



Minister's Compensation Manual

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EFFECTIVELY PLANNING A MINISTER'S COMPENSATION

PACKAGE

2015 Edition

Introduction

Minister's Personal Budget

Expenditures

Housing Costs

Parsonage

Housing Allowance

Tax Planning Steps

Tax Reporting

Business Expenses

Mileage

Dues vs. Contributions

Records Required

Creating an Accountable Plan

Tax Reporting

Fringe Benefits

Tax-deferred Retirement Account

Tax Reporting of Retirement Contributions

Health Insurance Assistance

Tax Reporting of Health Insurance Premiums

Health Reimbursement Arrangements (HRA)

Tax Reporting on HRAs

Social Security Reimbursement

Tax Reporting - Social Security Reimbursement

Worksheet on Ministers' Compensation

Reporting Minister's Compensation

Reportable Income for the Minister

Items NOT Considered Reportable Income for Ministers

Completing Form W-2

Summary

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EFFECTIVELY PLANNING A MINISTER'S COMPENSATION PACKAGE

The *Minutes* of the Church of God General Assembly at *Section 68* provide detailed guidance to the local church as to what should be included in the pastor's basic compensation package. The *Minutes* state that the "basic pastoral compensation shall consist of the following based on the availability of appropriate tithe funds in the local church:



1. The compensation as designated for the appropriate membership category in *S69*, entitled *Pastor's Minimum Compensation Scale*.
2. One-half of the pastor's Social Security tax (which is to be reported as taxable income...)
3. Premiums for health insurance coverage (Editor's Note: Such is now taxable income.)
4. Contribution by the local church to the Church of God Ministers' Retirement Plan for the pastor of an amount equal to at least 5 percent of the cash compensation received by the pastor, and
5. Adequate housing accommodations, including utilities."

In the same section, the *Minutes* go on to point out that where funds are not available to meet these minimum compensation requirements, the pastor should receive 90 percent of the gross tithe, and that the church should take up freewill offerings to increase the pastor's compensation to the minimum scale. The *Minutes* also include an encouragement for the local church to provide "automobile travel expense allowances" and other "incentives" to their pastor.

There is absolutely no question about the importance of crafting a well-designed compensation package for the pastor. The labourer is truly worthy of his reward (I Timothy 5:18).

In this manual, there will be no attempt made to cover *all* of the compensation and taxation issues that may arise in dealing with a minister. However, basic guidance will be given so that a compensation package can be created that will provide maximum tax savings for the minister and comply with the directives provided in the Church of God *Minutes* for the local church.

MINISTER'S PERSONAL BUDGET



While it may seem strange to start a discussion about a compensation package with a look at the minister's personal budget, there is really no better starting point or ending point. It is important for the minister (or pastor) to reasonably estimate his expenditures for the month – and year. Without knowing certain expenditures, housing costs in particular, a well-designed compensation package cannot be created.

The *Personal Budget Worksheet* (see Attachment A) provides a basic framework for a minister – or for that matter, anyone else - to create a monthly budget. It has been said that balancing your budget gets worse each year. It seems as though you cannot balance your net income with your gross spending habits.

A person has only two options when it comes to having a “balanced” budget – either increase income or decrease expenditures. Simply put, you cannot plan a trip without knowing two things: where you are and where you are going. The same applies to your finances. Without getting a second job, it is extremely difficult to increase your income in the ministry, especially if you are a pastor. This is true for most professionals. Therefore, the only options become reducing your expenditures or better planning your compensation package. Since increasing income is probably not an option, decreasing expenditures must be the first avenue approached.

EXPENDITURES

Housing Costs

The largest expenditure in the average household is on housing costs, whether the costs are from owning the home or renting. Generally, 25% to 55% of a household’s income is spent on providing the house and utilities. When asked how much they spend on housing, most people would say around 25% of their gross income. However, when they combine utilities and other maintenance and upkeep associated with the house, the figure begins to approach 50% of their “take home” pay. That figure is generally surprising to most.

Ministers are unique when it comes to housing costs. The costs are still the same but the way that they deal with such for tax purposes is extremely different.

Parsonage

Up until the last 20 or so years, most churches provided a parsonage for their pastor on or near the property where the church facilities were located. In the mid-1980’s, the ministerial housing allowance became more popular and many parsonages were sold or converted into other church meeting rooms.



There are both positives and negatives in regards to a church maintaining a parsonage. On the positive side, a parsonage is an attractive proposition for a young minister that does not have the resources to put towards a down payment on his own home. A parsonage also is a ready-made home, usually containing church owned furnishings, that is available immediately for occupancy by the new pastor. Parsonages are also generally in close proximity to the church, allowing the pastor to have immediate access to the church facilities for his use. In a volatile housing market, a parsonage becomes a huge asset for a church in attracting a suitable pastor. Not to be forgotten, but since the church owns the house, they are responsible for all maintenance and repairs. So when the roof leaks, it is the church’s responsibility.

On the negative side, the church owns the parsonage. Such ownership cannot only be a source of irritation for the pastor and his family, but it also prohibits the pastor from building equity in a home. Any increase in value to the home, even though it may occur due to the efforts of the pastor, inure to the benefit of the local church rather than the pastor. Some churches have created “equity housing allowances” for their pastor when he lives in a church-owned parsonage to offset the equity that he might have gained from owning his own home. Generally, these “equity housing allowances” are taxable to the minister. To offset the taxable nature of the “equity housing allowances,” instead of providing such an allowance, some churches maximize their contribution to the minister’s tax-deferred retirement account.

Even if the church provides a parsonage for the minister, the church should establish a “parsonage allowance” to cover incidental costs that may occur in the normal course of the minister living in the house.

Most church leaders contend that parsonages are “horse and buggy.” However, there is still a valid reason for many churches to maintain parsonages. If a church is in a remote area, or contrastingly in a very urbanized area, a parsonage may be vital in attracting a pastor.

For tax purposes, it should be remembered that the annual rental value of living in the parsonage is not considered as income to the minister for federal income tax purposes but is taxable for self-employment taxes (Social Security/Medicare).

Housing Allowance

Where a church has no parsonage, generally the church seeks to provide for the housing needs of the pastor by giving him a “ministerial housing allowance” so that he may secure his own home, either by renting or owning. Again, housing allowances have become extremely popular over the past few years as churches have sought to shed the burden of providing a self-contained house for their pastor. If properly documented, the amount a church provides to a minister (either the senior pastor or any other credentialed minister) for housing allowance is non-taxable for federal income tax purposes but is taxable for Social Security purposes.

The Ministerial Housing Allowance has been the subject of much controversy over the past few years and has even been challenged on constitutional grounds of violation of church and state (*see next article*). In 2002 the Clergy Housing Allowance Clarification Act of 2002 (Public Law 107-181) was enacted to bring some clarification to this issue. The law basically provides that the ministerial housing allowance exclusion 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 church as a housing allowance;
- whichever is less.***

Simply put, in looking at the three qualifiers above, you must use the least of the three. 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.*

It is the responsibility of the church to establish the amount of the housing allowance in cooperation with the minister based on his or her actual housing expenses. The church in conference or by the Pastor's Council should set that amount each year. In determining his housing allowance, the minister may include (but is not limited to) the following expenses:

- Mortgage payments/rent
- Property taxes
- Homeowners insurance
- Furniture, appliances, etc.
- Decorating/carpet/lamps
- Repairs and upkeep
- Improvements
- Utilities/basic cable TV
- Lawn care, snow removal, shrubbery

To accurately report his expenses to the local church body, the minister should complete an *Estimate of Housing Allowance* form (see Attachment B) and submit the same to the governing body of the church for adoption prior to any designation of housing allowance being made. In other words, the church's governing body has to adopt the housing allowance before the minister can claim such. A housing allowance cannot be made retroactively.

