how should I show this on my W-2.***

A: Assuming what is listed here is all your compensation for a year from the church, you have a relatively simple tax issue. If the church provides you no salary, nothing goes in Box 1 on the IRS Form W-2. In Box 14 (the OTHER box), we would suggest that you put "Ministerial Housing Allowance – 10400.00" - that assumes that you got the $200 each week for 52 weeks. If the amount is different, you simply adjust the amount.

The $200 a month that the church puts in your retirement account is not reported on your W-2 and therefore, it does not show up anywhere, nor does it have to be reported to the IRS as long as the church is making those contributions. On the other hand, if you reduce your salary to make retirement contributions, you would check box 13 that you have a retirement plan (that box needs to be checked even if the church makes the contributions) and then in Box 12, you would put as the code "E" and the amount - $2,400 ($200 x 12).

Q: ***Who is responsible for determining the fair rental value of the parsonage - the church, the pastor, or a professional (realtor or appraiser)? Is more at stake than the "more a person pays into Social Security the more he draws"?***

A: The "fair rental value" comes into play in dealing with both the parsonage allowance and the housing allowance. Under the parsonage allowance, the fair rental value is the amount that is added into the minister's income for Social Security purposes (such is tax exempt for Federal income tax purposes). According to the IRS directives, the fair rental value of the parsonage should be determined by an impartial third party (i.e. a realtor) and provided to the church in writing. The fair rental value should be based upon how the house is provided to the pastor. If it is furnished with all utilities paid, the fair rental value should be of a comparable house in your community furnished with all utilities paid. Getting a realtor to provide such an estimate is often difficult in some areas. Some churches have resorted to the "1% of value" theory - meaning that they claim that 1% of the value of the house is the monthly fair rental value. For example, if the parsonage is worth $100,000, then the monthly fair rental value is $1,000. The IRS does not approve of this method but it is often used.

In a housing allowance situation, the fair rental value becomes a cap at which the church or the minister cannot exceed each month. In other words, the rules say that you can claim housing allowance up to the amount designated by the church, the amount actually spent by the minister for housing, or the fair rental value of the house, whichever of the three is less. Generally, the fair rental value is the highest and becomes a cap. For example, let's assume the minister receives a housing allowance of $12,000 a year from his church. In the year in question, he had to put a roof on his house in addition to his payments and he paid out $16,000 towards his housing costs. Further, the house he lives in, fully furnished with all utilities paid, would rent for $2,000 a month ($24,000 a year). In this example, the most the minister could exclude from his income would be $12,000 – the amount designated by the church as housing allowance since it is the least of the three. Assuming the same example, but with the fact that the minister paid out only $8,000 for actual housing costs in the year, the housing exclusion would be limited to $8,000, again the least of the three qualifiers. *Just because the church designates a certain amount does not automatically make that amount excludable from the minister's income.*

Again, the fair rental value of the housing allowance needs to be determined by an independent, unbiased third party.

In both cases (parsonage allowance or housing allowance), we recommend that such be reported in Box 14 (the other box) on the minister's W-2 form. While not required by the IRS (but recommended), it makes a simple place to place the housing/parsonage allowance for the calculation of Social Security taxes.

So, I would suggest that there is much more to the fair rental value than just "the more one pays, the more he draws" philosophy.

Q: ***I am a full time pastor and have always lived in a parsonage. My wife and I have just purchased a piece of property and we are putting a manufactured home on the property to serve as our primary residence.***

Could you guide us in the best way to set up the payments and other moving expenses for tax and other purposes? For example, should I reduce my salary by the payment and claim housing allowance or just pay the payments and file on 1040?

A: First of all, congratulations on your new home. You will soon learn that having a home of your own, rather than living in a parsonage, is a true delight.

I am assuming that the church is going to use the parsonage for some other purpose, such as Sunday School classes, a home for an associate pastor, or rent it out – and that they are supportive of you obtaining your own home. With that being the assumed case, the best way to go is to have the church establish for you a housing allowance to cover the costs of your new home.

While establishing a housing allowance sounds like it will be more costs to the church, it does not have to be. Let's use a very simplistic example. Let's assume that the church is paying you $20,000 a year now as salary and benefits. Also, let's assume that your housing costs are estimated to be $1000 a month or $12,000 a year. The church council (or the governing body in the church), based upon your estimated housing costs, can designate as housing $12,000 a year of your $20,000 salary. This has not costs the church another penny. However, it saves you from having to pay federal income taxes on the $12,000 designated as housing (although you still have to pay Social Security on the housing amount). In effect, you are getting the same money each week but a portion has been designated as housing, thus reducing your tax liability.

Of course, if the church so desires, they can certainly give you money above and beyond your salary to cover the costs of your housing. Such is actually recommended in S69 of the General Assembly Minutes.

Having a housing allowance is by far a much better method than just being able to claim the mortgage interest deduction on Schedule A on your 1040 Form.

