

MINISTERS' INCOME GUIDE

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This memorandum explains special tax rules which apply to Ministers, churches and church missions. Many of the questions are related, thus it is important to read this paper in its entirety.

While this memorandum is prepared to assist churches and Ministers regarding tax rules, pursuant to IRS Circular 230, it is not intended to provide specific legal or tax advice and cannot be used to avoid penalties or to promote, market, or recommend any tax plan or arrangement. Additional assistance is available on the IRS website, IRS.gov. For specific tax advice, consult a Certified Public Accountant or a Tax Attorney that is familiar with Ministerial tax issues.

This worksheet and white paper is not endorsed by the Government or the Social Security Department. Investment advisory services offered by Simplicity Wealth.



Determining Who Qualifies as a Minister for Tax Purposes

Over the past decade the Guardian team has been fortunate to help many ministers better understand the proper way to structure their income and help church leaders understand how to properly compensate both their ministry and non-ministry staff. What we have discovered is that a minister's income is very unique and widely misunderstood but when compensation is done properly it can help a minister reduce their tax burden while employed and in retirement. In this guide we will break down some important rules that apply to ministers while they are working and when they begin to take retirement distributions. The first step is to understand WHO IS A MINISTER!

While each denomination has their own guidelines for determining who they will credential as a Minister, it is crucial for individuals and churches alike to understand who qualifies as a Minister for Tax Purposes. Unfortunately, the IRS has not directly addressed the issue of who is a minister however according to Clergy Financial Resources (<https://www.clergyfinancial.com/who-is-a-minister-for-tax-purposes/>) These five criteria have emerged as crucial considerations:

1. The individual must hold ordination, licensing, or commissioning by a local church or denomination.
2. They should perform "sacerdotal functions," including officiating marriage and funeral ceremonies, baby dedications, baptizing believers, and administering communion.
3. Be recognized as a religious leader within the church or denomination.
4. The individual should lead religious worship.
5. Have management responsibilities in overseeing the control, conduct, or maintenance of the local church or religious denomination.

While all five factors may not always be present, courts and the IRS typically adopt a balancing approach for determination. The first criterion is steadfast; without ordination, licensing, or commissioning, an individual isn't considered a minister. However, this requirement offers flexibility. The ordination, licensing, or commissioning can be granted by a denomination or an individual church. It's plausible for someone to establish a church and be ordained by it. Given the varying terminologies across different churches, precise wording isn't necessary; what matters is evidence of recognition by the church or denomination as a minister.



The balancing approach remains flexible, as individuals serving in roles like minister of music, worship, youth, education, or administration may fulfil some criteria but not all. Performing sacerdotal functions entails various activities such as conducting marriage and funeral services, dedicating infants, baptizing believers, and serving communion. It's acknowledged that not all ministers engage in all of these functions, and there's no requirement for a minister to perform every sacramental function within their church. Meeting this criterion hinges on being qualified to perform some functions and doing so occasionally.

Being regarded as a religious leader pertains to both the role and the perception of members toward the minister. It's about whether members and others see the individual as a religious leader rather than someone merely carrying out routine tasks like clerical or janitorial duties. Job titles hold little weight; what matters is whether the minister is performing religious duties.

The definition of conducting religious worship isn't rigidly defined. It encompasses not only senior pastors but also youth pastors leading youth group services, ministers of music or worship leading services, or ministers of education overseeing church education programs that may include leading worship.

Having management responsibilities in church or denomination affairs is broadly defined to encompass ministerial roles within local churches or leadership positions within denominations. Any organizational oversight a minister provides qualifies them as such.

It's worth noting that many laypersons may meet the final four criteria, as some churches allow laypersons to perform these activities. This underscores the importance of the ordination criteria.

Now that we know who can qualify as a minister for tax purposes, we need to understand their Employment Status.

Understanding the Employment Status of Ministers

Determining whether ministers fall under the category of employees or self-employed individuals for federal tax purposes is a common dilemma. This distinction holds significant ramifications for the minister's tax filings and how churches report the minister's earnings.



Various tests, as employed by the IRS and Federal Courts, typically categorize most ministers as employees. In 1994, the United States Tax Court employed a comprehensive seven-factor test to address this issue:

1. The extent of control exerted by the employer over work details.
2. Investment in work facilities by either party.
3. Potential for individual profit or loss.
4. The employer's authority to terminate the individual.
5. Whether the work aligns with the employer's regular business activities.
6. The nature of the relationship's permanence.
7. The perceived relationship between the parties involved.

