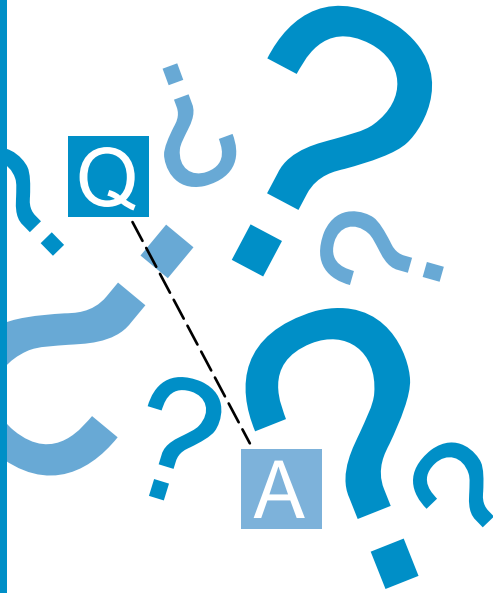




ANNUITY BOARD  
OF THE SOUTHERN  
BAPTIST CONVENTION



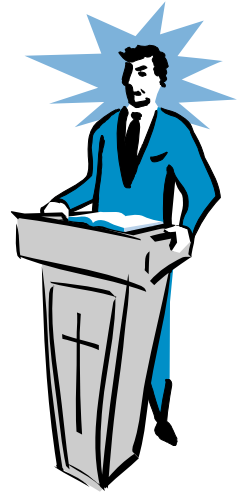
# Ministerial Tax Issues

**Answers to Common  
Questions**

# Table of contents

|  |    |
|--|----|
| Who is a “minister” for<br>tax purposes? .....             | 5  |
| What is a minister’s<br>housing allowance? .....           | 11 |
| Social Security basics<br>for ministers and churches ..... | 20 |
| Employee or self-employed?.....                            | 26 |

# Who is a “minister” for tax purposes?



In addition to pastors, Southern Baptist churches often have youth ministers, ministers of education and ministers of music. Although these people are clearly ministers in the eyes of the church, they may not be ministers in the eyes of the Internal Revenue Service (IRS). Taxpayers who incorrectly classify themselves as ministers when they file their tax returns could wind up owing back taxes and penalties. Churches that incorrectly treat paid workers as ministers could violate federal payroll reporting obligations, possibly leading to IRS penalties.

This section answers some basic questions about who is a minister for tax purposes. Many church employees, regardless of their titles, consider their work as a ministry. This brochure does not address theological issues, only tax issues. As always, seek advice from a competent tax adviser if you need assistance.

## **Q** Why is it important to know whether a taxpayer is a minister for tax purposes?

- A** Taxpayers who are ministers for tax purposes may:
- Be eligible for a tax-free housing allowance.
  - Be treated as self-employed for purposes of Social Security.
  - Be exempt from federal income tax withholding.
  - Be eligible to opt out of Social Security [although few Southern Baptist ministers are eligible].

**Q** If an employee’s title includes “minister of,” is that person a minister for tax purposes?

**A** Not necessarily. A title does not make someone a minister for tax purposes in the eyes of the IRS. The IRS uses other criteria.

**Q** Are ordained ministers always ministers for tax purposes?

**A** Not always. As discussed below, ordained ministers are more likely than licensed or commissioned ministers to be considered ministers for tax purposes; however, the IRS also looks at other criteria.

**Q** Are licensed or commissioned Southern Baptist ministers considered ministers for tax purposes?

**A** Some licensed or commissioned Southern Baptist ministers may be considered ministers for tax purposes; however, as discussed below, they are less likely to be considered ministers for tax purposes than ordained clergy. Each individual’s circumstances are important.

**Q** How does the IRS decide whether a taxpayer is a minister for tax purposes?

**A** The IRS will ask a series of questions to determine if a taxpayer is a minister for tax purposes. Unfortunately, the law is unclear about the questions the IRS should ask.

