2023 Clergy Tax Return Preparation Guide for 2022 Returns

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This publication is intended to provide a timely, accurate, and authoritative discussion of tax reporting compliance, and the impact of recent changes in the tax laws. It is not intended as a substitute for legal, accounting, or other professional advice. If legal, tax, or other expert assistance is required, the services of a competent professional should be sought. Although we believe this book provides accurate information, there may be changes resulting from IRS or judicial interpretations of the Tax Code, new tax regulations, or technical corrections that occurred after the printing of this edition that are not reflected in the text.

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PART 1
INTRODUCTION

All references in this publication to line numbers on IRS forms are for the "draft" versions of the 2022 forms since the final forms had not been released by the IRS as of the date of publication.

How to use this guide

This book contains the basic information you need to complete your 2022 federal income tax return. It gives special attention to several forms and schedules and the sections of each form most relevant to ministers. The companion resource—Federal Reporting Requirements for Churches—helps churches comply with their federal tax reporting requirements.

This guide is divided into the following sections:

Part 1: Introduction—This section reviews tax highlights for 2022 and presents several preliminary questions you should consider before preparing your tax return.

Part 2: Special Rules for Ministers—In this section, you learn if you are a minister for tax purposes, whether you are an employee or self-employed for both income tax and Social Security purposes, and how you pay your taxes.

Part 3: Tax Return Preparation—This section explains how to complete the most common tax forms and schedules for ministers.

Part 4: Comprehensive Examples and Sample Forms—This section shows a sample tax return prepared for an ordained minister and spouse and for a retired minister and spouse.

Federal Reporting Requirements for Churches—This resource provides assistance to churches (especially treasurers and bookkeepers) in filing federal tax forms.

Tax highlights for 2022

The Inflation Reduction Act of 2022 ("IRA")

1. Improve affordability of health insurance for consumers
The Inflation Reduction Act extends through 2025 changes made by the American Rescue Plan Act of 2021.

2. Clean vehicle credit
The Inflation Reduction Act modifies the tax credit for plug-in electric vehicles, allowing certain clean vehicles to qualify and eliminating the current per manufacturer limit. The maximum credit per vehicle is $7,500. Clean vehicles include plug-in electric vehicles with a battery capacity of at least 7 kilowatt hours and fuel cell vehicles.

3. Residential clean energy credit
The Inflation Reduction Act extends the credit through December 31, 2034, restoring the 30% credit rate through 2032, and then reducing the credit rate to 26% in 2033 and 22% in 2034.

4. Deduction for state and local taxes
In the past, an itemized deduction of state and local income, sales, and property taxes was limited to a combined total deduction of $10,000 ($5,000 if married filing separately). The expiration date for this provision remains at 2025 under the Inflation Reduction Act, as under prior law. And, as an individual, your deduction of state and local income, sales, and property taxes remains limited to a combined total deduction of $10,000 ($5,000 if married filing separately). Efforts to significantly increase this cap during negotiations on the Inflation Reduction Act were unsuccessful.

5. IRS funding
The Inflation Reduction Act gives the IRS $45.6 billion for tax enforcement activities such as hiring more enforcement agents, providing legal support, and investing in "investigative technology."

> **KEY POINT** Supporters argue these funds will reduce the "tax gap," or the average annual value of unpaid federal taxes. The IRS estimates the tax gap averaged $381 billion after accounting for enforcement between 2011 and 2013, the most recent years available. Some argue the 19% decline in the IRS's inflation-adjusted funding between 2010 and 2019 facilitated tax evasion. Funding rose in 2020 and 2021, in large part to help the IRS administer COVID-related benefits. The Congressional Budget Office estimates that the additional enforcement measures funded by this bill would generate $204 billion in revenues through 2031, although such estimates are highly uncertain.

Other tax changes of interest to ministers and other church staff

There were several tax developments in prior years that affect tax reporting by both ministers and churches for 2022 and future years. Here is a rundown of some of the key provisions:

- You may be able to claim the earned income credit for 2022 if (1) you do not have a qualifying child and you earned less than $16,480 ($22,610 if married); (2) a qualifying child lived with you and you earned less than $43,492 ($49,622 if married filing jointly); (3) two qualifying children lived with you and you earned less than $49,399 ($55,529 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than $53,057 ($59,187 if married filing jointly). The maximum earned income credit for 2022 is (1) $560 with no qualifying child; (2) $3,733 with one qualifying child; (3) $6,164 with two qualifying children; and (4) $6,935 with three or more qualifying children.

- For contributions in 2022 to a traditional IRA, the deduction phaseout range for an individual covered by a retirement plan at work begins at income of $109,000 for joint filers and $68,000 for a single person or head of household. These are 2022 amounts that increase to $116,000 for joint filers and $73,000 for a single person or head of household for 2023.

- The dollar limit on annual elective deferrals an individual could make to a 403(b) retirement plan was $20,500 for 2022. It increases to $22,500 for 2023.

- The catch-up contribution limit on elective deferrals to a 403(b) retirement plan for individuals who had attained age 50 by the end of the year was $6,500 for 2022. For 2023, the limit increases to $7,500.

- The IRS has announced that it will not issue private letter rulings addressing the following questions: (1) Whether an individual is a minister of the gospel for federal tax purposes; (2) eligibility for a parsonage exclusion or housing allowance; (3) eligibility for exemption from self-employment taxes; (4) self-employed status for Social Security; or (5) exemption of wages from income tax withholding; and (6) whether amounts distributed to a retired minister from a pension or annuity plan are excludible from the minister's gross income as a parsonage allowance.

- The standard business mileage rate was 58.5 cents per mile for business miles driven during the first half of 2022, and 62.5 cent per mile for business miles driven during the second half of 2022. The mileage rate for 2023 was not available at the time of publication but will be available on the IRS website.

- Many churches employ retired persons who are receiving Social Security benefits. Persons younger than full retirement age may have their Social Security retirement benefits cut if they earn more than a specified amount. Full retirement age (the age at which you are entitled to full retirement benefits) for persons born in 1943–1954 is 66 years. If you are under full retirement age for the entire year, $1 is deducted from your benefit payments for every $2 you earn above the annual limit. For 2023 that limit is $21,240. In the year you reach full retirement age, your monthly benefit payments are reduced by $1 for every $3 you earn above a different limit. For 2023 that limit is $56,520 ($4,710 per month) but only earnings before the month you reach full retirement age are counted.

- Will Congress give ministers another opportunity to revoke an exemption from Social Security? It does not look likely, at least for now. No legislation is pending that would provide ministers with this option.

- In March 2019 a three-judge panel of a federal appeals court (the Seventh Circuit Court of Appeals) unanimously affirmed the constitutionality of the ministers' housing allowance. *Gaylor v. Mnuchin, 919 F.3d 420 (7th Cir. 2019).* No further legal challenges to the housing allowance occurred in 2022.

Preliminary Questions

Below are several questions you should consider before preparing your 2022 federal tax return.

Q. Must ministers pay federal income taxes?

A. Yes. Ministers are not exempt from paying federal income taxes.

Q. How much income must I earn to be required to file a tax return?

A. Generally, ministers are required to file a federal income tax return if they have earnings of $400 or more to report their self-employment tax. Different rules apply to ministers who are exempt from self-employment taxes.

Q. What records should I keep?

A. You should keep all receipts, canceled checks, and other evidence to prove amounts you claim as deductions, exclusions, or credits. Documentation should be maintained for six years from the time you file your tax return.

Q. What is the deadline for filing my federal income tax return?

A. The instructions for Form 1040 state that the deadline for filing Form 1040 for the 2022 tax year is April 18, 2023 (April 19, 2023 if you live in Maine or Massachusetts because of the Patriots' Day holiday).

Your return is filed on time if it is properly addressed and postmarked no later than the due date or submitted electronically by midnight on the filing due date. The return must have sufficient postage to be considered timely mailed.

TIP Many post offices will have extended hours of operation on April 18, 2023, to accommodate late filers.

Q. What if I am unable to file my tax return by the deadline?

A. You can obtain an automatic six-month extension (from April 18 to October 16, 2023) to file your 2022 Form 1040 if you file Form 4868 by April 18, 2023 with the IRS service center for your area. Your Form 1040 can be filed at any time during the six-month extension period. An extension only relieves you from the obligation to *file your return; it is not an extension of the obligation to pay your taxes*. You must make an estimate of your tax for 2022 and pay the estimated tax either with your Form 4868 or through one of the electronic payment methods.

Q. Should I prepare my own tax return?

A. The answer depends on your ability and experience in working with financial information and in preparing tax returns. Keep in mind: Ministers' taxes present a number of unique rules, but these rules are not complex. Many ministers will be able to prepare their own tax returns if they understand the unique rules that apply. These rules are summarized in this document. Easily accessible tax software will also accommodate the unique rules applicable to ministers, but it does not relieve a minister from understanding the rules in order to accurately utilize the software. On the other hand, if you experienced unusual events in 2022, such as the sale or purchase of a home or the sale of other capital assets, it may be prudent to obtain professional tax assistance. The IRS provides a service called Taxpayer Assistance, but it is not liable in any way if its agents provide you with incorrect answers to your questions. Free taxpayer publications are available from the IRS and many of these are helpful to ministers.

RECOMMENDATION If you need professional assistance, here are some tips that may help you find a competent tax professional:

- Ask other ministers in your community for their recommendations.

- If possible, use a CPA who specializes in tax law and who is familiar with the rules that apply to ministers. A CPA has completed a rigorous educational program and is subject to strict ethical requirements. However, the tax law is complex and so it should not be assumed that all CPAs are familiar with the unique rules applicable to ministers.

- Ask local tax professionals if they work with ministers and, if so, with how many.

- Ask local tax professionals a few questions to test their familiarity with ministers' tax issues. For example, ask whether ministers are employees or self-employed for Social Security. Anyone familiar with ministers' taxes will know that ministers are self-employed for Social Security with respect to their ministerial duties. Or ask a tax professional if a minister's church salary is subject to income tax withholding. The answer is no, and anyone familiar with ministers' taxes should be able to answer this question.

PART 2
SPECIAL RULES FOR MINISTERS

Who is a minister for federal tax purposes?

KEY POINT The IRS has its own criteria for determining who is a minister for tax purposes. The criteria the IRS uses to determine who is a minister are not necessarily the same as those used by churches and denominations. Whether or not one qualifies as a minister for tax purposes is an important question since special tax and reporting rules apply to ministers under federal tax law. These rules include:

- eligibility for housing allowances and the parsonage exclusion;
- self-employed status for Social Security;
- exemption of wages from income tax withholding (ministers use the quarterly estimated tax procedure to prepay their taxes, unless they elect voluntary withholding); and
- eligibility, under very limited circumstances, to exempt themselves from self-employment taxes.

These special rules only apply to persons qualifying as a minister and with respect to compensation received in the exercise of ministerial services.

EXAMPLE Pastor J is an ordained minister employed by a church. In addition, he works a second job for a secular employer. Assume that Pastor J qualifies as a minister for federal tax purposes. Since his church duties constitute services performed in the exercise of his ministry, the church can designate a portion of his compensation as a housing allowance. However, the secular employer cannot designate any portion of Pastor J’s compensation as a housing allowance since this work would not be the exercise of ministry.

According to the IRS, ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination. They are given the authority to conduct religious worship, perform sacerdotal functions, and administer ordinances or sacraments according to the tenets and practices of that church or denomination. If a church or denomination ordains some ministers and licenses or commissions others, anyone licensed or commissioned must be able to perform substantially all the religious functions of an ordained minister to be treated as minister for tax purposes. See IRS Publication 517.

Are ministers employees or self-employed for federal tax purposes?

> **KEY POINT** Most ministers are employees for federal income tax purposes under the tests currently used by the IRS and the courts and should receive a Form W-2 from their church reporting their taxable income. However, ministers are self-employed for Social Security with respect to services they perform in the exercise of their ministry (except for some chaplains).

Ministers have a *dual* tax status. For federal income taxes they ordinarily are employees, but for Social Security they are self-employed with regard to services performed in the exercise of their ministry. These two rules are summarized below:

Income taxes

For federal income tax reporting, most ministers are employees under the tests currently used by the IRS. This means that they should receive a Form W-2 from their church at the end of each year (rather than a Form 1099-NEC). Formerly, it meant that they reported their employee business expenses on Schedule A rather than on Schedule C. (The deduction for employee business expenses as a Miscellaneous Itemized Deduction on Schedule A is suspended through 2025, so employee business expenses are not deductible at this time.)

A few ministers are self-employed, such as some traveling evangelists and some interim pastors. Also, many ministers who are employees of a local church are self-employed for other purposes. For example, the minister of a local church almost always will be an employee but will be self-employed with regard to guest speaking appearances in other churches and services performed directly for individual members (such as weddings and funerals).

