The information provided in this 2018 Tax Guide for Ministers ("Guide") is the work of a third-party provider and is designed to provide general tax information to the user in the preparation of his or her tax returns. Please note that the information contained in this publication may be affected by changes made by the IRS or judicial interpretations of the Tax Code, new tax regulations, or technical corrections that occurred after the printing of this publication, which will not be reflected in this Guide. The Guide is not intended to be a substitute for consultation with professional accountants, tax advisers, attorneys, or other professionals. The Pension Boards is not responsible for any errors or omissions in the Guide, or for the results obtained through the use of this information. The Guide is provided "as is," with no guarantee of accuracy or completeness and without any express or implied warranty of any kind, including without limitation warranties of performance, merchantability, and fitness for a particular purpose.
4. Part 1: Introduction

4. How to use this Guide
4. Tax highlights for 2018
7. Preliminary Questions

8. Part 2: Special Rules for Ministers

8. Who is a minister for federal tax purposes?
8. Are ministers employees or self-employed for federal tax purposes?
9. Exemption from Social Security (self-employment) taxes
10. How do ministers pay their taxes?


11. Tax forms and schedules
12. Form 1040
   12. Step 1: Filing status
   12. Step 2: Name and address
   13. Step 3: Dependents
   13. Step 4: Income
      13. Line 1. Wages, salaries, tips, etc.
      15. Housing Allowance
         15. Housing expenses to include in computing your housing allowance exclusion
      17. How much should a church designate as a housing allowance?
      18. Section 403(b) plans
         18. Contribution limits
         18. Minister's housing allowance and contribution limits
      19. Taxation of distributions from a 403(b) plan
      19. Salary reduction contributions (Section 402(g))
   20. Qualified scholarships
   20. Sale or exchange of your principal residence
   20. Line 2 Interest income: attach Schedule B if over $1,500
   20. Line 3. Dividend income: attach schedule B if over $1,500
   20. Lines 4a and 4b. IRA, pension, and annuity income
   21. Line 5. Social security benefits
   22. Line 6. Total income
   22. Step 5: Adjustments to income
      22. Line 7. Adjusted gross income
      22. Schedule 1 (Form 1040) line 27. One-half of self-employment tax
      22. Schedule 1 (Form 1040) line 32. Payments to an Individual Retirement Account
   24. Step 6: Tax computation
      24. Line 8. Itemized deduction or standard deduction
      24. Line 11. Compute tax
   24. Step 7: Credits
      25. Line 12a Schedule 3 (Form 1040) Line 49. Credit for child and dependent care expenses
      25. Line 12b Schedule 3 (Form 1040) line 51. Retirement savings contributions credit
26. Step 8: Other taxes
   26. Line 14. Other taxes
26. Step 9: Payments
   26. Line 17 Schedule 5 (Form 1040) Line 66. 2018 estimated tax payments
   26. Line 17a. Earned income credit
27. Step 10: Refund or amount you owe
27. Step 11: Sign here
28. Other forms and schedules
28. Schedule A
   28. Step 1: Medical and dental expenses (lines 1-4)
   28. Step 2: Taxes you paid (lines 5-7)
29. Step 3: Interest you paid (lines 8-10)
30. Step 4: Gifts to charity (lines 11-14)
31. Step 5: Casualty and theft losses (line 15)
   31. Note: Job expenses and most other miscellaneous deductions
32. Schedule B
   32. Step 1: Interest income (lines 1-4)
   32. Step 2: Dividend income (lines 5-6)
   33. Step 3: Foreign accounts and foreign trusts (lines 7-8)
33. Schedule C
   33. Step 1: Introduction
   33. Step 2: Income (lines 1-7)
   33. Step 3: Expenses (lines 8-27)
34. Schedule C-EZ
34. Schedule SE
   34. Step 1: Section A (line 2)
   35. Step 2: Section A (line 4)
   35. Step 3: Section A (line 5)
35. Form 2106

36. Part 4: Comprehensive examples and forms
36. Example One: Active Minister
47. Example Two: Retired Minister

55. APPENDIX
55. SPECIAL SUPPLEMENT: CURRENT STATUS OF THE PARSONAGE AND HOUSING ALLOWANCE EXCLUSIONS
HOW TO USE THIS GUIDE

This book contains the basic information you need to complete your 2018 federal income tax return. It gives special attention to several forms and schedules and the sections of each form most relevant to ministers. The companion resource—Federal Reporting Requirements for Churches—helps churches comply with their federal tax reporting requirements, and may be downloaded from the Pension Boards’ website by clicking here.

This Guide is divided into the following sections:

Part 1: Introduction

This section reviews tax highlights for 2018 and presents several preliminary questions you should consider before preparing your tax return.

Part 2: Special Rules for Ministers

In this section, you learn whether or not you are a minister for tax purposes, whether you are an employee or self-employed for both income tax and Social Security purposes, and how you pay your taxes.

Part 3: Step-By-Step Tax Return Preparation

This section explains how to complete the most common tax forms and schedules for ministers.

Part 4: Comprehensive Examples and Sample Forms

This section shows a sample tax return prepared for an active minister and spouse and for a retired minister and spouse.

TAX HIGHLIGHTS FOR 2018

1. The Tax Cuts and Jobs Act of 2017

On December 22, 2017, President Donald Trump signed into law the $1.5 trillion, 500-page Tax Cuts and Jobs Act of 2017. In brief, the Act amends the Internal Revenue Code to reduce tax rates and modify credits and deductions for individuals and businesses. With respect to individuals, the bill:

- Replaces the seven existing tax brackets (10%, 15%, 25%, 28%, 33%, 35%, and 39.6%) with seven new and lower brackets (10%, 12%, 22%, 24%, 32%, 35%, and 37%).

- Temporarily increases (through 2025) the basic standard deduction to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other individuals. The significantly increased standard deduction will reduce the number of persons who are able to itemize deductions on Schedule A (Form 1040) from 30% to as few as 5% of all taxpayers. The result will be a significant decrease in the number of taxpayers who can claim a tax deduction for contributions they make to churches and other charities.

- Modifies section 529 plans to allow such plans to distribute not more than $10,000 in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a public, private, or religious elementary or secondary school. The new rules apply to distributions made after December 31, 2017. A section 529 plan (also known as a qualified tuition plan) is a plan operated by a state or educational institution with tax advantages and potentially other incentives to make it easier to save for college and other post-secondary training for a designated beneficiary, such as a child or grandchild. The main tax advantage of a 529 plan is that earnings are not subject to federal tax and generally are not subject to state tax when used for the qualified education expenses of the designated beneficiary, such as tuition, fees, and books, as well as room and board.

- Repeals both the moving expense deduction, and the exclusion of employer reimbursements of moving expenses, under an accountable arrangement—except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order. This provision is effective for taxable years 2018 through 2025.

- Under the Affordable Care Act, individuals must be covered by a health plan that provides at least “minimum essential coverage” or be subject to a penalty for failure to do so (commonly referred to as the “individual mandate”). For 2018, the penalty could be up to $2,085 for a family, or $695 for an individual. The Tax Cuts and Jobs Act reduces the amount of the ACA’s individual mandate to zero with respect to health coverage status for months beginning after December 31, 2018.

- Removes the deductions for personal exemptions for taxable years 2018 through 2025. Under prior law, in determining taxable income, an individual reduced AGI by any personal exemption deductions and either the applicable...
Tax Guide 2018

standard deduction or itemized deductions. Personal exemptions generally were allowed for the taxpayer, the taxpayer’s spouse, and any dependents.

• Eliminates the deductions for miscellaneous itemized deductions. Under prior law, individuals could claim itemized deductions for certain miscellaneous expenses. Certain of these expenses were not deductible unless, in aggregate, they exceeded 2% of the taxpayer’s adjusted gross income (AGI). The deductions described below were subject to the aggregate 2% floor:

  • appraisal fees for a casualty loss or charitable contribution;
  • casualty and theft losses from property used in performing services as an employee;
  • clerical help and office rent in caring for investments;
  • hobby expenses, but generally not more than hobby income;
  • investment fees and expenses
  • safe deposit box rental fees, except for storing jewelry and other personal effects;
  • trustee’s fees for an IRA, if separately billed and paid;
  • tax preparation expenses;
  • job search expenses in the taxpayer’s present occupation;
  • licenses and regulatory fees;
  • passport fees for a business trip;
  • tools and supplies used in the taxpayer’s work;
  • Unreimbursed employee business expenses subject to the 2% AGI floor include such items as:
    • overnight out-of-town travel;
    • local transportation;
    • meals (subject to a 50% AGI floor);
    • entertainment (subject to a 50% AGI floor);
    • home office expenses;
    • business gifts;
  • dues to professional societies;
  • work-related education;
  • work clothes and uniforms if required and not suitable for everyday use;
  • malpractice insurance;
  • subscriptions to professional journals and trade magazines related to the taxpayer’s work; and
  • equipment and supplies used in the taxpayer’s work.

✔ KEY POINT. The new law temporarily changes the structure of the individual income tax by modifying the rate structure so that the tax brackets are 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The bill temporarily increases the size of the standard deduction (for 2018 the standard deduction is $24,000 for joint filers, $18,000 for heads of household, and $12,000 for other filers), and temporarily eliminates personal exemptions. These and several other provisions in the Act sunset for taxable years beginning after 2025 unless extended by Congress.

1. Other tax changes of interest to churches and church staff

There were several tax developments in 2018 that will affect tax reporting by both ministers and churches for 2018 and future years. Here is a rundown of some of the key provisions:

• You may be able to claim the earned income credit for 2018 if: 1) you do not have a qualifying child and you earned less than $15,270 ($20,950 if married); 2) a qualifying child lived with you and you earned less than $40,320 ($46,010 if married filing jointly); 3) two qualifying children lived with you and you earned less than $45,802 ($51,492 if married filing jointly); or, 4) three or more qualifying children lived with you and you earned less than $49,194 ($54,884 if married filing jointly). The maximum earned income credit for 2018 is: 1) $519 with no qualifying child; 2) $3,461 with one qualifying child; 3) $5,716 with two qualifying children; and, 4) $6,431 with three or more qualifying children.

• For contributions in 2018 to a traditional IRA, the deduction phaseout range for an individual covered by a retirement plan at work begins at income of $101,000 for joint filers, and $63,000 for a single person or head of household. These
are 2018 amounts that increase to $103,000 for joint filers, and $64,000 for a single person or head of household for 2019.

- The dollar limit on annual elective deferrals an individual may make to a 403(b) retirement plan is $18,500 for 2018. It increases to $19,000 for 2019.

- The catch-up contribution limit on elective deferrals to a 403(b) retirement plan for individuals who had attained age 50 by the end of the year was $6,000 for 2018, and remains at $6,000 for 2019.

- The IRS has announced that it will not issue private letter rulings addressing the question of "whether an individual is a minister of the gospel for federal tax purposes." This means taxpayers will not be able to obtain clarification from the IRS in a letter ruling on their status as a minister for any one or more of the following matters: 1) eligibility for a parsonage exclusion or housing allowance; 2) eligibility for exemption from self-employment taxes; 3) self-employed status for Social Security; or, 4) exemption of wages from income tax withholding. The IRS also has announced that it will not address "whether amounts distributed to a retired minister from a pension or annuity plan should be excludible from the minister's gross income as a parsonage allowance."

- The standard business mileage rate was 54.5 cents per mile for business miles driven during 2018. The standard business mileage rate for 2019 is 58 cents per mile.

- Recent tax law changes will result in lower taxes, and lower estimated tax payments, for many taxpayers. Be sure your estimated tax calculations or withholdings take into account the most recent tax law changes.

- Many churches employ retired persons who are receiving Social Security benefits. Persons younger than full retirement age may have their Social Security retirement benefits cut if they earn more than a specified amount. Full retirement age (the age at which you are entitled to full retirement benefits) for persons born in 1943-1954 is 66 years. If you are under full retirement age for the entire year, $1 is deducted from your benefit payments for every $3 you earn above the annual limit. For 2019, that limit is $17,640. In the year you reach full retirement age, your monthly benefit payments are reduced by $1 for every $3 you earn above a different limit. For 2019, that limit is $46,920 ($3,910 per month), but only earnings before the month you reach full retirement age are counted.

- Will Congress give ministers another opportunity to revoke an exemption from Social Security? It does not look likely, at least for now. No legislation is pending that would provide ministers with this option.

- The housing allowance is being challenged in federal court as an unconstitutional preference for religion. This development is addressed fully in the Special Supplement at the beginning of this Guide.

- A provision in the comprehensive tax reform legislation enacted by Congress in 2017 (the Tax Cuts and Jobs Act, or TCJA) imposes a tax (the unrelated business income tax) of 21% on expenses associated with benefits provided to employees through a qualified transportation fringe benefit program as defined by IRC Section 132(f). These benefits include employer-provided parking, mass transit passes, and commuter vans. Churches providing these benefits must file Form 990-T to report the costs and the related tax. The provision of parking to employees may come through payment of parking fees for employees or by provision of parking on the church's premises. While there has been much debate over the application of the new law to onsite employer-provided parking, the current consensus is that the new tax applies to employers whose onsite parking provided to employees has value because parking in the area is only provided on a paid basis. The protest from nonprofit organizations, including churches, has been great during 2018. Petitions have been submitted to Congress requesting repeal of the provision and several bills have been introduced to repeal the provision. However, until Congress or the IRS provides relief, churches should prepare to comply with the new law by reporting expenses associated with qualified transportation fringe benefits on Form 990-T and paying the unrelated business income tax (21%) on this income. Future developments will be reported on www.churchlawandtax.com.
PRELIMINARY QUESTIONS

Below are several questions you should consider before preparing your 2018 federal tax return.

Q. Must ministers pay federal income taxes?
A. Yes. Ministers are not exempt from paying federal Income taxes.

Q. How much income must I earn to be required to file a tax return?
A. Generally, ministers are required to file a federal income tax return if they have earnings of $400 or more to report their self-employment tax. Different rules apply to ministers who are exempt from self-employment taxes.

Q. Can I use the simpler Forms 1040A or 1040EZ rather than the standard Form 1040?
A. All taxpayers use the newly redesigned Form 1040 for 2018 and future years. Forms 1040A and 1040EZ no longer will be used.

Q. What records should I keep?
A. You should keep all receipts, canceled checks, and other evidence to prove amounts you claim as deductions, exclusions or credits.

Q. What is the deadline for filing my federal income tax return?
A. The instructions to Form 1040 state that the deadline for filing Form 1040 for the 2018 tax year is April 15, 2019. If you live in Maine or Massachusetts, you have until April 17, 2019, because of the Patriots’ Day holiday (April 16, 2019).

Q. What if I am unable to file my tax return by the deadline?
A. You can obtain an automatic six-month extension (from April 15 to October 15, 2019) to file your 2018 Form 1040 if you file Form 4868 by April 15, 2019 with the IRS service center for your area. Your Form 1040 can be filed at any time during the six-month extension period. An extension only relieves you from the obligation to file your return; it is not an extension of the obligation to pay your taxes. You must make an estimate of your tax for 2018 and pay the estimated tax with your Form 4868.

Q. Should I prepare my own tax return?
A. The answer depends on your ability and experience in working with financial information and in preparing tax returns. Keep in mind: Ministers’ taxes present a number of unique rules, but these rules are not complex. Many ministers will be able to prepare their own tax returns if they understand the unique rules that apply. These rules are summarized in this document. Easily accessible tax software will also accommodate the unique rules applicable to ministers, but it does not relieve a minister from understanding the rules in order to accurately utilize the software. On the other hand, if you experienced unusual events in 2018, such as the sale or purchase of a home or the sale of other capital assets, it may be prudent to obtain professional tax assistance. The IRS provides a service called Taxpayer Assistance, but it is not liable in any way if its agents provide you with incorrect answers to your questions. Free taxpayer publications are available from the IRS and many of these are helpful to ministers.

RECOMMENDATION. If you need professional assistance, here are some tips that may help you find a competent tax professional:

• Ask other ministers in your community for their recommendations.

• If possible, use a CPA who specializes in tax law and who is familiar with the rules that apply to ministers. A CPA has completed a rigorous educational program and is subject to strict ethical requirements. However, the tax law is broad and complicated, so it should not be assumed that all CPAs are familiar with the unique rules applicable to ministers.

• Ask local tax professionals if they work with ministers and, if so, with how many.

• Ask local tax professionals a few questions to test their familiarity with ministers’ tax issues. For example, ask whether ministers are employees or self-employed for Social Security. Anyone familiar with ministers’ taxes will know that ministers are self-employed for Social Security with respect to their ministerial duties. Or, ask a tax professional if a minister’s church salary is subject to income tax withholding. The answer is no, and anyone familiar with ministers’ taxes should be able to answer this question.
WHO IS A MINISTER FOR FEDERAL TAX PURPOSES?

KEY POINT. The IRS has its own criteria for determining who is a minister for tax purposes. The criteria the IRS uses to determine who is a minister are not necessarily the same as those used by churches and denominations, including the United Church of Christ. Whether or not one qualifies as a minister for tax purposes is a very important question, since special tax and reporting rules apply to ministers under federal tax law. These rules include:

- eligibility for housing allowances;
- self-employed status for Social Security;
- exemption of wages from income tax withholding (ministers use the quarterly estimated tax procedure to pay their taxes, unless they elect voluntary withholding); and
- eligibility, under very limited circumstances, to exempt themselves from self-employment taxes.

These special rules only apply to persons qualifying as a minister and with respect to compensation received in the exercise of ministerial services.

EXAMPLE. Pastor James is an ordained minister employed by a church. In addition, he works a second job for a secular employer. Assume that Pastor James qualifies as a minister for federal tax purposes. Since his church duties constitute services performed in the exercise of his ministry, the church can designate a portion of his compensation as a housing allowance. However, the secular employer cannot designate any portion of Pastor James’ compensation as a housing allowance, since this work would not be the exercise of ministry.

According to the IRS, ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination. They are given the authority to conduct religious worship, perform sacramental functions, and administer ordinances or sacraments according to the tenets and practices of that church or denomination. If a church or denomination ordains some ministers and licenses or commissions others, anyone licensed or commissioned must be able to perform substantially all the religious functions of an ordained minister to be treated as minister for tax purposes. See IRS Publication 517.

ARE MINISTERS EMPLOYEES OR SELF-EMPLOYED FOR FEDERAL TAX PURPOSES?

KEY POINT. Most ministers are employees for federal income tax purposes under the tests currently used by the IRS and the courts and should receive a Form W-2 from their church reporting their taxable income. However, ministers are self-employed for Social Security (with respect to services they perform in the exercise of their ministry).

Ministers have a dual tax status. For federal income taxes they ordinarily are employees, but for Social Security they are self-employed with regard to services performed in the exercise of their ministry. These two rules are summarized below:

Income taxes. For federal income tax reporting, most ministers are employees under the tests currently used by the IRS. This means that they should receive a Form W-2 from their church at the end of each year (rather than a Form 1099). Formerly, it meant that they reported their employee business expenses on Schedule A rather than on Schedule C. (The deduction for employee business expenses as Miscellaneous Itemized Deductions on Schedule A is suspended through 2025, so employee business expenses are not deductible at this time.)

A few ministers are self-employed, such as some traveling evangelists and some interim pastors. Also, many ministers who are employees of a local church are self-employed for other purposes. For example, the minister of a local church almost always will be an employee but will be self-employed with regard to guest speaking appearances in other churches and services performed directly for individual members (such as weddings and funerals).

