2012 Tax Return Preparation and Federal Reporting Guide

MINISTERS TAX GUIDE FOR 2011 RETURNS

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Congress extends payroll tax holiday through February 29, 2012

The Tax Relief Act of 2010 provided a temporary payroll tax and self-employment tax "holiday" during 2011 of two percentage points off the employee share of Social Security tax and the Social Security component of self-employment taxes. This meant that the employee's share of Social Security taxes dropped from 6.2 to 4.2% of wages, and the Social Security component of self-employment taxes dropped from 12.4 to 10.4% of self-employment earnings for 2011. This reduction in taxes was enacted to stimulate the economy by increasing the take-home pay of millions of workers.

Late in 2011 Congress voted to extend for two months the reduced payroll tax rate that applied in 2011. The Temporary Payroll Tax Cut Continuation Act of 2011 extends the two percentage point payroll tax cut for employees, continuing the reduction of their Social Security tax withholding rate from 6.2% to 4.2% of wages paid through February 29, 2012. This reduced Social Security withholding will have no effect on employees' future Social Security benefits. The reduced self-employment tax rate is also extended through February 29, 2012.

The IRS is advising employers to implement the new payroll tax rate as soon as possible in 2012 but not later than January 31, 2012. For any Social Security tax over-withheld during January, employers should make an offsetting adjustment in workers' pay as soon as possible but not later than March 31, 2012.

Employers and payroll companies will handle the withholding changes, so workers should not need to take any additional action.

Under the terms negotiated by Congress, the law also includes a new "recapture" provision, which applies only to those employees who receive more than $18,350 in wages during the two-month extension period (the Social Security wage base for 2012 is $110,100, and $18,350 represents two months of the full-year amount). This provision imposes an additional income tax on these higher-income employees in an amount equal to 2% of the amount of wages they receive during the two-month period in excess of $18,350 (and not greater than $110,100).

This additional recapture tax is an add-on to income tax liability that the employee would otherwise pay for 2012 and is not subject to reduction by credits or deductions. The recapture tax would be payable in 2013 when the employee files his or her income tax return for the 2012 tax year.

Before February 29, 2012, Congress will need to decide whether to terminate or further extend the payroll tax holiday. Church leaders should monitor developments to ensure compliance.

The IRS has announced that it will issue guidance as needed to implement the provisions of this new two-month extension, including revised employment tax forms and instructions and information for employees who may be subject to the new "recapture" provision.

Welcome to the *Tax Return Preparation and Federal Reporting Guide* for ministers and churches. We're privileged to provide you with this useful guide to help you prepare your federal income tax forms.

The guide is written once again by Richard Hammar, and has been edited by our legal and compliance staff to address the tax issues that impact ministers.

In addition to this helpful guide, you can find additional assistance on the IRS website, *www.irs.gov*. For specific tax advice, you'll want to consult an accountant or attorney who is familiar with the unique issues surrounding ministers' taxes.

Copies of this booklet may be ordered through our customer relations specialists by calling **1-888-98-GUIDE** (1-888-984-8433), weekdays from 7 a.m. to 6 p.m. CST. You can also download this booklet in its entirety, or by section at *www.GuideStone.org/TaxGuide*.

Once again, we are thankful to serve you with this free annual *Ministers Tax Guide*, and we hope it will be a great help to you. May God bless you in your ministry in 2012 and beyond.

Sincerely,

O.S. Hawkins
President – Chief Executive Officer
GuideStone Financial Resources of the Southern Baptist Convention

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Part 1. Introduction

How to use this guide

This book contains the basic information you need to complete your 2011 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* — helps churches comply with their federal tax reporting requirements.

☞ **Key Point.** Congress, the courts or the IRS may cause tax changes at any time, in some cases retroactively. This guide includes only the law in effect at the time of preparation. Be certain to refer to the final instructions to Form 1040 when completing your tax return.

This guide is divided into the following sections:

- **Part 1. Introduction.** This section reviews tax highlights for 2011 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 ordained minister and spouse and for a retired minister and spouse.
- **Federal Reporting Requirements for Churches.** This resource provides assistance to churches (especially treasurers and bookkeepers) in filing federal tax forms.

Tax highlights for 2011

Several tax provisions expired at the end of 2009, and several more expired at the end of 2010. Congress enacted the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act (the "Tax Relief and Jobs Creation Act") late in 2010 which extended many of these provisions through either 2010, 2011 or 2012, meaning that some will be available when preparing your 2011 tax return and when computing estimated taxes and payroll tax withholding in 2012. Here is a summary of the extended provisions of most relevance to clergy and church staff:

- **Income tax brackets.** The lower income tax rates enacted by Congress in 2001 and 2003 were to expire at the end of 2010. They were extended for two years (through 2012) for all taxpayers by the Tax Relief and Jobs Creation Act.
- **Capital gains and dividends.** Under prior law, the capital gains and dividend rates for taxpayers below the 25% income tax bracket was equal to 0%. For those in the 25% tax bracket and above, the capital gains and dividend rates were 15%. These rates were to expire at the end of 2010, and higher rates (10% and 20%) were to apply. The Tax Relief and Jobs Creation Act extends the lower capital gains and dividends rates for all taxpayers for an additional two years, through 2012.
- **Child tax credit.** Generally, taxpayers with income below certain threshold amounts may claim the child tax credit to reduce federal income tax for each qualifying child under the age of 17. In 2001, Congress increased the credit from $500 to $1,000 and made it refundable up to 15% of earnings above $10,000. In 2009, Congress amended the law to allow earnings above $3,000 to count toward refundability for 2009 and 2010. The Tax Relief and Jobs Creation Act extends these changes (which were scheduled to expire at the end of 2010) for an additional two years, through 2012.
- **Marriage penalty relief.** For many years married couples filing a joint tax return paid more taxes than if they were unmarried filing individual returns. In 2001, Congress ended this so-called "marriage penalty" by (1) increasing the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return; and (2) increasing the 15% income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for an unmarried individual filing a single return. These provisions were to have expired at the end of 2010, but both were extended by the Tax Relief and Jobs Creation Act for two years, through 2012.
- **Dependent care credit.** The dependent care credit allows taxpayers a credit for a percentage of child-care expenses for children under 13 and disabled dependents. In 2001, Congress increased the amount of eligible expenses from $2,400 for one child and $4,800 for two or more children to $3,000 and $6,000, respectively, and increased the applicable percentage from 30% to 35%. The Tax Relief and Jobs Creation Act extends these changes (which were scheduled to expire at the end of 2010) for an additional two years, through 2012.

- **Earned income tax credit.** Under prior law, working families with two or more children qualified for an earned income tax credit equal to 40% of the family's first $12,570 of earned income. In 2009, Congress increased the earned income tax credit to 45% of the family's first $12,570 of earned income for families with three or more children and increased the beginning point of the phase-out range for all married couples filing a joint return (regardless of the number of children). The Tax Relief and Jobs Creation Act extends for an additional two years, through 2012, the increased credit for families with three or more children and the higher phase-out ranges for all married couples filing a joint return.
- **Coverdell Education Savings Accounts.** Coverdell Education Savings Accounts are tax-exempt savings accounts used to pay the higher education expenses of a designated beneficiary. In 2001, Congress increased the annual contribution amount from $500 to $2,000 and expanded the definition of education expenses to include elementary and secondary school expenses. These changes, which were to have expired at the end of 2010, were extended by the Tax Relief and Jobs Creation Act through 2012.
- **Employer-provided educational assistance.** An employee may exclude from taxable income up to $5,250 per year of employer-provided educational assistance. Prior to 2001, this incentive was temporary and only applied to undergraduate courses. Congress enacted legislation in 2001 that expanded this provision to graduate education and extended it to the end of 2010. The Tax Relief and Jobs Creation Act extends the changes to this provision for an additional two years, through 2012.
- **American Opportunity Tax Credit.** The American Opportunity Tax Credit is available for up to $2,500 of the cost of tuition and related expenses paid during the taxable year. Under this tax credit, taxpayers receive a tax credit based on 100% of the first $2,000 of tuition and related expenses (including course materials) paid during the taxable year and 25% of the next $2,000 of tuition and related expenses paid during the taxable year. Forty percent of the credit is refundable (i.e., payable to individuals with no income tax liability). This tax credit is subject to a phase-out for taxpayers with adjusted gross income in excess of $80,000 ($160,000 for married couples filing jointly). The Tax Relief and Jobs Creation Act extends this credit, which was scheduled to expire at the end of 2010, for an additional two years, through 2012.
- **Alternative minimum tax.** The Act allows an individual to offset the entire regular tax liability and alternative minimum tax liability by non-refundable personal credits for 2010 and 2011. The provision provides that the individual AMT exemption amount for taxable years beginning in 2011 is (1) $74,450, in the case of married individuals filing a joint return and surviving spouses; (2) $48,450 in the case of other unmarried individuals; and (3) $37,225 in the case of married individuals filing separate returns. Without these changes, the AMT exemption amounts would have plummeted in 2010 and beyond, exposing tens of millions of Americans to the AMT.
- **Energy-efficient new homes credit.** The Tax Relief and Jobs Creation Act extends through 2011 the credit for manufacturers of energy-efficient residential homes.
- **Energy-efficient appliances.** The Act extends through 2011 the credit for U.S.-based manufacture of energy-efficient clothes washers, dishwashers and refrigerators.
- **Energy-efficient existing homes.** The Act extends through 2011 the credit for energy-efficient improvements to existing homes. Standards for eligible improvements are updated to reflect advances in energy efficiency.
- **Above-the-line deduction for certain expenses of elementary and secondary school teachers.** The Act extends through 2011 the $250 above-the-line tax deduction for teachers and other school professionals for expenses paid or incurred for books, supplies (other than non-athletic supplies for courses of instruction in health or physical education), computer equipment (including related software and service), other equipment and supplementary materials used by the educator in the classroom.
- **Deduction of state and local general sales taxes.** Congress enacted legislation in 2004 that provided an itemized deduction for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes. Taxpayers could deduct the total amount of general state and local sales taxes they paid by accumulating receipts showing general sales taxes paid, or they could use tables created by the IRS. This provision was adopted to address the unequal treatment of taxpayers in the nine states that have no 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. This deduction, which was scheduled to expire at the end of 2009, was extended by the Tax Relief and Jobs Creation Act through 2011.
- **Above-the-line deduction for qualified tuition and related expenses.** Under prior law, an above-the-line deduction of up to $4,000 was available for qualified education expenses incurred by a taxpayer or a taxpayer's spouse or dependent. Qualified education expenses included tuition and certain related expenses required for enrollment or attendance at an eligible educational institution (any college, university, vocational school or other post-secondary

educational institution eligible to participate in a student aid program administered by the Department of Education). Student activity fees and expenses for course-related books, supplies and equipment were included in qualified education expenses only if the fees and expenses had to be paid to the institution as a condition of enrollment or attendance. This deduction, which was scheduled to expire at the end of 2009, was extended through 2011 by the Tax Relief and Jobs Creation Act.

- **Extension of tax-free distributions from individual retirement plans (IRAs) for charitable purposes.** The Act extends through 2011 a provision that permits tax-free distributions to charity from an IRA of up to $100,000 per taxpayer, per taxable year. Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70½ and only to the extent the distribution would be includible in gross income (without regard to this provision).
- **Personal exemption phase-out.** Personal exemptions allow a certain amount per person to be exempt from tax (currently $3,700). Due to the Personal Exemption Phase-out (PEP), the exemptions are phased out for taxpayers with income above a certain level. The PEP was repealed in 2010. This repeal was extended by the Tax Relief and Jobs Creation Act through 2012.
- **Itemized deduction limitation.** Generally, taxpayers itemize deductions if their total deductions are more than the standard deduction amount. Since 1991, the amount of itemized deductions is reduced for taxpayers with income above a certain amount. This limitation is generally known as the "Pease limitation." It was repealed for 2010. The Tax Relief and Jobs Creation Act extends the repeal of the Pease limitation though 2012.

The Tax Relief and Jobs Creation Act of 2010 contained two other significant provisions that were not extensions of expiring provisions:

- **Payroll tax "holiday."** Under prior law, employees paid a 6.2% Social Security tax on all wages earned up to a specified amount ($106,800 for 2010 and 2011) and self-employed individuals paid a 12.4% Social Security self-employment tax on all their self-employment income up to the same threshold. The Tax Relief and Jobs Creation Act provided a payroll tax and self-employment tax "holiday" during 2011 of two percentage points off the employee share of Social Security tax and the Social Security component of self-employment taxes. This meant that the employee share of Social Security taxes dropped from 6.2 to 4.2% of wages, and the Social Security component of self-employment taxes dropped from 12.4 to 10.4% of self-employment earnings. This reduction in taxes was enacted to stimulate the economy by increasing the take-home pay for millions of workers. The IRS has issued new withholding tables (see Publication 15) that reflect this change. (This situation remains fluid. Please visit *www.GuideStone.org/TaxGuide* for the latest updates.)
- **Estate tax relief.** In 2001, Congress phased out the estate tax which was fully repealed in 2010. The Tax Relief and Jobs Creation Act revives the estate tax, but establishes an exemption of $5 million per person and a top tax rate of 35% through 2012. The exemption amount is indexed for inflation beginning in 2012. The inflation-adjusted exemption amount for 2012 is $5,120,000 per person. Under prior law, couples had to do complicated estate planning to claim their entire exemption. The Tax Relief and Jobs Creation Act allows the executor of a deceased spouse's estate to transfer any unused exemption to the surviving spouse without such planning. This provision is effective for estates of decedents dying after December 31, 2010.

There were several tax developments in 2011 that will affect tax reporting by both ministers and churches for 2011 and future years. Here is a rundown of some of the key provisions:

1. You may be able to claim the earned income credit for 2011 if (1) you do not have a qualifying child and you earned less than $13,660 ($18,740 if married); (2) a qualifying child lived with you and you earned less than $36,052 ($41,132 if married filing jointly); (3) two qualifying children lived with you and you earned less than $40,964 ($46,044 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than $43,998 ($49,078 if married filing jointly). The maximum earned income credit for 2011 is (1) $464 with no qualifying child; (2) $3,094 with one qualifying child; (3) $5,112 with two qualifying children; and (4) $5,751 with three or more qualifying children.
2. If you are covered by a retirement plan at work, your deduction for contributions to a traditional IRA is reduced (phased out) if your modified adjusted gross income (AGI) is more than $90,000 but less than $110,000 for a married couple filing a joint return or a qualifying widow(er), or more than $56,000 but less than $66,000 for a single individual. If you file a joint return, and your spouse is covered by a retirement plan at work, but you are not, your deduction is phased out if your modified AGI is more than $169,000 but less than $179,000.
3. The dollar limit on annual elective deferrals an individual may make to a 403(b) retirement plan is $16,500 in 2011. It increases to $17,000 for 2012.

4. 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 $5,500 in 2011. It remains at $5,500 for 2012.
5. 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 housing allowance."
6. The standard business mileage rate was 51 cents per mile for business miles driven during the first six months of 2011, and 55.5 cents per mile for business miles driven during the last six months of 2011. The standard business mileage rate for 2012 is 55.5 cents per mile.
7. The IRS maintains that a minister's housing allowance is "earned income" in determining eligibility for the earned income credit for ministers who have not opted out of Social Security by filing a timely Form 4361. For ministers who have opted out of Social Security the law is less clear, and the IRS has not provided guidance.
8. 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.
9. The Creating Small Business Jobs Act of 2010 removed cell phones from the definition of listed property. As a result, the heightened substantiation requirements and special depreciation rules that apply to listed property no longer apply to cell phones. This provision is effective for years ending after 2009. It also allows employees to claim a depreciation deduction for cell phones that they purchase for business use without having to establish that the phones meet the "condition of employment" and "convenience of the employer" requirements. The IRS is taking additional steps to address the cell phone problem. In 2011, it issued guidance on two issues associated with cell phone use: (1) When an employer provides an employee with a cell phone primarily for non-compensatory business reasons, the business and personal use of the cell phone is generally non-taxable to the employee. The IRS will not require recordkeeping of business use in order to receive this tax-free treatment. IRS Notice 2011-72; (2) Employers that require employees, primarily for non-compensatory business reasons, to use their personal cell phones for business purposes may treat reimbursements of the employees' expenses for reasonable cell phone coverage as non-taxable. This treatment does not apply to reimbursements of unusual or excessive expenses or to reimbursements made as a substitute for a portion of the employee's regular wages. IRS News Release IR-2011-93, IRS Notice 2011-72
10. Many churches employ retired persons who are receiving Social Security benefits. Persons younger than full retirement age may have their Social Security retirement benefits reduced 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. In the year you reach full retirement age, your monthly Social Security retirement benefits are reduced by $1 for every $3 you earn above a specified amount ($3,240 per month for 2012). No reduction in Social Security benefits occurs for income earned in the month full retirement age is attained (and all future months). Persons who begin receiving Social Security retirement benefits prior to the year in which they reach full retirement age will have their benefits reduced by $1 for every $2 of earned income in excess of a specified amount. For 2012 this annual amount is $14,640.
11. For 2011 the following three inflation adjustments took effect:
    - The amounts of income you need to earn to boost you to a higher tax rate were adjusted for inflation.
    - The value of each personal and dependency exemption, available to most taxpayers, increased to $3,700.
    - The new standard deduction is $11,600 for married couples filing a joint return, and $5,800 for singles and married individuals filing separately. Nearly two out of three taxpayers take the standard deduction, rather than itemizing deductions, such as mortgage interest, charitable contributions and state and local taxes.
12. 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.

Preliminary questions

Below are several questions you should consider before preparing your 2011 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. Different rules apply to some 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. Most ministers must use the standard Form 1040.

Q. What records should I keep?

A. You should keep all receipts, cancelled 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. Typically, federal income tax returns must be filed by April 15. However, 2011 federal income tax returns are due on April 17, 2012, to accommodate Emancipation Day, a federal holiday that falls on Monday, April 16 this year.

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 17 to October 15, 2012) to file your 2011 Form 1040 if you file Form 4868 by April 17, 2012 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 2011 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. This is not hard. These rules are summarized in this document. On the other hand, if you experienced unusual events in 2011, 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.
- 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 always 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.

Part 2. Special Rules for Ministers

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 specific churches. 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 purposes;
- Exemption of wages from income tax withholding (ministers use the quarterly estimated tax procedure to pay their taxes, unless they elect voluntary withholding);
- Eligibility under very limited circumstances to exempt themselves from self-employment taxes.

These special rules only apply with respect to services performed in the exercise of ministry.

✍ **Example.** Pastor J is an ordained minister at his church. In addition, he works a second job for a secular employer. Assume that Pastor J qualifies as a minister for federal tax purposes. Since his church duties constitute services performed in the exercise of ministry, the church can designate a portion of his compensation as a housing allowance. However, the secular employer cannot designate any portion of Pastor J's compensation as a housing allowance, since this work would not be service in 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 sacerdotal 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 Social Security purposes. See IRS Publication 517.

Are ministers employees or self-employed for federal tax purposes?

☞ **Key Point.** Most ministers are considered 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 ministry. These two rules are summarized below:

1. **Income taxes.** For federal income tax reporting, most ministers are employees under the test 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). It also means that they report their employee business expenses on Schedule A rather than on Schedule C. A few ministers are self-employed, such as some traveling evangelists and 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 B is a minister at First Church. He is an employee for federal income tax reporting purposes with respect to his church salary. However, he is self-employed with respect to honoraria he receives for speaking in other churches and for compensation church members give him for performing personal services such as weddings and funerals. The church issues Pastor B a Form W-2 reporting his church salary. Pastor B reports this amount as wages on line 7 of Form 1040. He reports his compensation and expenses from 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.

$ **Tax-savings tip.** Ministers and other church staff members should carefully review their Form W-2 to be sure that it does not report more income than was actually received. 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.

2. **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 Social Security (self-employment) 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). As a result, a minister who files the exemption application may still purchase life insurance or participate in retirement programs administered by non-governmental institutions (such as a life insurance company).

A minister's opposition must be to accepting benefits under Social Security (or any other public insurance program). 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 exemption. Many younger ministers opt out of Social Security without realizing that they do not qualify for the exemption. A decision to opt out of Social Security 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 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 2012 is $1,130. 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 pay Social Security tax on their wages (unless they exempted themselves from Social Security as a minister and they are employed in a ministerial capacity).

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 have entered into a voluntary withholding arrangement with their church. Estimated taxes must be paid in quarterly installments. If your estimated taxes for the current year are less than your actual taxes, 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.

You will need to make estimated tax payments for 2012 if you expect to owe at least $1,000 in tax for 2012 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 2012 tax return, or (2) 100% of the tax shown on your 2011 tax return (110% if adjusted gross income exceeds $150,000). Your 2011 tax return must cover all 12 months.

The four-step procedure for reporting and prepaying estimated taxes for 2012 is summarized below.

Step 1. Obtain a copy of IRS Form 1040-ES for 2012 before April 17, 2012. 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)*.

Step 2. Compute your estimated tax for 2012 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 2012 in each of four quarterly installments as follows:

For the Period	Due Date
January 1–March 31	April 17, 2012
April 1–May 31	June 15, 2012
June 1–August 31	September 17, 2012
September 1–December 31	January 15, 2013

If the due date for making an estimated tax payment falls on a Saturday, Sunday or legal holiday, the payment will be on time if you make it on the next day that is not a Saturday, Sunday or legal holiday. You must send each payment to the IRS, accompanied by one of the four payment vouchers contained in Form 1040-ES.

Step 4. After the close of 2012, 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 2012 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). Since ministers are not employees for Social Security purposes, the church must not withhold the employee's share of Social Security and Medicare taxes. However, ministers can request on Form W-4 (line 6) that an additional amount of income tax be withheld to cover their estimated self-employment tax liability for the year. The excess income tax withheld is a credit that can be applied against the minister's self-employment tax liability. Many churches understandably withhold Social Security and Medicare taxes in addition to income taxes for a minister who requests voluntary withholding. Such withholding must be reported as income tax withheld.

Part 3. Step-by-Step Tax Return Preparation

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.

Schedule A is for itemized deductions for medical and dental expenses, taxes, interest, contributions, casualty and theft losses, and miscellaneous items. Some expenses related to ministerial income may also be deducted on Schedule A.

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 Social Security taxes due on your self-employment income and on your salary and housing allowance as an employee of the church, if you are an ordained minister.

Form 2106 is used to report expenses you incur in your capacity as an employee of the church.

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, but you may have a need for others. These forms may be obtained at your local post office 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: 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 2010 and you are filing a joint return for 2011 with the same spouse, be sure to enter your names and Social Security numbers in the same order as on your 2010 return.

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

If you 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.

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 "yes." If you are filing a joint return, your spouse can also have $3 go to the fund. If you check a box, your tax or refund will not change.

Step 2: Filing status

Select the appropriate filing status from the five options listed in this section of the Form 1040.

Step 3: Exemptions

You cannot claim a person as a dependent unless that person is your qualifying child or qualifying relative. To claim a dependency exemption for a qualifying child, the following tests must be met:

- The child must be your son, daughter, stepchild, foster child, brother, sister, half brother, half sister, stepbrother, stepsister or a descendant of any of them.
- The child must be (a) under age 19 at the end of the year and younger than you (or your spouse, if filing jointly), (b) under age 24 at the end of the year, a full-time student, and younger than you (or your spouse, if filing jointly), or (c) any age if permanently and totally disabled.
- The child must have lived with you for more than half of the year.
- The child must not have provided more than half of his own support for the year.
- The child is not filing a joint return for the year (unless that return is filed only as a claim for refund).

If the child meets the rules to be a qualifying child of more than one person, only one person can actually treat the child as a qualifying child.