EXAMPLE Pastor B is a minister at First Church. She is an employee for federal income tax reporting purposes with respect to her church salary. However, she is self-employed with respect to honoraria she receives for speaking in other churches and for compensation church members give her for performing personal services such as weddings and funerals. The church issues Pastor B a Form W-2 reporting her church salary. Pastor B reports this amount as wages on line 1 of Form 1040. She reports her compensation and expenses from the outside self-employment activities on Schedule C.

KEY POINT Most ministers will be better off financially being treated as employees, since the value of some fringe benefits will be tax-free, the risk of an IRS audit is substantially lower, and reporting as an employee avoids the additional taxes and penalties that often apply to self-employed ministers who are audited by the IRS and reclassified as employees.

KEY POINT Ministers and other church staff members should carefully review their Form W-2 to be sure it does not report more income than was actually received or fails to report taxable benefits provided by the church. If an error was made, the church should issue a corrected tax form (Form W-2c). If the church refuses to correct the income reported on the original Form W-2, the minister should still include the additional income on the Form 1040.

The Tax Court Test. The United States Tax Court has created a seven-factor test for determining whether a minister is an employee or self-employed for federal income tax reporting purposes. The test requires consideration of the following seven factors: (1) the degree of control exercised by the employer over the details of the work; (2) which party invests in the facilities used in the work; (3) the opportunity of the individual for profit or loss; (4) whether or not the employer has the right to discharge the individual; (5) whether the work is part of the employer's regular business; (6) the permanency of the relationship; and (7) the relationship the parties believe they are creating. Most ministers will be employees under this test.

Social Security

The federal tax code treats ministers as self-employed for Social Security with respect to services performed in the exercise of their ministry—even if they report their income taxes as an employee. This means that ministers must pay self-employment taxes (Social Security taxes for the self-employed) unless they have timely filed an exemption application (Form 4361) that has been approved by the IRS. As noted below, few ministers qualify for this exemption.

> **KEY POINT** While most ministers are employees for federal income tax reporting purposes, they are self-employed for Social Security with respect to services they perform in the exercise of their ministry. This means that ministers are not subject to the employee's share of Social Security and Medicare taxes, even though they report their income taxes as employees and receive a Form W-2 from their church. A minister's Form W-2 should not report any amounts in Boxes 3, 4, 5 & 6. Rather, they pay the self-employment tax (SECA) by completing Schedule SE with their Form 1040.

Exemption from self-employment (Social Security) taxes

If ministers meet several requirements, they may exempt themselves from self-employment taxes with respect to their ministerial earnings. Among other things, the exemption application (Form 4361) must be submitted to the IRS within a limited time period. The deadline is the due date of the federal tax return for the second year in which a minister has net earnings from self-employment of $400 or more, any part of which comes from ministerial services. Further, the exemption is available only to ministers who are opposed on the basis of religious considerations to the acceptance of benefits under the Social Security program (or any other public insurance system that provides retirement or medical benefits). A minister who files the exemption application may still purchase life insurance or participate in retirement programs administered by nongovernmental institutions (such as a life insurance company). Additionally, the exemption does not require ministers to revoke all rights to Social Security benefits earned through their participation in the system through secular employment.

A minister's opposition must be to accepting benefits under Social Security (or any other public insurance program) which are related to services performed as a minister. Economic, or any other nonreligious considerations, are not a valid basis for the exemption, nor is opposition to paying the self-employment tax.

The exemption is only effective when it is approved by the IRS. Few ministers qualify for the exemption. Many younger ministers opt out of the self-employment tax without realizing that they do not qualify for the exemption. A decision to opt out of self-employment tax is irrevocable. But section 4.19.6.4.11.3 (02-13-2020) of the IRS *Internal Revenue Manual* explicitly recognizes that under some conditions ministers who have exempted themselves from self--employment taxes solely for economic reasons can revoke their exemption. The IRS does have the authority to revoke a minister's decision to opt out of self-employment tax, if it is determined the decision is based on economic reasons rather than theological reasons. Check with a tax attorney or CPA for additional information.

An exemption from self-employment taxes applies only to compensation for ministerial services. Ministers who have exempted themselves from self-employment taxes must pay Social Security taxes on any nonministerial compensation they receive. And they remain eligible for Social Security benefits based on their nonministerial employment assuming that they have worked enough quarters. Generally, 40 quarters are required. Ministers who exempt themselves from self-employment taxes may qualify for Social Security benefits (including retirement and Medicare) on the basis of their spouse's coverage, if the spouse had enough credits.

> **KEY POINT** The amount of earnings required for a quarter of coverage in 2023 is $1,640. A quarter of coverage is the basic unit for determining whether a worker is insured under the Social Security program.

> **KEY POINT** Ministers who work after they retire must continue to pay self-employment tax on their ministerial income and wages (unless they exempted themselves from self-employment tax as a minister and they are employed in a ministerial capacity). However, amounts received from retirement plans related to ministerial services are not subject to self-employment tax.

How do ministers pay their taxes?

> **KEY POINT** Ministers must prepay their income taxes and self-employment taxes using the estimated tax procedure unless they have entered into a voluntary withholding arrangement with their church with respect to federal income tax.

As noted above, ministers' wages are exempt from federal income tax withholding. This means that a church may not withhold income taxes from a minister's paycheck without specific written permission. And, since ministers are self-employed for Social Security with respect to their ministerial services, a church does not withhold the employee's share of Social Security and Medicare taxes from a minister's wages. Ministers must prepay their income taxes and self-employment taxes using the estimated tax procedure unless they enter into a voluntary withholding arrangement with their church. Estimated taxes must be paid in quarterly installments. If your estimated tax paid for the current year is less than your actual tax, you may have to pay an underpayment penalty. You can amend your estimated tax payments during the year if your circumstances change. For example, if your income or deductions increase unexpectedly, you should refigure your estimated tax liability for the year and amend your remaining quarterly payments accordingly.

You will need to make estimated tax payments for 2023 if (1) you expect to owe at least $1,000 in tax for 2023 after subtracting your withholding and refundable credits, and (2) you expect your withholding and refundable credits to be less than the smaller of (i) 90 percent of the tax to be shown on your 2023 tax return, or (ii) 100 percent of the tax shown on your 2022 tax return (110 percent if adjusted gross income exceeds $150,000, or if married filing separately, more than $75,000). Your 2022 tax return must cover all 12 months.

The four-step procedure for reporting and paying estimated taxes for 2023 is summarized below.

Step 1

Compute your estimated tax for 2023 using the Form 1040-ES worksheet. Ministers' quarterly estimated tax payments should take into account both income taxes and self-employment taxes. A refund associated with an overpayment of your taxes for 2022 may be applied to your estimated tax payments due for 2023.

Step 2

For estimated tax purposes, the year is divided into four payment periods. Each period has a specific payment due date. If you don't pay enough tax by the due date of each of the payment periods, you may be charged a penalty even if you are due a refund when you file your income tax return. Pay one-fourth of your total estimated taxes for 2023 in each of four quarterly installments as follows:

FOR THE PERIOD	DUE DATE
January 1 – March 31	April 18, 2023
April 1 – May 31	June 15, 2023
June 1 – August 31	September 15, 2023
September 1 – December 31	January 17, 2024

Step 3

There are several ways to make your quarterly payment, including:

IRS Direct Pay. For online transfers directly from your checking or savings account at no cost to you, go to IRS.gov/Payments.

Pay by Card. To pay by debit or credit card, go to IRS.gov/Payments. A convenience fee is charged by these service providers.

Electronic Fund Withdrawal (EFW). EFW is an integrated e-file/e-pay option offered when filing your federal taxes electronically using tax preparation software, through a tax professional, or the IRS at IRS.gov/Payments.

EFTPS. Enroll in the Electronic Federal Tax Payment System at www.eftps.gov and establish an online account to be used to submit payments. If enrolled in the EFTPS system, all four payments may be prescheduled for automatic payment at the schedule dates.

Pay by check using an estimated tax payment voucher. If you choose this method note that there is a separate estimated tax payment voucher for each quarterly due date. The due date is shown in the upper right corner. Complete and send in the voucher only if you are making a payment by check or money order. If you and your spouse plan to file separate returns, file separate vouchers instead of a joint voucher. If you paid estimated taxes last year, you should receive a copy of your 2023 Form 1040-ES in the mail with payment vouchers preprinted with your name, address, and Social Security number. These payments should be mailed to the IRS certified return receipt to provide for proof of timely filing.

CAUTION If your 2022 tax return is not completed by April 18, 2023, you must go ahead and begin making your estimated tax payments to avoid potential underpayment penalties. A tax refund on your 2022 tax return can be used to adjust any estimated tax payment not made at the time of the filing of the return. Do not wait until your 2022 return is completed to determine and pay your 2023 estimated tax payments.

Step 4

After the close of 2023, compute your actual tax liability on Form 1040. Only then will you know your actual income, deductions, exclusions, and credits. If you overpaid your estimated taxes (that is, actual taxes computed on Form 1040 are less than all of your estimated tax payments plus any withholding), you can elect to have the overpayment credited against your first 2024 quarterly estimated tax payment or spread it out in any way you choose among any or all of your next four quarterly installments. Alternatively, you can request a refund of the overpayment. If you underpaid your estimated taxes (that is, your actual tax liability exceeds the total of your estimated tax payments plus any withholding), you may have to pay a penalty.

KEY POINT Ministers who report their income taxes as employees can request that their employing church *voluntarily* withhold income taxes from their wages. Simply furnish the church with a completed W-4 (withholding allowance certificate) or other written authorization. Since ministers are not employees for Social Security with respect to ministerial compensation, the church may not withhold the employee's share of Social Security and Medicare taxes. However, ministers can request on Form W-4 (line 4c) that an additional amount of income tax be withheld to cover their estimated self-employment tax liability for the year. The excess income tax withheld is a credit that is applied against the minister's self-employment tax liability. Many churches unintentionally withhold Social Security and Medicare taxes in addition to income taxes for a minister who requests voluntary withholding. Such withholding must be reported as income tax withheld. Withholding income tax is a preferential method of paying taxes, since it is considered to have been equally paid throughout the year, no matter the date it is actually withheld. This means, withholding can be adjusted later in the year, and it is treated as if it was paid evenly throughout the year, thus avoiding potential underpayment penalties.

PART 3
STEP-BY-STEP TAX RETURN PREPARATION

Tax forms and schedules

This step-by-step analysis covers these forms and schedules:

Form 1040 is the basic document you will use. It summarizes all your tax information. Details are reported on supplementary schedules and forms.

Schedule A is for itemized deductions for medical and dental expenses, taxes, interest, certain disaster related casualty losses and charitable contributions.

Schedule B is for reporting dividend and interest income.

Schedule C is for reporting your income and expenses from business activities you conduct other than in your capacity as an employee. Examples would be fees received for guest speaking appearances in other churches or fees received directly from members for performing personal services, such as weddings and funerals.

Schedule SE is for reporting Social Security taxes due on your self-employment income. Ministers use this schedule since they are deemed self-employed for Social Security with respect to ministerial services (unless they have obtained an approved Form 4361 from the IRS).

These forms and schedules, along with others, are included in the illustrated example in Part 4 of this guide. These forms and schedules are the ones most commonly used by ministers. You can obtain them by calling the IRS toll-free forms hotline at 800-TAX-FORM (800-829-3676). They also are available on the IRS website (irs.gov).

Form 1040

> **SPECIAL NOTE** The U.S. Treasury is seeking various new laws and reporting requirements related to digital assets such as cryptocurrencies. As a part of this effort, every taxpayer is required to answer a question on page 1 of the Form 1040 regarding transactions involving digital assets. A "yes" response is required if a taxpayer has received payment for property or services utilizing a digital asset or disposed of digital assets in any manner.

Step 1: Filing status

Select the appropriate filing status from the five options listed in this section of the Form 1040.

Step 2: Name and address

Print or type the information in the spaces provided. If you are married filing a separate return, enter your spouse's name in the space provided in the "Filing Status" section at the top of the Form 1040. If you filed a joint return for 2021 and you are filing a joint return for 2022 with the same spouse, be sure to enter your names and Social Security numbers in the same order as on your 2021 return.

If you plan to move after filing your return, use Form 8822 to notify the IRS of your new address.

If you (or your spouse) changed your name because of marriage, divorce, etc., be sure to report the change to the Social Security Administration (SSA) before filing your return. This prevents delays in processing your return and issuing refunds. It also safeguards your future Social Security benefits. If a name change with the SSA has not been completed, the name on SSA file must be used in filing your tax return.

Enter your P.O. Box number only if your post office does not deliver mail to your home.

For taxpayers with foreign mailing addresses, spaces have been added to include the name of the foreign country/province/state and a foreign postal code.

If you want $3 to go to the presidential election campaign fund, check the box labeled "you." If you are filing a joint return, your spouse can also have $3 go to the fund (check "spouse"). If you check a box, your tax or refund will not change.