EXAMPLE. Pastor Barrios is a minister at First United Church. She is an employee for federal income tax reporting purposes with respect to her church salary. However, she is self-employed with respect to honoraria she receives for speaking in other churches and for compensation church members give her for performing personal services such as weddings and funerals. The church issues Pastor Barrios a Form W-2 reporting her church salary. Pastor Barrios reports this amount as wages on line 1 of Form 1040. She reports her compensation and expenses from the outside self-employment activities on Schedule C.
KEY POINT. Most ministers will be better off financially being treated as employees, since the value of various fringe benefits will be tax free, the risk of an IRS audit is substantially lower, and reporting as an employee avoids the additional taxes and penalties that often apply to self-employed ministers who are audited by the IRS and reclassified as employees.

KEY POINT. Ministers and other church staff members should carefully review their Form W-2 to be sure it does not report more income than was actually received or fails to report taxable benefits provided by the church. If an error was made, the church should issue a corrected tax form (Form W-2c).

The Tax Court Test. The United States Tax Court has created a seven-factor test for determining whether a minister is an employee or self-employed for federal income tax reporting purposes. The test requires consideration of the following seven factors: 1) the degree of control exercised by the employer over the details of the work; 2) which party invests in the facilities used in the work; 3) the opportunity of the individual for profit or loss; 4) whether or not the employer has the right to discharge the individual; 5) whether the work is part of the employer’s regular business; 6) the permanency of the relationship; and, 7) the relationship the parties believe they are creating. Most ministers will be employees under this test.

SOCIAL SECURITY

The Tax Code treats ministers as self-employed for Social Security with respect to services performed in the exercise of their ministry—even if they report their income taxes as an employee. This means that ministers must pay self-employment taxes (Social Security taxes for the self-employed) unless they have filed a timely exemption application (Form 4361) that has been approved by the IRS. As noted below, few ministers qualify for this exemption.

KEY POINT. While most ministers are employees for federal income tax reporting purposes, they are self-employed for Social Security with respect to services they perform in the exercise of their ministry. This means that ministers are not subject to the employee’s share of Social Security and Medicare taxes, even though they report their income taxes as employees and receive a Form W-2 from their church. Rather, they pay the self-employment tax (SECA).

EXEMPTION FROM SELF-EMPLOYMENT (SOCIAL SECURITY) TAXES.

If ministers meet several requirements, they may exempt themselves from self-employment taxes with respect to their ministerial earnings. Among other things, the exemption application (Form 4361) must be submitted to the IRS within a limited time period. The deadline is the due date of the federal tax return for the second year in which a minister has net earnings from self-employment of $400 or more, any part of which comes from ministerial services. Further, the exemption is available only to ministers who are opposed on the basis of religious considerations to the acceptance of benefits under the Social Security program (or any other public insurance system that provides retirement or medical benefits). A minister who files the exemption application may still purchase life insurance or participate in retirement programs administered by nongovernmental institutions (such as a life insurance company). Additionally, the exemption does not require a minister to revoke all rights to Social Security benefits earned through their participation in the system through secular employment.

A minister’s opposition must be to accepting benefits under Social Security (or any other public insurance program) which are related to services performed as a minister. Economic, or any other nonreligious considerations, are not a valid basis for the exemption, nor is opposition to paying the self-employment tax.

The exemption is only effective when it is approved by the IRS. Few ministers qualify for the exemption. Many younger ministers opt out of the self-employment tax without realizing that they do not qualify for the exemption. A decision to opt out of self-employment tax is irrevocable. Congress did provide ministers with a brief window of time to revoke an exemption by filing Form 2031 with the IRS. This opportunity expired in 2002 and has not been renewed.

An exemption from self-employment taxes applies only to compensation for ministerial services. Ministers who have exempted themselves from self-employment taxes must pay Social Security taxes on any non-ministerial compensation they receive. And, they remain eligible for Social Security benefits based on their non-ministerial employment assuming...
that they have worked enough quarters. Generally, 40 quarters are required. Also, the Social Security Administration has informed the author of this text that ministers who exempt themselves from self-employment taxes may qualify for Social Security benefits (including retirement and Medicare) on the basis of their spouse's coverage, if the spouse had enough credits. However, the amount of these benefits will be reduced by the so-called windfall elimination provision. Contact a Social Security Administration office for details.

KEY POINT. The amount of earnings required for a quarter of coverage in 2019 is $1,360. A quarter of coverage is the basic unit for determining whether a worker is insured under the Social Security program.

KEY POINT. Ministers who work after they retire must continue to pay self-employment tax on their ministerial income and wages (unless they exempted themselves from self-employment tax as a minister and they are employed in a ministerial capacity).

KEY POINT. In 1970, the IRS ruled that ministers who exempt themselves from self-employment taxes solely on the basis of economic considerations are not legally exempt. Revenue Ruling 70-197. The IRS concluded: "The taxpayer filed the Form 4361 solely for economic considerations and not because he was conscientiously opposed to, or because of religious principles opposed to, the acceptance of any public insurance of the type described on the form. Accordingly...the taxpayer did not qualify for the exemption since the Form 4361 filed solely for economic reasons is a nullity." Ministers wanting to revoke an exemption from self-employment taxes should discuss this ruling with a tax professional.

HOW DO MINISTERS PAY THEIR TAXES?

KEY POINT. Ministers must prepay their income taxes and self-employment taxes using the estimated tax procedure, unless they have entered into a voluntary withholding arrangement with their church with respect to federal income tax only.

As noted above, ministers’ wages are exempt from federal income tax withholding. This means that a church does not have to withhold income taxes from a minister’s paycheck. And, since ministers are self-employed for Social Security with respect to their ministerial services, a church does not withhold the employee’s share of Social Security and Medicare taxes from a minister’s wages. Ministers must prepay their income taxes and self-employment taxes using the estimated tax procedure, unless they enter into a voluntary withholding arrangement with their church. Estimated taxes must be paid in quarterly installments. If your estimated tax paid for the current year is less than your actual tax, you may have to pay an underpayment penalty. You can amend your estimated tax payments during the year if your circumstances change. For example, if your income or deductions increase unexpectedly, you should refigure your estimated tax liability for the year and amend your remaining quarterly payments accordingly or submit additional payments.

You will need to make estimated tax payments for 2019 if you expect to owe at least $1,000 in tax for 2019 after subtracting your withholding and credits and if you expect your withholding and credits to be less than the smaller of: 1) 90% of the tax to be shown on your 2019 tax return; or, 2) 100% of the tax shown on your 2018 tax return (110% if adjusted gross income exceeds $150,000, or if married filing separately, more than $75,000). Your 2018 tax return must cover all 12 months.

The four-step procedure for reporting and prepaying estimated taxes for 2019 is summarized below.

Step 1. Estimated tax payments may be paid using either of the following methods:

- Obtain a copy of IRS Form 1040ES for 2019 before April 15, 2019. You can obtain forms by calling the IRS toll-free forms hotline at 1.800.TAX.FORM (1.800.829.3676), or from the IRS website (www.irs.gov). If you paid estimated taxes last year, you should receive a copy of your 2019 Form 1040-ES in the mail with payment vouchers preprinted with your name, address, and Social Security number; or,
- Enroll in the Electronic Federal Tax Payment System at www.eftsps.gov and establish an online account to be used to submit payments.

Step 2. Compute your estimated tax for 2019 using the Form 1040-ES worksheet. Ministers’ quarterly estimated tax payments should take into account both income taxes and self-employment taxes.
Step 3. Pay one-fourth of your total estimated taxes for 2019 in each of four quarterly installments as follows:

<table>
<thead>
<tr>
<th>FOR THE PERIOD</th>
<th>DUE DATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1–March 31</td>
<td>April 17, 2019</td>
</tr>
<tr>
<td>April 1–May 31</td>
<td>June 17, 2019</td>
</tr>
<tr>
<td>June 1–August 31</td>
<td>September 16, 2019</td>
</tr>
<tr>
<td>September 1–December 31</td>
<td>January 15, 2020</td>
</tr>
</tbody>
</table>

You must send each payment to the IRS, accompanied by one of the four payment vouchers contained in Form 1040-ES. If enrolled in the EFTPS system, all four payments may be prescheduled for automatic payment at the schedule dates.

Step 4. After the close of 2018, compute your actual tax liability on Form 1040. Only then will you know your actual income, deductions, exclusions, and credits. If you overpaid your estimated taxes (that is, actual taxes computed on Form 1040 are less than all of your estimated tax payments plus any withholding), you can elect to have the overpayment credited against your first 2019 quarterly estimated tax payment, or spread it out in any way you choose among any or all of your next four quarterly installments. Alternatively, you can request a refund of the overpayment. If you underpaid your estimated taxes (that is, your actual tax liability exceeds the total of your estimated tax payments plus any withholding), you may have to pay a penalty.

✔ KEY POINT. Ministers who report their income taxes as employees can request that their employing church voluntarily withhold income taxes from their wages. Simply furnish the church with a completed W-4 (withholding allowance certificate) or other written authorization. Since ministers are not employees for Social Security with respect to ministerial compensation, the church does not withhold the employee’s share of Social Security and Medicare taxes. However, ministers can request on Form W-4 (line 6) that

TAX FORMS AND SCHEDULES

This step-by-step analysis covers these forms and schedules:

Form 1040 is the basic document you will use. It summarizes all of your tax information. Details are reported on supplementary schedules and forms. Note that the IRS has unveiled a new and redesigned Form 1040 that reflects the many tax law changes made by the Tax Cuts and Jobs Act of 2017. The new 1040—about half the size of the current version—replaces the current Form 1040 as well as the Form 1040A and the Form 1040EZ. The new Form 1040 is different from its predecessors in several ways including the following:

1. It is half the size of the previous Form 1040 and consists of two half pages.

2. Health care coverage (mandatory through 2018) is reported by checking a box on page 1 (it was reported on line 61 on the 2017 form).

3. All personal exemptions were repealed after 2017 and so there is no way to claim them on the 2018 Form 1040.

4. Some lines have been consolidated. For example, several items of income, capital gains, rental income, etc. are consolidated and reported on Line 6.

5. Wages are now reported on line 1 (instead of line 7 for the past several years).

6. Adjusted gross income is reported on line 7 and without detail on the form (instead of line 37 for the past several years).

7. The standard deduction is reported on line 8, and is significantly larger than in 2017 ($12,000 for unmarried persons and $24,000 for married persons filing jointly).

8. Several credits are now reported on Schedule 3 and consolidated on line 12b (they were reported on separate lines in 2017).

9. Many lines in the previous Form 1040 have been deleted and transferred to various schedules. In fact, the 79 lines on the 2017 Form 1040 have been reduced to 23, a reduction of more than 50 lines. For example:

- Business income is reported on Schedule C as in prior years, but is then posted to Schedule
1 of Form 1040 rather than line 12 as in prior years.

- Adjustments to income, reported on lines 23-36 of the 2017 Form 1040 are now reported on lines 23-36 of Schedule 1 (Form 1040).
- Schedule 2 (Form 1040) lists taxes that were reported on lines 45-47 in the 2017 Form 1040.
- Schedule 3 (Form 1040) lists “nonrefundable credits,” including credits for child and dependent care expenses and education credits that were reported on lines 48-55 in the 2017 Form 1040.
- Schedule 4 (Form 1040) lists “other taxes” (including the self-employment tax) reported on lines 57-64 in the 2017 Form 1040.
- Schedule 5 (Form 1040) lists “other payments,” including self-employment taxes that were reported on lines 65-75 in the 2017 Form 1040.

**KEY POINT.** Some references in this Guide are to lines in the new Form 1040, but others refer to lines in the new schedules. Be sure you distinguish between these terms to avoid confusion.

**Schedule A** is for itemized deductions for medical and dental expenses, taxes, interest, certain disaster related casualty losses and charitable contributions.

**NEW IN 2018.** Beginning with tax year 2018 no miscellaneous itemized deductions that formerly were subject to a 2% of adjusted gross income limitation are allowed. This and other changes to Schedule A are addressed later in this Guide.

**Schedule B** is for reporting dividend and interest income.

**Schedule C** is for reporting your income and expenses from business activities you conduct other than in your capacity as an employee. Examples would be fees received for guest speaking appearances in other churches or fees received directly from members for performing personal services, such as weddings and funerals.

**Schedule SE** is for reporting Social Security taxes due on your self-employment income. Ministers use this schedule since they are deemed self-employed for Social Security with respect to ministerial services (unless they have obtained an approved Form 4361 from the IRS).

These forms and schedules, along with others, are included in the illustrated example in Part 4 of this Guide. These forms and schedules are the ones most commonly used by ministers. These forms may be obtained at certain local post offices or IRS office. Or, you can obtain them by calling the IRS toll-free forms hotline at 1.800.TAX.FORM (1.800.829.3676). They also are available on the IRS website (www.irs.gov).

**Form 1040**

**Step 1: Filing status.** Select the appropriate filing status from the five options listed in this section of the Form 1040.

In 2015, the United States Supreme Court ruled that the right of same-sex couples to marry is part of the Fourteenth Amendment’s guarantees of due process and equal protection of the laws, and therefore any state law that in any way limits this right is unconstitutional and void. Obergefell v. Hodges, 135 S. Ct. 2584 (2015). The effect of the Court’s decision was to invalidate laws and constitutional provisions in several states defining marriage solely as a union between one man and one woman, and to treat same-sex marriages the same as opposite-sex marriages for purposes of federal tax law.

**Step 2: Name and address.** Print or type the information in the spaces provided. If you are married filing a separate return, enter your spouse’s name on line 3 instead of below your name. If you filed a joint return for 2017 and you are filing a joint return for 2018 with the same spouse, be sure to enter your names and Social Security numbers in the same order as on your 2017 return.

If you plan to move after filing your return, use Form 8822 to notify the IRS of your new address.

If you (or your spouse) changed your name because of marriage, divorce, etc., be sure to report the change to the Social Security Administration (SSA) before filing your return. This prevents delays in processing your return and issuing refunds. It also safeguards your future Social Security benefits. If a name change with the SSA has not been completed, the name on SSA file must be used in filing your tax return.

Enter your P.O. Box number only if your post office does not deliver mail to your home.

If you want $3 to go to the presidential election campaign fund, check the box labeled “you.” If you
are filing a joint return, your spouse can also have $3 go to the fund (check “spouse”). If you check a box, your tax or refund will not change.

**Step 3: Dependents.** In the past taxpayers were allowed a personal exemption for themselves and certain dependents. All personal exemptions were repealed after 2017 and so they cannot be claimed on the 2018 Form 1040. However, it is still necessary to determine who qualifies as dependents and include them on the return. Dependents determine various credits, such as the child tax credit, as well as other tax related items such as educational credits, medical expenses, child care credit and earned income credit, just to name a few.

**Step 4: Income.** Several items of income are reported on lines 1 through 6 (including amounts carried over from Schedule 1, lines 10-22). The most important of these (for ministers) are discussed below.

**KEY POINT.** Some items, such as the housing allowance, are not reported as income. They are called exclusions and are explained below.

**Line 1. Wages, salaries, tips, etc.**

As an employee, you should receive a Form W-2 from your church reporting your wages at the end of each year. Report this amount on line 1.

**Determining church wages or salary.** Besides a salary, ministers’ wages reported on Form W-2 may include several other items; some items are:

- Bonuses
- The cost of sending a minister to the Holy Land (if paid by the church)
- Most Christmas and special occasion offerings
- Retirement gifts paid by a church
- The portion of a minister’s self-employment tax paid by a church
- Personal use of a church-owned vehicle
- Purchases of church property for less than fair market value
- Business expense reimbursements under a nonaccountable plan
- Imputed cost of group term life insurance coverage (including death benefits under the UCC Life Insurance and Disability Income (LIDI) Benefit Plan) exceeding $50,000 and cost of coverage of spouse and dependents if over $2,000 which is paid by the church
- Church reimbursements of a spouse’s travel expenses incurred while accompanying a minister on a business trip (unless the spouse’s presence serves a legitimate business purpose and the spouse’s expenses are reimbursed under an accountable arrangement)
- Discretionary funds established by a church for a minister to spend on current needs—if the minister is allowed to distribute funds for his or her personal benefit
- Imputed interest from below-market interest loans of at least $10,000 made by a church to a minister (some exceptions apply)
- Cancellation of a minister’s debt to a church
- Severance pay
- Payment of a minister’s personal expenses by the church
- “Love gifts”

**KEY POINT.** The IRS can assess intermediate sanctions in the form of substantial excise taxes against a minister who is a “disqualified person” (meaning an officer, director, or other control party as well as relatives of such persons) and in some cases against church board members who authorize excess benefit transactions. Excess benefit transactions may occur if a church pays a minister an excessive salary, makes a large retirement or other special occasion gift to a minister, gives church property (such as a parsonage) to the minister, or sells church property to the minister at an unreasonably low price. A rebuttable presumption arises that compensation is reasonable if it is approved by an independent board on the basis of outside comparable data, such as independent compensation surveys, and the basis for the board’s decision is documented.

**KEY POINT.** The IRS has ruled that disqualified persons receive “automatic” excess benefits resulting in intermediate sanctions, regardless of amount, if they use church assets (vehicles, homes, credit cards, computers, etc.) for personal purposes, or receive nonaccountable expense reimbursements (not supported by adequate documentation of business purpose),
unless such benefits are reported as taxable income by the church on the disqualified person’s Form W-2, or by the disqualified person on his or her Form 1040, for the year in which the benefits are provided. The concept of automatic excess benefits directly affects the compensation practices of most churches, and exposes some ministers and church board members to intermediate sanctions.

If some of these items were not reported on your Form W-2, they still must be reported as income. Your church should issue a "corrected" Form W-2 (Form W-2c) for the year in which one or more items of taxable income was not reported on your Form W-2. If you receive a Form W-2c and have filed an income tax return for the year shown, you may have to file an amended return. Compare amounts on Form W-2c with those reported on your income tax return. If the corrected amounts change your U.S. income tax, file Form 1040X, Amended U.S. Individual Income Tax Return, with Copy B of Form W-2c to amend the return you previously filed.

In addition to what is reported on Form W-2 (or Form W-2c), Line 1 will also report the amount of excess housing allowance calculated (the amount by which the housing allowance exceeds the lesser of the minister’s housing expenses or the fair rental value of the minister’s home plus utilities.)

Items not reported on line 1. Some kinds of income are not taxable. These items are called exclusions. Most exclusions apply in computing both income taxes and self-employment taxes. The housing allowance is an example of an exclusion that applies only to income taxes and not to self-employment taxes. Some of the more common exclusions for ministers include:

- **Gifts.** Gifts, as defined by the Internal Revenue Code and the courts, are excludable from taxable income so long as they are not compensation for services. However, employers are not permitted to give tax-free gifts to employees. Likewise, the IRS and the courts have ruled that gifts ministers receive directly from members of their congregations may not always be excludable as gifts from taxable income. Before excluding gifts from taxable income, to the minister should consult with a CPA or a tax attorney.

- **Life insurance and inheritances.** Life insurance and inheritances are excludable from taxable income. Income earned before distributions of proceeds is generally taxable as income.

- **Employer-paid group life insurance.** Employees may exclude the cost of employer-provided group term life insurance (including benefits under the UCC Life Insurance and Disability Income (LIDI) Benefit Plan) so long as the amount of coverage does not exceed $50,000.

- **Tuition reductions.** School employees may exclude from their taxable income a qualified tuition reduction provided by their employer. A qualified tuition reduction is a reduction in tuition charged to employees or their spouses or dependent children by an employer that is an educational institution.

- **Lodging.** The value of lodging furnished to a minister, e.g., a parsonage, is excluded from income. This exclusion is not available in the computation of self-employment taxes. The value of lodging furnished to a non-minister employee on an employer’s premises and for the employer’s convenience may be excludable from taxable income if the employee is required to accept the lodging as a condition of employment.

