

**CLERGY TAXATION**

**BY**

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## I. CLASSIFICATION OF CHURCH EMPLOYEES

### A. INTRODUCTION

1. Church employees are divided into two classifications for tax purposes: lay employees and dual-status ministers.
2. Because there are different tax rules for each classification, it is imperative that the proper status of each employee be determined at the outset of the employment relationship.

### B. DUAL-STATUS MINISTERS w 2

1. Definition. One who has been given the authority by the church to perform substantially all of the ministerial duties of the church.
2. Significance.
  - a. A dual-status minister is considered an employee of the church for income reporting, fringe benefit and expense deducting purposes and is considered self-employed for social security purposes.
  - b. The dual-status minister has distinct tax advantages over the lay employee through his entitlement to a **parsonage allowance** exclusion and the ability to deduct **professional expenses**.

### C. LAY EMPLOYEES w 2

1. Definition. Employees of churches and integral agencies of churches who do not perform ministerial duties.
2. Employee Status. Lay employees are considered employees of the church for all tax purposes. Thus, they receive none of the tax advantages of the dual-status minister.

## II. PARSONAGE ALLOWANCE

A. **ELIGIBILITY.** There are three conditions that must be met before an individual is considered a dual-status minister and, thus, eligible for a parsonage allowance.

1. Employed by a Church. The individual must be employed by a church or an integral agency of a church.

a. This rule does not apply if one of the following exceptions are true:

- i. The individual is assigned or appointed by his church to perform services at an organization that is not a church; or
- ii. The services being performed are that of conducting religious worship or ministering sacerdotal functions.

b. An integral agency of a church is one which meets most of the following requirements:

- i. The institution was incorporated by the religious organization;
- ii. The corporate name of the institution indicates a church relationship;
- iii. The religious organization continuously controls, manages, and maintains the institution;
- iv. The trustees or directors of the institution are approved by or must be approved by the religious organization or church;
- v. The trustees or directors may be removed by the religious organization or church;
- vi. Annual reports of finances and general operations are required to be made to the religious organization or church;
- vii. The religious organization or church contributes to the support of the institution; and
- viii. In the event of dissolution of the institution, its assets would be turned over to the religious organization or church.

2. Ministerial Services. The individual must perform ministerial services.

a. To meet this requirement, ministers are only required to perform substantially all of the ministerial duties of the church. Ministerial duties include:

- i. The ministration of sacerdotal functions;
- ii. The conduct of religious worship;

- iii. Service in the administration, control, conduct, and maintenance of religious organizations, including integral agencies, under the authority of a church or church denomination; and
- iv. The performance of teaching and administrative duties at theological seminaries.

b. Performance of the following services would satisfy this requirement:

- i. Acting as pastor of a church;
- ii. Conducting religious worship services or administering sacerdotal functions, even if not performed for a church or integral agency of a church;
- iii. Acting as chaplain at hospital or health and welfare institution;
- iv. Directing, managing, or promoting the activities of an integral agency of the church;
- v. Performing services for an organization that is not a church, if assigned or designated by a church to perform such services;
- vi. Acting as a rabbi;
- vii. Conducting evangelistic services at churches away from the minister's permanent home; and
- viii. Writing religious books or articles.

c. Performance of the following services does not satisfy this requirement:

- i. Administration of non-profit nursing home;
- ii. Chaplain in the armed services; and
- iii. Service by an employee of the State as a chaplain.

3. Ordained or the Equivalent Thereof. The individual must be ordained by a church or the "equivalent thereof."

- a. The equivalent of ordainment means having the ability to perform services in control, conduct and maintenance of the church.
- b. Thus, being hired by a church to perform its ministerial services would be the equivalent of ordainment because the church is granting the authority to conduct religious worship and administer ordinances.

**B. PARSONAGE EXCLUSION RULES.**

**1. Basic Concepts.**

- a. A dual-status minister is entitled to have a portion of his salary designated as a "parsonage allowance."
- b. All amounts designated as parsonage allowance and used to provide a home for the minister and his family are entitled to tax-free treatment with respect to income tax. However, these amounts are required to be reported as self-employment income, making them subject to social security and medicare tax.
- c. If the minister owns or rents the home, the parsonage allowance can be used for house payments or rent and expenses in maintaining the home.
- d. If a parsonage is provided, the fair rental value of the house is included in the amount designated as parsonage allowance and, thus, is not included in income.