**Q** What test will the IRS use to decide if a taxpayer is a minister for tax purposes?

**A** The IRS may use the *Wingo* test. The U.S. Tax Court approved this test in *Wingo v. Commissioner*, 89 T.C. 922 (1987). The court said that a person is a minister for tax purposes if all of the following questions can be answered yes:

1. Is the person licensed, commissioned or ordained?
2. Does the person perform sacerdotal functions?
3. Does the person conduct religious worship?
4. Does the person maintain and control a religious organization?

**Q** Is there another test the IRS could use?

**A** The IRS could use the *Knight* test; however, it has recently been using the *Wingo* test. In *Knight v. Commissioner*, 92 T.C. 12 (1989), the U.S. Tax Court held that a licensed minister of the Cumberland Presbyterian Church was a minister for tax purposes. The court used this five-part balancing test:

1. Is the person licensed, commissioned, or ordained?
2. Does the person perform religious worship?
3. Does the person administer the sacraments?
4. Does the person have management responsibilities in the church or denomination?
5. Is the person considered to be a religious leader?

Under the *Knight* test, the person must be licensed, commissioned or ordained. If the person is licensed, commissioned or ordained, then the answers to the other four questions are balanced. One factor is not necessarily more important than another.

**Q** Is there an important difference between the *Wingo* and *Knight* tests?

**A** Yes. A taxpayer has a better chance of passing the *Knight* test. In other words, it's easier to be classified as a minister for tax purposes if the IRS uses the *Knight* test. That's because the *Knight* test is a balancing test. A taxpayer does not have to answer yes to all five questions with the *Knight* test. Under the *Knight* test, the minister must be licensed, commissioned or ordained. The answers to the other four questions are then weighed. On the other hand, a taxpayer would have to answer yes to all four questions to be classified as a minister under the *Wingo* test.

**Q** Why doesn't the IRS use the *Knight* test?

**A** We don't know why the IRS has been using the *Wingo* test instead of the *Knight* test. The *Knight* case was decided two years after *Wingo*; however, the IRS has continued to rely on *Wingo*.

**Q** Which test should Southern Baptist clergy use?

**A** As a practical matter, most ordained Southern Baptist ministers serving churches will pass either the *Knight* or *Wingo* tests, so this question is not that important to them. Many licensed and commissioned ministers could not pass either test, so this question is not that important to them either. Ministers who could pass the *Knight* test but not the *Wingo* test should consider consulting their own tax advisers before treating themselves as ministers for tax purposes. After consulting an attorney or accountant, these ministers may decide to follow the *Knight* test and consider themselves ministers for tax purposes. Nevertheless, they need to be aware that they could be audited and the IRS could take a different position.

**Q** Is there any other information about how the IRS decides if a person is a minister for tax purposes?

**A** The IRS has given its agents some guidance. In 1995, the IRS published its *Market Segment Specialization Program Audit Techniques Guide for Ministers' Returns*. This document was designed for training purposes and cannot be used as authority. Nevertheless, it is instructive about how IRS agents are trained to look at issues about ministers. It is available on the IRS Web site at [www.irs.gov](http://www.irs.gov).

One section discusses who qualifies for special tax treatment as a minister. Unfortunately, these guidelines don't give specific guidance about how to tell if someone is a minister for tax purposes. Instead, they summarize some important cases. It's interesting that the guidelines discuss the *Knight* case, but not the *Wingo* case.

**Q** How does a taxpayer's qualification as a minister for tax purposes affect a church?

**A** Churches have different payroll reporting obligations for ministers and non-ministers. By law, a church does not have to withhold income taxes from ministers; however, many ministers voluntarily elect withholding. Churches have to pay FICA for their non-ministerial employees. Ministers are always considered self-employed for Social Security purposes. That means they always pay SECA. Their churches cannot pay FICA for them. The church can designate a tax-free housing allowance for ministers only. A tax-free housing allowance is not available to taxpayers who are not ministers in the eyes of the IRS.