- **Educational assistance.** Amounts paid by an employer for an employee’s tuition, fees, and books may be excludable from the employee’s taxable income, if the church has adopted a written educational assistance plan. The exclusion may not exceed $5,250 per year.

- **Employer-provided childcare.** The value of free childcare services provided by a church to its employees is excluded from employees’ income so long as the benefit is based on a written plan that does not discriminate in favor of highly compensated employees. Other conditions apply.

- **Nondiscrimination rules.** Many of the exclusions are not available to employees who are either “highly compensated employees” or “key employees” if the same benefit is not available on a nondiscriminatory basis to lower-paid employees. For 2019, a highly compensated employee is an employee whose compensation for the previous year was in excess of $125,000.

**KEY POINT.** Some exclusions are available only to taxpayers who report their income taxes as employees and not as self-employed persons. Many, however, apply to both employees and self-employed persons.

Four other exclusions are explained below—the housing allowance, tax-sheltered annuities, qualified scholarships, and sale of a home.
Housing Allowance

✓ KEY POINT. The housing allowance is being challenged in a federal lawsuit as an unconstitutional preference for religion. The current status of this case is summarized in a special section at the beginning of this tax Guide.

The most important tax benefit available to ministers who own or rent their homes is the housing allowance exclusion. Ministers who own or rent their home do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a housing allowance, to the extent that: 1) the allowance represents compensation for ministerial services; 2) it is used to pay housing expenses; and, 3) it does not exceed the fair rental value of the home (furnished, plus utilities). Housing-related expenses include mortgage payments, rent, utilities, repairs, furnishings, insurance, property taxes, additions, and maintenance.

A church cannot designate a housing allowance retroactively. Some churches fail to designate housing allowances prospectively and thereby deprive ministers of an important tax benefit.

Ministers who live in a church-owned parsonage do not pay federal income taxes on the fair rental value of the parsonage.

✓ TAX SAVINGS TIP. Ministers who live in a church parsonage and incur any out-of-pocket expenses in maintaining the parsonage (such as utilities, property taxes, insurance, furnishings, or lawn care) should be sure that their employing church designates in advance a portion of their annual compensation as a parsonage allowance. The amount so designated is not reported as wages on the minister's Form W-2 at the end of the year (if the allowance exceeds the actual expenses, the difference must be reported as income by the minister). This is an important tax benefit for ministers living in a church-provided parsonage. Unfortunately, many of these ministers are not aware of this benefit or are not taking advantage of it.

✓ TAX SAVINGS TIP. Ministers who own their homes lose the largest component of their housing allowance exclusion when they pay off their home mortgage loan. Many ministers in this position have obtained home equity loans, or a conventional loan secured by a mortgage on their otherwise debt-free home and have claimed their payments under these kinds of loans as a housing expense in computing their housing allowance exclusion. The Tax Court has ruled that this is permissible only if the loan proceeds were spent on housing-related expenses.

✓ TAX SAVINGS TIP. Ministers should be sure that the designation of a housing or parsonage allowance for the next year is on the agenda of the church (or church board) for one of its final meetings during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items—assuming in each case that the designation was appropriately adopted in advance by the church and supported by underlying documentation as to each minister’s anticipated housing expenses.

The rental value of a parsonage, and a housing allowance, are exclusions only for federal income tax reporting purposes. Ministers cannot exclude a housing allowance or the fair rental value of a parsonage when computing self-employment (Social Security) taxes unless they are retired. The Tax Code specifies that the self-employment tax does not apply to “the rental value of any parsonage or any parsonage allowance provided after the [minister] retires.”

Ministers should check their state income tax rules to determine the housing allowance rules for state income taxes.

The housing allowance is available to ministers whether they report their income taxes as employees or as self-employed (whether the church issues them a Form W-2 or a Form 1099).

Housing expenses to include in computing your housing allowance exclusion.

Ministers who own or rent their home should take the following expenses into account in computing their housing allowance exclusion:

- Down payment on a home (but note that a housing allowance is nontaxable only to the
extent that it does not exceed the lesser of the amount designated by their church, the actual housing expenses or the fair rental value of a minister’s home, as furnished, plus utilities)

- Mortgage payments on a loan to purchase or improve your home (include both interest and principal)
- Rent
- Real estate taxes
- Property insurance
- Utilities (electricity, gas, water, trash pickup, landline telephone charges)
- Furnishings and appliances (purchase and repair)
- Structural repairs and remodeling
- Yard maintenance and improvements
- Maintenance items (pest control, etc.)
- Homeowners association dues

KEY POINT. In 2007, the Tax Court characterized Internet expenses as utility expenses. This suggests that a housing allowance may be used to pay for Internet expenses (i.e., Internet access, cable television). Neither the IRS nor the Tax Court has addressed this issue directly, so be sure to check with a tax professional about the application of a housing allowance to these expenses.

Please note the following:

- A housing allowance must be designated in advance. Retroactive designations of housing allowances are not effective.

- The housing allowance designated by the church is not necessarily nontaxable. It is nontaxable (for income taxes) only to the extent that it is used to pay for housing expenses, and, for ministers who own or rent their home, does not exceed the fair rental value of their home (furnished, plus utilities).

- A housing allowance can be amended during the year if a minister’s housing expenses are more than expected. However, an amendment is only effective prospectively. Ministers should notify their church if their actual housing expenses are significantly more than the housing allowance designated by their church. But note that it serves no purpose to designate a housing allowance greater than the fair rental value of a minister’s home (as furnished, plus utilities).

- If the housing allowance designated by the church exceeds housing expenses or the fair rental value of a minister’s home, the excess housing allowance should be reported on line 1 of Form 1040.

- The housing allowance exclusion is an exclusion for federal income taxes only. Ministers must add the housing allowance as income in reporting self-employment taxes on Schedule SE (unless they are exempt from self-employment taxes).

- The fair rental value of a church-owned home provided to a minister as compensation for ministerial services is not subject to federal income tax.

EXAMPLE. A church designated $25,000 of Pastor D’Acosta’s 2018 compensation as a housing allowance. Pastor D’Acosta’s housing expenses for 2018 were utilities of $4,000, mortgage payments of $18,000, property taxes of $4,000, insurance payments of $1,000, repairs of $1,000, and furnishings of $1,000. The fair rental value of the home (including furnishings) is $19,000. Pastor D’Acosta’s housing allowance is nontaxable in computing income taxes only to the extent that it is used to pay housing expenses and does not exceed the fair rental value of her home (furnished, plus utilities). Stated differently, the nontaxable portion of a housing allowance is the least of the following three amounts: 1) the housing allowance designated by the church; 2) actual housing expenses; or, 3) the fair rental value of the home (furnished, plus utilities). In this case, the lowest of these three amounts is the fair rental value of the home, furnished plus utilities ($23,000), so this represents the nontaxable portion of Pastor D’Acosta’s housing allowance. Pastor D’Acosta must report the difference between this amount and the housing allowance designated by her church ($2,000) as additional income on line 1 of Form 1040.

EXAMPLE. Same facts as the previous example, except the church designated $12,000 of Pastor D’Acosta’s salary as a housing allowance. The lowest of the three amounts in this case would be $12,000 (the church designated housing allowance) and so this represents the nontaxable amount. Note that the Pastor D’Acosta’s actual housing expenses were more than the allowance, and so she was penalized because of the low allowance designated by her church.
**EXAMPLE.** Pastor Yang owns a home and incurred housing expenses of $12,000 in 2018. These expenses include mortgage principal and interest, property taxes, utilities, insurance and repairs. The church designated (in advance) $12,000 of Pastor Yang’s 2018 compensation as a housing allowance. Pastor Yang is able to itemize expenses on Schedule A (Form 1040). He is able to claim itemized deductions on Schedule A for both his mortgage interest and his property taxes (up to $10,000), even though his taxable income was already reduced by these items because of their inclusion in the housing allowance. This is often referred to as the “double deduction.” In fact, it represents an exclusion and a deduction.

**EXAMPLE.** In preparing his income tax return for 2018, Pastor Hill discovers that his church failed to designate a housing allowance for him for 2018. He asks his church to pass a resolution retroactively granting the allowance for 2018. Such a resolution is ineffective, and Pastor Hill will not be eligible for any housing allowance exclusion in 2018.

✔ **KEY POINT.** The Sarbanes-Oxley Act makes it a crime to knowingly falsify any document with the intent to influence “the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States...or in relation to or contemplation of any such matter or case,” and this provision contains no exemption for churches or pastors. It is possible that a pastor’s backdating of a board resolution to qualify for a housing allowance for the entire year is fraud and violates this provision in the Sarbanes-Oxley Act, exposing the pastor to a fine or imprisonment. Even if the pastor’s action does not violate the Act, it may result in civil or criminal penalties for tax fraud under the Tax Code.

✔ **TAX SAVINGS TIP.** Ministers should be sure that the designation of a housing or parsonage allowance for the next year is on the agenda of the church board for one of its final meetings during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items—assuming in each case that the designation was duly adopted in advance by the church.

**How much should a church designate as a housing allowance?**

The IRS has stated that there are no limitations on how much of a minister’s compensation can be designated by his or her employing church as a housing allowance. However, as noted above, this means little, since the nontaxable portion of a church-designated housing allowance for ministers who own or rent their home cannot exceed the lesser of: 1) actual housing expenses; or, 2) the fair rental value of the home (furnished, plus utilities).

Many churches base the housing allowance on their minister’s estimate of actual housing expenses for the new year. The church provides the minister with a form on which anticipated housing expenses for the new year are reported. For ministers who own their homes, the form asks for projected expenses in the following categories: down payment, mortgage payments, property taxes, property insurance, utilities, furnishings and appliances, repairs and improvements, maintenance, and miscellaneous. Many churches designate an allowance in excess of the anticipated expenses itemized by the minister. Basing the allowance solely on a minister’s anticipated expenses penalizes the minister if actual housing expenses turn out to be higher than expected. In other words, the allowance should take into account unexpected housing costs or inaccurate projections of expenses.

✔ **KEY POINT.** The housing allowance is available only if two conditions are met: 1) the recipient is a minister for tax purposes (as defined above); and, 2) the allowance is compensation for services performed in the exercise of ministry.

Churches sometimes neglect to designate a housing allowance in advance of a new calendar year. For example, a church board may discover in March of 2019 that it failed to designate a housing allowance for its pastor for 2019. It is not too late to act. The church should immediately designate a portion of its minister’s remaining compensation for 2019 as a housing allowance. This problem can be avoided by stipulating in each annual housing allowance designation that the allowance is for the current year and all future years unless otherwise provided. If such a resolution had been adopted in the December 2017 board meeting (i.e., “for 2018 and future years”) it would not matter that the church neglected to designate a minister’s 2019 allowance until March of 2019, since the previous designation would have carried over. Such “safety net” designations are not a substitute for annual housing allowances (they have never been addressed or endorsed by the IRS or Tax
Court). Rather, they provide a basis for claiming a housing allowance if a church neglects to designate one.

KEY POINT. Churches cannot designate a housing allowance retroactively.

KEY POINT. The IRS has ruled that a retired minister is eligible for a housing allowance exclusion if the following conditions are satisfied: 1) a portion of the retired minister’s pension income is designated as a housing allowance by his or her church or the church pension board of a denominational pension fund; 2) the retired minister has severed his or her relationship with the local church and relies on the fund for a pension; and, (3) the pensions paid to retired ministers “compensate them for past services to the local churches of the denomination or to the denomination.” Retired ministers who receive benefits from a denominational pension fund, such as the Annuity Plan for the United Church of Christ, will be eligible in most cases to have some or all of their benefits designated in advance as a housing allowance. This is an attractive benefit for retired ministers that is not available with some other kinds of retirement plans. Retired ministers also can exclude from their gross income the rental value of a home (plus utilities) furnished to them by their church as a part of their pay for past services. A minister’s surviving spouse cannot exclude a housing allowance or rental value of a parsonage unless the allowance or parsonage is for ministerial services he or she performs or performed.

The self-employment tax does not apply to the rental value of a parsonage or a housing allowance provided after a minister retires.

KEY POINT. Ministers who own their homes lose the largest component of their housing allowance exclusion when they pay off their home mortgage loan. Many ministers in this position have obtained home equity loans—or a conventional loan secured by a mortgage on their otherwise debt-free home—and have claimed their payments under these kinds of loans as a housing expense in computing their housing allowance exclusion. The Tax Court has ruled that this is permissible only if the loan proceeds were spent on housing-related expenses.

Section 403(b) plans.

Payments made by your church and your salary reduction contributions to a 403(b) plan are not reportable income for income tax or self-employment tax purposes as long as the total amount credited to your retirement account does not exceed contribution limits under Sections 415(c) and 402(g) of the Tax Code.

Contribution limits.

For 2018, total annual additions (employer contributions, salary reduction, and tax-paid contributions) could not exceed the lesser of 100% of your compensation (excluding a minister’s housing allowance) or $55,000. This rule is known as the Section 415(c) limit. Excess contributions can result in income tax, additional taxes, and penalties. The effect of excess contributions depends on the type of excess contribution. The distributed excess amount may not be rolled over to another 403(b) plan or to an IRA.

NEW IN 2019. The limit on annual additions is increased to $56,000 for 2019.

Minister’s housing allowance and contribution limits.

For 2018, the Section 415(c) limit restricts 403(b) contributions to the lesser of 100% of compensation or $55,000. For 2019, this amount is $56,000. Does the term compensation include a minister’s housing allowance? This is an important question for ministers, since the answer will determine how much can be contributed to a 403(b) plan. If the housing allowance is treated as compensation, then ministers will be able to contribute larger amounts. The Tax Code specifies that the term “compensation” for purposes of applying the Section 415(c) limit to a 403(b)(3) plan “means the participant’s includible compensation determined under section 403(b)(3).” Section 403(b)(3) defines compensation to include “the amount of compensation which is received from the employer… and which is includible in gross income.” Section 107 of the Tax Code specifies that a minister’s housing allowance (or the annual rental value of a parsonage) is not included in the minister’s gross income for income tax reporting purposes. Therefore, it would appear that the definition of compensation for purposes of computing the Section 415(c) limit would not include the portion of a minister’s housing allowance that is excludable from gross income, or the annual rental value of a parsonage. For many years the IRS website included the following question and answer addressing this issue:
Q. I am an employee minister in a local church. Each year, my church permits $25,000 as a yearly tax-free housing allowance. I would like to use my yearly housing allowance as compensation to determine my annual contribution limits (to a TSA) under Section 415(c) of the Internal Revenue Code. May I do so?

A. No. For purposes of determining the limits on contributions under Section 415(c) of the Internal Revenue Code, amounts paid to an employee minister, as a tax-free housing allowance, may not be treated as compensation pursuant to the definitions of compensation under Section 1.415-2(d) of the income tax regulations.

✔ KEY POINT. Churches that include the housing allowance as compensation when calculating the amount of the church’s contribution to 403(b) plans must perform an additional calculation to ensure the total contributions to the plan do not exceed the maximum contribution allowed under Section 415(c).

Taxation of distributions from a 403(b) plan.

Amounts you contribute through salary reduction, and the earnings attributable to these contributions, generally cannot be withdrawn before you reach age 59½, separate from service, die, or become disabled. In some cases of financial hardship, you may withdraw your own salary reduction contributions (but not the earnings on them) prior to the occurrence of any of the above events. A 403(b) plan may make hardship distributions only if permitted by the plan. The Annuity Plan for the United Church of Christ does not have a provision for hardship distributions.

Once amounts are distributed, they are generally taxable as ordinary income unless designated in advance as a minister's housing allowance. In addition, if amounts are distributed prior to your reaching age 59½, you will be assessed an additional tax of 10% of the amount which is includable in income, unless one of the following exceptions applies:

- The distributions are part of a series of substantially equal periodic payments made over your life or the lives of your beneficiaries and after you separate from service.
- The distributions are made after you separate from service in or after the year in which you reach age 55.
- The distributions do not exceed the amount of unreimbursed medical expenses that you could deduct for the current year.
- The distributions are made after your death, or after you become disabled.
- The distributions are made to an alternate payee pursuant to a qualified domestic relations order.

The additional tax is computed on Form 5329.

✔ KEY POINT. You must receive all, or at least a certain minimum, of your interest accruing after 1986 in a 403(b) plan by April 1 of the calendar year following the later of the calendar year in which you become age 70 1/2, or the calendar year in which you retire. This required minimum is called your required minimum distribution (RMD).

Salary reduction contributions (Section 402(g)). In addition to the Section 415(c) limit there is an annual limit on elective deferrals. The limit applies to the total of all elective deferrals contributed (even if contributed by different employers) for the year on your behalf to a variety of retirement plans, including 403(b) plans. Generally, you cannot defer more than an allowable amount each year for all plans covering you. For 2018 the allowable limit was $18,500. If you defer more than the allowable amount for a tax year, you must include the excess in your taxable income for that year.

NEW IN 2019. The dollar limit on annual elective deferrals increases to $19,000.

✔ KEY POINT. Church employees can make a special election that allows their employer to contribute up to $10,000 for the year, even if this is more than 100% of your compensation. The total contributions over your lifetime under this election cannot be more than $40,000.

The limit on elective deferrals increases for individuals who have attained age 50 by the end of the year. The additional amount that may be made is the lesser of: 1) the “applicable dollar amount”; or 2) the participant’s compensation for the year reduced by any other elective deferrals of the participant for the year. The applicable dollar amount is $6,000 for 2018 and 2019. Catch-up contributions are not subject to any other contribution limits and are not taken into account in applying other contribution limits.
**Qualified scholarships**

**KEY POINT.** Qualified scholarships are excludable from taxable income.

Amounts received as a qualified scholarship by a candidate for a degree may be excluded from gross income. A qualified scholarship is any grant amount that, in accordance with the conditions of the grant, is used for tuition and course-related expenses. Qualified tuition and related expenses are those used for (1) tuition and fees required for the enrollment or attendance at an educational institution or (2) fees, books, supplies, and equipment required for courses of instruction at the educational institution. The scholarship need not specify that it is to be used only for qualified tuition and related expenses. All that is required is that the recipient uses the scholarship for such expenses and that the scholarship does not specify that it is to be used for nonqualified expenses (such as room and board). In addition to these requirements, the scholarship must meet the additional requirements if the recipient is an employee or a family member of an employee. Generally, the scholarship must be noncompensatory in nature, selected using nonemployment related criteria, and an independent committee must make the selection of the recipient. Additional requirements may also apply. The church should seek the advice of a CPA or tax attorney to determine the proper treatment of scholarships to employees and their children.

Any amount received in excess of the qualified tuition and related expenses, such as amounts received for room and board, is not eligible for this exclusion.

Any amount received that represents payment for teaching, research, or other services required as a condition for receiving a qualified scholarship cannot be excluded from gross income. In addition, amounts paid by a church for the education of a pastor or other church employee cannot be treated as a nontaxable scholarship if paid "as compensation for services."

**EXAMPLE.** Primera Iglesia establishes a scholarship fund for seminary students. Roberta is a church member who is pursuing a master’s degree at a seminary. The church votes to award her a scholarship of $2,500 for 2019. As long as Roberta uses the scholarship award for tuition or other course-related expenses, she need not report it as income on her federal tax return. The better practice would be for the church to stipulate that the scholarship is to be used for tuition or other course-related expenses (for example, fees, books, supplies), or for the church to pay the expenses directly to the educational institution. This will ensure that the scholarship does not inadvertently become taxable income because its specific use was not designated and the recipient used it for nonqualified expenses. As long as amounts are paid through a qualified scholarship plan, the church is not required to report the scholarship on Form 1099-MISC to the recipient.