Despite the belief held by some ministers that reporting income taxes as self-employed could result in lower taxes, this notion is rarely true. Nevertheless, it's imperative for ministers to adhere to established criteria regarding their employment status.

KEY TAKEAWAYS

A noteworthy aspect is the “dual tax” status many ministers hold:

- Ministers are generally deemed employees for Federal Income Tax purposes.
- Yet, they are considered self-employed for Social Security purposes concerning earnings from ministry services, such as guest preaching or conducting weddings and funerals.

KEY TAKEAWAYS

Many Ministers benefit from being categorized as employees for several reasons:

- Reduced risk of IRS audits compared to self-employed individuals.¹
- Avoidance of additional taxes and penalties post-IRS audit.
- Eligibility for tax-free fringe benefits, such as employer-paid medical coverage.

Regarding Social Security, ministers should attach Schedule SE to Form 1040 unless they've obtained approval from the IRS to exempt themselves from SECA taxes. It's crucial to note that opting out of Social Security is rare and subject to specific eligibility criteria based on religious considerations.



Social Security Benefits Application Form

By signing and submitting Social Security Benefits, I certify that this application is complete and all information provided is true and accurate and contains no willful falsifications or misrepresentations. I understand that falsifications, representations, or omissions may disqualify me from receiving Social Security benefits. I hereby authorize responsible person to conduct a background investigation.

KEY TAKEAWAYS

- Employees and self-employed individuals complete tax returns differently.
- Incorrectly filing as self-employed instead of as an employee can result in IRS reclassification and potential financial penalties.
- Churches cannot classify workers as independent contractors to avoid tax obligations; adherence to IRS rules is essential for both ministers and churches.

Understanding Social Security for Ministers

Dual Status and Opting Out

Navigating the landscape of Social Security can be a bit more complex for ministers due to their unique employment status and the option to opt out.

Dual Status of Ministers: Employee or Self-Employed?

Ministers are often considered to have a “dual status” for tax purposes. This stems from the multifaceted nature of their work, which may involve employment by a religious organization while also engaging in self-employment activities. The Internal Revenue Service (IRS) typically classifies ministers as employees for income tax purposes and self-employed for Social Security and Medicare tax purposes.

When a minister performs services in the exercise of their ministry, whether as a pastor, priest, rabbi, or any other religious leader, the IRS generally considers them self-employed for Social Security tax purposes. This distinction arises because ministers typically aren’t subject to withholding for Social Security and Medicare taxes from their compensation. Instead, they’re responsible for paying self-employment taxes on their earnings from ministerial services, including fees for performing weddings, funerals, and other religious ceremonies. However, the dual status of ministers can create confusion regarding their eligibility for Social Security benefits and the taxes they owe. It’s crucial for ministers and their religious organizations to understand these nuances to ensure compliance with tax laws and to make informed decisions regarding Social Security.

Opting Out of Social Security

Ministers have the opportunity to file an exemption application with the IRS to opt out of Social Security and Medicare taxes. By doing so, they forfeit their eligibility for Social Security retirement benefits, disability benefits, and Medicare coverage based on their ministerial earnings. However, they also become exempt from paying self-employment taxes on those earnings.

It’s essential to recognize that opting out of Social Security is an irrevocable decision with significant implications for retirement planning and financial security. Ministers who choose this path must carefully consider alternative retirement savings strategies and ensure they have adequate provisions in place for their future.



Factors to Consider

When deciding whether to opt out of Social Security, ministers should weigh various factors, including:

1. **Long-Term Financial Planning:** Opting out of Social Security means forgoing potential retirement benefits and Medicare coverage. Ministers must evaluate whether they can adequately replace these benefits through other retirement savings vehicles.
2. **Employer Benefits:** Some religious organizations may offer retirement plans or other benefits to supplement ministerial income. Ministers should assess the adequacy of these benefits in comparison to Social Security.
3. **Tax Obligations:** Opting out of Social Security can also prevent a minister from receiving medicare benefits.

KEY TAKEAWAY

- Understanding how Social Security applies to ministers involves navigating their dual status as employees and self-employed individuals, as well as the option to opt out of the program. While ministers have the flexibility to choose whether to participate in Social Security, it's a decision that requires careful consideration of their long-term financial security and retirement planning needs. By being informed about their options and seeking professional advice, ministers can make the best choice for their individual circumstances and future well-being.

