



## **Taxation for Ministers**

### **A Practical Guide**

In 1913 federal income taxes were ratified, signed into law and imposed on all US citizens. In 1921, Congress, the Courts and the Internal Revenue Service all agreed that a “Minister of the Gospel”, should receive certain tax benefits beyond the general population. For tax reporting purposes you are a “Minister of the Gospel” if you meet the following criteria:

- You must be ordained, commissioned, or licensed as a minister, through a church, religious organization, or parachurch ministry. For the purposes of this guide, I will refer to each of these entities as a church.
- A minister includes priests, rabbis, imams, and similar members of the clergy. For the purposes of this guide, I will refer to each of these occupations as ministers.
- A minister must generally perform the following functions:
  1. Administration of sacraments
  2. Religious worship, administration
  3. Be under the authority of a church.

Therefore, once you meet the above criteria you must be associated with a church which you are accountable to and that oversees your activities.

## Federal income taxes:

All US citizens are required to file an annual income tax return based on your worldwide income, not just income earned while in the states. For income tax reporting purposes ministers are taxed as follows:

- The US government imposes two types of taxes on citizens. The first tax is an income tax and the second is the social security or self-employment tax.
- Ministers are generally considered to be employees for federal income tax reporting purposes and thus must file an annual income tax return, (form 1040).
- However, a minister is exempt from income tax **withholding**, but may elect to have federal and or state income tax withheld from their wages by their church employer.
- Even though ministers are considered employees for income tax purposes, ministers are considered self-employed for Social Security taxes. Therefore, ministers must pay self-employment taxes on their wages unless they file tax form 4361 to be exempt from self-employment taxes.

## When to file a tax Return:

As a US citizen you are required to file an annual tax return by April 15<sup>th</sup> of the following year, based on income earned and received in the calendar year. However, if you are residing outside of the US (on the regular due date of your return), you are allowed an automatic 2-month extension to file your return without requesting an extension. If you use a calendar year, the regular due date of your return is April 15, and the automatic extended due date would be June 15. If the due date falls on a Saturday, Sunday, or legal holiday, the due date is delayed until the next business day. This applies to all US citizens residing abroad, not just ministers.

To effectively obtain this automatic extension, I would advise you file your tax return stating your foreign address on your personal

tax return. This will assist the IRS in granting the extension which will hopefully avoid a late filing notice from their office.

## **Taxation of Ministers:**

A licensed, commissioned, or ordained minister who performs ministerial services is treated as a self-employed person for social security tax reporting purposes. This means when a pastor is employed by a church they are to be treated as employees for income tax wage reporting purposes. The church employer should generally issue a W-2 for all wage payments received. Note, only the following boxes are reported on the W-2.

W-2 box#1 – Only report net taxable wages paid after applying any housing allowance deduction claimed.

W-2 box#2 – This is generally blank except if the minister elects to have federal withholding on their wages. However, if the minister has **not** elected out of self-employment tax by filing tax form 4361, I would advise as follows:

- Electing to have your church employer withhold income tax on wages to cover any income and self-employment tax due.
- File quarterly estimated vouchers, (1040ES) so that any income tax and or self-employment tax which is estimated to be due is paid prior to year-end.
- Note for 2024 the self-employment tax rate is 15.3% on wages received.
- Self-employment tax is due on all payments received including base pay and payments for a housing allowance or parsonage allowance.

W-2 box f: This box contains your address. You may want to use your home address in the states to avoid listing your foreign address.

W-2 box #14: This is where you state your excluded housing or parsonage allowance.

W-2 box#16 – If applicable report state wages paid while residing in the US.

W-2 box#17 – Report state income tax withholdings on the state wages paid.

Note: If the minister is residing abroad box 16 and 17 will be blank.

Remember: Generally, ministers are employees for income tax wage reporting purposes. Ministers are to report their wage payments on form 1040. However, under certain circumstances ministers may be treated as self-employed for income tax reporting purposes and therefore, report wage payments on schedule “C” as a self-employed minister.

## **Special Exemptions and deductions just for Ministers:**

Ministers have been granted two special tax benefits under the Internal Revenue code as follows:

### **1. Housing allowance and parsonage exclusion, (IRC section 107)**

*Code Section 107 reads as follows:*

*In the case of a minister of the gospel, gross income does not include—*

*(1) the rental value of a home furnished to him as part of his compensation; or*

*(2)*

*the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities.*

Much overlooked and generally incorrectly computed, this housing and or parsonage deduction only applies to ministers. To correctly

compute this deduction, you must first determine the lesser of the following computations at the end of the year:

- Total your actual annual housing costs including mortgage payments, real estate taxes, appliances, household items, utilities, and maintenance, then compare this to the following,
- The fair rental value of your fully furnished house plus utilities, then compare this to the following,
- Reasonable compensation for your ministry services.

The allowed housing deduction will be the lower of the three computations computed above.

At the beginning of each tax year, you are required to provide an estimate of the anticipated lower of the three computations to your church employer. Your employer is to proportionally apply this estimate amount over your annual pay periods and exclude that amount as taxable wages from each income tax wage reporting period. To be able to exclude the housing allowance from income, the minister's employing church organization must officially designate the housing allowance as such before paying it to the minister.