**Sale or exchange of your principal residence.**

A taxpayer who is an individual may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the date of the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or (to the extent provided under regulations) unforeseen circumstances, is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met. The exclusion under this provision may not be claimed for more than one sale or exchange during any two-year period unless the special provisions for unforeseen circumstances apply.

**Line 2 (Form 1040). Interest income. Attach Schedule B if over $1,500.**

Complete this line if you had interest income. Tax-exempt interest income is reported on Line 2a with taxable interest income reported on Line 2b. If you had taxable interest income of more than $1,500, complete Schedule B.

**Line 3 (Form 1040). Dividend income. Attach Schedule B if more than $1,500.**

Complete this line only if you had dividend income. Qualified dividend income is reported on Line 3a and enter all dividend income on Line 3b. If you had dividend income of more than that $1,500, complete Schedule B.

**Lines 4a and 4b (Form 1040). IRA, pension, and annuity income.**

You should receive a Form 1099-R showing the total amount of your pension and annuity payments before income tax or other deductions were withheld. This
amount should be shown in box 1 of Form 1099-R. Pension and annuity payments include distributions from 401(k) and 403(b) plans. Do not include the following payments, instead report them on line 1.

- Disability pensions received before you reach the minimum retirement age set by your employer.
- Corrective distributions (including any earnings) of excess salary deferrals or excess contributions to retirement plans. The plan must advise you of the year(s) the distributions are includible in income.

Many denominational pension funds, including the Annuity Plan for the United Church of Christ, annually designate 100% of pension and disability benefits paid to retired ministers as a housing allowance. In such cases the Form 1099-R may show that the taxable amount of the pension income is "not determined" by checking the box on line 2b. If you are a retired or disabled minister, you may exclude all or a portion of your pension or disability income from your gross income paid to you. Box 4 will show the amount of any benefits you repaid in 2018. If you received railroad retirement benefits treated as social security, you should receive a Form RRB-1099. Use the Social Security Benefits Worksheet in these instructions to see if any of your benefits are taxable.

1. How much, if any, of your Social Security benefits are taxable depends on your total income and marital status.

2. Generally, if Social Security benefits were your only income for 2018, your benefits are not taxable, and you probably do not need to file a federal income tax return.

3. If you received income from other sources, your benefits will not be taxed unless your modified adjusted gross income (AGI) is more than the base amount for your filing status.

4. Your taxable benefits and modified adjusted gross income are computed on a worksheet in the instructions to Form 1040.

5. You can do the following quick computation to determine whether some of your benefits may be taxable:
   - First, add one-half of the total Social Security benefits you received to all your other income, including any tax-exempt interest and other exclusions from income.

   • The tax year 2018 base amounts are:
     - $32,000 for married couples filing jointly
     - $25,000 for single, head of household, qualifying widow/widower with a dependent child, or married individuals filing separately who did not live with their spouses at any time during the year
     - $0 for married persons filing separately who lived together during the year

**Line 6 (Form 1040). Total income.**

Report total income on this line. This is the sum of the amounts reported on lines 1-5 of Form 1040, plus the additional categories of income reported on lines 10-22 of Schedule 1 (Form 1040). The most important of these for ministers are discussed below.

**Line 12 (Schedule 1). Business income.**

Report self-employment earnings (from Schedule C or C-EZ). Self-employment earnings include:

- compensation reported to you on a Form 1099-MISC
- fees received directly from church members for performing personal services (such as marriages and funerals)
- honoraria you received for guest speaking appearances in other churches

If you received income from any of these kinds of activities, compute your net earnings on Schedule C and transfer this amount to line 12 of Schedule 1 (Form 1040) and then to line 6 (Form 1040).

**Line 13 (Schedule 1). Capital gains.**

Also report on line 13 capital gains or losses (attach Schedule D) from the sale of capital assets. These include stocks, bonds, and property. Gain or loss is reported on Schedule D. You also may have to file Form 8949 (see the instructions to both forms for details). This amount, along with the other amounts reported on Schedule 1, is carried over to line 6 (Form 1040).

**Line 21 (Schedule 1). Other income.**

Other income is reported on line 21 of Schedule 1 (Form 1040) and carried over to line 6 (Form 1040). Other income includes the following items:

- A canceled debt or a debt paid for you by another person (unless the person who canceled or paid your debt intended it to be a gift)
- The fair market value of a free tour you receive from a travel agency for organizing a group of tourists (in some cases this may be reported on Schedule C)
- Most prizes and awards
- Some taxable distributions from a health savings account (HSA) or Archer MSA (see IRS Publication 969)
- Jury duty pay
- Taxable benefits provided by the church but not included on Form W-2 or Form W-2c. (Also remember to include these benefits on Schedule SE for the calculation of self-employment tax.)

**Step 5: Adjustments to income**

**Line 7 (Form 1040). Adjusted gross income**

You may deduct certain adjustments from total income (line 6) to compute your adjusted gross income. Report the adjustments on lines 23 through 36 of Form 1040 (Schedule 1). The total amount is subtracted from line 6 to compute adjusted gross income that is reported on line 7.

If you have no adjustments to income, enter the amount from line 6 on this line.

The two most relevant adjustments for ministers the deduction for one-half of the self-employment tax, and payments to an individual retirement account (IRA). Both are summarized below.

**Schedule 1 (Form 1040) line 27. One-half of self-employment tax**

**KEY POINT.** Every minister who pays self-employment taxes on ministerial income qualifies for this deduction. Some are not claiming it.

All ministers are self-employed for Social Security with respect to their ministerial income. They can deduct half of their actual self-employment taxes as an adjustment on line 27 (Schedule 1) of Form 1040, whether or not they are able to itemize deductions on Schedule A.

**Schedule 1 (Form 1040) line 32. Payments to an individual retirement account (IRA)**

An individual retirement arrangement, or IRA, is a personal savings plan which allows you to set aside money for retirement, while offering you tax advantages. You can set up different kinds of IRAs with a variety of organizations, such as a bank or other financial institution, a mutual fund, or a life insurance company.

The original IRA is referred to as a “traditional IRA.” A traditional IRA is any IRA that is not a Roth IRA or a SIMPLE IRA. You may be able to deduct some or all of your contributions to a traditional IRA. You may also be eligible for a tax credit equal to a percentage of your contribution. Amounts in your
traditional IRA, including earnings, generally are not taxed until distributed to you. IRAs cannot be owned jointly. However, any amounts remaining in your IRA upon your death can be paid to your beneficiary or beneficiaries.

To contribute to a traditional IRA, you must be under age 70½ at the end of the tax year. You, or your spouse if you file a joint return, must have taxable compensation, such as wages, salaries, commissions, tips, bonuses, or net income from self-employment. Compensation does not include earnings and profits from property, such as rental income, interest and dividend income, or any amount received as pension or annuity income, or as deferred compensation.

If you file a joint return for tax year 2018 and your taxable compensation is less than that of your spouse, the most that can be contributed for the year to your IRA is the smaller of the following two amounts: 1) $5,500 ($6,500 if you are age 50 or older), or 2) the total compensation includible in the gross income of both you and your spouse for the year, reduced by your spouse’s IRA contribution for the year to a traditional IRA and any contributions for the year to a Roth IRA on behalf of your spouse.

NEW IN 2019. The maximum annual dollar contribution limit for IRA contributions remains at $6,000 for 2019. Also, the additional catch-up contribution limit for an individual who has attained age 50 before the end of the taxable year remains at $1,000.

All IRA contributions must be made by the due date of your tax return, not including extensions. This means that your 2018 IRA contribution must be made by April 15, 2019, even if you obtain an extension for filing this return.

Your allowable deduction may be reduced or eliminated, depending on your filing status, the amount of your income, and if you or your spouse are covered by an employer provided retirement plan. The deduction begins to decrease (phase out) when your income rises above a certain amount and is eliminated altogether when it reaches a higher amount. The amounts vary depending on your filing status. If you were covered by an employer provided retirement plan, then the deduction for contributions to your IRA are completely phased out when adjusted gross income reaches $121,000 (Married Filing Jointly) or $73,000 (Single). (For 2019 limits are $123,000 (Married Filing Jointly) and $74,000 (Single).) If your spouse was covered by an employer retirement plan, then the deduction for contributions to your IRA and any contributions for the year to a Roth IRA on behalf of your spouse.

You do not report Roth contributions on your tax return. To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is set up. Like a
traditional IRA, a Roth IRA can be set up but there are limitations on the amount that can be contributed and the time of year that contributions can be made. You do not include in your gross income qualified distributions or distributions that are a return of your regular contributions from your Roth IRA. Refer to Publication 590 for additional information on Roth IRA(s).

For information on conversions from a traditional IRA to a Roth IRA, refer to Publication 590. No further contributions to a traditional IRA are permissible in the year you reach age 70½ or for any later year, and distributions from a traditional IRA must generally begin by April 1 of the year following the year in which you reach age 70½. However, you must receive at least a minimum amount for each year starting with the year you reach age 70½ (your “70½ year”). If you do not (or did not) receive that minimum amount in your 70½ year, then you must receive distributions for your 70½ year by April 1 of the next year. This means that you will have two required distributions in that year.

Even if you receive a distribution from your IRA before age 59½, you may not have to pay the 10% penalty if the distributions are not more than your qualified education expenses, or you use the distributions to buy, build, or rebuild a first home. See IRS Publication 590-B for an explanation of exceptions to the age 59½ rule.

Charitable contributions. An IRA owner, age 70½ or over, can directly transfer, tax-free, up to $100,000 per year to an eligible charity. Distributions from employer-sponsored retirement plans, including SIMPLE IRA plans and simplified employee pension (SEP) plans, are not eligible. To qualify, the funds must be transferred directly by the IRA custodian to the eligible charity. Distributed amounts may be excluded from the IRA owner’s income, resulting in lower taxable income for the IRA owner. However, if the IRA owner excludes the distribution from income, no deduction, such as a charitable contribution deduction on Schedule A, may be taken for the distributed amount.

To report a qualified charitable distribution on your Form 1040 tax return, you generally report the full amount of the charitable distribution on the line for IRA distributions (line 4, Form 1040). On the line for the taxable amount, enter zero if the full amount was a qualified charitable distribution. Enter "QCD" next to this line. See the Form 1040 instructions for additional information.

Not all charities are eligible. For example, donor-advised funds and supporting organizations are not eligible recipients.

Amounts transferred to a charity from an IRA are counted in determining whether the owner has met the IRA’s required minimum distribution (RMD).

**EXAMPLE.** A church has a senior pastor who is 52 years old, and a youth pastor who is 30 years old. The church does not participate in a retirement program for its staff. In 2019 the senior pastor can contribute $6,500 to an IRA (maximum annual contribution of $5,500 plus a “catch-up” contribution of $1,000), and the youth pastor can contribute $5,500.

**Step 6: Tax computation**

Line 8 (Form 1040). Itemized deductions or standard deduction

**KEY POINT.** Itemize your deductions on Schedule A only if they exceed the standard deduction for your filing status.

On line 8, you enter either your itemized deductions from Schedule A or a standard deduction amount. Itemized deductions are discussed under Schedule A in this guide. For 2018, the standard deduction amounts are as follows:

<table>
<thead>
<tr>
<th>FILING STATUS</th>
<th>STANDARD DEDUCTION AMOUNT (2018)</th>
</tr>
</thead>
<tbody>
<tr>
<td>single</td>
<td>$12,000</td>
</tr>
<tr>
<td>married filing jointly or qualifying widow(er)</td>
<td>$24,000</td>
</tr>
<tr>
<td>married filing separately</td>
<td>$12,000</td>
</tr>
<tr>
<td>head of household</td>
<td>$18,000</td>
</tr>
</tbody>
</table>

**Line 11 (Form 1040). Compute tax**

Most ministers can use the tax tables to determine their income taxes. Some higher income ministers must use the tax rate schedules (a spouse’s income is considered in deciding whether or not to use the tax rate schedules).

**Step 7: Credits**

A credit is a direct dollar-for-dollar reduction in your tax liability. It is much more valuable than deductions and exclusions, which merely reduce taxable income.
However, the maximum amount refundable may not exceed $1,400 per qualifying child. Additionally, in order to receive the child tax credit (i.e., both the refundable and non-refundable portion) a taxpayer must include a Social Security number for each qualifying child for whom the credit is claimed on the tax return. For these purposes, a Social Security number must be issued before the due date for the filing of the return for the taxable year. This requirement does not apply to a non-child dependent for whom the $500 nonrefundable credit is claimed.

Further, the Tax Cuts and Jobs Act of 2017 retains the present-law age limit for a qualifying child. As a result, a qualifying child is an individual who has not attained age 17 during the taxable year. The law also modifies the adjusted gross income phaseout thresholds. The credit begins to phase out for taxpayers with adjusted gross income in excess of $400,000 (in the case of married taxpayers filing a joint return) and $200,000 (for all other taxpayers). These phaseout thresholds are not indexed for inflation.

These new provisions are effective for taxable years beginning after December 31, 2017, and expire for taxable years beginning after December 31, 2025, unless extended by Congress.

**Line 12a (from Form 1040, Schedule 3, line 49). Credit for child and dependent care expenses: attach Form 2441**

Complete this line if you are eligible for a credit for child or dependent care expenses. See the instructions to Form 1040, line 12a, for details and conditions.

See IRS Publication 972 for additional information.

**Line 12b (from Form 1040, Schedule 3, line 51. Retirement Savings Contributions Credit (Saver’s Credit)**

If you make eligible contributions to certain eligible retirement plans or to an individual retirement arrangement (IRA), you may be able to take a tax credit. The amount of the saver’s credit you can get is generally based on the contributions you make and your credit rate. Refer to Publication 590 or the instructions for Form 8880 for more information. If you are eligible for the credit, your credit rate can be as low as 10% or as high as 50%, depending on your adjusted gross income. The lower your income, the higher the credit rate; your credit rate also depends on your filing status. These two factors will determine the maximum credit you may be allowed to take. You are not eligible for the credit if your adjusted gross income exceeds a certain amount.

The credit is available with respect to elective deferrals to a 401(k) plan, a 403(b) annuity, a SIMPLE or a simplified employee pension (SEP), contributions to a traditional or Roth IRA, and voluntary after-tax employee contributions to a 403(b) annuity or qualified retirement plan. The amount of the credit for 2018 is described in the following table.

<table>
<thead>
<tr>
<th>Adjusted Gross Income</th>
<th>joint returns</th>
<th>heads of household</th>
<th>single filers</th>
<th>amount of credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1–$38,000</td>
<td>$1–$28,500</td>
<td>$1–$19,000</td>
<td></td>
<td>50% of eligible contributions up to $2,000 ($1,000 maximum credit)</td>
</tr>
<tr>
<td>$38,001–$41,000</td>
<td>$28,501–$30,750</td>
<td>$19,001–$20,500</td>
<td></td>
<td>20% of eligible contributions up to $2,000 ($400 maximum credit)</td>
</tr>
<tr>
<td>$41,001–$63,000</td>
<td>$30,751–$47,250</td>
<td>$20,501–$31,500</td>
<td></td>
<td>10% of eligible contributions up to $2,000 ($200 maximum credit)</td>
</tr>
<tr>
<td>over $63,000</td>
<td>over $47,250</td>
<td>over $31,500</td>
<td></td>
<td>0%</td>
</tr>
</tbody>
</table>

For married couples filing jointly, each spouse is eligible for the credit.

For more information about this credit, see IRS Form 8880 and Publication 590.
Step 8: Other taxes

On the Form 1040 for 2017, other taxes were reported on lines 57-63. On the 2018 Form 1040, other taxes are reported on lines 57-63 of Schedule 4 and the total of all taxes is carried over to line 14 of Form 1040.

**Line 14 (Form 1040). Other taxes**

Report the following additional taxes on this line:

- **Self-employment tax**
  Ministers are self-employed for Social Security with respect to their ministerial income. They compute their self-employment taxes on Schedule SE and report the tax on line 57 of Form 1040 Schedule 4, and report this and other taxes line 14 of Form 1040.

- **Individual responsibility payment**
  For 2018 you must either:
  - Check the "Full-year health care coverage or exempt" box on the front of Form 1040 to indicate that you, your spouse (if filing jointly), and anyone you can or do claim as a dependent had qualifying health care coverage or a coverage exemption that covered all of 2018 or a combination of qualifying health care coverage and coverage exemption(s) for every month of 2018, or
  - Make a shared responsibility payment if, for any month in 2018, you, your spouse (if filing jointly), or anyone you can or do claim as a dependent didn’t have coverage and doesn’t qualify for a coverage exemption. If you can claim any part-year exemptions or exemptions for specific members of your household, use Form 8965. This will reduce the amount of your shared responsibility payment. For more information, see the Form 8965 instructions. This payment is reported on line 61 of Schedule 4 (Form 1040) and carried over to Line 14 (Form 1040).

Step 9: Payments

On the Form 1040 for 2017, payments were reported on lines 64-73. On the 2018 Form 1040, amounts representing federal income tax withholding is reported on line 16 and other taxes are reported on lines 66-74 of Schedule 5 and the total of these payments is carried over to line 17 of Form 1040. The two most important categories of tax payments are withheld taxes and estimated tax payments, as noted below.

**Line 16 (Form 1040). Federal income tax withheld**

Ministers' wages based on the performance of ministerial services are exempt from federal income tax withholding. As a result, only those ministers who have entered into a voluntary withholding arrangement with their church will have income taxes withheld. The church should report the amount of voluntarily withheld taxes on the minister's Form W-2.

- **KEY POINT.** Ministers who enter into voluntary withholding arrangements will have federal and state income taxes withheld from their wages. However, a church does not withhold the employee's share of Social Security and Medicare taxes, since ministers are self-employed for Social Security with respect to ministerial compensation. Ministers can request (on Form W-4 or through other written instructions) that their church withhold an additional amount of income taxes to cover their expected self-employment tax liability. These additional withholdings must be treated as income taxes withheld (on Forms W-2 and 941) rather than the employee's share of Social Security and Medicare taxes. They constitute a credit that can be applied to both income taxes and self-employment taxes. Ministers still must complete Schedule SE to report their self-employment tax liability.

**Line 17 (Form 1040). Estimated tax payments**

Compensation paid to ministers for ministerial duties is not subject to mandatory tax withholding. As a result, ministers must prepay their income tax and Social Security (self-employment) taxes by using the quarterly estimated tax procedure, unless they have entered into a voluntary withholding agreement with their employing church. The estimated tax procedure is summarized in Part 2 of this Guide in the section "How do ministers pay their taxes?" The total amount of estimated tax payments made to the IRS is reported as a payment of taxes on line 66 of Schedule 5 (Form 1040), and carried over with the other kinds of payments listed on Schedule 5 to line 17 of Form 1040.

**Line 17a (Form 1040). Earned income credit**

The earned income credit reduces tax you owe and may give you a refund even if you do not owe any tax. A number of technical requirements must be met in order to qualify for this credit. Unfortunately, many
taxpayers who qualify for the earned income credit do not claim it because it is so difficult to compute. In most cases, the amount of your earned income credit depends on: 1) whether you have no qualifying child, one qualifying child, two qualifying children, or three or more qualifying children; and, 2) the amount of your earned income and modified adjusted gross income.

You may be able to claim the earned income credit for 2018 if: 1) you do not have a qualifying child and you earned less than $15,270 ($20,950 if married); 2) a qualifying child lived with you and you earned less than $40,320 ($46,010 if married filing jointly); 3) two qualifying children lived with you and you earned less than $45,802 ($51,492 if married filing jointly); or, 4) three or more qualifying children lived with you and you earned less than $49,194 ($54,884 if married filing jointly). The maximum earned income credit for 2018 is: 1) $519 with no qualifying child; 2) $3,461 with one qualifying child; 3) $5,716 with two qualifying children; and, 4) $6,431 with three or more qualifying children.