What is Housing Allowance?

The housing allowance exclusion stands as a paramount tax benefit for Ministers, offering them the opportunity to exclude some or all of their church-designated housing allowance from their income for income tax purposes, albeit under stringent regulations. However, when it comes to reporting their income for SECA tax purposes, Ministers are not permitted to exclude the allowance, except for certain exemptions applicable to retired Ministers, as discussed below.

A housing allowance must serve as compensation for Ministerial services and should not surpass a Minister's reasonable compensation. Ministers are required to validate their actual housing expenses; otherwise, the housing allowance designation, in whole or in part, is counted as gross income. To aid Ministers in estimating their annual housing expenses, a worksheet is provided.

This housing allowance may be accessible to Ministers who own their homes, rent their homes, or reside in a rent-free church-owned parsonage.



Ministers who own their homes are entitled to exclude the smallest of three amounts from their income for federal income tax purposes when their church employer duly designates a housing allowance for them:

1. The housing allowance amount specified by their church.
2. Actual housing expenses (including mortgage payments, utilities, property taxes, insurance, furnishings, repairs, and improvements).
3. The Fair Rental Value of the home, furnished and inclusive of utilities.

For Ministers who rent their homes, they can exclude the lesser of these two amounts:

1. The housing allowance amount specified by their church.
2. Actual expenses, including rent, renter's insurance, utilities, furnishings, repairs, and improvements.

Ministers who reside rent-free in a church-owned parsonage should not include the Fair Rental Value of the parsonage as income for federal income taxes. Churches have the authority to designate a housing allowance for a Minister residing in a parsonage if the Minister covers the utilities, repairs, furnishings, or other eligible expenses.

Ministers who reside rent-free in a church-owned parsonage may exclude the lesser of these amounts:

1. The housing allowance amount specified by their church.
2. Actual housing expenses not covered by the church, including utilities, furnishings, repairs, and improvements.

If a designated housing allowance surpasses a Minister's actual housing expenses and the Fair Rental Value of the home, the excess housing allowance must be reported as wages for federal income tax purposes on line 1 of Form 1040.

Churches are required to adhere to legal requirements when designating a housing allowance; failure to do so could result in Ministers being deprived of this tax benefit. It is imperative for churches to officially designate a housing allowance and document it in the official business meeting minutes.

The IRS acknowledges designations included in employment contracts and budget line items, provided they are appropriately adopted in advance by the church.



Designation of a housing or parsonage allowance for the following year should be a topic on the church agenda for one of its final meetings during the current year. Churches should contemplate designating a housing allowance “for the current year and for all future years unless otherwise provided.” This precaution ensures that the designation carries over from year to year, preventing oversights if a church fails to designate the allowance in a given year. However, safety net allowances should not be seen as a substitute for designating a housing allowance each year.

Churches are required to designate a housing allowance in advance as retroactive designations are not recognized as valid by the IRS.

KEY TAKEAWAYS

A pastor’s retroactive backdating of a board resolution to secure a housing allowance for the entire year could potentially breach the Sarbanes-Oxley Act, leading to penalties such as fines or imprisonment. Even if the pastor’s actions don’t contravene the Act, they could still incur civil or criminal repercussions under the tax code.

Churches are encouraged to request estimates of housing expenses from Ministers to determine a reasonable housing allowance amount. Designated housing allowances are not reported as wages on the Minister’s W-2 form.

