

CLERGY AND NON-PROFITS



**Tax information for religious
and non-profit employees**



CLERGY

Members of the clergy are in many ways treated like non-clergy taxpayers, but there are special tax treatments that recognize their position as members of a church.

Income

General Rules of Income - for all taxpayers

U.S. individual taxpayers are required to report as gross income all compensation for personal services in the year they receive it, no matter what the form of payment. This includes:

- Salaries/wages
- Bonuses
- Commissions
- Retirement pay
- Tips
- Profit sharing
- Director's fees
- Jury fees

In addition to the guidelines above, Clergy must report compensation such as:

- Marriage Fees
- Baptismal and Funeral Offerings
- Other Stipends received

Employee or Self-employed?

For tax purposes, members of the clergy may be treated as either employees (preferred by the IRS) or independent contractors. In either case, with approval from the IRS, clergy may decide to be made exempt from self-employment (Social Security and Medicare) taxes. If an exemption is claimed, no benefits are available to the clergy member under either program in retirement. So unlike other taxpayers who are *required* to pay Social Security and Medicare, clergy may choose whether or not to participate.

As an Employee:

- Clergy receive a W-2 statement of income from their employer (church) organization.
- As discussed, Social Security may or may not be withheld. A minister is always considered self-employed when it comes to Social Security, but the minister must file Form 4361 on a timely basis to opt out of Social Security withholdings.
- Federal income tax withholding is voluntary, but if it is not withheld, quarterly estimated tax payments must be made.
- Housing allowance is generally exempt from income as long as it is spent for housing related expenses.

- Only expenses that exceed 2% of income can be deducted.

As an Independent Contractor:

- Clergy receive a 1099 from organizations receiving their services.
- Self-employed tax return is filed (Schedule C).
- No withholdings are taken for Social Security, Federal income tax or State income tax as noted above.
- Any housing allowance is not included in income.
- All clergy-related business expenses may be deducted and are not subject to the excess of 2% income threshold.

Fringe Benefits

Fringe benefits given to clergy do not have to be included as income provided the clergy does not utilize them for personal use. If used for personal use, you must calculate the value of the percentage of your personal use. Such fringe benefits could be:

- Automobile
- Airfare
- Computers
- Travel Expenses
- Entertainment
- Moving Expenses
- Educational Benefits
- The rental value of a home furnished to an ordained minister is exempt from tax.
- A rental allowance provided to a minister by a church for the purpose of the minister renting a home is tax exempt.
- Any rental allowance included in a retired minister's pension payments is also exempt.
- Housing allowance income exclusions only apply to ordained, commissioned or licensed clergy. Any unused amounts must be reported as miscellaneous income.
- A housing allowance must be spent on housing related expenses or it is considered self-employed income subject to federal, state and self-employment taxes.
- A minister's housing allowance is not subject to income tax, but may be subject to the self-employment tax. For the housing allowance to be excluded from income, the church organization that employs you must officially designate the payments (in the minutes) as a housing allowance BEFORE payment is made.

Caution: Housing provided or a housing allowance paid to a member of the clergy for teaching or administrative services by a non-church affiliated college, university or other institution may not be excluded from income.

Tip: Have your church adopt an accountable business expense reimbursement plan. Without one, unreimbursed business expenses are only deductible in excess of 2% of your income and are limited on a pro-rata basis to the extent of any housing allowance received (Deacon Rule).

Accident and Health Plans

Ministers do not have to include as income the amount their church or religious organization pays for accident and health insurance on their behalf. This includes most reimbursements for out of pocket medical treatment or disability income.

Retirement Plans-403(b)s

Many religious, charitable, educational and public non-profit organizations offer deferred compensation retirement savings plans. These are commonly called 403(b) plans and are usually funded through the purchase of annuities or custodial accounts comprised of mutual funds.

Contributions made to qualified retirement plans of a church or religious organization:

- may be excluded from income
- will be taxed at withdrawal as ordinary income
- will incur a 10% penalty if withdrawn prematurely

Tip: Contributions made for a self-employed minister to a qualified retirement plan of a church or religious organization may be excluded from income.

Common Mistakes

Mortgage Interest

A minister is allowed to deduct mortgage interest and real estate taxes paid for a personal residence even if the funds paid are from a rental/housing allowance that is exempt from income tax.

Self-employment Tax

Duly ordained members of the clergy who have taken vows of poverty are not subject to the self-employment tax when they perform duties connected with their religious order.

Employees of a church electing exemption from Social Security Withholdings are considered self-employed and subject to the self-employment tax if their *church income* is more than \$108.00.

This is a tax trap for many church employees whose wages are subject to the full 15.3% self-employment tax.

(see reverse for continued clergy information and non-profit information)

Withholding on Salary and Wages

Wages and salaries paid to members of a religious order for services performed for the order or any associated institution are exempt from mandatory withholdings.

Caution: Check whether tax withholdings are taken from your pay. It's voluntary. If not, you could be in for a big tax at the end of the year and possible penalties if you should fail to make quarterly estimated tax payments.



NON-PROFITS

Typically non-profit organizations are classified as tax-exempt charitable organizations under IRS code section 501(c)(3). They are organized for charitable purposes or for the mutual benefit of their members. Examples of such organizations include: charities, charitable trusts, professional associations, private foundations, local YMCAs, neighborhood churches and other religious groups and co-ops. Any net income directly related to their purposes are not taxed and may be retained by the organization for future operational needs.

Tax-exempt Status

Tax-exempt status must be applied for by filing Form 1023, 1024 or, in the case of a private foundation, Form 990PF. Although not taxed, these groups must file an informational return each year.

Public Disclosure

All non-profit tax-exempt organizations are required to allow public examination of their application for tax-exempt status and disclose their most recent informational returns.

Income Rules

Tax-exempt Income

The more common types of tax-exempt income include:

- Income from primary not-for-profit activities
- Tax deductible contributions
- Qualified member dues and fees
- Government grants for service to the public
- Rent from real property
- Income from research performed by a college, university or hospital for a person or the U.S. Government or it's agencies
- Gains or losses on sale or exchange of property

- Income from entertainment activities provided by the non-profit in connection with a fair or exposition
- Income of agricultural, horticultural, or labor organization for trade show participation to promote products and services
- Income from rental of a non-profit mailing list, name, logo or intangible asset is considered tax exempt royalty income provided:
 - the agreement states they are not forming a joint venture, partnership or agent relationship
 - the non-profit has limited responsibilities
 - the renter/licensor party keeps the books
 - the non-profit provides only inconsequential services to the business activity
- If members receive no significant benefits from their dues they may be treated as contributions not dues (income)
- All non-cash contributions must be assigned a Fair Market Value as of the date received
- All free use of service facilities or materials must be valued and reported separately on the information return
- If more than Fair Market Value is received for items sold in a fund raising campaign the excess is deemed a contribution

Taxable Income

Non-profits may earn unrelated taxable income from business activities. Any non-related business income must be filed on a taxable return (Form 990-T). This includes:

- All non-related business income and income from non-tax deductible contributions
- Rental income derived from the purchase of property that is debt financed by the non-profit and leased back by the seller
- Investment in a S-Corp. or private foundation

Losses where there is no profit motive may not be used to reduce income from any taxable activities.

Caution: With taxable income, non-profits are treated and taxed like corporations and are expected to pay quarterly estimated taxes.

Employee Income

Most employees of non-profit organizations, unless officially ordained ministers and/or religious clergy, must pay income tax on their wages, salaries and other forms of compensation.

(see reverse for clergy tax information)

This publication provides only summary information regarding the subject matter. Please call with any questions on how this information may impact your situation.