You can compute the credit yourself or the IRS will compute it for you. To figure the amount of your earned income credit, you must use the EIC Worksheet and EIC Table in the instructions for Form 1040, line 17. Ministers may want to consider having the IRS compute the credit for them, especially due to confusion about how the housing allowance affects the credit.

The credit is reported on line 17a of Form 1040.

IRS Publication 596 is a 41-page publication that explains the earned income credit. The 2017 edition (the most recent available at the time of publication of this text) states, in general: “The rental value of a home or a housing allowance provided to a minister as part of the minister’s pay generally isn’t subject to income tax but is included in net earnings from self-employment. For that reason, it is included in earned income for the EIC” except for ministers who have opted out of self-employment taxes by filing a timely Form 4361 exemption application with the IRS.

Excerpts from Publication 596 confirm that ministers who are employees for income tax reporting purposes and who have not exempted themselves from self-employment taxes by filing a timely Form 4361 with the IRS include their housing allowance or the fair rental value of a parsonage in computing earned income for purposes of the earned income credit.

But what about ministers who have exempted themselves from self-employment taxes by filing a timely Form 4361 with the IRS? Do they include a housing allowance or the rental value of a parsonage in computing their earned income for purposes of the earned income credit? As noted above, Publication 596 explicitly states, with regard to ministers who have filed Form 4361, that “a nontaxable housing allowance or the nontaxable rental value of a home is not earned income.”

With respect to ministers who have filed a timely Form 4361, Publication 596 states:

Whether or not you have an approved Form 4361, amounts you received for performing ministerial duties as an employee count as earned income. This includes wages, salaries, tips, and other taxable employee compensation. [But] if you have an approved Form 4361, a nontaxable housing allowance or the nontaxable rental value of a home isn’t earned income. Also, amounts you received for performing ministerial duties, but not as an employee, don’t count as earned income. Examples include fees for performing marriages and honoraria for delivering speeches.

Ministers who are affected by this issue should consult their own tax advisor for help.

Step 10: Refund or amount you owe

After totaling your payments, you can calculate whether you owe the government, or a refund is due you. If you owe a tax, be certain to enclose with your return a check in the amount you owe payable to the “United States Treasury” or by making the payment through your EFTPS account. Do not attach the check to your return, but include it with a Form 1040-V. If you file your return electronically, the payment may be sent in separately using the Form 1040-V. Include your daytime phone number, your Social Security number, and write Form 1040 for 2018 on the check. If you owe taxes, you also may have to pay an underpayment penalty (refer to line 23 of Form 1040).

If you have overpaid your taxes, you have two options: 1) request a full refund; or, 2) apply the overpayment to your 2019 estimated tax.

Step 11: Sign here

You must sign and date the return at the bottom of page 2. If you are filing a joint return, your spouse must also sign the return. In the “your occupation” space, enter your occupation—minister. In prior year’s
the signature portion of the return was on page 2 of the Form 1040, but the redesigned form has the signature section on page 1.

Other forms and schedules

Schedule A

✓ KEY POINT. If your itemized deductions exceed your standard deduction, you should report your itemized deductions on Schedule A (Form 1040). This section will summarize the itemized deductions.

Step 1: Medical and dental expenses (lines 1–4)

You may deduct certain medical and dental expenses (for yourself, your spouse, and your dependents) if you itemize your deductions on Schedule A, but only to the extent that your expenses exceed 7.5% of your adjusted gross income. You must reduce your medical expenses by the amounts of any reimbursements you receive for those expenses before applying the 7.5% test. Reimbursements include amounts you receive from insurance or other sources for your medical expenses (including Medicare). It does not matter if the reimbursement is paid to the patient, the doctor, or the hospital.

The following expenses ARE deductible as medical expenses:

- fees for medical services
- fees for hospital services
- meals and lodging at a hospital during medical treatment (subject to some limits)
- medical and hospital insurance premiums that you pay (do not include amounts paid to health sharing arrangements)
- special equipment
- Medicare A premiums you pay if you are exempt from Social Security and voluntarily elect to pay Medicare A premiums
- Medicare B premiums you pay
- Medicare D premiums you pay
- Medicare Supplement premiums you pay (or are deducted from your pension)
- long-term care insurance premiums, subject to certain limitations on the amount that may be deducted
- special items (false teeth, artificial limbs, eyeglasses, hearing aids, crutches, etc.)
- transportation for necessary medical care. For 2018, the standard mileage rate for medical travel was 18 cents per mile (it increases to 20 cents for 2019)
- medicines and drugs requiring a prescription, and insulin
- the portion of a life-care fee or founder’s fee paid either monthly or in a lump sum under an agreement with a retirement home that is allocable to medical care
- wages of an attendant who provides medical care
- the cost of home improvements if the main reason is for medical care
- smoking cessation program
- exercise expenses (including the cost of equipment to use in the home) if required to treat an illness (including obesity) diagnosed by a physician, and the purpose of the expense is to treat a disease rather than to promote general health and the taxpayer would not have paid the expense but for this purpose

The following items are NOT deductible as medical expenses:

- funeral services
- health club dues (except as noted above)
- household help
- life insurance
- maternity clothes
- nonprescription medicines and drugs
- nursing care for a healthy baby
- toothpaste, cosmetics, toiletries
- trip for general improvement of health
- most cosmetic surgery

Step 2: Taxes paid (lines 5–7)

In the past, individuals were permitted a deduction for certain taxes paid or accrued, whether or not incurred in a taxpayer’s trade or business. These taxes were:
• state and local real property taxes,
• state and local personal property taxes, and
• state and local income taxes.

At the election of the taxpayer, an itemized deduction may be taken for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes. This provision was added to address the unequal treatment of taxpayers in the seven states that do not have an income tax. Taxpayers in these states cannot take advantage of the itemized deduction for state income taxes. Allowing them to deduct sales taxes helps offset this disadvantage.

The Tax Cuts and Jobs Act allows taxpayers to claim an itemized deduction of up to $10,000 ($5,000 for married taxpayer filing a separate return) for the aggregate of:

• state and local property taxes, and
• state and local income taxes (or sales taxes in lieu of income taxes) paid or accrued in the taxable year.

The new rules apply to taxable years 2018 through 2025.

Step 3: Interest you paid (lines 8-10)

As a general matter, personal interest is not deductible. Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations. Qualified residence interest means interest paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness. A qualified residence means the taxpayer’s principal residence and one other residence of the taxpayer selected to be a qualified residence. A qualified residence can be a house, condominium, cooperative, mobile home, house trailer, or boat.

Acquisition indebtedness is indebtedness that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer and which secures the residence. The maximum amount treated as acquisition indebtedness is $1 million ($500,000 in the case of a married person filing a separate return). Acquisition indebtedness also includes indebtedness from the refinancing of other acquisition indebtedness but only to the extent of the amount (and term) of the refinanced indebtedness. For example, if the taxpayer incurs $200,000 of acquisition indebtedness to acquire a principal residence and pays down the debt to $150,000, the taxpayer’s acquisition indebtedness with respect to the residence cannot thereafter be increased above $150,000 (except by indebtedness incurred to substantially improve the residence).

Home equity indebtedness is indebtedness (other than acquisition indebtedness) secured by a qualified residence. In order for interest related to home equity indebtedness to be considered as qualified residence interest, the proceeds must be used to buy, build or substantially improves the residence that secures the loan. (Prior law did not restrict the use of the proceeds, but limited the total debt to $100,000.)

The Tax Cuts and Jobs Act provides that, in the case of taxable years beginning after December 31, 2017, and beginning before January 1, 2026, a taxpayer may treat no more than $750,000 as qualified residence loans including acquisition indebtedness and qualifying home equity indebtedness ($375,000 in the case of married taxpayers filing separately). In the case of acquisition indebtedness incurred before December 15, 2017, this limitation is $1,000,000 ($500,000 in the case of married taxpayers filing separately).

The term points is sometimes used to describe certain charges paid by a borrower. They are also called loan origination fees, maximum loan charges, or premium charges. If the payment of any of these charges is only for the use of money, it ordinarily is interest paid in advance and must be deducted in installments over the life of the mortgage (not deducted in full in the year of payment). However, points are deductible in the year paid if the following requirements are satisfied:

1. Your loan is secured by your main home. (Your main home is the one you ordinarily live in most of the time.)
2. Paying points is an established business practice in the area where the loan was made.
3. The points paid were not more than the points generally charged in that area.
4. You use the cash method of accounting. This means you report income in the year you receive it and deduct expenses in the year you pay them. Most individuals use this method.
5. The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
6. The funds you provided at or before closing, plus any points the seller paid, were at least as much as
the points charged. The funds you provided are not required to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds you paid at or before closing for any purpose. You cannot have borrowed these funds from your lender or mortgage broker.

7. You use your loan to buy or build your main home.

8. The points were computed as a percentage of the principal amount of the mortgage.

9. The amount is clearly shown on the settlement statement (such as the Settlement Statement, Form HUD-1) as points charged for the mortgage. The points may be shown as paid from either your funds or the seller's.

Step 4: Gifts to charity (lines 11-14)

Cash contributions to churches, schools, and most other public charities, that are U.S. organizations, are deductible up to 60% of adjusted gross income. Contributions of property are subject to different limitations. See IRS Publication 526. Contributions of cash or checks are reported on line 11, while contributions of noncash property are reported on line 12. If you do not itemize deductions, you cannot deduct any of your charitable contributions.

The value of personal services is never deductible as a charitable contribution, but unreimbursed expenses incurred in performing services on behalf of a church or other charity may be. For example, if you drive to and from volunteer work on behalf of a charity, you may deduct the actual cost of gas and oil or you may claim the standard charitable mileage rate of 14 cents for each substantiated mile (for 2018 and 2019). Unreimbursed travel expenses incurred while away from home (whether within the United States or abroad) in the course of donated services to a tax-exempt religious or charitable organization are deductible as a charitable contribution. There are two ways to do this.

Individuals performing the charitable travel can keep track of their own travel expenses and then claim a charitable contribution for the total on Schedule A. (A letter acknowledging the individual's service should be obtained from the charity.) Or, these individuals could provide their church or charity with a travel report substantiating all travel expenses. In such a case, the church or charity could issue the individual a charitable contribution receipt for the total amount of the substantiated travel expenses. Travel expenses that can be receipted include airfare, lodging, meals and incidental expenses.

No charitable deduction is allowed for travel expenses incurred while away from home in performing services for a religious or charitable organization unless there is no significant element of personal pleasure, recreation, or vacation involved in the travel.

EXAMPLE. Pastor Guillame goes on a trip to Europe. She is in Europe for 10 days and conducts one-hour worship services on two of those days. Pastor Guillame will not be able to claim a charitable contribution deduction for the travel expenses that she incurs in making this trip. The same rule would apply if Pastor Guillame's spouse or children go along on the trip.

Charitable contributions must be claimed in the year they are delivered. One exception is a check that is mailed to a charity—it is deductible in the year the check is mailed (and postmarked), even if it is received early in the next year.

Charitable contributions generally are deductible only to the extent they exceed the value of any premium or benefit received by the donor in return for the contribution.

There are limits on the amount of a contribution that can be deducted. Generally, cash contributions to churches, schools, and other public charities are deductible up to a maximum of 60% of adjusted gross income. In some cases, contributions that exceed these limits can be carried over and claimed in future years. Some charitable contributions are limited to 20% or 30% of adjusted gross income, depending on the recipient and the form of the contribution.

Designated contributions are those that are made to a church with the stipulation that they be used for a specified purpose. If the purpose is an approved project or program of the church, the designation will not affect the deductibility of the contribution. An example is a contribution to a church building fund. However, if a donor stipulates that a contribution be spent on a designated individual, no deduction is allowed unless the church exercises full administrative control over the donated funds to ensure that they are being spent in furtherance of the church's exempt purposes. Designated contributions that ordinarily are not deductible include contributions to church benevolence or scholarship funds that designate a specific recipient.
 Contributions to benevolence or scholarship funds ordinarily are deductible if the donor does not earmark a specific recipient.

 Contributions to a church or missions board that specify a particular missionary may be tax-deductible if the church or missions board exercises full administrative and accounting control over the contributions and ensures that they are spent in furtherance of the church’s mission. Direct contributions to missionaries, or any other individual, are not tax-deductible, even if they are used for religious or charitable purposes.

 Charitable contributions must be properly substantiated. Individual cash contributions of less than $250 may be substantiated by a canceled check or a receipt from the charity. Special rules govern the substantiation of individual contributions of cash or property of $250 or more. The donor must substantiate these contributions with a qualifying receipt from the charity including a listing of the contributions and a statement that there were no goods or services provided in exchange for the contributions. These rules are further explained in the supplement to this guide entitled Federal Reporting Requirements for Churches.

 If you contribute property that you value at $500 or more, you must include a completed Form 8283 with your Form 1040. Complete only section A if the value claimed is $500 or more but less than $5,000. If you claim a deduction of more than $5,000 for a contribution of noncash property (other than publicly traded securities), then you must obtain a qualified appraisal of the property and include a qualified appraisal summary (Section B of Form 8283) with your Form 1040.

 Special rules apply to donations of cars, boats, and planes. See the instructions to IRS Form 1098-C for details.

 ✓ KEY POINT. The Tax Court ruled that a donor who contributed property worth more than $10,000 to a church was not eligible for a charitable contribution deduction, even though there was no dispute as to the value of the property, because he failed to attach a qualified appraisal summary (Form 8283) to the tax return on which the contribution was claimed.

 Step 5: Casualty and theft losses (line 15)

 Under prior law, a taxpayer could claim an itemized deduction for any loss sustained during the taxable year, not compensated by insurance or otherwise. For individual taxpayers, deductible losses had to be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Personal casualty or theft losses were deductible only if they exceeded $100 per casualty or theft. In addition, aggregate net casualty and theft losses were deductible only to the extent they exceeded 10% of an individual taxpayer’s adjusted gross income.

 The Tax Cuts and Jobs Act temporarily modifies the deduction for personal casualty and theft losses. Taxpayers may claim a personal casualty loss (subject to the limitations described above) only if the loss was attributable to a disaster declared by the President under the Disaster Relief and Emergency Assistance Act.

 The above-described limitation is effective for losses incurred in taxable years 2018 through 2025.

 NOTE: Job expenses and most other miscellaneous deductions

 Under prior law, individuals could claim itemized deductions for certain miscellaneous expenses. Certain of these expenses were not deductible unless, in aggregate, they exceeded 2% of the taxpayer’s adjusted gross income. The deductions described below were subject to the aggregate 2% floor:

 - appraisal fees for a casualty loss or charitable contribution;
 - casualty and theft losses from property used in performing services as an employee;
 - clerical help and office rent in caring for investments;
 - hobby expenses, but generally not more than hobby income;
 - investment fees and expenses;
 - safe deposit box rental fees, except for storing jewelry and other personal effects;
 - trustee’s fees for an IRA, if separately billed and paid;
 - tax preparation expenses;
unreimbursed employee business expenses (see below);

- job search expenses in the taxpayer's present occupation;
- licenses and regulatory fees;
- passport fees for a business trip;
- tools and supplies used in the taxpayer's work;

Unreimbursed employee business expenses subject to the 2% AGI floor included such items as:

- overnight out-of-town travel;
- local transportation;
- meals (subject to a 50% AGI floor);
- entertainment (subject to a 50% AGI floor);
- home office expenses;
- business gifts;
- dues to professional societies;
- work-related education;
- work clothes and uniforms if required and not suitable for everyday use;
- malpractice insurance;
- subscriptions to professional journals and trade magazines related to the taxpayer's work; and
- equipment and supplies used in the taxpayer's work.

The Tax Cuts and Jobs Act suspends all miscellaneous itemized deductions that are subject to the 2% floor under present law. As a result, taxpayers may not claim the above-listed items as itemized deductions for the taxable years to which the suspension applies. This provision is effective for taxable years 2018 through 2025 unless extended by Congress.

The elimination of an itemized deduction for most expenses, including unreimbursed employee business expenses, will hit some clergy hard. Some have suggested that this impact can be minimized if a church reimburses employees business expenses under an accountable expense reimbursement arrangement. To be accountable, a church's reimbursement arrangement must comply with all four of the following rules:

- Expenses must have a business connection—that is, the reimbursed expenses must represent expenses incurred by an employee while performing services for the employer.
- Employees are only reimbursed for expenses for which they provide an adequate accounting within a reasonable period of time (not more than 60 days after an expense is incurred).
- Employees must return any excess reimbursement or allowance within a reasonable period of time (not more than 120 days after an excess reimbursement is paid).
- The income tax regulations caution that in order for an employer's reimbursement arrangement to be accountable, it must meet a "reimbursement requirement" in addition to the three requirements summarized above. The reimbursement requirement means that an employer's reimbursements of an employee's business expenses come out of the employer's funds and not by reducing the employee's salary.

The basis for this workaround is the fact that while the Tax Cuts and Jobs Act eliminated "all miscellaneous itemized deductions that are subject to the 2% floor under present law" (including unreimbursed employee business expenses), it did not modify or repeal section 62(a)(2)(A) of the Tax Code, which excludes from tax employer reimbursements of employee business expenses under an accountable plan (defined above).

Schedule B

Schedule B is used to report taxable interest income and dividend income of more than $1,500.

Step 1: Interest income (lines 1–4)

List (on line 1) the name of each institution or individual that paid you taxable interest if you received more than $1,500 of taxable interest in 2018. Be sure the interest you report on line 1 corresponds to any 1099INT forms you received from such institutions. Do not include tax-exempt interest. Interest income is carried over to line 2b of Form 1040.

Step 2: Dividend income (lines 5–6)

List (on line 5) the name of each institution that paid you dividends if you received more than $1,500 in dividends in 2018. Be sure the dividends you report on line 1 correspond to any 1099-DIV forms you
received from such institutions. Dividend income is carried over to line 3b of Form 1040.

**Step 3: Foreign accounts and foreign trusts (lines 7-8)**

Be sure to complete this part of the schedule if you had more than $1,500 of either taxable interest or dividends.

**Schedule C**

- **KEY POINT.** Most ministers who serve local churches or church agencies are employees for federal income tax purposes with respect to their church salary. They report their church salary on line 1 of Form 1040 and receive a Form W-2 from the church. They do not report their salary as self-employment earnings on Schedule C.

- **KEY POINT.** Use Schedule C to report income and expenses from ministerial activities you conduct other than in your capacity as a church employee. Examples would be fees for guest speaking in other churches, and fees received directly from church members for performing personal services, such as weddings and funerals.

**RECOMMENDATION.** Some ministers are eligible to use the simpler Schedule C-EZ.

**Step 1: Introduction**

Complete the first several questions on Schedule C. Ministers should list code 541990 on line B, since this is the code the IRS uses in a clergy tax illustration in Publication 517. Some ministers who report their church compensation as self-employed point to this code as proof that ministers serving local churches can report as self-employed. This is not so. This code applies to the incidental self-employment activities of ministers who report their church salaries as employees. It also applies to those few ministers who are self-employed, such as traveling evangelists.

**Step 2: Income (lines 1–7)**

Report on line 1 your gross income from your self-employment activity.

**Step 3: Expenses (lines 8–27)**

**WARNING.** Many ministers continue to report their income taxes as self-employed. One perceived advantage of doing so is the ability to deduct business expenses on Schedule C (and avoid the nondeductibility of unreimbursed and nonaccountable reimbursed employee business expenses as itemized deductions on Schedule A). This advantage is often illusory. Most ministers, if audited by the IRS, would be reclassified as employees and their Schedule C deductions disallowed. This could result in substantial additional taxes, penalties, and interest. The best way for ministers to handle their business expenses is through an accountable expense reimbursement arrangement, when they are truly an employee of the church.