Court Hears Arguments on Constitutionality of Ministerial Housing Allowance

In a decision issued on Nov. 21, 2013, Federal District Court Judge Barbara Crabb of Wisconsin struck down a law that allows ministers a tax-free housing allowance. Judge Crabb wrote that the housing allowance provision for ministers “provides a benefit to religious persons and no one else, even though doing so is not necessary to alleviate a special burden on religious exercise.”

However, the appellate court, the Seventh Circuit Court of Appeals in Chicago, issued a ruling on Nov. 12, 2014 that brought an end to the suit. The appellate court dismissed the suit on grounds that the plaintiffs, two executives with the Freedom From Religion Foundation (FFRF) – a group of atheists and agnostics, did not have the legal authority, or “standing,” to bring the lawsuit. The appellate court was very clear that the suit was being dismissed on a technicality and therefore, the court did not reach the issue of the constitutionality of the parsonage exemption or the ministerial housing allowance found in Section 107 of the Tax Code.

The ministerial housing allowance provision, commonly known as Section 107 and included in the tax code since 1954, has been under attack as providing a special benefit to ministers that is not available to other taxpayers. Section 107 allows ministers to have a portion of their income

designated as tax-free housing allowance or live in a parsonage without having to pay taxes on the fair rental value of the parsonage.

Under Section 107, active credentialed ministers are able to have a portion of their ministerial compensation designated as tax-free housing allowance. Further, retired ministers who participated in their church-sponsored pension plans, like the Church of God's Ministers' Retirement Plan, can have some or all of their retirement distributions designated as ministerial housing allowance as well.

The plaintiffs in the lawsuit contended that the housing allowance provision granted ministers an unfair benefit that violated the U.S. Constitution. In the lower court ruling, Judge Crabb noted that a lot of tax revenue was a stake. The tax savings to ministers over a five year period of time was estimated to be more than \$2.3 billion.

It is anticipated that the plaintiffs from the Freedom From Religion Foundation will seek to file a new action to challenge the ministerial housing allowance in the near future. Since the dismissal was only on grounds of a technicality, another suit on constitutional grounds could be filed prior to the end of 2015.

Reporting Housing Allowance

As mentioned earlier, if properly set up the housing allowance is non-taxable for federal income tax purposes but is taxable for Social Security purposes for the minister. There are three basic ways that the housing allowance is handled for tax purposes:

Actual Exclusion Method – (Best, most accurate, most difficult, but preferred method by the IRS)

- a. Minister provides estimate for next year's housing expenses
- b. Church designates a housing allowance.
- c. Minister substantiates actual housing expenses.
- d. Church computes actual housing allowance exclusion.
- e. Minister's W-2 is reduced by the actual exclusion.

Estimated Exclusion Method

- a. Minister provides estimate of next year's housing expenses
- b. Church designates a housing allowance.
- c. Minister's W-2 reduced by church-designated housing allowance.
- d. Minister reports any "excess housing allowance" as taxable income.

Non-accountable Method – (Though probably the most common method, this is the least desirable and least accurate method)

- a. Minister requests housing allowance with no estimate of housing expenses.
- b. Church designates a housing allowance.
- c. Minister's W-2 reduced by church-designated housing allowance.
- d. Minister reports any "excess housing allowance" as taxable.



The Actual Exclusion Method is the most difficult because it requires the minister to have all his housing receipts in to his local church's treasurer before the end of January following the year in which the expenses were incurred so that his IRS Form W-2 may be reduced by the actual amount used for housing, as long as such is under the limit set by the church and does not exceed

fair rental value. The “actual” method also creates problems because it places the church treasurer in the position of determining whether or not an expenditure actually qualifies as a legitimate housing cost. While the IRS would prefer that the “actual” exclusion method be used, their examples primarily use the “estimated” exclusion method. Generally, the estimated exclusion method is going to be the best way for the church and the pastor to deal with reporting his housing allowance. The non-accountable method is just that – non-accountable. It should not be used under any circumstances, simply because it places the amount that the minister receives as housing subject to tax liability.

Tax Planning Steps

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 (See Attachment B).
- 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. For 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 (for example) 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. These limitations are included in the *Exclusion Worksheet* (see Attachment C).
- The minister must pay federal income taxes on any “excess housing allowance.” On the dotted line next to Line 7 (IRS Form 1040), enter “Excess Allowance” and the amount.
- The minister must pay self-employment tax (Social Security and Medicare) on the entirety of the housing allowance.
- A housing allowance provision has to be adopted by the church before the minister can claim such. Further, 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.

Tax Reporting

As noted, the housing allowance is not included in income for federal income tax purposes but is taxable for Social Security purposes. Therefore, it is recommended that the ministerial housing allowance be reported on the minister’s Form W-2. IRS instructions for the Form W-2 notes that the ministerial housing allowance may be reported in Box 14 of the minister’s W-2. 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.” However, the ministerial housing allowance is **not** included in Box 1 on the Form W-2.

Business Expenses

Business expenses place more ministers in the “cross hairs” of the Internal Revenue Service than any other issue. Claiming excessive business mileage is probably the number one reason that ministers are audited.

Since most ministers (especially those in a pastoral role) are W-2 employees, they can claim expenses on Schedule A if the expenses were unreimbursed or if they were “nonaccountable” reimbursed business expenses. However, a great audit risk is created by ministers claiming to be self-employed so that they can file Schedule C and get a direct deduction, rather than filing as an employee and being limited by the 2% floor used on Schedule A (no deduction for unreimbursed or nonaccountable business expenses can be taken on Schedule A unless those expenses exceed 2% of your adjusted gross income.)



To avoid both the Schedule C audit problem and the floor provided in Schedule A, the church should adopt an “accountable plan” for their minister. Simply put, under an accountable plan the minister accounts for his business expenses to the local church entity and they reimburse him for those business expenses. To have an accountable plan, the governing body of the church must approve and adopt the “accountable plan” prior to the minister submitting expenses. 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).

Expenses covered under an accountable plan would include auto expenses, entertainment, conventions and conferences, professional books and magazines, travel expenses (air, motel,

etc), and a variety of other expenses incurred in the regular course of the minister carrying out his duties.

Usually, churches will adopt an accountable plan that provides full reimbursement for all professional business expenses or provides reimbursement up to a specified annual limit. Even if a limit is placed on the accountable reimbursement account, it should be viewed as an annual limit. It is also better not to break down the different categories of the limit, such as so much for mileage, so much for conventions, etc. An overall limit works best. For example, assume that the church sets an accountable reimbursement limit of \$500 a month. That amount should be considered as an overall amount, with the minister submitting receipts to show how the money was spent that month. In one month, mileage may be a big factor while travel may be the overriding factor in another month. The annual limit allows for those deviations and also allows the pastor to spend \$1000 in one month to attend a convention while only spending \$200 or so in other months. Again, the monthly limits can be used for the local church to track the budgetary impact but the \$500 a month used in the example should be viewed as a \$6,000 annual limit. An estimate of accountable reimbursement expenses is helpful for planning purposes. The *Estimate of Accountable Reimbursement Expenses* form allows for such planning (see Attachment D).

If the accountable plan meets all the requirements of the IRS regulations as set out earlier, the amounts paid under the arrangement are excluded from the minister's gross income and are not required to be reported on his Form W-2. On the other hand, if the plan does not meet IRS standards, then the payments are included as gross wages and are taxable.

The IRS makes very clear that a salary reduction arrangement which "reimburses" the minister for business expenses by reducing his salary does not qualify as an accountable plan. They apply this rule whether the amount varies by pay period or is a specific amount. As long as the minister is entitled to receive the full amount of annual compensation, regardless of whether or not business expenses are incurred during the year, the arrangement does not meet the "accountable plan" provisions.

Mileage



Documentation of expenses is vital to an acceptable accountable reimbursement plan. As earlier mentioned, 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 business 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.

Effective January 1, 2015, the standard mileage rate for the use of a car for business purposes is **57.5 cents a mile** for all business miles driven.