To learn more about Ministerial Housing Allowance and to get a copy of a resolution to create such and an estimation form for housing expenses, you can go to our web site at www.benefitsboard.com and look at the manual entitled Minister's Compensation. You will find all kind of helpful ideas in that manual.

Q: ***Can our pastor roll a portion of his 403(b) contract to an IRA or another 403(b) at retirement and still qualify for the tax free housing allowance assuming he takes distributions from the portion left with the Benefit Board (qualified church pension plan) over a period longer than 10 years?***

A: All distributions from the MRP account will be designated as housing as long as the minister retains credentials with the COG. However, any amounts moved from the plan can not be designated as housing unless they are moved to a church plan as specified in the ERISA legislation. However, some of the funds could be moved to an IRA for instance and lose their ability to be designated as housing, while the remaining funds could stay in the MRP and be designated as housing upon distribution. I would note that once funds leave the "church plan" by rollover, they can never be re-designated as "church plan" assets again if they are rolled back to the MRP unless they are held in a "conduit" account in the interim.

Q: ***Since I no longer receive any retirement from the Church of God Benefits Board, can I still deduct housing allowance from our income when reporting to the IRS?***

A: If you receive distributions from the old Aged Ministers' Fund, you can continue to claim your housing costs against that income. In addition, if you have "ministerial income" from pastoring, filling in, or evangelizing, you may be able to offset your "ministerial income" by claiming your housing costs.

To be able to claim the housing allowance, you would need the church you are pastoring or filling in at to designate a portion of your income as housing. If you are evangelizing, your "evangelistic ministerial organization" that you set up for evangelizing, would need to make that designation or you would have to claim such as a Schedule C deduction.

On the other hand, if you just have income from investments or other non-ministerial related income, you can not offset that income with the ministerial housing allowance exclusion. Of course, you still could claim any taxes or mortgage interest allowable to all itemizing tax payers on Schedule A.

REIMBURSEMENT TAX ISSUES

Mileage

Documentation of expenses is vital to an acceptable accountable reimbursement plan. Mileage driven in the course of business is generally the minister's greatest expense. Some ministers have contended that every mile they travel is in the furtherance of their business – and thus reimbursable. Their contention is based upon the fact that they never stop being a minister and technically are "on call" at all times. The IRS has not accepted this argument, just as they have declined similar claims by doctors and other professionals. Commuting, going to the grocery store, or the local department store are miles that are not ministerial in nature and thus can not be claimed for reimbursement. In their publications, the IRS clearly agrees that trips to the hospital or nursing home, or to attend conferences or other church meetings are business miles and can be deducted. However, they go on to point out that trips to and from the church are considered nondeductible commuting expenses.

A minister should carefully document his business mileage by the use of a daily (or trip) log. The log should contain the odometer reading at the beginning of the trip and the end of the trip, the date, and the purpose of the trip. Stopping by the grocery store on the way home does not take the trip out of the business expense category, as long as the stop was incidental. The log should be used to calculate your mileage for submission to the church and should be retained long term to document such expenses if ever questioned by the IRS.

The IRS standard mileage rate for the use of a car for business purposes changes yearly. Please contact the Benefits Board at info@benefitsboard.com to get the latest IRS rate.

Q: ***Is having to get a replacement vehicle an accountable expense for a pastor? What about repairs to the pastor's vehicle?***

A: If an employee/pastor is using an accountable plan, the costs of a replacement vehicle or the costs of repairs to a vehicle are **not** accountable expenses. For automobile expenses under an accountable plan, the minister is paid a per mile reimbursement. For 2010 the IRS has set the rate at 50 cents per mile. That per mile reimbursement is supposed to cover fuel, oil, repairs, payment on the vehicle, etc. Any amount paid above and beyond the per-mile cost set by the IRS would be strictly additional salary – and would be taxable to the minister. Even if the church decided to pay 60 cents a mile currently, the amount over the IRS set rate (currently 50 cents per mile) would be considered as taxable income.

On the other hand, if the church sets a specific amount – say $50 a week – for automobile costs, and requires no substantiation by the minister that he or she actually used that amount for auto expenses (either by submitting mileage, tolls, parking, etc), then the $50 a week becomes taxable income. There must be substantiation of the expenses to make it non-taxable under an accountable reimbursement plan.

Travel Expenses for a Spouse

When a pastor or church staff person travels on business for the church, the spouse of that person often travels with them. For example, a pastor may attend a conference on behalf of the church and the pastor's wife may accompany him to the conference. If the local church reimburses the pastor for all travel expenses associated with the conference, the question arises as to whether such can be treated as a non-taxable event.

Clearly, assuming the rules for an accountable reimbursement plan are met, the pastor's expenses can be reimbursed without creating tax liability. However, what about the reimbursement of the expenses solely attributable to the pastor's wife?