Report any business expenses associated with your self-employment earnings on lines 8 through 27. For example, if you incur transportation, travel or other expenses in the course of performing self-employment activities, you deduct these expenses on lines 8 through 27 of Schedule C. Self-employed persons can deduct only 50% of business meals and meals associated with entertainment.

- **KEY POINT.** The Tax Cuts and Jobs Act of 2017 provides that no deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement or recreation, (2) membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, or (3) a facility or portion thereof used in connection with any of the above items. Thus, the provision repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50% limit to such deductions). Taxpayers may still generally deduct 50% of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel). For amounts incurred and paid after December 31, 2017 and until December 31, 2025, the Tax Cuts and Jobs Act expands this 50% limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for de minimis fringes and for the convenience of the employer. This new law does not affect the taxation of reimbursement of entertainment expenses. As long as the church has adopted and followed an accountable expense reimbursement plan, the minister does not include reimbursement of entertainment expenses in his taxable income.

Since self-employed ministers list only their net self-employment earnings (that is, after deducting all business and professional expenses) as a component of gross income on line 6 of Form 1040 (line 7 if
adjustments) they in effect are able to deduct 100% of their business and professional expenses even though they cannot deduct business expenses as an itemized deduction on Schedule A.

KEY POINT. In the past, one of the reasons the audit rate was higher for self-employed taxpayers was that only 30% of all taxpayers had sufficient itemized expenses to use Schedule A. If the IRS could reclassify taxpayers from self-employed to employee status, it generated more tax dollars since only 30% of taxpayers could itemize deductions on Schedule A. Business expenses that could have been claimed by a self-employed taxpayer on Schedule C were lost if a taxpayer was reclassified as an employee and had insufficient expenses to itemize on Schedule A.

Report self-employment income From Schedule C on Schedule 1, line 12, and carry over this and other items of additional income reported on Schedule 1 to line 6 of Form 1040 (line 7 if you are claiming adjustments).

Schedule C-EZ

The IRS has released a simpler form of Schedule C that can be used by some people with self-employment earnings. The new Schedule C-EZ can be used instead of Schedule C if you meet all of these requirements:

- You had business expenses associated with your trade or business of $5,000 or less in 2018.
- You use the cash rather than the accrual method of accounting.
- You did not have an inventory at any time during the year.
- You did not have a net loss from your trade or business.
- You had only one business as a sole proprietor.
- You had no employees.
- You do not use Form 4562 to compute a depreciation deduction with regard to your trade or business.
- You do not claim a deduction for the business use of your home.

Many ministers who report their church compensation as employees will be able to use this form to report small amounts of self-employment earnings they receive during the course of a year as honoraria for occasional guest speaking in other churches or as fees received directly from church members for services rendered on their behalf (for example, marriages and funerals).

Schedule SE

KEY POINT. Use Schedule SE to report Social Security taxes on any income you earned as a minister if you have not applied for and received IRS approval of an exemption application (Form 4361). Remember, ministers (except for some chaplains) are self-employed for Social Security with respect to their ministerial services. They pay self-employment (SECA) taxes, and not Social Security and Medicare (FICA) taxes, with respect to compensation from such services.

KEY POINT. Ministers who have received IRS approval of an application for exemption from self-employment taxes (Form 4361) do not pay self-employment taxes on compensation received for their ministerial services.

Step 1: Section A (line 2)

Most ministers use the short Schedule SE rather than the long Schedule SE. This means that they complete section A on page 1 of the schedule rather than Section B on page 2.

Ministers report their net self-employment earnings on line 2 of Section A. This amount is computed as follows:

Add the following to your church salary:

- other items of church income (including taxable fringe benefits)
- fees you receive for marriages, baptisms, funerals, masses, etc.
- self-employment earnings from outside businesses
- annual rental value of a parsonage, including utilities paid by church (unless you are retired)
- a housing allowance (unless you are retired)
- business expense reimbursements (under a nonaccountable plan)

- the value of meals served on the church’s premises for the convenience of the employer
- any amount a church pays toward your income tax or self-employment tax

And then deduct the following:

- most income tax exclusions other than meals or lodging furnished for the employer’s convenience, and the foreign earned income exclusion
- annual fair rental value of a parsonage provided to you after you retire
- housing allowance provided to you after you retire
- contributions by your church to a tax-sheltered annuity plan set up for you, including any salary reduction contributions (elective deferrals) that are not included in your gross income
- pension payments or retirement allowances you receive for your past ministerial services

Unreimbursed, and nonaccountable reimbursed, expenses. The clear implication of the Tax Code and IRS Revenue Ruling 80-110 is that unreimbursed business expenses, and reimbursed business expenses under a nonaccountable plan, are deductible by pastors in computing their self-employment tax liability even if they are not able to deduct these expenses in computing their income tax liability. This understanding is clearly reflected in IRS Publication 517. This position is also reflected in the following statement in the instructions to Schedule SE: “If you were a duly ordained minister who was an employee of a church and you must pay SE tax, the unreimbursed business expenses that you incurred as a church employee are not deductible as an itemized deduction for income tax purposes. However, when figuring SE tax, subtract on line 2 the allowable expenses from your self-employment earnings and attach an explanation.”

Step 2: Section A (line 4)

Ministers (and other taxpayers who are self-employed for Social Security) can reduce their taxable earnings by 7.65%, which is half the Social Security and Medicare tax paid by employers and employees. To do this, multiply net earnings from self-employment times 0.9235 on line 4. Self-employment taxes are paid on the reduced amount.

Step 3: Section A (line 5)

The self-employment tax for 2018 is computed on this line. The self-employment tax rate for 2018 is 15.3%, which consists of the following two components:

1. a Medicare hospital insurance tax of 2.9%, and
2. an old-age, survivor and disability (Social Security) tax of 12.4%.

In 2018, the 2.9% Medicare tax applied to all net earnings from self-employment regardless of amount. The 12.4% Social Security tax applied to only the first $128,400 of net self-employment earnings.

Form 2106

✓ KEY POINT. In the past Form 2106 was used by employees to compute employee business expenses claimed on Schedule A. For most taxpayers this form is now obsolete because of the suspension of an itemized deduction for employee business expenses on Schedule A. Form 2016 is now used only by Armed Forces reservists, qualified performing artists, fee-basis state or local government officials, and employees with impairment-related work expenses.
Example One: Active Minister: Note: This example is based on an illustrated example contained at the end of IRS Publication 517. Because the 2018 version of IRS Publication 517 was not available as of the date of printing and due to the major changes to tax law effective for the 2018 tax year, this example may be somewhat different than the example in the IRS Publication.

Rev. John Michaels is the minister of the First United Church. He is married and has one child. The child is considered a qualifying child for the child tax credit. Mrs. Michaels is not employed outside the home. Rev. Michaels is a common-law employee of the church, and he has not applied for an exemption from SE tax. The church paid Rev. Michaels a salary of $45,000. In addition, as a self-employed person, he earned $4,000 during the year for weddings, baptisms, and honoraria. He made estimated tax payments during the year totaling $12,000. He taught a course at the local community college, for which he was paid $3,400. Rev. Michaels owns a home next to the church. He makes a $1,125 per month mortgage payment of principal and interest only. His utility bills and other housing-related expenses for the year totaled $12,000. He taught a course at the local community college, for which he was paid $3,400. Rev. Michaels owns a home next to the church. He makes a $1,125 per month mortgage payment of principal and interest only. His utility bills and other housing-related expenses for the year totaled $1,450, and the real estate taxes on his home amounted to $1,750 for the year. The church paid him $1,400 per month as his parsonage allowance. The home's fair rental value is $1,380 per month (including furnishings and utilities).

The parts of Rev. and Mrs. Michaels’ income tax return are explained in the order they are completed. They are illustrated in the order that Rev. Michaels will assemble the return to send it to the IRS.

Because of tax reform, certain schedules prepared by Rev. Michaels in the prior tax year are not prepared for this example. First, because unreimbursed business expenses are no longer deductible as itemized deductions for purposes of federal income tax, Schedule 2106-EZ is not prepared. Additionally, because the $14,535 remaining available itemized deductions (comprised of state and local sales taxes of $1,175, real estate taxes of $1,750, home mortgage interest of $6,810, and cash contributions of $4,800) are less than the new $24,000 standard deduction for married couples filing jointly, Schedule A is not prepared.

Form W–2 from Church

The church completed Form W–2 for Rev. Michaels as follows:

Box 1. The church entered Rev. Michaels' $45,000 salary.

Box 2. The church left this box blank because Rev. Michaels did not request federal income tax withholding.

Boxes 3 through 6. Rev. Michaels is considered a self-employed person for purposes of Social Security and Medicare tax withholding, so the church left these boxes blank.

Box 14. The church entered Rev. Michaels' total parsonage allowance for the year and identified it.

✓ Turbo Tax Tip. Listed below are tips for ministers who use Turbo Tax to complete their returns. We have listed our recommended responses to some of the questions asked by the software when entering your W-2 from your church. These tips should not be construed as an endorsement or recommendation of the Turbo Tax software.

1. “Do any of these apply to this W-2?”
   Be sure to check the box that says, "Religious employment – This income was for religious employment (clergy, nonclergy, religious sect)."

2. “About your religious employment.”
   Please note that ministers fall under the category of clergy employment.

3. “Tell us about your clergy housing.” Turbo Tax then asks for the Parsonage or Housing Allowance, as well as the amount of qualifying expenses.

   The amount you should enter for qualifying expenses is the lesser of your actual housing expenses, the annual fair rental value of your home (including furnishings and utilities), or the amount of your pay that was designated as ministerial housing allowance by your Church.

4. “How would you like us to calculate clergy self-employment tax?”
   Please note that self-employment tax should be paid on wages and housing allowance. See Schedule SE Turbo Tax Tip for additional information.

Form W–2 from College

The community college gave Rev. Michaels a Form W–2 that showed the following:

Box 1. The college entered Rev. Michaels' $3,400 salary.
Box 2. The college withheld $272 in federal income tax on Rev. Michaels’ behalf.

Boxes 3 and 5. As an employee of the college, Rev. Michaels is subject to Social Security and Medicare withholding on his full salary from the college.

Box 4. The college withheld $210.80 in Social Security taxes.

Box 6. The college withheld $49.30 in Medicare taxes.

Schedule C–EZ (Form 1040)

Some of Rev. Michaels’ entries on Schedule C–EZ are explained here:

Line 1. Rev. Michaels reports the $4,000 from weddings, baptisms, and honoraria.

Line 2. Rev. Michaels reports his expenses related to the line 1 amount. The total consisted of $87 for marriage and family booklets and $251 for 461 miles of business use of his car, mainly in connection with honoraria. Rev. Michaels used the standard mileage rate to figure his car expense. He multiplied the standard mileage rate of 54.5 cents by 461 miles for a total of $251. These expenses total $338 ($251 + $87). However, he cannot deduct the part of his expenses allocable to his tax-free parsonage allowance. He attaches the required statement, Attachment 1 (shown later) to his return showing that 25% (or $85) of his business expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the $85 from the $338 and enters the $253 difference on line 2.

Line 3. He enters his net profit of $3,747 both on line 3 and on Schedule 1 (Form 1040), line 12.

Lines 4 through 8b. Rev. Michaels fills out these lines to report information about his car.

✔ TURBO TAX TIP. Turbo Tax does not appear to calculate the nondeductible portion of the expenses which should be allocated to the tax-free portion of the housing allowance. The taxpayer will need to adjust the expenses (as shown in Attachment 1) and input the reduced figure into the software.

Schedule SE (Form 1040)

After Rev. Michaels prepares Schedule C–EZ, he fills out Schedule SE (Form 1040). He reads the chart on page 1 of the schedule which tells him he can use Section A—Short Schedule SE to figure his self-employment tax. Rev. Michaels is a minister, so his salary from the church is not considered church employee income. Thus, he does not have to use Section B—Long Schedule SE. He fills out the following lines in Section A.

Line 2. Rev. Michaels attaches a statement (see Attachment 2, later) that explains how he figures the amount ($63,826) he enters here. The calculation in Attachment 2 includes unreimbursed business expenses from his work for the church. Although unreimbursed business expenses are clearly no longer deductible on Schedule A as itemized deductions for federal income tax purposes, there is still some ambiguity as of the date of this writing as to whether these expenses remain deductible for self-employment tax purposes. Based on the commentary in Chapter 9 and the underlying rulings discussed therein, the author has prepared this example assuming these expenses are deductible against self-employment earnings. Ministers should consult with their personal tax advisors regarding the deductibility of these expenses for purposes of self-employment tax on their 2018 Form 1040, in light of the developing nature of guidance in this area as of the date of this writing. Rev. Michaels records show that he drove 2,600 miles. He multiplies miles driven by the mileage rate of 54.5 cents. The combined result is $1,417. Additionally, Rev. Michaels paid for $219 of professional publications and booklets in connection with his work for the church. The total unreimbursed business expenses were $1,636. After including the $85 of Schedule C-EZ expenses allocable to tax-free income, the total deductions against self-employment income is $1,721.

Line 4. He multiplies $63,826 by .9235 to get his net earnings from self-employment ($58,943).

Line 5. The amount on line 4 is less than $128,400, so Rev. Michaels multiplies the amount on line 4 ($58,943) by .153 to get his self-employment tax of $9,018. He enters that amount here and on Schedule 4 (Form 1040), line 57 and 64.

Line 6. Rev. Michaels multiplies the amount on line 4 by .50 to get his deduction for the employer-equivalent portion of self-employment tax of $4,509. He enters that amount here and on Schedule 1 (Form 1040), line 27.

✔ TURBO TAX TIP. The software asks about self-employment tax on clergy wages. The taxpayer should check the box to pay self-employment tax on wages and housing allowance (assuming, as shown in this example, that the minister has
not applied for exemption from the SE tax). Please note that the software does not appear to automatically reduce self-employment wages by the business expenses allocated to tax free income. The taxpayer will need to adjust net self-employment income (as shown in Attachment 2) and input the reduced figure into the software. This can be done by going into the "Business Taxes" section, and selecting "Self-Employment Tax." Choose "Make Adjustments," and enter in the "Ministerial Business Expenses" item the additional expenses that were allocable to tax-free income ($1,721 in this example – see Attachment 2).

Form 1040, Schedule 1 (Form 1040), Schedule 4 (Form 1040), and Schedule 5 (Form 1040)

After Rev. Michaels prepares the above schedules, he fills out Form 1040, along with Schedules 1 through 5 to the extent required. He files a joint return with his wife. First he fills out Form 1040, Page 1 and completes the appropriate lines for his filing status and exemptions. Then, he fills out the rest of the forms as follows:

Form 1040, Page 2, Line 1. Rev. Michaels reports $48,640. This amount is the total of his $45,000 church salary, $3,400 college salary, and $240, the excess of the amount designated and paid to him as a parsonage allowance over the lesser of his actual expenses and the fair rental value of his home (including furnishings and utilities). The two salaries were reported to him in box 1 of the Forms W–2 he received.

Schedule 1 (Form 1040), Line 12. He reports his net profit of $3,747 from Schedule C–EZ, line 3. Since no other amounts are reported on Schedule 1 (Form 1040), Lines 1-21, he also reports this amount on Line 22, and carries the figure to the blank space on Form 1040, Page 2, line 6.

Form 1040, Page 2, Line 6. Rev. Michaels adds Form 1040, Page 2, line 1 and the amount reported on the blank space on Form 1040, Page 2, line 6, and enters the total ($52,387) on line 6.

Form 1040, Page 2, Line 7. Because Rev. Michaels has reported deductible self-employment tax on Schedule 1 (Form 1040) Line 27, Rev. Michaels goes to Schedule 1 (Form 1040) and completes the bottom section of the form. Since there are no other amounts listed on lines 23-33, Rev. Michaels reports $4,509 on Line 36 and subtracts this amount from the amount reported on Form 1040, Page 2, Line 6. The result ($47,878) is entered on Form 1040, Page 2, Line 7. This is his adjusted gross income.

Form 1040, Page 2, Line 8. He enters the standard deduction for married couples filing jointly ($24,000) on Line 8.

Form 1040, Page 2, Line 10. Subtract line 8 from line 7. This is his taxable income.

Form 1040, Page 2, Line 11a and Line 11. Rev. Michaels uses the tax tables in the 2018 Form 1040 instructions to determine his applicable tax and enters the amount ($2,484) on the space provided on Line 11a and on Line 11.

Form 1040, Page 2, Line 12a. The Michaels can take the child tax credit for their daughter, Jennifer. Rev. Michaels figures the credit by completing the Child Tax Credit Worksheet (not shown) contained in the Form 1040 general instructions. He enters the $2,000 credit. (Note: The Michaels are not required to attach Schedule 8812 to claim the child tax credit since they are not eligible for the additional child tax credit and their daughter does not have an individual taxpayer identification number (ITIN). The IRS issues ITINs to foreign nationals and others who have federal tax reporting or filing requirements and do not qualify for social security numbers (SSNs). Since Jennifer has a SSN, she is not required to obtain an ITIN and therefore Schedule 8812 is not applicable.)

Form 1040, Page 2, Line 14 and Schedule 4 (Form 1040). Rev. Michaels completes Schedule 4 (Form 1040). Since the only amount reported on Schedule 4 (Form 1040) is his self-employment tax from Schedule SE, he reports the amount ($9,018) on Schedule 4 (Form 1040), Line 64, and on Form 1040, Page 2, line 14.

Form 1040, Page 2, Line 16. He enters the federal income tax shown in box 2 of his Form W–2 from the college.

Form 1040, Page 2, Line 17 and Schedule 5 (Form 1040). Rev. Michaels enters the $12,000 estimated tax payments he made for the year on Schedule 5 (Form 1040), Line 66. Since there are no amounts reported on Schedule 5 (Form 1040), he reports the amount on Schedule 5 (Form 1040), Line 75, and also enters the amount on the blank space provided beside Schedule 5 on Line 17 and on Line 17 itself.
### W-2 Wage and Tax Statement 2018

**Copy B—To Be Filed With Employee's FEDERAL Tax Return.**

This information is being furnished to the Internal Revenue Service.

#### John E. Michaels

1040 Main Street  
Hometown, Texas 77099

<table>
<thead>
<tr>
<th>Employee’s social security number</th>
<th>011-00-1111</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer identification number (EIN)</td>
<td>00-0246810</td>
</tr>
</tbody>
</table>
| Employer’s name, address, and ZIP code | First United Church  
1042 Main Street  
Hometown, Texas 77099 |
| Control number |  |
| Employee’s first name and initial | John E. |
| Last name | Michaels |
| State | TX |
| Employer’s state ID number |  |
| State wages, tips, etc. |  |
| State income tax |  |
| Local wages, tips, etc. |  |
| Local income tax |  |
| Locality name |  |
| Wages, tips, other compensation | 45,000.00 |
| Federal income tax withheld |  |

#### John E. Michaels

1040 Main Street  
Hometown, Texas 77099

<table>
<thead>
<tr>
<th>Employee’s social security number</th>
<th>011-00-1111</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer identification number (EIN)</td>
<td>00-1357913</td>
</tr>
</tbody>
</table>
| Employer’s name, address, and ZIP code | Hometown College  
40 Honor Road  
Hometown, Texas 77099 |
| Control number |  |
| Employee’s first name and initial | John E. |
| Last name | Michaels |
| State | TX |
| Employer’s state ID number |  |
| State wages, tips, etc. |  |
| State income tax |  |
| Local wages, tips, etc. |  |
| Local income tax |  |
| Locality name |  |
| Wages, tips, other compensation | 3,400.00 |
| Federal income tax withheld | 272.00 |
| Social security wages | 3,400.00 |
| Social security tax withheld | 210.80 |
| Medicare wages and tips | 3,400.00 |
| Medicare tax withheld | 49.30 |
| Social security tips |  |
| Allocated tips |  |
Part I. General Information

You may use Schedule C-EZ instead of Schedule C only if you:

- Had business expenses of $5,000 or less,
- Use the cash method of accounting,
- Did not have an inventory at any time during the year,
- Did not have a net loss from your business,
- Had only one business as either a sole proprietor, qualified joint venture, or statutory employee,
- Had no employees during the year,
- Do not deduct expenses for business use of your home,
- Do not have prior year unallowed passive activity losses from this business, and
- Are not required to file Form 4562, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, to find out if you must file.

