

**FREQUENTLY ASKED
QUESTIONS:**

**PERSONNEL/ PAYROLL
MATTERS**

**GENERAL COUNCIL OF THE ASSEMBLIES OF GOD
DIVISION OF THE TREASURY**

FREQUENTLY ASKED QUESTIONS CONCERNING PERSONNEL AND PAYROLL MATTERS

QUESTIONS ADDRESSED IN THIS PAMPHLET

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What are the rules for giving church staff a W-2 or 1099?

Are all ministers self-employed?

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How do we determine whether staff are to be treated as employees or self-employed?

Although the IRS has not published clear guidelines to assist in determining whether a minister is an employee of the church versus being self-employed, there are at least four sets of standards that have been used to legally determine whether an individual should rightly be classified as an employee versus an independent contractor. Regardless of which of these tests is used, it is safe to say that the vast majority of ministers serving in local churches ought to be classified as employees of the church. There are exceptions to this and these will be discussed later in this article.

One helpful test to determine the employment status of an individual is the “7-Factor Test”. It should be noted that this is not simply used as a “yes” versus “no” tabulation with the majority response determining the correct employment status of the individual. Rather, all of the factors are weighed and each may carry more or less importance based upon the circumstances of the work being performed.

FACTOR	EXPLANATION
1. How much control does the employer have over the details of the work of the potential employee?	The greater control that the church has with regard to the work and expectation with regard to how it is carried out (such as ministerial responsibilities of preaching, teaching, keeping of office hours, visitation, etc.), the more likely the worker is to be classified as an employee.
2. Which party pays for the tools and facility used in the work?	If the church supplies an office, computer, phones, etc., the worker is more likely to be classified as an employee.
3. Can the individual earn additional profit or incur loss in this work?	If the worker is provided a salary as compensation, he/she is more likely to be classified as an employee. Self-employed workers would be more likely to personally, financially benefit from the business prospering.
4. Does the employer have the right to discharge the worker?	If the congregation, church board or church management can remove or discharge a worker, that worker is more likely to be an employee.
5. Is the individual’s work a part of the church’s regular “business?”	If the worker performs work that furthers the church’s regular or customary “business,” they are more likely to be an employee.
6. How permanent is the work relationship?	A church worker hired for a temporary assignment is less likely to be considered an employee than one hired for an extended or undetermined amount of time.
7. Do both parties believe they are in an employer/employee relationship?	The church issuing a W-2 to a worker and the offering and receiving of fringe benefits are both indicators that parties believe they are entering into an employer/employee relationship.

As we stated, the vast majority of church-pastor relationships ought to be considered employer-employee relationships. Exceptions to this may occur when a pastor is not supervised by a board of the local church or perhaps is compensated by an organization other than the congregation to which he/she is assigned and serves.

What are the rules for giving church staff a W-2 or 1099?

Whether church staff receive a W-2 or 1099-MISC depends entirely upon whether the staff member is considered an employee of the church or a self-employed contractor. Employees of the church always receive a Form W-2 from the church to report their compensation and withholdings. Staff considered to be self-employed contractors of the church will receive a Form 1099-MISC if they have been paid \$600 or more by the church. If they have been paid less than \$600, it is not necessary for the church to issue a 1099-MISC to an individual, although the payments would still need to be reported as income by the contractor. (See FAQ “How do we determine whether staff are to be treated as employees or self-employed?”)

Are all ministers self-employed?

The notion that all ministers are self-employed is widely communicated but, unfortunately, poorly understood by many. First, to determine whether a minister is to be treated as an employee of the church or self-employed, the church should examine the criteria set out for making this determination. (See FAQ “How do we determine whether staff are to be treated as employees or self-employed?”) Whether a minister is to be treated as an employee or self-employed follows the same rules as other types of employees. In the vast majority of cases, a minister on staff at a church will be considered an employee of the church.

Where ministers are treated uniquely is with regard to self-employment tax (the equivalent of FICA and Medicare – Social Security). Ministers are always required to report and pay self-employment tax on Schedule SE of their tax return (unless they have an approved exemption from self-employment tax).