Dues vs. Contributions

Some ministers contend that since they are “required” to pay tithe, that such amounts to “dues,” and therefore should be deductible as a business expense. The IRS clearly refutes this effort at tax evasion. Tithes for a minister are treated just like anyone else that pays tithes – they are a charitable contribution that can be deducted on Schedule A.



Records Required

The Internal Revenue Services requires that any expenditure over \$75 included in an accountable reimbursement plan must be documented by a receipt. However, the local church can require receipts for a lesser amount if they so desire. The best policy is to require receipts for **all** expenditures except for incidental expenses such as tolls.

It is important to note that a credit card bill is not a sufficient receipt. The actual receipt from the point of transaction must be used and not the monthly statement from American Express, VISA, etc.

Creating an Accountable Plan



The following steps should be taken to create 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 (for example) 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.”

This resolution should be 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* (see Attachment E) 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.

A historical note is in order at this point in relationship to compensation paid to Church of God ministers. Prior to General Assembly action in 1992, the Church of God salary structure was divided into two separate categories – salary and expenses. Basically, the *Minutes* assumed that every pastor in the same category incurred the same expenses on a weekly basis. The Internal Revenue Service raised questions about this structure on two major grounds. First, they contended that a blanket designation of expenses was incorrect because some ministers may have more expenses than others. For example, a minister pastoring a rural church would generally incur more mileage expenses than a pastor in a “city” church. Second, under the approach taken in the *Minutes*, the IRS correctly pointed out that the pastor was not required to “account” for his expenses. The *Minutes* had just assumed that he had such expenses – and therefore had designated such. The IRS basically advised the church that such created a “non-accountable” reimbursement plan and that they would more than likely rule that the expense designation was income – and therefore taxable to the minister.

To deal with this issue, the 1992 General Assembly combined the two (salary and expenses) into what is now know as the “minimum compensation scale.” Based upon interviews with those that were involved in this proposal, it was the intention of the General Assembly to create one big

“pot” that the minister could use in setting up an accountable plan. If he could justify more expenses, then he could have more of his weekly “compensation” designated as expenses, thereby reducing his tax burden.

For example, let us assume that a pastor is entitled to minimum compensation of \$675.00 per week using the compensation scale – or \$35,100.00 per year. Using the *Estimate of Accountable Reimbursement Expenses Form* (see Attachment D), the minister estimates that his weekly expenses will be \$150.00 (\$7,800.00 per year). Under the approach as adopted by the 1992 General Assembly – and that continues in the most current *Minutes*, the church governing body (either the Council or the church as a whole) should designate \$7,800.00 as an accountable reimbursement plan and designate \$27,300.00 as salary. If the minister substantiates, documents, and reports expenses up to \$7,800, that amount would not be taxable. The remainder (\$27,300) would be taxable income to the minister.

This process differs from salary reduction. Under this type of arrangement, the “total” compensation scale is used to determine what expenses, if any, the minister will incur. In addition, an amount is set in advance as to how much is expenses and how much is “taxable salary.” Again, from a historical review, it was anticipated that the “minimum compensation scale” would cover *both* taxable compensation **and** expenses. This is made evident by the list of elements that are included in the basic compensation package of the pastor as found in Section 68 of the *Minutes*.

Some pastors contend that expenses are *in addition to* the “minimum compensation scale” found in Section 69 of the *Minutes*. These ministers use paragraph III of Section 68 to justify their position: “Therefore, all churches are encouraged to provide automobile travel expense allowances and to provide incentives such as higher percentages of retirement, annuity, and insurance plans, and so forth, based on increases in finances, pastoral responsibility, pastoral effectiveness, and longevity.” If the local church is financially able to provide the minimum compensation scale as taxable income **plus** an accountable expense allowance in addition, that would be a wonderful blessing to the pastor. However, the “minimum” income for the pastor should be the compensation scale contained in Section 69 of the *Minutes*, which would include his accountable reimbursable expenses and his taxable income.



From a church bookkeeping standpoint, the local church does not have to cut the pastor a separate check each week for expenses. He can be given one check that includes his taxable compensation, his accountable reimbursement expense funds, his housing allowance, and any other compensation or reimbursement for which he is entitled. Those differences can be noted in the ledger – and should be dealt with on the minister’s Form W-2 as well.

It must be remembered that any amounts paid under a valid accountable plan is not considered income to the minister and does not appear on his Form W-2.

Any amounts in excess of those to cover substantiated expenses must be returned to the church. For example, at the end of the year the minister has documented and substantiated expenses to the church treasurer of \$5,500. However, each month he has received \$500 for expenses from the church in advance – or \$6,000 for the year. The minister must return the \$500 difference to the church or the plan is deemed by the IRS to be a nonaccountable plan. Even if the church decides

to give the \$500 to the pastor as a gift, the IRS suggests that it must be returned by the minister to show a paper trail that the accountable plan is separate from the gift. Of course, if the \$500 is given as a gift, it becomes taxable to the minister as income.

A valid accountable plan for business expenses is as important as having a housing resolution in place. If an accountable plan is not provided for the minister, it is almost a certainty that the minister will pay too much in income taxes.

Tax Reporting

If an accountable reimbursement plan is set up properly, any amounts paid to the minister under the plan do not appear on his Form W-2, nor does the minister have to claim these expenses as a deduction. On the other hand, if the minister does not have an accountable reimbursement plan that was adopted by the church, all funds paid to the minister as reimbursement for expenses are treated as ordinary income – and are included as compensation in Box 1 on the minister's Form W-2.



Fringe Benefits

A key component of a minister's compensation package involves "fringe benefits." Usually by the time the minister and the church get the housing allowance and the accountable expense plan worked out, they have little or no energy left to deal with any other aspects of the compensation package. Not creating a fringe benefits package can be devastating to the minister in the long run. The fringe benefits package can contain many different elements but most often deals with retirement accounts, health insurance, and reimbursement of half of the minister's Social Security payments.

Tax-deferred Retirement Account

As cited above, the *Minutes* of the Church of God General Assembly states that the local church should make contributions "to the Church of God Ministers' Retirement Plan for the pastor of an amount equal to at least 5 percent of the cash compensation received by the pastor." The Ministers' Retirement Plan is a 403(b)(9) retirement plan set up under the auspices of the Internal Revenue Service. The Ministers' Retirement Plan, or MRP, is administered for the Church of God by the Benefits Board, Inc. The MRP operates almost identically to a 401(k) plan.

In 2015, the regular contribution limit to the Ministers' Retirement Plan is \$53,000 or the amount of the minister's (or church-related employees') taxable ministerial income, *whichever is less*. Of that amount, no more than \$18,000 in 2015 can be contributed by salary reduction. The remainder of the limit must come from the church's contribution.

In addition to the regular contribution limit, anyone that is 50 years of age or older during 2015 can contribute an additional \$6,000 for the year, either through salary reduction or by the employer, as a catch-up contribution.

A second addition applies to those who have been in the ministry or have worked for a church-related organization for 15 years or more – commonly called the “church plan catch-up.” This catch-up provision allows those individuals that qualify to contribute an additional \$3,000 per year, either through salary reduction or by employer contribution, as church plan catch-up. This catch-up provision is capped at a lifetime maximum of \$15,000.

As ministers approach the retirement years, they become much more interested in preparing for retirement. However, then it is often too late to save enough to provide for the standard of living that they desire in retirement. Therefore, planning for retirement is important for ministers of all ages. Money saved in a retirement account as a young person has many more opportunities to compound than money saved in the last few years of a person’s working career.

While a young minister may not see a retirement account as a valuable fringe benefit, it should be included in his package at least at the five percent level recommended by the *Minutes*. A more reasonable figure would be to set aside 10% of the minister’s cash compensation for contribution to the Ministers’ Retirement Plan. The church should take the position that they are not only providing for the minister now – but also in his retirement years.

If the church includes payments to the Ministers’ Retirement Plan in their compensation package, a resolution should be entered on the local church records to memorialize such.