**2. What is included.** Parsonage expenses include all costs related to the maintenance of the house, its contents, the garage and the yard. Typical expenses include:

- a. Rent or principal payments
- b. Real estate taxes and mortgage interest of the home. These expenses are also deductible as itemized deductions, essentially resulting in a double deduction;
- c. Insurance on the home and/or its contents;
- d. Improvements, repairs and upkeep of the home and/or contents;
- e. Furniture;
- f. Furnishings (cookware, dishes, etc.)
- g. Appliances, including but not limited to:
  - dishwasher                      vacuum sweeper
  - TV                                      VCR
  - stereo                                  piano

personal computer      washer and dryer  
sewing machine      garage door opener  
lawnmower      hedge trimmer  
small kitchen appliances

h. Decorator items, including but not limited to:

drapes      throw rugs  
pictures      knick knacks  
painting      wallpaper  
towels      sheets/bedspreads

i. Utilities

- i. Heat
- ii. Electric
- iii. Non-business telephone
- iv. Water
- v. Cable TV
- vi. Sewer charge
- vii. Garbage removal

j. Anything else that maintains the home and its contents.

- i. Examples include cleaning supplies for the home, light bulbs, etc.
- ii. These items are often purchased at a grocery or variety store. It is a good practice to buy household cleaning supplies separately and save the receipt.

3. What is excluded. Expenses that are not to be included:

- a. Maids or hired lawn care;
- b. Groceries;
- c. Personal toiletries such as toothpaste, shampoo, soap, laundry and dish soap, paper products, etc.;
- d. Personal clothing, shoes, jewelry, etc.; and
- e. Toys, hobby items, cassette tapes, CD's, computer games, personal computer software, VCR movies, etc.

4. Ceiling/Limitation on Amount of Allowance.

- a. If the minister owns or rents the home, the parsonage allowance is limited by the smallest of the following amounts:
  - i. The amount actually used to provide a home,
  - ii. The amount officially designated as a rental allowance, or
  - iii. The **fair rental value** of the home, including furnishings, utilities, garage, etc.
- b. A reasonable estimate of the fair rental value of a home, without furnishings, is 1% of the appraised value per month. Thus, a house appraised at \$100,000 would have a fair rental value of:

$$\$100,000 \times .01 = \$1000/\text{month or } \$12,000/\text{year}$$

This amount must then be adjusted by other factors such as condition of the home, location, local market demand, and local economic conditions.

- c. The worksheet for making these calculations has been attached as Exhibit A, with sample numbers for illustration.

5. Recordkeeping. Although receipts and records detailing the expenses used from the parsonage allowance are not required to be turned over to the employer, the minister should maintain adequate records for the following reasons:

- a. Any amounts designated as parsonage allowance and not used to provide a home are to be included in income. Thus, it is imperative that records are maintained in order to determine the amount, if any, that is to be included in income.
- b. The records can be used for substantiation in the event of an IRS audit.

C. **OFFICIAL DESIGNATION OF THE PARSONAGE ALLOWANCE**

- 1. To be eligible for tax-free treatment of the parsonage allowance, an official designation of what portion of the minister's salary shall be designated as parsonage allowance must be made in advance of the expenditures.

2. Thus, by official action, the employer must designate an amount the minister expects to spend for all the expenses of his home prior to the time the minister begins doing his duties.
3. The official designation can be done by the board or the congregation and should be recorded in the minutes. A new designation must be done annually. Sample wording is as follows:

- a. Church Owned Parsonage.

“The Chairman informed the meeting that under the tax law, a minister of the Gospel is not subject to federal income tax on the ‘parsonage allowance paid to him as a part of his compensation to the extent used by him to rent or provide a home.’

The parsonage is owned by the church and the actual utility expenses will be paid by the church.

After considering the estimate of Father \_\_\_\_\_ of his additional home expenses, a motion was made by \_\_\_\_\_, seconded by \_\_\_\_\_, and passed to adopt the following resolution:

Resolved that of the total cash salary for the year 19 \_\_, \$ \_ is hereby designated as parsonage allowance.”

- b. Minister Owns/Rents Home.

“The Chairman informed the meeting that under the tax law, a minister of the Gospel is not subject to federal income tax on the ‘parsonage allowance paid to him as a part of his compensation to the extent used by him to rent or provide a home.’

After considering the estimate of Father \_\_\_\_\_ of his home expenses, a motion was made by \_\_\_\_\_, seconded by \_\_\_\_\_ and passed to adopt the following resolution:

Resolved that of the total cash salary for the year 19 \_\_, \$ \_ is hereby designated parsonage allowance.”