To claim a dependency exemption for a qualifying relative, the following tests must be met:

- The person cannot be your qualifying child or the qualifying child of any other taxpayer.
- The person either (a) must be your child, stepchild, foster child or a descendant of any of them; your brother, sister, half brother, half sister, stepbrother or stepsister; your father, mother, grandparent or other direct ancestor, but

not a foster parent; your stepfather or stepmother; a son or daughter of your brother or sister; a brother or sister of your father or mother; your son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law; or (b) must live with you all year as a member of your household (and your relationship must not violate local law).

- The person's gross income for the year must be less than $3,700.
- You must provide more than half of the person's total support for the year.

The following conditions apply both to the qualifying child or qualifying relative exemptions:

- You cannot claim any dependents if you, or your spouse if filing jointly, could be claimed as a dependent by another taxpayer.
- You cannot claim a married person who files a joint return as a dependent unless that joint return is only a claim for refund and there would be no tax liability for either spouse on separate returns.
- You cannot claim a person as a dependent unless that person is a U.S. citizen, U.S. resident alien, U.S. national or a resident of Canada or Mexico, for some part of the year.

For more information on dependents, see IRS Publication 501.

Step 4: Income

Several items of income are reported on lines 7 through 21. 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 7. Wages, salaries, tips, etc.

☞ **Key Point.** The amount reported on line 7 ordinarily will be the same as reported by the church as wages in Box 1 of the minister's Form W-2.

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 7.

Determining church wages or salary. Besides a salary, ministers' wages may include several other items; some items are:

1. Bonuses.
2. Excess housing allowance (the amount by which a housing allowance exceeds the lesser of a minister's actual housing expenses or the fair rental value of the minister's home).
3. The cost of sending a minister to the Holy Land (if paid by the church).
4. Most Christmas and special occasion offerings.
5. Retirement gifts paid by a church.
6. The portion of a minister's Social Security tax paid by a church.
7. Personal use of a church-provided car.
8. Purchases of church property for less than fair market value.
9. Business expense reimbursements under a non-accountable plan.
10. Reimbursements the church made for the minister's moving expenses (but not if the minister substantiated the reimbursed expenses under an accountable arrangement).
11. Imputed cost of group term life insurance coverage (including death benefits under the Benefits Plan) exceeding $50,000 and cost of coverage of spouse and dependents over $2,000 which is paid by the church.
12. Church reimbursements of a spouse's travel expenses incurred while accompanying a minister on a business trip; this represents income to the minister unless the spouse's presence serves a legitimate business purpose and the spouse's expenses are reimbursed under an accountable arrangement.
13. "Discretionary funds" established by a church for a minister to spend on current needs — if the minister is allowed to distribute funds for his personal benefit.
14. "Below-market interest loans" of at least $10,000 made by a church to a minister (some exceptions apply).
15. Cancellation of a minister's debt to a church.
16. Severance pay.
17. Payment of a minister's personal expenses by the church.

☞ **Key Point.** The IRS can assess intermediate sanctions in the form of substantial excise taxes against a minister who is an officer or director of his employing church, and in some cases against church board members, if the minister is paid an excess benefit. Excess benefits 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 "comparable data" or 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, cell phones, etc.) for personal purposes, or receive non-accountable 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 Form 1040, for the year in which the benefits are provided. A disqualified person is an officer or director of the employer, or a relative of such a person. The concept of automatic excess benefits will directly affect the compensation practices of most churches, and expose 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 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.

Items not reported on line 7. 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:

1. **Gifts.** Gifts are excludable from taxable income so long as they are not compensation for services performed. However, employers generally are not permitted to give tax-free gifts to employees.
2. **Life insurance and inheritances.** Life insurance proceeds and inheritances are excludable from taxable income. Income earned before distributions of proceeds is generally taxable as income.
3. **Employer-paid medical insurance premiums.** Medical insurance premiums paid by an employer for employees (and their spouses and dependents) are excludable from taxable income. This exclusion is not available to self-employed individuals.
4. **Accident and health plans.** Amounts received by employees as reimbursements for medical care under an employer-financed accident and health plan are excludable from taxable income. This exclusion is not available to self-employed individuals.
5. **Employer-paid group life insurance.** Employees may exclude the cost of employer-provided group term life insurance so long as the amount of coverage does not exceed $50,000.
6. **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.
7. **Lodging.** The value of lodging furnished to an 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. This exclusion is not available in the computation of self-employment taxes.
8. **Educational assistance.** Amounts paid by an employer for an employee's tuition, fees and books may be excludable from the employee's taxable income. The exclusion may not exceed $5,250 per year.
9. **Employer-provided child care.** The value of free child-care 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.
10. **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.
11. **Employee status.** 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.

There are four other exclusions that will be discussed separately — the housing allowance, tax-sheltered annuities, qualified scholarships and sale of one's home.

Housing allowance

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.

Under no circumstances can a church designate a housing allowance retroactively. Unfortunately, many churches fail to designate housing allowances 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 housing 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 a very 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 was obtained for housing-related expenses.

$ **Tax-savings tip.** Ministers should be sure that the designation of a housing 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."

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:

1. Down payment on a home (but remember, a housing allowance is non-taxable only to the extent that it does not exceed the lesser of actual housing expenses or the fair rental value of a minister's home).
2. Mortgage payments on a loan to purchase or improve your home (include both interest and principal).
3. Rent.
4. Real estate taxes.
5. Property insurance.
6. Utilities (electricity, gas, water, trash pickup, local telephone charges).
7. Furnishings and appliances (purchase and repair).
8. Structural repairs and remodeling.
9. Yard maintenance and improvements.
10. Maintenance items (pest control, etc.).
11. Homeowners association dues.

Please note the following:

1. A housing allowance must be designated in advance. Retroactive designations of housing allowances are not effective.
2. The housing allowance designated by the church is not necessarily non-taxable. It is non-taxable (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).
3. 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. Remember, however, that it serves no purpose to designate a housing allowance greater than the fair rental value of a minister's home (furnished, plus utilities).
4. 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 7 of Form 1040.

5. 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).
6. 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 $20,000 of Pastor D's 2011 compensation as a housing allowance. Pastor D's housing expenses for 2011 were utilities of $2,000, mortgage payments of $8,000, 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 $12,000. Pastor D's housing allowance is non-taxable 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 his home (furnished, plus utilities). Stated differently, the non-taxable 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; (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 ($14,000), and so this represents the non-taxable portion of Pastor D's housing allowance. Pastor D must report the difference between this amount and the housing allowance designated by his church ($6,000) as additional income on line 7 of Form 1040.

✍ **Example.** Same facts as the previous example, except the church designated $12,000 of Pastor D'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 non-taxable amount. Note that Pastor D's actual housing expenses were more than the allowance, and so he was penalized because of the low allowance designated by his church.

✍ **Example.** Pastor Y owns a home and incurred housing expenses of $12,000 in 2011. These expenses include mortgage principal and interest, property taxes, utilities, insurance and repairs. The church designated (in advance) $12,000 of Pastor Y's 2011 compensation as a housing allowance. Pastor Y 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, 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 reality, it represents an exclusion and a deduction.

✍ **Example.** In preparing his income tax return for 2011, Pastor H discovers that his church failed to designate a housing allowance for him for 2011. He asks his church to pass a resolution retroactively granting the allowance for 2011. Such a resolution is ineffective, and Pastor H will not be eligible for any housing allowance exclusion in 2011.

☞ **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 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 under the tax code.

$ **Tax-savings tip.** Ministers should be sure that the designation of a housing 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?

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 actual 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 on March 1, 2012, that it failed to designate a housing allowance for its pastor for 2012. It is not too late to act. The church should immediately designate a portion of its minister's remaining compensation in 2012 as a housing allowance. This unfortunate problem can be avoided by stipulating in each annual housing allowance designation that the allowance shall be for the current year *and for all future years unless otherwise provided*. If such a resolution had been adopted in the December 2011 meeting, it would not matter that the church neglected to designate a minister's 2012 allowance until March of 2012, since the previous designation would have carried over. Such "safety net" designations are not a substitute for annual housing allowances. Rather, they provide a basis for claiming a housing allowance if a church neglects to designate one.

☞ **Key Point.** Remember — 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 church or the church pension board of a denominational pension fund; (2) the retired minister has severed his relationship with the local church and relies on the fund for a pension; (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 will be eligible in most cases to have some or all of their benefits designated in advance as a housing allowance. This is a very 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 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 was obtained for housing-related expenses.

Section 403(b) plans

For 2011, payments made by your church and your salary reduction contributions to a 403(b) plan are not reportable income for income tax or SE 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 2011, 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 $49,000. 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 retirement plan or to an IRA.

New in 2012. The limit on annual additions increases to $50,000 for 2012.

☞ **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.

Minister's housing allowance and contribution limits

For 2011 the section 415(c) limit restricts 403(b) contributions to the lesser of 100% of compensation or $49,000. For 2012, this amount increases to $50,000. 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.

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 2011, the allowable limit was $16,500. 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 2012. The dollar limit on annual elective deferrals is $17,000.** 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 $5,500 for 2011 and 2012. 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).

☞ **Key Point.** Amounts paid by a church for the education of a pastor or other church employee cannot be treated as a non-taxable scholarship if paid "as compensation for services."

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 non-taxable

scholarship if paid "as compensation for services."

✍ **Example.** First Church establishes a scholarship fund for seminary students. Robert is a church member who is pursuing a master's degree at a seminary. The church votes to award him a scholarship of $1,500 for 2012. So long as Robert uses the scholarship award for tuition or other course-related expenses, he need not report it as income on his federal tax return, and the church need not issue him a Form 1099-MISC. 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.

Sale or exchange of your principal residence

An individual taxpayer can 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 sale or exchange. A taxpayer who failed to meet these requirements by reason of a change of place of employment, health or certain unforeseen circumstances could exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) equal to the fraction of the two years that the ownership and use requirements were met.

In most cases, gain from the sale or exchange of your main home will not qualify for the exclusion to the extent that the gains are allocated to periods of nonqualified use. Nonqualified use is any period after December 31, 2008, during which the property is not used as the main home.

The gain resulting from the sale of the property is allocated between qualified and nonqualified use periods based on the amount of time the property was held for qualified and nonqualified use. Gain from the sale or exchange of a main home allocable to periods of qualified use will continue to qualify for the exclusion for the sale of your main home. Gain from the sale or exchange of property allocable to nonqualified use will not qualify for the exclusion.

Gain is in most cases allocated to periods of nonqualified use based on the ratio which: (1) the aggregate periods of nonqualified use during the period the property was owned by you over (2) the total period the property was owned by you. You do not incorporate any period before 2009 for the aggregate periods of nonqualified use. Certain exceptions apply. For details, see IRS Publication 523.

A period of nonqualified use does not include: (1) Any portion of the 5-year period ending on the date of the sale or exchange after the last date you (or your spouse) use the property as a main home; (2) any period (not to exceed an aggregate period of 10 years) during which you (or your spouse) are serving on qualified official extended duty as a member of the Uniformed Services; (3) any other period of temporary absence (not to exceed an aggregate period of two years) due to change of employment, health conditions or such other unforeseen circumstances as may be specified by the IRS.

Line 8a. Interest income: Attach Schedule B if over $1,500

Complete this line only if you had taxable interest income. If you had taxable interest income of more than $1,500, complete parts I and III of Schedule B. Report tax-exempt interest income on line 8b.

Line 9a. "Ordinary" dividend income: Attach Schedule B if over $1,500

Complete this line only if you had dividend income. If you had dividend income of more than $1,500, complete parts II and III of Schedule B.

Line 12. Business income (or loss): Attach Schedule C or C-EZ

Complete this line only if you have any net earnings from self-employment activities. These include:

1. Compensation reported to you on a Form 1099-MISC.
2. Fees received directly from church members for performing personal services (such as marriages and funerals).
3. 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. This guide includes more detailed information in the section on Schedule C in this guide. You may be able to use the simpler Schedule C-EZ if several conditions are met. See the instructions to Schedule C-EZ for details.

Line 13. Capital gain (or loss): Attach Schedule D

Complete this line only if you have any gains or losses from the sale of capital assets. These include stocks, bonds and property. Gain or loss is reported on Schedule D.

Line 16a. Total pensions and annuities

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 403(b) and 401(k) plans. Do not include the following payments on lines 16a and 16b. Instead, report them on line 7.

- 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 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 determinable." 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 reported on line 16a of Form 1040 if (1) you can document that the monies were actually spent on housing-related expenses during the tax year, and (2) the amount excluded does not exceed the fair rental value of the home (furnished, including utilities).

IRS Publication 517 states: "If you are a retired minister, you exclude from your gross income the rental value of a home (plus utilities) furnished to you by your church as a part of your pay for past services, or the part of your pension that was designated as a rental allowance. However, a minister's surviving spouse cannot exclude the rental value unless the rental value is for ministerial services he or she performs or performed."

☞ **Key Point.** Surviving spouses are not entitled to exclude any portion of their benefits as housing allowance.

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 hardship, you may withdraw your own salary reduction contributions (but not the earnings on these) prior to the occurrence of any of the above events.

Once amounts are distributed, they are generally taxable as ordinary income unless properly designated 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:

1. 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.
2. The distributions are made after you separate from service on or after age 55.
3. The distributions do not exceed the amount of medical expenses that you could deduct for the current year.
4. The distributions are made after your death, or after you become disabled.
5. The distributions are made to an alternate payee pursuant to a qualified domestic relations order.
6. The distribution is a qualified reservist distribution.

The additional tax is computed on Form 5329.

Line 20a. Social Security benefits

☞ **Key Point.** Individuals who receive Social Security retirement, disability or survivor benefits may have to pay taxes on a portion of their benefits.

If you received Social Security benefits in 2011, you need to know whether or not these benefits are taxable. Here are several rules the IRS has formulated to assist Social Security beneficiaries in knowing if their 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 2011, 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 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 1040A and 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.
   - Then, compare this total to the base amount for your filing status. If the total is more than your base amount, some of your benefits may be taxable.
6. The 2011 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.

7. For additional information on the taxability of Social Security benefits, see IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*. Publication 915 is available at *www.irs.gov*.

Working after you retire

Many churches employ retired persons who are receiving Social Security benefits. But 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. In the year you reach full retirement age, your monthly Social Security retirement benefits are reduced by $1 for every $3 you earn above a specified amount ($3,240 per month for 2012). No reduction in Social Security benefits occurs for income earned in the month full retirement age is attained (and all future months).

Persons who begin receiving Social Security retirement benefits prior to the year in which they reach full retirement age will have their benefits reduced by $1 for every $2 of earned income in excess of a specified amount. For 2012, this annual amount is $14,640.

While the Social Security Administration has never officially addressed the issue, it is likely that a minister's housing allowance counts as earnings for purposes of the annual earnings test.

Line 21. Other income: List the type and amount

➤ **Recommendation.** If you have other income to report on line 21, consider enclosing an explanation of your other income with your Form 1040 or write a brief explanation in the space provided next to line 21. This will help to avoid confusion.

Complete this line only if you have other income. This includes the following items:

1. A cancelled debt or a debt paid for you by another person (unless the person who cancelled or paid your debt intended it to be a gift).
2. 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).
3. Most prizes and awards.
4. Taxable distributions from a health savings account (HSA) or Archer MSA.

Step 5: Adjustments to income

You may deduct certain adjustments from gross income in computing your adjusted gross income. Report the adjustments on lines 23 through 37 of Form 1040. The most relevant adjustments to ministers are summarized in the following sections.

Line 26. Moving expenses

If your "allowable moving expenses" are not reimbursed by your employer, or they are reimbursed under a non-accountable plan, you compute your moving expense deduction on Form 3903 and report your deduction on line 26. Allowable moving expenses are expenses you incurred because of a change of jobs or your acceptance of a new job, if you satisfy the following three conditions:

1. Your new job location is at least 50 miles farther from your former home than your old job location was. For example, if your old job was three miles from your former home, your new job must be at least 53 miles from that home (measured according to the shortest of the more commonly traveled routes between those points).
2. If you report your income taxes as an employee, you must work full-time for at least 39 weeks during the first 12 months after you arrive in the general area of your new job location. You do not have to work for one employer for the 39 weeks. However, you must work full-time within the same general commuting area. If you are married and file a joint return and both you and your spouse work full-time, either of you may satisfy the full-time work test. However, you may not combine your weeks of work.
3. Your move must be closely related, both in time and place, to the start of work at your new job location. In general, moving expenses incurred within one year from the date you first reported to work are considered closely related *in time* to the start of work at the new location. It is not necessary that you make arrangements to work before moving to a new location, as long as you actually do go to work. If you do not move within one year, you ordinarily may not deduct the expenses unless you can show that circumstances existed that prevented the move within that time. A move is generally not closely related *in place* to the start of work if the distance from your new home to the new job location is greater than the distance from your former home to the new job location.

If your employer reimburses your allowable moving expenses under an accountable plan, the reimbursements are not reported by the employer as taxable income, and you have no deduction to report on line 26. To be an accountable plan, your employer's reimbursement arrangement must require you to meet all three of the following rules: (1) your expenses must have a business connection — that is, you must have paid or incurred deductible expenses while performing services as an employee of your employer; (2) you must adequately account

to your employer for these expenses within a reasonable period of time; and (3) you must return any excess reimbursement or allowance within a reasonable period of time.

If for all reimbursements you meet the three rules for an accountable plan (listed earlier), your employer should not in-clude any reimbursements of expenses in your income in Box 1 of your Form W-2. Instead, your employer should include the reimbursements in Box 12 (code P) of your Form W-2.

An employer's reimbursements of an employee's moving expenses under an arrangement that does not meet the three requirements of an accountable plan must be reported as wages in Box 1 of the employee's Form W-2.

Deductible moving expenses include the following:

Moving your household goods and personal effects. You may deduct the cost of packing, crating and transporting your household goods and personal effects from your former home to your new one. You may also deduct the cost of storing and insuring household goods and personal effects within any consecutive 30-day period after the day your things are moved from your former home and before they are delivered to your new home.

Travel expenses. You may deduct the cost of transportation and lodging (but not meals) for yourself and members of your household while traveling from your former home to your new home. You may deduct expenses of only one trip to your new home. However, all of the members of your household do not need to travel together.

You may not deduct any of the following expenses as moving expenses: pre-move house-hunting expenses, the expenses of disposing of your former home and obtaining your new home, home improvements to help you sell your former home, loss on the sale of your former home, mortgage penalties, any part of the purchase price of your new home, meal expenses incurred while moving to your new home and real estate taxes. Use Form 3903 to compute the deduction.

As noted above, if your employer reimburses your allowable moving expenses under an accountable arrangement, the reimbursements are not reportable as taxable income to you and there are no deductions to report.

Line 27. One-half of self-employment tax

☞ **Key Point.** Every minister who pays Social Security 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 of Form 1040, whether or not they are able to itemize deductions on Schedule A.

Line 32. Payments to an individual retirement account (IRA)

An individual retirement account (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.

For 2011, if you file a joint return 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) $5,000 ($6,000 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.

All IRA contributions must be made by the due date of your tax return, not including extensions. This means that your 2011 IRA contribution must be made by April 17, 2012, even if you obtain an extension for filing this return.

If you or your spouse were covered by an employer-sponsored retirement plan at any time during 2011 and you made IRA contributions, your allowable IRA deduction may be less than your contributions. Even if your spouse is covered by an employer-sponsored retirement plan, you may be able to deduct your contributions to an IRA for 2011 if you were not covered by an employer plan and your adjusted gross income was less than $179,000 ($183,000 for 2012).

Your allowable deduction may be reduced or eliminated, depending on your filing status and the amount of your income. 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. (See IRS Publication 590.) The amounts

vary depending on your filing status. The Form W-2 you receive from your church or other employer has a box used to show whether you were covered for the year. The "Pension Plan" box should have a mark in it if you were covered. Employer retirement plans include 403(b) tax-sheltered annuities.

Figure your deduction using the worksheets in the instructions to Form 1040 or in Publication 590.

Individuals who cannot claim a deduction for an IRA contribution still can make non-deductible IRA contributions, subject to the lesser of $5,000 or earned income limits. Earnings on these amounts continue to accumulate on a tax-deferred basis. When distributions are made from the IRA, special rules apply in figuring the tax on the distributions when both deductible and non-deductible contributions were made to the IRA. Form 8606 is used to designate a contribution as non-deductible and must be filed or the full amount of future withdrawals may be taxed. Withdrawals before age 59½ are subject to a 10% penalty tax that also applies to deductible IRA contributions.

Distributions from a traditional IRA are fully or partially taxable in the year of distribution. If you made only deductible contributions, distributions are fully taxable. Use Form 8606 to figure the taxable portion of withdrawals.

Distributions made prior to age 59½ may be subject to a 10% additional tax. You also may owe an excise tax if you do not begin to withdraw minimum distributions by April 1 of the year after you reach age 70½.

A Roth IRA differs from a traditional IRA in several respects. A Roth IRA does not permit a deduction at the time of contribution. Regardless of your age, you may be able to establish and make non-deductible contributions to a Roth IRA. 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 (year 70½). 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.

Summarized below are a few important rules that pertain to IRAs.

1. Taxpayers can make early withdrawals from an IRA to pay for qualified higher education expenses of the taxpayer or the taxpayer's spouse, child or grandchild — without triggering the 10% penalty that applies to early distributions from an IRA.
2. Taxpayers can withdraw up to $10,000 from their IRA prior to age 59½ for first-time homebuyer expenses without triggering the 10% penalty that applies to "premature distributions."
3. Qualified charitable distributions of up to $100,000 can be made from an IRA to a church or other charity. A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to a charitable organization, including a church, that is made on or after the date the IRA owner attains age 70½. This provision has been extended through 2011.

✓ **New in 2012.** The maximum annual dollar contribution limit for IRA contributions is $5,000 for 2012. Also, the contribution limit for an individual who has attained age 50 before the end of the taxable year increases by $1,000.

✍ **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 2012 the senior pastor can contribute $6,000 to an IRA (maximum annual contribution of $5,000 plus a "catch-up" contribution of $1,000), and the youth pastor can contribute $5,000.

Step 6: Adjusted gross income

Line 37. Compute adjusted gross income

Subtract your total adjustments (line 36) from your total income (line 22) to compute your adjusted gross income (line 37). Carry this amount to line 38 at the top of page 2 of your Form 1040.

Step 7: Tax computation

Line 40. 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 40, 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 2011, the standard deduction amounts are as follows:

Filing Status	Standard Deduction Amount
Single	$5,800
Married filing jointly or qualifying widow(er)	$11,600
Married filing separately	$5,800
Head of household	$8,500

Line 42. Personal exemptions

For 2011, the personal exemption amount is $3,700. Multiply this amount times the number of exemptions claimed on line 6 and enter the total on line 42.

Line 44. 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 8: Credits

Line 48. 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.

Line 50. 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. This benefit can be especially helpful to ministers whose housing allowance causes their adjusted gross income to fall within the eligible limits.

The credit is available with respect to elective deferrals to a 403(b) annuity, a 401(k) plan, 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 2011 is described in the following table.

Adjusted Gross Income			
Joint Returns	Heads of Household	Single Filers	Amount of Credit
$1–34,000	$1–25,500	$1–17,000	50% of eligible contributions up to $2,000 ($1,000 maximum credit)
$34,001–36,500	$25,501–27,375	$17,001–18,250	20% of eligible contributions up to $2,000 ($400 maximum credit)
$36,501–56,500	$27,376–42,375	$18,251–28,250	10% of eligible contributions up to $2,000 ($200 maximum credit)
over $56,501	over $42,376	over $28,251	0%

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.