It should be noted that the Ministers’ Retirement Plan is the only tax-deferred plan recognized by the Church of God, and therefore, the only retirement plan that a church can make contributions to on behalf of a minister.

Tax Reporting of Retirement Plan Contributions

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."

As an additional note, it should be pointed out 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.

Health Insurance

The cost of health insurance for all Americans has become outrageous. Recognizing the need for health insurance, the *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 that have been in effect for more than fifty years prior to 2014, payments by the church directly to the insurance carrier or to the minister based upon substantiation of the health care costs **were** considered to be a tax-free benefit to the minister. If such payments were not made by the church and the minister had to pay his own health insurance premiums, he could only claim such on Schedule A of the 1040 tax form – and the minister could only get a deduction if those expenses exceed 10% of his adjusted gross income.

However, the Affordable Care Act (often called the “ACA” or “ObamaCare”) changed this process by 1) making payments made by the church towards individual health insurance premiums taxable and 2) prohibiting the reimbursement of such premiums by the church. See the following article on these specific topics.

No REIMBURSEMENT of Certain Health Insurance Policies with Pre-Tax or After-Tax Dollars

While most churches thought that they were exempt from the major impacts of the Affordable Care Act (often called “ACA” or “ObamaCare”), a seemingly innocuous Internal Revenue Service notice, issued in September 2013, has been interpreted to place many churches and businesses in the crossfire of the Affordable Care Act.

According to IRS Notice 2013-54, employers may no longer reimburse employees for, or directly pay, the cost of *individual* health insurance policy premiums and exclude such amounts from the employee's gross income. Effective January 1, 2014, these “employer payment plans” must be paid with “after tax” dollars, rather than with “pre-tax” dollars, and cannot be a “reimbursement.” The employer is only allowed to use “pre-tax” dollars to pay for health insurance premiums if the employer offers a *group* health insurance plan.

Further, [more recent guidance](#) suggested that “reimbursement” by an employer of an *individual* health insurance policy premium creates a non-compliant health care plan under the Affordable Care Act – and therefore subjects the employer to a **\$100 per day penalty**, per employee. According to this recent guidance, an employer/church who reimburses a pastor or staff member for their individual health insurance policy premium, *even if such is subject to taxes*, has violated the Affordable Care Act and is subject to \$36,500 a year in penalties, per employee.

While an employer/church can increase an employee's salary to cover the costs of that employee's individual insurance policy – and can even increase the amount to cover additional taxes, it should not be deemed as reimbursement of the employee's individual health insurance policy premiums, nor should the employer/church request verification of the insurance premium costs. If the insurance premium notice is requested or provided, the U.S. Department of Labor's recent guidance suggests that such creates a non-compliant group health plan and triggers the penalties mentioned above.

Since an IRS revenue ruling in 1961, churches and businesses have been able to structure compensation plans where employees could obtain their own individual health care plan, provide documentation and substantiation of such to the employer, and the employer could reimburse the employee for, or directly pay, the cost of the individual health insurance policy premiums and such amounts were excluded from the employee's gross income. Under IRS Notice 2013-54, the Affordable Care Act no longer allows such an arrangement to occur with pre-tax dollars or even with after-tax dollars if such is deemed reimbursement. An employer can still withhold funds and transmit those to pay the premiums on the individual health insurance policy, as a convenience to the employee, but the amounts must come from after-tax funds and cannot be reimbursements.

Consider the following examples:

- 1.) A local church agrees to pay a pastor \$40,000 a year salary, plus pay another \$10,000 a year towards the pastor's individual health insurance premium. According to IRS Notice 2013-54, the pastor would have taxable income of \$50,000 in the year in question. It should be noted that the amount designated for insurance must be taxed whether the pastor has secured the health insurance independently or through the government-operated Health Care Exchange. Further, the pastor should not submit nor should the church require documentation of the pastor's individual health insurance premium costs.
- 2.) A pastor's wife has health insurance through a *group* plan at her employment and her company pays the entirety of her premium. Such amounts paid by her company are not taxable income to her since she is covered by a *group* plan that meets the requirements of the Affordable Care Act. In addition, her company offers full family coverage but the employee must pay the difference between the company provided employee group coverage and the family coverage premium. If the pastor's church offers to pay the additional \$500 per month to cover the pastor and the pastor's children, the \$500 per month is taxable income to the pastor. If documentation of the costs is requested or submitted, the church may be subject to the penalties discussed earlier.

As noted above, IRS Notice 2013-54 took effect January 1, 2014. Therefore, any additional amounts paid by a church to a pastor or staff member for that person's individual health insurance plan must be treated as taxable income. Treating such amounts as taxable income means that the amounts are subject to federal income taxes, state income taxes, and self-employment taxes (Social Security and Medicare taxes). Using example one above, and assuming a 20% federal income tax bracket, the pastor would be subject to federal income taxes of \$2,000, plus SECA taxes of \$1,530, as well as any state income taxes.

Because the Affordable Care Act has converted the policy premium payments from pre-tax to after-tax funds for individual health insurance plans, the self-employed minister stands to lose forty or so percent of this benefit that was previously considered a fringe benefit, assuming state taxes are due.

While these rules are currently in place and effective, the conversations with Congress, the U.S. Department of Treasury, the U.S. Department of Labor, and the Internal Revenue Service have continued as we have tried to eliminate this onerous burden created by the Affordable Care Act. However, those efforts have been unsuccessful, and in fact, the most recent guidance has made the impact of the Act even more challenging. The Internal Revenue Service continues to contend that the new procedure is necessary to prevent "double dipping" from a person receiving

insurance premiums paid with pre-tax dollars and additionally the new “premium tax credit” available under the Affordable Care Act.

Therefore, the bottom line is that churches may no longer reimburse employees for, or directly pay, the cost of *individual* health insurance policy premiums with either pre-tax or after-tax dollars. If the church wants to assist a pastor or staff member in paying for their individual health insurance policy costs, the church may raise the person’s salary, the church may not request or receive documentation of the premium costs, and the church must include such additional compensation in the employee’s gross income.

Health Insurance Now

In the *Minutes* previously discussed, churches are encouraged to pay the entire premium for the minister’s health insurance. While the Affordable Care Act now prohibits the church from making such payments directly or reimbursing the pastor for such, the church may still increase the pastor’s salary with an additional amount to provide “assistance” to him in securing insurance. However, if the resources are not available in the local church to increase the pastor’s salary to cover all his insurance costs, the church should consider increasing the pastor’s salary as much as possible to assist him in providing insurance for the pastor and his family.

While the church may take into consideration the pastor’s insurance costs in setting his total compensation, the church should not seek documentation from the pastor of those costs nor should the pastor provide to the church documentation of those costs. As with any salary increase, a resolution should be entered on the local church records to memorialize such, but such should only state, at the most, that the pastor’s salary is being increased to “assist” him and his family in obtaining health insurance. There should be absolutely no mention of reimbursement of health insurance premiums.

Medical expenses of the pastor may be deductible on Schedule A as an itemized deduction. Of course, medical expenses that are reimbursed under a health insurance plan cannot be deducted as medical expenses on an individual’s tax return.



Tax Reporting of Health Insurance Premiums

Simply put, the payment of health insurance premiums for the minister under an *individual* policy are now completely taxable – and therefore must be included as a part of Box 1 income on the minister’s IRS Form W-2. Only premium payments made towards a *group* health insurance plan can still be made with pre-tax dollars and considered as a fringe benefit.

Health Reimbursement Arrangements

Even under the best insurance plans, there are going to be some charges not covered either because they do not fall under the coverage of the policy or because they are subject to a deductible or a co-payment provision in the insurance policy. These costs can be substantial after a major surgery or dental procedure. While medical costs can be claimed on Schedule A, only the amount that exceeds 10% of the minister's adjusted gross income actually becomes a deduction. Therefore, these costs come out of the pocket of the minister.