Step 3: Dependents

In the past taxpayers were allowed a deduction for personal exemptions. An exemption is a dollar amount that can be deducted from an individual's total income, thereby reducing

taxable income. This deduction was suspended by Congress for tax years 2018 through 2025. Although the exemption amount is zero, the ability to claim a dependent may make taxpayers eligible for other tax benefits, including the child tax credit, educational credits, medical expenses, the childcare credit and earned income credit, to name a few.

Step 4: Income

Several items of income are reported on lines 1 through 8 of Form 1040 including amounts carried over from Schedule 1, lines 1-10. The most important of these (for ministers) are discussed below.

> **KEY POINT** Some items, such as the housing allowance, are not reported as income. They are called exclusions and are explained below.

Line 1. Wages, salaries, tips, etc.

As an employee, you should receive a Form W-2 from your church reporting your wages at the end of each year. Report this amount on line 1a.

Determining church wages or salary. Besides a salary, ministers' wages reported on Form W-2 may include several other items, including the following:

- Bonuses
- The cost of sending a minister to the Holy Land (if paid by the church)
- Most Christmas and special occasion offerings
- Retirement gifts paid by a church
- The portion of a minister's self-employment tax paid by a church
- Personal use of a church-owned vehicle

- Purchases of church property for less than fair market value

- Business expense reimbursements under a nonaccountable plan

- Imputed cost of group term life insurance coverage exceeding $50,000.

- Church reimbursements of a spouse's travel expenses incurred while accompanying a minister on a business trip (unless the spouse's presence serves a legitimate business purpose and the spouse's expenses are reimbursed under an accountable arrangement)

- "Discretionary funds" established by a church for a minister to spend on current needs—if the minister is allowed to distribute funds for his or her personal benefit or does not have to account for the funds in an arrangement similar to an accountable expense reimbursement plan

- "Imputed interest" from "below-market interest loans" of at least $10,000 made by a church to a minister (some exceptions apply)

- Cancellation of a minister's debt to a church

- Severance pay

- Payment of a minister's personal expenses by the church

- "Love gifts" or other special occasion gifts

> **KEY POINT** The IRS can assess intermediate sanctions in the form of substantial excise taxes, i.e., monetary penalties, against ministers who benefit from an excess benefit transaction. Sanctions only apply to a minister who is a "disqualified person" (meaning an officer, director, or other control party as well as relatives of such persons). In some cases, the IRS can assess additional penalties against members of a church board that approved an excess benefit transaction. Excess benefit transactions may occur if a church pays a minister an excessive salary, makes a large retirement or other special occasion "gift" to a minister, gives church property (such as a parsonage) to the minister, loans money to the minister, or sells church property to the minister at an unreasonably low price. Sanctions may be avoided, if a transaction or an item of compensation is approved by an independent board on the basis of outside "comparable data" such as independent compensation surveys or fair

market evaluations, and the basis for the board's decision is documented.

> **KEY POINT** The IRS has ruled that disqualified persons receive "automatic" excess benefits resulting in intermediate sanctions, regardless of amount, if they use church assets (vehicles, homes, credit cards, computers, etc.) for personal purposes, or receive nonaccountable expense reimbursements (not supported by adequate documentation of business purpose), unless such benefits are reported as taxable income by the church on the disqualified person's Form W-2, or by the disqualified person on his or her Form 1040 for the year in which the benefits are provided. The concept of automatic excess benefits directly affects the compensation practices of most churches and exposes some ministers and church board members to intermediate sanctions.

If some of these items were not reported on your Form W-2, they still must be reported as income. Your church should issue a "corrected" Form W-2 (Form W-2c) for the year in which one or more items of taxable income were not reported on your Form W-2. If you receive a Form W-2c and have filed an income tax return for the year shown, you may have to file an amended return. Compare amounts on Form W-2c with those reported on your income tax return. If the corrected amounts change your US income tax, file Form 1040X, Amended US Individual Income Tax Return, with Copy B of Form W-2c to amend the return you previously filed. Even if the church does not issue Form W-2c, the additional items of income should be included on the original or an amended Form 1040. You, the taxpayer, have the ultimate responsibility to report all taxable income even if your church does not properly report the income.

In addition to what is reported on Form W-2 (or Form W-2c), Line 1 will also report the amount of excess housing allowance (the amount by which the housing allowance exceeds the lesser of the minister's housing expenses or the fair rental value of the minister's home plus utilities).

Items not reported on line 1. Some kinds of income are not taxable. These items are called *exclusions*. Most exclusions apply in computing both income taxes and self-employment taxes. The housing allowance is an example of an exclusion that applies only to income taxes and not to self-employment taxes. Some of the more common exclusions for ministers include:

Gifts. Gifts, as defined by the Internal Revenue Code and the courts, are excludable from taxable income so long as they are not compensation for services. However, employers are not permitted to give tax-free gifts to employees. Likewise, the IRS and the courts have ruled that gifts ministers receive directly from members of their congregations may not always be excluded as gifts from taxable income. Before excluding gifts from taxable income, the minister should consult with a tax professional.

Life insurance and inheritances. Life insurance proceeds and inheritances are excludable from taxable income. Income earned before distributions of proceeds is generally taxable as income.

Employer-paid group life insurance. Employees may exclude the cost of employer-provided group term life insurance so long as the amount of coverage does not exceed $50,000.(This exclusion does not apply to individual life insurance policies provided outside of a "group" arrangement.)

Tuition reductions. School employees may exclude from their taxable income a "qualified tuition reduction" provided by their employer. A qualified tuition reduction is a reduction in tuition charged to employees or their spouses or dependent children by an employer that is an educational institution.

Lodging. The value of lodging furnished to a minister, i.e., a parsonage, is excluded from income. This exclusion is not available in the computation of self-employment taxes. The value of lodging furnished to a nonminister employee on an employer's premises and for the employer's convenience may be excludable from taxable income if the employee is required to accept the lodging as a condition of employment.

Educational assistance. Amounts paid by an employer for an employee's tuition, fees, and books may be excludable from the employee's taxable income if the church has adopted a written educational assistance plan. The exclusion may not exceed $5,250 per year.

Employer-provided childcare. Churches may provide for childcare to employees through free or reduced fees at a church's childcare facility or may reimburse employees for out-of-pocket costs for dependent care if the church has adopted a dependent care plan. The exclusion may not exceed $5,000 per year. The amount of employer provided childcare must be considered in calculating the child and dependent care credit available on an employee's Form 1040. The total benefits provided through the plan is reported on the employee's Form W-2 in Box 10.

> **KEY POINT** Some exclusions are available only to taxpayers who report their income taxes as employees and not as self-employed persons. Many, however, apply to both employees and self-employed persons.

There are four other exclusions that are explained below—the housing allowance, tax-sheltered annuities, qualified scholarships, and sale of a home.

Housing Allowance

> **KEY POINT** The housing allowance was challenged in federal court as an unconstitutional preference for religion. In 2019, a federal appeals court rejected the challenge and affirmed the constitutionality of the housing allowance.

The most important tax benefit available to ministers who own or rent their homes is the housing allowance exclusion. Ministers who own or rent their home do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a housing allowance, to the extent that (1) the allowance represents compensation for ministerial services, (2) it is used to pay housing expenses (see below), and (3) it does not exceed the fair rental value of the home (furnished, plus utilities).

A church cannot designate a housing allowance retroactively. Some churches fail to designate housing allowances prospectively and thereby deprive ministers of an important tax benefit.

Ministers who live in a church-owned parsonage do not pay federal income taxes on the fair rental value of the parsonage.

> **TAX SAVINGS TIP** Ministers who live in a church parsonage and incur any out-of-pocket expenses in maintaining the parsonage (such as utilities, property taxes, insurance, furnishings, or lawn care) should be sure that their employing church designates in advance a portion of their annual church compensation as a parsonage allowance. The amount so designated is not reported as wages on the minister's Form W-2 at the end of the year (if the allowance exceeds the actual expenses, the difference must be reported as income by the minister). This is an important tax benefit for ministers living in a church-provided parsonage. Unfortunately, many of these ministers are not aware of this benefit or are not taking advantage of it.

> **TAX SAVINGS TIP** Ministers who own their homes lose the largest component of their housing allowance exclusion when they pay off their home mortgage loan. Many ministers in this position have obtained home equity loans, or a conventional loan secured by a mortgage on their

otherwise debt-free home and have claimed their payments under these kinds of loans as a housing expense in computing their housing allowance exclusion. The Tax Court has ruled that this is permissible only if the loan proceeds were spent on housing-related expenses.

TAX SAVINGS TIP Ministers should be sure that the designation of a housing or parsonage allowance for the next year is on the agenda of the church membership (or church board) for one of its final meetings during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items– assuming in each case that the designation was appropriately adopted in advance by the church.

The rental value of a parsonage, and a housing allowance, are exclusions only for federal income tax reporting purposes. Ministers cannot exclude a housing allowance or the fair rental value of a parsonage when computing self-employment (Social Security) taxes *unless they are retired*. The tax code specifies that the self-employment tax does *not* apply to "the rental value of any parsonage or any parsonage allowance provided after the [minister] retires."

States vary in the tax treatment of the housing allowance under state law so ministers should check their state income tax rules to determine eligibility for a housing allowance or parsonage exclusion

The housing allowance is available to ministers whether they report their income taxes as employees or as self-employed (whether the church issues them a Form W-2 or a Form 1099-NEC).

Housing expenses to include in computing your housing allowance exclusion

Ministers who own or rent their home should take the following expenses into account in computing their housing allowance exclusion:

- Down payment on a home (since a housing allowance is nontaxable only to the extent that it does not exceed the lesser of the housing allowance designated by the church, actual housing expenses, or the fair rental value of a minister's home, as furnished, plus utilities, it is often difficult to exclude the full amount of a down payment for a new home.)

- Mortgage payments on a loan to purchase or improve your home (include both interest and principal)
- Rent
- Real estate taxes
- Property insurance
- Utilities (electricity, gas, water, trash pickup, land-line telephone charges)
- Furnishings and appliances (purchase and repair)
- Structural repairs and remodeling
- Yard maintenance and improvements
- Maintenance items (pest control, etc.)
- Homeowners association dues

KEY POINT In 2007 the Tax Court characterized Internet expenses as utility expenses. This suggests that a housing allowance may be used to pay for Internet expenses (i.e., Internet access, cable television). Neither the IRS nor the Tax Court has addressed this issue directly, so be sure to check with a tax professional about the application of a housing allowance to these expenses.

Please note the following:

- A housing allowance must be designated in advance. Retroactive designations of housing allowances are not effective.
- The housing allowance designated by the church is not necessarily nontaxable. It is nontaxable (for income taxes) only to the extent that it is used to pay for housing expenses, and, for ministers who own or rent their home, does not exceed the fair rental value of their home (as furnished, plus utilities).
- A housing allowance can be amended during the year if a minister's housing expenses are more than expected. However, an amendment is only effective

prospectively. Ministers should notify their church if their actual housing expenses are significantly more than the housing allowance designated by the church. But note that it serves no purpose to designate a housing allowance greater than the fair rental value of a minister's home (as furnished, plus utilities).

- If the housing allowance designated by the church exceeds housing expenses or the fair rental value of a minister's home, the excess housing allowance should be reported on line 1a of Form 1040.

- The housing allowance exclusion is an exclusion for federal income taxes only. Ministers must add the housing allowance as income in reporting self-employment taxes on Schedule SE (unless they are exempt from self-employment taxes).

- The fair rental value of a church-owned home provided to a minister as compensation for ministerial services is not subject to federal income tax.

EXAMPLE A church designated $25,000 of Pastor D's 2022 compensation as a housing allowance. Pastor D's housing expenses for 2022 were utilities of $4,000, mortgage payments of $18,000, property taxes of $4,000, insurance payments of $1,000, repairs of $1,000, and furnishings of $1,000. The fair rental value of the home (including furnishings) is $19,000. Pastor D's housing allowance is nontaxable in computing income taxes only to the extent that it is used to pay housing expenses and does not exceed the fair rental value of her home (furnished, plus utilities). Stated differently, the nontaxable portion of a housing allowance is the least of the following three amounts: (1) the housing allowance designated by the church; (2) actual housing expenses; or (3) the fair rental value of the home (furnished, plus utilities). In this case, the lowest of these three amounts is the fair rental value of the home, furnished plus utilities ($23,000), and so this represents the nontaxable portion of Pastor D's housing allowance. Pastor D must report the difference between this amount and the housing allowance designated by her church ($2,000) as additional income on line 1a of Form 1040.

EXAMPLE Same facts as the previous example, except the church designated $12,000 of Pastor D's salary as a housing allowance. The lowest of the three amounts in this case would be $12,000 (the church designated housing allowance) and so this represents the nontaxable amount. Note that the Pastor D's actual housing expenses were more than the allowance, and so she was penalized because of the low allowance designated by her church.