Ministers do not have the employee one-half of FICA and Medicare withheld, matched by the employer's half, and shown as FICA earnings and withholding and Medicare earnings and withholding on their W-2 Form. The amount that a minister will owe for self-employment tax will be calculated on his/her tax return on Schedule SE submitted as an attached schedule with his/her federal income tax return Form 1040.

So, with regard to the original question "are all ministers self-employed," the answer is both "yes" and "no." If a minister meets the criteria as an employee, then he/she will be treated as an employee for purposes of income taxes. Earnings after deduction of the housing allowance would be reported in Box 1 (wages) of the Form W-2 issued to the minister by the church. However, with regard to FICA and Medicare tax, the minister is treated as self-employed. The minister is responsible for reporting and paying his/her own self-employment tax similar to a person owning their own business.

How do we adopt a housing allowance for our pastoral staff?

Ideally, a minister's housing allowance will be adopted and documented in the minutes of a church board meeting held prior to the beginning of the calendar year for which the allowance is to be paid. A minister's housing allowance must be designated by the board in advance of the allowance being paid – retroactive designations are not permitted. So, if a board fails to adopt a housing allowance for a minister until February 1 of the year, the designation can only apply to the minister's pay after that date and not before. The housing allowance may be adopted as a yearly, monthly or weekly fixed dollar amount or could be adopted as a percentage of the minister's total pay.

As a safeguard, a church board may wish to adopt a "safety net" housing allowance for all its ministers on staff that would be effective unless and until a specific housing allowance is designated for the ministers for any particular year. This "safety net" designation would still allow for the housing allowance to be in effect in case the board failed to adopt housing allowances for the ministers. This default could be a stated percentage of the ministers' pay. (See Exhibit 1 for a sample housing allowance form.)

The maximum amount of the housing allowance is limited in amount by the tax code. (See the FAQ “Are there housing allowance maximums that we are not permitted to exceed?” for a discussion of these limits.)

Does a pastoral staff member need to be credentialed to receive a housing allowance?

Yes. Although the tax code indicates that the employee must be “ordained” in order to be considered a minister for employment purposes, this would translate to meaning that the employee must be credentialed at any level in the Assemblies of God Fellowship. This would include ordained, licensed, certified and the local church credential. Any of these levels of credential would qualify the employee to receive a portion of their salary as housing allowance if the other requirements to be treated as a minister for tax purposes are met.

Are there housing allowance maximums that we are not permitted to exceed?

While the tax code does not limit the amount of a minister’s salary that may be designated as the housing allowance, there are three stated maximum limits that govern what may be claimed by the minister as his/her housing allowance. The maximum amount that a minister may claim as his/her housing allowance is limited to the lesser of three amounts:

1. The amount of housing expenses that the minister has paid during the calendar year,
2. The amount of the housing allowance adopted or designated by the church board for the minister, or
3. The fair rental value of the minister’s home, furnished plus utilities.

Item 1, “housing expenses that the minister has paid during the calendar year,” represents actual payments or purchases made in cash, by check or by bank credit or debit cards during the calendar year for eligible housing expenses. Expenses purchased on store credit cards count as housing expenses in the year the payments are made to pay the balance on the card. For examples of what expenses may be counted when computing the housing allowance exclusion, see Exhibit 3.

Item 2, "housing allowance adopted or designated by the church board" is simply that amount recorded in the board minutes as the approved housing allowance for the minister. If amendments to the approved housing allowance have been made and approved in the minutes, these are also to be considered.

Item 3, "fair rental value of the minister's home, furnished plus utilities" is a bit more complicated. This is typically interpreted to mean the rental value of the furnished minister's home plus the cost of utilities. While the IRS has not provided guidance on the manner in which this amount should be established, there are some measurements that are generally accepted. First, the minister may have a realtor provide an informal opinion of what the house would rent for. Second, the minister may obtain a formal appraisal from a real estate appraiser to establish this amount. Third, some have used what is termed the "one percent rule" that assumes that a house's monthly rental value is approximately equal to one percent of its total value. This third method may or may not provide a realistic rental value. Once a rental value for the furnished home is established, you would then add the costs paid during the year for utilities (electricity, gas, water, sewer, trash pickup, local telephone charges, internet access fees, basic cable television charges).

