

Tax Issues for Clergy

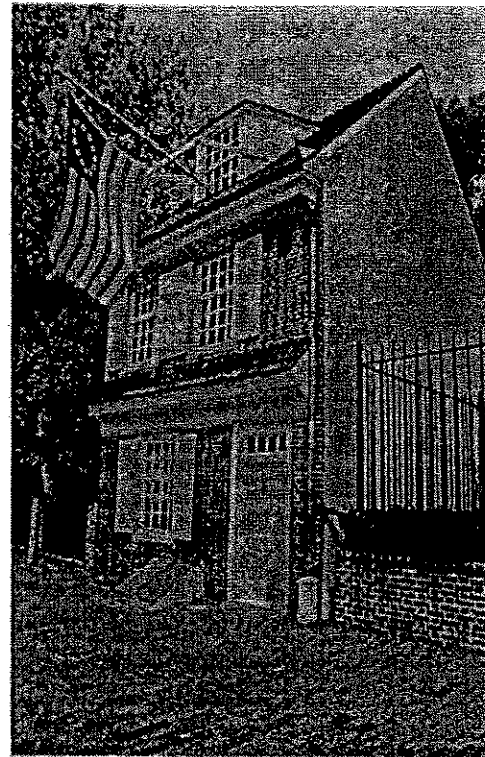
Harvey J. Berger, CPA, JD
Grant Thornton LLP

The Greek Orthodox Archdiocese of America
Clergy Laity Conference
July 1, 2002

Today's Presentation

1. Housing Allowances
2. Expense Reporting and Reimbursement
3. Retirement
4. Social Security
5. Education Incentives

Housing Allowances



General Tax Rules

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

- the rental value of a home furnished to him as part of his compensation; or
- the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home.

Interpretations and Rules

- Annual designation must be made before compensation is earned. Appendix includes a Sample Housing Allowance Designation Letter
- Amount of the allowance which is not taxable is limited to actual expenses.
- If the housing allowance exceeds actual cost, the excess is taxable
- Minister can still deduct interest and taxes

Clergy Housing Clarification Act of 2002

- Signed by President Bush on May 20
- Adds limitation to current tax law -
 - Exclusion cannot exceed the "fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities."
 - Applies for 2002 and later years

Clergy Housing Clarification Act of 2002

- It also declares that "no person shall be subject to the limitations added to section 107 of such Code by this Act for any taxable year beginning before January 1, 2002."
- It will apply if you previously filed and limited the exclusion, or you file after April 16, 2002 for 2001 or prior
- No amended returns

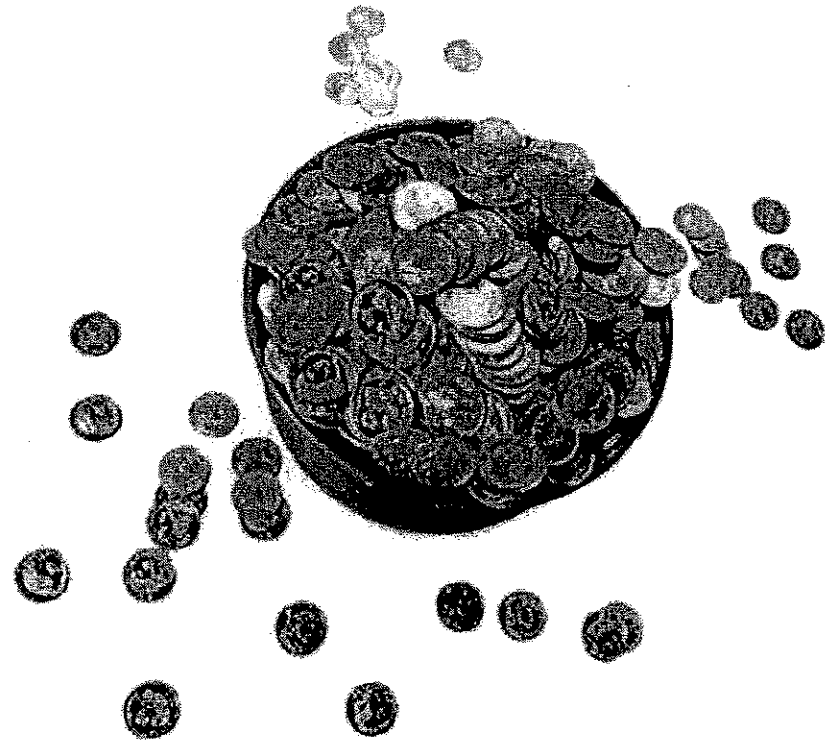
Income Tax Reporting Issues

- Housing allowances should be reported in Box 14 of Form W-2.
- The allowance is not reported as taxable income on Form 1040, unless the amount paid exceeds the lesser of:
 - (1) the fair rental value of the home, or
 - (2) the actual housing expenses
- The allowance is subject to self-employment tax and should be reported on Form 1040, Schedule SE.