EXAMPLE Pastor Y owns a home and incurred housing expenses of $12,000 in 2022. These expenses include mortgage principal and interest, property taxes, utilities, insurance, and repairs. The church designated (in advance) $12,000 of Pastor Y's 2022 compensation as a housing allowance. Pastor Y is able to itemize expenses on Schedule A (Form 1040). He is able to claim itemized deductions on Schedule A for both his mortgage interest and his property taxes (up to $10,000), even though his taxable income was already reduced by these items because of their inclusion in the housing allowance. This is often referred to as the "double deduction." In fact, it represents an exclusion and a deduction.

EXAMPLE In preparing his income tax return for 2022, Pastor H discovers that his church failed to designate a housing allowance for him for 2022. He asks his church to pass a resolution retroactively granting the allowance for 2022. Such a resolution is ineffective, and Pastor H will not be eligible for any housing allowance exclusion in 2022.

KEY POINT Federal law makes it a crime to knowingly falsify any document with the intent to influence "the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States . . . or in relation to or contemplation of any such matter or case," and this provision contains no exemption for churches or pastors. It is possible that a pastor's backdating of a board resolution to qualify for a housing allowance for the entire year is fraud and violates federal law exposing the pastor to a fine or imprisonment. Even if the pastor's action does not violate federal law under this provision, it may result in civil or criminal penalties under the tax code.

TAX SAVINGS TIP Ministers should be sure that the designation of a housing or parsonage allowance for the next year is on the agenda of the church board, membership, or appropriate committee for one of its final meetings during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items—assuming in each case that the designation was duly adopted in advance by the church.

How much should a church designate as a housing

allowance?

> **KEY POINT** The housing allowance is available only if three conditions are met: (1) the recipient is a minister for tax purposes (as defined above), (2) the allowance is compensation for services performed in the exercise of ministry, and (3) the allowance is properly designated by the church.

The IRS has stated that there are no limitations on how much of a minister's compensation can be designated by his or her employing church as a housing allowance. However, as noted above, this means little, since the nontaxable portion of a church-designated housing allowance for ministers who own or rent their home cannot exceed the lesser of (1) actual housing expenses, or (2) the fair rental value of the home (furnished, plus utilities).

Many churches base the housing allowance on their minister's estimate of actual housing expenses for the new year. The church provides the minister with a form on which anticipated housing expenses for the new year are reported. For ministers who own their homes, the form asks for projected expenses in the following categories: down payment, mortgage payments, property taxes, property insurance, utilities, furnishings and appliances, repairs and improvements, maintenance, and miscellaneous. Many churches designate an allowance in excess of the anticipated expenses itemized by the minister. Basing the allowance solely on a minister's anticipated expenses penalizes the minister if actual housing expenses turn out to be higher than expected. In other words, the allowance should take into account unexpected housing costs or inaccurate projections of expenses.

Churches sometimes neglect to designate a housing allowance in advance of a new calendar year. For example, a church board may discover in March of 2023 that it failed to designate a housing allowance for its pastor for 2023. It is not too late to act. The church should immediately designate a portion of its minister's remaining compensation for 2023 as a housing allowance. This problem can be avoided by stipulating in each annual housing allowance designation that the allowance is for the current year *and all future years unless otherwise provided*. If such a resolution had been adopted in the December 2021 board meeting (i.e., "for 2022 and future years") it would not matter that the church neglected to designate a minister's 2023 allowance until March of 2023, since the previous designation would have "carried over". Such "safety net" designations are not a substitute for annual housing allowances (they have never been addressed or endorsed by the IRS or Tax Court). Rather, they provide a basis for claiming a housing allowance if a church neglects to designate one.

KEY POINT Churches cannot designate a housing allowance retroactively but only prospectively.

The IRS has ruled that a *retired minister* is eligible for a housing allowance exclusion if the following conditions are satisfied: (1) a portion of the retired minister's pension income is designated as a housing allowance by his or her church or the church pension board of a denominational pension fund; (2) the retired minister has severed his or her relationship with the local church and relies on the fund for a pension; (3) the pensions paid to retired ministers "compensate them for past services to the local churches of the denomination or to the denomination." Retired ministers who receive benefits from a denominational pension fund will be eligible in most cases to have some or all of their benefits designated in advance as a housing allowance. This is an attractive benefit for retired ministers that is not available with some other kinds of retirement plans. Retired ministers also can exclude from their gross income the rental value of a home (plus utilities) furnished to them by their church as a part of their pay for past services. A deceased minister's surviving spouse cannot exclude a housing allowance or rental value of a parsonage unless the allowance or parsonage is for ministerial services he or she performs or performed.

The self-employment tax does not apply to the rental value of a parsonage, or a housing allowance provided after a minister retires.

Section 403(b) plans

Payments made by your church and your salary reduction contributions to a 403(b) plan are not reportable income for income tax or self-employment tax purposes as long as the total amount credited to your retirement account does not exceed contribution limits under Sections 415(c) and 402(g) of the tax code.

Contribution limits

For 2022 total annual additions (employer contributions, salary reduction and after-tax paid contributions) could not exceed the lesser of 100 percent of your compensation (excluding a minister's housing allowance) or $61,000. This rule is known as the "section 415(c) limit." The limit does not include the additional catch-up contributions of $6,500 that may be contributed through elective deferrals by persons over 50. Excess contributions can result in income tax, additional taxes, and penalties. The effect of excess contributions depends on the type of excess contribution. The distributed excess amount may not be rolled over to another 403(b) plan or to an IRA.

NEW IN 2023 The limit on annual additions increases to $66,000 for 2023 and the additional catch-up contributions for persons over 50 increases to $7,500.

Minister's housing allowance and contribution limits

For 2022 the Section 415(c) limit restricts 403(b) contributions to the lesser of 100 percent of compensation or $61,000. For 2023, this amount is $66,000. Does the term "compensation" include a minister's housing allowance? This is an important question for ministers, since the answer will determine how much can be contributed to a 403(b) plan. If the housing allowance is treated as compensation, then ministers will be able to contribute larger amounts. The tax code specifies that the term "compensation" for purposes of applying the section 415(c) limit to a 403(b)(3) plan "means the participant's includible compensation determined under section 403(b)(3)." Section 403(b)(3) defines compensation to include "the amount of compensation which is received from the employer . . . and which is includible in gross income." Section 107 of the tax code specifies that a minister's housing allowance (or the annual rental value of a parsonage) is *not* included in the minister's gross income for income tax reporting purposes. Therefore, it would appear that the definition of compensation for purposes of computing the Section 415(c) limit would *not* include the portion of a minister's housing allowance that is excludable from gross income, or the annual rental value of a parsonage. For many years the IRS website included the following question and answer addressing this issue:

> *Question.* I am an employee minister in a local church. Each year, my church permits $25,000 as a yearly tax-free housing allowance. I would like to use my yearly housing allowance as compensation to determine my annual contribution limits (to a TSA) under section 415(c) of the Internal Revenue Code. May I do so?
>
> *Answer.* No. For purposes of determining the limits on contributions under section 415(c) of the Internal Revenue Code, amounts paid to an employee minister, as a tax-free housing allowance, may not be treated as compensation pursuant to the definitions of compensation under section 1.415-2(d) of the income tax regulations.
>
> **KEY POINT** Churches that include the housing allowance as compensation when calculating the amount of the church's contribution to 403(b) plans must perform an additional calculation to ensure the total contributions to the plan do not exceed the

maximum contribution allowed under section 415(c). This is especially important for ministers who designate a significant portion of their income as housing allowance. It is possible that the amount of contribution required under a denomination plan is greater than the amount legally allowed under the law. In these instances, a church should contact its denominational offices for clarification on the correct amount to contribute to the plan.

KEY POINT Church employees can make a special election that allows their employer to contribute up to $10,000 for the year, even if this is more than 100 percent of your compensation. The total contributions over your lifetime under this election cannot be more than $40,000.

Taxation of distributions from a 403(b) plan

Amounts you contribute through employer discretionary contributions, employee salary reduction contributions, and the earnings attributable to these contributions, generally cannot be withdrawn until an employee:

- reaches age 59½
- has a severance from employment
- dies
- becomes disabled
- in the case of elective deferrals, encounters financial hardship

In some cases of financial hardship, you may withdraw your own salary reduction contributions (but not the earnings on them) prior to the occurrence of any of the above events. A 403(b) plan may make hardship distributions only if permitted by the plan.

Once amounts are distributed, they are generally taxable as ordinary income unless designated in advance as a minister's housing allowance. In addition, if amounts are distributed prior to your reaching age 59½, you will be assessed an additional tax of 10 percent of the amount which is includable in income unless one of several exceptions applies, including the following:

- The distributions are part of a series of substantially equal periodic payments made over your life or the lives of your beneficiaries and after you separate from service.

- The distributions are made after you separate from service in or after the year in which you reach age 55.
- The distributions do not exceed the amount of unreimbursed medical expenses that you could deduct for the current year.
- The distributions are made after your death, or after you become totally and permanently disabled.
- The distributions are made to an alternate payee pursuant to a qualified domestic relations order.
- IRA distributions made for qualified higher education expenses.
- IRA distributions made for the purchase of a first home, up to $10,000.

The additional tax is computed on Form 5329.

You cannot keep retirement funds in your retirement account indefinitely. You generally have to start taking withdrawals from your IRA or 403(b) plan when you reach age 70½. However, because of changes made by the SECURE Act (2019) if your 70th birthday is July 1, 2019, or later, you do not have to take withdrawals until you reach age 72. Roth IRAs do not require withdrawals until after the death of the owner. Your required minimum distribution is the minimum amount you must withdraw from your account each year. Your withdrawals will be included in your taxable income except for any part that can be received tax-free (such as qualified distributions from designated Roth accounts). Calculating your required minimum distribution can be difficult. Basically, it is the account balance as of the end of the immediately preceding calendar year divided by a distribution period from the IRS's "Uniform Lifetime Table." The beginning date for your first RMD for a 403(b) plan is April 1 of the year following the calendar year in which you: (1) reach age 72 (age 70½ if born before July 1, 1949), or (2) retire (if your plan allows this), whichever date is later. The IRS website contains helpful resources for computing your required distribution amounts and payout. periods.

CAUTION If you do not take any required distributions, or if the distributions are not large enough, you may have to pay a 50 percent excise tax on the amount not distributed as required.

Salary reduction contributions (Section 402(g))

In addition to the section 415(c) limit there is an annual limit on elective deferral contributions also known as salary reduction contributions. The limit applies to the total of all elective deferrals contributed (even if contributed through different employers) for the year on your behalf to a variety of retirement plans, including 403(b) plans. Generally, you cannot defer more than an allowable amount each year for all plans covering you. For 2022 the allowable limit was $20,500. If you defer more than the allowable amount for a tax year, you must include the excess in your taxable income for that year.

> **NEW IN 2023** The dollar limit on annual elective deferrals increases to $22,500.

The limit on elective deferrals increases for individuals who have attained age 50 by the end of the year. The additional amount that may be made is the lesser of (1) the "applicable dollar amount," or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year. The applicable dollar amount is $6,500 for 2022 and $7,500 for 2023. Catch-up contributions are not subject to any other contribution limits and are not taken into account in applying other contribution limits.

The elective deferral limit may also be increased by as much as $3,000 if the 403(b) plan allows for a 15-year catch-up contribution. This catch-up contribution is in addition to the age-50 catch-up contribution. The eligible amount is subject to an intricate calculation. See Publication 571 for more information.

> **NEW IN 2023** As this guide was going to press, a comprehensive package of retirement plan reforms (Enhancing American Retirement Now Act) was being considered by Congress with overwhelming bipartisan support. It is virtually certain that some or all of these reforms will be enacted in the coming months. Even if enacted, it is unlikely that any of the provisions in the Act will apply to the preparation of taxes for tax year 2022.

Qualified scholarships

Amounts received as a qualified scholarship by a candidate for a degree may be excluded from gross income. A qualified scholarship is any grant amount that, in accordance with the conditions of the grant, is used for tuition and course-related expenses. Qualified tuition and related expenses are those used for (1) tuition and fees required for the enrollment or attendance at an educational institution or (2) fees, books, supplies, and equipment required for courses of instruction at the educational institution.

The scholarship need not specify that it is to be used only for qualified tuition and related expenses. All that is required is that the recipient uses the scholarship for such expenses and that the scholarship does not specify that it is to be used for nonqualified expenses (such as room and board).

In addition to these requirements, the scholarship must meet additional requirements if the recipient is an employee or a family member of an employee. Generally, the scholarship must be noncompensatory in nature, selected using nonemployment related criteria, and an independent committee must make the selection of the recipient. Additional requirements may also apply. The church should seek the advice of a CPA or tax attorney to determine the proper treatment of scholarships to employees and their children.

> **KEY POINT** Amounts paid by a church for the education of a pastor or other church employee cannot be treated as a nontaxable scholarship if paid "as compensation for services."

Any amount received in excess of the qualified tuition and related expenses, such as amounts received for room and board, is not eligible for this exclusion and must be included on the recipient's Form 1040.