#### **D. PARSONAGE ALLOWANCE PROCESS**

1. Estimate the expected living expenses of the minister.
  - a. It is best to overstate the parsonage allowance, make all household expenses with tax-free dollars and be required to include any excess in income.



- b. Understating the allowance will result in the taxpayer being required to make household expenses with non-tax free dollars.
  2. Make an official designation as described in section C, above.
  3. At the close of the tax year, compare the actual expenses of maintaining the home to the amount designated. The lesser of the amount designated or the amount substantiated is the amount allowed tax-free.
    - a. Parsonage expense detail, receipts and records are not to be submitted to the employer.
    - b. If the designated amount is greater than the amount substantiated, the "excess parsonage allowance" is shown as income on Form 1040, line 21.

### **III. PROFESSIONAL EXPENSES**

#### **A. INTRODUCTION**

1. In addition to the significant tax advantages of the parsonage allowance, the dual-status minister gets the added advantage of being able to deduct all the ordinary and necessary expenses incurred in order to earn his income.
2. The main difference between the parsonage allowance and the deduction of professional expenses is that records of parsonage expenses are not required to be turned over to the employer, whereas records of professional expenses must be adequately accounted to the employer in order to receive the best tax treatment.

#### **B. IMPORTANCE OF AN ACCOUNTABLE REIMBURSEMENT PLAN**

1. To obtain the best tax treatment, the employer must establish an accountable reimbursement plan wherein the employee is required to make an adequate accounting of his professional expenditures to the employer.
  - a. The employer can choose to reimburse the employee for all adequately accounted professional expenses or only for adequately accounted professional expenses up to a fixed limit.

- b. The IRS regulations require evidence of an obligation of the employee to account to the employer for his expenses. Thus, there must be a written reimbursement plan. Suggested language for such plan is as follows:

i. Unlimited Reimbursement.

“The Chairman informed the meeting that according to Section 62(a)(2)(A), an employee that adequately accounts to the employer the details of their professional expenses, is allowed a deduction from gross income. Section 62(c) further requires an employee to return any excess reimbursement or advance to the employer within a reasonable time. Reg. 1.62-2(d)(3) further requires that no part of our employee’s salary be recharacterized as being paid under this reimbursement arrangement.

A motion was made by \_\_\_\_, seconded by \_\_\_\_ and passed to adopt the following resolution:

Resolved that in addition to the salary provided our employee, we will reimburse him for auto, travel and professional expenses considered ordinary and necessary for him to carry out his duties. (Special modifications may be added)

It is further understood that a person other than the employee will examine the adequately accounted records and that the records will be kept for at least four years by the employer.”

ii. Fixed Limit Reimbursement.

“The Chairman informed the meeting that according to Section 62(a)(2)(A), an employee that adequately accounts to the employer the details of their professional expenses, is allowed a deduction from gross income. Section 62(c) further requires an employee to return any excess reimbursement or advance to the employer within a reasonable time. Reg. 1.62-2(d)(3) further requires that no part of our employee’s salary be recharacterized as being paid under this reimbursement arrangement.

A motion was made by \_\_\_\_, seconded by \_\_\_\_ and passed to adopt the following resolution:

Resolved that in addition to the salary provided our employee, we will reimburse him for auto, travel and professional expenses considered ordinary and necessary for him to carry out his duties up to a fixed limit of \$\_\_\_\_. (Special modifications may be added) If his actual expenses are less than this fixed limit, he cannot be given the

difference as bonus or salary. If his actual expenses are greater than this fixed limit, he will be required to deduct the extra expenses on Form 2106 and Schedule A.

It is further understood that a person other than the employee will examine the adequately accounted records and that the books will be kept for at least four years by the employer."

iii. Monthly Expense Allowance

"The Chairman informed the meeting that according to Section 62(a)(2)(A), an employee that adequately accounts to the employer the details of their professional expenses, is allowed a deduction from gross income. Section 62(c) further requires an employee to return any excess reimbursement or advance to the employer within a reasonable time. Reg. 1.62-2(d)(3) further requires that no part of our employee's salary be recharacterized as being paid under this reimbursement arrangement.

