



MMS Position Paper: Pastors-Dual Status Employment

MMS position papers are a compilation of our staff's research, education, training classes and seminars attended, 20 years field experience and interpretation of current laws as we understand them. The information contained in this paper is not legal advice and is intended to be used as general information to help your organization formulate your organization's guidelines. It is understood that your organization is legally responsible for all policies and procedures, and their legal basis.

Application: Ordained or licensed clergy are often misunderstood employment classifications. This paper is intended to help clarify the unique nature of clergy employment status and give practical advice on the handling of taxes.

Dual Status Filers: By IRS mandate, ordained and/or licensed clergy are required to be "dual" status tax filers. This means that clergy are treated as "employees" for benefit purposes (health insurance, retirement plans, etc) and "self employed" for taxation purposes.

Housing Allowance: Clergy are eligible to have their expenses related to living quarters separated from their salary, and if justified with actual receipts, are allowed to reduce taxable wages for federal and state income tax. See housing allowance position paper.

The amount designated as housing allowance must be declared no later than December 31 of the year prior to the year it is being declared for and must be confirmed, accepted and otherwise approved by the church or its governing board and must appear in the minutes of an official meeting.

Once declared, the housing allowance cannot be adjusted unless:

- A new job with a different qualifying organization is accepted
- Actual monthly expenses change significantly (i.e., new house with a larger payment). At that point, only the difference of the new and old housing monthly expenses can be claimed for the remaining months. No other make up amounts may be included in the change.

FICA Tax: During the first year of employment as a clergy, they have the right to “opt out” of the Social Security System if they can morally sign an agreement that they have “religious beliefs that prevent you from accepting government benefits from taxes paid into a government system from compensation received from a church.” Most people attempt to make this decision based on the investment worthiness of the Social Security System, when in reality, it has nothing to do with rate of returns or benefits.

If a pastor has chosen to opt out of the social security system, then they will not be responsible for paying in the self employed FICA payments equal to 15.3% of the salary and housing allowance. They must also understand that unless they have worked enough to qualify for Social Security coverage, they and their family will not receive retirement, disability or supplemental death payments. (If a spouse has earned enough credits, then they and the children would receive benefits from any change in their health or life status.)

If they chose to stay in the social security system, then they will be responsible for paying 15.3% of their combined salary and housing allowance. The IRS requires quarterly payments (that do not match the calendar quarters) or they have the option of taking out extra federal withholding tax from their paychecks to compensate for the amount owed for social security.

The self employed social security tax is broken down into two parts:

OASDI – (retirement)	6.2% employee + 6.2 % employer = 12.4%
Medicare – (retirement health insurance)	1.45% employee + 1.45% employer = <u>2.9%</u>
Total	15.3%

OASDI is no longer deducted after you reach the annual limit, see IRS website for current level. Medicare has no limits.

Federal Income Tax Withholding: The IRS does not require that federal income tax withholding be deducted from clergy’s paychecks. Clergy are still responsible for paying federal income tax on their base salary, but actual liability will depend on marital status, total household income, deductions for interest payments on their home if you own it, the number of dependant children and other tax deductions and tax credits allowed by federal income tax laws.

There are two options for paying in estimated federal withholding income tax:

- Withhold tax from paycheck
- Pay into the government quarterly (same as FICA)

State Income Tax Withholding: State income tax withholding is also based on salary only. Actual liability owed is computed in a similar manner as federal income tax, just at a lesser rate. Check with state website for up-to-date information.

Payment requirements differ from state to state.

Payment can be made through the regular payroll check withholding just like federal withholding.

Recommendations:

1) Get with a qualified, experienced tax accountant who has experience with clergy tax preparation for guidance.

2) Determine your estimated annual liabilities for:

FICA (if applicable)
Federal income tax
State income tax

3) Determine the method of payment.

Through payroll deductions
Through quarterly payments

4) Follow through with payment method.