And you:

- Had no employees during the year,
- Do not deduct expenses for business use of your home,
- Do not have prior year unallowed passive activity losses from this business, and
- Are not required to file Form 4562, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, to find out if you must file.

Part II. Figure Your Net Profit

1. Gross receipts. Caution: If this income was reported to you on Form W-2 and the “Statutory employee” box on that form was checked, see Statutory employees in the instructions for Schedule C, line 1, and check here ▶ .

2. Total expenses (see page 2). If more than $5,000, you must use Schedule C .

3. Net profit. Subtract line 2 from line 1. If less than zero, you must use Schedule C. Enter on both Schedule 1 (Form 1040), line 12, and Schedule SE, line 2, or on Form 1040NR, line 13, and Schedule SE, line 2 (see page 2). (Statutory employees do not report this amount on Schedule SE, line 2.) Estates and trusts, enter on Form 1041, line 3. .

Part III. Information on Your Vehicle. Complete this part only if you are claiming car or truck expenses on line 2.

4. When did you place your vehicle in service for business purposes? (month, day, year) ▶ 7/15/11.

5. Of the total number of miles you drove your vehicle during 2018, enter the number of miles you used your vehicle for:

   a. Business 461
   b. Commuting (see page 2) 0
   c. Other 7,478

6. Was your vehicle available for personal use during off-duty hours? ▶ Yes □ No

7. Do you (or your spouse) have another vehicle available for personal use? ▶ Yes □ No

8a. Do you have evidence to support your deduction? ▶ Yes □ No

b. If “Yes,” is the evidence written? ▶ Yes □ No

For Paperwork Reduction Act Notice, see the separate instructions for Schedule C (Form 1040).

*See statement attached.
### Other Taxes

- **57** Self-employment tax. Attach Schedule SE
- **58** Unreported social security and Medicare tax from: Form a [ ] 4137 b [ ] 8919
- **59** Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required
- **60a** Household employment taxes. Attach Schedule H
- **60b** Repayment of first-time homebuyer credit from Form 5405. Attach Form 5405 if required
- **61** Health care: individual responsibility (see instructions)
- **62** Taxes from: a [ ] Form 8959 b [ ] Form 8960 c [ ] Instructions; enter code(s)
- **63** Section 965 net tax liability installment from Form 965-A
- **64** Add the amounts in the far right column. These are your total other taxes. Enter here and on Form 1040, line 14

<table>
<thead>
<tr>
<th>Other Taxes</th>
<th>Name(s) shown on Form 1040</th>
<th>Your social security number</th>
</tr>
</thead>
<tbody>
<tr>
<td>57</td>
<td>John E. &amp; Susan R. Michaels</td>
<td>011-00-1111</td>
</tr>
<tr>
<td>58</td>
<td></td>
<td>9,018</td>
</tr>
<tr>
<td>59</td>
<td></td>
<td></td>
</tr>
<tr>
<td>60a</td>
<td></td>
<td></td>
</tr>
<tr>
<td>60b</td>
<td></td>
<td></td>
</tr>
<tr>
<td>61</td>
<td></td>
<td></td>
</tr>
<tr>
<td>62</td>
<td></td>
<td></td>
</tr>
<tr>
<td>63</td>
<td></td>
<td></td>
</tr>
<tr>
<td>64</td>
<td></td>
<td>9,018</td>
</tr>
</tbody>
</table>

For Paperwork Reduction Act Notice, see your tax return instructions.

*See statement attached.*
### SCHEDULE 5
(Form 1040)

**Other Payments and Refundable Credits**

► Attach to Form 1040.
► Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

<table>
<thead>
<tr>
<th>Name(s) shown on Form 1040</th>
<th>Your social security number</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Other Payments and Refundable Credits</strong></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>65</td>
</tr>
<tr>
<td>66</td>
<td>2018 estimated tax payments and amount applied from 2017 return</td>
</tr>
<tr>
<td>67a</td>
<td>Reserved</td>
</tr>
<tr>
<td>67b</td>
<td>Reserved</td>
</tr>
<tr>
<td>68–69</td>
<td>Reserved</td>
</tr>
<tr>
<td>70</td>
<td>Net premium tax credit. Attach Form 8962</td>
</tr>
<tr>
<td>71</td>
<td>Amount paid with request for extension to file (see instructions)</td>
</tr>
<tr>
<td>72</td>
<td>Excess social security and tier 1 RRTA tax withheld</td>
</tr>
<tr>
<td>73</td>
<td>Credit for federal tax on fuels. Attach Form 4136</td>
</tr>
</tbody>
</table>
| 74 | Credits from Form:  
   a) 2439  
   b) Reserved  
   c) 8885  
   d) Reserved |
| 75 | Add the amounts in the far right column. These are your total other payments and refundable credits. Enter here and include on Form 1040, line 17. |

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71482C

Schedule 5 (Form 1040) 2018
Before you begin: To determine if you must file Schedule SE, see the instructions.

May I Use Short Schedule SE or Must I Use Long Schedule SE?

Note: Use this flowchart only if you must file Schedule SE. If unsure, see Who Must File Schedule SE in the instructions.

Did you receive wages or tips in 2018?

Are you a minister, member of a religious order, or Christian Science practitioner who received IRS approval not to be taxed on earnings from these sources, but you owe self-employment tax on other earnings?

Are you using one of the optional methods to figure your net earnings (see instructions)?

Did you receive church employee income (see instructions) reported on Form W-2 of $108.28 or more?

Was the total of your wages and tips subject to social security or railroad retirement (tier 1) tax plus your net earnings from self-employment more than $128,400?

Did you receive tips subject to social security or Medicare tax that you didn’t report to your employer?

Did you report any wages on Form 8919, Uncollected Social Security and Medicare Tax on Wages?

You may use Short Schedule SE below

You must use Long Schedule SE on page 2

Section A—Short Schedule SE. Caution: Read above to see if you can use Short Schedule SE.

1a Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A.

b If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code AH.

2 Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report.

3 Combine lines 1a, 1b, and 2.

4 Multiply line 3 by 92.35% (0.9235). If less than $400, you don’t owe self-employment tax; don’t file this schedule unless you have an amount on line 1b.

5 Self-employment tax. If the amount on line 4 is:

   • $128,400 or less, multiply line 4 by 15.3% (0.153). Enter the result here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55.

   • More than $128,400, multiply line 4 by 2.9% (0.029). Then, add $15,921.60 to the result. Enter the total here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55.

6 Deduction for one-half of self-employment tax.

For Paperwork Reduction Act Notice, see your tax return instructions.

*See statement attached.
## Additional Income and Adjustments to Income

- **Attach to Form 1040.**
- Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

### Additional Income

<table>
<thead>
<tr>
<th>Additional Income</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-9b</td>
<td>Reserved</td>
<td>1-9b</td>
</tr>
<tr>
<td>10</td>
<td>Taxable refunds, credits, or offsets of state and local income taxes</td>
<td>10</td>
</tr>
<tr>
<td>11</td>
<td>Alimony received</td>
<td>11</td>
</tr>
<tr>
<td>12</td>
<td>Business income or (loss). Attach Schedule C or C-EZ</td>
<td>12</td>
</tr>
<tr>
<td>13</td>
<td>Capital gain or (loss). Attach Schedule D if required. If not required, check here</td>
<td>13</td>
</tr>
<tr>
<td>14</td>
<td>Other gains or (losses). Attach Form 4797</td>
<td>14</td>
</tr>
<tr>
<td>15a</td>
<td>Reserved</td>
<td>15a</td>
</tr>
<tr>
<td>15b</td>
<td>Reserved</td>
<td>15b</td>
</tr>
<tr>
<td>16a</td>
<td>Reserved</td>
<td>16a</td>
</tr>
<tr>
<td>16b</td>
<td>Reserved</td>
<td>16b</td>
</tr>
<tr>
<td>17</td>
<td>Rental real estate, royalties, partnerships, S corporations, trusts, etc.</td>
<td>17</td>
</tr>
<tr>
<td>18</td>
<td>Farm income or (loss). Attach Schedule F</td>
<td>18</td>
</tr>
<tr>
<td>19</td>
<td>Unemployment compensation</td>
<td>19</td>
</tr>
<tr>
<td>20a</td>
<td>Reserved</td>
<td>20a</td>
</tr>
<tr>
<td>20b</td>
<td>Reserved</td>
<td>20b</td>
</tr>
<tr>
<td>21</td>
<td>Other income. List type and amount</td>
<td>21</td>
</tr>
<tr>
<td>22</td>
<td>Combine the amounts in the far right column. If you don’t have any adjustments to income, enter here and include on Form 1040, line 6. Otherwise, go to line 23.</td>
<td>22</td>
</tr>
<tr>
<td>23</td>
<td>Educator expenses</td>
<td>23</td>
</tr>
<tr>
<td>24</td>
<td>Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106</td>
<td>24</td>
</tr>
<tr>
<td>25</td>
<td>Health savings account deduction. Attach Form 8889</td>
<td>25</td>
</tr>
<tr>
<td>26</td>
<td>Moving expenses for members of the Armed Forces. Attach Form 3903</td>
<td>26</td>
</tr>
<tr>
<td>27</td>
<td>Deductible part of self-employment tax. Attach Schedule SE</td>
<td>27</td>
</tr>
<tr>
<td>28</td>
<td>Self-employed SEP, SIMPLE, and qualified plans</td>
<td>28</td>
</tr>
<tr>
<td>29</td>
<td>Self-employed health insurance deduction</td>
<td>29</td>
</tr>
<tr>
<td>30</td>
<td>Penalty on early withdrawal of savings</td>
<td>30</td>
</tr>
<tr>
<td>31a</td>
<td>Alimony paid</td>
<td>31a</td>
</tr>
<tr>
<td>32</td>
<td>IRA deduction</td>
<td>32</td>
</tr>
<tr>
<td>33</td>
<td>Student loan interest deduction</td>
<td>33</td>
</tr>
<tr>
<td>34</td>
<td>Reserved</td>
<td>34</td>
</tr>
<tr>
<td>35</td>
<td>Reserved</td>
<td>35</td>
</tr>
<tr>
<td>36</td>
<td>Add lines 23 through 35</td>
<td>36</td>
</tr>
</tbody>
</table>

### Adjustments to Income

<table>
<thead>
<tr>
<th>Adjustments to Income</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>Educator expenses</td>
<td>23</td>
</tr>
<tr>
<td>24</td>
<td>Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106</td>
<td>24</td>
</tr>
<tr>
<td>25</td>
<td>Health savings account deduction. Attach Form 8889</td>
<td>25</td>
</tr>
<tr>
<td>26</td>
<td>Moving expenses for members of the Armed Forces. Attach Form 3903</td>
<td>26</td>
</tr>
<tr>
<td>27</td>
<td>Deductible part of self-employment tax. Attach Schedule SE</td>
<td>27</td>
</tr>
<tr>
<td>28</td>
<td>Self-employed SEP, SIMPLE, and qualified plans</td>
<td>28</td>
</tr>
<tr>
<td>29</td>
<td>Self-employed health insurance deduction</td>
<td>29</td>
</tr>
<tr>
<td>30</td>
<td>Penalty on early withdrawal of savings</td>
<td>30</td>
</tr>
<tr>
<td>31a</td>
<td>Alimony paid</td>
<td>31a</td>
</tr>
<tr>
<td>32</td>
<td>IRA deduction</td>
<td>32</td>
</tr>
<tr>
<td>33</td>
<td>Student loan interest deduction</td>
<td>33</td>
</tr>
<tr>
<td>34</td>
<td>Reserved</td>
<td>34</td>
</tr>
<tr>
<td>35</td>
<td>Reserved</td>
<td>35</td>
</tr>
<tr>
<td>36</td>
<td>Add lines 23 through 35</td>
<td>36</td>
</tr>
</tbody>
</table>

For Paperwork Reduction Act Notice, see your tax return instructions.
Attachment 1. Computation of expenses, allocable to tax-free ministerial income, that are nondeductible.

<table>
<thead>
<tr>
<th></th>
<th>Taxable</th>
<th>Tax-Free</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary as a minister</td>
<td>$45,000</td>
<td>$45,000</td>
<td></td>
</tr>
<tr>
<td>Parsonage allowance:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount designated and paid by church ($1,400 x 12)</td>
<td>$16,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actual expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Mortgage $1,125 x 12, Utilities/other $1,450, Real estate taxes $1,750)</td>
<td>$16,700</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair rental value of home (including furnishings and utilities) ($1,380 x 12)</td>
<td>$16,560</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable portion of allowance</td>
<td>$240</td>
<td>240</td>
<td>240</td>
</tr>
<tr>
<td>(excess of amount designated &amp; paid over lesser of actual expenses or fair rental value)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax-free portion of allowance (lesser of amount designated, actual expenses or fair rental value)</td>
<td>$16,560</td>
<td>$16,560</td>
<td></td>
</tr>
<tr>
<td>Gross income from weddings, baptisms, and honoraria</td>
<td>$4,000</td>
<td>$4,000</td>
<td></td>
</tr>
<tr>
<td>Ministerial Income</td>
<td>$49,240</td>
<td>$16,560</td>
<td>$65,800</td>
</tr>
</tbody>
</table>

% of nondeductible expenses: $16,560/$65,800 = 25%

Schedule C-EZ Deduction Computation

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Marriage and family booklets</td>
<td>$87</td>
<td></td>
</tr>
<tr>
<td>Business use of car:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>461 miles x 44.5¢</td>
<td>251</td>
<td></td>
</tr>
<tr>
<td>Unadjusted Schedule C-EZ expenses</td>
<td>338</td>
<td></td>
</tr>
<tr>
<td>Minus:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nondeductible part of Schedule C-EZ expenses (25% x $338)</td>
<td>(85)</td>
<td></td>
</tr>
<tr>
<td>Schedule C-EZ deductions (line 2)</td>
<td>$253</td>
<td></td>
</tr>
</tbody>
</table>

Attachment 2. Attachment to Schedule SE (Form 1040)

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Church wages</td>
<td>$45,000</td>
<td></td>
</tr>
<tr>
<td>Parsonage allowance</td>
<td>16,800</td>
<td></td>
</tr>
<tr>
<td>Net profit from Schedule C-EZ</td>
<td>3,747</td>
<td></td>
</tr>
<tr>
<td></td>
<td>65,547</td>
<td></td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Schedule C-EZ expenses allocable to tax-free income</td>
<td>$85</td>
<td></td>
</tr>
<tr>
<td>Ministerial employee unreimbursed business expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Car expenses for church business:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2,600 miles x 44.5¢</td>
<td>1,417</td>
<td></td>
</tr>
<tr>
<td>Publications and booklets</td>
<td>219</td>
<td>(1,721)</td>
</tr>
<tr>
<td>Net Self-Employment Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Schedule SE, Section A, line 2</td>
<td>$63,826</td>
<td></td>
</tr>
</tbody>
</table>
Example Two: Retired Minister: Rev. William K. Green is a retired minister. He is 69 years old. He is married to Sarah J. Green. She is 65 years old and is also retired. For 2018, Rev. Green received $15,000 in annuity income, all of which was designated in advance by the Board of Pensions as a housing allowance. Rev. Green had housing expenses of $13,000. The home’s fair rental value is $1,200 per month (including furnishings and utilities). Housing allowances for retired ministers are not taxable in computing federal income tax to the extent that they do not exceed the lesser of actual housing expenses or the annual fair rental value of the home (including furnishings and utilities). Retirement benefits, whether or not designated in advance as a housing allowance, are not subject to self-employment taxes.

Rev. Green received $12,000 of Social Security benefits in 2018, and his wife received $6,000. None of this income is taxable, however, because the Green’s income is not enough to expose their Social Security benefits to tax.

In 2018, Rev. Green received $2,000 from occasional guest preaching engagements. He incurred $590 in expenses as a result of these activities ($436 of travel expenses, and $150 of meal expenses). Note that Rev. Green will pay self-employment tax on this income (see Schedule SE), since it represents compensation from active ministry.

The parts of Rev. and Mrs. Green’s income tax return are explained in the order they are completed. They are illustrated in the order that the Rev. Green will assemble the return to send it to the IRS.

Form 1099-R from the Board of Pensions

The Board of Pensions completed Form 1099-R for Rev. Green as follows:

Box 1. The $15,000 pension income Rev. Green receives from the Board of Pensions.

Box 2b. Taxable amount not determined. – The Board of Pensions designated in advance 100% of pension income as a housing allowance. It is not taxable to the extent that it does not exceed the lesser of actual housing expenses or the annual fair rental value of the home (including furnishings and utilities).

Box 7. Rev. Green’s pension income is a normal distribution.

Schedule C–EZ (Form 1040)

Some of Rev. Green’s entries on Schedule C–EZ are explained here.

Line 1. Rev. Green reports the $2,000 from occasional guest preaching engagements.

Line 2. Rev. Green reports his expenses related to the line 1 amount. He drove 800 miles of business use of his car, in connection with guest preaching. Rev. Green used the standard business mileage rate to figure his car expense. He multiplied the standard mileage rate of 54.5 cents by 800 miles for a total of $436. He also incurred $75 ($150 x 50% nondeductible) in business meal expenses (i.e., non-entertainment-related, see italicized note below) in connection with the guest preaching for total expenses of $511. However, he cannot deduct the part of his expenses allocable to his tax-free parsonage allowance. He attaches the required statement, Attachment 1 (shown later) to his return showing that 76% (or $388) of his business expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the $388 from the $511 and enters the $123 difference on line 2. Note, due to changes in the tax law as a result of recent tax reform, there are certain scenarios where food and beverage expenses incurred in connection with entertainment may not be deductible. Business-related meal expenses remain 50% deductible. In this example, the author has assumed the meal expenses incurred in connection with the guest preaching were 50% deductible business meal expenses. As of the date of this writing, the IRS is in the process of drafting formal guidance to clarify when food and beverage expenses would be considered entertainment expenses and therefore not deductible by taxpayers. Interim guidance has been provided in IRS Notice 2018-76. Taxpayers should consult with their personal tax advisors regarding the deductibility of food and beverage expenses on Schedule C–EZ in light of recent tax reform.

Line 3. He enters his net profit of $1,877 both on line 3 and on Schedule 1 (Form 1040), line 12.

Lines 4 through 8b. Rev. Green fills out these lines to report information about his car.

✔️ TurboTax Tip. Listed below are tips for ministers who use Turbo Tax to complete their returns. These tips should not be construed as an endorsement or recommendation of the Turbo Tax software.