A motion was made by \_\_\_\_, seconded by \_\_\_\_ and passed to adopt to following resolution:

Resolved that in addition to the salary provided for our employee we will reimburse him for auto, travel and professional expenses considered ordinary and necessary for him to carry out his duties up to a fixed limit of \$\_\_\_\_. This reimbursement will be in the form of a monthly expense allowance equal to 1/12 of the fixed limit. If his actual expenses are less than this fixed limit, he must return the excess and cannot keep the difference as a bonus or salary. If his actual expenses are greater than this fixed limit, he will be required to deduct the extra expenses on Form 2106 and Schedule A.

It is further understood that a person other than the employee will examine the adequately accounted records and that the books will be kept at least four years by the employer."

- c. The regulations also require the reimbursement to be identified as such by making a separate check or by specifically indicating the reimbursement portion if wages and reimbursement are combined in one check.
2. To qualify as an accountable reimbursement plan, the following requirements must be met:
- a. No part of an employee's salary may be recharacterized as being paid under a reimbursement plan, which means that salary and reimbursements must be two separate budget items. Thus, the

employer must establish at the beginning of the year the amount of expenses it thinks the employee will incur. The employer must then subtract this amount from the employee's salary and record it in the budget as a separate entry.

- i. Example 1. Church pays Minister \$500/week. At the end of the week, Minister adequately accounts for \$50 of professional expenses and Church designates \$50 of the \$500 check as reimbursement. This does not satisfy the reimbursement requirement because Minister was getting \$500/week regardless of his expenses.
  - ii. Example 2. Church pays Minister \$500/week or \$26,000/year. At the beginning of the year, Church estimates that Minister will incur \$6,000/year in professional expenses. Church sets aside \$6,000 in the budget for reimbursement, adopts a written reimbursement plan, and pays Minister for his professional expenses as Minister adequately accounts for them. The \$6,000 entry in the budget is in addition to the \$26,000 allocated to Minister's salary. This does satisfy the reimbursement requirement.
  - iii. Example 3. Church pays Minister \$500/week or \$26,000/year. At the beginning of the year, church estimates that Minister will incur \$6,000/year in professional expenses. Church sets aside \$6,000 in the budget for reimbursement, adopts a written reimbursement plan, and pays minister an additional \$500/month for professional expenses. The \$6,000 entry in the budget is in addition to the \$26,000 allocated to Minister's salary. At the end of an agreed period (no more than one year), Minister's actual expenses for which he adequately accounted to Church are compared to the amounts already paid to Minister for professional expenses and Minister returns any excess. This does satisfy the reimbursement requirement.
- b. The employee must make an adequate accounting to the employer.
- i. The employee must submit to the employer a book or diary in which information as to the elements of each expenditure were recorded at or near the time of the expenditure. Supporting documentation must also be submitted. See "Expense Reimbursement Form," attached as Exhibit B.

- ii. Actual receipts are required for any expense over \$75 and for lodging.
    - iii. A log maintained weekly is made "at or near the time of the expenditure."
    - iv. The expense must be described with reasonable detail. Generic descriptions such as "travel" or "miscellaneous business expense" are inadequate.
  - c. The employee must return any excess reimbursement.
3. The tax treatment of professional expenses depends on whether the expenses are reimbursed and whether there is an accountable reimbursement plan in place:
- a. Unreimbursed. The employer can choose to increase the minister's salary by the amount he expects the minister to spend on professional expenses, rather than requiring the minister to turn over his receipts for reimbursement.
    - i. This amount must be reported as income on the minister's income tax return and the professional expenses are taken as deductions on a Schedule A.
    - ii. One disadvantage to this method is that expenses for meals and entertainment are reduced by 50%.
    - iii. Another disadvantage is that deductions are limited to the excess of 2% of adjusted gross income. Thus, if the minister did not incur expenses in excess of 2% of adjusted gross income, no deductions may be taken for professional expenses.
    - iv. A final disadvantage is the expenses are taken as itemized deductions, which means that if the amount of the itemized deductions do not exceed the standard deduction, no deductions may be taken.
  - b. Reimbursed with no accountable reimbursement plan. If the employer reimburses the employee for professional expenses and

there is no written accountable reimbursement plan in place and/or the employee does not adequately account to the employer for the expenses, the reimbursements will be treated in the following manner:

- i. The reimbursed amounts must be reported by the employee as income on his income tax return.
- ii. The expenses are deductible on Schedule A, as they are with unreimbursed expenses, with the same disadvantages.
- c. Reimbursed with an accountable reimbursement plan. The employee is not required to report reimbursed expenses as income if the employer chooses to establish a written reimbursement plan in accordance with the IRS regulations and the above requirements are met with respect to the plan. This clearly affords the employee the best tax treatment.