**Q** Should a church ordain, commission or license its staff so they can get housing allowances?

**A** No. A church should never ordain, commission or license an individual just to allow that person to receive a tax-free housing allowance. Churches should ordain, license, or commission clergy for theological reasons, not tax reasons. Also, as explained below, an individual is not automatically a minister in the eyes of the IRS simply because that person is ordained, commissioned or licensed.

**Q** Can a taxpayer be a minister for some tax purposes, but not for others?

**A** No, at least not in connection with a ministerial position. For example, if a person is a minister for tax purposes, that person should be entitled to a tax-free housing allowance. But that person will also have to pay SECA taxes; the church cannot pay FICA for a minister. On the other hand, it is possible for people who are ministers for tax purposes to have non-ministerial income. For example, a bivocational pastor could be eligible for a housing allowance and would pay SECA on ministerial income. On income from a secular employer, however, the bivocational pastor could not claim a housing allowance and would only pay SECA if self-employed for purposes of that other income.

## What is a minister's housing allowance?



The housing allowance exclusion is usually the most important tax benefit available to ministers. Unfortunately, many ministers and church leaders do not understand the basic rules about the housing allowance. Some ministers therefore do not get the full advantage of a housing allowance, and others may be underpaying their federal taxes.

This text answers some basic questions about the housing allowance. As always, seek advice from a competent tax advisor if you need assistance.

**Q** What is a housing allowance?

**A** When reporting income for federal income tax purposes, ministers can exclude part of their incomes designated by their church employers as a housing allowance. The amount designated as a housing allowance must be used to provide housing for the minister, and there are limits on the amount the minister can exclude. If a minister lives in a parsonage provided by the church, the minister does not have to report the value of the parsonage as income.

**Q** Is the housing allowance a deduction or an exclusion from income?

**A** The housing allowance is an exclusion from income permitted by Section 107 of the Internal Revenue Code. It is not a deduction. In other words, a housing allowance is money that is not reported as income. A housing allowance is never deducted — it is never reported as income in the first place.

**Example:** First Baptist Church designates 40% of a minister's \$40,000 salary [\$16,000] as housing allowance. The minister does not claim the \$16,000 as a tax deduction when filing a tax return. Instead, the minister only reports \$24,000 as income (assuming the minister can claim the full amount designated by the church).

### **Q Does a housing allowance cost the church more money?**

**A** Not necessarily. If a church can afford to pay a minister, it can afford to give the minister a housing allowance. When a church designates a housing allowance for a minister, it is merely calling part of the minister's salary by a different name.

**Example:** Reverend Parker's church pays him \$20,000 a year. The church could designate part of that \$20,000, for example, 40%, as a housing allowance. Reverend Parker could exclude \$8,000 from income (assuming he can exclude the full amount designated by the church). Designating part of Reverend Parker's salary as a housing allowance has not cost the church anything.

### **Q Can all church employees have a tax-free housing allowance?**

**A** No. Section 107 of the Internal Revenue Code only allows a "minister of the gospel" to have a housing allowance. Only taxpayers who are ministers for tax purposes are eligible for a housing allowance. For example, a church custodian or secretary cannot have a tax-free housing allowance. Most

ordained Southern Baptist ministers are eligible for a housing allowance; however, licensed and commissioned Southern Baptist ministers may not be eligible. See the previous section "Who is a minister for tax purposes?"

### **Q Does a minister have to pay Social Security taxes on the amount excluded from income as a housing allowance?**

**A** Yes. Ministers must pay Social Security taxes (SECA) on the amount excluded from income as a housing allowance. A housing allowance is free from income taxes but not from SECA taxes.

**Example:** Reverend Smith's housing allowance is 40% of his \$40,000 salary [\$16,000]. Reverend Smith does not pay income taxes on the \$16,000 (assuming he can claim the full amount designated by the church). But he must pay SECA taxes on the \$16,000 housing allowance.

### **Q How much income can ministers who own their own homes exclude through a housing allowance?**

**A** Ministers who own their homes can exclude the lowest of the following three amounts:

- The amount designated by their church; or
- Actual housing expenses (including mortgage payments, utilities, property taxes, insurance, furnishings, repairs and improvements); or
- The annual fair rental value of the home (furnished, including utilities).