To fill this void on unreimbursed expenses, some churches have set up Health Reimbursement Arrangements (HRA) as a fringe benefit to provide assistance to their employees who fall in this gap. HRA are a technical creation of the IRS and are set up under Section 105(b) of the Internal Revenue Code. Professional assistance from a CPA or an attorney is not only advisable but is critical in creating such a plan. The *Zondervan Minister's Tax & Financial Guide* by Dan Busby is an informative source of information on health reimbursement arrangements.

As a general rule now under the Affordable Care Act, employer/churches may **only** offer a Health Reimbursement Arrangement if the HRA is integrated with a *group* health insurance plan (and not with *individual* insurance plans). Further, a valid HRA requires a written plan or procedures manual, all employees must be allowed to participate in such (not just the pastor if there are other employees, although it seems probable that a distinction could be made between full and part-time employees), the HRA must provide a maximum dollar amount of coverage (for example, \$2,500 a year), the church/employer must fund the HRA and not the employee through salary reduction, and the plan document may allow for money not used in one year to carry forward to the next. However, if a person has the right to receive cash under the plan without such being a reimbursement, the entire HRA is disqualified and all benefits paid out of such becomes taxable.

HRAs offer additional benefits in that they can be used to reimburse expenses not normally covered under health insurance policies, such as laser eye surgery, chiropractic care, or the extra cost of a private hospital room.

While a Health Reimbursement Arrangement is not for every minister or every church, if the church has a *group* health insurance plan, it is a fringe benefit that can be of great benefit to a minister and other church-related employees.

Tax Reporting on Health Reimbursement Arrangements

If the Health Reimbursement Arrangement is properly created and administered in conjunction with a *group* health insurance plan, reimbursements from such are not considered wages for federal income tax purposes or for Social Security purposes. Therefore, such do not appear on the minister's IRS Form W-2.

Health Savings Accounts

If you have a high-deductible health insurance plan (HDHP), the Tax Code allows you to have a Health Savings Account (or “HSA”). Funds placed into a HSA can come from the employee and/or the employer (while contributions to the Health Reimbursement Arrangements discussed above come solely from the employer). Funds contributed to an HSA are made with pre-tax dollars and further, there are no taxes owed when the funds are spent, as long as they are spent on qualified health expenses that appear on the IRS approved list.

If Health Savings Account funds are spent on non-approved items, you are not only responsible for the tax on the amount spent but you will be subject to a 20% penalty as well.

While a Health Savings Account can only be used by those ministers with a high-deductible health insurance plan, the accounts can be a substantial benefit.

Tax Reporting on Health Savings Account

If paired with a high-deductible health insurance plan, and if expenditures from such are made on qualified health expenses, the contributions to an HSA and the payments from such are made without tax consequences. However, it should be noted that there is a tax reporting of Health Savings Account – and such accounts should be set up with assistance from a reputable provider.

Social Security Reimbursement

As mentioned earlier in our analysis, a minister has a dual tax status: he is an employee for federal income tax purposes but he is self-employed for Social Security purposes. Further discussion on this issue is found elsewhere in this document. Due to the minister’s status as self-employed for Social Security purposes, he is required to pay the self-employment Social Security tax of 15.3% on his wages. In a regular employment relationship, the employer would pay half (7.65%) and the employee would pay half (7.65%) through withholdings.

Recognizing the inequity of the dual tax status, the *Minutes* of the Church of God General Assembly encourages the local church to pay at least “one-half of the pastor’s Social Security tax.” These payments basically put the minister in the same position as any other employee. There is one exception – the payments are taxable for income and Social Security tax purposes whether they are paid directly to the minister or to the Internal Revenue Service. Therefore, an allowance to cover half of the minister’s self employment Social Security tax provides absolutely no tax benefit since the amount is fully taxable. However, paying at least a portion of the minister’s Social Security tax is important so this amount can be properly shown as a fringe benefit for compensation analysis purposes.

Tax Reporting on Social Security Reimbursement

Any payments made by the church for reimbursement of any portion of the minister’s Social Security tax liability, whether they are paid directly to the minister or to the IRS,

are taxable for federal income tax purposes and Social Security tax purposes. Although such payments are considered a “fringe benefit,” they are included in the minister’s taxable compensation. Therefore, they are included in Box 1 income on the minister’s IRS Form W-2.

WORKSHEET ON MINISTER’S COMPENSATION

The entire discussion on minister’s compensation began with a discussion of the minister’s personal budget. A good compensation package from the employer/church should also benefit the minister on his personal budgeting. The minister’s entire compensation can be summarized on one form – the *Worksheet for Minister’s Compensation* (see Attachment F). By using this simple form, the minister can determine quickly and accurately what his tax liability will be for the year. This information is absolutely essential for the minister who files estimated tax payments quarterly.

The first part of the *Worksheet on Minister’s Compensation* includes all that goes into a compensation package – salary, parsonage or housing allotment, accountable reimbursements, and other fringe benefits. The total derived here determines exactly how much it will cost the employer/church to have the minister on staff. This number is essential to the church in planning and budgeting for a new year.



The second part of the *Worksheet on Minister’s Compensation* allows the minister to determine how much of his compensation package will be taxable. While this information is not as important to the employer/church, it is vitally important to the minister as he tries to insure that he is meeting his tax liability obligations. Also, this analysis allows the minister to determine what amounts he can contribute to his retirement plan through a salary reduction agreement.

REPORTING MINISTER’S COMPENSATION

As previously noted, most ministers are employees of the church for federal income tax purposes. However, the Internal Revenue Code places the pastor and other ministerial staff in a “dual tax status”. This dual status means that while the pastor and other ministers are employees for income tax purposes, they are self-employed for Social Security tax purposes with respect to ministerial income. This dual tax status creates a unique tax withholding or payment situation for ministers.

According to the Internal Revenue Code [IRC 3401(a)(9)], it is unlawful for a church to withhold income tax or FICA taxes on a minister. However, the minister can voluntarily have the employer/church withhold income taxes. In addition, due to the minister’s status as self-employed for Social Security purposes, he does not pay FICA taxes – but rather pays self-employment taxes (or SECA taxes).

The employer/church **does not** withhold self-employment taxes (SECA) from the minister's salary. The minister is responsible for the payment of these taxes on a quarterly basis. However, the minister may voluntarily have the church withhold extra income taxes to cover the amount owed for self-employment taxes. Entering into a voluntary agreement with the church to withhold income taxes, and an additional amount for self-employment taxes, is by far the easiest way for the minister to meet his tax liability obligations. IRS Form W-4 can be used for this purpose (*see Attachment G*). A minister can simply complete lines 1 through 3, and then complete line 6 to show the voluntary amount that he would like withheld.

For Social Security purposes, self-employment earnings include pastoral salary, the fair rental value of a parsonage or a housing allowance, Social Security reimbursement, and business expenses (except where the church has an "accountable reimbursement" plan in place for business expenses). The current rate for self-employment taxes is 15.3%. The self-employment tax is computed by using IRS Form 1040 Schedule SE.

Due to the minister's status as an employee of the church, he should receive a Form W-2 each year before February 1 to reflect his wages for the previous year (*see Attachment H*). Non-employees of the employer/church should receive a Form 1099 Misc. if they received income in excess of \$600 during the year (*see Attachment I*). Evangelist should receive a Form 1099, rather than a Form W-2. It should be noted that a church does not have to provide an incorporated ministry (Phil Pulpit Evangelistic Ministries, Inc.) with a Form 1099 if the revival receipts/love offerings were made payable to that incorporated ministry. **NOTE:** Based upon an IRS proposal, all Form 1099 rules are scheduled to change. Information on these changes will be forthcoming from the Internal Revenue Service once Congress adopts such.

Reportable Income for the Minister

Ministers and churches often find it difficult to determine or agree upon what is or is not reportable income for the minister.