Line 51. Child tax credit

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of credit per child is $1,000. A child who is not a citizen, national or resident of the United States cannot be a qualifying child.

Generally, taxpayers with income below certain threshold amounts may claim the child tax credit to reduce federal income tax for each qualifying child under the age of 17. In 2001, Congress increased the credit from $500 to $1,000 and made it refundable up to 15% of earnings above $10,000. In 2009, Congress amended the law to allow earnings above $3,000 to count towards refundability for 2009 and 2010. The Tax Relief and Jobs Creation Act extends these changes (which were scheduled to expire at the end of 2010) through 2012.

Earned income is defined as the sum of wages, salaries and other taxable employee compensation plus net self-employment earnings. Unlike the EIC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income.

The child tax credit is in addition to the dependent care credit you can claim if you pay someone to care for your dependent child who is under age 13 (or a disabled dependent) so you can work.

Step 9: Other taxes

Now that you have subtracted credits from your federal income tax, you report other taxes you may owe.

Line 56. Self-employment tax: Attach Schedule SE (also see line 27)

☞ **Key Point.** All ordained ministers must pay self-employment taxes on compensation received from the exercise of their ministry, unless they have received IRS recognition of exempt status.

Ministers are self-employed for Social Security purposes with respect to their ministerial income. They compute their self-employment taxes on Schedule SE and report the total tax on line 56 of Form 1040.

Step 10: Payments

Line 62. Federal income tax withheld

Ordained ministers' wages 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 and reported on line 62. 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 income taxes withheld from their wages. Under no circumstances should a church withhold the employee's share of Social Security and Medicare taxes from the wages of such a minister, since ministers are self-employed for Social Security purposes with respect to their ministerial duties. Ministers can request (on Form W-4) 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 Form W-2 and Form 941) rather than the employee's share of Social Security and Medicare taxes. These ministers must still complete Schedule SE.

Line 63. 2011 estimated tax payments

Compensation paid to ministers for ministerial duties is not subject to tax withholding. As a result, ministers must pre-pay 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 63.

Line 64. Earned income credit

✓ **For 2011.** The maximum earned income credit for 2011 is (1) $464 with no qualifying child; (2) $3,094 with one qualifying child; (3) $5,112 with two qualifying children; and (4) $5,751 with three or more qualifying children.

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 2011 if (1) you do not have a qualifying child and you earned less than $13,660 ($18,740 if married); (2) a qualifying child lived with you and you earned less than $36,052 ($41,132 if married filing jointly); (3) two qualifying children lived with you and you earned less than $40,964 ($46,044 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than $43,998 ($49,078 if married filing jointly).

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 64a. 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.

☞ **Key Point.** The instructions to Form 1040, line 64, clearly state that a housing allowance, or fair rental value of a parsonage, are included in the definition of earned income when computing the earned income credit for ministers who have not exempted themselves from self-employment taxes. Unfortunately, the instructions are less clear for ministers who have exempted themselves from self-employment taxes, but the instructions suggest that these ministers do not include a housing allowance or the fair rental value of a parsonage in computing their earned income for purposes of the credit. The author has confirmed with the IRS national office that this is not the intent of the law, but the IRS has failed to clarify this issue. Ministers who are affected by this issue should consult their own tax adviser for help.

Step 11: Refund or amount you owe

After totaling your payments, you can calculate whether you owe the government or a refund is due to 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." Do not attach the check to your return. Include your daytime phone number, your Social Security number and write Form 1040 for 2011 on the check. You also may have to pay an underpayment penalty (refer to line 77 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 2012 estimated tax.

Step 12: 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*.

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:

1. Fees for medical services.
2. Fees for hospital services.
3. Meals and lodging provided by a hospital during medical treatment (subject to some limits).
4. Medical and hospital insurance premiums that you pay.
5. Special equipment.
6. Medicare A premiums you pay if you are exempt from Social Security and voluntarily elect to pay Medicare A premiums.
7. Medicare B premiums you pay.
8. Medicare D premiums you pay.
9. Medicare Supplement premiums you pay (or are deducted from your pension).
10. Long-term care insurance premiums, subject to certain limitations on the amount that may be deducted.
11. Special items (false teeth, artificial limbs, eyeglasses, hearing aids, crutches, etc.).
12. Transportation for necessary medical care. For 2011, the standard mileage rate for medical travel was 19 cents per mile for the first six months of the year, and 23.5 cents per mile for the last six months of the year.
13. Medicines and drugs requiring a prescription.
14. 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.
15. Wages of an attendant who provides medical care.
16. The cost of home improvements if the main reason is for medical care.
17. Program to stop smoking.
18. 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:

1. Funeral services.
2. Health club dues (except as noted above).
3. Household help.
4. Life insurance.
5. Maternity clothes.
6. Non-prescription medicines and drugs.
7. Nursing care for a healthy baby.
8. Toothpaste, cosmetics, toiletries.
9. Trip for general improvement of health.

Step 2: Taxes you paid (lines 5–9)

Generally, real estate, state and local income, and personal property taxes actually paid during 2011 are deductible. Ministers who own their homes and pay real property taxes can include the full amount of such taxes in computing their housing allowance exclusion. They may also fully deduct the amount of the taxes as an itemized deduction on Schedule A. Federal income tax and gasoline taxes are not deductible for federal income tax purposes.

Congress enacted legislation in 2004 that provided an itemized deduction for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes. Taxpayers could deduct the total amount of general state and local sales taxes paid by accumulating receipts showing general sales taxes paid, or they could use tables created by the IRS. This provision was adopted to address the unequal treatment of taxpayers in the nine states that have no income tax. Taxpayers in these states could not take advantage of the itemized deduction for state income taxes. Allowing them to deduct sales taxes helped offset this disadvantage. This deduction, which was scheduled to expire at the end of 2009, was extended by the Tax Relief and Jobs Creation Action through 2011.

In the past, taxpayers could claim an above-the-line deduction for qualified motor vehicle taxes. Qualified motor vehicle taxes included any state or local sales or excise tax imposed on

the purchase of a qualified motor vehicle. A qualified motor vehicle was a passenger automobile, light truck or motorcycle which has a gross vehicle weight of not more than 8,500 pounds that was acquired for use by the taxpayer after February 17, 2009 and before January 1, 2011, the original use of which begins with the taxpayer. The deduction was limited to the tax on up to $49,500 of the purchase price of a qualified motor vehicle. Congress has not extended this deduction.

Step 3: Interest you paid (lines 10–15)

Interest is an amount paid for the use of borrowed money. Interest that you pay for personal reasons (that is, interest on a car loan, credit card or a personal loan) is not deductible as an itemized deduction on Schedule A. In most cases, you will be able to deduct all of your mortgage interest on any loans secured by your main home, including first and second mortgages, home equity loans and refinanced mortgages. Whether your home mortgage interest is deductible under these rules depends on the date you took out the mortgage, the amount of the mortgage and your use of the proceeds. If all of your mortgages fit into one of the following categories, you can deduct all of your interest and report it on Schedule A (Form 1040):

1. Mortgages you took out on your main home on or before October 13, 1987.
2. Mortgages you took out on your main home after October 13, 1987, to buy, build or improve your home, but only if these mortgages (plus any mortgages in the preceding category) total $1 million or less throughout 2011 ($500,000 if married filing separately).
3. Mortgages you took out after October 13, 1987, on your main home, other than to buy, build or improve your home, but only if these mortgages total $100,000 or less throughout 2011 ($50,000 if married filing separately).

If you had a main home and a second home, the dollar limits explained in the second and third categories described above apply to the total mortgage on both homes.

☞ **Key Point.** Ministers who own their homes can deduct mortgage interest payments as an itemized deduction even though such payments were included in computing the housing allowance exclusion (the so-called double deduction). However, ministers are subject to the limitations on mortgage loans discussed in this section.

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; (2) paying points is an established business practice in your area; (3) the points you paid were not more than the points generally charged in your area; (4) you use the cash method of accounting; (5) the points were not paid in the place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, attorney fees and property taxes; (6) you use your loan to buy or build your main home; (7) the points were computed as a percentage of the principal amount of the mortgage; (8) the amount is clearly shown on the settlement statement; (9) the funds you provided at or before closing, plus any points the seller paid, were at least as much as the points charged.

Step 4: Gifts to charity (lines 16–19)

Cash contributions to churches, schools and most other public charities are deductible up to 50% 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 16, while contributions of non-cash property are reported on line 17. 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 2011 and 2012). 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. 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 J goes on a trip to Europe. He is in Europe for 10 days and conducts one-hour services

on two of those days. Pastor J will not be able to claim a charitable contribution deduction for the travel expenses that he incurs in making this trip. The same rule would apply if Pastor J'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 50% 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 cancelled check or a receipt from the charity. Current rules govern the substantiation of individual contributions of cash or property of $250 or more. These rules are 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 20)

Most taxpayers have at some time suffered damage to their property as a result of hurricanes, earthquakes, tornadoes, fires, vandalism, car accidents, floods or similar events. When property is damaged or destroyed by such events, it is called a casualty. If your property is stolen, you may also have a deductible theft loss. You must itemize your deductions on Schedule A to be able to claim a casualty or theft loss to non-business property. To determine your deduction, you must reduce the amount of your casualty and theft losses by any insurance or reimbursement you receive. No deduction is allowed for a casualty or theft loss that is covered by insurance unless a timely insurance claim for reimbursement has been filed.

You can deduct personal casualty or theft losses only to the extent that:

1. The amount of each separate casualty or theft loss is more than $100, and
2. The total amount of all losses during the year (reduced by the $100 limit) is more than 10% of the amount on Form 1040, line 38.

The 10% of AGI limitation does not apply to a casualty loss that occurred in an area determined by the President of the United States to warrant federal disaster assistance. For information on disaster losses, see IRS Publication 547.

To claim a casualty or theft loss, you must be able to show that the loss in fact occurred. In addition, the loss generally is defined as the lesser of (1) the decrease in fair market value of the property as a result of the casualty or theft or (2) your adjusted basis in the property before the casualty or theft.

Calculate non-business casualty and theft losses on Form 4684, and report them on Schedule A as an itemized deduction.

Step 6: Job expenses and most other miscellaneous deductions (lines 21–27)

You may deduct certain miscellaneous expenses on Schedule A. These deductions are in addition to the itemized deductions for medical expenses, taxes, interest, charitable contributions and casualty and theft losses. Most miscellaneous itemized expenses are deductible only to the extent that they exceed 2% of adjusted gross income. Miscellaneous expenses subject to the 2% floor include:

1. Unreimbursed and non-accountable reimbursed employee business expenses (discussed more fully below).
2. Professional society dues.
3. Safety deposit box rental.
4. Employee educational expenses.
5. Tax preparation fees.
6. Home office used regularly and exclusively for work.
7. Tools and supplies used in your work.
8. Expenses of looking for a new job.
9. Investment counsel fees.
10. Professional books and periodicals.
11. Investment expenses.
12. 50% of unreimbursed business meals and entertainment.
13. IRA custodial fees.

Certain miscellaneous expenses are not subject to the 2% floor. However, these expenses ordinarily are not available to ministers.

Employee business expenses

☞ **Key Point.** Most ministers incur business expenses. How these expenses are handled, by both the minister and the church, significantly impacts whether (and to what extent) they are deductible.

The more common examples of ministerial business expenses are summarized below.

Local transportation expenses

These expenses include the cost of transportation by air, rail, bus, taxi, etc. and the cost of driving and maintaining your car. Transportation expenses include:

1. The ordinary and necessary costs of getting from one workplace to another in the course of your ministry when you are traveling within the city or general area of your home.
2. Visiting church members.
3. Going to business meetings away from your regular workplace.

Transportation expenses do not include expenses you incur in traveling away from home overnight. Those expenses are travel expenses (see below).

Expenses incurred in driving your car for business purposes within your community represent one of the most important business expenses for ministers. A common example would be driving your car from your church to a hospital to visit members. Commuting to and from work is never a business expense. However, if you drive to a hospital (or some other business location) on the way home from church, the expenses incurred in driving from the church to the second business location are business expenses even though you are on the way home. The remaining miles between the second business location and your home are non-deductible commuting expenses. If you have an office in your home (see below) that you use as your principal place of business for your church, you may deduct the cost of traveling between your home office and work places associated with your employment.

These expenses can be deducted using either a standard mileage rate or the actual costs of operating the car for business miles. Most ministers choose the standard mileage rate because of its simplicity. However, it is available only if it is selected for the first year a car is used in your trade or business. The actual expense method is very complex and is explained fully in IRS Publication 917.

The standard business mileage rate for 2011 was 51 cents per mile for business miles driven during the first six months of the year, and 55.5 cents per mile for business miles driven during the last six months of the year. The standard business mileage rate remains at 55.5 cents for 2012.

☞ **Key Point.** The standard business mileage rate for 2012 is 55.5 cents per mile.

Ministers should consider the advantages of using a church-owned car for their business travel. This will eliminate most recordkeeping and reporting requirements. Some conditions apply. See the illustration at the end of this guide for a summary of the various tax options pertaining to business use of a car.

Travel expenses

Travel expenses are the ordinary and necessary expenses of traveling away from your "tax home" (your regular place of business) on ministry-related business. You are traveling away from home if your duties require you to be away from the general area of your tax home substantially longer than an ordinary day's work, and you need to sleep or rest to meet the demands of your work while away from home.

Deductible travel expenses include:

1. Air, rail and bus fares.
2. Operating and maintaining your car.
3. Taxi fares or other costs of transportation between the airport or station and your hotel, or from one work site to another.
4. Meals and lodging while you are away from home on business.
5. Cleaning and laundry expenses.
6. Telephone and telegraph expenses.
7. Tips.

Ministers need not report as taxable income a church's reimbursement of their spouse's travel expenses, even though the spouse is not an employee and therefore cannot deduct such expenses. However, this assumes that the church has not reported the reimbursement of the spouse's expenses as income, the spouse's presence on the trip is for a legitimate business purpose and the spouse's expenses are reimbursed under an accountable arrangement. If any of these conditions is not met, then the church's reimbursement of the spouse's travel expenses represents taxable income for the minister.

One way for the *unreimbursed* travel expenses of a non-employee spouse to be deductible would be if the spouse performed substantial church-related activities during the trip. Under these circumstances, the spouse's unreimbursed travel expenses could be claimed as a charitable contribution deduction.

Entertainment expenses

You may be able to deduct entertainment expenses you incur for your ministry. You may take the deduction only if you can demonstrate that the amounts spent are either (1) directly related to the active conduct of your ministry or (2) associated with the active conduct of your ministry, and the entertainment occurred directly before or after a substantial business discussion. These two tests are summarized below:

Directly related test. To show that entertainment was directly related to the active conduct of your business, you ordinarily must be able to demonstrate that (1) the main purpose of the entertainment was the transaction of business; (2) you did engage in business during the entertainment period; and (3) you had more than a general expectation of deriving income or some other specific business benefit at some indefinite future time.

Associated entertainment. To show that entertainment was associated with the active conduct of your ministry, you must be able to demonstrate that you had a clear business purpose in incurring the expense, and that the meal or entertainment directly preceded or followed a substantial business discussion.

Entertainment includes any activity generally considered to provide entertainment, amusement or recreation. This covers entertaining guests at restaurants, social or athletic facilities, sporting events, or on hunting, fishing, vacation or similar trips. Expenses are not deductible when business acquaintances take turns picking up each other's entertainment expenses without regard to whether any business purposes are served. Ministers incur entertainment expenses in a variety of situations. Common examples include entertaining denominational leaders, guest speakers, church groups (youth, choir, the deacons, etc.) or meeting with members at a restaurant for counseling purposes.

☞ **Key Point.** You may deduct only 50% of your business-related entertainment expenses, including meals. This 50% limitation is incorporated directly into the tax returns (see Form 2106). This rule does not apply to expenses you incur that are reimbursed by your employer under an "accountable reimbursement plan" (described elsewhere in this guide).

Entertainment expenses incurred in your home are especially scrutinized by the IRS. You must be able to demonstrate that your expenses were not purely social but rather had a primary business purpose.

Entertainment expenses of spouses may also be deductible if their presence serves a legitimate business purpose or if it would be impractical under the circumstances to entertain the business associate without including his spouse.

The IRS frequently challenges entertainment expenses, and so you should be prepared to fully substantiate such expenses as described below.

✍ **Example.** Pastor S invites the members of the church board to his home for dinner and a meeting. The expenses incurred by Pastor S and his guests for food and beverages ordinarily will constitute entertainment expenses.

✍ **Example.** Pastor S invites a friend and fellow minister to his home for dinner. The friend resides in another state and is visiting Pastor S for the day. Ordinarily, such a visit will be a social visit and the expenses associated with it will not be deductible.

✍ **Example.** Pastor K is the head of staff of his church. He takes a prospect for a ministerial staff position out to dinner, where they discuss the person's background

and suitability for the position. The person's spouse comes along because it would be impractical to discuss the position solely with the prospect. Further, Pastor K's spouse accompanies her husband because the other spouse is present. Pastor K pays everyone's meal expense. The cost of the meals of all four people is a deductible entertainment expense.

Educational expenses

Certain educational expenses are deductible by ministers. You may deduct expenses you have for education, such as tuition, books, supplies, correspondence courses and certain travel and transportation expenses, even though the education may lead to a degree, if the education satisfies one or both of the following conditions:

1. The education is required by your employer, or by law or regulation, to keep your salary, status or job; or
2. The education maintains or improves skills required in your present work.

However, you may not deduct expenses incurred for education, even if one or both of the requirements mentioned above are met, if the education is required to meet the minimum educational requirements to qualify you in your trade or business or is part of a program of study that will lead to qualifying you in a new trade or business, even if you did not intend to enter that trade or business.

✍ **Example.** The minister at First Church takes a class at a local university. Expenses associated with the course are deductible educational expenses if the course maintains or improves job skills and is not a part of a program of study that will qualify the minister for a new trade or business.

Subscriptions and books

Ministers often purchase books and subscribe to journals and other periodicals that are directly relevant to the performance of their professional duties. The income tax regulations specify that "a professional man may claim as deductions the cost of . . . subscriptions to professional journals [and] amounts currently paid for books . . . the useful life of which is short."

The cost of a subscription will be deductible as a business expense if it is related to the conduct of a minister's trade or business. Professional clergy journals and specialized clergy periodicals clearly satisfy this test. News magazines may also qualify if a minister can demonstrate that the information contained in such periodicals is related to his ministry (e.g., sources of illustrations for sermons). The cost of a general circulation daily newspaper is not deductible.

The unreimbursed cost of books that are related to one's ministry is a business expense. The same is true for the cost of books reimbursed by the church under a non-accountable arrangement. Deduct the cost of any book that you acquired for use in your ministry and that has a useful life (not the same as its physical life) of less than one year. For example, the cost of a book that you purchase and read, but have no intention of using again, can be deducted in full in the year of purchase.

The unreimbursed cost of commentaries or theological dictionaries and encyclopedias that are acquired for extended reference use also may be deducted fully in the year of purchase. Alternatively, ministers can allocate the purchase price of reference books to their useful life by means of annual depreciation deductions. The depreciation deduction is computed using the Modified Accelerated Cost Recovery System (MACRS) method. See IRS Publication 946 for details.

Personal computers

You can claim a depreciation deduction for the cost of a computer that you use in your work as an employee if its use is:

1. For the convenience of your employer, and
2. Required as a condition of your employment.

For the convenience of your employer means that you can clearly demonstrate that you cannot perform your job without the home computer. The fact that the computer enables you to perform your work more easily and efficiently is not enough. Further, you must prove that the computers available at your place of employment are insufficient to enable you to properly perform your job. Obviously, this is a difficult test to satisfy. Required as a condition of your employment means that you must not be able to properly perform your duties without the computer. It is not necessary that your employer explicitly requires you to use the computer. On the other hand, it is not enough that your employer merely states that your use of the home computer is a condition of your employment. If you are an employee and these tests are not met, you cannot deduct any of the cost of your home computer.

If you are an employee and you meet both tests described above, you can claim a business deduction if you use your home computer more than 50% of the time during the year in your work. You can claim a deduction for the entire purchase price in the year of purchase (you do not need to depreciate the computer). Of course, the price must be reduced by the percentage of use that is personal as opposed to business related.

✍ **Example.** You occasionally take work home at night rather than work late at the office. You own and use a computer that is similar to the one you use at the office to complete your work at home. Since your use of the

computer is not for the convenience of your employer and is not required as a condition of your employment, you cannot claim a depreciation deduction for it.

The depreciation method you use depends on whether you meet the more-than-50%-use test. You meet this test if you use the computer more than 50% in your work. If you meet this test, you may be able to take the section 179 deduction for the year you place the item in service. This means that you can deduct in the year of purchase the portion of the purchase price that corresponds to the percentage of business use. If you do not meet the more-than-50%-use test, you are limited to the straight line method of depreciation and you cannot claim the section 179 deduction for the cost of the computer in the year of purchase. The more-than-50%-use test does not apply to a computer used only in a part of your home that meets the requirements of a home office. You may be able to take a section 179 deduction for the year you place the computer in service.

Your use of a computer in connection with investments does not count as use in your work. However, you can combine your investment use with your work use in figuring your depreciation deduction.

For more information on depreciation and the section 179 deduction for computers and other items used in a home office, see Publication 587.

You must keep records to prove your percentage of business and investment use.

Cell phones

In 2010, Congress removed cell phones from the definition of listed property. As a result the heightened substantiation requirements and special depreciation rules that apply to listed property no longer apply. This provision is effective for taxable years ending after December 31, 2009. See "Tax Highlights for 2011" at the beginning of this guide for additional information.

Office in the home

The IRS audit guidelines for ministers instruct IRS agents to take the position that a minister who excludes all of his housing expenses as a housing allowance exclusion has, in effect, already deducted all of the expenses associated with an office in the home and should not be able to claim any additional deduction of these expenses as an itemized (home office) deduction on Schedule A.

How to report employee business expenses

The deductibility of your business expenses depends on whether you are an employee or self-employed, whether or not the expenses are reimbursed by the church, and whether any reimbursed expenses are paid under an accountable or a non-accountable reimbursement plan. This section addresses the tax treatment of business expenses for ministers who report their income taxes as employees. The tax treatment of business expenses for ministers with self-employment income is discussed later (under the section on Schedule C).

The business expenses of ministers who are employees for federal income tax reporting purposes (this includes most ministers as explained earlier) can be handled in any of the following three ways:

Method 1: Accountable reimbursed expenses

The best way for ministers to handle business expenses is to have their employing church adopt an accountable business expense reimbursement arrangement. To be an accountable plan, your employer's reimbursement or allowance arrangement must include all of the following rules:

1. Your expenses must have a business connection — that is, you must have paid or incurred deductible expenses while performing services as an employee of your employer.
2. You must adequately account to your employer for these expenses within a reasonable period of time (generally, within 60 days after they are paid or incurred).
3. You must return any excess reimbursement or allowance within a reasonable period of time (generally, within 120 days after the expense was paid or incurred). An excess reimbursement or allowance is any amount you are paid that is more than the business-related expenses that you adequately accounted for to your employer.

Reimbursements of business expenses under such an arrangement are not reported as taxable income on the minister's Form W-2 or Form 1040, and there are no deductions to claim. In effect, the minister is reporting to the church rather than to the IRS.

An accountable business expense reimbursement arrangement should be established by the church in an appropriate resolution. In adopting a resolution, pay special attention to the following rules:

1. Condition the reimbursement of any expense on adequate substantiation. This will include written evidence for all expenses, and receipts for expenses of $75 or more. The evidence must substantiate the amount, date, place and business nature of each expense. The key point is this: A church must require the same degree of substantiation as would be required for a deduction on the minister's income tax return.