**Example:** Reverend Smith's church designates 40% of his \$40,000 salary [\$16,000] as a housing allowance for 2001. His actual housing expenses for 2001 were \$20,000. For 2001, the fair rental value of the house (furnished, including utilities) was \$21,000. Reverend Smith can exclude \$16,000 from his income because the church-designated amount

was lower than either the fair rental value or his actual expenses.

### **Q How much income can ministers who rent their homes exclude through a housing allowance?**

**A** Ministers who rent their homes can exclude the lower of the following two amounts:

- The amount designated by the church; or
- Actual housing expenses (including rent, utilities, furnishings and other costs for renting the home).

**Example:** Reverend Smith's church designates 40% of his \$40,000 salary [\$16,000] as a housing allowance in 2001. His actual housing expenses for 2001 were \$15,000. Reverend Smith can exclude \$15,000 from income because his actual housing expenses were lower than the amount designated by the church.

### **Q Can ministers who live in a parsonage have a housing allowance?**

**A** Yes. Ministers who live in a parsonage can have a housing allowance if they pay for utilities, furnishings or other items required to maintain a home. Churches should designate a housing allowance so these ministers can exclude from income the amounts required to pay for these expenses.

**Example:** Reverend Brown lives in a church-owned parsonage. He pays some expenses for maintaining the parsonage himself. His church should designate part of his salary as a housing allowance to cover those expenses.

### **Q Can bivocational ministers have a housing allowance?**

**A** Yes. Bivocational ministers can have a housing allowance, but only from their ministerial income. Secular employers cannot designate tax-free housing allowances for clergy.

**Example:** Reverend Young's church pays him \$10,000 a year for a part time position. He also earns \$20,000 a year teaching at a public high school. Reverend Young's church can designate up to \$10,000 as a housing allowance for him. His church cannot designate more than his ministerial compensation. The school cannot designate any part of his \$20,000 income as a housing allowance because it is not compensation from ministerial services.

### **Q What kinds of expenses can ministers count when calculating a housing allowance?**

**A** Ministers can count the following expenses when calculating a housing allowance: mortgage payments (principal and interest); rent payments; real estate taxes; property insurance; utilities (gas, electricity, water, sewer, garbage pickup, local telephone service); appliances and furniture (purchase or rental price plus repairs); remodeling expenses; homeowners' dues; and pest control. Remember, however, that there are limits on a tax-free housing allowance.

### **Q Can ministers include home equity loan payments in their housing allowance?**

**A** Ministers cannot include home equity loan payments in their housing allowance unless the home equity loan paid for housing expenses. For example, payments on a home equity loan used to remodel the home could be part of a housing allowance. Payments on a home equity loan used for college tuition could not be counted as housing allowance.

### **Q Can ministers who pay off their mortgages have a housing allowance?**

**A** Yes. Ministers who pay off their mortgages can have a housing allowance; however, the amount they exclude from income as a housing allowance cannot exceed their

expenses for maintaining a home. With no mortgage payment, the expenses of maintaining a home are obviously lower. The housing allowance can still be used to pay for utilities and other costs of maintaining a home. Ministers who have paid off their homes cannot claim the “fair rental value” of the home as a housing allowance.

**Q Can ministers include down payments on their homes as part of their housing allowance?**

**A** Yes. A down payment on a home may be part of a housing allowance. But because a housing allowance cannot exceed the fair rental value of the home (furnished, including utilities), ministers may not be able to count all of the down payment as part of a housing allowance.

**Example:** Reverend Black made a \$50,000 down payment on a home in 2001. His church designated \$55,000 of his \$60,000 salary as a housing allowance. Reverend Black had other housing expenses of \$10,000, but the fair rental value of the home (furnished, including utilities) was \$25,000. He can only exclude \$25,000 because the fair rental value was less than the church designated amount or his actual expenses (including the down payment). What if he had made a down payment of \$12,000? His total housing expenses would have been \$22,000. He could exclude \$22,000 because that amount is lower than the church-designated amount and the fair rental value.