Most churches just automatically assume that the pastor and wife are treated as one - and therefore, any expenses reimbursed for either would be non-taxable. The IRS regulations do not make such an automatic assumption. Instead, the regulations point out that at least three stringent rules must be in place before the spouse's travel expenses qualify as "nontaxable working condition fringe benefits:"

- The amount reimbursed can not be treated by the church as compensation to the pastor or spouse,
- The spouse's presence on the business trip must be for a "legitimate business purpose," and
- The reimbursement must be substantiated under an accountable reimbursement arrangement.

The second point - the "legitimate business purpose" - is the one that generally causes the most concern. If the spouse does not substantially participate in the "business" activities, it is highly unlikely that this portion of the test is met. While attending Camp Meeting or General Assembly with her husband probably meets this test, going to Orlando with her husband to attend a conference but visiting Disney World while he attends business meetings would probably not meet the test.

Even if the spouse's activities are not business related, it does not mean that the total expenses are just split in half - with half being nontaxable business reimbursement and the other half being taxable income. Instead, the amount that is taxable to the minister would be the travel expenses directly attributable to the spouse's travel. For example, if the minister traveled by car, there would be no additional charges and generally there would be no additional charges for the hotel room to have another person in the room. However, food charges and other things directly attributable to the spouse would become taxable to the minister.

Some churches promote the spouse's travel with the minister for accountability purposes. If the church follows this policy, the policy should be in writing and consistently followed to keep the spouse's travel expenses in the nontaxable category.

Finally, it should be noted that if the spouse's taxable travel expenses are not reported as income to the minister, the IRS could determine that such amounted to an "automatic excess benefit" which could result in "intermediate sanction" - meaning that the IRS potentially could levy a substantial excise tax against the pastor and possibly even church board members who had approved the payment for such expenses.

Reimbursement of travel expenses for a pastor's spouse is another area where advice from a competent local certified public accountant is vital.

Health Insurance

The cost of health insurance for all Americans has become outrageous. Recognizing the need for health insurance, the Church of God *Minutes* point out that the local church should provide the funds to pay for the minister's premiums for health insurance coverage. According to the IRS regulations, payments by the church directly to the insurance carrier or to the minister based upon substantiation of the health care costs are considered to be a tax-free benefit to the minister. If such payments are not made and the minister has to pay his own health insurance premiums, he can only claim such on Schedule A – and he only gets a deduction if those expenses exceed 7.5% of his adjusted gross income.

Obtaining health insurance as a minister may be as big of challenge as paying for such. In states where the denomination offers health insurance through a state plan, the Benefits Board encourages ministers of all ages to participate in those plans. In states where a state plan is not available, the best alternative may be to secure health insurance through a plan offered to your spouse through her employment. It is permissible for a church's fringe benefits plan to reimburse health insurance premiums paid by a spouse through payroll deduction at her job.

In the *Minutes* previously discussed, churches are encouraged to pay the entire premium for the minister's health insurance. However, if the resources are not available in the local church, it is permissible for the church to pay a percentage of the minister's health insurance costs – and such payments are non-taxable to him as a fringe benefit. In other words, the total premium does not have to be paid by the church for such to qualify as a fringe benefit.

If the church includes health insurance premiums in their compensation package, a resolution should be entered on the local church records to memorialize such.

Medical expenses that are not eligible for reimbursement under a health insurance plan are deductible on Schedule A as an itemized deduction. On the other hand, medical expenses that are reimbursed under a health insurance plan cannot be deducted as medical expenses on an individual's tax return.

Q: ***If the pastor has a secular job where he receives health insurance coverage on his family through payroll deduction, can this amount be treated as a health insurance reimbursement by the church? In other words, can we specify that a portion of his salary is reimbursement for health insurance premiums and reduce his W-2 income in Box 1 by this amount?***

A: If the pastor has a secular job and health insurance is offered to him (and his family) through that employer, the church can reimburse the pastor for that health insurance as a "fringe benefit." This, of course, assumes that the secular employer is not paying for the insurance and that the reimbursement from the church is a true reimbursement – and not double dipping. To include the health insurance premiums in the pastor's accountable reimbursement package, he needs to provide documentation to the church treasurer as to the insurance premiums at least annually or if there is a change in the amount.

Assume for instance that the secular employer provides health insurance to him. They pay no premium and he has to pay the entire amount through salary reduction. Upon documentation of that expense, the church could designate the monthly amount as a fringe benefit to the pastor and such would be a tax-free benefit for the church to provide him. It is still a tax-free benefit even if the church can't pay the whole amount. For example, assume the premium was $500 a month and the church could only afford $300 a month. That amount is still a tax-free benefit even though it does not cover all his health insurance liability.