This is your housing allowance which was deducted from your gross wages as non-taxable wages. You must then compare this amount to the above computations to reconcile this amount to the actual amount you may claim based on the lower of your actual computations. If your W-2 housing allowance exceeds the lesser of your reasonable compensation, the fair rental value of the home, or your actual expenses directly relating to providing the home, you must include this excess amount as additional taxable wages.

If you own your home, you may still in addition to the housing allowance claim deductions for mortgage interest and real property taxes on your tax return.

Remember: A minister of the Gospel is a licensed, commissioned, or ordained minister who performs ministerial services as an employee. Once you pass this test you can exclude from your taxable compensation a parsonage allowance, or a housing

allowance provided if is used to rent or otherwise provide a home. This estimate should be determined at the beginning of each tax year and provided to the church for wage reporting purposes.

A minister who is furnished with a parsonage may exclude from gross income the fair rental value of the parsonage, including utilities.

Further clarification was provided by the Rick Warren IRS case and later signed into law by President Bush as follows:

*Since 1921, pastors and other religious leaders have been able to deduct from federal taxes a portion of their income for housing. The new law is intended to preserve the exemption by amending the Internal Revenue Code to make clear the allowance **should not exceed** the “fair rental value” of a house, including furnishings, accessories and utilities.*

*While the bill would not settle the issue of constitutionality, its supporters believe it will end the Ninth Circuit’s threat to the allowance by codifying the “fair rental value” language formerly used by the Internal Revenue Service. The legislation would provide a way for both sides in the Ninth Circuit case to resolve the dispute. It would not prevent a future challenge to the allowance’s constitutionality, however.*

Note, the fair rental value of a parsonage or the housing allowance is excludable only for income tax purposes. A minister who has **not** filed form 4361 must include the parsonage or housing allowance as additional taxable income for self-employment tax.

## **2. Exemption from Self-employment tax, (also called Social Security tax on wages)**

For normal non-ministry wage reporting purposes, the IRS requires your non-church employer to withhold income tax and social security taxes on your wage payments. However, a licensed, commissioned, or ordained minister who performs ministerial services as an employee may request an exemption from self-employment tax for your ministerial earnings.

Payments made to you as a minister are payments to a self-employed person. If you meet the tests mentioned above and are performing sacerdotal duties for the church or organization your employer is only to report to the IRS your wage payments and any income tax withholdings. They are not to withhold and remit any social security payments from your wages.

Since ministers are self-employed for social security tax they must pay self-employment tax on their wages. However, they are allowed to be exempt from self-employment tax for only ministry related wages based any of the following positions:

- i. You are opposed to public Social Security coverage, or
- ii. You have not taken a vow of poverty.
- iii. Ministers can't request an exemption for economic reasons.

To request the exemption, file Form 4361, (Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners) with the IRS. You must file form 4361 by the due date of your income tax return (including extensions) for the second tax year in which you have net earnings from self-employment of at least \$400.

This rule applies if any part of your net earnings from each of the two years came from the performance of ministerial services. The two years don't have to be consecutive. The exemption is granted if the IRS approves your application. Once granted, the exemption is irrevocable.

Note: I have experienced a 50/50 split on this issue with the ministers I have served. If you file form 4361 for the exemption, be sure to save for retirement through some other means. If you have filed this exemption request, you will not be eligible to receive social security benefits at age 62 or Medicare benefits at age 65 unless you have paid social security taxes from non-ministry related employment.

I would recommend if you filed the exemption request, please also supplement your present or future income with non-ministry wages by paying in social security taxes so that you may qualify for Medicare benefits at age 65.

## **Foreign Earned income deduction:**

If you are present or residing in a foreign country, you may be entitled to exclude your wages received from income taxation while residing in a foreign country. This applies to wages paid by any US entity or foreign entity while you are abroad. To claim this deduction, you must file form 2555 with your 1040 tax return. However, I would recommend not filing this form under the following conditions:

1. Your foreign address must be stated on the form. If you are concerned about stating your foreign address do not submit the form. Note, form 2555 only is filed with the IRS and it is a crime if your personal information becomes public. You may want to consider claiming a housing allowance instead. However, a housing allowance may only exclude a portion of your foreign wages received.
2. If you file form 2555 you are not able to also claim any of the following:
  - **Additional child tax credit.** The IRS allows taxpayers to claim a credit for all children under the age of 17, called the Child credit. The entire child credit is first computed on tax form 8812. The credit is first applied against an income tax due on your tax return. If there is an excess child credit unused it is generally a refundable credit on your tax return. However, if you claim either the foreign earned income exclusion or the housing deduction the additional child credit **is lost and is not refundable**.
  - **Earned income credit.** You can't take the earned income credit if you claim either the foreign earned income exclusion or the housing deduction.



- **Foreign tax credit or deduction.** You can't take a credit or deduction for foreign income taxes paid or accrued on income that is excluded under either of the above exclusions. If all your foreign earned income is excluded, you can't claim a credit or deduction for the foreign taxes paid or accrued on that income. If only part of your income is excluded, you can't claim a credit or deduction for the foreign taxes allocable to the excluded income. See Pub. 514 for details on how to figure the amount allocable to the excluded income.
- **IRA deduction.** If you claim either of the above exclusions, special rules apply in figuring the amount of your IRA deduction. For details, see Pub. 590-A.

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References:

- 2024 Church & Clergy Tax Guide (Book)  
<https://store.churchlawandtax.com/2024-church-clergy-tax-guide-book/>
- IRS topic #417, Earnings for Clergy