Of these three amounts, the minister would be entitled to claim the lowest of the three as their minister's housing allowance. If the housing allowance deducted on the minister's W-2 Form (item 2) was greater than either items 1 or 3, the minister would be required to add back the portion of the designated housing allowance that could not be claimed as income on line 7 of his/her Form 1040.

Can a minister's housing allowance be changed during the year?

A minister's designated housing allowance may be changed or altered during the year by action of the church board. This change can only be effective prospectively and cannot change the designation of pay received earlier in the year by the minister.

Does the church pay Social Security on its employees?

Although a church does not pay Social Security Tax on its ministerial employees, most churches are required to pay Social Security Tax (FICA and Medicare) on their non-ministerial employees just as typical, secular companies are required to do. This means that the church is required to withhold the employee portion from the employees' paychecks and match this amount with the employer's portion and forward both amounts with withheld income tax for deposit with the IRS.

There is an exception to this general rule. Churches who filed Form 8274 with the IRS (usually by October 31, 1984 or before) thereby exempting them from the payment of Social Security and Medicare taxes are not required to pay these taxes on their employees. Their employees are treated as self-employed with regard to Social Security and Medicare and are required to pay these taxes personally.

Is an auto allowance a taxable benefit to our minister?

An amount paid to a member of the pastoral staff to offset the costs of operating their own vehicle for ministry use is commonly called an "auto allowance." Although at one time these payments to the minister did not represent taxable income to the minister, this is no longer the case. Amounts paid to staff (even if for church expenses) for which they are not required to report back to the church on how the funds were spent in accordance with the requirements of an accountable reimbursement plan are considered fully taxable to the staff member. With regard to the auto allowance, even though these amounts are provided to the staff member with the intention that they will help to offset auto expenses connected with legitimate ministry activities, they are 100% taxable to the staff member if not reported upon under an accountable reimbursement plan. (See FAQ "How do we create and administer an accountable reimbursement plan for our employees?")

If a staff member does receive an auto allowance without reporting required by the church as discussed above, the allowance would be taxable to the staff member; however, the staff member would also be entitled to deduct allowed vehicle expenses as employee business expenses on Form 2145 of his/her personal income tax return. They can offset some of the taxable impact of the auto allowance being received as taxable income.

How do we create and administer an accountable reimbursement plan for our employees?

An accountable reimbursement plan is a policy adopted by the church board that allows employees to be reimbursed for legitimate, approved church business expenses that they have personally paid (or paid from advances) by reporting to the church rather than to the IRS on their personal tax return. The accountable reimbursement plan, in order to meet IRS specifications, ought to have the following qualities:

- There must be a business connection of the expenses reimbursed.
- The employee must make an adequate accounting of the expenses (according to IRS standards) within a reasonable period of time.
- Any excess reimbursements or advances must be returned to the church employer and may not be retained by the employee.
- Reimbursements may not be made out of salary reductions – this means that reimbursements may not reduce the employee's taxable wages.

What are the advantages of an accountable reimbursement plan versus a non-accountable reimbursement plan for employee expenses?

Expenses that are reimbursed via an accountable reimbursement plan are treated favorably for tax purposes for two reasons. First, these reimbursements are not counted as taxable income to the employee. Expenses reimbursed under non-accountable plans, by contrast, are counted as income to the employee. Second, the employee gets 100 percent of the tax advantage of the expense versus claiming an expense as an employee business expense on his/her tax return. When employee expenses are claimed by a minister as employee business expenses on Form 2145 of their individual tax return, these expenses are reduced by both the application of the Deason Rule and the two percent of adjusted gross income that employee business expenses must exceed before becoming eligible as itemized deductions. Further, a minister could only deduct these expenses if he/she itemized deductions on Schedule A of their individual income tax return.

How can we appropriately reimburse travel expenses to our employees?