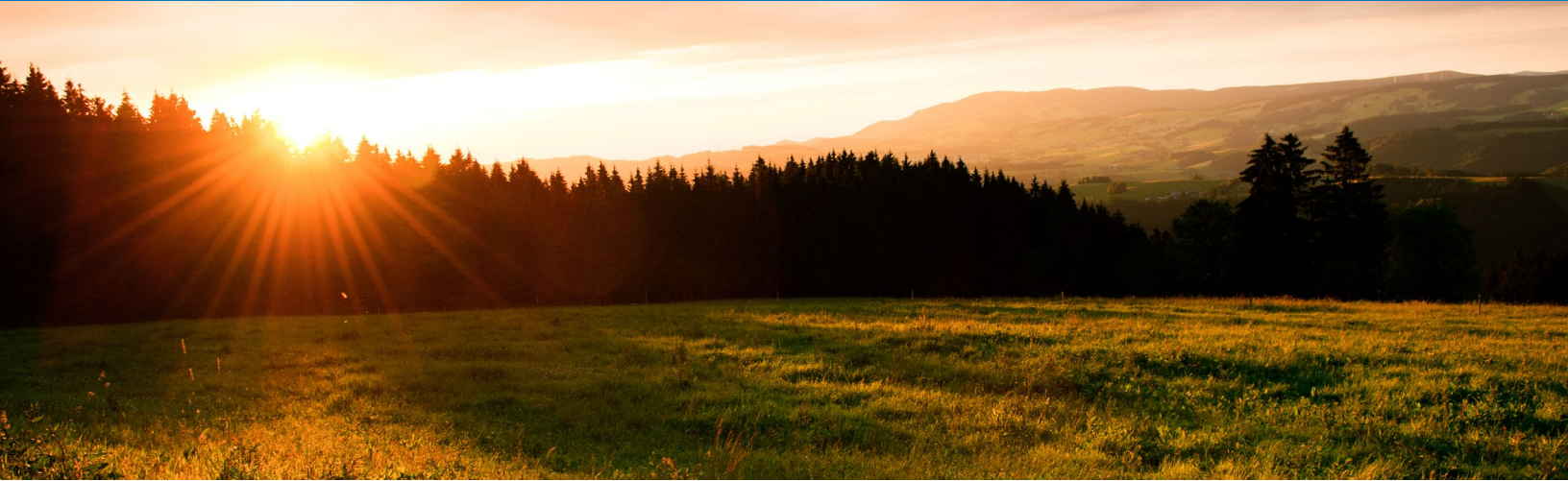
While home mortgage payments qualify as housing allowance expenses, costs for refinancing or home equity loans are only eligible for inclusion as housing allowance if the proceeds are utilized to purchase or maintain a principal residence. When a Minister pays off a home mortgage, the amount that can be excluded as housing allowance significantly diminishes.

KEY TAKEAWAYS

Minsters housing allowance in retirement:

The integration of a minister’s housing allowance with a 403(b)(9) plan, allows for a minister to capitalize on the tax advantage of housing allowance in retirement.

- 1.** A 403(b)(9) plan serves as a retirement savings vehicle specifically designed to cater to the needs of ministers and employees of tax-exempt organizations.
- 2.** Contributions to this plan are made on a pre-tax basis, effectively reducing taxable income and yielding immediate tax benefits.
- 3.** Ministers can strategically allocate a portion of their retirement savings towards housing expenses, ensuring a tax-efficient means to address housing needs during retirement.



KEY TAKEAWAYS

In conclusion, the alignment of a minister's housing allowance with a 403(b)(9) plan offers a strategic framework for retirement planning that acknowledges the unique financial circumstances of religious leaders.

Disclosure. What constitutes retirement for purposes of these rules concerning SECA and the housing allowance depends upon an individual's specific facts and circumstances. Ministers with questions about whether they are retired for this purpose should consult their tax advisors. The qualification for retirement is specific to a Minister's individual circumstances. Ultimately, the Minister must determine if he is retired for this purpose.

What is a 403(b)(9) and its Benefits

A 403(b)(9) plan, also known as a retirement income account, is a specialized retirement savings vehicle designed specifically for ministers and employees of tax-exempt organizations, including religious institutions. Here are several advantages for a minister to utilize a 403(b)(9) plan:

- 1. Tax Advantages:** Contributions to a 403(b)(9) plan are made on a pre-tax basis, meaning they are deducted from the minister's taxable income. This reduces the minister's current tax burden, allowing them to keep more of their earnings for retirement savings.
- 2. Higher Contribution Limits:** 403(b)(9) plans often have higher contribution limits compared to traditional Individual Retirement Accounts (IRAs), allowing ministers to save more for retirement on a tax-advantaged basis.
- 3. Flexibility in Investments:** Like other 403(b) plans, a 403(b)(9) plan typically offers a wide range of investment options, including mutual funds, annuities, and other investment vehicles. This flexibility allows ministers to tailor their investment strategy according to their risk tolerance and retirement goals.
- 4. Specialized Features for Ministers:** Some 403(b)(9) plans may offer specialized features catering to the unique financial needs of ministers. For example, they may allow ministers to designate a portion of their contributions specifically for housing expenses in retirement, providing tax-efficient means to address housing needs.
- 5. Employer Contributions:** In some cases, religious institutions may offer matching contributions or other employer-sponsored benefits within a 403(b)(9) plan. These contributions can significantly boost the minister's retirement savings over time, accelerating their journey towards financial security in retirement.
- 6. Portability:** If a minister changes employers or leaves the ministry, they can typically roll over their 403(b)(9) plan into another qualified retirement account without penalty. This portability ensures that the minister's retirement savings remain intact and continue to grow, regardless of career transitions.