2. Business expense reimbursements cannot be funded under an accountable plan out of a minister's own salary (for example, through salary reductions).

✍ **Example.** Pastor R is senior minister at First Church. He reports his federal income taxes as an employee, and the church reimburses him for all of his business and professional expenses (by means of a credit card or cash reimbursements). However, Pastor R is not required to account for such expenses by providing the church treasurer with receipts documenting the amount, time and place, business purpose and business relationship of each expense. Pastor R simply informs the treasurer at the end of each month of the total expenses incurred during that month. Assume further that Pastor R cannot itemize deductions on Schedule A (he does not have sufficient deductions). If Pastor R received reimbursements of $4,000 in 2011: (1) the church would report the entire reimbursements ($4,000) as income on Pastor R's Form W-2, and Pastor R would report them as income (salary) on his Form 1040; and (2) Pastor R cannot deduct the reimbursed expenses as a miscellaneous itemized deduction on Schedule A since he does not have sufficient expenses to itemize. In other words, all of Pastor R's business expense reimbursements are includable in his income for tax purposes, but he cannot offset any of this income by deducting any portion of his business expenses. Even if Pastor R could itemize deductions, his non-accountable reimbursed expenses would be treated just like unreimbursed expenses—they are deductible only as miscellaneous itemized deductions, and then only to the extent that they (along with most other miscellaneous expenses) exceed 2% of his adjusted gross income. Clearly, the tax impact of these rules can be costly for ministers who do not account to their employing church for their business expenses. Further, if the church and Pastor R neglect to report the reimbursements as taxable income, the reimbursements become an "automatic excess benefit" triggering intermediate sanctions against (1) Pastor R (assuming he is an officer or director, or the relative of one) of up to 225% of the excess benefit ($9,000), and (2) the board, up to a maximum penalty of $20,000.

✍ **Example.** Same facts as the previous example, except that the church adopts a reimbursement plan that meets the requirements of an accountable plan, and Pastor R is reimbursed for $4,000 of substantiated expenses. Under these facts, the church would not report the $4,000 of reimbursements as income on Pastor R's Form W-2, and Pastor R would not have to report the reimbursements or claim the expenses on his Form 1040.

Churches occasionally reimburse ministers for non-business expenses. Such reimbursements, though they require an accounting, ordinarily must be included in the minister's wages for income tax reporting purposes, and they are not deductible by the minister. Such personal, living or family expenses are not deductible, and the entire amount of a church's reimbursement must be included on the minister's Form W-2 and Form 1040.

Business expenses must be substantiated by adequate evidence to support an income tax deduction or an expense reimbursement under an accountable reimbursement plan of an employer. Stricter substantiation rules apply to transportation, travel and entertainment expenses.

Method 2: Non-accountable reimbursed expenses

☞ **Key Point.** Ministers who are employees for income tax reporting purposes deduct any business expenses reimbursed by their church under a non-accountable reimbursement plan on Schedule A if they are able to itemize and only to the extent that such expenses exceed 2% of adjusted gross income. The full amount of the church's reimbursements must be included in the minister's income whether or not the expenses are deductible. A church has a non-accountable plan if it reimburses ministers (or other employees) for business expenses without requiring adequate substantiation of the amount, date, place and business purpose of the expenses, or not requiring excess reimbursements to be returned to the church.

A non-accountable plan is a reimbursement or expense allowance arrangement that does not meet one or more of the three rules listed earlier under Method 1. In addition, even if your employer has an accountable plan, the following payments will be treated as being paid under a non-accountable plan:

1. Excess reimbursements you fail to return to your employer, and
2. Reimbursement of non-deductible expenses related to your employer's business.

An arrangement that repays you for business expenses by reducing the amount reported as your wages, salary or other pay will be treated as a non-accountable plan. This is because you are entitled to receive the full amount of your pay whether or not you have any business expenses.

It is common for churches to reimburse a minister's

business expenses without requiring any substantiation of actual expenses or a return of reimbursements in excess of substantiated expenses (for example, excess reimbursements). The most common example is the monthly car allowance. Many churches pay their minister a monthly allowance to cover business use of an automobile, without requiring any substantiation of actual expenses or a return of the amount by which the allowances exceed actual expenses. Such a reimbursement arrangement is called non-accountable since the minister is not required to account for (substantiate) the actual amount, date, place and business purpose of each reimbursed expense. Another common example would be a church that reimburses expenses that are claimed by a minister without adequate substantiation.

For ministers who are employees, the full amount of the church's reimbursements or allowances must be reported as income on the minister's Form W-2 (and Form 1040). The minister can deduct actual expenses only as a miscellaneous itemized deduction on Schedule A to the extent these expenses exceed 2% of adjusted gross income. The church's reimbursements are fully reported as income to the minister who in many cases is unable to claim any deduction because of insufficient itemized expenses to use Schedule A.

Caution. Non-accountable expense reimbursements that are not reported as taxable income on a minister's Form W-2 or Form 1040 are classified as an "automatic excess benefit" by the IRS, meaning that the minister and church board members are exposed to substantial excise taxes (called "intermediate sanctions"). Only officers and directors (and their relatives) are subject to this rule.

☞ **Key Point.** The limitations on the deductibility of unreimbursed and non-accountable reimbursed employee business expenses can be avoided if the church adopts an accountable reimbursement plan. Reimbursements paid by the church under an accountable arrangement are not reported as income to the minister, and the minister need not claim any deductions.

The IRS has advised ministers to comply with the so-called *Deason* allocation rule when computing deductions for unreimbursed business expenses as well as business expenses reimbursed by a church under a non-accountable arrangement. This rule requires ministers to reduce their business expense deduction by the percentage of their total compensation that consists of a tax-exempt housing allowance. This rule does not apply to the computation of self-employment taxes since the housing allowance is not deductible in computing these taxes. The *Deason* rule can be avoided if a church adopts an accountable business expense reimbursement arrangement.

☞ **Key Point.** The IRS audit guidelines for ministers instruct agents to apply the so-called *Deason* allocation rule when auditing ministers.

Method 3: Unreimbursed expenses

☞ **Key Point.** Unreimbursed expenses are expenses that are not reimbursed by the church. They may be deducted only as a miscellaneous itemized deduction on Schedule A to the extent they exceed 2% of a minister's adjusted gross income.

Many ministers incur unreimbursed business expenses. These are expenses that are not reimbursed by the church. Ministers who are employees for income tax reporting purposes claim their unreimbursed business expenses on Schedule A — if they are able to itemize, and only to the extent that such expenses exceed 2% of adjusted gross income.

☞ **Key Point.** Ministers who are employees for income tax reporting purposes cannot claim any deduction for unreimbursed employee business expenses for which an employer reimbursement was available.

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 2011. Be sure the interest you report on line 1 corresponds to any 1099-INT forms you received from such institutions. Do not include tax-exempt interest.

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 2011. Be sure the dividends you report on line 1 correspond to any 1099-DIV forms you received from such institutions.

Step 3: Foreign accounts and foreign trusts

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 7 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 received for guest speaking appearances 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 of the minister to fully deduct business expenses on Schedule C whether or not the minister can itemize deductions on Schedule A. This advantage is 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, particularly if the minister is not able to use Schedule A. The best way for all ministers to handle their business expenses is through an accountable expense reimbursement arrangement.

Report any business expenses associated with your self-employment earnings on lines 8 through 27. For example, if you incur transportation, travel or entertainment expenses in the course of performing self-employment activities, you deduct these expenses on lines 8 through 27 of Schedule C.

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 12 of Form 1040, they in effect are able to deduct 100% of their business and professional expenses even if they do not have enough itemized deductions to use Schedule A.

Self-employed persons can deduct only 50% of business meals and entertainment. Further, self-employed persons who use Schedule C to report their business deductions are not subject to the 2% floor that applies to the deduction of employee business and professional expenses that are either unreimbursed or reimbursed under a non-accountable reimbursement plan. In addition, ministers who report their church income as self-employed are taxed on the value of certain fringe benefits (including employer-paid medical insurance).

☞ **Key Point.** One of the reasons the audit rate is much higher for self-employed taxpayers is that only 30% of all taxpayers have sufficient itemized expenses to use Schedule A. If the IRS can reclassify taxpayers from self-employed to employee status, it will generate far more tax dollars since only 30% of taxpayers can itemize deductions on Schedule A. Business expenses that could have been claimed by a self-employed taxpayer on Schedule C are lost if that taxpayer is reclassified as an employee and has insufficient expenses to itemize on Schedule A.

✍ **Example.** Pastor M reports his income taxes as a self-employed person. He has $4,000 of business expenses in 2011 that were not reimbursed by his church. He deducted all of them on Schedule C. He did not have enough expenses to itemize deductions on Schedule A. Pastor M is later audited by the IRS, and he is reclassified as an employee. He will not be able to deduct any of the $4,000 of business expenses since they are deductible, by an employee, only as an itemized deduction on Schedule A. Further, Pastor M will have to pay interest and possibly penalties in addition to the additional taxes.

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:

1. You had business expenses associated with your trade or business of $5,000 or less in 2011.
2. You use the cash rather than the accrual method of accounting.
3. You did not have an inventory at any time during the year.
4. You did not have a net loss from your trade or business.
5. You had only one business as a sole proprietor.
6. You had no employees.

7. You do not use Form 4562 to compute a depreciation deduction with regard to your trade or business.
8. 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 appearances 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 always are self-employed for Social Security purposes with respect to their ministerial services. They pay self-employment taxes, and never FICA taxes, with respect to such services.

☞ **Key Point.** Ministers who have received IRS approval of an application for exemption from self-employment taxes (Form 4361) do not pay any Social Security taxes on compensation received for their ministerial services. They do not use Schedule SE.

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 the church salary:

- Other items of church income (including taxable fringe benefits).
- Fees you receive for marriages, baptisms, funerals, 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 non-accountable 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:

- Unreimbursed business expenses (disregard the *Deason* reduction rule).
- Business expenses reimbursed under a non-accountable plan (disregard the *Deason* reduction rule).
- 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.
- Net self-employment earnings (without regard to this deduction) multiplied by 7.65%.

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 2011 is computed on this line. The self-employment tax rate for 2011 is 13.3%, 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 10.4%.

✓ **New in 2011.** The Tax Relief and Jobs Creation Act of 2010 provided a payroll tax "holiday" for 2011 in the form of a two percentage point reduction in Social Security taxes. This meant that a minister's share of the Social Security component of self-employment taxes decreased from 12.4 to 10.4% of self-employment earnings. (This situation remains fluid. Please visit *www.GuideStone.org/TaxGuide* for the latest updates.)

Form 2106

☞ **Key Point.** Use Form 2106 to compute your employee business expenses claimed on Schedule A.

Step 1: Enter your expenses

On lines 1 through 6, you report your employee business expenses. For most ministers, the most significant employee business expense is the business use of a car. This expense is computed on Part II (side 2) of Form 2106 and then reported on line 1 of Part I. Ministers may use the actual expense method of computing their car expenses, or the standard mileage rate. Most ministers elect the standard mileage rate. Under this method, substantiated business miles are multiplied times the current standard mileage rate (51 cents per mile for business miles driven during the first six months of 2011, and 55.5 cents per mile for business miles driven during the last six months of 2011. You compute your vehicle expenses using the standard mileage rate in Section B of Part II (line 22).

☞ **Key Point.** The business standard mileage rate for 2012 is 55.5 cents per mile.

Those ministers using the actual expense method compute their car expenses in Section C of Part II. Some restrictions apply to use of the standard mileage rate. First, you must maintain adequate records to substantiate your business miles, and second, you must use the standard mileage rate for the first year you began using your car for business purposes.

On line 3, you report your travel expenses incurred while away from home overnight on business. This would include travel to other cities to perform weddings or funerals, or trips to denominational meetings. Do not include meals and entertainment on line 3 (these items are reported separately on line 5). On line 4, report business expenses other than local transportation, overnight travel, and meals and entertainment. This would include education, publications and the other kinds of business expenses discussed previously in this guide.

Step 2: Enter amounts your employer gave you for expenses listed in Step 1

If your employer (church) reimbursed some or all of your business expenses and does not report them as income in Box 1 of your Form W-2, report the amount of these reimbursements on line 7. This would include any amount reported under code L in Box 13 of your Form W-2 (substantiated car expense reimbursements up to the standard business mileage rate).

Step 3: Figure expenses to deduct on Schedule A (Form 1040)

On lines 8 through 10, you compute the amount of your business expense deduction to be claimed on Schedule A. The de-duction will be limited to the amount that exceeds 2% of your adjusted gross income.

Form 2106-EZ

Employees can use a simplified Form 2106-EZ to compute their business expense deduction for 2011 if their employer did not reimburse business expenses and they use the standard mileage rate for computing automobile expenses.

Part 4. Comprehensive Example and Forms

Example one: Senior minister

Note: This example is based on an illustrated example contained at the end of IRS Publication 517.

Rev. John Michaels is the minister of the First Baptist 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 $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 housing 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 the Rev. Michaels will assemble the return to send it to the IRS.

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 housing allowance for the year and identified it.

Turbo Tax tips: 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. Please note that, at the time of publication, the 2011 Turbo Tax software had not been released, so the Turbo Tax tips listed throughout this example are based on the 2010 version of the software. 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, "I earned this income 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 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 1b. Rev. Michaels reports the $4,000 from weddings, baptisms and honoraria.

Line 2. Rev. Michaels reports his expenses related to the line 1b amount. The total consisted of $87 for marriage and family

booklets and $253 for 476 miles of business use of his car (240 miles from 1/1-6/30/11 and 236 miles from 7/1-12/31/11), mainly in connection with honoraria. Rev. Michaels used the standard mileage rate to figure his car expense. He multiplied the standard mileage rate of 51 cents for miles driven before July 1, 2011 by 240 miles and multiplied the standard mileage rate of 55.5 cents for miles driven after June 30, 2011 by 236 miles for a total of $253. These expenses total $340 ($253 + $87). However, he cannot deduct the part of his expenses allocable to his tax-free housing 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 $340 and enters the $255 difference on line 2.

Line 3. He enters his net profit of $3,745 both on line 3 and on Form 1040, line 12.

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

Turbo Tax tips: Turbo Tax does not appear to calculate the non-deductible 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.

Form 2106–EZ

Rev. Michaels fills out Form 2106–EZ to report the unreimbursed business expenses he had as a common-law employee of First Baptist Church.

Line 1. Before completing line 1, Rev. Michaels fills out Part II because he used his car for church business. His records show that he drove 2,690 business miles (1,400 miles from 1/1-6/30/11 and 1,290 miles from 7/1-12/31/11), which he reports in Part II. On line 1, he multiplies 1,400 miles driven before July 1, 2011 by the mileage rate of 51 cents and multiplies 1,290 miles driven after June 30, 2011 by the mileage rate of 55.5 cents. The combined result of $1,430 is reported on line 1.

Line 4. He enters $219 for his professional publications and booklets.

Line 6. Before entering the total expenses on line 6, Rev. Michaels must reduce them by the amount allocable to his tax-free housing allowance. On the required Attachment 1 (shown later), he shows that 25% (or $412) of his employee business expenses are not deductible because they are allocable to the tax-free housing allowance. He subtracts $412 from $1,649 and enters the result, $1,237, on line 6. He also enters $1,237 on line 21 of Schedule A (Form 1040).

Turbo Tax tips: Turbo Tax does not appear to calculate the non-deductible 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 A (Form 1040)

Rev. Michaels fills out Schedule A as explained here.

Line 5. Rev. and Mrs. Michaels do not pay state income tax, however a deduction is available for state and local general sales taxes. For the purpose of this example, the author did not include an amount on Schedule A.

Line 6. Rev. Michaels deducts $1,750 in real estate taxes.

Line 10. He deducts $6,810 of home mortgage interest.

Line 16. Rev. and Mrs. Michaels contributed $4,800 in cash during the year to various qualifying charities. Each individual contribution was less than $250. For each contribution, Rev. and Mrs. Michaels maintain the required bank record (such as a cancelled check) or written communication from the charity showing the charity's name, the amount of the contribution and the date of the contribution. (This substantiation is required in order for any contribution of money (cash, check or other monetary instrument) made in 2007 and thereafter to be deductible.)

Line 21. Rev. Michaels enters his unreimbursed employee business expenses from Form 2106–EZ, line 6.

Lines 25, 26 and 27. He can deduct only the part of his employee business expenses that exceeds 2% of his adjusted gross income. He fills out these lines to figure the amount he can deduct.

Line 29. The total of all the Michaels' itemized deductions is $13,639, which they enter on line 29 and on Form 1040, line 40.

Schedule SE (Form 1040)

After Rev. Michaels prepares Schedule C–EZ and Form 2106–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 ($63,811) he enters here.

Line 4. He multiplies $63,811 by .9235 to get his net earnings from self-employment ($58,929).

Line 5. The amount on line 4 is less than $106,800, so Rev. Michaels multiplies the amount on line 4 ($58,929) by .133 to get his self-employment tax of $7,838. He enters that amount here and on Form 1040, line 56.

Line 6. Rev. Michaels multiplies the amount on line 5 by .5751 to get his deduction for the employer-equivalent portion of self-employment tax of $4,508. He enters that amount here and on Form 1040, line 27.

Turbo Tax tips: 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 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

After Rev. Michaels prepares Form 2106–EZ and the other schedules, he fills out Form 1040. He files a joint return with his wife. First he fills out the address area and completes the appropriate lines for his filing status and exemptions. Then, he fills out the rest of the form as follows:

Line 7. 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 housing 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.

Line 12. He reports his net profit of $3,745 from Schedule C–EZ, line 3.

Line 27. He enters $4,508, the deductible part of his SE tax from Schedule SE, line 6.

Line 37. Subtract line 36 from line 22. This is his adjusted gross income and he carries this amount forward to line 38.

Line 40. He enters the total itemized deductions from Schedule A, line 29.

Line 42. He multiplies the number of exemptions claimed (3 from line 6d) by $3,700 and enters an exemption amount of $11,100 on line 42.

Line 51. 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 $1,000 credit.

Line 56. He enters the self-employment tax from Schedule SE, line 5.

Line 62. He enters the federal income tax shown in Box 2 of his Form W–2 from the college.

Line 63. He enters the $12,000 estimated tax payments he made for the year.

a Employee's social security number 011-00-1111	OMB No. 1545-0008	Safe, accurate, FAST! Use	Visit the IRS website at *www.irs.gov/efile*
b Employer identification number (EIN) 00-0246810	1 Wages, tips, other compensation 45,000.00	2 Federal income tax withheld	
c Employer's name, address, and ZIP code First Baptist Church 1042 Main Street Hometown, Texas 77099	3 Social security wages	4 Social security tax withheld	
	5 Medicare wages and tips	6 Medicare tax withheld	
	7 Social security tips	8 Allocated tips	
d Control number	9	10 Dependent care benefits	
e Employee's first name and initial Last name Suff. John E. Michaels 1040 Main Street Hometown, Texas 77099	11 Nonqualified plans	12a See instructions for box 12 Code	
	13 Statutory employee ☐ Retirement plan ☐ Third-party sick pay ☐	12b Code	
	14 Other Housing Allowance $16,800	12c Code	
f Employee's address and ZIP code		12d Code	

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** **Wage and Tax Statement** 2011 Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.

a Employee's social security number 011-00-1111	OMB No. 1545-0008	Safe, accurate, FAST! Use IRS e-file	Visit the IRS website at www.irs.gov/efile
b Employer identification number (EIN) 00-1357913	1 Wages, tips, other compensation 3,400.00		2 Federal income tax withheld 272.00
c Employer's name, address, and ZIP code Hometown College 40 Honor Road Hometown, Texas 77099	3 Social security wages 3,400.00		4 Social security tax withheld 210.80
	5 Medicare wages and tips 3,400.00		6 Medicare tax withheld 49.30
	7 Social security tips		8 Allocated tips
d Control number	9		10 Dependent care benefits
e Employee's first name and initial Last name Suff. John E. Michaels 1040 Main Street Hometown, Texas 77099	11 Nonqualified plans		12a See instructions for box 12 Code
	13 Statutory employee ☐ Retirement plan ☐ Third-party sick pay ☐		12b Code
	14 Other		12c Code
			12d Code
f Employee's address and ZIP code			

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** **Wage and Tax Statement** 2011 Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.

Form **1040** Department of the Treasury—Internal Revenue Service (99)

U.S. Individual Income Tax Return 2011

OMB No. 1545-0074 | IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2011, or other tax year beginning , 2011, ending , 20 | See separate instructions.

Your first name and initial	Last name	Your social security number
John E.	Michaels	0 1 1 0 0 1 1 1 1
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Susan R.	Michaels	0 1 1 0 0 2 2 2 2

Home address (number and street). If you have a P.O. box, see instructions. Apt. no.
1040 Main Street

▲ Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).
Hometown, Texas 77099

Foreign country name | Foreign province/county | Foreign postal code

Presidential Election Campaign
Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse

Filing Status

Check only one box.