Creating an Accountable Reimbursement Plan

Only at tax time do many ministers find out that their "accountable reimbursement plan" is not really "accountable" under the rules of the IRS. Included here is an excerpt from the Church Treasurers' Manual, available at www.benefitsboard.com without charge, which should be helpful in creating a valid "accountable" plan:

The church governing body (Church Council or the church as a whole operating in a business meeting) should adopt a resolution creating an accountable reimbursement plan. The resolution could be very simple, for example:

"The Anytown Church of God, through this action of the Church Council, does hereby create an accountable reimbursement plan for Pastor Phil Pulpit. In addition to the compensation paid to Pastor Pulpit, the church agrees to reimburse all necessary and proper business expenses incurred by him during the normal course of conducting business on behalf of the Anytown Church of God up to an amount not to exceed $6,000 a year. Expenses must be substantiated to the church treasurer as to the date, amount, and purpose within 30 days after they are incurred. Any excess reimbursement must be refunded to the church within 60 days after expenses are paid or incurred. This resolution shall be good and valid for the upcoming fiscal year and all years afterward unless changed by this body."

It is the responsibility of the church treasurer to make sure that this resolution is reviewed and examined each year. However, the last sentence of the resolution keeps such active in case the church fails to place a new resolution in the records.

Disbursement of the "expense" money can be made on a regular basis, either in advance or upon submission of the receipts. If expenses are paid upon submission of expense receipts, there is no problem of "excess" expenses that has to be returned at year-end. However, many ministers would rather receive their "expense" money in advance so that they do not have to use their personal funds to "float" the expenses of the church for a month or so. Advancing expenses is perfectly fine. However, the minister still must provide receipts to the church treasurer. While the IRS regulations require that receipts must be submitted with 60 days of incurring the expense, the church can demand that receipts be submitted more often – say every 30 days (or by the first of the month). A shorter time period generally helps assure that proper receipts are presented. The *Accountable Reimbursement Plan Ministry Related Expense Form* can be used by the minister to submit his expenses to the church treasurer, whether he is getting payment in advance or if he is receiving payment upon receipt of proper documentation.

The minister should maintain a detailed log of all mileage traveled for business purposes. The log should be used to calculate the mileage claimed on the Accountable Reimbursement Plan Ministry Related Expense Form. In addition, the minister should save the logs for at least seven years to respond to any inquiry that might be raised by the Internal Revenue Service.

The church should not use a salary reduction arrangement to pay for the minister's business expenses. Under this type of plan, the minister's "salary" check would be reduced weekly or monthly by the amount of expenses he submitted. Such arrangement is nonaccountable and any "reimbursement" must be counted as income to the minister.

End of Year Reconciliation of an Accountable Reimbursement Plan

Every year questions are raised about the reconciliation of an accountable reimbursement plan. Since 1992, the *Church of God Minutes* (S.70) has listed only one amount in the Pastor's Minimum Compensation Scale. Previously, the amount had been broken into salary and expenses. A discussion on why this change occurred can be found in the financial manuals published by the Board.

Assuming that the "scale" lists the pastor's compensation at $500 a week, the pastor in conjunction with the governing body of the church can designate a portion of that amount, say $100 a week, as expenses under an accountable plan. To qualify under the IRS regulations, an accountable plan must be for business expenses and have a business connection, the minister must substantiate the expenses within a reasonable time (within 60 days of the expense) to the church, and the minister must return any amounts in excess of substantiated expenses within a reasonable time (generally within 120 days).

The problem occurs at year-end when the pastor or staff member has not provided documentation to substantiate all the "expense" money they have received during the year. The IRS rules are clear that if the pastor or staff person does not return the "excess" expense money the entire amount paid for the year as expenses must be included as taxable income on the person's W-2.

However, the pastor will contend that he is entitled to the "excess" amount because the *Minutes* say that such is his compensation. Generally, the pastor will ask that the "excess" reimbursement be included on his W-2 as taxable income – and that he will just keep the money rather than returning it to the church. The IRS prohibits this practice.

To keep the plan accountable, the pastor must return the excess reimbursement to the church and such must be documented. The question then arises as to whether the church can then cut the pastor a taxable check for the same amount that he just returned as excess reimbursement which would make him receive the total compensation provided for in the *Minutes*. The simple answer is no.

However, the church governing body can decide to give the pastor a year-end or Christmas bonus with available funds on hand. That amount could be the same as returned, greater than or less than the amount returned. Regardless, the decision by the church's governing body should be totally separate and distinct from the return of the excess contribution. The pastor also takes the risk that the governing body will not be generous at all.

This discussion clearly points out the need for the pastor to accurately project what his business and professional expenses will be for the coming year – and for the pastor to actually substantiate all the expenses that he incurs throughout the year. An accountable reimbursement plan that is accurately projected and substantiated will be a wonderful blessing to the minister in tax savings since the reimbursement is not taxable for income tax purposes or Social Security (SECA) tax purposes.

RETIREMENT PLAN ISSUES

Accounting for Losses

For those who participate in the Benefits Board's equity (stock) accounts, you may suffer a loss in any particular year. We are sometimes asked if you can claim, or deduct, that loss on your tax return. The answer is simply NO! Since your accounts at the Benefits Board are a part of a tax-sheltered investment vehicle (specifically, a 403(b) account), you can not deduct losses that you suffered in the stock market. Just as you are not required to claim the gains (or interest earned on your account), you can not deduct losses. Other than the tremendous tax advantages of contributing to a tax-sheltered account, your account with the Benefits Board has no tax consequences until you start making withdrawals from the account.

