

Dear Pastor:

Enclosed is general income tax information for those in the ministry. You may copy and distribute it as you see fit.

The income tax laws for those in the ministry are very different from other occupations. There is a wider range of business deductions, a unique way to compute self-employment tax, and you are entitled to deduct the money you spend to provide housing for yourself and your family (in addition to deducting the interest and taxes on your home). Because of this, very few tax preparers and IRS agents understand minister's tax returns.

The IRS is conducting more and more correspondence audits. They ask the taxpayer to mail in all receipts to verify deductions claimed. A minister will usually be audited on contributions and ministry related expenses. Please read the information in this letter and be sure to keep good records.

Contributions to Charities

In order to claim a contribution for a monetary contribution you must have a receipt, cancelled check or bank statement verifying the contribution before you can put it on your return. Therefore, the church must stress the importance of using envelopes for cash donations. In the past we were able to estimate these amounts and put them on the return. No longer. No receipt – No deduction.

Housing Allowance

Each licensed pastor should submit their estimated housing allowance to the church council or board for approval. This must be done before the money is actually spent, so do it now if you have not done it already. There is no official IRS form for this purpose, however, I have enclosed a form that you can use which lists the various items qualified as housing allowance. **The most important thing to remember about a housing allowance is that you cannot deduct more than you have estimated with your church.** Therefore, always overestimate this amount and revise it during the year if needed.

Your church council, when approving the housing allowances for the following year, should add the following wording to their minutes, *"these estimated amounts for housing allowance will continue, year after year, unless modified and approved by the church council."* This wording will protect you if the approval does not happen until January or February.

<p>Tax Tip: The church should not report the amount of your estimated housing allowance on your W-2. The IRS states in their instructions that this is an <u>optional</u> entry, so you are not required to show it</p>
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Expense Reimbursements

Some ministers receive a flat auto allowance, education allowance, etc. from their church without having to submit receipts or documentation to support the expenses. In this case, the allowance must be added to your income at the end-of-the-year (either on your W-2 or 1099). You then deduct the expenses on your tax return.

An "accountable plan" is much better than the above. With an accountable plan the minister submits an expense report to the church and the church reimburses the minister to the actual auto expenses (55 cents per mile in 2009), entertainment, books, etc. This removes all of these deductions from the minister's tax return, thus making it less susceptible to an IRS audit.

If you want more details on an accountable reimbursement plan, please contact me in our Northridge office.

W-2 Form or Form 1099

Most ministers should be on a W-2 Form instead of a Form 1099. Your audit potential is much less and there are other benefits. If you currently receive a Form 1099 from your church, please contact me so that we can discuss changing to a W-2 form. We can still do this for last year if we get it done prior to March 11.

Electing Out of Social Security

Newly licensed ministers can elect out of social security if they meet certain requirements. This means that the minister does not have to pay social security taxes (currently 15.3%) on income earned in the ministry. The requirements are listed below.

1. The election cannot be made based on economic considerations.
2. You must be conscientiously opposed to (or because of religious principles, opposed to) the acceptance of any public insurance that makes payments in the event of death, disability, old age or retirement.
3. You must be a licensed, commissioned or ordained minister.
4. You must file Form 4361 and required supporting statements within 2 years of first receiving more than \$400 income in the ministry.

The IRS will contact you to verify that you are entitled to elect out of social security, so be careful in making this decision. Some denominations take a stance against this election.

Remember that social security provides more protection than just income at retirement. If you elect out, be sure to have term life insurance, disability insurance and planned savings for retirement.

Withdrawals of Retirement Benefits Can Be Tax-Free

If a minister withdraws retirement benefits from a denomination sponsored plan they can qualify as housing, and be completely free of tax if you meet the other requirements for housing. The key is to have your money in a denomination plan. For example, if you are a member of the International Church of the Foursquare Gospel, it is a good idea to transfer all retirement accounts into the ICFG retirement plan prior to retirement so you can qualify for a housing allowance. For more information, contact Jonathan Phillips at headquarters.