#### **C. TYPICAL PROFESSIONAL EXPENSES FOR A MINISTER**

##### **1. Auto expense**

###### **a. Including, but not limited to:**

- i. Gas
- ii. Oil
- iii. Lubrication
- iv. Repairs
- v. Parts
- vi. Tires
- vii. Batteries
- viii. Tune-ups
- ix. Car washes
- x. Insurance
- xi. Auto club dues
- xii. Licenses
- xiii. Parking fees
- xiv. Tolls

###### **b. All mileage should be logged in a journal and should include the following information:**

- i. Date;
- ii. Odometer reading at beginning of trip;

- iii. Odometer reading at end of trip;
- iv. Business miles driven for the day; and
- v. Place and purpose of the trip.

- c. Auto interest and personal property tax are not available as an employee business expense.
- d. If an employer provides a vehicle to the employee, the employee must report as income, the value of any personal use of the vehicle.

2. Travel (lodging, meals, entertainment)

- a. Including, but not limited to:

- i. Airplane fares
- ii. Auto rental
- iii. Taxi
- iv. Food costs
- v. Hotel or motel
- vi. Tips and gratuities
- vii. Telephone
- viii. Travel insurance
- ix. Baggage charges
- x. Cleaning and laundry costs

- b. To substantiate travel expenses, the employee must record, at or near the time of the event, the following information:

- i. The amount spent;
- ii. The date of the business trip;
- iii. The place traveled to; and
- iv. The business reason or purpose of the trip.

- c. Actual receipts for lodging must be submitted to the employer.
- d. Deductions for unreimbursed meals while away from home are limited to 50%.

3. Entertainment

- a. An employee can be reimbursed for 100% of meal and entertainment expenses, but if the employee is not reimbursed, he can only deduct 50% of the expenses.

- b. To be deductible, the entertainment expense must meet the following conditions:
  - i. The event must have been directly related to the active conduct of the employee's job and
  - ii. Must have directly preceded or followed a bona fide business discussion on a subject associated with the active conduct of the employee's business.
- c. Remember that any expense over \$75 must be substantiated by the actual receipt. If the entertainment is in the home, save the receipt from the grocery store.

4. Educational expenses

- a. Educational expenses are deductible if they are incurred:
  - i. For the purpose of maintaining or improving the employee's present job; or
  - ii. For meeting the express requirements of an employer to retain a new job.
- b. Typical education expenses include:
  - i. Tuition
  - ii. Books
  - iii. Supplies
  - iv. Fees
  - v. Any transportation away from your hometown
  - vi. Meals and lodging if necessary to be away from home overnight to attend classes.

5. Library and equipment depreciation

- a. The following items in your library can be depreciated or expensed under Section 179:
  - i. Books and equipment purchased during college and seminary training;
  - ii. Office furniture;
  - iii. Typewriters;
  - iv. Computers and printers;
  - v. Overhead projectors; or
  - vi. Copiers.



- b. If a computer is used for both personal and business use, a log must be maintained to determine the percent of business use. If less than 50% of computer use is for business, the employee cannot choose Section 179 expensing and must depreciate the computer at the rate of 5 years straight-line.

6. Office supplies and postage

- a. A home office deduction is not available if your employer provides an office on their premises.
- b. Typical office expenses include:
  - i. Stationery
  - ii. Carbon paper
  - iii. Erasers
  - iv. Ink
  - v. Stapler
  - vi. Paper clips
  - vii. Record books
  - viii. Secretarial or typing expenses
  - ix. Postage
  - x. Copier supplies
  - xi. Computer supplies

7. Religious materials

- a. Typical expenditures include:
  - i. Robes
  - ii. Shirt collars
  - iii. Musical supplies
  - iv. Booklets purchased for distribution
- b. Clothing is only deductible if it is required as a condition of employment and is not adaptable for general wear. Thus, robes would be deductible, but suits or shirts suitable for general wear would not.

8. Subscriptions, paperbacks and tapes

- a. Subscriptions to periodicals or journals that are directly related to the ministry are deductible.

- b. Except for one subscription to a local newspaper, which the IRS considers to be personal, subscriptions to newspapers are also deductible.
- 9. Seminars and dues are deductible if directly related to your profession; and
- 10. Long distance phone calls related to the profession are deductible.