Rolled In Accounts

Many participants express interest in rolling other retirement funds into their account at the Benefits Board. Those transfers are allowed and the Board will be glad to work with the participant to effectuate the transfer of funds. However, there are several important factors that must be remembered about transferring funds from one account to another:

- While there is no tax consequences associated with such a transfer, the current custodian of your funds may charge a withdrawal fee if their contract with you allows for such. This fee may be as high as 15%.
- Funds rolled into an account at the Benefits Board do not become available for disbursement as housing allowance. Such accounts are disbursed as taxable amounts just like they would have been by the prior custodian.
- All funds transferred to the Benefits Board are placed in sub-accounts. Therefore, if your account number is 12345, your rolled-in account will be designated as 12345-a (or some similar designation). This separate designation is made so that we can track all rolled-in funds and apply whatever new rules the IRS may apply at some point in the future. If no new rules are applied by the IRS, the rolled-in funds will be treated as taxable amounts just like they would have been by the prior custodian.

Contributing to Retirement Fund when all Income is Designated as Housing

Statistics show that approximately 70% of Church of God ministers are bi-vocational. Most bi-vocational pastors do not depend on the church for their primary source of income but only as a supplement to their secular income. In some situations, the pastor may only be receiving a housing allowance from the church – and no other income whatsoever.

When the minister's entire income is designated as housing, he has no taxable income, but he is required to pay self-employment taxes (Social Security and Medicare) on the housing allowance. Even though the minister is receiving a check each week for housing, he cannot contribute to his retirement account through salary reduction since he has no taxable income, assuming the entire amount is designated as ministerial housing allowance. The IRS rules say that in 2010 you can contribute up to $16,500 **or** an amount equal to your "taxable income," whichever is less, through salary reduction to your Ministers' Retirement Plan account. Additional limits apply if the church is making contributions and if you are entitled to certain catch-up contribution limits. Again, if the minister's compensation is totally designated as housing allowance, he has no taxable income and therefore can make no contribution through salary reduction to his MRP account.

To get around this prohibition, the minister could request that his housing allowance be reduced and a portion of his compensation be designated as salary. This action would have to be approved by the church's governing body (the finance committee, church council, or full church).

For example, assume that the pastor is currently receiving $500 a month as housing allowance ($6,000 a year) as total compensation from the church. For discussion purposes, the pastor could request that $400 a month be designated by the church as housing ($4,800 a year) and the other $100 a month could be designated by the pastor as a salary reduction retirement contribution. Interestingly enough, such a plan would actually lower the pastor's overall tax liability. Using this example, currently the pastor is required to pay self-employment taxes on the $6,000 housing allowance (but no federal income taxes). Under the revised plan, the pastor would pay self-employment taxes on the $4,800 amount for housing – but would pay neither self-employment taxes nor federal income taxes on the $1,200 deferred into the pension plan since he is a minister of the Gospel.

The Minister's Compensation Manual available on our web site at www.benefitsboard.com can provide more direction on compensation planning.

Deferred Taxation on Contributions

The Ministers' Retirement Plan currently only accepts "pre-tax" contributions. The participant does not pay federal income taxes on contributions made to the Plan, whether the contributions were made by the participant's employer or by the participant through a salary reduction agreement. All taxes are deferred until benefits (distributions) are paid to the participant (or the participant's beneficiary), generally in retirement. In many situations, the taxes paid in retirement will be less than those paid while fully employed.

For ministers, contributions to the Plan, whether made by the employer or through a salary reduction agreement, are not subject to federal income taxes **or** subject to Social Security taxes. If the minister does not pay Social Security taxes on the contributions, they are also not creditable towards his or her Social Security benefits.

For the church-related employee (non-credentialed), contributions made by the employer are not subject to federal income taxes or subject to Social Security taxes. However, contributions made by salary reduction are not subject to federal income taxes *but are* subject to Social Security taxes

State and local taxation issues vary by jurisdiction. You should contact your tax advisor to determine your state and local tax liability on deferred income. It should be noted that several states do not defer state taxation on certain contributions that are considered tax deferred for federal tax purposes. Because of the constant changing of state laws, your local tax advisor should be consulted for advice on state and local taxation issues.

Paying Taxes on Amounts Withdrawn Early from Pension Funds

Some participants question whether they have to include money that is withdrawn early from their pension account as income in the year that it is withdrawn. The answer is simply yes. You must include as a part of your income the total amount of your distribution from the Ministers' Retirement Plan. The Benefits Board has reported to you the exact amount of the distribution on Form 1099-R. You should receive the Form 1099-R in late January following the year of withdrawal.

If you make a lump sum withdrawal prior to age 70½, the Benefits Board is required to withhold 20% as prepayment of taxes. You should include the federal income taxes withheld on the appropriate line of your federal tax return along with any other federal income taxes you paid.