1 ☐ Single
2 ☑ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child

Exemptions

6a ☑ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☑ **Spouse**

Boxes checked on 6a and 6b 2

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
Jennifer Michaels	0 1 1 0 0 3 3 3 3	Daughter	☑
			☐
			☐
			☐

If more than four dependents, see instructions and check here ▶ ☐

No. of children on 6c who:
• **lived with you** 1
• **did not live with you due to divorce or separation (see instructions)**

Dependents on 6c not entered above

d Total number of exemptions claimed

Add numbers on lines above ▶ 3

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

Enclose, but do not attach, any payment. Also, please use **Form 1040-V.**

7	Wages, salaries, tips, etc. Attach Form(s) W-2 Excess parsonage allowance $240		7	48,640
8a	**Taxable** interest. Attach Schedule B if required		8a	
b	**Tax-exempt** interest. **Do not** include on line 8a	8b		
9a	Ordinary dividends. Attach Schedule B if required		9a	
b	Qualified dividends	9b		
10	Taxable refunds, credits, or offsets of state and local income taxes		10	
11	Alimony received		11	
12	Business income or (loss). Attach Schedule C or C-EZ		12	3,745
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		13	
14	Other gains or (losses). Attach Form 4797		14	
15a	IRA distributions 15a	b Taxable amount	15b	
16a	Pensions and annuities 16a	b Taxable amount	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17	
18	Farm income or (loss). Attach Schedule F		18	
19	Unemployment compensation		19	
20a	Social security benefits 20a	b Taxable amount	20b	
21	Other income. List type and amount		21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22	52,385

Adjusted Gross Income

23	Educator expenses	23		
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24		
25	Health savings account deduction. Attach Form 8889	25		
26	Moving expenses. Attach Form 3903	26		
27	Deductible part of self-employment tax. Attach Schedule SE	27	4,508	
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	Tuition and fees. Attach Form 8917	34		
35	Domestic production activities deduction. Attach Form 8903	35		
36	Add lines 23 through 35		36	4,508
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶		37	47,877

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

Cat. No. 11320B Form **1040** (2011)

Tax and Credits	38	Amount from line 37 (adjusted gross income)		38	47,877
	39a	Check if: ☐ **You** were born before January 2, 1947, ☐ Blind. ☐ **Spouse** was born before January 2, 1947, ☐ Blind. **Total boxes checked ▶ 39a**			
Standard Deduction for— • People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $5,800 Married filing jointly or Qualifying widow(er), $11,600 Head of household, $8,500	b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b ☐			
	40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)		40	13,639
	41	Subtract line 40 from line 38		41	34,238
	42	**Exemptions.** Multiply $3,700 by the number on line 6d		42	11,100
	43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43	23,138
	44	**Tax** (see instructions). Check if any from: **a** ☐ Form(s) 8814 **b** ☐ Form 4972 **c** ☐ 962 election		44	2,619
	45	**Alternative minimum tax** (see instructions). Attach Form 6251		45	
	46	Add lines 44 and 45 ▶		46	2,619
	47	Foreign tax credit. Attach Form 1116 if required	47		
	48	Credit for child and dependent care expenses. Attach Form 2441	48		
	49	Education credits from Form 8863, line 23	49		
	50	Retirement savings contributions credit. Attach Form 8880	50		
	51	Child tax credit (see instructions)	51	1,000	
	52	Residential energy credits. Attach Form 5695	52		
	53	Other credits from Form: **a** ☐ 3800 **b** ☐ 8801 **c** ☐	53		
	54	Add lines 47 through 53. These are your **total credits**		54	1,000
	55	Subtract line 54 from line 46. If line 54 is more than line 46, enter -0- ▶		55	1,619
Other Taxes	56	Self-employment tax. Attach Schedule SE		56	7,838
	57	Unreported social security and Medicare tax from Form: **a** ☐ 4137 **b** ☐ 8919		57	
	58	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		58	
	59a	Household employment taxes from Schedule H		59a	
	b	First-time homebuyer credit repayment. Attach Form 5405 if required		59b	
	60	Other taxes. Enter code(s) from instructions		60	
	61	Add lines 55 through 60. This is your **total tax** ▶		61	9,457
Payments	62	Federal income tax withheld from Forms W-2 and 1099	62	272	
	63	2011 estimated tax payments and amount applied from 2010 return	63	12,000	
If you have a qualifying child, attach Schedule EIC.	64a	**Earned income credit (EIC)**	64a		
	b	Nontaxable combat pay election 64b			
	65	Additional child tax credit. Attach Form 8812	65		
	66	American opportunity credit from Form 8863, line 14	66		
	67	First-time homebuyer credit from Form 5405, line 10	67		
	68	Amount paid with request for extension to file	68		
	69	Excess social security and tier 1 RRTA tax withheld	69		
	70	Credit for federal tax on fuels. Attach Form 4136	70		
	71	Credits from Form: **a** ☐ 2439 **b** ☐ 8839 **c** ☐ 8801 **d** ☐ 8885	71		
	72	Add lines 62, 63, 64a, and 65 through 71. These are your **total payments** ▶		72	12,272
Refund	73	If line 72 is more than line 61, subtract line 61 from line 72. This is the amount you **overpaid**		73	2,815
	74a	Amount of line 73 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		74a	
Direct deposit? See instructions.	▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings			
	▶ d	Account number			
	75	Amount of line 73 you want **applied to your 2012 estimated tax** ▶	75	2,815	
Amount You Owe	76	**Amount you owe.** Subtract line 72 from line 61. For details on how to pay, see instructions ▶		76	
	77	Estimated tax penalty (see instructions)	77		

Third Party Designee Do you want to allow another person to discuss this return with the IRS (see instructions)? ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	Daytime phone number
John Michaels	3/15/12	Minister	212-444-5555
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
Susan Michaels	3/15/12	Homemaker	

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶		Firm's EIN ▶		
Firm's address ▶		Phone no.		

SCHEDULE A (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Itemized Deductions

▶ Attach to Form 1040. ▶ See Instructions for Schedule A (Form 1040).

OMB No. 1545-0074

2011

Attachment Sequence No. 07

Name(s) shown on Form 1040: John E. & Susan R. Michaels

Your social security number: 011-00-1111

Medical and Dental Expenses		**Caution.** Do not include expenses reimbursed or paid by others.				
	1	Medical and dental expenses (see instructions)	1			
	2	Enter amount from Form 1040, line 38 [2]				
	3	Multiply line 2 by 7.5% (.075)	3			
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-			4	
Taxes You Paid	5	State and local **(check only one box):** a ☐ Income taxes, **or** b ☐ General sales taxes	5			
	6	Real estate taxes (see instructions)	6	1,750		
	7	Personal property taxes	7			
	8	Other taxes. List type and amount ▶	8			
	9	Add lines 5 through 8			9	1,750
Interest You Paid	10	Home mortgage interest and points reported to you on Form 1098	10	6,810		
Note. Your mortgage interest deduction may be limited (see instructions).	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ▶	11			
	12	Points not reported to you on Form 1098. See instructions for special rules	12			
	13	Mortgage insurance premiums (see instructions)	13			
	14	Investment interest. Attach Form 4952 if required. (See instructions.)	14			
	15	Add lines 10 through 14			15	6,810
Gifts to Charity	16	Gifts by cash or check. If you made any gift of $250 or more, see instructions	16	4,800		
If you made a gift and got a benefit for it, see instructions.	17	Other than by cash or check. If any gift of $250 or more, see instructions. You **must** attach Form 8283 if over $500	17			
	18	Carryover from prior year	18			
	19	Add lines 16 through 18			19	4,800
Casualty and Theft Losses	20	Casualty or theft loss(es). Attach Form 4684. (See instructions.)			20	
Job Expenses and Certain Miscellaneous Deductions	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See instructions.) ▶	21	1,237		
	22	Tax preparation fees	22			
	23	Other expenses—investment, safe deposit box, etc. List type and amount ▶	23			
	24	Add lines 21 through 23	24	1,237		
	25	Enter amount from Form 1040, line 38 [25] 47,877				
	26	Multiply line 25 by 2% (.02)	26	958		
	27	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-			27	279
Other Miscellaneous Deductions	28	Other—from list in instructions. List type and amount ▶			28	
Total Itemized Deductions	29	Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40			29	13,639
	30	If you elect to itemize deductions even though they are less than your standard deduction, check here ▶ ☐				

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 17145C **Schedule A (Form 1040) 2011**

SCHEDULE C-EZ (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Net Profit From Business

(Sole Proprietorship)

▶ **Partnerships, joint ventures, etc., generally must file Form 1065 or 1065-B.**
▶ **Attach to Form 1040, 1040NR, or 1041.** ▶ **See instructions on page 2.**

OMB No. 1545-0074

2011

Attachment Sequence No. **09A**

Name of proprietor: John E. Michaels

Social security number (SSN): 011-00-1111

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.
- Did not receive any credit card or similar payments that included amounts that are not includible in your income (see instructions for line 1a).

And You:

- Had no employees during the year.
- 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.
- Do not deduct expenses for business use of your home.
- Do not have prior year unallowed passive activity losses from this business.

A Principal business or profession, including product or service
Minister

B Enter business code (see page 2) ▶ 5 4 1 9 9 0

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.
1042 Main Street

City, town or post office, state, and ZIP code
Hometown, Texas 77099

F Did you make any payments in 2011 that would require you to file Form(s) 1099? (see the Schedule C instructions) . . . ☐ Yes ☑ No

G If "Yes," did you or will you file all required Forms 1099? . . . ☐ Yes ☐ No

Part II Figure Your Net Profit

1a	Merchant card and third party payments. For 2011, enter -0-	1a			
b	Gross receipts or sales not entered on line 1a (see instructions)	1b	4,000		
c	Income reported to you on Form W-2 if the "Statutory Employee" box on that form was checked. **Caution.** See Schedule C instructions before completing this line	1c			
d	Total of lines 1a, 1b, and 1c. If any adjustments to line 1a, you **must** use Schedule C (see instructions)			1d	4,000
2	**Total expenses** (see page 2). If more than $5,000, you **must** use Schedule C			2	255
3	**Net profit.** Subtract line 2 from line 1d. If less than zero, you **must** use Schedule C. Enter on both **Form 1040, line 12,** and **Schedule SE, line 2,** or on **Form 1040NR, line 13** and **Schedule SE, line 2** (see instructions). (If you entered an amount on line 1c, **do not** report the amount from line 1c on Schedule SE, line 2.) Estates and trusts, enter on **Form 1041, line 3**			3	3,745

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) ▶ 07/15/05

5 Of the total number of miles you drove your vehicle during 2011, enter the number of miles you used your vehicle for:

a Business 476 b Commuting (see page 2) 0 c Other 7,466

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 your tax return instructions. Cat. No. 14374D **Schedule C-EZ (Form 1040) 2011**

SCHEDULE SE (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Self-Employment Tax

▶ **Attach to Form 1040 or Form 1040NR.** ▶ **See separate instructions.**

OMB No. 1545-0074

2011

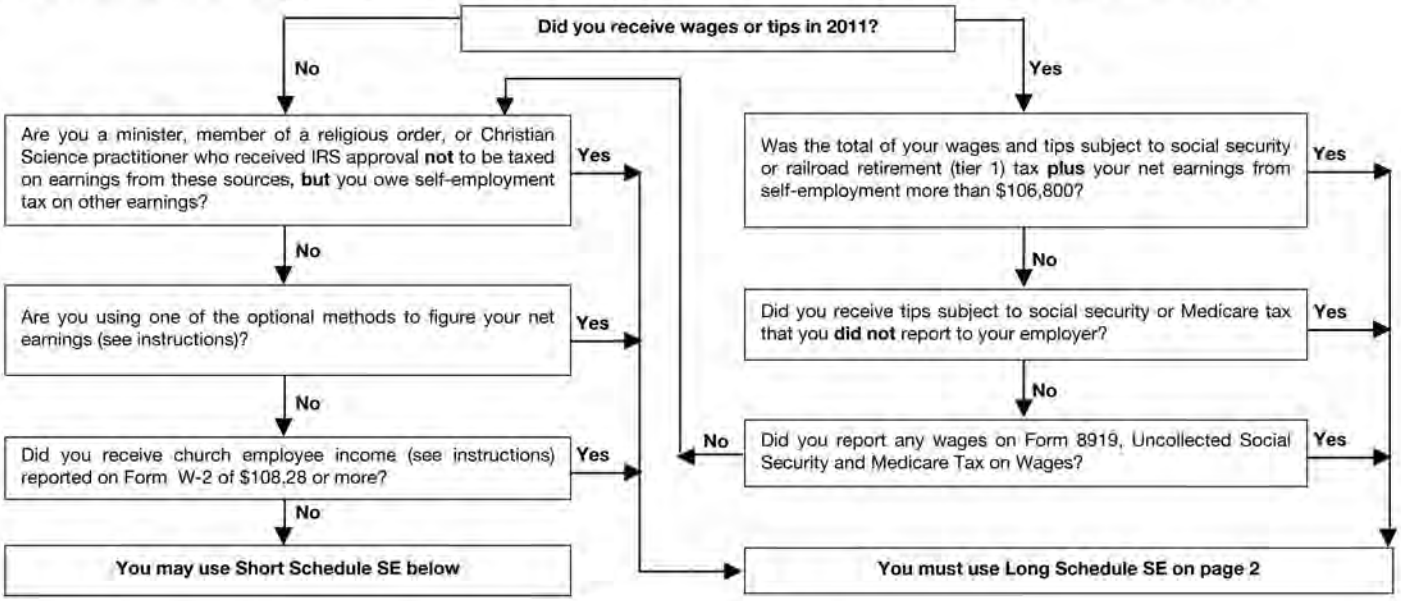
Attachment Sequence No. **17**

Name of person with **self-employment** income (as shown on Form 1040)	Social security number of person with **self-employment** income ▶
John E. Michaels	011-00-1111

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	1a	
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 Y	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	2	63,811
3	Combine lines 1a, 1b, and 2	3	63,811
4	Multiply line 3 by 92.35% (.9235). If less than $400, you do not owe self-employment tax; **do not** file this schedule unless you have an amount on line 1b ▶	4	58,929
	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: • $106,800 or less, multiply line 4 by 13.3% (.133). Enter the result here and on **Form 1040, line 56,** or **Form 1040NR, line 54** • More than $106,800, multiply line 4 by 2.9% (.029). Then, add $11,107.20 to the result. Enter the total here and on **Form 1040, line 56,** or **Form 1040NR, line 54**	5	7,838
6	**Deduction for employer-equivalent portion of self-employment tax.** If the amount on line 5 is: • $14,204.40 or less, multiply line 5 by 57.51% (.5751) • More than $14,204.40, multiply line 5 by 50% (.50) and add $1,067 to the result. Enter the result here and on **Form 1040, line 27,** or **Form 1040NR, line 27**	6	4,508

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 11358Z **Schedule SE (Form 1040) 2011**

Name of person with **self-employment** income (as shown on Form 1040)	Social security number of person with **self-employment** income ▶
John E. Michaels	011-00-1111

Section B—Long Schedule SE

Part I Self-Employment Tax

Note. If your only income subject to self-employment tax is **church employee income,** see instructions. Also see instructions for the definition of church employee income.

A If you are a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361, but you had $400 or more of **other** net earnings from self-employment, check here and continue with Part I ▶ ☐

1a	Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A. **Note.** Skip lines 1a and 1b if you use the farm optional method (see instructions)		**1a**	
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 Y		**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. **Note.** Skip this line if you use the nonfarm optional method (see instructions)		**2**	
3	Combine lines 1a, 1b, and 2		**3**	
4a	If line 3 is more than zero, multiply line 3 by 92.35% (.9235). Otherwise, enter amount from line 3 **Note.** If line 4a is less than $400 due to Conservation Reserve Program payments on line 1b, see instructions.		**4a**	
b	If you elect one or both of the optional methods, enter the total of lines 15 and 17 here		**4b**	
c	Combine lines 4a and 4b. If less than $400, **stop**; you do not owe self-employment tax. **Exception.** If less than $400 and you had **church employee income,** enter -0- and continue ▶		**4c**	
5a	Enter your **church employee income** from Form W-2. See instructions for definition of church employee income	**5a**		
b	Multiply line 5a by 92.35% (.9235). If less than $100, enter -0-		**5b**	
6	Add lines 4c and 5b		**6**	
7	Maximum amount of combined wages and self-employment earnings subject to social security tax or the 4.2% portion of the 5.65% railroad retirement (tier 1) tax for 2011		**7**	106,800 00
8a	Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) and railroad retirement (tier 1) compensation. If $106,800 or more, skip lines 8b through 10, and go to line 11	**8a**		
b	Unreported tips subject to social security tax (from Form 4137, line 10)	**8b**		
c	Wages subject to social security tax (from Form 8919, line 10)	**8c**		
d	Add lines 8a, 8b, and 8c		**8d**	
9	Subtract line 8d from line 7. If zero or less, enter -0- here and on line 10 and go to line 11 ▶		**9**	
10	Multiply the **smaller** of line 6 or line 9 by 10.4% (.104)		**10**	
11	Multiply line 6 by 2.9% (.029)		**11**	
12	**Self-employment tax.** Add lines 10 and 11. Enter here and on **Form 1040, line 56,** or **Form 1040NR, line 54**		**12**	
13	**Deduction for employer-equivalent portion of self-employment tax.** Add the two following amounts. • 59.6% (.596) of line 10. • One-half of line 11. Enter the result here and on **Form 1040, line 27,** or **Form 1040NR, line 27**	**13**		

Part II Optional Methods To Figure Net Earnings (see instructions)

Farm Optional Method. You may use this method **only** if **(a)** your gross farm income[1] was not more than $6,720, **or (b)** your net farm profits[2] were less than $4,851.

14	Maximum income for optional methods	**14**	4,480 00
15	Enter the **smaller** of: two-thirds (2/3) of gross farm income[1] (not less than zero) **or** $4,480. Also include this amount on line 4b above	**15**	

Nonfarm Optional Method. You may use this method **only** if **(a)** your net nonfarm profits[3] were less than $4,851 and also less than 72.189% of your gross nonfarm income,[4] **and (b)** you had net earnings from self-employment of at least $400 in 2 of the prior 3 years. **Caution.** You may use this method no more than five times.

16	Subtract line 15 from line 14	**16**	
17	Enter the **smaller** of: two-thirds (2/3) of gross nonfarm income[4] (not less than zero) **or** the amount on line 16. Also include this amount on line 4b above	**17**	

[1] From Sch. F, line 9, and Sch. K-1 (Form 1065), box 14, code B.

[2] From Sch. F, line 34, and Sch. K-1 (Form 1065), box 14, code A—minus the amount you would have entered on line 1b had you not used the optional method.

[3] From Sch. C, line 31; Sch. C-EZ, line 3; Sch. K-1 (Form 1065), box 14, code A; and Sch. K-1 (Form 1065-B), box 9, code J1.

[4] From Sch. C, line 7; Sch. C-EZ, line 1d; Sch. K-1 (Form 1065), box 14, code C; and Sch. K-1 (Form 1065-B), box 9, code J2.

Form **2106-EZ**

Department of the Treasury
Internal Revenue Service (99)

Unreimbursed Employee Business Expenses

▶ **Attach to Form 1040 or Form 1040NR.**

OMB No. 1545-0074

2011

Attachment Sequence No. **129A**

Your name	Occupation in which you incurred expenses	Social security number
John E. Michaels	Minister	011 00 1111

You Can Use This Form Only if All of the Following Apply.

- You are an employee deducting ordinary and necessary expenses attributable to your job. An ordinary expense is one that i common and accepted in your field of trade, business, or profession. A necessary expense is one that is helpful and appropriate fo your business. An expense does not have to be required to be considered necessary.
- You **do not** get reimbursed by your employer for any expenses (amounts your employer included in box 1 of your Form W-2 are no considered reimbursements for this purpose).
- If you are claiming vehicle expense, you are using the standard mileage rate for 2011.

Caution: *You can use the standard mileage rate for 2011* ***only if: (a)*** *you owned the vehicle and used the standard mileage rate for the first yea you placed the vehicle in service,* ***or (b)*** *you leased the vehicle and used the standard mileage rate for the portion of the lease period after 1997.*

Part I Figure Your Expenses

1	Complete Part II. Multiply line 8a by 51¢ (.51) for miles driven **before** July 1, 2011, and by 55.5¢ (.555) for miles driven **after** June 30, 2011. Add the amounts , then enter the result here	1	1,430
2	Parking fees, tolls, and transportation, including train, bus, etc., that **did not** involve overnight travel or commuting to and from work	2	
3	Travel expense while away from home overnight, including lodging, airplane, car rental, etc. **Do not** include meals and entertainment	3	
4	Business expenses not included on lines 1 through 3. **Do not** include meals and entertainment	4	219
5	Meals and entertainment expenses: $ _____ × 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses incurred while away from home on business by 80% (.80) instead of 50%. For details, see instructions.)	5	
6	**Total expenses.** Add lines 1 through 5. Enter here and on **Schedule A (Form 1040), line 21** (or on **Schedule A (Form 1040NR), line 7**). (Armed Forces reservists, fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter this amount.)	6	1,237

Part II Information on Your Vehicle. Complete this part **only** if you are claiming vehicle expense on line 1.

7 When did you place your vehicle in service for business use? (month, day, year) ▶ 07 / 15 / 05

8 Of the total number of miles you drove your vehicle during 2011, enter the number of miles you used your vehicle for:

a Business 2,690 b Commuting (see instructions) 0 c Other 5,112

9 Was your vehicle available for personal use during off-duty hours? ☑ Yes ☐ No

10 Do you (or your spouse) have another vehicle available for personal use? ☑ Yes ☐ No

11a 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 your tax return instructions. Cat. No. 20604Q Form **2106-EZ** (201

Attachment 1. Computation of expenses, allocable to tax-free ministerial income, that are non-deductible.

		Taxable	Tax-Free	Total
Salary as a minister		$ 45,000		$ 45,000
Parsonage allowance:				
Amount designated and paid by church ($1,400 x 12)	$ 16,800			
Actual expenses				
(Mortgage $1,125 x 12, Utilities/other $1,450, Real estate taxes $1,750)	16,700			
Fair rental value of home (including furnishings and utilities) ($1,380 x 12)	16,560			
Taxable portion of allowance				
(excess of amount designated & paid over lesser of actual expenses or fair rental value)	$ 240	240		240
Tax-free portion of allowance (lesser of amount designated, actual expenses or fair rental value)			16,560	16,560
Gross income from weddings, baptisms and honoraria		4,000		4,000
Ministerial Income		$ 49,240	$ 16,560	$ 65,800
% of non-deductible expenses: $16,560/$65,800 = 25%				

Schedule C-EZ Deduction Computation

Marriage and family booklets		$ 87
Business use of car:		
1/1-6/30/11: 240 miles x 51¢	$ 122	
7/1-12/31/11: 236 miles x 55.5¢	131	253
Unadjusted Schedule C-EZ expenses		340
Minus:		
Non-deductible part of Schedule C-EZ expenses (25% x $340)		(85)
Schedule C-EZ deductions (line 2)		$ 255

Form 2106-EZ - Employee Business Expense Deduction Computation

Car expenses for church business:		
1/1-6/30/11: 1,400 miles x 51¢	$ 714	
7/1-12/31/11: 1,290 miles x 55.5¢	716	$ 1,430
Publications and booklets		219
Unadjusted Form 2106-EZ expenses		1,649
Minus:		
Non-deductible part of Form 2106-EZ expenses (25% x $1,649)		(412)
Employee business expense deduction — Form 2106-EZ line 6		$ 1,237

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

Attachment 2. Attachment to Schedule SE (Form 1040)

Church wages		$ 45,000
Parsonage allowance		16,800
Net profit from Schedule C-EZ		3,745
		65,545
Less:		
Schedule C-EZ expenses allocable to tax-free income	$ 85	
Ministerial employee business expenses		
(unadjusted Form 2106-EZ expenses)	1,649	(1,734)
Net Self-Employment Income		
Schedule SE, Section A, line 2		$ 63,811

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 2011, Rev. Green received $15,000 in annuity income, all of which was designated in advance by GuideStone 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 2011, 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 2011, Rev. Green received $2,000 from occasional guest preaching engagements. He incurred $590 in expenses as a result of these activities ($440 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 GuideStone

GuideStone completed Form 1099-R for Rev. Green as follows:

Box 1. The $15,000 pension income Rev. Green receives from GuideStone.

Box 2b. GuideStone 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 1b. Rev. Green reports the $2,000 from occasional guest preaching engagements.

Line 2. Rev. Green reports his expenses related to the line 1b amount. He drove 829 miles of business use of his car (450 miles from 1/1–6/30/11 and 379 miles from 7/1–12/31/11), 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 51 cents for miles driven before July 1, 2011 by 450 miles and multiplied the standard mileage rate of 55.5 cents for miles driven after June 30, 2011 by 379 miles for a total of $440. He also incurred $75 ($150 x 50% non-deductible) in meal expenses in connection with the guest preaching for total expenses of $515. 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 $391) of his business expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the $391 from the $515 and enters the $124 difference on line 2.

Line 3. He enters his net profit of $1,876 both on line 3 and on Form 1040, line 12.

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

Turbo Tax tips: Listed below are tips for ministers who use Turbo Tax to complete their returns. Please note that, at the time of publication, the 2011 Turbo Tax software had not been released, so the Turbo Tax tips listed throughout this example are based on the 2010 version of the software. These tips should not be construed as an endorsement or recommendation of the Turbo Tax software.

Turbo Tax does not appear to calculate the non-deductible 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. 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 $1,485 and he enters that amount here.

Line 4. He multiplies the $1,485 by .9235 to get his net earnings from self-employment ($1,371).

Line 5. The amount on line 4 is less than $106,800, so Rev. Green multiplies the amount on line 4 ($1,371) by .133 to get his self-employment tax of $182. He enters that amount here and on Form 1040, line 56.

Line 6. Rev. Green multiplies the amount on line 5 by .5751 to get his deduction for the employer-equivalent portion of self-employment tax of $105. He enters that amount here and on Form 1040, line 27.