#### **IV. EXEMPTION FROM SOCIAL SECURITY**

##### **A. INTRODUCTION**

- 1. Members of the clergy may decide that, based on their religious principles, they are opposed to accepting any public insurance, including Social Security, for services performed as a member of the clergy.
- 2. Members who make this determination may file a Form 4361 exempting them from social security.
- 3. Opposition must be based on religious grounds rather than economic reasons.
  - Form 4361 requires the minister of the church to state: "I certify that I am conscientiously opposed to, or because of my religious principles I am opposed to, the acceptance (for services I perform as a minister, member of a religious order not under a vow of poverty, or a Christian Science practitioner) of any public insurance that makes payments in the event of death, disability, old age, or retirement; or that makes payments toward the cost of, or provides services for, medical care. (Public insurance includes insurance systems established by the Social Security Act)."
- 4. Once made, the exemption is irrevocable. However, the Service has, on two occasions, made provisions for revocation.

##### **B. FORM 4361**

- 1. Members of the clergy opposed to receiving public insurance must fill out a Form 4361 attesting to such opposition.
- 2. By filing the Form 4361, the minister is certifying that he has notified the ordaining, licensing or commissioning body of his church of such opposition.

3. The Form 4361 must be filed by the due date of the tax return, including extensions, for the second tax year in which net self-employment earnings of \$400 or more was realized from services as a minister. The two years need not be consecutive.
  - a. Example 1. Father has net earnings of \$400 from services as a minister in 1994 and \$700 from services as a minister in 1995. Form 4361 must be filed by April 15, 1996.
  - b. Example 2. Father has net earnings of \$400 from services as a minister in 1990 and \$700 from services as a minister in 1995. Form 4361 must be filed by April 15, 1996 (the two years need not be consecutive).
  - c. Example 3. Father has net earnings of \$200 from services as a minister in 1990, \$400 in 1991, \$300 in 1992 and \$400 in 1993. Form 4361 must be filed by April 15, 1994 -- the due date of the tax return for the second year in which Father made \$400 or more from services as a minister.
4. If a minister changes faith, the time period in which to file a Form 4361 starts anew.
  - a. Example 1. Father worked for Church 1 and made \$400 in 1994 for his services. In 1995, Father transferred to Church 2, of a different denomination, and made \$400 in 1995 for his services and \$700 in 1996 for his services. Form 4361 must be filed by April 15, 1997.
  - b. Example 2. Father worked for Church 1 and made \$400 in 1990 and \$700 in 1991. In 1992, Father went to work for Church 2, of a different denomination and made \$500 in 1992 and \$800 in 1993. Form 4361 must be filed by April 15, 1994.
  - c. Example 3. Father worked for Church 1 and made \$400 in 1990, \$700 in 1991, and \$800 in 1992. On April 15, 1993, Father filed an untimely Form 4361, which was disapproved. In 1994, Father went to work for Church 2, of a different denomination and made \$500 in 1994 and \$800 in 1995. Form 4361 must be filed by April 15, 1996.

**C. EFFECT OF FILING A FORM 4361**

1. Any earnings from the services performed in the exercise of the ministry will be exempt from social security.

2. The minister will still be subject to either social security or self-employment tax for employment work that is not done in the exercise of the ministry.
  - a. A minister becomes vested after 10 years or forty quarters of social security contributions.
  - b. Thus, a minister may become vested from secular earnings and be entitled to receive social security benefits from the contributions on those earnings.
3. The exemption is retroactive and exempts ministry income from the date the ministry or change of faith began. A refund of amounts paid in prior to acceptance of the Form 4361 may be requested using a Form 1040X.

### EXAMPLE 1

This example will illustrate the difference in the taxes of a taxpayer that is eligible for the parsonage allowance and one that is not.

#### **REV. BROWN:**

Married with one child

Rev. Brown's Salary = \$32,000

Parsonage Allowance = \$18,000

Total Salary = \$50,000

Itemized Deductions = \$17,000  
(mortgage interest, taxes, and medical expenses)

Adequately Accounted for  
Reimbursed Prof. Exps. = \$10,000

#### **JOHN DOE:**

Married with one child

John's Salary = \$50,000

Itemized Deductions = \$17,000  
(mortgage interest, taxes, and medical expenses)