**Q Can ministers have a housing allowance for more than one home at a time (a primary residence and a vacation home)?**

**A** No. For housing allowance purposes, ministers can only include expenses for a primary residence.

**Example:** Reverend Martin has houses in town and at the lake. He cannot combine the expenses of both homes for purposes of his housing allowance. He can only count the expenses of his primary residence, the home in town.

**Q Can ministers deduct mortgage interest on their homes even if they have a tax-free housing allowance?**

**A** Yes. Ministers who have a housing allowance may still deduct mortgage interest and real estate taxes.

**Q Should a church report the value of a housing allowance on a minister’s Form W-2?**

**A** No. The housing allowance should not be reported on a minister’s Form W-2.

**Q Is there a limit on the amount of a minister’s salary that a church can designate as a housing allowance?**

**A** No. There is no limit on the amount of a minister’s salary that a church can designate as a housing allowance. In appropriate situations, a church could designate 100% of a minister’s salary as housing allowance; however, remember that the minister’s exclusion is limited, as explained above. For example, a church could designate 100% of a minister’s \$10,000 compensation as a housing allowance. But if the minister owned a home, the minister could only exclude the smallest of: (1) the church-designated amount (\$10,000); (2) actual housing expenses; or (3) the annual fair rental value of the home.

**Q How does a church designate a housing allowance for a minister?**

**A** Churches should designate a housing allowance in writing before the beginning of a calendar year. Although the IRS has recognized oral designations, they are difficult to

prove. The governing board of the church should make the designation. In most Southern Baptist churches, this is the congregation in regular or called conference, but in some churches the body of deacons, a finance committee or trustees could be empowered to make the designation. Although a housing allowance can be shown as a line item in a church budget, it is better for the church's governing board to pass a specific resolution making the designation.

**Q Can a church designate a housing allowance retroactively?**

**A** No. The church cannot designate a housing allowance retroactively.

**Example:** When Reverend Smith prepared his 2001 tax return, he realized that his church had not designated a housing allowance for him in 2001. The church cannot fix its mistake by retroactively designating an allowance for 2001. Unfortunately, Reverend Smith cannot exclude any income as a housing allowance for 2001.

**Q What if the church does not designate an allowance?**

**A** If the church does not designate a housing allowance, the minister cannot exclude housing expenses from income. Churches should consider adopting "safety net" designations to avoid this problem. For example, a church could designate "40% of the minister's salary for 2002 and for all years in the future until changed in writing by the church."

**Q What if the church designates more than the minister can claim as a housing allowance?**

**A** If the church designates more than the minister can claim as a housing allowance, the minister is responsible for reporting and paying taxes on the correct amount of income. Ministers and churches should work together to

make this process easier. Ministers and churches have several options for calculating the housing allowance.

**Example:** At his request, Reverend Jones' church designates 40% of his \$50,000 salary [\$20,000] as housing allowance for 2001. In January of 2002, the church issues a Form W-2 to Reverend Jones showing income of \$30,000 [\$50,000 minus \$20,000]. For 2001, Reverend Jones had actual housing expenses of \$15,000, and the fair rental value of his house (furnished, including utilities) was \$25,000. He can therefore exclude only \$15,000 although the church designated \$20,000. He must therefore report \$5,000 as additional income on his tax return.

**Q Can eligible retired ministers receive part of their retirement benefits from the Annuity Board as a tax-free housing allowance?**

**A** Yes. Eligible retired ministers can receive up to 100% of their retirement benefits from a church pension board as a tax-free housing allowance, subject to other housing allowance limits. Ministers who receive retirement benefits but continue their service in the ministry will have to pay SECA taxes on the part of their retirement benefits designated as housing.

**Q Can surviving spouses of ministers receive part of their benefits from the Annuity Board as a housing allowance?**

**A** Unless a surviving spouse is also an eligible retired minister for tax purposes, a surviving spouse may not receive any benefits as a housing allowance.