Turbo Tax does not appear to calculate the nondeductible portion of the expenses which should be allocated to the tax-free portion of the housing allowance. The taxpayer will need to adjust the expenses (as shown in Attachment
Tax Guide 2018

Schedule SE (Form 1040)

After Rev. Green prepares Schedule C–EZ he fills out Schedule SE (Form 1040). He reads the chart on page 1 of the schedule, which tells him he can use Section A – Short Schedule SE to figure his self-employment tax. Ministers are not church employees under this definition. He fills out the following lines in Section A.

Line 2. Rev. Green attaches a statement (see Attachment 2, later) that calculates his net profit of $1,489 and he enters that amount here.

Line 4. He multiplies the $1,489 by .9235 to get his net earnings from self-employment ($1,375).

Line 5. The amount on line 4 is less than $128,400, so Rev. Green multiplies the amount on line 4 ($1,375) by .153 to get his self-employment tax of $210. He enters that amount here and on Schedule 4 (Form 1040), line 57.

Line 6. Rev. Green multiplies the amount on line 5 by .50 to get his deduction for the employer-equivalent portion of self-employment tax of $105. He enters that amount here and on Schedule 1 (Form 1040), line 27.

✓ TURBO TAX TIP. The software does not appear to reduce self-employment wages by the business expenses allocated to tax free income. The taxpayer will need to adjust net self-employment income (as shown in Attachment 2) and input the reduced figure into the software.

Form 1040, Schedule 1 (Form 1040), and Schedule 4 (Form 1040)

After Rev. Green prepares Schedule C–EZ and Schedule SE, he fills out Form 1040, along with Schedules 1 through 5 to the extent required.

Rev. Green files a joint return with his wife. First he fills out Form 1040, Page 1 and completes the appropriate lines for his filing status, including checking the appropriate boxes indicating that he and his wife were born before January 2, 1954. Then, he fills out the rest of the form as follows:

Form 1040, Page 2, Line 4a and 4b. Rev. Green reports his total annuity income of $15,000 on line 4a. He reports the taxable amount ($2,000) as computed on Attachment 1 (shown later) on line 4b.
### Tax Guide 2018

**Part 4. Comprehensive Examples and Forms**

<table>
<thead>
<tr>
<th>Field</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and phone no.</strong></td>
<td>The Board of Pensions of the Presbyterian Church (USA) 2000 Market Street Philadelphia, PA 19103-3298 1-800-773-7752</td>
</tr>
<tr>
<td><strong>PAYER'S TIN</strong></td>
<td>23-1352040</td>
</tr>
<tr>
<td><strong>RECIPIENT'S TIN</strong></td>
<td>202-20-2002</td>
</tr>
<tr>
<td><strong>RECIPIENT'S name</strong></td>
<td>William K. Green</td>
</tr>
<tr>
<td><strong>Street address (including apt. no.)</strong></td>
<td>787 Adams Street</td>
</tr>
<tr>
<td><strong>City or town, state or province, country, and ZIP or foreign postal code</strong></td>
<td>Anytown, NY 10002</td>
</tr>
<tr>
<td><strong>1. Gross distribution</strong></td>
<td>$15,000.00</td>
</tr>
<tr>
<td><strong>2a. Taxable amount</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>2b. Taxable amount not determined</strong></td>
<td>X</td>
</tr>
<tr>
<td><strong>3. Capital gain (included in box 2a)</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>4. Federal income tax withheld</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>5. Employee contributions/Designated Roth contributions or insurance premiums</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>6. Net unrealized appreciation in employer's securities</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>7. Distribution code(s)</strong></td>
<td>S</td>
</tr>
<tr>
<td><strong>8. Other</strong></td>
<td>$ %</td>
</tr>
<tr>
<td><strong>9a. Your percentage of total distribution</strong></td>
<td>$ %</td>
</tr>
<tr>
<td><strong>9b. Total employee contributions</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>10. Amount allocable to IRR within 5 years</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>11. 1st year of desig. Roth contrib.</strong></td>
<td>FATCA filing requirement</td>
</tr>
<tr>
<td><strong>12. State tax withheld</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>13. State/Payer’s state no.</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>14. State distribution</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>Account number (see instructions)</strong></td>
<td>Date of payment</td>
</tr>
<tr>
<td><strong>15. Local tax withheld</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>16. Name of locality</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>17. Local distribution</strong></td>
<td>$</td>
</tr>
</tbody>
</table>

This information is being furnished to the IRS.

Copy B Report this income on your federal tax return. If this form shows federal income tax withheld in box 4, attach this copy to your return.
Net Profit From Business (Sole Proprietorship)

Part I  General Information

You may use Schedule C-EZ instead of Schedule C only if you:

- Had business expenses of $5,000 or less,
- Use the cash method of accounting,
- Did not have an inventory at any time during the year,
- Did not have a net loss from your business,
- Had only one business as either a sole proprietor, qualified joint venture, or statutory employee,
- Had no employees during the year,
- Do not deduct expenses for business use of your home,
- Do not have prior year unallowed passive activity losses from this business, and
- Are not required to file Form 4562, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, to find out if you must file.

A  Principal business or profession, including product or service

B  Enter business code (see page 2)

C  Business name. If no separate business name, leave blank.

D  Enter your EIN (see page 2)

E  Business address (including suite or room no.). Address not required if same as on page 1 of your tax return.

F  Did you make any payments in 2018 that would require you to file Form(s) 1099? (see the Instructions for Schedule C)

G  If “Yes,” did you or will you file required Forms 1099?

Part II  Figure Your Net Profit

1  Gross receipts. Caution: If this income was reported to you on Form W-2 and the “Statutory employee” box on that form was checked, see Statutory employees in the instructions for Schedule C, line 1, and check here .

2  Total expenses (see page 2). If more than $5,000, you must use Schedule C

3  Net profit. Subtract line 2 from line 1. If less than zero, you must use Schedule C. Enter on both Schedule 1 (Form 1040), line 12, and Schedule SE, line 2, or on Form 1040NR, line 13, and Schedule SE, line 2 (see page 2). (Statutory employees do not report this amount on Schedule SE, line 2.) Estates and trusts, enter on Form 1041, line 3.

Part III  Information on Your Vehicle. Complete this part only if you are claiming car or truck expenses on line 2.

4  When did you place your vehicle in service for business purposes? (month, day, year)

5  Of the total number of miles you drove your vehicle during 2018, enter the number of miles you used your vehicle for:

6  Was your vehicle available for personal use during off-duty hours?

7  Do you (or your spouse) have another vehicle available for personal use?

8a  Do you have evidence to support your deduction?

b  If “Yes,” is the evidence written?

*See statement attached.
Self-Employment Tax

Before you begin: To determine if you must file Schedule SE, see the instructions.

May I Use Short Schedule SE or Must I Use Long Schedule SE?

Note: Use this flowchart only if you must file Schedule SE. If unsure, see Who Must File Schedule SE in the instructions.

---

Section A—Short Schedule SE. Caution: Read above to see if you can use Short Schedule SE.

1a Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A.

1b If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code AH 1b

2 Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report

3 Combine lines 1a, 1b, and 2

4 Multiply line 3 by 92.35% (0.9235). If less than $400, you don’t owe self-employment tax; don’t file this schedule unless you have an amount on line 1b.

Note: If line 4 is less than $400 due to Conservation Reserve Program payments on line 1b, see instructions.

5 Self-employment tax. If the amount on line 4 is:
   • $128,400 or less, multiply line 4 by 15.3% (0.153). Enter the result here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55
   • More than $128,400, multiply line 4 by 2.9% (0.029). Then, add $15,921.60 to the result.

Enter the total here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55.

6 Deduction for one-half of self-employment tax.
   Multiply line 5 by 50% (0.50). Enter the result here and on Schedule 1 (Form 1040), line 27, or Form 1040NR, line 27.

For Paperwork Reduction Act Notice, see your tax return instructions.
Form 1040
U.S. Individual Income Tax Return

Filing status:
- [ ] Single
- [ ] Married filing jointly
- [ ] Married filing separately
- [ ] Head of household
- [ ] Qualifying widow(er)

Your first name and initial:
- [ ] William K.

Last name:
- [ ] Green

Your social security number:
- [ ] 2 0 2 2 0 0 2

Your standard deduction:
- [ ] Someone can claim you as a dependent
- [ ] You were born before January 2, 1954
- [ ] You are blind

If joint return, spouse’s first name and initial:
- [ ] Sarah J.

Last name:
- [ ] Green

Spouse’s social security number:
- [ ] 3 0 3 3 0 0 3

Spouse standard deduction:
- [ ] Someone can claim your spouse as a dependent
- [ ] Spouse was born before January 2, 1954
- [ ] Spouse is blind

Home address (number and street). If you have a P.O. box, see instructions.
- [ ] 787 Adams Street

City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule 6.
- [ ] Anytown, New York 10002

Sign Here
Joint return? See instructions. Keep a copy for your records.
- [ ] Your signature:
- [ ] Date:
- [ ] Your occupation:
- [ ] Your signature. If a joint return, both must sign.
- [ ] Date:
- [ ] Spouse’s occupation:
- [ ] Spouse’s signature. If a joint return, both must sign.
- [ ] Date:

Paid Preparer
Use Only
Preparer’s name:
- [ ] Preparer’s signature:
- [ ] PTIN:
- [ ] Firm’s EIN:
- [ ] Check if:
- [ ] 3rd Party Designee
- [ ] Self-employed
- [ ] Firm’s name:
- [ ] Firm’s address:

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions.

Go to www.irs.gov/Form1040 for instructions and the latest information.
# Additional Income and Adjustments to Income

_Attach to Form 1040._  
Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

## Additional Income

<table>
<thead>
<tr>
<th>1–9b</th>
<th>Reserved</th>
<th>1–9b</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>Taxable refunds, credits, or offsets of state and local income taxes</td>
<td>10</td>
</tr>
<tr>
<td>11</td>
<td>Alimony received</td>
<td>11</td>
</tr>
<tr>
<td>12</td>
<td>Business income or (loss). Attach Schedule C or C-EZ</td>
<td>12</td>
</tr>
<tr>
<td>13</td>
<td>Capital gain or (loss). Attach Schedule D if required. If not required, check here □</td>
<td>13</td>
</tr>
<tr>
<td>14</td>
<td>Other gains or (losses). Attach Form 4797</td>
<td>14</td>
</tr>
<tr>
<td>15a</td>
<td>Reserved</td>
<td>15b</td>
</tr>
<tr>
<td>16a</td>
<td>Reserved</td>
<td>16b</td>
</tr>
<tr>
<td>17</td>
<td>Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E</td>
<td>17</td>
</tr>
<tr>
<td>18</td>
<td>Farm income or (loss). Attach Schedule F</td>
<td>18</td>
</tr>
<tr>
<td>19</td>
<td>Unemployment compensation</td>
<td>19</td>
</tr>
<tr>
<td>20a</td>
<td>Reserved</td>
<td>20b</td>
</tr>
<tr>
<td>21</td>
<td>Other income. List type and amount ▶</td>
<td>21</td>
</tr>
</tbody>
</table>

Combine the amounts in the far right column. If you don’t have any adjustments to income, enter here and include on Form 1040, line 6. Otherwise, go to line 23 . . .

## Adjustments to Income

| 23   | Educator expenses | 23   |
| 24   | Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 | 24   |
| 25   | Health savings account deduction. Attach Form 8889 | 25   |
| 26   | Moving expenses for members of the Armed Forces. Attach Form 3903 | 26   |
| 27   | Deductible part of self-employment tax. Attach Schedule SE | 27   |
| 28   | Self-employed SEP, SIMPLE, and qualified plans | 28   |
| 29   | Self-employed health insurance deduction | 29   |
| 30   | Penalty on early withdrawal of savings | 30   |
| 31a  | Alimony paid b Recipient’s SSN ▶ | 31a  |
| 32   | IRA deduction | 32   |
| 33   | Student loan interest deduction | 33   |
| 34   | Reserved | 34   |
| 35   | Reserved | 35   |
| 36   | Add lines 23 through 35 | 36   |

Total Additional Income: 1,877

### Other Taxes

_Attach to Form 1040._  
Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

| 57   | Self-employment tax. Attach Schedule SE | 57   |
| 58   | Unreported social security and Medicare tax from: Form a □ 4137 b □ 8919 | 58   |
| 59   | Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required | 59   |
| 60a  | Household employment taxes. Attach Schedule H | 60a  |
| 60b  | Repayment of first-time homebuyer credit from Form 5405. Attach Form 5405 if required | 60b  |
| 61   | Health care: individual responsibility (see instructions) | 61   |
| 62   | Taxes from: a □ 8959 b □ 8960 c □ Instructions; enter code(s) | 62   |
| 63   | Section 965 net tax liability installment from Form 965-A | 63   |
| 64   | Add the amounts in the far right column. These are your total other taxes. Enter here and on Form 1040, line 14 | 64   |

Total Other Taxes: 210

---

For Paperwork Reduction Act Notice, see your tax return instructions.
Attachment 1. Computation of expenses, allocable to tax-free ministerial income, that are nondeductible.

<table>
<thead>
<tr>
<th>% of Nondeductible Expenses</th>
<th>Taxable</th>
<th>Tax-Free</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parsonage allowance:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministerial retirement benefits designated as housing allowance</td>
<td>$15,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actual expenses</td>
<td>$13,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair rental value of home (including furnishings and utilities) ($1,200 x 12)</td>
<td>$14,400</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable portion of allowance (excess of amount designated &amp; paid over lesser of actual expenses or fair rental value)</td>
<td>$2,000</td>
<td>$2,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>Tax-free portion of allowance (lesser of amount designated, actual expenses or fair rental value)</td>
<td>13,000</td>
<td>13,000</td>
<td></td>
</tr>
<tr>
<td>Gross income from occasional guest preaching engagements</td>
<td>2,000</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>Ministerial Income</td>
<td>$4,000</td>
<td>$13,000</td>
<td>$17,000</td>
</tr>
</tbody>
</table>

% of nondeductible expenses: $13,000/$17,000 = 76%

Schedule C-EZ Deduction Computation

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Business use of car: 800 miles x 54.5¢</td>
<td></td>
<td>$436</td>
<td></td>
</tr>
<tr>
<td>Meal expenses ($150 less 50% reduction)</td>
<td></td>
<td>75</td>
<td></td>
</tr>
<tr>
<td>Unadjusted Schedule C-EZ expenses</td>
<td></td>
<td>$511</td>
<td></td>
</tr>
<tr>
<td>Nondeductible part of expenses: $511 X 76%</td>
<td></td>
<td>(388)</td>
<td></td>
</tr>
<tr>
<td>Schedule C-EZ deductions, line 2</td>
<td></td>
<td>$123</td>
<td></td>
</tr>
</tbody>
</table>

None of the other deductions claimed in the return are allocable to tax-free income.

Attachment 2. Computation of Net Earnings from Self-Employment

**Computation for Schedule SE (Form 1040)**

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross income from Schedule C-EZ</td>
<td></td>
<td>$2,000</td>
<td></td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unadjusted Schedule C-EZ expenses</td>
<td></td>
<td>(511)</td>
<td></td>
</tr>
<tr>
<td>Net Self Employment Income, Schedule SE, Line 2</td>
<td></td>
<td>$1,489</td>
<td></td>
</tr>
</tbody>
</table>
On November 22, 2013, federal district court judge Barbara Crabb of the District Court for the Western District of Wisconsin struck down the ministerial housing allowance as an unconstitutional preference for religion. Freedom From Religion Foundation, Inc., v. Lew, 983 F. Supp. 2d 1051 (W.D. Wis. 2013). The ruling was in response to a lawsuit brought by the Freedom From Religion Foundation (FFRF) and two of its officers challenging the constitutionality of the housing allowance and the parsonage exclusion. The federal government, which defended the housing allowance, since it is a federal statute, asked the court to dismiss the lawsuit on the grounds that the plaintiffs lacked standing to pursue their claim in federal court.

Standing is a constitutional requirement of any plaintiff in a federal case and generally means that a plaintiff must have suffered some direct injury as a result of a challenged law. The Wisconsin court concluded that the plaintiffs had standing on the grounds that they would have been denied a housing allowance exclusion had they claimed one on their tax return. The government appealed this ruling to a federal appeals court—the Seventh Circuit Court of Appeals in Chicago.

On November 13, 2014, the appeals court issued its ruling reversing the Wisconsin court's decision. Freedom From Religion Foundation, Inc., v. Lew, 773 F.3d 815 (7th Cir. 2014). It concluded that the plaintiffs lacked standing to pursue their challenge to the housing allowance. The plaintiffs had asserted that they had standing due to their “injury” of being denied a tax-free housing allowance should they claim one on their tax return. But the appeals court refused to base standing on theoretical injury. It concluded: “Only a person that has been denied such a benefit can be deemed to have suffered cognizable injury. The plaintiffs here have never been denied the parsonage exemption because they have never requested it; therefore, they have suffered no injury.”

It suggested that this deficiency could be overcome if the FFRF’s officers filed tax returns claiming a housing allowance that was later rejected by the IRS in an audit: “The plaintiffs could have sought the exemption by excluding their housing allowances from their reported income on their tax returns and then petitioning the Tax Court if the IRS were to disallow the exclusion. Alternatively, they could have…paid income tax on their housing allowance, claimed refunds from the IRS, and then sued if the IRS rejected or failed to act upon their claims.”

The FFRF responded to the appeals court’s ruling by designating a housing allowance for two of its officers. The officers reported their allowances as taxable income on their tax returns and thereafter filed amended tax returns seeking a refund of the income taxes paid on the amounts of their designated housing allowances. FFRF claims that in 2015 the IRS denied the refunds sought by its officers (one of whom had died and was represented by her executor).

Having endeavored to correct the standing problem, the FFRF renewed its legal challenge to the housing allowance in the federal district court in Wisconsin, where the litigation began. On October 6, 2017, judge Crabb again ruled that the ministerial housing allowance is an unconstitutional preference for religion. Gaylor v. Mnuchin, (W.D. Wis. 2017). Judge Crabb observed: “[The housing allowance] violates the establishment clause because it does not have a secular purpose or effect and because a reasonable observer would view the statute as an endorsement of religion.” The government promptly appealed this ruling to the Seventh Circuit Court of Appeals in Chicago. A ruling by the Seventh Circuit Court of Appeals ordinarily would apply only to ministers in that circuit, which includes the states of Illinois, Indiana, and Wisconsin. But Judge Crabb issued an injunction requiring the IRS to disallow the housing allowance on all tax returns filed by ministers. Judge Crabb delayed the effective date of the injunction for 180 days after a final ruling in the case. In effect, the ruling will become a national precedent if affirmed by the appellate court and U.S. Supreme Court, if applicable.

What should churches and clergy do now? Consider the following steps:

1. Monitor developments.
2. Many ministers will experience an immediate increase in income taxes. As a result, they should be prepared to increase their quarterly estimated tax payments to reflect the increase in income taxes in order to avoid an underpayment penalty. Note that there will be no effect on self-employment taxes for which the housing allowance is not tax-exempt.
3. Many churches will want to increase ministers’ compensation to offset the adverse financial impact. Thousands of ministers have purchased a home, and obtained a mortgage loan, on the assumption that the housing
allowance would continue to be available as it has for more than a half century. The sudden elimination of this tax benefit will immediately thrust many clergy into a dire financial position with a mortgage loan based on a tax benefit that no longer is available. Many church leaders will want to reduce the impact of such a predicament by increasing compensation. Such an increase could be phased out over a period of years to minimize the impact on the church.

4. Ministers who are considering the purchase of a new home should not base the amount and affordability of a home mortgage loan on the availability of a housing allowance exclusion unless and until the courts conclusively uphold the constitutionality of the allowance.

5. The fair rental value of church-provided parsonages remains a nontaxable benefit, for now.
WHERE FAITH AND FINANCE INTERSECT