Adequately Accounted for  
Reimbursed Prof. Exps. = \$10,000

#### **THE FOLLOWING AMOUNTS WOULD BE REPORTED ON THE TAX RETURNS OF REV. BROWN AND JOHN DOE**

	<b>REV. BROWN</b>	<b>JOHN DOE</b>
Total Income (doesn't include parsonage allowance)	\$32,000	\$50,000
Minus ½ self-employment tax	<u>\$3,532</u>	<u>\$0</u>
Adjusted Gross Income	\$28,468	\$50,000
Itemized Deductions (doesn't include any prof. exps.)	<u>\$17,000</u>	<u>\$17,000</u>
	\$11,468	\$33,000
\$3200 x number of exemptions (3)	<u>\$9,600</u>	<u>\$9,600</u>
<b>Taxable Income</b>	\$1,868	\$23,400
<b>Total Income Tax</b>	\$280	\$3,510
<b>Difference in Taxes</b>		<u><b>\$3,230</b></u>

## EXAMPLE 2

This example will illustrate the difference in the taxes of a taxpayer that is eligible for the parsonage allowance and adequately accounts for his professional expenses and a taxpayer that is not eligible for the parsonage allowance and does not adequately account for his professional expenses.

### REV. BROWN:

Married with one child

Rev. Brown's Salary = \$32,000

Parsonage Allowance = \$18,000

Total Salary = \$50,000

Itemized Deductions = \$17,000

(mortgage interest, taxes, and medical expenses)

Adequately Accounted for

Reimbursed Prof. Exps. = \$10,000

### JOHN DOE:

Married with one child

John's Salary = \$50,000

Itemized Deductions = \$17,000

(mortgage interest, taxes, and medical expenses)

Reimbursed Prof. Exps. Not

Adequately Accounted for = \$10,000

### **THE FOLLOWING AMOUNTS WOULD BE REPORTED ON THE TAX RETURNS OF REV. BROWN AND JOHN DOE**

	<b>REV. BROWN</b>	<b>JOHN DOE</b>
Total Income (includes reimbursed expenses not adequately accounted for)	\$32,000	\$60,000
Minus ½ self-employment tax	<u>\$3,532</u>	<u>\$0</u>
Adjusted Gross Income	\$28,468	\$60,000
Itemized Deductions (doesn't include any prof. exps.)	<u>\$17,000</u>	<u>\$25,450*</u>
	\$11,468	\$34,550
\$3200 x number of exemptions (3)	<u>\$9,600</u>	<u>\$9,600</u>
<b>Taxable Income</b>	\$1,868	\$24,950
<b>Total Income Tax</b>	\$280	\$3,743

### **Difference in Taxes**

**\$3,463**

\*Assume \$700 is for meals and entertainment, only 50% of which may be deducted. The balance is then reduced by 2% of AGI, or \$1,200, leaving deductions for professional expenses at \$8,450.

### EXAMPLE 3

This example will illustrate the differences in the taxes of two taxpayers eligible for the parsonage allowance -- one adequately accounts for his professional expenses and the other does not.

#### REV. BROWN:

Married with one child

Rev. Brown's Salary = \$32,000

Parsonage Allowance = \$18,000

Total Salary = \$50,000

Itemized Deductions = \$17,000

(mortgage interest, taxes, and medical expenses)

Adequately Accounted for

Reimbursed Prof. Exps. = \$10,000

#### REV. BLACK:

Married with one child

Rev. Black's Salary = \$32,000

Parsonage Allowance = \$18,000

Total Salary = \$50,000

Itemized Deductions = \$17,000

(mortgage interest, taxes, and medical expenses)

Reimbursed Prof. Exps. Not

Adequately Accounted for = \$10,000

#### **THE FOLLOWING AMOUNTS WOULD BE REPORTED ON THE TAX RETURNS OF REV. BROWN AND REV. BLACK**

	<b>REV. BROWN</b>	<b>REV. BLACK</b>
Total Income (includes reimbursed expenses not adequately accounted for)	\$32,000	\$42,000
Minus ½ self-employment tax	<u>\$3,532</u>	<u>\$3,613</u>
Adjusted Gross Income	\$28,468	\$38,387
Itemized Deductions (doesn't include any prof. exps.)	<u>\$17,000</u>	<u>\$25,854*</u>
	\$11,468	\$12,533
\$3200 x number of exemptions (3)	<u>\$9,600</u>	<u>\$9,600</u>
<b>Taxable Income</b>	\$1,868	\$2,933
<b>Total Income Tax</b>	\$280	\$440

#### **Difference in Taxes**

**\$160**

\*Assume \$700 is for meals and entertainment, only 50% of which may be deducted. The balance is then reduced by 2% of AGI, or \$1,200, leaving deductions for professional expenses at \$8,854.