Simply put, it is unlawful for a minister (or anyone else) to try to "hide" income by calling it something else. The following are clearly income to a minister:

- salary
- bonuses
- Additional salary payments to assist in payment of health insurance costs
- love offerings (Christmas or Pastor's Appreciation offerings from the church)
- gifts that are run through the church for tax credit
- trips given to the pastor as a gift (i.e. Holy land trips)
- Social Security paid by the church for the minister
- business expense reimbursement under a *non-accountable* plan

- Personal use of church-provided automobile, and
- honoraria given for weddings and funerals (*list is not inclusive*)

While this is not an exhaustive list, it provides a good framework for the employer/church to determine what items should be included on the minister's W-2 form. Suffice it to say, the IRS will scrutinize the minister's income very carefully should he or she be audited. Good records are essential for preventing penalties and interest on unpaid taxes from unreported income.



A simple rule of thumb is if a person has reason to believe that they can claim their gift as a charitable deduction, it is taxable to the recipient. In times past, a person who gave the minister a \$20 bill on the way out of church was said to have given the minister a "gift," creating no charitable contribution deduction for the giver and no tax liability for the recipient. However, the IRS has recently taken the position that such a "gift" is actually additional compensation for the minister – and therefore taxable to him, although the donor probably does not get a charitable deduction since it was not recorded and made through the church. On the other hand, had the person written a check to the Anytown Church of God for \$20 and designated such as "pastor love offering," the person now has a reasonable expectation that the "gift" is a charitable contribution and can claim a deduction for such. In addition, the "gift" becomes a taxable item to the minister.

Items Not Considered Reportable Income for Ministers

Lawyers often jokingly state that there is a simple distinction between *tax evasion* and *tax avoidance* – twenty years in federal prison. Hiding income is tax evasion and punishable by imprisonment upon conviction. However, there are several items mentioned within this document that can legitimately be excluded from taxable income for ministers. Since these items are dealt with at length elsewhere, only a brief mention of each will be noted here. The primary items not considered as reportable taxable income for ministers are:

- Retirement Plan Contributions – It should be noted that *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 IRS Form W-2, but "retirement plan" would be checked in Box 13 and Box 12 would report "E - \$5000.00."
- group term life insurance premiums for policies up to \$50,000
- fringe benefits (GROUP medical insurance premiums, etc.)
- qualified reimbursement of moving expenses
- business expense reimbursement under an *accountable* plan, and
- the minister's housing allowance – which is 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. Further, the employer/church should be aware 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. For ministers, salary reduction contributions are excluded for both tax purposes and Social Security purposes.

Completing Form W-2

Completing the minister's IRS Form W-2 should be relatively simple for the employer/church. Step-by-step instructions and tips follow:

- Box a – list the minister's Social Security number (**NOTE: The employee's Social Security number has been relocated from Box d to Box a.**)
- 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 minister
- Box f – list the address of the minister
- Box 1 – list all reportable taxable income for the minister (do not include employer/church retirement plan contributions or amounts reduced from the minister's salary through a valid salary reduction agreement)
- 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.
- Box 3 through Box 11 – nothing generally appears in these boxes for ministers
- 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
 - P – Reports qualified moving expenses reimbursed directly to the minister. If the employer/church pays the moving company directly, those costs are not reported on the Form W-2.

2222		a Employee's social security number 123-45-6789		OMB No. 1545-0008	
b Employer identification number (EIN) 38-1234567		1 Wages, tips, other compensation 30000.00		2 Federal income tax withheld	
c Employer's name, address, and ZIP code Anytown Church of God 123 Praise street Anytown, TN 45678		3 Social security wages		4 Social security tax withheld	
		5 Medicare wages and tips		6 Medicare tax withheld	
		7 Social security tips		8 Allocated tips	
d Control number		9		10 Dependent care benefits	
e Employee's first name and initial Last name Phil B. Pulpit		11 Nonqualified plans		12a E 6000.00	
f Employee's address and ZIP code 456 Board Street Cleveland, TN 37320		13 Salary, retirement, etc. <input type="checkbox"/> Salary <input checked="" type="checkbox"/> Retirement <input type="checkbox"/> Health <input type="checkbox"/> Life		12b	
		14 Other 12000.00 Minister's Housing Allowance		12c	
				12d	
15 State Employer's state ID number		16 State wages, tips, etc.		17 State income tax	
				18 Local wages, tips, etc.	
				19 Local income tax	
				20 Locality name	

W-2 Wage and Tax Statement **2012** Department of the Treasury—Internal Revenue Service
Form 1040-SS
Copy 1—For State, City, or Local Tax Department

- DD – Reports cost of employer-sponsored *group* health coverage. The amount reported with Code DD is not taxable.
- Box 13 – If the minister 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 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 generally appears in these boxes unless state and local withholding is required by law.

The IRS provides detailed instructions on the completion of Form W-2 if such is needed beyond these cursory guidelines.

SUMMARY

As stated earlier, this guide is not meant to be exhaustive. There are some subjects that have not been covered because professional, legal, or accounting assistance is needed to address your specific circumstances. This “manual” is primarily made available so that ministers (and churches) will be familiar with most of the components of a well-defined compensation package. There has been absolutely no attempt to cover every single aspect of a minister’s compensation package or to discuss every possible tax implication of a particular financial decision.

As a minister reads through this “manual,” he or she will find things that they are doing “right” and things that they are doing “differently.” It has been our attempt to present items in a way that meet the requirements of the Internal Revenue Code. That is not to say, however, that the way that you are doing something would not pass the muster of the IRS. The Service issues hundreds of opinions per year and often even those opinions differ on ways that particular issues should be handled. While we would all like to have clear “black and white” interpretations when it comes to tax laws, that is often not the case. However, the matters dealt with here come from Internal Revenue Service publications and the recommended course of action found in this document comes from the IRS itself.

It is the hope of the Benefits Board that this “manual” will serve you well in providing for the local pastor or leader of your congregation. He is God’s choice servant and should be treated as such.

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.*

The Board of Trustees, or the staff of the Benefits Board, is not engaged in rendering financial advice, legal advice, or other financial planning services. If such advice is desired or required, the services of a competent professional should be sought.

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Attachment A

PERSONAL BUDGET WORKSHEET

Income

Salary _____
Pension Income _____
Social Security _____
Interest _____
Other _____
Other _____
Other _____

Gross Income per Month _____

Less

Taxes (Fed., State, FICA) _____
Tithes _____
Savings _____

NET AVAILABLE INCOME _____

Expenditures

Housing

Mortgage/Rent _____
Insurance _____
Real Estate Taxes _____
Electricity _____
Gas _____
Water/Sewer/Garbage _____
Cable TV _____
Telephone _____
Repairs/Upkeep _____
Furnishings/Appliances _____
Lawn Care _____
Total _____

Food

Groceries _____
Dining Out _____
Total _____

Automobile

Payment _____
Gas & Oil _____
Auto Insurance _____
Auto Taxes and Fees _____
Maintenance _____
Total _____

Insurance

Life _____
Medical _____
Other _____
Total _____

Debts

Consumer Loans _____
Credit Cards _____
Total _____

Entertainment and Recreation

Vacation _____
Trips _____
Health/Fitness Club _____
Baby Sitters _____
Other _____
Total _____

Clothing

Husband _____
Wife _____
Children _____
Total _____

Medical Expenses (Un-reimbursed)

Doctor _____
Dentist _____
Drugs _____
Other _____
Total _____

School/Child Care

Tuition/Fees _____
Supplies _____
Total _____

Investments

Retirement Plan _____
Stocks/bonds/etc. _____
Other _____
Total _____

Miscellaneous

Toiletry, cosmetics _____
Beauty, barber _____
Laundry, cleaning _____
Newspaper/magazines _____
Gifts _____
Cash _____
Other _____
Other _____
Total _____

TOTAL EXPENSES _____

INCOME vs. EXPENSES

Net Available Income _____
Less Total Expenses _____
Equals Surplus Income* _____

Surplus income should be designated to savings or investments. It should not be spent just because it is available.