In addition, if you took the distribution before age 59½, you may be required to pay a 10 percent penalty tax on early distributions from qualified retirement plans unless you meet one of the exceptions in IRS Publication 575, *Pension and Annuity Income*. While the 20% tax discussed above counts as prepayment of taxes owed, the 10% penalty tax is just that – a penalty, and does not apply against your tax liability. Due to the almost universal applicability of the 10% "penalty" tax, such should be figured into the realized amount when contemplating an early withdrawal.

Tax Reporting of Retirement Plan Contributions made by Chaplains and Evangelists

Chaplains and evangelists are the only participants in the Ministers' Retirement Plan who can make direct contributions by personal checks to their retirement accounts. All others must make their contributions by salary reduction or by employer contributions by the way of an employer (or church) check. Since the plan is a before-tax, income retirement savings account, in other words a 403(b) account, all contributions must be made by the employer before the money is taxable to the participant. The Plan currently does not take "after-tax" contributions, such as could be made to a Roth-type individual retirement account. Again, the Board can accept personal checks only from chaplains and evangelists.

IRS Publication 571 goes into great detail discussing contributions to a 403(b) retirement account. The publication notes that generally *employer contributions* to your 403(b) account are not reported on the employer-provided W-2 form. Your employer, however, should report *salary reduction* amounts on your W-2 in Box 12 while checking "retirement plan" in Box 13. Again, contributions above and beyond your salary made by the employer (the church) to your account, as noted above, do not have to be reported at all on the W-2.

For evangelists (the IRS calls evangelists "self-employed ministers"), Publication 571 states that you must report your total contributions to your 403(b) plan as a deduction on your tax return by deducting them on line 28 of Form 1040.

On the other hand, Publication 571 notes that chaplains should take a deduction for their contributions by writing "403(b)" on the dotted line next to line 36 and deducting their contributions on that line.

Since lines 28 and 36 are both in the adjustment section of the 1040 tax return, noting the contributions on either line 28 for evangelists or line 36 for chaplains allows the minister to be able to deduct the contributions from his income just as though he were in an employment situation as a pastor or staff member of a church and such was deducted from his W-2 Box 1 income.

Please remember that these special rules only apply to evangelists or chaplains. For more information on this issue, please review IRS Publication 571.

Supplemental Retirement Benefit Program

In 2006, the General Assembly of the Church of God passed a provision providing for a supplemental retirement benefit for senior pastors.

Previously under the denomination's financial structure, 15% of the tithe fund dollars sent to the International Office by a local church was dedicated to the Aged Ministers Fund. Due to an aging group and associated deaths, the participants in that fund are declining rapidly. It is expected that with the current surplus in the Aged Ministers Fund and declining liabilities, the full 15% will not be needed in future years to maintain the stability of the Aged Ministers Fund.

Therefore, the General Assembly-passed provision allows up to 10% of the current allocation to the tithe fund to be re-allocated to the supplemental retirement program with the remaining 5% ultimately being sufficient to fund the liabilities of the Aged Ministers Fund.

To begin the implementation of the new supplemental retirement benefit program, the International Executive Council provided that 1% of the tithe sent to the International Office in Fiscal Year 2007/2008 should go into the supplemental retirement accounts, with that amount potentially scheduled to increase by 1% each year for the next 10 years. Pastors are eligible for the supplemental retirement benefit if "the pastor's and church's reports, with appropriate percentages, are current" for the year. Failure by the senior pastor or his church to report timely jeopardizes this annual supplemental benefit.

On Thursday, September 25, 2008, the first deposits from the supplemental benefits program were made into participant's accounts. While this amount only represents approximately 10% of the benefit that pastors will receive when the program is fully implemented, it was a historic day in that the denomination made a commitment to assist pastors in preparing for retirement.

If senior pastors did not qualify for the supplemental benefit in the first two years, he or she should make a concerted effort to get their reports - and the church reports - in on a timely manner during the church's fiscal year.

The Possibility of Offering ROTH-type Accounts

The Benefits Board is often asked if we have ever considered the possibility of adding a ROTH 403(b) option (the equivalent of a ROTH IRA) to the Ministers' Retirement Plan. In reality, we have been studying such for the last couple of years.

The ROTH option is a great provision for after-tax contributions. However, for most of the Board's ministerial participants, the traditional 403(b) option will always remain the best choice for them. Under the traditional 403(b) plan, ministers can contribute to their retirement account with tax-deferred dollars, taxes on the gain are deferred, and then no taxes are owed on the amounts taken out in distribution if the minister properly designated such as ministerial housing allowance. Therefore, for the majority of our participants, the traditional plan will almost always be a better option than the ROTH plan.