Turbo Tax tips: 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

After Rev. Green prepares Schedule C–EZ and Schedule SE, he fills out Form 1040. Rev. Green files a joint return with his wife. First he fills out the address area and completes the appropriate lines for his filing status and exemptions. Then, he fills out the rest of the form as follows:

Line 12. He reports his net profit of $1,876 from Schedule C–EZ, line 3.

Line 16a and 16b. Rev. Green reports his total annuity income of $15,000 on line 16a. He reports the taxable amount ($2,000) as computed on Attachment 1 (shown later) on line 16b.

Line 20a and 20b. Since none of Rev. Green's Social Security benefits are taxable, he does not report any amounts on line 20a or 20b.

Line 27. He enters $105, the deductible part of his SE tax from Schedule SE, line 6.

Line 37. Subtract line 36 from line 22. This is his adjusted gross income and he carries this amount forward to line 38.

Line 39a. He checks the boxes indicating that he and his wife were born before January 2, 1947 and enters "2" in the "total" box.

Line 40. Rev. Green enters his standard deduction of $13,900 which takes into consideration the fact he and his wife were born before January 2, 1947.

Line 42. He multiplies the number of exemptions claimed (2 from Line 6d) by $3,700 and enters an exemption amount of $7,400 on line 42.

Line 43. Rev. Green has no taxable income.

Line 56. He enters the self-employment tax from Schedule SE, line 5.

Line 62. Rev. Green did not have any income tax withheld from his pension.

Line 76. Amount Rev. Green owes to the IRS.

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution	OMB No. 1545-0119	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
GuideStone Financial Resources 2401 Cedar Springs Road Dallas, TX 75201-1498		$ 15,000.00 2a Taxable amount $	2011 Form 1099-R	
		2b Taxable amount not determined [X]	Total distribution ☐	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.
PAYER'S federal identification number 23-1352040	RECIPIENT'S identification number 202-20-2002	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	
RECIPIENT'S name William K. Green		5 Employee contributions /Designated Roth contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	
Street address (including apt. no.) 787 Adams Street		7 Distribution code(s) 7 — IRA/SEP/SIMPLE ☐	8 Other $ %	This information is being furnished to the Internal Revenue Service.
City, state, and ZIP code Anytown, NY 10002		9a Your percentage of total distribution %	9b Total employee contributions $	
10 Amount allocable to IRR within 5 years $	11 1st year of desig. Roth contrib.	12 State tax withheld $ $	13 State/Payer's state no.	14 State distribution $ $
Account number (see instructions)		15 Local tax withheld $ $	16 Name of locality	17 Local distribution $ $

Form **1099-R** Department of the Treasury - Internal Revenue Service

Form **1040** Department of the Treasury—Internal Revenue Service (99)

U.S. Individual Income Tax Return

2011 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2011, or other tax year beginning , 2011, ending , 20 See separate instructions.

Your first name and initial	Last name	Your social security number
William K.	Green	2 0 2 2 0 2 0 0 2
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Sarah J.	Green	3 0 3 3 0 3 0 0 3

Home address (number and street). If you have a P.O. box, see instructions. Apt. no.

787 Adams Street

▲ Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).

Anytown, New York 10002

Foreign country name | Foreign province/county | Foreign postal code

Presidential Election Campaign

Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse

Filing Status

Check only one box.

1 ☐ Single

2 ☑ Married filing jointly (even if only one had income)

3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶

4 ☐ Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶

5 ☐ Qualifying widow(er) with dependent child

Exemptions

6a ☑ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a

b ☑ **Spouse**

Boxes checked on 6a and 6b: 2

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
			☐
			☐
			☐
			☐

If more than four dependents, see instructions and check here ▶ ☐

No. of children on 6c who:
- lived with you
- did not live with you due to divorce or separation (see instructions)

Dependents on 6c not entered above

d Total number of exemptions claimed

Add numbers on lines above ▶ 2

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

Enclose, but do not attach, any payment. Also, please use **Form 1040-V.**

7	Wages, salaries, tips, etc. Attach Form(s) W-2		7	
8a	**Taxable** interest. Attach Schedule B if required		8a	
b	**Tax-exempt** interest. **Do not** include on line 8a	8b		
9a	Ordinary dividends. Attach Schedule B if required		9a	
b	Qualified dividends	9b		
10	Taxable refunds, credits, or offsets of state and local income taxes		10	
11	Alimony received		11	
12	Business income or (loss). Attach Schedule C or C-EZ		12	1,876
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		13	
14	Other gains or (losses). Attach Form 4797		14	
15a	IRA distributions 15a	b Taxable amount	15b	
16a	Pensions and annuities 16a 15,000	b Taxable amount	16b	2,000
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17	
18	Farm income or (loss). Attach Schedule F		18	
19	Unemployment compensation		19	
20a	Social security benefits 20a	b Taxable amount	20b	
21	Other income. List type and amount		21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22	3,876

Adjusted Gross Income

23	Educator expenses	23		
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24		
25	Health savings account deduction. Attach Form 8889	25		
26	Moving expenses. Attach Form 3903	26		
27	Deductible part of self-employment tax. Attach Schedule SE	27	105	
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	Tuition and fees. Attach Form 8917	34		
35	Domestic production activities deduction. Attach Form 8903	35		
36	Add lines 23 through 35		36	105
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶		37	3,771

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2011)

Tax and Credits	38	Amount from line 37 (adjusted gross income)		38	3,771
	39a	Check if: ☑ **You** were born before January 2, 1947, ☐ Blind. ☑ **Spouse** was born before January 2, 1947, ☐ Blind. **Total boxes checked ▶ 39a** 2			
Standard Deduction for— • People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $5,800 Married filing jointly or Qualifying widow(er), $11,600 Head of household, $8,500	b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ **39b** ☐			
	40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)		40	13,900
	41	Subtract line 40 from line 38		41	0
	42	**Exemptions.** Multiply $3,700 by the number on line 6d		42	7,400
	43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43	0
	44	**Tax** (see instructions). Check if any from: **a** ☐ Form(s) 8814 **b** ☐ Form 4972 **c** ☐ 962 election		44	0
	45	**Alternative minimum tax** (see instructions). Attach Form 6251		45	
	46	Add lines 44 and 45 ▶		46	0
	47	Foreign tax credit. Attach Form 1116 if required	47		
	48	Credit for child and dependent care expenses. Attach Form 2441	48		
	49	Education credits from Form 8863, line 23	49		
	50	Retirement savings contributions credit. Attach Form 8880	50		
	51	Child tax credit (see instructions)	51		
	52	Residential energy credits. Attach Form 5695	52		
	53	Other credits from Form: **a** ☐ 3800 **b** ☐ 8801 **c** ☐	53		
	54	Add lines 47 through 53. These are your **total credits**		54	
	55	Subtract line 54 from line 46. If line 54 is more than line 46, enter -0- ▶		55	0
Other Taxes	56	Self-employment tax. Attach Schedule SE		56	182
	57	Unreported social security and Medicare tax from Form: **a** ☐ 4137 **b** ☐ 8919		57	
	58	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		58	
	59a	Household employment taxes from Schedule H		59a	
	b	First-time homebuyer credit repayment. Attach Form 5405 if required		59b	
	60	Other taxes. Enter code(s) from instructions		60	
	61	Add lines 55 through 60. This is your **total tax** ▶		61	182
Payments	62	Federal income tax withheld from Forms W-2 and 1099	62		
	63	2011 estimated tax payments and amount applied from 2010 return	63		
If you have a qualifying child, attach Schedule EIC.	64a	**Earned income credit (EIC)**	64a		
	b	Nontaxable combat pay election	64b		
	65	Additional child tax credit. Attach Form 8812	65		
	66	American opportunity credit from Form 8863, line 14	66		
	67	First-time homebuyer credit from Form 5405, line 10	67		
	68	Amount paid with request for extension to file	68		
	69	Excess social security and tier 1 RRTA tax withheld	69		
	70	Credit for federal tax on fuels. Attach Form 4136	70		
	71	Credits from Form: **a** ☐ 2439 **b** ☐ 8839 **c** ☐ 8801 **d** ☐ 8885	71		
	72	Add lines 62, 63, 64a, and 65 through 71. These are your **total payments** ▶		72	0
Refund	73	If line 72 is more than line 61, subtract line 61 from line 72. This is the amount you **overpaid**		73	
	74a	Amount of line 73 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		74a	
Direct deposit? See instructions.	▶ b	Routing number ▶ **c** Type: ☐ Checking ☐ Savings			
	▶ d	Account number			
	75	Amount of line 73 you want **applied to your 2012 estimated tax** ▶	75		
Amount You Owe	76	**Amount you owe.** Subtract line 72 from line 61. For details on how to pay, see instructions ▶		76	182
	77	Estimated tax penalty (see instructions)	77		

Third Party Designee Do you want to allow another person to discuss this return with the IRS (see instructions)? ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	Daytime phone number
William Green	3/15/12	Retired Minister	212-333-4444
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
Sarah Green	3/15/12	Retired	

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶		Firm's EIN ▶		
Firm's address ▶		Phone no.		

SCHEDULE C-EZ (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Net Profit From Business

(Sole Proprietorship)

▶ **Partnerships, joint ventures, etc., generally must file Form 1065 or 1065-B.**
▶ **Attach to Form 1040, 1040NR, or 1041.** ▶ **See instructions on page 2.**

OMB No. 1545-0074

2011

Attachment Sequence No. **09A**

Name of proprietor: William K. Green

Social security number (SSN): 202-20-2002

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.
- Did not receive any credit card or similar payments that included amounts that are not includible in your income (see instructions for line 1a).

And You:

- Had no employees during the year.
- 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.
- Do not deduct expenses for business use of your home.
- Do not have prior year unallowed passive activity losses from this business.

A Principal business or profession, including product or service: Minister

B Enter business code (see page 2): ▶ 5 4 1 9 9 0

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.

City, town or post office, state, and ZIP code

F Did you make any payments in 2011 that would require you to file Form(s) 1099? (see the Schedule C instructions) . . . ☐ Yes ☑ No

G If "Yes," did you or will you file all required Forms 1099? . . . ☐ Yes ☐ No

Part II Figure Your Net Profit

1a	Merchant card and third party payments. For 2011, enter -0-	**1a**			
b	Gross receipts or sales not entered on line 1a (see instructions)	**1b**	2,000		
c	Income reported to you on Form W-2 if the "Statutory Employee" box on that form was checked. **Caution.** See Schedule C instructions before completing this line	**1c**			
d	Total of lines 1a, 1b, and 1c. If any adjustments to line 1a, you **must** use Schedule C (see instructions)			**1d**	2,000
2	**Total expenses** (see page 2). If more than $5,000, you **must** use Schedule C			**2**	124
3	**Net profit.** Subtract line 2 from line 1d. If less than zero, you **must** use Schedule C. Enter on both **Form 1040, line 12,** and **Schedule SE, line 2,** or on **Form 1040NR, line 13** and **Schedule SE, line 2** (see instructions). (If you entered an amount on line 1c, **do not** report the amount from line 1c on Schedule SE, line 2.) Estates and trusts, enter on **Form 1041, line 3**			**3**	1,876

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) ▶ 07/15/05

5 Of the total number of miles you drove your vehicle during 2011, enter the number of miles you used your vehicle for:

a Business 829 **b** Commuting (see page 2) 0 **c** Other 12,711

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

SCHEDULE SE (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Self-Employment Tax

▶ **Attach to Form 1040 or Form 1040NR.** ▶ **See separate instructions.**

OMB No. 1545-0074

2011

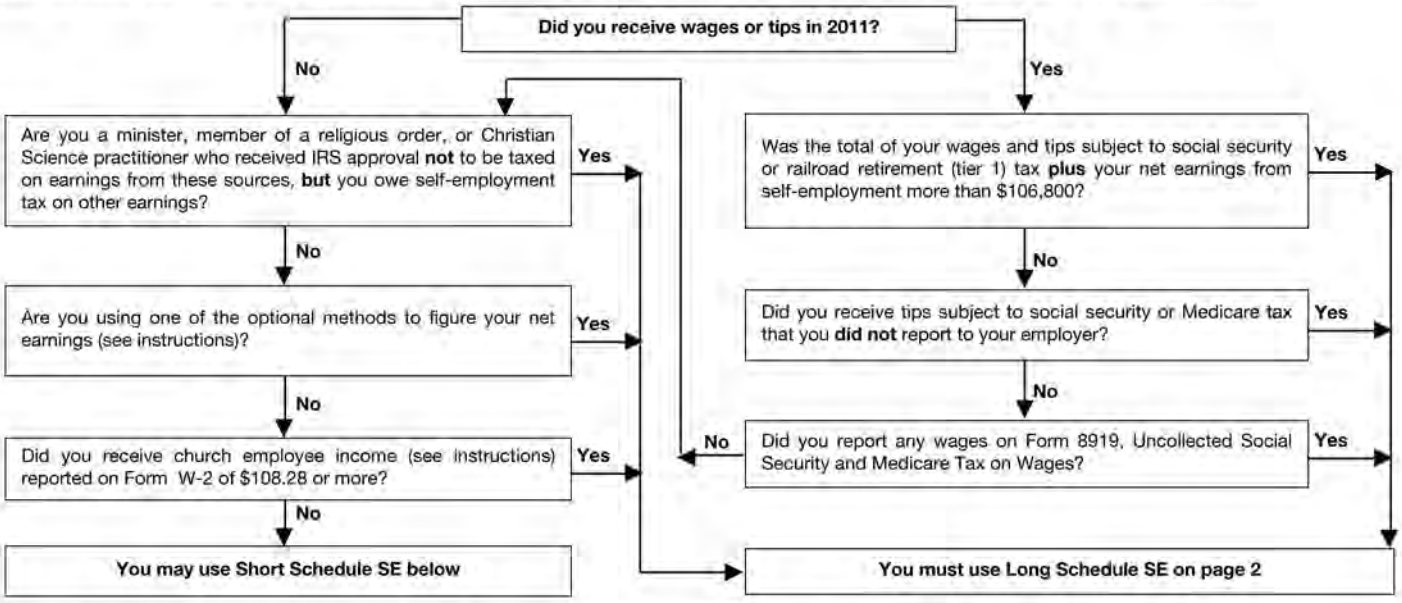
Attachment Sequence No. **17**

Name of person with **self-employment** income (as shown on Form 1040)	Social security number of person with **self-employment** income ▶
William K. Green	202-20-2002

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	**1a**		
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 Y	**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	**2**	1,485	
3	Combine lines 1a, 1b, and 2	**3**	1,485	
4	Multiply line 3 by 92.35% (.9235). If less than $400, you do not owe self-employment tax; **do not** file this schedule unless you have an amount on line 1b ▶	**4**	1,371	
	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: • $106,800 or less, multiply line 4 by 13.3% (.133). Enter the result here and on **Form 1040, line 56,** or **Form 1040NR, line 54** • More than $106,800, multiply line 4 by 2.9% (.029). Then, add $11,107.20 to the result. Enter the total here and on **Form 1040, line 56,** or **Form 1040NR, line 54**	**5**	182	
6	**Deduction for employer-equivalent portion of self-employment tax.** If the amount on line 5 is: • $14,204.40 or less, multiply line 5 by 57.51% (.5751) • More than $14,204.40, multiply line 5 by 50% (.50) and add $1,067 to the result. Enter the result here and on **Form 1040, line 27,** or **Form 1040NR, line 27**	**6**	105	

Name of person with **self-employment** income (as shown on Form 1040)	Social security number of person with **self-employment** income ▶
William K. Green	202-20-2002

Section B—Long Schedule SE

Part I Self-Employment Tax

Note. If your only income subject to self-employment tax is **church employee income,** see instructions. Also see instructions for the definition of church employee income.

A If you are a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361, but you had $400 or more of **other** net earnings from self-employment, check here and continue with Part I . . . . . ▶ ☐

1a	Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A. **Note.** Skip lines 1a and 1b if you use the farm optional method (see instructions)		**1a**	
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 Y		**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. **Note.** Skip this line if you use the nonfarm optional method (see instructions)		**2**	
3	Combine lines 1a, 1b, and 2		**3**	
4a	If line 3 is more than zero, multiply line 3 by 92.35% (.9235). Otherwise, enter amount from line 3 **Note.** If line 4a is less than $400 due to Conservation Reserve Program payments on line 1b, see instructions.		**4a**	
b	If you elect one or both of the optional methods, enter the total of lines 15 and 17 here		**4b**	
c	Combine lines 4a and 4b. If less than $400, **stop**; you do not owe self-employment tax. **Exception.** If less than $400 and you had **church employee income,** enter -0- and continue ▶		**4c**	
5a	Enter your **church employee income** from Form W-2. See instructions for definition of church employee income	**5a**		
b	Multiply line 5a by 92.35% (.9235). If less than $100, enter -0-		**5b**	
6	Add lines 4c and 5b		**6**	
7	Maximum amount of combined wages and self-employment earnings subject to social security tax or the 4.2% portion of the 5.65% railroad retirement (tier 1) tax for 2011		**7**	106,800 00
8a	Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) and railroad retirement (tier 1) compensation. If $106,800 or more, skip lines 8b through 10, and go to line 11	**8a**		
b	Unreported tips subject to social security tax (from Form 4137, line 10)	**8b**		
c	Wages subject to social security tax (from Form 8919, line 10)	**8c**		
d	Add lines 8a, 8b, and 8c		**8d**	
9	Subtract line 8d from line 7. If zero or less, enter -0- here and on line 10 and go to line 11 ▶		**9**	
10	Multiply the **smaller** of line 6 or line 9 by 10.4% (.104)		**10**	
11	Multiply line 6 by 2.9% (.029)		**11**	
12	**Self-employment tax.** Add lines 10 and 11. Enter here and on **Form 1040, line 56,** or **Form 1040NR, line 54**		**12**	
13	**Deduction for employer-equivalent portion of self-employment tax.** Add the two following amounts. • 59.6% (.596) of line 10. • One-half of line 11. Enter the result here and on **Form 1040, line 27,** or **Form 1040NR, line 27**	**13**		

Part II Optional Methods To Figure Net Earnings (see instructions)

Farm Optional Method. You may use this method **only** if **(a)** your gross farm income[1] was not more than $6,720, **or (b)** your net farm profits[2] were less than $4,851.

14	Maximum income for optional methods	**14**	4,480 00
15	Enter the **smaller** of: two-thirds (2/3) of gross farm income[1] (not less than zero) **or** $4,480. Also include this amount on line 4b above	**15**	

Nonfarm Optional Method. You may use this method **only** if **(a)** your net nonfarm profits[3] were less than $4,851 and also less than 72.189% of your gross nonfarm income,[4] **and (b)** you had net earnings from self-employment of at least $400 in 2 of the prior 3 years. **Caution.** You may use this method no more than five times.

16	Subtract line 15 from line 14	**16**	
17	Enter the **smaller** of: two-thirds (2/3) of gross nonfarm income[4] (not less than zero) **or** the amount on line 16. Also include this amount on line 4b above	**17**	

[1] From Sch. F, line 9, and Sch. K-1 (Form 1065), box 14, code B.

[2] From Sch. F, line 34, and Sch. K-1 (Form 1065), box 14, code A—minus the amount you would have entered on line 1b had you not used the optional method.

[3] From Sch. C, line 31; Sch. C-EZ, line 3; Sch. K-1 (Form 1065), box 14, code A; and Sch. K-1 (Form 1065-B), box 9, code J1.

[4] From Sch. C, line 7; Sch. C-EZ, line 1d; Sch. K-1 (Form 1065), box 14, code C; and Sch. K-1 (Form 1065-B), box 9, code J2.

Attachment 1. Computation of expenses, allocable to tax-free ministerial income, that are non-deductible.

% of Non-deductible Expenses

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

% of non-deductible expenses: $13,000/$17,000 = 76%

Schedule C-EZ Deduction Computation

Business use of car:		
1/1-6/30/11: 450 miles x 51¢	$ 230	
7/1-12/31/11: 379 miles x 55.5¢	210	$ 440
Meal expenses ($150 less 50% reduction)		75
Unadjusted Schedule C-EZ expenses		$ 515
Non-deductible part of expenses: $515 X 76%		(391)
Schedule C-EZ deductions, line 2		$ 124

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)

Gross income from Schedule C-EZ	$ 2,000
Less:	
Unadjusted Schedule C-EZ expenses	(515)
Net Self Employment Income, Schedule SE, line 2	$ 1,485

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Federal Reporting Requirements for Churches

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This publication is intended to provide a timely, accurate and authoritative discussion of tax reporting compliance, and the impact of recent changes in the tax laws. It is not intended as a substitute for legal, accounting or other professional advice. If legal, tax or other expert assistance is required, the services of a competent professional should be sought. Although we believe this book provides accurate information, there may be changes resulting from IRS or judicial interpretations of the Tax Code, new tax regulations or technical corrections that occurred after the printing of this edition that are not reflected in the text.

Introduction

The most important federal reporting obligation for most churches is the withholding and reporting of employee income taxes and Social Security taxes. These payroll reporting requirements apply, in whole or in part, to almost every church. Yet many churches do not fully comply with them for various reasons, including the following:

1. The church treasurer is elected by the congregation and does not remain in office long enough to understand the application of the payroll tax reporting rules to churches.
2. Church leaders assume that churches are exempt from the payroll tax reporting requirements. This is a false assumption. The courts have rejected the argument that the application of the payroll tax reporting rules to churches violates the constitutional guaranty of religious freedom.
3. There are a number of special payroll tax reporting rules that apply to churches, and these often are not clearly understood by church staff members. These special rules include the following:

- **Ministers are self-employed for Social Security with respect to their ministerial services.** 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 ministry. This means that they pay the "self-employment tax" (SECA) rather than the employee's share of Social Security and Medicare taxes — even if they report their federal income taxes as a church employee. It is incorrect for churches to treat ministers as employees for Social Security and to withhold the employee's share of Social Security and Medicare taxes from their wages.
- **A minister's wages are exempt from income tax withholding.** Wages paid to a minister as compensation for ministerial services are exempt from income tax withholding whether the minister reports income taxes as an employee or as self-employed. Ministers use the estimated tax procedure to pay their federal taxes, unless they have entered into a voluntary withholding agreement with their employing church.
- **Some churches are exempt from the employer's share of Social Security and Medicare taxes because they filed a timely exemption application.** For most churches, this exemption had to be filed before October 31, 1984. The exemption does not excuse the church from income tax withholding, filing Form 941, or issuing W-2 forms to church employees. The non-minister employees of a church that filed such an exemption application are treated as self-employed for Social Security, and must pay the self-employment tax (SECA) if they are paid $108.28 or more during the year.

✓ **For 2011.** The Tax Relief and Jobs Creation Act of 2010 provided a payroll tax holiday for 2011 in the form of a two percentage point reduction in Social Security taxes. This meant that the employee's share of Social Security taxes dropped from 6.2% to 4.2% of wages (the employer's share was not affected), and self-employed workers' Social Security tax dropped from 12.4% to 10.4% of self-employment earnings. (This situation remains fluid. Please visit *www.GuideStone.org/TaxGuide* for the latest updates.)

▲ **Warning.** Federal law specifies that any corporate officer, director or employee who is responsible for withholding taxes and paying them over to the government may be liable for a penalty in the amount of 100% of such taxes if they are either not withheld or not paid over to the government. This penalty is of special relevance to church leaders, given the high rate of non-compliance by churches with the payroll reporting procedures.

Maximizing tax benefits for your minister

Housing allowance

The most important tax benefit available to ministers who own or rent their home is the housing allowance exclusion. Unfortunately, many churches fail to designate a portion of their minister's compensation as a housing allowance, and thereby deprive the minister of an important tax benefit.