Attachment B

ESTIMATE OF HOUSING ALLOWANCE FOR 20_____

I, _____, certify that I am a licensed/credentialed minister of the gospel, and I estimate my housing cost for the calendar year of 20__ as follows:

- | | |
|---|----------|
| 1. Rent | \$ _____ |
| 2. Mortgage (including down payment) | \$ _____ |
| 3. Real Estate Tax | \$ _____ |
| 4. Insurance (home and contents) | \$ _____ |
| 5. Repairs, Improvements, and Maintenance | \$ _____ |
| 6. Household Furnishings and Appliances | \$ _____ |
| 7. Decorator items (drapes, carpet, pictures, etc.) | \$ _____ |
| 8. Utilities (electricity, gas, water, and sewage) | \$ _____ |
| 9. Lawn Maintenance, Landscape, and Pest Control | \$ _____ |
| 10. Any other allowance expense (Specify) | \$ _____ |

Estimated Total Annual Housing \$ _____

Allowance Amount per Month (1/12 of yearly total) \$ _____

I understand that the total allowance permitted is limited to 1) the fair market rental value of my home plus the cost of utilities and furnishings, 2) the amount I actually spend on housing, or 3) the amount designated by the church as ministerial housing allowance, **WHICHEVER IS LESS.**

Signature _____ Date _____

Adopted by the Board on _____

Attachment C

Housing/Parsonage Allowance Exclusion Worksheet

A. Housing Allowance

Home Owned or Rented

The exclusion is limited to the least of:

1. Amount designated as housing allowance by Church _____

2. Amount actually used to provide a home:

Rent	_____
House Payments	_____
Furnishings	_____
Repairs	_____
Insurance, Taxes	_____
Utilities	_____
Other expenses	_____
(include down payment, interests, etc., but not food or servants or entertainment)	

3. Fair rental value of home, including furniture, utilities, and garage _____

B. Parsonage

Parsonage Provided

Fair Rental Value of Parsonage _____

Based on the above figures (either A or B), the amount of the minister's housing allowance excludible from income tax liability is _____.

The entire designated ministerial housing allowance is subject to self-employment tax unless the minister has "opted out" of Social Security or the minister is retired.



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(TRS310)

Attachment D

ESTIMATE OF ACCOUNTABLE REIMBURSEMENT EXPENSES

NAME _____

YEAR _____

EMPLOYER _____

POSITION _____

(Please list only ministry related expenses)

- | | | |
|-----|--|----------|
| 1. | Car Miles _____ @ _____ cents | \$ _____ |
| 2. | Parking Fees and Tolls | \$ _____ |
| 3. | Meals and Entertainment | \$ _____ |
| 4. | Dues and Publications | \$ _____ |
| 5. | Office Expense | \$ _____ |
| 6. | Telephone Calls | \$ _____ |
| 7. | Business Gifts | \$ _____ |
| 8. | Depreciation on Equipment | \$ _____ |
| 9. | Conventions and Seminars | \$ _____ |
| 10. | Insurance on Professional Items | \$ _____ |
| 11. | Travel – Airline, Motels, Etc. | \$ _____ |
| 12. | Repairs to Equipment | \$ _____ |
| 13. | Audio and Video Cassettes | \$ _____ |
| 14. | Advertising – calling cards, ads, etc. | \$ _____ |
| 15. | Interest on Business Debts | \$ _____ |
| 16. | Other _____ | \$ _____ |

Estimated Total Yearly Business Expenses \$ _____

Allowance Amount per Month (1/12 of yearly total) \$ _____

I understand that all expenses, when submitted, must be substantiated as to the date, amount, and business purpose within 60 days after they are incurred and that any excess reimbursement must be refunded to the church within 120 days after expenses are paid or incurred.

Signature _____ Date _____

Adopted by the Board on _____

Attachment E

ACCOUNTABLE REIMBURSEMENT PLAN MINISTRY RELATED EXPENSE FORM

NAME _____

YEAR _____

POSITION _____

MONTH ENDING _____

(Please list only ministry related expenses)

- | | | |
|-----|--|----------|
| 1. | Car Miles _____ @ _____ cents | \$ _____ |
| 2. | Parking Fees and Tolls | \$ _____ |
| 3. | Meals and Entertainment | \$ _____ |
| 4. | Dues and Publications | \$ _____ |
| 5. | Office Expense | \$ _____ |
| 6. | Telephone Calls | \$ _____ |
| 7. | Business Gifts | \$ _____ |
| 8. | Depreciation on Equipment | \$ _____ |
| 9. | Conventions and Seminars | \$ _____ |
| 10. | Insurance on Professional Items | \$ _____ |
| 11. | Travel – Airline, Motels, Etc. | \$ _____ |
| 12. | Repairs to Equipment | \$ _____ |
| 13. | Audio and Video Cassettes | \$ _____ |
| 14. | Advertising – calling cards, ads, etc. | \$ _____ |
| 15. | Interest on Business Debts | \$ _____ |
| 16. | Other _____ | \$ _____ |

(Mileage log, receipts, etc. must be attached.)

Total Ministry related expense

For the month of _____ \$ _____

Signed by: _____

Date _____

Church Office Use Only

Reimbursed by: _____

Check #: _____

Date: _____

Attachment F

WORKSHEET FOR MINISTER'S COMPENSATION

(Duplicate and complete a separate sheet for each minister.)

<u>NAME OF CHURCH</u>		<u>PASTOR</u>	<u>DATE</u>
		Actual (Current Year)	Proposed (Next Year)
I.	PASTOR'S MINIMUM COMPENSATION (See <i>Minutes</i> for Scale)	\$ _____	\$ _____
II.	PARSONAGE / HOUSING ALLOTMENT (Include additions to salary only - or fair rental value of parsonage)	\$ _____	\$ _____
III.	ACCOUNTABLE REIMBURSEMENTS (Include amounts that are designated for ministry-related expenses in addition to salary)	\$ _____	\$ _____
IV.	FRINGE BENEFITS		
	1. Retirement Plan Contributions	\$ _____	\$ _____
	2. Medical Insurance Assistance	\$ _____	\$ _____
	3. Social Security Reimbursement	\$ _____	\$ _____
	4. Other _____	\$ _____	\$ _____
	5. Other _____	\$ _____	\$ _____
V.	SUMMARY:		
	Total Compensation Package	\$ _____	\$ _____

TAXABLE COMPENSATION

Total Compensation	\$ _____	\$ _____
LESS: Housing Allowance (Minister must complete Estimate of Housing Allowance and a resolution must be adopted by church)	\$ _____	\$ _____
LESS: Accountable Reimbursements (Minister must complete Accountable Reimbursement Plan Expense Form and a resolution must be adopted by church)	\$ _____	\$ _____
LESS: Fringe Benefits (Exclude Social Security and Medical Insurance Assistance on a non-group plan)	\$ _____	\$ _____
Total Reportable Compensation	\$ _____	\$ _____
LESS: Retirement Plan Contributions (By Salary Reduction Agreement)	\$ _____	\$ _____
TAXABLE COMPENSATION (Reported in Box 1 on Form W-2)	\$ _____	\$ _____

Sample Form W-4

Form W-4 (2012)

Purpose. Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay. Consider completing a new Form W-4 each year and when your personal or financial situation changes.

Exemption from withholding. If you are exempt, complete only lines 1, 2, 3, 4, and 7 and sign the form to validate it. Your exemption for 2012 expires February 18, 2013. See Pub. 505, Tax Withholding and Estimated Tax.

Note. If another person can claim you as a dependent on his or her tax return, you cannot claim exemption from withholding if your income exceeds \$950 and includes more than \$300 of unearned income (for example, interest and dividends).

Basic instructions. If you are not exempt, complete the **Personal Allowances Worksheet** below. The worksheets on page 2 further adjust your withholding allowances based on itemized deductions, certain credits, adjustments to income, or two-earners/multiple jobs situations.