The Benefits Board does recognize that a growing number of our participants are not ministers. For them (i.e. those participants who can not claim the ministerial housing allowance exclusion during distribution), the ROTH becomes a more viable option depending upon the participant's tax situation during the accumulation stage versus that person's tax status during the distribution stage. However, since there are so many unknown variables in making that decision, it is often difficult for a non-minister participant to decide whether it is better to pay taxes on his or her retirement contributions now (i.e. ROTH) or wait and pay taxes as he or she takes distributions in retirement (traditional 403(b) option).

The Board has spent several years working with vendors on a "calculator" that could be used to help participants make that decision. However, due to the many variables that could occur regarding the tax laws over a period of a lifetime, it is extremely challenging to come up with a calculator that considers all the possible options.

However, the Board continues to pursue the possibility of offering a ROTH option in the future. It remains a viable possibility. Although the Board has already modified the plan document to allow us to offer a ROTH option, it is not expected that such will be offered in the immediate future.

Q: ***I have been serving as an evangelist and missionary evangelist for some time now and have made no contributions to my retirement account. I was not aware that I was able to make contributions to my account and now I understand that I may pay in contributions by personal checks. What are my options and what can I do to increase my income for retirement?***

A: As an evangelist, you can make deposits into your account by personal check. IRS Publication 571 (Page 3) goes into great detail on how you (as a self-employed minister, i.e. evangelist) can make contributions to a 403(b) retirement account and how you account for those contributions when you file your tax return. You may access a copy of Publication 571 from the IRS web site (www.irs.gov).

If you are over 50 years of age and/or if you have been in the ministry longer than 15 years, you may contribute not only towards the standard salary reduction contribution limit but you may also contribute towards the "church plan" catch-up provision and/or the "over-50" catch-up provision. The contribution amounts for each of these limits change each year.

You may print copies of MRP Contribution vouchers off our web site (www.benefitsboard.com) to make your contributions.

Q: ***I am a 27 year-old COG-licensed minister with interest in the Minister's Retirement Plan. Is the main difference between the Benefits Board Plan and a Roth IRA the housing exemption for ministers provided by the Plan? Does an IRA provide more flexibility for early withdrawals than the Plan if they are for the purchase of a new home, children's college education, etc.?***

A: The plan offered by the Benefits Board is the Ministers' Retirement Plan (MRP), a church retirement plan created under Section 403(b) of the Internal Revenue Code. The MRP is more in line with a 401(k) plan offered by an employer than an Individual

Retirement Account (IRA) that you create individually. IRAs come in two forms – (1) Traditional IRA – those to which you make contributions with <u>before</u> tax dollars and (2) Roth IRAs – those to which you make contributions with <u>after</u> tax dollars.

So the MRP (before tax contributions) and the Roth IRA (after tax contributions) are really totally different. The MRP is closer aligned with Traditional IRAs – but still there are several huge differences. With IRAs (Roth or Traditional), your annual giving limit is limited to $5,000 (since you are under the age of 50), while your contribution limit to a 401 or 403 employer provided plan is $49,000 in 2010. Further, in a 403 plan, your employer (the Church) and you individually can make contributions to your retirement account while contributions to an IRA (Roth or Traditional) are limited to your "individual" contributions - and employer contributions are not allowed.

Further, as you noted, distributions from your MRP account in retirement can be designated as ministerial housing allowance, subject to you using such for housing, and thus may be tax free. Distributions from a Traditional IRA, on the other hand, will be taxable in retirement – and cannot be designated as housing allowance. While Roth IRA distributions in retirement are generally non taxable, you do have to pay taxes on the money before it goes into the Roth IRA.

With the MRP, as a minister, your contributions and those of the Church go into the plan before taxes; your account grows without tax liability; and in retirement, as much of your distribution that is used for housing is non-taxable. That is a rather nice benefit for ministers.

And the MRP provides as much flexibility as an IRA in terms of withdrawal options, such as for purchasing a home, etc.

Probably the biggest difference between the MRP and an IRA would be the investment selections. Most IRAs offer dozens of investment choices while the Ministers' Retirement Plan only offers four choices. However, statistics show that most investors choose to invest in only two or three options anyway. We feel that our choices are sufficiently broad to allow for solid diversification.

Q: ***After reading information on the Savers Tax Credit, I was wondering what IRS Tax Form you would use to get this credit?***

A: You have to complete IRS Form 8880 - and then put the credit on line 53 of the IRS 1040 form. *(Subject to Congressional approval, this credit may not be available in future years.)*

℘

Q: ***Will our pastor be required to take minimum required distributions (MRD) from his 403(b) at age 70½ or has he been grandfathered because of the age of his contract?***

A: Since the Ministers' Retirement Plan is an "employer" provided plan, he will not have to take MRD at 70½ if he is still working for a church or church-sponsored entity. The IRS says that how he reports to his "overseeing" body determines whether he is retired or not. If he reports he is retired, then he would have to take MRD after 70½. If he reports he is not retired, the MRD are tolled until the April 1 following his actual retirement. We have some who are in their late 70, still contributing, still active, and still tolling the MRD.