Ministry Related Expenses

The tax law states that expenses that are ordinary and necessary in the normal pursuit of your trade or business are deductible. As a minister, the question is, "What is ordinary and necessary?" The answer is different depending on your role and responsibilities in your church. The more people contact you have, the more deductions you qualify for.

A worksheet listing all the possible deductions for ministers is enclosed. Not all of these deductions may apply to you. To help you decide if an item is deductible, answer the following questions as they relate to each category of deductions.

1. Is it normal for a minister to incur this type of expense?
2. Does the expense help you in ministering to your congregation?
3. Was the primary purpose of the expense to help you minister versus a personal expenditure?
4. Did the expense improve your skills as a minister?
5. Did other members of your family benefit from the expense. If so, show only your portion.

Even if you do not have receipts for all of the following deductions, if you feel you are entitled to the deduction, based on the information contained herein, please estimate how much you spent and we will discuss this when you are in for your appointment.

I trust this information will be of benefit to you in preparing for your tax appointment.

Sincerely,

Jon Cook, E.A.

P.S. If you enter your ministry expenses on the enclosed worksheets, please do not also enter them on the organizer.

Ministry Related Expenses

Admissions and Tickets must relate to your job description and be actually used by you in the counseling and teaching you do. Make notes as to what you learned from the movie, concert, etc. and how it could be used on "the job." The best example of this is when you keep a file with the receipt and notes you made about the movie, concert, etc. that you could use in a teaching.

These deductions are without a doubt in the gray area and require documentation if you are audited.

Live Concerts	\$ _____
Movies	_____
Plays	_____
Movie Rentals	_____
Movie Purchase	_____
Music Purchase	_____

Auto Expense is deductible as long as you document your mileage. Keep a daily log of your business mileage (where, who, and how many miles). Use your appointment book. If you have not kept good records, start now and reconstruct for last year. Your mileage from home to church and back home is commuting and is not deductible.

Airport	_____
Conferences	_____
Education	_____
Entertainment	_____
Hospital visitation	_____
Library/Research	_____
Meetings	_____
Speaking	_____
Travel	_____

Books used for research, teaching, etc. This can include secular books if they are used in your teaching or ministering. The best documentation you can have is notes on how you used the book in a teaching.

Amount _____

Cable TV is not for everyone. When you have children, the question is, "How often do you watch TV?" To be deductible you should be watching stations you cannot get on regular TV (i.e., CNN and CBN) and that you use some of what you see in teaching or counseling.

Monthly Cable Fee _____

Camera and Film if used for church activities exclusively. Probably not deductible if you have small children.

Camera _____
Film _____

Cards sent to church members.

Cards _____
Postage _____

Computer and Computer Supplies is a hard deduction to get now. If you are an employee, a computer is only deductible if your employer required you to purchase it.

Computer _____
Supplies _____
Software _____

Convention Expenses are deductible as long as it is ordinary and necessary for you to attend.

Lodging _____
Meals _____
Registration _____
Travel _____

Credit Card Membership Fee is allowed if that credit card is used exclusively for church related purchases.

Amount _____

Education Expenses are deductible if they (1) do not qualify you for a new trade or profession, (2) improve and maintain your skill on the job, and (3) are not part of the minimum requirements of your job.

Books _____
Parking _____
Supplies _____
Tuition _____

Entertainment includes meals out and meals in your home where "business" is discussed. For most ministers, counseling of some type happens when you are out with members of your church. To be deductible, you must pay the entire cost of the meal. If you split the check at a restaurant, none of it is deductible. You must keep records of who you took out, what was discussed and the receipt if it is more than \$75. If you did not keep detailed records, estimate what you spent below.