# Social Security basics for ministers and churches



Like other taxpayers, most ministers and church employees pay a significant portion of their income for Social Security each year. Unfortunately, however, some ministers and churches may not understand the basic rules about Social Security. Failure to understand these rules can lead taxpayers to underpay Social Security taxes, a situation which may result in substantial penalties in the event of an IRS audit. Churches not aware of the rules could violate federal payroll tax procedures, possibly leading to IRS penalties and erroneous Social Security records for church employees.

This section answers some basic questions about Social Security. All churches and ministers should know this information. As always, seek advice from a competent tax adviser if you need assistance.

## **Q** Do ministers have to pay Social Security taxes?

**A** Yes, unless they have properly followed IRS rules to opt out of Social Security, discussed in more detail below, ministers must pay Social Security taxes on their ministerial income. Moreover, even if they have opted out of Social Security for their ministerial income, they must pay Social Security taxes on income they earn from secular employment, a concept that is particularly important to bivocational ministers.

## **Q** Do ministers have to pay self-employment taxes on their ministerial income?

**A** Yes, ministers must pay Social Security taxes at the self-employment — or SECA — rate on their ministerial income because ministers are always considered self-employed for purposes of Social Security. On the other hand, they may have to pay FICA on income they receive from secular employment.

## **Q** What's the difference between SECA and FICA?

**A** SECA is short for Self-Employment Contributions Act and refers to the rate which self-employed people pay toward Social Security. FICA is short for Federal Insurance Contributions Act and refers to the rate at which employees and employers contribute toward Social Security. Employers and employees pay FICA, and self-employed individuals pay SECA.

## **Q** What are the rates for FICA and SECA?

**A** There are two parts to SECA. A self-employed person pays a percentage of income for retirement, death and disability income benefits. An additional percentage is paid for Medicare. Self-employed persons pay the full SECA rate on income up to a certain amount. On income above that amount, they must pay for Medicare only.

Similarly, there are two parts to FICA. Employers and employees each pay half of the percentage on employee wages up to a certain amount, and each pay an additional amount for Medicare.

Be sure you have the correct information each year. Rates and maximum earnings amounts are available on the Social Security Administration's Web site, [www.ssa.gov](http://www.ssa.gov).

## Q Can a church pay FICA for a minister since paying SECA is so expensive?

A No, a church cannot pay FICA for a minister. By law, ministers are always treated as self-employed for Social Security purposes and therefore are subject to SECA for their ministerial earnings. Churches that pay FICA for their ministers are not doing them a favor; they are violating the law. Additionally, when churches report FICA for their ministers, they can mess up the Social Security Administration's records, which could lead to incorrect benefit calculations when the minister begins drawing a benefit.

## Q Can a church give a minister a Social Security allowance to help offset the expense of SECA?

A Yes, a church can give a minister an allowance to help offset the expense of SECA. But remember, an allowance is taxable income, so the minister will have to pay Social Security taxes as well as income taxes on the allowance.

## Q Does a minister have to pay Social Security taxes on a housing allowance?

A Yes. Although a housing allowance is excluded from income for federal income tax purposes, a minister must pay Social Security taxes on a housing allowance until the minister actually retires. Ministers who receive retirement benefits but continue their service in the ministry will have to pay SECA taxes on the part of their retirement benefits designated as housing.

## Q What are the implications of opting out of Social Security?

A A minister can opt out of Social Security by meeting strict IRS guidelines required when filing Form 4361, *Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners*.

Three copies of this form must be filed by the due date of the minister's tax return for the second year in which the minister had net earnings from self-employment of at least \$400, any part of which came from ministerial income. If a minister does not file a Form 4361 by that date, he's out of luck and cannot opt out of Social Security. Additionally, the IRS must approve the application.

There's a lot more to opting out of Social Security than filing Form 4361 by its deadline. Ministers should carefully review Form 4361 and its instructions to see how stringent the IRS requirements are for opting out.