A housing allowance is simply a portion of a minister's compensation that is so designated in advance by the minister's employing church. For example, in December of 2011, a church agrees to pay its pastor "total compensation" of $45,000 for 2012, and designates $15,000 of this amount as a housing allowance (the remaining $30,000 is salary). This "costs" the church nothing. It is simply a matter of designating part of a minister's salary as a housing allowance.

The tax code specifies that the housing allowance of a minister who owns or rents a home is non-taxable in computing federal income taxes to the extent that it is (1) declared in advance, (2) used for housing expenses, and (3) does not exceed the fair rental value of the minister's home (furnished, plus utilities).

☞ **Key Point.** Under no circumstances can a church designate a housing allowance retroactively.

☞ **Key Point.** Although repayments of principal and interest on a home mortgage loan qualify as a housing expense to which a housing allowance can be applied, costs associated with refinancing a principal residence or a home equity loan qualify only if the proceeds are used for housing expenses.

Ministers who live in a church-owned parsonage that is provided "rent-free" as compensation for ministerial services do not include the annual fair rental value of the parsonage as income in computing their federal income taxes. The annual fair rental value is not "deducted" from the minister's income. Rather, it is not reported as additional income on Form 1040 (as it generally would be by non-clergy workers). Ministers who live in a church-provided parsonage do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a parsonage allowance, to the extent that the allowance represents compensation for ministerial services and is used to pay parsonage-related expenses such as utilities, repairs and furnishings.

Note that the housing allowance and fair rental value of a parsonage are non-taxable only when computing federal income taxes. Ministers must include their housing allowance and rental value of a parsonage as taxable income when computing their self-employment taxes (except for retired ministers).

☞ **Key Point.** Be sure that the designation of a housing allowance for the following year is on the agenda of the church for one of its final business meetings of 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 in employment contracts and budget line items — assuming that the church duly adopted the designation and it is reflected in a written document.

Accountable reimbursements

The best way for ministers to handle their ministry-related business expenses is to have their employing church adopt an *accountable* expense reimbursement arrangement. An accountable arrangement is one that meets the following four requirements: (1) only business expenses are reimbursed; (2) no reimbursement without an adequate accounting of expenses within a reasonable period of time (not more than 60 days after an expense is incurred); (3) any excess reimbursement or allowance must be returned to the employer within a reasonable period of time (not more than 120 days after an excess reimbursement is paid); (4) an employer's reimbursements must come out of the employer's funds and not by reducing the employee's salary. Under an accountable plan, an employee reports to the church rather than to the IRS. The reimbursements are not reported as taxable income to the employee, and the employee does not claim any deductions. This is the best way for churches to handle reimbursements of business expenses.

☞ **Key Point.** Reimbursements of business expenses under such an accountable arrangement are not reported as taxable income on an employee's Form W-2 or Form 1040, and there are no deductions to claim. In effect, the employee is reporting to the church rather than to the IRS. This often translates into significant tax savings for the employee.

An *accountable* reimbursement arrangement should be established by the church board or congregation in an appropriate resolution. In adopting a resolution, pay special attention to the following rules:

1. **Condition the reimbursement of any expense on adequate substantiation.** This will include written evidence for all expenses and receipts for expenses of $75 or more. For most expenses, the evidence must substantiate the amount, date, place and business nature of each expense. The key point is this: A church must require the same degree of substantiation as would be required for a deduction on the minister's income tax return.
2. **Expenses must be substantiated, and excess reimbursements returned to the church, within a reasonable time.** Expenses will be deemed substantiated within a reasonable time if they are substantiated within 60 days. Excess reimbursements will be deemed to be returned to the employer within a reasonable time if they are returned within 120 days.

Churches occasionally reimburse ministers for non-business expenses. Such reimbursements, though they require an accounting, ordinarily must be included in the minister's wages for income tax reporting purposes, and they are not deductible by the minister. Such personal, living or family expenses are not deductible, and the entire amount of a church's reimbursement must be reported as taxable income on the minister's Form W-2 and Form 1040.

Flexible spending accounts

A health flexible spending arrangement (FSA) allows employees to be reimbursed for medical expenses. FSAs are usually funded through voluntary salary reduction agreements with one's employer. No payroll taxes are deducted from employee contributions. The employer also may contribute.

☞ **Key Point.** Unlike health spending arrangements which must be reported on Form 1040, FSA contributions are not reported on the employee's Form 1040.

FSAs have several benefits, including the following: (1) employer contributions can be non-taxable; (2) no payroll taxes are deducted from employee contributions; (3) withdrawals may be tax-free if used to pay qualified medical expenses; (4) employees can withdraw funds from an FSA to pay qualified medical expenses even if they have not placed the funds in the account.

Generally, distributions from a health FSA must be paid to reimburse the employee for qualified medical expenses. Qualified medical expenses are those incurred by an employee, or the employee's spouse and certain dependents (including a child under age 27 at the end of the year).

Employees must be able to receive the total amount they have elected to contribute for the year at any time during the year, regardless of the amount they have actually contributed.

☞ **Key Point.** Non-prescription medicines (other than insulin) do not qualify as an expense for FSA purposes.

FSAs are "use-it-or-lose-it" plans. This means that amounts in the account at the end of the plan year cannot be carried over to the next year. However, the plan can provide for a grace period of up to 2½ months after the end of the plan year. If there is a grace period, any qualified medical expenses incurred in that period can be paid from any amounts left in the account at the end of the previous year. An employer is not permitted to refund any part of the balance to the employee.

Section 403(b) plans

A 403(b) plan, also known as a tax-sheltered annuity or retirement income account, is a retirement plan for certain employees of churches and other tax-exempt organizations. These plans have the following tax benefits: (1) Employees do not pay income tax on allowable contributions until they begin making withdrawals from the plan, usually after they retire. Note, however, that non-minister employees must pay Social Security and Medicare tax on their contributions to a 403(b) plan, including those made under a salary reduction agreement. (2) Earnings and gains on amounts in an employee's 403(b) account are not taxed until they are withdrawn. (3) Employees may be eligible to claim the retirement savings contributions credit for elective deferrals contributed to a 403(b) account.

There are limits on the amount of contributions that can be made to a 403(b) account each year. If contributions made to a 403(b) account are more than these contribution limits, penalties may apply. Generally, annual contributions to a 403(b) plan cannot exceed either the limit on annual additions or the limit on elective deferrals. See IRS Publication 571 for details.

Complying with federal payroll tax reporting obligations

Step 1. Obtain an employer identification number (EIN) from the federal government if this has not been done.

This number must be recited on some of the returns listed below and is used to reconcile a church's deposits of withheld taxes with the Forms W-2 it issues to employees. The EIN is a nine-digit number that looks like this: 00-0246810. If your church does not have an EIN, you may apply for one online. Go to the IRS website at *www.irs.gov* for information. You may also apply for an EIN by calling 1-800-829-4933, or you can fax or mail Form SS-4 to the IRS. You should have only one EIN.

☞ **Key Point.** An employer identification number is not a "tax exemption number" and has no relation to your non-profit corporation status. It merely identifies you as an employer subject to tax withholding and reporting and ensures that your church receives proper credit for payments of withheld taxes. You can obtain an EIN by submitting a Form SS-4 to the IRS.

Step 2. Determine whether each church worker is an employee or self-employed.

In some cases, it is difficult to determine whether a particular worker is an employee or is self-employed. If in doubt, churches should treat a worker as an employee, since substantial penalties can be assessed against a church for treating a worker as self-employed whom the IRS later reclassifies as an employee. In general, a self-employed worker is one who is not subject to the control of an employer with respect to how a job is to be done. Further, a self-employed person typically is engaged in a specific trade or business and offers his or her services to the general public.

The IRS and the courts have applied various tests to assist in classifying a worker as an employee or self-employed. Factors that tend to indicate employee status include the following:

1. The worker is required to follow an employer's instructions regarding when, where and how to work.
2. The worker receives "on-the-job" training from an experienced employee.
3. The worker is expected to perform the services personally and not use a substitute.
4. The employer rather than the worker hires and pays any assistants.
5. The worker has a continuing working relationship with the employer.
6. The employer establishes set hours of work.

7. The worker is guaranteed a regular wage amount for an hourly, weekly or other period of time.
8. The worker is expected to work full time.
9. The work is done on the employer's premises.
10. The worker must submit regular oral or written reports to the employer.
11. The worker's business expenses are reimbursed by the employer.
12. The employer furnishes the worker's tools, supplies and equipment.
13. The worker does not work for other employers.
14. The worker does not advertise his services to the general public.

Not all of these factors must be present for a worker to be an employee. But if most of them apply, the worker is an employee. Once again: If in doubt, treat the worker as an employee.

☞ **Key Point.** For 2012, churches must withhold 28% of the compensation paid to a self-employed person who fails to provide his Social Security number to the church. This is referred to as "backup withholding" and is designed to promote the reporting of taxable income.

☞ **Key Point.** Some fringe benefits are non-taxable only when received by employees. A common example is employer-paid medical insurance.

Step 3. Obtain the Social Security number for each worker.

After determining whether a worker is an employee or self-employed, you must obtain the worker's Social Security number. A worker who does not have a Social Security number can obtain one by filing Form SS-5. This is a Social Security Administration form, not an IRS form. If a self-employed worker performs services for your church (and earns at least $600 for the year), but fails to provide you with his Social Security number, then the church is required by law to withhold a specified percentage of compensation as backup withholding. The backup withholding rate is 28% for 2012.

A self-employed person can stop backup withholding simply by providing the church with a correct Social Security number.

The church will need the correct number to complete the worker's Form 1099-MISC (discussed later).

Churches can be penalized if the Social Security number they report on a Form 1099-MISC is incorrect, unless they have exercised "due diligence." A church will be deemed to have exercised due diligence if it has self-employed persons provide their Social Security numbers using Form W-9. It is a good idea for churches to present self-employed workers (e.g., guest speakers, contract laborers) with a Form W-9, and to backup withhold unless the worker returns the form. The church should retain each Form W-9 to demonstrate its due diligence.

All taxes withheld through backup withholding must be reported to the IRS on Form 945. The Form 945 for 2011 must be filed with the IRS by January 31, 2012. However, if you made deposits on time in full payment of the taxes for the year, you may file the return by February 10, 2012.

Step 4. Have each employee complete a Form W-4.

These forms are used by employees to claim withholding allowances. A church will need to know how many withholding allowances each non-minister employee claims to withhold the correct amount of federal income tax. Ministers need not file a Form W-4 unless they enter into a voluntary withholding arrangement with the church. A withholding allowance lowers the amount of tax that will be withheld from an employee's wages. Allowances generally are available for the employee, the employee's spouse, each of the employee's dependents, and in some cases for itemized deductions.

Ask all new employees to give you a signed Form W-4 when they start work. If an employee does not complete such a form, then the church must treat the employee as a single person without any withholding allowances or exemptions. Employers must put into effect any Form W-4 that replaces an existing certificate no later than the start of the first payroll period ending on or after the 30th day after the day on which you received the replacement Form W-4. Of course, you can put a Form W-4 into effect sooner, if you wish. Employers are not responsible for verifying the withholding allowances that employees claim.

Tip. *The "withholding calculator" found on the IRS website (www.irs.gov) can help employees determine the proper amount of federal income tax withholding. Another useful resource, Publication 919 (How Do I Adjust My Tax Withholding?), is available on the IRS website.*

Step 5. Compute each employee's taxable wages.

The amount of taxes that a church should withhold from an employee's wages depends on the amount of the employee's wages and the information contained on his or her Form W-4. A church must determine the wages of each employee that are subject to withholding. Wages subject to federal withholding include pay given to an employee for service performed. The pay may be in cash or in other forms. Measure pay that is not in money (such as property) by its fair market value. Wages often include a number of items in addition to salary. (There is a comprehensive list of examples in Step 10.)

Step 6. Determine the amount of income tax to withhold from each employee's wages.

The amount of federal income tax the employer should withhold from an employee's wages may be computed in a number of ways. The most common methods are the wage bracket method and the percentage method.

Wage bracket method. Under the wage bracket method, the employer simply locates an employee's taxable wages for the applicable payroll period (that is, weekly, biweekly, monthly) on the wage bracket withholding tables in IRS Publication 15 ("Circular E"), and determines the tax to be withheld by using the column headed by the number of withholding allowances claimed by the employee. You can obtain a copy of IRS Publication 15 at any IRS office by calling the IRS forms number (1-800-829-3676), or by downloading a copy from the IRS website (*www.irs.gov*).

Percentage method. Under the percentage method, the employer multiplies the value of one withholding allowance (derived from a table contained in Publication 15) by the number of allowances an employee claims on Form W-4, subtracts the total from the employee's wages and determines the amount to be withheld from another table.

➤ **Recommendation.** Be sure to obtain a new IRS Publication 15 (Circular E) in January of 2012. It will contain updated tables for computing the amount of income taxes to withhold from employees' 2012 wages and other helpful information.

Both of these methods are explained in detail in Publication 15. Each year, a church should obtain a copy of Publication 15 to ensure that the correct amount of taxes is being withheld.

Wages paid to a minister as compensation for ministerial services are exempt from income tax withholding. However, ministers who report their income taxes as employees can enter into a voluntary withholding arrangement with their church. Under such an arrangement, the church withholds federal income taxes from the minister's wages in an amount specified by the minister. Some ministers find voluntary withholding attractive, since it avoids the additional work and discipline associated with the estimated tax procedure.

A minister who elects to enter into a voluntary withholding arrangement with his church need only file a completed IRS Form W-4 (Employee's Withholding Allowance Certificate) with the church. The filing of this form is deemed to be a request for voluntary withholding.

Voluntary withholding arrangements may be terminated at any time by either the church or minister, or by mutual consent of both.

Ministers are always deemed to be self-employed for Social Security with respect to services performed in the exercise of ministry. Therefore, a church whose minister elects voluntary withholding is only obligated to withhold the minister's federal income taxes. The minister is still required to use the estimated tax procedure to report and prepay the self-employment tax (the Social Security tax on self-employed persons). However, ministers electing voluntary withholding can indicate on line 6 of Form W-4 that they want an additional amount of income taxes to be withheld from each pay period that will be sufficient to pay the estimated self-employment tax liability by the end of the year. This additional withholding of income taxes becomes a credit that can be applied against a minister's self-employment taxes on his Form 1040. It is reported by the church as additional income taxes withheld on its quarterly Form 941.

Since any tax paid by voluntary withholding is deemed to be timely paid, a minister who pays self-employment taxes using this procedure will not be liable for any underpayment penalty (assuming that a sufficient amount of taxes are withheld).

Step 7. Withhold Social Security and Medicare taxes from non-ordained employees' wages.

Employees and employers each pay Social Security and Medicare taxes (FICA) equal to 7.65% of an employee's wages. The 7.65% tax rate is comprised of two components: (1) a Medicare hospital insurance tax of 1.45%, and (2) an "old age, survivor and disability" (Social Security) tax of 6.2%. There is no maximum amount of wages subject to the Medicare tax. For 2012, the maximum wages subject to Social Security taxes (the 6.2% amount) is $110,100.

The Tax Relief and Jobs Creation Act of 2010 provides a payroll tax "holiday" for 2011. In order to stimulate the economy by increasing the take-home pay of millions of Americans, Congress reduced the employees' share of Social Security taxes from 6.2% to 4.2%. Employers still paid the full 6.2%.

The Social Security tax rates for 2011 and 2012 are as follows (this assumes that the payroll tax holiday is not extended to 2012)	Tax on Employee	Tax on Employer	Combined Tax
2011	5.65%	7.65%	13.3%
2012	7.65%	7.65%	15.3%

☞ **Key Point.** Federal law allowed churches that had non-minister employees as of July 1984 to exempt themselves from the employer's share of Social Security and Medicare taxes by filing a Form 8274 with the IRS by October 30, 1984. Many churches did so. The exemption was available only to those churches that

were opposed for religious reasons to the payment of Social Security taxes. The effect of such an exemption is to treat all non-minister church employees as self-employed for Social Security purposes. Such employees must pay the self-employment tax (SECA) if they are paid $108.28 or more for the year. Churches hiring their first non-minister employee after 1984 have until the day before the due date for their first quarterly 941 form to file the exemption application. Churches can revoke their exemption by filing a Form 941 accompanied by full payment of Social Security and Medicare taxes for that quarter. Many churches have done so, often inadvertently.

Step 8. The church must deposit the taxes it withholds.

Churches accumulate three kinds of federal payroll taxes:

- income taxes withheld from employees' wages,
- the employees' share of Social Security and Medicare taxes (withheld from employees' wages), and
- the employer's share of Social Security and Medicare taxes.

Most employers must deposit payroll taxes on a monthly or semiweekly basis. An employer's deposit status is determined by the total taxes reported in a four-quarter "lookback" period. For 2012, the lookback period will be July 1, 2010 through June 30, 2011.

Monthly depositor rule. Churches that reported payroll taxes of $50,000 or less in the lookback period will deposit their withheld taxes for 2012 on a monthly basis. Payroll taxes withheld during each calendar month, along with the employer's share of FICA taxes, must be deposited by the 15th day of the following month.

Semiweekly depositor rule. Churches that reported payroll taxes of more than $50,000 in the lookback period must deposit their withheld taxes on a semiweekly basis. This means that for paydays falling on Wednesday, Thursday or Friday, the payroll taxes must be deposited on or by the following Wednesday. For all other paydays, the payroll taxes must be deposited on the Friday following the payday.

Payment with return rule. If you accumulate less than a $2,500 tax liability during the quarter, you may make a payment with Form 941 instead of depositing monthly. See IRS Publication 15, Circular E, for more information.

☞ **Key Point.** Beginning in 2011, all deposits must be made using the Electronic Federal Tax Payment System (EFTPS). There are penalties for depositing late, or for mailing payments directly to the IRS that are required to be deposited, unless you have reasonable cause for doing so. To enroll in EFTPS, call 1-800-555-4477, or to enroll online, visit *www.eftps.gov*. For general information about EFTPS, call 1-800-829-4933.

Step 9. All employers subject to income tax withholding, Social Security and Medicare taxes, or both, must file Form 941 quarterly.

Form 941 reports the number of employees and amount of Social Security and Medicare taxes and withheld income taxes that are payable. Form 941 is due on the last day of the month following the end of each calendar quarter:

Quarter	Ending	Due Date of Form 941
1st (January–March)	March 31	April 30
2nd (April–June)	June 30	July 31
3rd (July–September)	September 30	October 31
4th (October–December)	December 31	January 31

If any due date for filing shown above falls on a Saturday, Sunday or legal holiday, you may file your return on the next business day.

Form 941 may be filed electronically. For more information, visit the IRS website at *www.irs.gov/efile* or call 1-866-255-0654.

☞ **Key Point.** Form 944 replaces Form 941 for eligible small employers. The purpose of new Form 944 is to reduce burden on the smallest employers by allowing them to file their employment tax returns annually, and in most cases pay the employment tax due with their return. Generally, you are eligible to file this form only if your payroll taxes for the year are less than $1,000. Do not file Form 944 unless the IRS has sent you a notice telling you to file it.

Step 10. Prepare a Form W-2 for every employee, including ordained ministers employed by the church.

✓ **For 2011.** Starting in 2011, the healthcare reform legislation (Affordable Care Act) required employers to report the cost of coverage under an employer-sponsored group health plan on employees' Forms W-2 . To allow employers more time to update their payroll systems, the IRS announced in late 2011 that it was making this reporting requirement optional for all employers in 2011. IRS Notice 2011-28, issued in 2011, provided further relief by making this requirement optional for smaller employers in calendar year

2012 (for Forms W-2 filed in January of 2013). Small employers are defined as those issuing fewer than 250 Forms W-2 for the previous year. The IRS has further announced that this reporting requirement will not apply to small employers after 2012 until it publishes guidance "giving at least six months of advance notice of any change to the transition relief."

The IRS has stressed that "there is nothing about the reporting requirement that causes or will cause excludable employer-provided health coverage to become taxable. The purpose of the reporting requirement is to provide employees useful and comparable consumer information on the cost of their healthcare coverage."

☞ **Key Point.** If your employees give their consent, you may be able to furnish Forms W-2 to your employees electronically. See IRS Publication 15-A for additional information. If you file your 2011 Forms W-2 with the Social Security Administration electronically, the due date is extended to April 2, 2012. For information on how to file electronically, call the SSA at 1-800-772-6270. You may file a limited number of Forms W-2 and W-3 online using the SSA website at *www.ssa.gov/employer*. The site also allows you to print out copies of the forms for filing with state or local governments, distribution to your employees, and for your records.

A church reports each employee's taxable income and withheld income taxes as well as Social Security and Medicare taxes on this form. A church should furnish copies B, C, and 2 of the 2011 Form W-2 to each employee by January 31, 2012. File Copy A with the Social Security Administration by February 29, 2012. Send all Copies A with Form W-3, Transmittal of Wage and Tax Statements. If you file electronically, the due date is April 2, 2012.

☞ **Key Point.** Be sure to add cents to all amounts. Make all dollar entries without a dollar sign and comma, but with a decimal point and cents. For example, $1,000 should read "1000.00." Government scanning equipment assumes that the last two figures of any amount are cents. If you report $40,000 of income as "40000," the scanning equipment would interpret this as 400.00 ($400)!

You may need some assistance with some of the boxes on the Form W-2. Consider the following:

Box a. Report the employee's Social Security number. Insert "applied for" if an employee does not have a Social Security number but has applied for one. If you do not provide the correct employee name and Social Security number on Form W-2, you may owe a penalty unless you have reasonable cause.

Box b. Insert your church's federal employer identification number (EIN). This is a nine-digit number that is assigned by the IRS. If you do not have one, you can obtain one by submitting a completed Form SS-4 to the IRS. Some churches have more than one EIN (for example, some churches that operate a private school have a number for both the church and the school). Be sure that the EIN listed on an employee's Form W-2 is the one associated with the employee's actual employer.

Box c. Enter your church's name, address and ZIP Code. This should be the same address reported on your Form 941.

Box d. You may use this box to identify individual W-2 forms. You are not required to use this box.

Box e. Enter the employee's name.

Box f. Enter the employee's address and ZIP Code.

Box 1. Report all wages paid to workers who are treated as employees for federal income tax reporting purposes. This includes:

1. Salary, bonuses, prizes and awards.
2. Taxable fringe benefits (including cost of employer-provided group term life insurance coverage that exceeds $50,000).
3. The value of the personal use of an employer-provided car.
4. Most Christmas, birthday, anniversary and other special occasion gifts paid by the church.
5. Business expense reimbursements paid under a non-accountable plan (one that does not require substantiation of business expenses within a reasonable time, or does not require excess reimbursements to be returned to the church, or reimburses expenses out of salary reductions). Also note that such reimbursements are subject to income tax and Social Security withholding if paid to non-minister employees.
6. If you reimburse employee travel expenses under an accountable plan using a per diem rate, include in Box 1 the amount by which your per diem rate reimbursements for the year exceed the IRS-approved per diem rates. Also note that such excess reimbursements are subject to income tax and Social Security withholding if paid to non-minister employees or ministers who have elected voluntary tax withholding. Use code L in Box 12 to report the amount equal to the IRS-approved rates.
7. If you reimburse employee travel expenses under an accountable plan using a standard mileage rate in excess of the IRS-approved rate (51 cents per mile for business miles driven during the first six months of 2011 and 55.5 cents per mile for business miles driven during the last six months of 2011), include in Box 1 the amount by which your mileage rate reimbursements for the year exceed the IRS-approved rates. Also, note that such excess reimbursements are

subject to income tax and Social Security withholding if paid to non-minister employees or ministers who have elected voluntary tax withholding. Use code L in Box 12 to report the amount equal to the IRS-approved rates.