Any amount received that represents payment for teaching, research, or other services required as a condition for receiving a qualified scholarship cannot be excluded from gross income. In addition, amounts paid by a church for the education of a pastor or other church employee cannot be treated as a nontaxable scholarship if paid "as compensation for services."

> **EXAMPLE** First Church establishes a scholarship fund for seminary students. Robert is a church member who is pursuing a master's degree at a seminary. The church board votes to award him a scholarship of $2,500 for 2023. So long as Robert uses the scholarship award for tuition or other course-related expenses, he need not report it as income on his federal tax return. The better practice would be for the church to stipulate that the scholarship is to be used for tuition or other course-related expenses (for example, fees, books, supplies), or for the church to pay the expenses directly to the educational institution. This will ensure that the scholarship does not inadvertently become taxable income because its specific use was not designated, and the recipient used it for nonqualified expenses. As

long as amounts are paid through a qualified scholarship plan, the church is not required to report the scholarship on Form 1099-MISC or 1099-NEC to the recipient.

KEY POINT A church may not establish a scholarship plan that is solely directed at a small group of potential candidates. For example, a church cannot set up a scholarship plan for its ministers or the children of its ministers. A smaller church may even be limited in establishing a plan solely for its members. To navigate these essential rules, qualified counsel should be sought in developing any scholarship plan for the church.

Sale or exchange of your principal residence

A taxpayer who is an individual may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the date of the sale or exchange.

A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or (to the extent provided under regulations) unforeseen circumstances, is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met. The exclusion under this provision may not be claimed for more than one sale or exchange during any two-year period unless the special provisions for unforeseen circumstances apply. See IRS *Publication 523* for details.

Line 2 (Form 1040). Interest income: attach Schedule B if over $1,500

Complete this line if you had interest income. Tax-exempt interest income is reported on Line 2a with taxable interest income reported on Line 2b. If you had taxable dividend and interest income of more than $1,500, complete Schedule B.

Line 3 (Form 1040). Dividend income; attach Schedule B if more than $1,500.

Complete this line only if you had dividend income. Qualified dividend income is reported on Line 3a and enter all dividend income on Line 3b. If you had dividend and interest income of more than that $1,500, complete Schedule B.

Line 4a- (Form 1040). IRA distributions

You should receive a Form 1099-R showing the total amount of distributions from your Individual Retirement Accounts (IRAs) before income tax or other deductions were withheld. This amount should be shown in box 1 of Form 1099-R and should always be reported on Line 4a with any taxable amount reported on Line 4b.

Line 5a (Form 1040). Pensions and annuities

Pension and annuity payments include distributions from 401(k) and 403(b) plans. Do not include the following payments on lines 5a and 5b. Instead report them on line 1.

- Disability pensions received before you reach the minimum retirement age set by your employer.
- Corrective distributions (including any earnings) of excess salary deferrals or excess contributions to retirement plans. The plan must advise you of the year(s) the distributions are includible in income.

Many denominational pension funds annually designate 100 percent of pension and disability benefits paid to retired ministers as a housing allowance. In such cases the 1099-R form may show that the taxable amount of the pension income is "not determined" by checking the box on line 2b.

If you are a retired minister, you may exclude all or a portion of your pension or disability income from your gross income reported on Form 1040 if (1) you can document that the monies were actually spent on housing-related expenses during the tax year, (2) the amount excluded does not exceed the fair rental value of the home (furnished, including utilities) and (3) the applicable pension board designated the retirement payments as housing allowance.

IRS Publication 517 states: "If you are a retired minister, you can exclude from your gross income the rental value of a home (plus utilities) furnished to you by your church as a part of your pay for past services, or the part of your pension that was designated as a rental allowance. However, a minister's surviving spouse cannot exclude the rental value unless the rental value is for ministerial services he or she performs or performed."

> **KEY POINT** Surviving spouses of deceased ministers cannot exclude any portion of the benefits received from their deceased spouse's 403(b) account as a housing allowance.

Line 6a (Form 1040). Social Security benefits

KEY POINT Individuals who receive Social Security retirement, disability, or survivor benefits may have to pay taxes on a portion of their benefits.

If the only income you received during 2022 was your Social Security benefits, your benefits generally aren't taxable. But some taxpayers have to pay federal income taxes on their Social Security benefits (retirement, survivor, and disability). This usually happens only if you have other substantial income in addition to your benefits (such as wages, self-employment, interest, dividends and other taxable income that must be reported on your tax return).

If you:

- **file a federal tax return as an individual or married filing separately** and your *combined income* is
  - between $25,000 and $34,000, you may have to pay income tax on up to 50 percent of your benefits.
  - more than $34,000, up to 85 percent of your benefits may be taxable.
- **file a joint return**, and you and your spouse have a *combined income* that is
  - between $32,000 and $44,000, you may have to pay income tax on up to 50 percent of your benefits.
  - more than $44,000, up to 85 percent of your benefits may be taxable.

Your combined income is your adjusted gross income plus non-taxable interest and ½ of your Social Security benefits.

Each January, you will receive a *Social Security Benefit Statement* (Form SSA-1099) showing the amount of benefits you received in the previous year. You can use this *Benefit Statement* when you complete your federal income tax return to find out if your benefits are subject to tax.

For additional information on the taxability of Social Security benefits, see IRS Publication 915 (Social Security and Equivalent Railroad Retirement Benefits). Publication 915 is available at IRS.gov.

Line 7 (Form 1040). Capital gain (or loss)

Report on line 7 capital gains or losses (attach Schedule D) from the sale of capital assets. These include stocks, bonds, and property. Gain or loss is reported on Schedule D. You also may have to file Form 8949 (see the instructions to both forms for details).

> **KEY POINT** Schedule D is for reporting capital gains and losses from investments. Schedule 1, line 4 ("other gains or losses") is for reporting sales of other assets such as equipment used in a business.

Line 8 (Form 1040). Other Income

Income not reported on the Lines 1 through 7 is reported on Schedule 1 with the total reported on Schedule 1 reported on Line 8. The most important of these for minsters include:

(1) Line 3 (Schedule 1). Business income

Report self-employment earnings (from Schedule C). Self-employment earnings include:

- Compensation reported to you on a Form 1099-NEC
- Fees received directly from church members for performing personal services (such as marriages and funerals)
- Honoraria you received for guest speaking in other churches

If you received income from any of these kinds of activities, compute your net earnings on Schedule C and transfer this amount to line 3 of Schedule 1 (Form 1040).

(2) Line 8 (Schedule 1). "Other income"

"Other income" is reported on line 8z of Schedule 1 (Form 1040). Other income includes the following items:

- A canceled debt or a debt paid for you by another person (unless the person who canceled or paid your debt intended it to be a gift)
- The fair market value of a free tour you receive from a travel agency for organizing a group of tourists (in some cases this may be reported on Schedule C)
- Most prizes and awards
- Some taxable distributions from a health savings account (HSA) or Archer MSA

(see IRS Publication 969)

- Jury duty pay
- Recapture of a charitable contribution deduction if the charitable organization disposes of the donated property within 3 years of the contribution.
- Taxable benefits provided by the church but not included on Form W-2 or Form W-2c. (Also remember to include these benefits on Schedule SE for the calculation of self-employment tax.)

Line 9 (Form 1040). Total income

Report "total income" on this line. This is the sum of the amounts reported on lines 1-7 of Form 1040, plus the additional categories of income reported on lines 1-9 of Schedule 1 (Form 1040) included on Line 8 of Form 1040.

Line 10 (Form 1040) Adjustments to income

You may deduct certain adjustments from total income (line 9) to compute your adjusted gross income. Report the adjustments on lines 11 through 26 of Form 1040 (Schedule 1) and on line 10 (Form 1040). The total amount is subtracted from line 9 (Form 1040) to compute adjusted gross income that is reported on line 11.

The two most relevant adjustments for ministers are the deduction for one-half of the self-employment tax, and payments to an individual retirement account (IRA). Both are summarized below.

(1) Line 15 (Schedule 1) One-half of self-employment tax

> **KEY POINT** Every minister who pays self-employment taxes on ministerial income qualifies for this deduction. Some are not claiming it.

All ministers are self-employed for Social Security with respect to their ministerial income. They can deduct half of their actual self-employment taxes as an adjustment on line 15 (Schedule 1) of Form 1040, whether they are able to itemize deductions on Schedule A or not.

(2) Line 20 (Schedule 1). Payments to an individual retirement account (IRA)

An individual retirement arrangement, or IRA, is a personal savings plan which allows you to set aside money for retirement, while offering you tax advantages. You can set up different kinds of IRAs with a variety of organizations, such as a bank or other financial institution, a mutual fund, or a life insurance company.

The original IRA is referred to as a "traditional IRA." A traditional IRA is any IRA that is not a Roth IRA or a SIMPLE IRA. You may be able to deduct some or all of your contributions to a traditional IRA. You may also be eligible for a tax credit equal to a percentage of your contribution. Amounts in your traditional IRA, including earnings, generally are not taxed until distributed to you. IRAs cannot be owned jointly. However, any amounts remaining in your IRA upon your death can be paid to your beneficiary or beneficiaries.

Prior to 2020, if you were 70 ½ or older, you could not make a regular contribution to a traditional IRA. However, you could contribute to a Roth IRA and make rollover contributions to a Roth or traditional IRA regardless of your age. For 2020 and later, there is no age limit on making regular contributions to traditional or Roth IRAs.

To contribute to a traditional IRA, you or your spouse if you file a joint return, must have taxable compensation, such as wages, salaries, commissions, tips, bonuses, or net income from self-employment. Compensation does not include earnings and profits from property, such as rental income, interest and dividend income, or any amount received as pension or annuity income, or as deferred compensation.

If you file a joint return, you may be able to contribute to an IRA even if you didn't have taxable compensation as long as your spouse did. Each spouse can make a contribution up to the current limit; however, the total of your combined contributions can't be more than the taxable compensation reported on your joint return.

For 2022, if you file a joint return and your taxable compensation is less than that of your spouse, the most that can be contributed for the year to your IRA is the smaller of the following two amounts: (1) $6,000 ($7,000 if you are age 50 or older), or (2) the total compensation includible in the gross income of both you and your spouse for the year, reduced by your spouse's IRA contribution for the year to a traditional IRA and any contributions for the year to a Roth IRA on behalf of your spouse. (The contribution limit increases to $6,500 for 2023.)

All IRA contributions must be made by the due date of your tax return, not including extensions. This means that your 2022 IRA contribution must be made by April 18, 2023, even if you obtain an extension for filing this return.

> **EXAMPLE** A church has a senior pastor who is 52 years old, and a youth pastor who is 30 years old. The church does not participate in a

retirement program for its staff. In 2023, the senior pastor can contribute $7,500 to an IRA (maximum annual contribution of $6,500 plus a "catch-up" contribution of $1,000), and the youth pastor can contribute $6,500.

Your allowable deduction may be reduced or eliminated, depending on your filing status, the amount of your income, and if you or your spouse are covered by an employer provided retirement plan. The deduction begins to decrease (phase out) when your income rises above a certain amount and is eliminated altogether when it reaches a higher amount. The amounts vary depending on your filing status. For 2022, if you were covered by an employer provided retirement plan, then the deduction for contributions to your IRA are completely phased out when adjusted gross income reached $129,000 (MFJ) or $78,000 (Single). For 2023 the limits are $136,000 (MFJ) and $83,000 (Single).

If your spouse was covered by an employer retirement plan at any time during 2022 and you made contributions to your IRA, your allowable IRA deduction is completely phased out when adjusted gross income reaches $214,000 (MFJ). (For 2023 the limit is $228,000 (MFJ)). (See IRS *Publication 590-A*.) The Form W-2 you receive from your church or other employer has a box used to show whether you were covered by a retirement plan during the year. The "Retirement Plan" box should have a mark in it if you were covered. Employer retirement plans include 403(b) tax-sheltered annuities.

Figure your deduction using the worksheets in the instructions to Form 1040 or in Publication 590-A.

Individuals who cannot claim a deduction for an IRA contribution still can make nondeductible IRA contributions, subject to the lesser of $6,000 for 2022 (or $6,500 for 2023) or earned income limits. Earnings on these amounts continue to accumulate on a tax-deferred basis. When distributions are made from the IRA, special rules apply in figuring the tax on the distributions when both deductible and nondeductible contributions were made to the IRA. Form 8606 is used to designate a contribution as nondeductible and must be filed or the full amount of future withdrawals may be taxed. Withdrawals before age 59½ are subject to a 10 percent penalty tax that also applies to deductible IRA contributions.

Distributions from a traditional IRA are fully or partially taxable in the year of distribution. Use Form 8606 to figure the taxable portion of withdrawals. If you made only deductible contributions, distributions are fully taxable.