**Ministers are not allowed to opt out of Social Security because they think it is a bad investment.** Under penalty of perjury, a minister must make certain representations to the IRS on Form 4361. When filing Form 4361, a minister must certify that he is opposed on the basis of religious principles to acceptance of public insurance, which includes payments for death, disability, retirement or medical care. Additionally, the minister must certify that he has informed his ordaining body of his opposition to accepting public insurance benefits on the basis of religious principles. Few ministers will be able to meet these requirements.

**Q Do churches have to pay FICA for their non-ministerial employees?**

**A** Yes, a church must pay FICA for non-ministerial employees unless the church has elected to exempt itself, a process described in more detail below. Remember that churches cannot classify a non-ministerial employee as self-employed to avoid paying FICA.

**Q How can churches legally avoid paying FICA on their nonministerial employees?**

**A** Churches have one chance to exempt themselves from their obligation to pay FICA on behalf of their employees by filing Form 8274, *Certification by Churches and Qualified Church-Controlled Organizations Electing Exemption from Employer Social Security and Medicare Taxes*. Churches filing this form must certify that they are opposed for religious reasons to the payment of Social Security taxes. Accordingly, few churches can meet this standard. The deadline for filing Form 8274 is rather confusing and relates to the date on which the church must file its first Form 941 on which it reports its employer share of FICA taxes.

Churches that have filed Form 8274 should realize that they have shifted the burden of Social Security taxes to their employees who will have to pay SECA taxes. Unlike ministers who opt out of Social Security, these employees must pay SECA and churches should be sure that their employees understand this obligation.

**Q How can I know if the Social Security Administration has proper records about my earnings history?**

**A** You should review your Social Security Administration records. The Social Security Administration automatically sends annual statements to workers and former workers who are 25 and older. Your statement should arrive about three months before your birthday. Information about how to read your statement is available on the Social Security Administration's Web site, [www.ssa.gov](http://www.ssa.gov). You may also ask the Social Security Administration to mail a statement to you by completing Form SSA-7004, *Request for Earnings and Benefit Estimate Statement*, available on the Web site or by calling 1-800-772-1213. Although you can complete an on-line request for a statement, your results will be mailed to you.

By knowing your records, you may be able to correct a mistake that could cost you benefits when you retire. If you do suspect a mistake in your records, your statement gives you a toll-free number to call to begin the process of correcting the error.

# Employee or self-employed?



Because they are called to the ministry, many ministers do not think of themselves as employees. But most ministers get paid for their services. In the eyes of the IRS, people who get paid for performing services are either employees or self-employed.

This section answers some basic questions about what it means to be an employee or self-employed for tax purposes. All churches and ministers should know this information. As always, seek advice from a competent tax adviser if you need assistance.

## Q Are most ministers employees or self-employed?

A Most ministers have a “dual tax status.” That means that although ministers are always self-employed for Social Security purposes (for their ministerial income), they are usually employees for income tax purposes.

**Example:** Reverend Brown is the senior pastor at First Baptist Church. He is an employee for income tax purposes, but he is self-employed for Social Security tax purposes.

## Q Can a minister ever be self-employed for income tax purposes?

A Yes, some ministers are self-employed for income tax purposes.

**Example:** Reverend White is an ordained Southern Baptist minister. He is a full-time evangelist and receives compensation from a number of churches every year. Reverend White is self-employed for income tax purposes. He is also self-employed for Social Security purposes.

## Q Can a minister who is an employee have self-employment income?

A Yes, a minister who is an employee can have self-employment income.

**Example:** Reverend Marks is senior pastor at First Baptist Church. He is an employee for income tax purposes and should report his compensation from the church as an employee. If he also has income from other sources, such as preaching at other churches, he should report it as self-employment income.

## Q Do employees complete their tax returns differently than self-employed persons?

A Yes. Employees report income on Form 1040. Employees can deduct their unreimbursed business expenses on Schedule A only if they itemize their deductions. If they itemize their deductions, they can deduct their business expenses to the extent they exceed 2% of their adjusted gross income.