What To Do?

- You should have already designated a housing allowance amount for 2002.
 - You will have to get a determination of fair rental value. (e.g., a real estate broker's opinion)
- If you haven't filed your 2001 tax return yet, you will need to determine fair rental value for 2001

Expense Reporting and Reimbursement



Expense Reporting and Reimbursement – Accountable and Nonaccountable Plans

- Accountable Plans – A reimbursement arrangement that includes all three of the following:
 - All reimbursed expenses have a business connection
 - All reimbursed expenses are adequately accounted for within a reasonable time
 - Any excess reimbursement is returned
- Nonaccountable Plans – A reimbursement or expense allowance arrangement that does not meet one of the three rules for Accountable Plans.

Ways to Handle Expenses – Accountable Versus Nonaccountable Plans

	Accountable Plans	Nonaccountable Plans
Who pays?	Clergy pays business expenses. Church reimburses clergy.	Church pays clergy a set amount. Clergy pays business expenses.
Are receipts required?	Yes – IRS requires receipts for expenses over \$75	Yes – IRS requires receipts for expenses over \$75

Accountable Versus Nonaccountable Plans – Income Tax Consequences

	Accountable Plans	Nonaccountable Plans
Is the payment taxable?	No – payment is not taxable and should not be reported on Form W-2.	Yes – payment is taxable and should be reported on Form W-2, Box 1.
Are the expenses deductible?	No. The clergy cannot deduct the reimbursed expenses.	Yes – the expenses are deductible and reported on Form 2106.

Accountable versus Nonaccountable Plans – Advantages and Disadvantages

	Accountable Plans	Nonaccountable Plans
Advantages	<ul style="list-style-type: none"> •Simpler income tax reporting •Avoids problems of the <i>Deason</i> case. 	<ul style="list-style-type: none"> •Predetermined expense allowance amount. •Less recordkeeping for church.
Disadvantages	<ul style="list-style-type: none"> •Additional recordkeeping for church. 	<ul style="list-style-type: none"> •Additional taxable income for clergy. •Clergy's business expense deduction may be limited.

Common Deductible Expenses

- Books and periodicals used in parish-related work.
- Computer equipment used for parish-related work. Deductible amount is limited, based on the business use percentage.
- Cost and care of vestments
- Cost of meals and entertainment in connection with parish activities
- Gifts, subject to limitations

Automobile Expenses – What is deductible?

- The cost of local transportation is deductible.
- Deductible local transportation includes the cost of:
 - Traveling from the parish to a meeting
 - Visiting parishioners at home or in the hospital
 - Traveling from home to a temporary workplace
- Commuting costs are not deductible and should not be reimbursed
 - Commuting is going from home to regular place of business

Automobile Expenses –How much is deductible?

- Deductible amount is determined by a mileage allowance or actual expenses.
- The mileage allowance is \$.365 per mile in 2002
- Alternatively, clergy can deduct a proportion of actual expenses:
 - total expenses x business miles/total miles
- Adequate records must be kept to substantiate the deductible amount. See Appendix for Recordkeeping Summary.

Retirement Plans



Plans Available

- Plans available for employees
 - Pension plan
 - Section 403(b) plans (similar to 401(k) plan)

Section 403(b) Plan

- Employees can defer some of their compensation
- Up to \$11,000 for individuals under 50
- Up to \$12,000 for individuals over 50
- Section 403(b) investments are somewhat limited
- Employer can provide some matching funds, but these are subject to qualified plan rules

Distribution Events

- Contributions under a plan may not be distributed earlier than:
 - separation from service;
 - death;
 - disability;
 - attainment of age 59-1/2, or
 - hardship.

Minimum Required Distributions

- A participant who has terminated employment and who has attained age 70-1/2 must begin taking distributions
 - Based on life expectancy
 - Can use joint lives with second beneficiary
 - Recent regulations have lengthened periods
 - Can always take more than minimum
- Failure can lead to 50% penalty

Social Security



General Rules

- Unlike other employees, ordained ministers can claim exemption from Social Security and Medicare taxes
 - Minister must be ordained
 - Ordaining body must be a tax exempt church
 - Must be conscientiously opposed accepting public insurance benefits due to religious principles
 - Files Form 4361 with return for second year of SE earnings as a minister