A Roth IRA differs from a traditional IRA in several respects. A Roth IRA does not permit a deduction at the time of contribution. Regardless of your age, you may be able to establish and make nondeductible contributions to a Roth IRA. However, you may be limited in the amount of nondeductible contributions you may make to your Roth IRA due to your adjusted gross income (AGI). For those filing as married filing jointly, no contribution may be made to a Roth IRA in 2022 if your AGI, as modified, is $214,000 or above. For those filing as single, no contribution may to be made to a Roth IRA if your AGI, as modified, is $144,000 or more. (For 2023, the Roth IRA contribution is phased out totally when AGI is $228,000 for taxpayers married filing jointly and $153,000 for singles and head of household filers.)

You do not report Roth contributions on your tax return. To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is set up. Like a traditional IRA, a Roth IRA can be set up but there are limitations on the amount that can be contributed and the time of year that contributions can be made. You do not include in your gross income qualified distributions or distributions that are a return of your regular contributions from your Roth IRA. Refer to Publication 590-A for additional information on Roth IRA(s).

For information on conversions from a traditional IRA to a Roth IRA, refer to Publication 590-A.

In the past, if you were 70 ½ or older, you could not make a regular contribution to a traditional IRA. However, you could still contribute to a Roth IRA and make rollover contributions to a Roth or traditional IRA regardless of your age subject to the above-described income limitations. For 2020 and later, there is no age limit on making regular contributions to traditional or Roth IRAs.

Charitable contributions. A qualified charitable distribution (QCD) is a distribution made directly by the trustee of your individual retirement arrangement (IRA), other than an SEP or SIMPLE IRA, to certain qualified organizations. You must have been at least age 70 1/2 when the distribution was made. Your total QCDs for the year can't be more than $100,000. If all the requirements are met, a QCD is nontaxable, but you can't claim a charitable contribution deduction for a QCD. For more information, see IRS Publications 526 (Charitable Contributions) and 590-B (Distributions from Individual Retirement Arrangements), or contact a tax professional.

Not all charities are eligible. For example, donor-advised funds and supporting organizations are not eligible recipients. Amounts transferred to a charity from an IRA are counted in determining whether the owner has met the IRA's required minimum distribution (RMD).

> **KEY POINT** The QCD does need a qualifying receipt from the recipient charity with the mandated "no goods or services" statement. A church may include the

gift on the IRA owner's regular giving statement in an attempt to fulfill this requirement, but care should be taken to not take a deduction for the QCD if it is included on the regular giving statement. Best practice is for the recipient charity or church to issue a separate statement for the gift.

Line 11 (Form 1040). Adjusted gross income

Adjusted Gross Income (AGI) is gross income minus adjustments to income. Gross income includes your wages, dividends, capital gains, business income, retirement distributions as well as other income. Adjustments to income include such items as educator expenses, student loan interest, alimony payments, or contributions to a retirement account. Your AGI will never be more than your Gross Total Income on you return and, in some cases, may be lower. AGI is an important number since it is used to determine the amount of various deductions and credits.

Tax computation

Line 12 (Form 1040). Itemized deductions or standard deduction

KEY POINT Itemize your deductions on Schedule A only if they exceed the standard deduction for your filing status.

On line 12 you enter either your itemized deductions from Schedule A or a standard deduction amount. Itemized deductions are discussed under Schedule A in this guide. For 2022, the standard deduction amounts are as follows:

FILING STATUS AND STANDARD DEDUCTION AMOUNT (2022)

single \$12,950

married filing jointly or qualifying widow(er).....................\$25,900

married filing separately \$12,950

head of household \$19,400

Additional standard deductions are available for each taxpayer who is over 65 and/or blind depending on their filing status.

Line 13 (Form 1040). Qualified business income deduction

Ministers who have income from business activities (conducted other than in their capacity as an employee of the church) and report their income on Schedule C, may be entitled to a federal tax deduction of up to 20% of their qualified business income (QBI). This deduction is also referred to as the IRC Section 199A deduction. Section 199A limits the deduction to the lesser of 1) 20% of the qualified business income (QBI) less one-half of the self-employment tax directly related to the qualified business income, the self-employed health insurance deduction and the self-employed qualified plan contribution deduction related to the qualified business, or 2) 20% of taxable income before the qualified business income deduction less net capital gains.

Upon publication of this guide, it has been interpreted that the qualified business trade or business activities of ministers who report their federal income taxes as self-employed may be considered a "specified service trade or business". Thus, there may be an exception to the deductibility of the QBI deduction. If a minister's taxable income (reported on Line 15 of the Form 1040), before this deduction exceeds $170,050 ($340,100 if married filing jointly) for 2022 then the deduction may be limited; if taxable income exceeds $220,050 ($440,100 married filing jointly) for 2022 then the deduction is unavailable. Attach either the Form 8995 or 8995-A and possibly Schedules A, B and C (Form 8995-A), as needed.

Line 16 (Form 1040). Compute tax

Most ministers can use the tax tables to determine their income taxes. Some higher income ministers must use the tax rate schedules (a spouse's income is considered in deciding whether or not to use the tax rate schedules).

Credits

A credit is a direct dollar-for-dollar reduction in your tax liability. It is much more valuable than deductions and exclusions, which merely reduce taxable income. There are two types of credits. Nonrefundable credits can only offset total taxes and can never create a refund. Refundable tax credits are reported on Form 1040 as a "payment" along with other tax payments and may create a refund, if total "payments" exceed total tax calculated on Line 24 of Form 1040.

Lines 19 & 28 (Form 1040) Child Tax Credit.

The child tax credit was greatly increased for 2021, but for 2022 it returns to its pre-2021 limits of $2,000 per qualifying child under the age of 17 and $500 per a qualifying dependent that does not meet the definition of a qualifying child. The $500 per qualifying dependent is a nonrefundable credit and reported on Line 19. A portion of the credit associated with a qualifying child may be nonrefundable, reported on Line 19, and a portion of the credit is refundable and reported on Line 28. This is referred to the "Additional Child Tax Credit" and the maximum amount of the refundable portion of the credit is $1500 per qualifying child. The credit is reduced based on a taxpayer's modified adjusted gross income (MAGI) and is completely phased out at $400,000 MAGI for jointly filed returns and $200,000 MAGI for all other filers. The credit is calculated on Form 8812.

Line 20 Schedule 3 (Form 1040)

On your 2022 Form 1040, nonrefundable credits are reported on lines 1-7 of Schedule 3, and the total amount for all credits is carried over to line 20 of Form 1040.

The more common and important nonrefundable credits for ministers reported on Schedule 3 are listed below along with the IRS Form and Publication that addresses them:

- the credit for child and dependent care expenses (Form 2441, Publication 503) The child and dependent care credit is a tax credit that may help you pay for the care of eligible children and other dependents (qualifying persons). The credit is calculated based on your income and a percentage of expenses that you incur for the care of qualifying persons to enable you to go to work, look for work, or attend school. Reverting to pre-2021 limits, the credit is limited to $1,050 for one qualifying individual and $2,100 if there are two or more qualifying individuals.

- the credit for education expenses –(see Form 8863 and Publication 970) – Credits for higher education include the American Opportunity Credit (partially refundable reported on Line 29) and the Lifetime Learning Credit (nonrefundable) Credits are fully phased out at $180,000 for those filing married filing jointly and $90,000 for other filers.

- the retirement savings credit (Form 8880, Publication 590-A) If you make eligible contributions to certain eligible retirement plans or to an individual retirement arrangement (IRA), you may be able to take a tax credit. The amount of the saver's credit you can get is generally based on the contributions you make and your credit rate. Refer to Publication 590-A or the instructions for Form 8880 for more information. The credit is phased out at $68,000 of adjusted gross income for those filing married filing jointly, at $51,000 for those filing head of household and at $34,000 for those filing single or married filing separately.

Lines 27, 28 & 29 (Form 1040)

The most common refundable credits for ministers are listed below along with the IRS Form and Publication that addresses them:

- the earned income credit reported on Form 1040 Line 27 (addressed later in this guide).
- Child tax credit calculated on Form 8812 reported on Line 28 of the Form 1040 (see previous discussion in this guide).
- American opportunity credit calculated on Form 8863 and reported on Line 29 of Form 1040 (see previous discussion in this guide).

Other taxes (Form 1040 line 23, from Schedule 2, line 21 ("other taxes")

On the Form 1040 for 2022, "other taxes" are derived from line 21 of Schedule 2 and the total of all taxes from Schedule 2 is carried over to line 23 of Form 1040. These include self-employment taxes which ministers must pay on ministerial income (unless exempt). Total taxes are reported on Line 24 of Form 1040.

Payments

On the 2022 Form 1040, amounts representing federal income tax withholding are reported on line 25 and estimated tax payments are reported on Line 26 as well as tax overpayments from the prior year applied to current year taxes. Other tax payments are reported on Schedule 3 and reported on Line 31 of Form 1040. The two most important categories of tax "payments" are withheld taxes and estimated tax payments, as noted below.

Line 25 (Form 1040). Federal income tax withheld

Federal income tax may be withheld from several sources of income. Form 1040 separately reports withholding from some of these different potential sources.

Line 25a – Federal income tax withheld from Forms W-2

Ministers' wages based on the performance of ministerial services are exempt from federal income tax withholding. As a result, only those ministers who have entered into a voluntary withholding arrangement with their church will have income taxes withheld. The church should report the amount of voluntarily withheld taxes on the minister's Form W-2.

> **KEY POINT** Ministers who enter into voluntary withholding arrangements will have federal and state income taxes withheld from their wages. However, a church does not withhold the employee's share of Social Security and Medicare taxes, since ministers are self-employed for Social Security with respect to ministerial compensation. Ministers can request (on Form W-4 or through other written instructions) that their church withhold an additional amount of income taxes to cover their expected self-employment tax liability. These additional withholdings must be treated as income taxes withheld (on Forms W-2 and 941) rather than the employee's share of Social Security and Medicare taxes. They constitute a payment that can be applied to both income taxes and self-employment taxes. Ministers still must complete Schedule SE to report their self-employment tax liability.

Line 25b – Federal income tax withheld from Forms 1099

Federal income tax may be withheld from pension payments or distributions reported on Form 1099-R or from Social Security payments reported on Form SSA-1099 or from other income reported on Form 1099-NEC. Other potential sources may be from interest and dividends reported on Form 1099-B.

Line 25c – Federal income tax withheld from other forms

> Income tax withheld from gambling winnings reported on Form W-2G or Additional Medicare Tax as calculated on Form 8959 is included on this line.

Line 26, (Form 1040). Estimated tax payments

Compensation paid to ministers for ministerial duties is not subject to mandatory tax withholding. As a result, ministers must prepay their income tax and Social Security (self-employment) taxes by using the quarterly estimated tax procedure, unless they have entered into a voluntary withholding agreement with their employing church. The estimated tax procedure is summarized in Part 2 of this guide in the section “How do ministers pay their taxes?”

The total amount of estimated tax payments made to the IRS for the 2022 tax year is reported as a payment of taxes on line 26 of Form 1040. Additionally, any amount of an overpayment from 2021 applied to the 2022 estimated tax payments is included on this line.

Line 27 (Form 1040). Earned income credit

The earned income credit reduces tax you owe and may give you a refund even if you do not owe any tax. A number of technical requirements must be met in order to qualify for this credit. Unfortunately, many taxpayers who qualify for the earned income credit do not claim it because it is so difficult to compute. In most cases, the amount of your earned income credit depends on: (1) whether you have no qualifying child, one qualifying child, two qualifying children, or three or more qualifying children; and (2) the amount of your earned income and modified adjusted gross income.

You may be able to claim the earned income credit for tax year 2022 if you have non-retirement investment income of $10,300 or less. The maximum earned income credit for 2022 is (1) $560 with no qualifying child, (2) $3,733 with one qualifying child, (3) $6,164 with two qualifying children, and (4) $6,935 with three or more qualifying children.

If you qualify for it, the earned income credit (EIC) reduces the tax you owe. Even if you do not owe tax, you can get a refund of the credit. Depending on your situation, the credit can be as high as $6,935 for 2022 ($7,430 for 2023).

You cannot take the credit for 2022 if your earned income (or AGI, if greater) is more than

- $16,480 ($22,610 if married filing jointly) if you do not have a qualifying child,
- $43,492 ($49,622 if married filing jointly) if you have one qualifying child,
- $49,399 ($55,529 if married filing jointly) if you have two qualifying children, or
- $53,057 ($59,187 if married filing jointly) if you have three or more qualifying children.

You can compute the credit yourself or the IRS will compute it for you. To figure the amount of your earned income credit, you must use the EIC Worksheet and EIC Table in the instructions for Form 1040, line 27. Ministers may want to consider having the IRS compute the credit for them, especially due to confusion about how the housing allowance affects the credit.

The credit is reported on line 27 of Form 1040.

IRS Publication 596 is a 44-page publication that explains the earned income credit. The 2021 edition (the most recent available at the time of publication of this text) states, in general: "The rental value of a home or a housing allowance provided to a minister as part of the minister's pay generally isn't 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 for ministers who have opted out of self-employment taxes by filing a timely Form 4361 exemption application with the IRS.

