

Church Treasurer's Guide to Changes in Federal Tax Law

I. Income Reporting

Years of tax law and even court cases show beyond a doubt that ministers who do not work under the direct supervision of others may consider themselves self-employed. Churches (and everyone else) making payments to self-employed persons may do so with Form 1099. Form W-2, which reports income and wage withholding for employees, has been suggested by the IRS for the reporting of ministerial income.

Despite law and rulings, many IRS workers and some ministerial tax "authorities" want to characterize all ministers as employees.

The law is clear. Persons who fit most (not necessarily all) of the following criteria may consider themselves self-employed, and not subject to W-2 reports as employees:

- 🕒 Set their own hours
- Determine the course of their work
- Are not under the direct supervision of another
- Have made a significant financial investment for their work (professional library, auto, equipment, etc.)
- Are under a call which specifies that their first and primary "boss" is God and His Holy Word
- Will likely be paid more as the church prospers, or less if the church suffers under their leadership.

For most ministers, this creates a tax advantage. Among the benefits:

- Lower tax rate
- Lower audit rate
- More deductions
- Easier qualifications for scholarships and grants

However, the 2001 federal tax act changes tax law in a way that could mean that *some ministers may now benefit from employee status.*

What this means to the church is that a proper and careful choice in tax reporting (the church can choose which form benefits their ministers the most) can greatly benefit the church worker. More of what the church pays a minister will be available to him and his family.

Simply put, the new law exempts the housing allowance or housing value, as well as other exempt income, from the calculation of the Earned Income Credit. The tax act specifically names employees as the recipients of this benefit. The Earned Income Credit grants a benefit to taxpayers with dependent children and whose Adjusted Gross Income is \$32,000 or less.

For example, a minister with two dependant children, spouse not employed outside the home:

OLD LAW

Compensation: \$25,000.
Housing allowance: \$25,000
Total: \$50,000
Therefore: Not eligible for EIC

NEW LAW

Compensation: \$25,000
Housing not included: \$ 0
Total for EIC: \$25,000
Therefore: **EIC benefit of \$1494.**

The bottom line:

The church may issue either a 1099 or a W-2 without fear of IRS retribution. Therefore, the decision should hinge on what benefits the minister the most. After all, what helps the minister ultimately helps the church.

II. Tax Credit for Retirement Savings

Another major change affecting ministers and other church workers is the enactment of a tax credit for workers who contribute to a Tax-Sheltered Annuity (403(b)) or an Individual Retirement Account.

The new law offers a tax credit of up to one-half of the amount placed into an account, up to a maximum credit of \$1,000.00. Church workers, who are generally not highly compensated, can benefit greatly.

Example:

A minister who pays taxes and whose Adjusted Gross Income is \$30,000 or less may receive a credit of \$1,000, a \$300 reduction in federal income tax, a self-employment tax cut of \$300 and a \$100 cut in state taxes.

Total savings: \$1,700.

Result: **Minister now has \$2,000 in new retirement savings at a cost of only \$300.**

No qualified church worker should ignore this opportunity. Please encourage your workers to look into this.

III. Tips for Filing Forms 1099 and W-2

Do not include reimbursed expenses in the total. This is an error. It can be corrected by a conscientious tax preparer, but it forces the minister to show the reimbursements are not income, and it raises the potential for an audit, no matter how accurately and honestly the return is filed.

If you have any doubt, allow CTFS to complete Form 1099. This economical service can save you and your pastor hours of work (and frustration). Download the form at http://clergytax.com/pdfs/CTFS_1099Service.pdf. Or go to www.clergytax.com; there's a link on the main page.

For help with Forms W-2, contact CTFS at 562 906-9906.

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