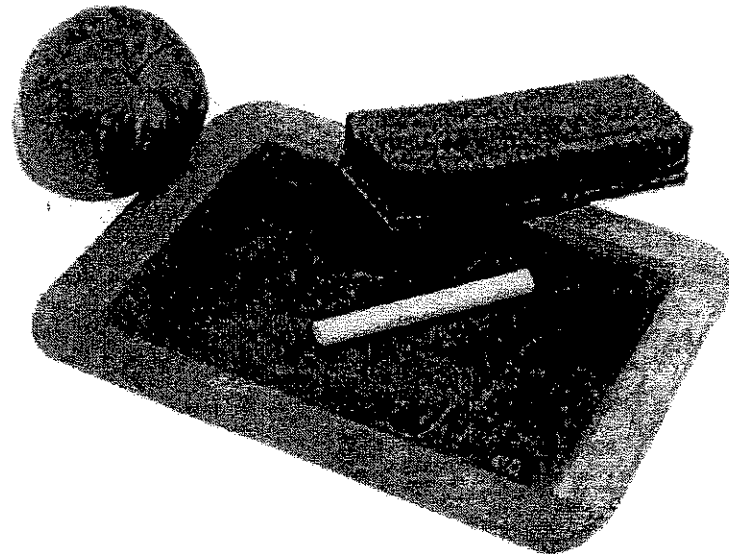
General Rules

- If not exempt, minister files under self-employment tax system
 - Pays tax on Form 1040, Schedule SE
 - Tax is based on 15.3% of self employment income
 - Gets a deduction for half the tax
 - Still more than employees pay
- For 2002 - FICA part (12.4%) up to \$84,900
Medicare part (2.9%) on total income

Revocation of Exemption

- Exemption is irrevocable
- Congress allowed a limited window to revoke exemption
 - File Form 2031 by 4/15/02
 - Extended if you requested an extension to file your 2001 return
- This is the third time Congress has allowed revocation of exemption

Education Incentives



Qualified State Savings Plans

- Certain states and, beginning in 2002, educational institutions maintain programs that allow you to either prepay a student's tuition or contribute to an account established for paying a student's qualified higher education expenses.
- Distributions are excludable from gross income to the extent that the distribution is used to pay for qualified higher education expenses.
- Earnings on contributions are not taxed.

Qualified State Savings Plans

- For information on a specific QTP, you will need to contact the state agency or educational institution that established and maintains it.
- Appendix includes a summary of the state programs current in place.

www.upromise.com

 **upromise** *the way to save for college*

my account

how it works

grocery

services

stores

restaurants

shop online

529 plans



Get college savings when you buy
gas, **groceries** and more. Every day.



[Join Free Today >>](#)

These companies and thousands more give you money back as college savings.



ExxonMobil

citi



toysrus



Coca-Cola

[View All Companies](#)

Educational IRA's: Coverdell Education Savings Account

- You may be able to establish a Coverdell ESA to finance the qualified education expenses of a designated beneficiary
- Contributions, up to \$2,000 per account, are made with after- tax dollars
- Any individual can contribute to a Coverdell ESA if the individual's *modified adjusted gross income* for the year is less than \$110,000. For individuals filing joint returns, that amount is \$220,000 for 2002.
- Generally, withdrawals are tax free if they are not more than the beneficiary's qualified education expenses for the tax year.
- Amounts may be used for elementary and secondary education expenses

Student Loan Interest Deduction

- The student loan interest deduction can reduce the amount of your income subject to tax by up to \$2,500.
- This deduction is taken as an adjustment to income. This means you can claim this deduction even if you do not itemize deductions on Schedule A (Form 1040).
- Interest paid during entire term of loan is now deductible subject to limitations
- Adjusted gross income phase out ranges are \$50,000 - \$60,000 for single taxpayers and \$100,000 - \$130,000 for married taxpayers

Deduction for Higher Education Expenses

- New above-the-line deduction for qualified tuition and related expenses available to individual taxpayers beginning after December 31, 2001
- Amount of the deduction allowable is \$3,000 in 2002 and 2003 and is available to taxpayers whose AGI does not exceed \$65,000 (\$130,000 for joint filers)
- Deduction terminates and will not be available in tax years after December 31, 2005

Deduction for Higher Education Expenses

- Tuition and fees a student is *required* to pay “out-of-pocket” in order to be enrolled at or attend the University are qualified expenses.
- Charges and fees associated with the following are not qualified:
 - room and board
 - student activities and athletics
 - insurance
 - books
 - equipment
 - transportation
 - similar personal, living, or family expenses

HOPE Scholarship Credit

- Credit of up to \$1,500 for eligible students' qualified education expenses
- Eligible students include college freshman and sophomores who are taking at least half the normal full time work load
- Credit is phased out for higher income taxpayers :
for single taxpayers, the phase out begins at \$40,000; for married taxpayers, the phase out begins at \$80,000

Lifetime Learning Credit

- Credit of up to \$1,000 for qualified education expenses; \$2,000 after 1/1/03
- Qualified education expenses include degree and nondegree programs. Nondegree programs must be taken to acquire or improve job skills.
- Credit is phased out for higher income taxpayers :
for single taxpayers, the phase out begins at \$40,000; for married taxpayers, the phase out begins at \$80,000