Complete all worksheets that apply. However, you may claim fewer (or zero) allowances. For regular wages, withholding must be based on allowances you claimed and may not be a flat amount or percentage of wages.

Head of household. Generally, you can claim head of household filing status on your tax return only if you are unmarried and pay more than 50% of the costs of keeping up a home for yourself and your dependent(s) or other qualifying individuals. See Pub. 501, Exemptions, Standard Deduction, and Filing Information, for information.

Tax credits. You can take projected tax credits into account in figuring your allowable number of withholding allowances. Credits for child or dependent care expenses and the child tax credit may be claimed using the **Personal Allowances Worksheet** below. See Pub. 505 for information on converting your other credits into withholding allowances.

Nonwage income. If you have a large amount of nonwage income, such as interest or dividends, consider making estimated tax payments using Form 1040-ES, Estimated Tax for Individuals. Otherwise, you may owe additional tax. If you have pension or annuity

income, see Pub. 505 to find out if you should adjust your withholding on Form W-4 or W-4P.

Two earners or multiple jobs. If you have a working spouse or more than one job, figure the total number of allowances you are entitled to claim on all jobs using worksheets from only one Form W-4. Your withholding usually will be most accurate when all allowances are claimed on the Form W-4 for the highest paying job and zero allowances are claimed on the others. See Pub. 505 for details.

Nonresident alien. If you are a nonresident alien, see Notice 1392, Supplemental Form W-4 Instructions for Nonresident Aliens, before completing this form.

Check your withholding. After your Form W-4 takes effect, use Pub. 505 to see how the amount you are having withheld compares to your projected total tax for 2012. See Pub. 505, especially if your earnings exceed \$130,000 (Single) or \$180,000 (Married).

Future developments. The IRS has created a page on irs.gov for information about Form W-4, at www.irs.gov/w4. Information about any future developments affecting Form W-4 (such as legislation enacted after we release it) will be posted on that page.

Personal Allowances Worksheet (Keep for your records.)

<p>A Enter "1" for yourself if no one else can claim you as a dependent A _____</p> <p>B Enter "1" if: <ul style="list-style-type: none"> • You are single and have only one job; or • You are married, have only one job, and your spouse does not work; or • Your wages from a second job or your spouse's wages (or the total of both) are \$1,500 or less. B _____</p> <p>C Enter "1" for your spouse. But, you may choose to enter "-0-" if you are married and have either a working spouse or more than one job. (Entering "-0-" may help you avoid having too little tax withheld.) C _____</p> <p>D Enter number of dependents (other than your spouse or yourself) you will claim on your tax return D _____</p> <p>E Enter "1" if you will file as head of household on your tax return (see conditions under Head of household above) E _____</p> <p>F Enter "1" if you have at least \$1,900 of child or dependent care expenses for which you plan to claim a credit F _____</p> <p>(Note. Do not include child support payments. See Pub. 503, Child and Dependent Care Expenses, for details.)</p> <p>G Child Tax Credit (including additional child tax credit). See Pub. 972, Child Tax Credit, for more information. • If your total income will be less than \$61,000 (\$90,000 if married), enter "2" for each eligible child; then less "1" if you have three to seven eligible children or less "2" if you have eight or more eligible children. • If your total income will be between \$61,000 and \$84,000 (\$90,000 and \$119,000 if married), enter "1" for each eligible child G _____</p> <p>H Add lines A through G and enter total here. (Note. This may be different from the number of exemptions you claim on your tax return.) ► H _____</p> <p>For accuracy, complete all worksheets that apply. • If you plan to itemize or claim adjustments to income and want to reduce your withholding, see the Deductions and Adjustments Worksheet on page 2. • If you are single and have more than one job or are married and you and your spouse both work and the combined earnings from all jobs exceed \$40,000 (\$10,000 if married), see the Two-Earners/Multiple Jobs Worksheet on page 2 to avoid having too little tax withheld. • If neither of the above situations applies, stop here and enter the number from line H on line 5 of Form W-4 below.</p>	<p>Separate here and give Form W-4 to your employer. Keep the top part for your records.</p>
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W-4 Form Department of the Treasury Internal Revenue Service		Employee's Withholding Allowance Certificate ► Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.		CMB No. 1545-0074 <div style="font-size: 2em; font-weight: bold;">2012</div>
1 Your first name and middle initial Phil B.		Last name Pulpit		2 Your social security number 123-45-6789
Home address (number and street or rural route) 456 Board Street		3 <input type="checkbox"/> Single <input checked="" type="checkbox"/> Married <input type="checkbox"/> Married, but withhold at higher Single rate. Note. If married, but legally separated, or spouse is a nonresident alien, check the "Single" box.		
City or town, state, and ZIP code Cleveland, TN 37320		4 If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1213 for a replacement card. ► <input type="checkbox"/>		
5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2)		6 Additional amount, if any, you want withheld from each paycheck		7
7 I claim exemption from withholding for 2012, and I certify that I meet both of the following conditions for exemption. • Last year I had a right to a refund of all federal income tax withheld because I had no tax liability, and • This year I expect a refund of all federal income tax withheld because I expect to have no tax liability. If you meet both conditions, write "Exempt" here ► 7		8 \$ 90.00		
Under penalties of perjury, I declare that I have examined this certificate and, to the best of my knowledge and belief, it is true, correct, and complete.				
Employee's signature (This form is not valid unless you sign it.) ► <i>Phil B. Pulpit</i>		Date ► January 1, 2012		
8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.)		9 Office code (optional)		10 Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 2.

Cat. No. 10220Q

Form W-4 (2012)

SAMPLE FORM W-2

22222		a Employee's social security number 123-45-6789		OMB No. 1545-0008	
b Employer identification number (EIN) 38-1234567			1 Wages, tips, other compensation 30000.00		2 Federal income tax withheld
c Employer's name, address, and ZIP code Anytown Church of God 123 Praise street Anytown, TN 45678			3 Social security wages		4 Social security tax withheld
			5 Medicare wages and tips		6 Medicare tax withheld
			7 Social security tips		8 Allocated tips
			9		10 Dependent care benefits
d Control number					
e Employee's first name and initial Last name Phil B. Pulpit			11 Nonqualified plans		12a E 6000.00
456 Board Street Cleveland, TN 37320			13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		12b
			14 Other 12000.00 Minister's Housing Allowance		12c
					12d
f Employee's address and ZIP code					
15 State Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form W-2 Wage and Tax Statement
 Copy 1—For State, City, or Local Tax Department

2012

Department of the Treasury—Internal Revenue Service

Attachment I

SAMPLE FORM 1099

9595 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED						
PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Rents	OMB No. 1545-0115			
Anytime Church of God 123 Praise Street Cleveland, TN 37320		\$	2014 Form 1099-MISC			
		2 Royalties				
		\$				
PAYER'S federal identification number		3 Other income	4 Federal income tax withheld	Miscellaneous Income Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2014 General Instructions for Certain Information Returns.		
38-1234567	5 Fishing boat proceeds	\$				
RECIPIENT'S identification number	6 Medical and health care payments	\$				
123-45-6789	7 Nonemployee compensation	\$ 900.00				
RECIPIENT'S name		8 Substitute payments in lieu of dividends or interest	2014 General Instructions for Certain Information Returns.			
Phil B. Evangelist		9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>				10 Crop insurance proceeds
Street address (including apt. no.)		11				12
456 Broad Street		13 Excess golden parachute payments				14 Gross proceeds paid to an attorney
City or town, state or province, country, and ZIP or foreign postal code		15a Section 409A deferrals	15b Section 409A income	16 State tax withheld	17 State/Payer's state no.	
Cleveland, TN 37320		\$	\$	\$	\$	
Account number (see instructions)		2nd TIN not <input type="checkbox"/>	18 State income			
			\$			
Form 1099-MISC		Cat. No. 14425J				
Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page		www.irs.gov/form1099misc				
		Department of the Treasury - Internal Revenue Service				