Restaurant - Breakfast	_____
Lunch	_____
Dinner	_____
At Home - Lunch	_____
Dinner	_____
Small Groups	_____
Staff	_____
Christmas	_____

Equipment Rental that is used for church business. Amount _____

Gifts to members of your church are limited to \$25 per person or couple. This includes birthdays, showers, anniversary, Christmas, etc. Many times you send cards for birthdays, anniversaries and births - these are deductible.

Amount _____

Internet used for business Amount _____

License Amount _____

Music, as long as it is used by you on the job. A youth pastor is the best example of someone who qualifies for these expenses (i.e., knowing the words to secular as well as Christian music and being able to explain to youth the impact of listening to certain music).

CDs	_____
Cassettes	_____
Sheet Music	_____
Blank Tapes	_____
Downloads	_____

Music Lessons are deductible if you use your musical skills on your job. Some of your congregation may even encourage this expenditure. Amount _____

Office Supplies Amount _____

Parking while at conferences, seminars, hospital visitation, library, prayer meetings, schools, airports (while traveling on business), etc. Amount _____

Piano Tuning Amount _____

Postage used for church related mail. Amount _____

Seminars Amount _____

Subscriptions if they help you on the job and you use the information in teaching or counseling. The newspaper only if you would not buy it except for the fact you are in ministry and need to keep current with the culture and world events.

Magazines _____
Newspapers _____
Newsstand Purchases _____

Telephone expense is only for toll calls. Amount _____

Travel can be deducted if the primary purpose of the trip is ministry related. A small amount of personal pleasure is O.K. Traveling to visit is generally never deductible. Keep good records of the amount of time spent on business.

Airfare _____
Lodging _____
Meals _____
Taxi _____

Questions you have on your taxes:

Computation of Unused Housing Allowance

Client: _____

Estimated Housing Allowance for the year \$ _____

Actual expenditures for the year:

House payments/Rent/Down Payment \$ _____

Association/Homeowner Dues/Special Assessment _____

Real Estate Taxes - not included in payment above _____

Loan/Re-finance/Purchase costs-Paid separately _____

Insurance (on home and contents) _____

Utilities (Water/Power/Gas/Phone/Cable) _____

Cleaning/cleaning supplies _____

Repairs and maintenance _____

Lawn/landscape/gardening/pest/pool _____

Household furnishings _____

 Appliances (TV, VCR, stereo, dishwasher, etc.) _____

 Decorator items (drapes, pictures, towels, etc.) _____

 Furniture (sofa, bed, chairs, tables, etc.) _____

 Miscellaneous (dishes, cookware, piano, rugs, etc.) _____

 Christmas tree/Christmas decorations _____

Improvements _____

 Roof/Block Walls/Sod/Sprinkler/AC/Heating _____

 Addition/Pool/Garage Door/Concrete _____

Total housing allowance spent during the year \$(_____)

Unused Housing Allowance \$ _____

Questionnaire for Pastors - New Clients

(Please fill-out prior to your appointment)

Dates that you were licensed _____ ordained _____ .

Year you first earned at least \$400 from the ministry: _____

Social Security

Have you filed Form 4361 to opt out of the social security system? ___ Yes ___ No

If yes, please bring or send a copy of the approved form to us for our files.
If no, and you are thinking of doing it, please review the form to see the requirements. They are very specific and not everyone qualifies to opt out. You must file Form 4361 within 12 months after the year in which you first earn at least \$400 in income from the ministry.

If you have not opted out of social security, you are liable for self-employment tax on your total income, including your housing allowance, less your business expenses.

Housing Allowance

How much was your housing allowance for last year? \$ _____

How much of the above did you actually spend? \$ _____

If you live in a church provided home:

What is the fair rental value of that home? \$ _____

How much did the church pay for utilities, repairs, maintenance, etc. \$ _____

Do you have your church council approve your housing allowance each year? Yes
No
(If no, you need to do so to insure its deductibility).

Expenses

Are you reimbursed for your auto expenses? ___ Yes ___ No

Are you reimbursed for your entertainment expenses? ___ Yes ___ No

Are you reimbursed for your other business expenses? ___ Yes ___ No