℘

Q: ***What are the investment options available to participants in addition to the trustees' fund?***

A: We currently offer three equity accounts (Large Cap, Small Cap, and International) in addition to the Trustees Fund. You can review the performance of each of those funds on our Web site.

℘

Q: ***If I die, does my wife have to withdraw the remaining funds from my Benefits Board account and place those funds in some other deposit since she is not a credentialed minister?***

A: No. Your wife can continue to draw from the account just like you have been doing - or she can start all over with all the options available to her again just like they were to you when you set up the account. Generally, the remaining spouse just continues to draw as before since they have become use to the monthly amount coming in. The only difference is that your spouse will not be able to claim the amount as ministerial housing since she does not have credentials. We feel that she should be able to claim such as housing but the IRS disagrees. So in summary, she can continue to draw, doesn't have to do anything other than give us a copy of your death certificate, but the withdrawals can not be designated as housing since she is not credentialed.

Q: ***Will I get something like a W-2 to report the income that I receive from the Benefits Board each year after I start taking withdrawals?***

A: Yes. You will get a 1099-R from us towards the end of January each year listing your distributions from the previous year. The box "taxable amount not determined" will be checked on the form. That means that the Benefits Board has designated up to 100% of the amount as housing, subject to you using such for housing under the applicable IRS rules and regulations.

Q: ***Will I continue to get statements from the Benefits Board even after I start taking withdrawals?***

A: Yes. You will continue to get quarterly statements from the Board just as you did when you were contributing.

Q: ***If interest rates rise, will those receiving monthly distribution checks get an increase in their retirement checks?***

A: Yes. If rates go up, all those in distributions get an increase. Of course, the same works in reverse – if rates should go down, you would see a decrease.

TAX WITHHOLDING ISSUES

Q: ***If a minister wants to have taxes voluntarily withheld from his paycheck, how does he complete the IRS W-4 form?***

A: I generally lean towards the minister just completing a W-4 and requesting the amount to be withheld in Line 6 - the additional amount line. Attachment G in the Minister's Compensation Manual shows that example. However, since the W-4 is for the employer's use (and only in limited circumstances is ever provided to the IRS), I see no problem in allowing the minister to just list his dependents, etc. on line 5.

The reason that most ministers would want to list the number of dependents on line 5 rather than put an amount on line 6 is that they do not know what their tax liability is or will be. They want you (or someone) to figure it out for them and take it out. They don't want to say take out $100 a pay period and then realize later that $100 was either too much or not enough. They are seeking to take the simple road.

Again, I don't see any problem in allowing the minister to use either line 5 or line 6.

I would note that if the minister chooses to go with line 5 listing of deductions, I would request that he either note on the W-4 that he is "voluntarily requesting withholding" or that he write a letter to the church clerk/bookkeeper voluntarily requesting withholding.

Further, you can withhold additional amounts to cover Social Security liability but on the year-end W-2 all the withholding must be reported under Box 2 tax withholdings. The minister must then use the Form 1040 (Schedule SE) to allocate the amounts to taxes and Social Security when he files his tax return.

Q: ***How do I obtain an employer identification number (EIN) for my church?***

A: To get an employer identification number (EIN), you need to file an IRS SS-4 form. You can now do that on-line, and get an immediate number. To access the on-line EIN application form, you may go directly to the following link at the IRS: http://www.irs.gov/businesses/small/article/0,,id=102767,00.html.

You should remember that the EIN is simply an identification number for your church with the IRS. Further, your EIN number should not be "shared" with another church nor should you be using the state/regional office's EIN. Each church should have their own EIN. It is also important to understand that the EIN is not a tax-exempt number. If your state offers exemption to churches/non-profits from the state's sales taxes, you must obtain a state tax exempt number from the state's Department of Revenue or state Tax Commission. The EIN does not cover the state tax exemption.

CONCLUSION

This manual is not intended to be an all-inclusive tax guide. There are many areas that have not been addressed and many others that have only been mentioned in passing. If you have any questions regarding tax issues on specific matters, you should contact a tax lawyer, a Certified Public Accountant, or some other tax professional. In providing this manual, the Board's desire is to provide general, non-specific information about generic tax issues that ministers, churches, and church-related employees face on a regular basis.

The information in this paper is provided as a service by the Church of God Benefits Board, Inc. For more information, you may contact the Benefits Board as follows:

Benefits Board, Inc.
4205 North Ocoee Street
Post Office Box 4608
Cleveland, Tennessee 37320-4608
(423) 478-7131 local
(877) 478-7190 Toll-free
Web Site: www.benefitsboard.com
E-mail: info@benefitsboard.com

Neither the Board of Trustees nor the staff of the Benefits Board is engaged in rendering financial advice, legal advice, tax advice, or other financial planning services. If such advice is desired or required, the services of a competent professional should be sought.

IRS Circular 230 Notice: *United States Department of the Treasury Regulations require the Board to inform you that to the extent this communication or any attachment or link hereto concerns tax matters, it was not intended nor written to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by United States Internal Revenue Code.*