8. Employer reimbursements of an employee's nonqualified (non-deductible) moving expenses.
9. Any portion of a minister's self-employment taxes paid by the church.
10. Amounts includible in income under a nonqualified deferred compensation plan because of section 409A.
11. Designated Roth contributions made under a section 403(b) salary reduction agreement.
12. Church reimbursements of a spouse's travel expenses incurred while accompanying a minister on a business trip represent income to the minister unless the spouse's presence serves a legitimate business purpose and the spouse's expenses are reimbursed under an accountable arrangement.
13. Churches that make a "below-market loan" to a minister of at least $10,000 create taxable income to the minister (some exceptions apply). A below-market loan is a loan on which no interest is charged, or on which interest is charged at a rate below the applicable federal rate.
14. Churches that forgive a minister's debt to the church create taxable income to the minister.
15. Severance pay.
16. Payment of a minister's personal expenses by the church.
17. Employee contributions to a health savings account (HSA).
18. Employer contributions to an HSA if includable in the income of the employee.

For ministers who report their income taxes as employees, do not report the annual fair rental value of a parsonage and do not report any portion of a minister's compensation that was designated (in advance) as a housing allowance by the church. Also, some contributions made to certain retirement plans out of an employee's wages are not reported.

☞ **Caution.** Taxable fringe benefits not reported as income in Box 1 may constitute an automatic excess benefit transaction exposing the recipient and members of the church board to intermediate sanctions in the form of substantial excise taxes.

☞ **Key Point.** Churches should not include in Box 1 the annual fair rental value of a housing allowance provided to a minister as compensation for ministerial services.

Box 2. List all federal income taxes that you withheld from the employee's wages. The amounts reported in this box (for all employees) should correspond to the amount of withheld income taxes reported on your four 941 forms.

Box 3. Report an employee's wages subject to the "Social Security" component (the 4.2% rate for 2011) of FICA taxes. Box 3 should not list more than the maximum wage base for the "Social Security" component of FICA taxes ($106,800 for 2011, and $110,100 for 2012). This box usually will be the same as Box 1, but not always. For example, certain retirement contributions are included in Box 3 that are not included in Box 1. To illustrate, contributions to a 403(b) plan by salary reduction agreement may be excludable from income and not reportable in Box 1, but they are subject to FICA taxes and accordingly they represent Social Security and Medicare wages for non-minister employees.

☞ **Key Point.** Remember that ministers (including those who report their income taxes as employees) are self-employed for Social Security with respect to their ministerial services, and so they pay self-employment taxes rather than the employee's share of Social Security and Medicare taxes.

Churches that filed a timely Form 8274 exempting themselves from the employer's share of FICA taxes do not report the wages of non-minister employees in this box since such employees are considered self-employed for Social Security purposes.

Box 4. Report the "Social Security" component (4.2% in 2011) of FICA taxes that you withheld from the employee's wages. This tax is imposed on all wages up to a maximum of $106,800 for 2011 and $110,100 for 2012. Do not report the church's portion (the "employer's share") of Social Security and Medicare taxes. Ministers who report their income taxes as employees are still treated as self-employed for Social Security purposes with respect to their ministerial services. For ministers, this box should be left blank.

✓ **For 2011.** The Tax Relief and Jobs Creation Act of 2010 provided a payroll tax "holiday" for 2011 in the form of a two percentage point reduction in Social Security taxes. This meant that the employee's share of Social Security taxes dropped from 6.2% to 4.2% of wages (the employer's share was not affected), and self-employed workers' Social Security tax dropped from 12.4% to 10.4% of self-employment earnings. (This situation remains fluid. Please visit *www.GuideStone.org/TaxGuide* for the latest updates.)

Box 5. Report a non-minister employee's current and deferred (if any) wages subject to the Medicare component (1.45 %) of FICA taxes. This will be an employee's entire wages regardless of amount. There is no ceiling. For most workers

(earning less than $106,800 in 2011 or $110,100 in 2012) the maximum amount of wages subject to the "Social Security" tax (Boxes 3 and 5) should show the same amount. If you paid more than $106,800 to a non-minister employee in 2011, Box 3 should show $106,800 and Box 5 should show the full amount of wages paid. This amount increases to $110,000 for 2012.

Box 6. Report the Medicare component (1.45%) of FICA taxes that you withheld from the non-minister employee's wages. This tax is imposed on all wages, current and deferred (if any), regardless of amount.

Box 10. Show the total dependent care benefits under a dependent care assistance program (section 129) paid or incurred by you for your employee. Include the fair market value of employer-provided daycare facilities and amounts paid or incurred in a section 125 cafeteria plan. Report all amounts paid or incurred including those in excess of the $5,000 exclusion. Include any amounts over $5,000 in Boxes 1, 3 and 5. For more information, see IRS Publication 15-B.

Box 11. Report the total amount you distributed to an employee under a non-qualified deferred compensation (NQDC) plan, including some rabbi trusts. Also report these distributions in Box 1. Unlike qualified plans, NQDC plans do not meet the qualification requirements for tax-favored status. NQDC plans include those arrangements traditionally viewed as deferring the receipt of current compensation, and include termination pay and rabbi trusts.

If you did not make distributions this year, show deferrals (plus earnings) under a NQDC plan that became taxable for Social Security and Medicare taxes during the year (but were for prior year services) because the deferred amounts were no longer subject to a substantial risk of forfeiture. Also report these amounts in Boxes 3 (up to the Social Security wage base) and 5. Do not report in Box 11 deferrals included in Boxes 3 or 5 and deferrals for current year services (such as those with no risk of forfeiture). Boxes 3 and 5 are used to report non-minister employees' wages subject to Social Security and Medicare taxes, and are generally blank for ministers with respect to compensation received for ministerial services.

The purpose of Box 11 is for the Social Security Administration (SSA) to determine if any part of the amount reported in Box 1 or Boxes 3 or 5 was earned in a prior year. The SSA uses this information to verify that it has properly applied the Social Security earnings test and paid the correct amount of benefits.

If your church made distributions and is reporting any deferrals in Boxes 3 and 5, do not complete Box 11.

For additional information, see IRS Publication 15.

Box 12. Insert the appropriate code and dollar amount in this box. Insert the code letter followed by a space and then insert the dollar amount on the same line within the box. Do not enter more than three codes in this box. If more are needed, use another Form W-2. Use capital letters for the codes, and remember not to use dollar signs or commas. For example, to report a $3,000 contribution to a section 403(b) tax-sheltered annuity, you would report "E 3000.00" in this box. The codes are as follows:

A — This will not apply to church employees.

B — This will not apply to church employees.

C — You (the church) provided your employee with more than $50,000 of group term life insurance. Report the cost of coverage in excess of $50,000. It should also be included in Box 1 (and in Boxes 3 and 5 for non-minister employees). See page 12 for additional information.

D — Generally not applicable to churches.

E — The church made contributions to a 403(b) plan pursuant to a "salary reduction agreement" on behalf of the employee. Report the amount of the contributions. While this amount ordinarily is not reported in Box 1, it is included in Boxes 3 and 5 for non-minister employees since it is subject to Social Security and Medicare taxes with respect to such workers.

F, G, H — Generally not applicable to churches.

J — You (the church) are reporting sick pay. Show the amount of any sick pay that is not includable in the employee's income because he contributed to the sick pay plan.

K — Generally not applicable to churches.

L — You (the church) reimbursed the employee for employee business expenses using the standard mileage rate or the per diem rates, and the amount you reimbursed exceeds the amounts allowed under these methods. Enter code "L" in Box 12, followed by the amount of the reimbursements that equal the allowable standard mileage or per diem rates. Any excess should be included in Box 1. For non-minister employees, report the excess in Boxes 3 (up to the Social Security wage base) and 5 as well. Do not include any per diem or mileage allowance reimbursements for employee business expenses in Box 12 if the total reimbursements are less than or equal to the amount deemed substantiated under the IRS-approved standard mileage rate or per diem rates.

M, N — Generally not applicable to churches.

P —You (the church) paid qualified moving expenses reimbursements directly to an employee. Report the amount of these reimbursements but only if they were made under a non-accountable arrangement. Do not report reimbursements of qualified moving expenses that you paid directly to a third party on behalf of the employee (for example, to a moving company), or the employee under an accountable arrangement.

R — Report employer contributions to a medical savings account on behalf of the employee. Any portion that is

not excluded from the employee's income also should be included in Box 1.

S — Report employee salary reduction contributions to a Simple retirement account. However, if the Simple account is part of a 401(k) plan, use code D.

T — Report amounts paid (or expenses incurred) by an employer for qualified adoption expenses furnished to an employee under an adoption assistance program.

W — Report employer contributions to a health savings account (HSA). Include amounts the employee elected to contribute using a cafeteria plan.

Y — It is no longer necessary to report deferrals under a section 409A non-qualified deferred compensation plan in Box 12 using code Y.

Z — Report all amounts deferred (including earnings on deferrals) under a nonqualified deferred compensation plan that are included in income under section 409A of the tax code because the NQDC fails to satisfy the requirements of section 409A. Do not include amounts properly reported on Forms 1099-MISC or W-2 for a prior year. Also, do not include amounts considered to be subject to a substantial risk of forfeiture for purposes of section 409A. The amount reported in Box 12 using code Z is also reported in Box 1.

BB — Report designated Roth contributions under a section 403(b) salary reduction agreement. Do not use this code to report elective deferrals under code E.

DD — Starting in tax year 2011, the Affordable Care Act requires employers to report the cost of coverage under an employer-sponsored group health plan. To give employers more time to update their payroll systems, IRS Notice 2010-69 made this requirement optional for all employers in 2011. IRS Notice 2011-28 provided further relief for smaller employers filing fewer than 250 W-2 forms by making the reporting requirement optional for them for 2012 as well and continuing this optional treatment for smaller employers until further guidance is issued. The reporting under this provision is for information only; the amounts reported are not included in taxable wages and are not subject to new taxes.

Box 13. Check the appropriate box.

- **Statutory employee.** Churches rarely, if ever, have statutory employees. These include certain drivers, insurance agents and salespersons.
- **Retirement plan.** Mark this checkbox if the employee was an active participant (for any part of the year) in any of the following: (1) a qualified pension, profit-sharing or stock bonus plan described in section 401(a) (including a 401(k) plan); (2) an annuity contract or custodial account described in section 403(b); (3) a simplified employee pension (SEP) plan; or (4) a SIMPLE retirement account.
- **Third-party sick pay.** Churches generally will not check this box.

Box 14. This box is optional. Use it to provide information to the church employee. Some churches report a church-designated housing allowance in this box. The IRS uses Box 14 for this purpose in a comprehensive minister tax example in the current edition of its Publication 517, but this is not a requirement.

$ **Tax Tip.** The IRS has provided the following suggestions to reduce the discrepancies between amounts reported on Forms W-2, W-3 and Form 941: First, be sure the amounts on Form W-3 are the total amounts from Forms W-2. Second, reconcile Form W-3 with your four quarterly Forms 941 by comparing amounts reported for: (1) Income tax withholding (Box 2). (2) Social Security and Medicare wages (Boxes 3, 5 and 7). (3) Social Security and Medicare taxes (Boxes 4 and 6). Amounts reported on Forms W-2, W-3 and 941 may not match for valid reasons. If they do not match, you should determine that the reasons are valid.

Step 11. Prepare a Form 1099-MISC for every self-employed person receiving non-employee compensation of $600 or more.

☞ **Key Point.** The Affordable Care Act, enacted by Congress in 2010, contained a provision eliminating the exemption of payments to corporations from the Form 1099-MISC reporting requirement for payments made after 2011. This provision ignited a firestorm of protest. Congress responded by enacting the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, which repealed the Form 1099-MISC requirement for payments made to corporations.

A Form 1099-MISC must be issued to any non-employee who is paid self-employment earnings of at least $600 during any year. For compensation paid in 2011, furnish Copy B of this form to the recipient by January 31, 2012, and file Copy A with the IRS by February 28, 2012. If you file electronically, the due date for filing Copy A with the IRS is April 2, 2012. Form 1099-MISC is designed to induce self-employed persons to report their full taxable income.

Self-employment earnings include compensation paid to any individual other than an employee. Examples include ministers who report their income as self-employed for income tax reporting purposes, some part-time custodians, and certain self-employed persons who perform miscellaneous services for the church (plumbers, carpenters, lawn maintenance providers, etc.) who are not incorporated.

To illustrate, if a guest speaker visited a church in 2011 and received compensation from the church in an amount of $600 or more (net of any travel expense reimbursement properly accounted for by the recipient) then the church must issue the person a Form 1099-MISC before February 1, 2012.

Exceptions apply. For example, a church need not issue a 1099-MISC to a corporation, or to a person who will be receiving a Form W-2 for services rendered to the church. Also, travel expense reimbursements paid to a self-employed person under an accountable reimbursement plan do not count toward the $600 figure.

To send the individual a properly completed Form 1099-MISC, the church will need to obtain his name, address and Social Security number. Churches should obtain this information at the time of the person's visit, since it often can be difficult to obtain the necessary information at a later date. IRS Form W-9 can be used to obtain this information. If a self-employed person who is paid $600 or more during the course of a year by a church refuses to provide a Social Security number, then the church is required to withhold a percentage of the person's total compensation as "backup withholding." See "Step 2," above. The backup withholding rate for 2011 and 2012 is 28%.

Other important requirements for churches

Reporting group term life insurance

You must include in the income of employees an imputed cost of employer-provided group term life insurance coverage (including death benefits under the Benefits Plan) that exceeds $50,000. You must also include the imputed cost of all employer-provided group term life insurance on the life of a spouse or dependent if the coverage provided exceeds $2,000. The imputed cost can be determined according to the following table.

Cost per $1,000 of protection for 1-month period	
Age Brackets	**Cost**
Under 25	5 cents
25–29	6 cents
30–34	8 cents
35–39	9 cents
40–44	10 cents
45–49	15 cents
50–54	23 cents
55–59	43 cents
60–64	66 cents
65–69	$1.27
70 and above	$2.06

✍ **Example.** Church A pays the premiums on a $70,000 group term insurance policy on the life of Pastor B with B's wife as beneficiary. Pastor B is 29 years old. Church A also pays the premium on a $5,000 group term policy which covers Pastor B's wife who is 30 years old. The church would have to report $21.90 as the imputed cost of the insurance provided to Pastor B and his wife. This amount is computed as follows: (1) For Pastor B, the table shows the "cost" per month for each $1,000 of group term life insurance in excess of $50,000. To compute the cost for Pastor B, take 6 cents x 12 months = 72 cents x 20 (corresponding to $20,000 of group term insurance in excess of $50,000) = $14.40. (2) In addition, the cost of the entire $5,000 of insurance provided to Pastor B's wife would have to be computed. Take 8 cents x 12 months = 96 cents x 5 = $4.80. Combine this amount with the cost of Pastor B's excess insurance to obtain the taxable amount of $19.20. Church A should include this amount with wages in Box 1 of Form W-2. This amount should also be reported in Box 12 and labeled "C." Any includable amount is subject to income tax as well as Social Security and Medicare withholding for non-minister church employees.

Form I-9

All employers are responsible for verifying the identity and eligibility of employees to work in the United States if those employees were hired after November 6, 1986. As employers, churches must complete an Employment Eligibility Verification form for each new employee. This form is better known as Form I-9.

Form I-9 is not an IRS form and is not filed with any government agency. However, it is important for churches to be familiar with this form because they can be assessed fines for failing to comply with the requirements summarized below.

Churches should:

- Ensure that each new employee completes Section 1 of the Form I-9 on or before his first day of compensated work. Review the employee's documents and fully complete Section 2 of the Form I-9 within 3 business days of the hire. Collect a Form I-9 for all employees, including ministers, hired after November 6, 1986 even if the church has no doubt that someone is a U.S. citizen. An employee signs part of the form and the employer signs part of the form. The form's instructions list documents employees may show to verify their identity and eligibility to work in the United States.
- Review the United States Citizenship and Immigration Services website (*www.uscis.gov*) for instructions that will assist you in completing the Form I-9. You can also download Form I-9 from the USCIS website.

- Collect forms from new employees only, not from all applicants. When extending job offers, churches should clarify that employment is conditioned on completion of a Form I-9. Employers should remind new employees to bring their documents the first day of work. Forms should be completed no later than the end of the employee's third day at work.
- Accept documents that appear to be genuine and relate to the employee. If churches act reasonably when deciding that a document is genuine, they will not be held responsible for a mistake. Churches may keep photocopies of original identification and verification documents with each employee form. This is not required by law but may be helpful in case there is ever a question about whether a document was genuine.
- Keep each Form I-9 for at least three years. If a church employs a person for more than three years, the church must retain the form until one year after the person leaves employment. Forms should be kept confidential.
- Upon request, show completed forms to authorized officials of the Department of Homeland Security, Department of Labor, or the Justice Department's Office of Special Counsel for Unfair Immigration-Related Employment Practices (OSC). Officials will give a minimum of three days' notice before inspection.

Churches, like any employer, can be penalized for failing to comply with the I-9 requirement. If you fail to complete, retain or make available for inspection a Form I-9 as required by law, you may face a civil penalty of not less than $110 and not more than $1,100 per violation. If DHS determines that you knowingly hired unauthorized aliens, you may be ordered to cease and desist from such an activity and pay a civil penalty of not less than $375 or more than $3,200 for the first offense. These penalties increase significantly for repeat offenses.

Annual certification of racial nondiscrimination

Churches and other religious organizations that operate, supervise or control a private school must file a certificate of racial nondiscrimination (Form 5578) each year with the IRS. The certificate is due by the 15th day of the fifth month following the end of the organization's fiscal year. This is May 15 of the following year for organizations that operate on a calendar year basis. For example, the Form 5578 for 2011 is due May 15, 2012.

A private school is defined as an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly conducted. The term includes primary, secondary, preparatory or high schools; and colleges and universities, whether operated as a separate legal entity or an activity of a church.

☞ **Key Point.** The term "school" also includes preschools, and this is what makes the reporting requirement relevant for many churches. As many as 25% of all churches operate a preschool program.

☞ **Key Point.** Independent religious schools that are not affiliated with a church or denomination, and that file Form 990, do not file Form 5578. Instead, they make their annual certification of racial nondiscrimination directly on Form 990.

Form 5578 is easy to complete. A church official simply identifies the church and the school and certifies that the school has "satisfied the applicable requirements of sections 4.01 through 4.05 of Revenue Procedure 75-50." This reference is to the following requirements:

1. The school has a statement in its charter, bylaws or other governing instrument, or in a resolution of its governing body, that it has a racially nondiscriminatory policy toward students.
2. The school has a statement of its racially nondiscriminatory policy toward students in all its brochures and catalogs dealing with student admissions, programs and scholarships.
3. The school makes its racially nondiscriminatory policy known to all segments of the general community served by the school through the publication of a notice of its racially nondiscriminatory policy at least annually in a newspaper of general circulation or through utilization of the broadcast media. However, such notice is not required if one or more exceptions apply. These include the following: (1) During the preceding three years, the enrollment consists of students at least 75% of whom are members of the sponsoring church or religious denomination, and the school publicizes its nondiscriminatory policy in religious periodicals distributed in the community. (2) The school draws its students from local communities and follows a racially nondiscriminatory policy toward students and demonstrates that it follows a racially nondiscriminatory policy by showing that it currently enrolls students of racial minority groups in meaningful numbers.
4. The school can demonstrate that all scholarships or other comparable benefits are offered on a racially nondiscriminatory basis.

Filing the certificate of racial nondiscrimination is one of the most commonly ignored federal reporting requirements. Churches that operate a private school (including a preschool), as well as independent schools, may obtain copies of Form 5578 by calling the IRS forms number (1-800-829-3676).

Charitable contribution substantiation rules

Several important rules apply to the substantiation of charitable contributions, including the following:

Cash contributions. All cash contributions, regardless of amount, must be substantiated by either a bank record (such as a cancelled check) or a written communication from the charity showing the name of the charity, the date of the contribution and the amount of the contribution. The recordkeeping requirements *may not be satisfied by maintaining other written records*. In the past, donors could substantiate cash contributions of less than $250 with "other reliable written records showing the name of the charity, the date of the contribution and the amount of the contribution" if no cancelled check or receipt was available. This is no longer allowed. As noted below, additional substantiation requirements apply to contributions (of cash or property) of $250 or more, and these must be satisfied as well.

Substantiation of contributions of $250 or more. Donors will not be allowed a tax deduction for any individual cash (or property) contribution of $250 or more unless they receive a written acknowledgment from the church that satisfies the following requirements:

1. The receipt must be in writing.
2. The receipt must identify the donor by name (a Social Security number is not required).
3. For contributions of property (not including cash) valued by the donor at $250 or more, the receipt must describe the property. No value should be stated.
4. The receipt must state whether or not the church provided any goods or services to the donor in exchange for the contribution, and if so, the receipt must include a good faith estimate of the value of those goods or services.
5. If the church provides no goods or services to a donor in exchange for a contribution, or if the only goods or services the church provides are "intangible religious benefits," then the receipt must contain a statement to that effect.
6. The written acknowledgment must be received by the donor on or before the earlier of the following two dates: (1) the date the donor files a tax return claiming a deduction for the contribution, or (2) the due date (including extensions) for filing the return.

Quid pro quo contributions of more than $75. If a donor makes a "quid pro quo" contribution of more than $75 (that is, a payment that is partly a contribution and partly a payment for goods or services received in exchange), the church must provide a written statement to the donor that satisfies two conditions:

1. The statement must inform the donor that the amount of the contribution that is tax-deductible is limited to the excess of the amount of any money (or the value of any property other than money) contributed by the donor over the value of any goods or services provided by the church or other charity in return. The statement must provide the donor with a good faith estimate of the value of the goods or services furnished to the donor.
2. A written statement need not be issued if only "token" goods or services are provided to the donor. For 2011, token goods or services were those having a value not exceeding the lesser of $96 or 2% of the amount of the contribution. This amount is adjusted annually for inflation. In addition, the rules do not apply to contributions in return for which the donor receives solely an intangible religious benefit that generally is not sold in a commercial context outside the donative context.

Gifts of property. Several additional rules apply to the substantiation of contributions of non-cash property valued by the donor at $500 or more. Donors who claim a deduction over $500 but not over $5,000 for a non-cash charitable contribution must retain certain records and complete the front side (Section A, Part I, and Part II if applicable) of IRS Form 8283 and enclose the completed form with the Form 1040 on which the charitable contribution is claimed.

Special rules apply to donations of cars, boats and planes valued by the donor at more than $500. The church must provide the donor with a written acknowledgment, and send a Form 1098-C to the IRS containing required information about the donation. The Form 1098-C can be used as the written acknowledgment that must be issued to a donor. See the instructions to Form 1098-C for more information.

For contributions of non-cash property valued at more than $5,000, a donor must obtain a qualified appraisal of the donated property from a qualified appraiser and complete a qualified appraisal summary (Section B of Form 8283) and have the summary signed by the appraiser and a church representative. The completed Form 8283 is then enclosed with the Form 1040 on which the charitable contribution deduction is claimed.

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Helpful Numbers and Resources

- Request IRS forms — **1-800-TAX-FORM** or **1-800-829-3676**
- IRS homepage — ***www.irs.gov***
- ***www.ChurchLawandTax.com*** — A Christianity Today website featuring Richard Hammar.
- ***www.YourChurchResources.com*** — An online store with church management resources to keep your church safe, legal and financially sound.
- **Church & Clergy Tax Guide** — Richard Hammar's comprehensive tax guide published annually by Christianity Today International.

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