Excerpts from Publication 596 confirm that ministers who are employees for income tax reporting purposes and who have *not* exempted themselves from self-employment taxes by filing a timely Form 4361 with the IRS *include* their housing allowance or the fair rental value of a parsonage in computing earned income for purposes of the earned income credit.

But what about ministers who have exempted themselves from self-employment taxes by filing a timely Form 4361 with the IRS? Do they include a housing allowance or the rental value of a parsonage in computing their earned income for purposes of the earned income credit? As noted above, Publication 596 explicitly states, with regard to ministers who have filed Form 4361, that "a nontaxable housing allowance or the nontaxable rental value of a home is not earned income."

With respect to ministers who have filed a timely Form 4361, Publication 596 states:

Whether or not you have an approved Form 4361, amounts you received for performing ministerial duties as an employee count as earned income. This includes wages, salaries, tips, and other taxable employee compensation.

If you have an approved Form 4361, a nontaxable housing allowance or the nontaxable rental value of a home isn't earned income. Also, amounts you received for performing ministerial duties, but not as an employee, don't count as earned income. Examples include fees for performing marriages and honoraria for delivering speeches.

Ministers who are affected by this issue should consult their tax professional for help.

KEY POINT The definition of "earned income" for the Earned Income Credit is not the same definition of "earned income" utilized in calculating the Additional Child Tax Credit.

KEY POINT Once again, tax benefits may be affected by the housing allowance. Ministers should consider these various provisions and determine if the housing allowance is beneficial for them in light of how it affects the Earned Income Credit and the Additional Child Tax Credit.

Refund or amount you owe

After totaling your payments on Form 1040 Line 33, you can calculate whether you owe the government, or a refund is due you. If you owe a tax, be certain to enclose with your return a check in the amount you owe payable to the "United States Treasury" or by making the payment through your EFTPS account or at *IRS.gov/payments*. There are also payments methods directly through the IRS available at www.irs.gov/payments or tax practitioners can assist you in making a payment as a part of electronically filing your tax return. Do not attach the check to your return, but include it with a Form 1040-V. If you file your return electronically, the payment may be sent in separately using the Form 1040-V. Include your daytime phone number, your Social Security number, and write "Form 1040 for 2022" on the check. If you owe taxes, you also may have to pay an underpayment penalty (refer to line 38 of Form 1040). If you are paying taxes after April 18, 2023, you may also owe late payment penalties and interest.

If you have overpaid your taxes, you have two options: (1) request a full refund, or (2) apply the overpayment to your 2023 estimated tax (refer to line 36 of the Form 1040).

Sign here

You must sign and date the return at the bottom of page 2. If you are filing a joint return, your spouse must also sign the return. In the "your occupation" space, enter your occupation—*minister*. If you have your return prepared by a paid preparer, you will sign Form 8879, IRS *e-file* Signature Authorization instead of signing the Form 1040, page 2.

If you or your spouse has been the victim of identity theft, the IRS will issue you an Identity Protection PIN that must also be entered in this section of the return. This PIN is issued to you each year. (The PIN must also be provided to your paid tax preparer in order for the return to be electronically filed.)

Other forms and schedules

Schedule A

> **KEY POINT** If your itemized deductions exceed your standard deduction, you should report your itemized deductions on Schedule A (Form 1040). This section will summarize the itemized deductions.

Step 1: Medical and dental expenses (lines 1–4)

You may deduct certain medical and dental expenses (for yourself, your spouse, and your dependents) if you itemize your deductions on Schedule A, but only to the extent that your expenses exceed 7.5 percent of your adjusted gross income. You must reduce your medical expenses by the amounts of any reimbursements you receive for those expenses before applying the 7.5 percent test. Reimbursements include amounts you receive from insurance or other sources for your medical expenses (including Medicare). It does not matter if the reimbursement is paid to the patient, the doctor, or the hospital.

The following expenses ARE deductible as medical expenses:

- Fees for medical services

- Fees for hospital services

- Lodging at a hospital during medical treatment (subject to some limits)
- Medical and hospital insurance premiums that you pay (do not include amounts paid to health sharing arrangements)
- Special equipment
- Medicare A premiums you pay if you are exempt from Social Security and voluntarily elect to pay Medicare A premiums
- Medicare B premiums you pay
- Medicare D premiums you pay
- Medicare Supplement premiums you pay (or are deducted from your pension)
- Long-term care insurance premiums, subject to certain limitations on the amount that may be deducted
- Special items (false teeth, artificial limbs, eyeglasses, hearing aids, crutches, etc.)
- Transportation for necessary medical care. For 2022, the standard mileage rate for medical travel was 18 cents per mile. The 2023 rate was not available at the time of publication. It can be found on the IRS website.
- Medicines and drugs requiring a prescription, and insulin
- The portion of a life-care fee or founder's fee paid either monthly or in a lump sum under an agreement with a retirement home that is allocable to medical care
- Wages of an attendant who provides medical care
- The cost of home improvements if the main reason is for medical care
- Program to stop smoking
- Exercise expenses (including the cost of equipment to use in the home) if required to treat an illness (including obesity) diagnosed by a physician, and the purpose of the expense is to treat a disease rather than to promote general health and the taxpayer would not have paid the expense but for this purpose

The following items are NOT deductible as medical expenses:

- The cost of diet food
- Funeral services
- Health club dues (except as noted above)
- Household help
- Life insurance
- Maternity clothes
- Nonprescription medicines and drugs
- Nursing care for a healthy baby
- Toothpaste, cosmetics, toiletries
- Trip for general improvement of health
- Most cosmetic surgery

Step 2: Taxes you paid (lines 5−7)

At the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes. This provision was added to address the unequal treatment of taxpayers in the seven states that do not have an income tax. Taxpayers in these states cannot take advantage of the itemized deduction for state income taxes. Allowing them to deduct sales taxes helps offset this disadvantage.

Taxpayers may claim an itemized deduction of up to $10,000 ($5,000 for married taxpayer filing a separate return) for the aggregate of:

- State and local property taxes, and
- State and local income taxes (or sales taxes in lieu of income taxes) paid or accrued in the taxable year.

The $10,000 limitation applies until 2025.

Some states attempted to assist taxpayers in avoiding the above limitations by creating state-run charities that would grant "tax credits" in exchange for charitable contributions that would qualify for a tax deduction. The IRS issued regulations stating that to the extent a tax credit was granted, the charitable contribution would not be deductible.

Step 3: Interest you paid (lines 8-10)

As a general matter, personal interest is not deductible. Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations. Qualified residence interest means interest paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness. A qualified residence means the taxpayer's principal residence and one other residence of the taxpayer selected to be a qualified residence. A qualified residence can be a house, condominium, cooperative, mobile home, house trailer, or boat.

Acquisition indebtedness is indebtedness that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer and which secures the residence. Note the following two rules:

Limit on loans taken out on or before December 15, 2017

For qualifying debt taken out on or before December 15, 2017, you can only deduct home mortgage interest on up to $1,000,000 ($500,000 if you are married filing separately) of that debt. The only exception is for loans taken out on or before October 13, 1987 (see IRS Publication 936 for more information about loans taken out on or before October 13, 1987.)

See Publication 936 to figure your deduction if you have loans taken out on or before December 15, 2017, that exceed $1,000,000 ($500,000 if you are married filing separately).

Limit on loans taken out after December 15, 2017

For qualifying debt taken out after December 15, 2017, you can only deduct home mortgage interest on up to $750,000 ($375,000 if you are married filing separately) of that debt. If you also have qualifying debt subject to the $1,000,000 limitation discussed above, the $750,000 limit for debt taken out after December 15, 2017, is reduced by the amount of your qualifying debt subject to the $1,000,000 limit. An exception exists for certain loans taken out after December 15, 2017. See IRS Publication 936 for details.

The term "points" is sometimes used to describe certain charges paid by a borrower. They are also called loan origination fees, maximum loan charges, or premium charges. If the payment of any of these charges is *only* for the use of money, it ordinarily is interest paid in advance and must be deducted in installments over the life of the mortgage (not deducted in full in the year of payment). However, points are deductible in the year paid if the following requirements are satisfied:

1. Your loan is secured by your main home. (Your main home is the one you

ordinarily live in most of the time.)

2. Paying points is an established business practice in the area where the loan was made.
3. The points paid were not more than the points generally charged in that area.
4. You use the cash method of accounting. This means you report income in the year you receive it and deduct expenses in the year you pay them. Most individuals use this method.
5. The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
6. The funds you provided at or before closing, plus any points the seller paid, were at least as much as the points charged. The funds you provided are not required to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds you paid at or before closing for any purpose. You cannot have borrowed these funds from your lender or mortgage broker.
7. You use your loan to buy or build your main home.
8. The points were computed as a percentage of the principal amount of the mortgage.
9. The amount is clearly shown on the settlement statement (such as the Settlement Statement, Form HUD-1) as points charged for the mortgage. The points may be shown as paid from either your funds or the seller's.

KEY POINT Points are not currently deductible when paid in association with the refinancing of the home. These points must be amortized over the life of the new mortgage.

Refinancing a home mortgage may also create tax considerations. The amount of the new debt eligible as home acquisition debt is limited to the amount of the balance of the original old mortgage principal just before the refinancing unless additional proceeds are used to buy, build, or substantially improve a qualified home. If refinancing costs are rolled into the new debt, there will automatically be a portion of the interest paid on the new mortgage that is not deductible.

Congress enacted legislation in 2021 that provides for the deductibility of mortgage insurance premiums (MIP) through 2022. The deduction is phased out if you're your adjusted gross income is more than $109,000 (MFJ).

Step 4: Gifts to charity (lines 11-14)

For 2022, cash contributions to churches, schools, and most other public charities, that are US organizations, are deductible up to 60 percent of adjusted gross income. Contributions of property or cash contributions to supporting organizations, donor advised funds or to private foundations are subject to different limitations. See IRS Publication 526. Contributions made via cash, checks, credit cards or other electronic transfer options are reported on line 11, while contributions of noncash property are reported on line 12.

If you cannot itemize your deductions, a cash contribution up to $300 ($600 for married persons filing a joint return) was allowed on Form 1040, Line 12b, in 2021. However, this deduction expired at the end of 2021, and will not be available in 2022 and future years unless extended by Congress.

The value of personal services is never deductible as a charitable contribution, but unreimbursed expenses incurred in performing services on behalf of a church or other charity may be. For example, if you drive to and from volunteer work on behalf of a charity, you may deduct the actual cost of gas and oil or you may claim the standard charitable mileage rate of 14 cents for each substantiated mile (for 2022 and 2023). Unreimbursed travel expenses incurred while away from home (whether within the United States or abroad) in the course of donated services to a tax-exempt religious or charitable organization are deductible as a charitable contribution. Individuals performing the charitable travel can keep track of their own travel expenses and then claim a charitable contribution for the total on Schedule A.

Whether it is for travel expenses or other substantial out of pocket expenses related to performing services for a church or other nonprofit charity, a letter acknowledging the individual's service and containing the "no goods or services" statement should be obtained from the church or charity.

No charitable deduction is allowed for travel expenses incurred while away from home in performing services for a religious or charitable organization unless there is no significant element of personal pleasure, recreation, or vacation involved in the travel. Therefore, it is important to maintain an itinerary of the trip to prove the charitable nature of the trip.

Charitable contributions must be claimed in the year they are delivered. One exception is a check that is mailed to a charity—it is deductible in the year the check is mailed (and postmarked), even if it is received early in the next year.

Charitable contributions generally are deductible only to the extent they exceed the value of any premium or benefit received by the donor in return for the contribution.

There are limits on the amount of a contribution that can be deducted. Generally, cash contributions to churches, schools, and other public charities are deductible up to a maximum of 60 percent of adjusted gross income (2022). In some cases, contributions that exceed this limit can be carried over and claimed on future returns for up to five years. Some charitable contributions are limited to 20 percent or 30 percent of adjusted gross income, depending on the recipient and the form of the contribution.

Restricted contributions are those that are made to a church with the stipulation that they be used for a specified purpose. If the purpose is an approved project or program of the church, the designation will not affect the deductibility of the contribution. An example is a contribution to a church building fund. However, if a donor stipulates that a contribution be spent on a designated individual, no deduction is allowed unless the church exercises full administrative control over the donated funds to ensure that they are being spent in furtherance of the church's exempt purposes. Restricted contributions that ordinarily are not deductible include contributions to church benevolence or scholarship funds that designate a specific recipient. Contributions to benevolence or scholarship funds ordinarily are deductible if the donor does not earmark a specific recipient.

Contributions to a church or missions board that specify a particular missionary may be tax-deductible if the church or missions board exercises full administrative and accounting control over the contributions and ensures that they are spent in furtherance of the church's mission. Direct contributions to missionaries, or any other individual, are not tax-deductible, even if they are used for religious or charitable purposes.