Overall, a 403(b)(9) plan offers ministers a powerful tool for saving for retirement while enjoying significant tax advantages and investment flexibility. By taking advantage of these benefits, ministers can secure their financial future and focus on their calling with confidence.

Contribution Limits 2024, 2025

Changing the lives of those who are Changing the World.

403(b) contribution limits for 2024

The 2024 403(b) contribution limit is \$23,000 for pretax and Roth employee contributions, and \$69,000 for employer and employee contributions. Employees who are 50 and older can save an extra \$7,500 in catch-up contributions, bringing their employee contribution limit to \$30,500. As in 2023, your total contributions can't surpass your yearly earnings at the employer that offers your plan.

403(b) contribution limits for 2025

The 2025 403(b) contribution limit is \$23,500 for pretax and Roth employee contributions, and \$70,000 for employer and employee contributions. Employees who are 50-59 or 64 and older can save an extra \$7,500 in catch-up contributions, bringing their employee contribution limits to \$31,000. Employees who are 60-63 can save an extra \$11,250 in catch-up contributions, bringing their employee contribution limits to \$34,750. As in 2024, your total contributions can't surpass your yearly earnings at the employer that offers your plan.

403(b) contribution limits³

403(b)	Pretax and Roth employee contributions	Employee and employer contributions	Catch-up contributions (in addition to the employee and employer limit)
2024 contribution limit	\$23,000	\$69,000	\$7,500
2025 contribution limit	\$23,500	\$70,000	\$7,500 (50-59 or 64+) \$11,250 (60-63)

Clergy Housing Allowance Worksheet / Tax Return Year 20_____

NOTE: This worksheet is provided for educational purposes only. You should discuss your specific situation with your professional advisors, including the individual who assists with the preparation of your final tax return.

Method 1: Amount actually spent for housing this month / year:

Down payment on purchase of primary residence		\$ _____
Mortgage principal and interest payments of primary residence		\$ _____
Home equity loan repayments (loan made for housing-related expenses)		\$ _____
Home refinancing costs paid up-front		\$ _____
Real estate commission, escrow fees		\$ _____
Real estate property taxes		\$ _____
Personal property taxes on primary residence contents		\$ _____
Homeowner's insurance		\$ _____
Furniture		\$ _____
Appliances		\$ _____
Art and decorative items		\$ _____
Decorator services		\$ _____
Lawn care and gardening supplies		\$ _____
Repairs and maintenance		\$ _____
Pest control		\$ _____
Supplies for cleaning and care of home		\$ _____
Carpet and home cleaning services		\$ _____
Homeowner's association dues / condominium fees		\$ _____
Other: _____		\$ _____
Utilities:		
	Cable	\$ _____
	Electricity	\$ _____
	Internet Provider	\$ _____
	Natural gas / Heating oil	\$ _____
	Security system	\$ _____
	Telephone (Base charge)	\$ _____
	Trash collection / recycling pick up	\$ _____
	Water / sewer	\$ _____
	Total Utilities (Also repeat on 3-e below)	\$ _____
Other: _____		\$ _____
		\$ _____ 0 _____ (1-a)
		\$ _____

Total computed housing expenses actually paid: (1)

Method 2: Officially designated (in advance) housing allowance:

From clergy's congregation or other employer	\$ _____	(2-a)
From board of pensions, as noted on IRS FORM 1099R	\$ _____	(2-b)

Total officially designated housing allowance: (2)

Method 3: Fair rental value of house, furnishings and utilities:

****It is suggested that you validate this number by checking with your local realtor.**
 Depending on your location, including seasonal rentals, this number may vary from the calculations in 3-a below.

Primary home (1% of house appraised value x 12 months)	\$ _____	(3-a)
**Reference — Appraised value is \$ _____	\$ _____	
Home furniture inventory — Cost for yearly rental	\$ _____	(3-c)
Home appliances & misc. inventory — Cost for yearly rental	\$ _____	(3-d)
Annual utilities (use figure from line 1-a above)	\$ _____	(3-e)

Total officially designated housing allowance: (3)

Conclusion: MY EXCLUDABLE HOUSING ALLOWANCE IS:

This is the smallest of the three totals from Methods 1, 2 and 3 above.

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