In order for travel reimbursements to be non-taxable to the employee who has incurred expenses related to travel, the employee must report expenses incurred in accordance with an accountable reimbursement plan (discussed previously). Specifically, this means the following:

- Purchases made on a church-owned credit card must be reported on by the employee including the submission of receipts and additional information if for business meals.
- Business meals (where the employee is paying for the meal of him or herself and additional individuals, must include the individuals included in the meal, the amount, the location, and an explanation of the business purpose of the meal (i.e., what was discussed that makes this related to the business of the church and not simply a personal meal).
- A log or listing of expenses incurred that are not supported by receipts, such as tips.
- If a personal auto is used by the employee in church-related travel for which they are to be reimbursed, the employee should report the number of miles driven for each trip, destinations, and a calculation of the reimbursement amount using miles driven times the church's reimbursement rate per mile (which should not exceed the IRS rate for business mileage) or expenses incurred if reimbursement is to be for actual expenses (gas).
- Expenses of less than \$75 are not required to be accompanied by receipts (according to the IRS); however, the church may wish to make its accountable reimbursement plan more stringent if it chooses to do so.

Exhibit 1:

SAMPLE HOUSING ALLOWANCE DECLARATION FOR A MINISTER

MINISTERS HOUSING ALLOWANCE

TO: _____

FROM: _____

SUBJECT: Housing Allowance for 2011

The amounts set forth below are an estimate of the actual expenses that will be paid by me to provide housing for the year 2011

Item	Annual Amount
-Down payment on House	\$ _____
-Installment payments on loans, principal and interest.	_____
-Furnishings	_____
-Repairs	_____
-Utilities connected with the dwelling	_____
-Home Insurance	_____
-Real Estate Taxes	_____
-Other expense of a home other than food or servants	_____
* TOTAL	\$ _____

DATE: _____

(MINISTER’S SIGNATURE)

The housing allowance designated by Faith Church is non-taxable, for income tax purposes, only to the extent that it is used to pay housing expenses and, in the case of ministers who own their home, does not exceed the fair rental value of the home (furnished, including utilities). You should keep an accurate record of your housing expenses so that you can substantiate the non-taxable portion of your housing allowance in the event of an audit.

Exhibit 2:

SAMPLE HOUSING ALLOWANCE NOTIFICATION LETTER

To: Rev. John Doe

From: Jane Smith – Church Treasurer

Date: January 2012

Subject: Notification of 2011 Housing Allowance

This is to advise you that the Board of First Assembly of God has officially designated your 2011 housing allowance in the amount of \$24,000.00. Accordingly, \$24,000.00 of your total compensation paid during the year 2011 will constitute housing allowance and the balance will constitute salary. The amount on your W-2 form is your 2011 salary earnings and should be reported on your Form 1040, line 7, "wages." Your housing allowance is NOT included in Box 1 of your W-2 form.

Housing allowance is not subject to income tax, however it is subject to self-employment tax and should be included on your Schedule SE, designated as "minister's housing allowance."

If your designated housing allowance is in excess of your actual expenses the excess should be reported on the 1040 Form, line 7, as "excess housing allowance."

For additional detailed information concerning your housing allowance, you can request publication 517 from the Internal Revenue Service.

Exhibit 3:

LISTING OF ELIGIBLE MINISTERIAL HOUSING ALLOWANCE EXPENSES

Generally, any expense incurred to provide or maintain the home can be used as a housing allowance expense. Expenses for groceries, paper products, personal toiletries, and maid service cannot be used.

Mortgage principle paid

Mortgage interest paid

Property taxes paid

Insurance on the home and contents, including renter's insurance

Utilities: including electric, gas, water, sewer, trash service

Furniture, appliances, dishes and cookware

Furnishings and decorating items, including rugs, pictures, curtains, bedspreads, sheets, towels, etc.

Phone service: the "basic" charge only

Cable television service: the "basic" plan only

Down payment on a home

Home repairs

Home remodeling costs paid (not out of a loan)

Yard maintenance and equipment, snow removal

Landscaping

Homeowners' association dues

Maintenance and cleaning items: including paper towels, cleaners, pest control, rags, light bulbs, etc.

Revision date August 10, 2011

For a current copy of this document, please e-mail treasurer@ag.org.

For more information on the topics contained in this document, see Rich Hammar's *2011 Church & Clergy Tax Guide*.

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Disclaimer: The purpose of this FAQ is to provide basic information regarding church administration. Information contained within is generic in nature and is intended as a guide, not a substitute for seeking professional advice specific to your church or any state laws. If you have explicit concerns, please consult a professional.

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