Charitable contributions must be properly substantiated. Individual cash contributions of less than $250 may be substantiated by a canceled check, other bank record or a receipt from the charity. Special rules govern the substantiation of individual contributions of cash or property of $250 or more. The donor must substantiate these contributions with a qualifying receipt from the charity that includes a listing of the contributions and a statement that there were no goods or services provided in exchange for the contributions. These rules are further explained in the supplement to this guide entitled Federal Reporting Requirements for Churches.

> **KEY POINT** It is the responsibility of the donor to confirm that all donations claimed are supported by qualifying receipts. The consequence of failure is a loss of any contribution not supported by a qualifying receipt. This error cannot be corrected if discovered after the tax return is filed. Some churches and charities

fail to issue qualifying receipts, so donors must be vigilant in meeting this requirement, since this is not an error that can be corrected after your tax return is filed.

If you contribute property that you value at $500 or more, you must include a completed Form 8283 with your Form 1040. Complete only section A if the value claimed is $500 or more but less than $5,000. If you claim a deduction of more than $5,000 for a contribution of noncash property (other than publicly traded securities), then you must obtain a qualified appraisal of the property by a qualified appraiser and include a qualified appraisal summary (Section B of Form 8283) with your Form 1040. If several related items are given, each with a value of less than $5,000, an appraisal may still be required since the group of items would be treated as one rather than on an individual basis. In addition to the above rules, the donor must also obtain a qualifying acknowledgement from the charity that includes a description of the property and a statement that there were no goods or services provided in exchange for the donation.

TAX TIP There are both timing and form requirements for the qualifying appraisal, so a donor must plan accordingly to be able to meet these requirements. Failure to meet any of the requirements can nullify the entire contribution.

Special rules apply to donations of cars, boats, and planes. A donation is not allowed if the value of the item is $500 or more unless the donor has received Form 1098-C. See the instructions to IRS Form 1098-C for details.

KEY POINT The Tax Court has ruled in several cases that a donor who contributed property worth more than $5,000 to a church was not eligible for a charitable contribution deduction even though there was no dispute that the gift was given, or its value, because the donor failed to obtain a qualified appraisal or attach a qualified appraisal summary (Form 8283) to the tax return on which the contribution was claimed or obtain a qualifying receipt.

Step 5: Casualty and theft losses (line 15)

You can only deduct personal casualty and theft losses attributable to a federally declared disaster to the extent that:

(1) The amount of each separate casualty or theft loss is more than $100, and

(2) The total amount of all losses during the year (reduced by the $100 limit discussed above) is more than 10 percent of the amount on Form 1040 or 1040-SR, line 11. See the

Instructions for Form 4684 and Pub. 547 for more information.

NOTE: Job expenses and most other miscellaneous deductions

Employee business expenses that are either unreimbursed, or reimbursed by an employer under a nonaccountable arrangement, are no longer deductible as an itemized deduction by an employee through 2025.

The elimination of an itemized deduction for unreimbursed employee business expenses hit some clergy hard. But this impact can be minimized if a church reimburses employees' business expenses under an accountable expense reimbursement arrangement. To be accountable, a church's reimbursement arrangement must comply with all four of the following rules:

- Expenses must have a business connection—that is, the reimbursed expenses must represent expenses incurred by an employee while performing services for the employer.

- Employees are only reimbursed for expenses for which they provide an adequate accounting within a reasonable period of time (not more than 60 days after an expense is incurred).

- Employees must return any excess reimbursement or allowance within a reasonable period of time (not more than 120 days after an excess reimbursement is paid).

- The income tax regulations caution that in order for an employer's reimbursement arrangement to be accountable, it must meet a "reimbursement requirement" in addition to the three requirements summarized above. The reimbursement requirement means that an employer's reimbursements of an employee's business expenses come out of the employer's funds and not by reducing the employee's salary.

The elimination of "all miscellaneous itemized deductions that are subject to the 2 percent floor under present law" (including unreimbursed employee business expenses, and employee expenses reimbursed under a nonaccountable plan) has encouraged many churches to move to an accountable expense reimbursement plan, since section 62(a)(2)(A) of the tax code, which excludes from tax employer reimbursements of employee business expenses under an accountable plan (defined above) has not been modified.

Schedule B

Schedule B is used to report taxable interest income and dividend income from certain transactions and to indicate if you have an interest in or signature authority over a financial account in a foreign country or involved with a foreign trust. For most taxpayers, the schedule is triggered by the reporting of taxable interest and/or dividends of more than $1,500.

Step 1: Interest income (lines 1–4)

List (on line 1) the name of each institution or individual that paid you taxable interest if you received more than $1,500 of taxable interest in 2022. Be sure the interest you report on line 1 corresponds to any 1099INT forms you received from such institutions. Do not include tax-exempt interest. Taxable interest income is carried over to line 2b of Form 1040. Also utilize Schedule B to report any amount of interest you received from a seller-finance mortgage, interest accrued from a bond, original issue discount amounts reported on Form 1099-OID, interest subject to the exclusion for series EE or I U.S. savings bonds or received as a nominee.

Step 2: Dividend income (lines 5–6)

List (on line 5) the name of each institution that paid you dividends if you received more than $1,500 in dividends in 2022. Be sure the dividends you report on line 5 correspond to any 1099-DIV forms you received from such institutions. Ordinary dividend income is carried over to line 3b of Form 1040.

Step 3: Foreign accounts and foreign trusts (lines 7-8)

Be sure to complete this part of the schedule if you had a financial interest in, or signature authority over, a financial account in a foreign county or you received a distribution from, or were a grantor of, or transferor to, a foreign trust.

> **KEY POINT** If you have foreign bank accounts, you may be subject to additional filings including the FinCen 114 or Form 8938. This can also occur if your church has foreign bank accounts and you have signature authority on the accounts. Many times, the foreign bank account reporting is overlooked by taxpayers. Failure to comply can create substantial penalties.

Schedule C

> **KEY POINT** Most ministers who serve local churches or church agencies are employees for federal income tax purposes with respect to their church salary. They report their church salary on line 1 of Form 1040 and receive a Form W-2 from the church. They do not report their salary as self-employment earnings on Schedule C.

> **KEY POINT** Use Schedule C to report income and expenses from ministerial activities you conduct other than in your capacity as a church employee. Examples would be fees for guest speaking in other churches, and fees received directly from church members for performing personal services, such as weddings and funerals.

Step 1: Introduction

Complete the first several questions on Schedule C. Ministers should list code 541990 on line B, since for many years this was the code the IRS used in a clergy tax illustration in Publication 517. Some ministers who report their church compensation as self-employed point to this code as proof that ministers serving local churches can report as self-employed. This is not so. This code applies to the incidental self-employment activities of ministers who report their church salaries as employees. It also applies to those few ministers who are self-employed, such as traveling evangelists.

Step 2: Income (lines 1–7)

Report on line 1 your gross income from your self-employment activity. Include all amounts reported to you on Form 1099-NEC. If you received more than $600 through an electronic payment system, then you may receive a Form 1099-K. Such payments may have come through credit card payments or other forms of third party electronic payments. In the past such payments were not reported unless they were $20,000 or more to one recipient. For 2022, the filing limit has been lowered to $600 or more. Even if the payments do not represent taxable income, they must be reported on your tax return. If they do not represent taxable income, then a corresponding deduction may be claimed against the income with a statement included in the tax return. If these amounts are simply omitted from your return, then the IRS will issue a matching notice with a corresponding tax bill within one to two years.

Step 3: Expenses (lines 8–27)

CAUTION Many ministers continue to report their income taxes as self-employed. One perceived advantage of doing so is the ability to deduct business expenses on

Schedule C (and avoid the nondeducibility of unreimbursed and nonaccountable reimbursed employee business expenses as itemized deductions on Schedule A). This advantage is often illusory. Most "self-employed" ministers, if audited by the IRS, would be reclassified as employees and their Schedule C deductions disallowed. This could result in substantial additional taxes, penalties, and interest. The best way for ministers to handle their business expenses is through an accountable expense reimbursement arrangement (see above).

Report any business expenses associated with your self-employment earnings on lines 8 through 27. For example, if you incur transportation, travel or other expenses in the course of performing self-employment activities, you deduct these expenses on lines 8 through 27 of Schedule C. Entertainment expenses are generally nondeductible. However, you may deduct 50% of the cost of business meals if you are present and the food or beverages are not considered lavish or extravagant. You may deduct 100% of your meal expenses if the food and beverages were provided by a restaurant, and paid or incurred after December 31, 2020, and before January 1, 2023.

Ministers may be required to reduce the expenses deducted on Schedule C, if a portion of the income is excluded from income as a housing allowance. The rules under IRC Section 265 state that expenses associated with tax-free income may not be deducted. Therefore, expenses on Schedule C may have to be allocated between taxable and non-taxable income. (Many refer to this rule as the Deason Rule.) See IRS Publication 517.

Report net self-employment income from Schedule C on Schedule 1, line 3 (Form 1040) and carry over this and other items of additional income reported on Schedule 1 to line 8 of Form 1040.

Schedule SE

KEY POINT Use Schedule SE to report Social Security taxes on any income you earned as a minister if you have not applied for and received IRS approval of an exemption application (Form 4361). Remember, ministers (except for some chaplains) are self-employed for Social Security with respect to their ministerial services. They pay self-employment taxes, and not Social Security ("FICA") and Medicare taxes, with respect to compensation from such services.

KEY POINT Ministers who have received IRS approval of an application for exemption from self-employment taxes (Form 4361) do not pay self-employment taxes on compensation received for their ministerial services. These ministers should enter “Exempt – Form 4361” on Form 1040, Schedule 2, line 4.

Step 1: Part I (line 2)

Ministers complete Part I “Self-Employment Tax” of the schedule. Ministers report their net self-employment earnings on line 2 of Part I. This amount is computed as follows:

Add the following to your church salary reported on Form W-2 in Box 1:

- other items of church income (including taxable fringe benefits omitted from your W-2)
- fees you receive for marriages, baptisms, funerals, masses, etc.
- self-employment earnings from outside businesses
- annual rental value of a parsonage, including utilities paid by church (unless you are retired)
- a housing allowance (unless you are retired)
- business expense reimbursements paid under a nonaccountable plan but omitted from your W-2
- the value of meals served on the church’s premises for the convenience of the employer
- any amount a church pays toward your income tax or self-employment tax

And then deduct the following:

- most income tax exclusions other than housing allowance, parsonage value, meals or lodging furnished for the employer’s convenience, and the foreign earned income exclusion
- salary reduction contributions (elective deferrals) to a tax-sheltered annuity plan (403(b) plan) if included in your gross income above
- pension payments or retirement allowances you receive for your past ministerial services
- unreimbursed employee business expenses

- business expenses that were not deducted on Schedule C due to the allocation of a portion of the business expenses to the tax-free housing allowance pursuant to the requirements of IRC Section 265(a)(1), better known as the "Deason Rule"

Step 2: Part I (line 4)

Ministers (and other taxpayers who are self-employed for Social Security) can reduce their taxable earnings by 7.65 percent, which is half the Social Security and Medicare tax paid by employers and employees. To do this, multiply net earnings from self-employment times 0.9235 on line 4. Self-employment taxes are paid on the reduced amount.

Step 3: Part I (line 12)

The self-employment tax for 2022 is totaled on this line. The self-employment tax rate for 2022 is 15.3 percent, which consists of the following two components:

1. a Medicare hospital insurance tax of 2.9 percent calculated on Line 11, and
2. an old-age, survivor and disability (Social Security) tax of 12.4 percent calculated on Line 10.

For 2022, the 2.9 percent Medicare tax applies to all net earnings from self-employment regardless of amount. For 2022, the 12.4 percent Social Security tax applies to only the first $147,000 of net self-employment earnings. (For 2023, the maximum earnings subject to Social Security tax is $160,200.)

Form 8959, Additional Medicare Tax

An additional Medicare tax is calculated on wages or self-employment income of higher income taxpayers. A Medicare (HI) tax of an additional tax of 0.9 percent on wages received in excess of certain amounts must be calculated. This additional tax applies to ministers subject to self-employment tax. Unlike other Social Security and Medicare taxes, this additional tax is on the combined wages of a taxpayer and the taxpayer's spouse, in the case of a joint return. The threshold amount is $250,000 in the case of a joint return or surviving spouse, and $200,000 for single persons. The $250,000 and $200,000 amounts are not adjusted for inflation and remain the same for 2023.

Ministers who are a part of a two-earner family may be subject to this additional tax and should plan accordingly. Each working spouse may have wages and self-employment income of less than $250,000, but when added together, the total exceeds the threshold. This additional tax should be considered in preparing estimated tax payments or withholding instructions.

PART 4
COMPREHENSIVE EXAMPLE AND FORMS

Example One: Active Minister

Example Two: Retired Minister