Self-employed persons report income and expenses on Schedule C. Self-employed persons can deduct their business expenses on Schedule C even if they do not itemize. They can deduct all of their business expenses, not just those that exceed 2% of their adjusted gross income.

**Q** Are there tax advantages in being treated as an employee instead of as self-employed for income tax purposes?

**A** Yes, there are tax advantages in being treated as an employee for income tax purposes. Employees may exclude from income the cost of up to \$50,000 coverage in employer-paid group life insurance. Employees may exclude from income the cost of employer-paid medical insurance. If a church paid for these benefits for a self-employed minister, the minister would have to report them as income.

**Q** Is a self-employed person more likely to be audited by the IRS?

**A** Yes, a self-employed person is more likely to be audited by the IRS. IRS data shows that self-employed people are less likely to report their income correctly than employees. Ministers who have income from only one church and receive only one Form 1099-MISC a year are likely to be viewed as employees by the IRS.

**Q** What can happen to ministers who incorrectly file as self-employed persons rather than as employees?

**A** If the IRS determines that a minister has incorrectly been classified as self-employed, the IRS can reclassify the minister as an employee. Remember that employees can deduct business expenses only if they can itemize and only to the extent their business expenses exceed 2% of their adjusted gross income. If the IRS reclassifies a minister as an employee, the minister will lose business expense deductions. That means the minister may owe back taxes and penalties to the IRS.

**Q** Should churches issue ministers 1099s or W-2s?

**A** In most cases, churches should issue ministers a Form W-2 because most ministers are employees for income tax purposes. Churches that pay self-employed ministers at least \$600 in one year should issue a Form 1099-MISC.

**Example:** First Baptist Church issues a Form W-2 to each of the six ministers on its regular staff. First Baptist Church issues a Form 1099-MISC to a vocational evangelist who received \$750 from the church for preaching a revival.

**Q** Are churches required by law to withhold income taxes from their ministers' pay if their ministers are employees for income tax purposes?

**A** No, churches are not required by law to withhold income taxes from their ministers' pay, even if their ministers are employees for income tax purposes. Ministers may, however, voluntarily elect to have churches withhold income taxes from their pay. In most cases, churches are legally required to withhold income taxes from non-minister employees.

**Q** Are most paid church workers employees or self-employed?

**A** Most paid church workers are employees for tax purposes. That means their churches should issue them a Form W-2, not a Form 1099.

**Q** Can churches classify paid workers as independent contractors to avoid paying FICA or withholding income taxes from them?

**A** No. Churches cannot classify paid workers as independent contractors to avoid these obligations.

**Q** How can you tell if a paid church worker is an employee or an independent contractor (self-employed)?

**A** The IRS has generally used a twenty-factor test to determine if a worker is an employee or self-employed. In 1994, the United States Tax Court issued opinions in two cases about the tax status of ministers. In those cases, the Tax Court used a seven factor test to determine whether a minister is an employee or self-employed for income tax purposes. The seven factors are:

1. The degree of control the employer has over the details of the work.
2. Which party invests in the facilities used for the work.
3. The opportunity the worker has for profit or loss.
4. Whether the employer has the right to discharge the worker.
5. Whether the work is part of the employer's regular business.
6. The permanency of the relationship.
7. The relationship the parties think they are creating.

Most Southern Baptist ministers are employees for income tax purposes under this test.

The Annuity Board's annual *Ministers Tax Guide* is available on our Web site, [www.absbc.org](http://www.absbc.org), or by calling **1-800-262-0511**.



**ANNUITY BOARD**  
OF THE SOUTHERN  
BAPTIST CONVENTION

2401 Cedar Springs Rd., Dallas, TX 75201-1498  
P.O. Box 2190, Dallas, TX 75221-2190  
1.800.262.0511 • [www.absbc.org](http://www.absbc.org)

*Serving Those Who Serve the Lord "...with the  
integrity of our hearts and the  
skillfulness of our hands." Psalm 78:72*