# WORKSHEET TO BE USED WITH FORM 2106

Taxable Year

Your Name

Social Security Number

Occupation in which expenses were incurred

☐ Ordained ☐ Licensed ☐ Commissioned ☐ Other

Filed Form 4361? ☐ Yes ☐ No

## ACTUAL AUTO EXPENSES

(Complete Form 2106, Part II, Sec. A & B first)

Vehicle 1 Vehicle 2

1. Garage rent
2. Gas, oil & lubrication
3. Repairs
4. Tires & batteries
5. Insurance & auto club
6. Miscellaneous
7. Washing and polishing
8. License (registration portion)
9. TOTAL


(enter on Form 2106, Part II, Section C, Line 23)

## LOCAL TRAVEL EXPENSES

1. Parking
2. Tolls
3. Fares
4. TOTAL


(enter on Form 2106-EZ, Part II, Line 2 or Form 2106, Part I, Line 2)

## OVERNIGHT TRAVEL EXPENSES

1. Auto rental, taxi, etc.
2. Fares (air, train, bus)
3. Parking & tolls
4. Laundry & cleaning
5. Lodging
6. Telephone, telegraph, postage, fax
7. Tips other than meals
8. TOTAL


(enter on Form 2106-EZ, Part II, Line 3 or Form 2106, Part I, Line 3)

## PROFESSIONAL EXPENSES (UNREIMBURSED)

1. Business-in-home (see attached)
2. Education expenses
3. Equipment depreciation (see attached)
4. Office supplies and postage
5. Religious materials
6. Sales aids
7. Seminars and dues
8. Subscriptions and paperbacks
9. Telephone
10. Other
11. TOTAL


(enter on Form 2106-EZ, Part II, Line 4 or Form 2106, Part I, Line 4)

## MEALS AND ENTERTAINMENT

1. Meals while away from home  
☐ Actual ☐ Optional
2. Entertainment, meals
3. Entertainment, other
4. Tips for meals
5. TOTAL


(enter on Form 2106-EZ, Part II, Line 5 or Form 2106, Part I, Line 5)

## COMPUTATION OF PARSONAGE ALLOWANCE

Date of purchase: 06 / 10 / 96

FMV of home you own: \$115,000

1. Value of parsonage provided by church
2. Rent or principal payments
3. Taxes
4. Interest
5. Insurance
6. Repairs & upkeep
7. Furniture, appliances, etc.
8. Decorator items
9. Utilities
10. Miscellaneous supplies
11. TOTAL
12. \*Fair Rental Value Computation

A  
PROVIDED  
BY CHURCH

B  
PAID BY  
MINISTER

	835
	1,182
	8,081
	340
	793
	1,409
	463
	2,738
	642
	16,483
	22,143

\*Compute in year of purchase and in any year of major expense. (Homeowners only)

FRV of Home	13,800
FRV of Furniture	4,500
Decorator items	463
Utilities	2,738
Miscellaneous	642
Total to line 12	22,143

13. Lesser of Column B, line 11 or line 12
14. Amount designated
- 15a. If line 14 is greater than line 13, enter the difference here and as income on Form 1040, line 21; or
- 15b. If amount designated is included in error on W-2, enter the lesser of line 13 or line 14 as a deduction on Form 1040, line 21

16,483  
18,000  
1,517

## COMPUTATION OF SOCIAL SECURITY BASE

If exempt, you may omit this section, write "Exempt-Form 4361" on the self-employee line, Form 1040, page 2.)

1. Salary from W-2
2. Parsonage provided, column A, line 11
3. Parsonage allowance, Column B, line 14
4. Recapture of auto depreciation
5. Less business portion of tax preparation
6. Less business % of auto interest and P.P. tax
7. Less unreimbursed employee business expense  
(enter from Form 2106-EZ, line 6 or Form 2106, line 10)
8. TOTAL (enter on Schedule SE, Sec. A, line 2)




**EXPENSE REIMBURSEMENT FORM**  
(Please Attach All Receipts To This Form)

NAME \_\_\_\_\_

ADDRESS \_\_\_\_\_

CITY \_\_\_\_\_ STATE \_\_\_\_\_ ZIP \_\_\_\_\_

[illegible]

**TOTAL.**

Approved By \_\_\_\_\_

Date \_\_\_\_\_

# Worth's Income Tax Guide *for* Ministers

2006 Edition  
(For Preparing 2005 Tax Returns)

*B.J. Worth*



**Evangel Publishing House**

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Nappanee, Indiana 46550

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