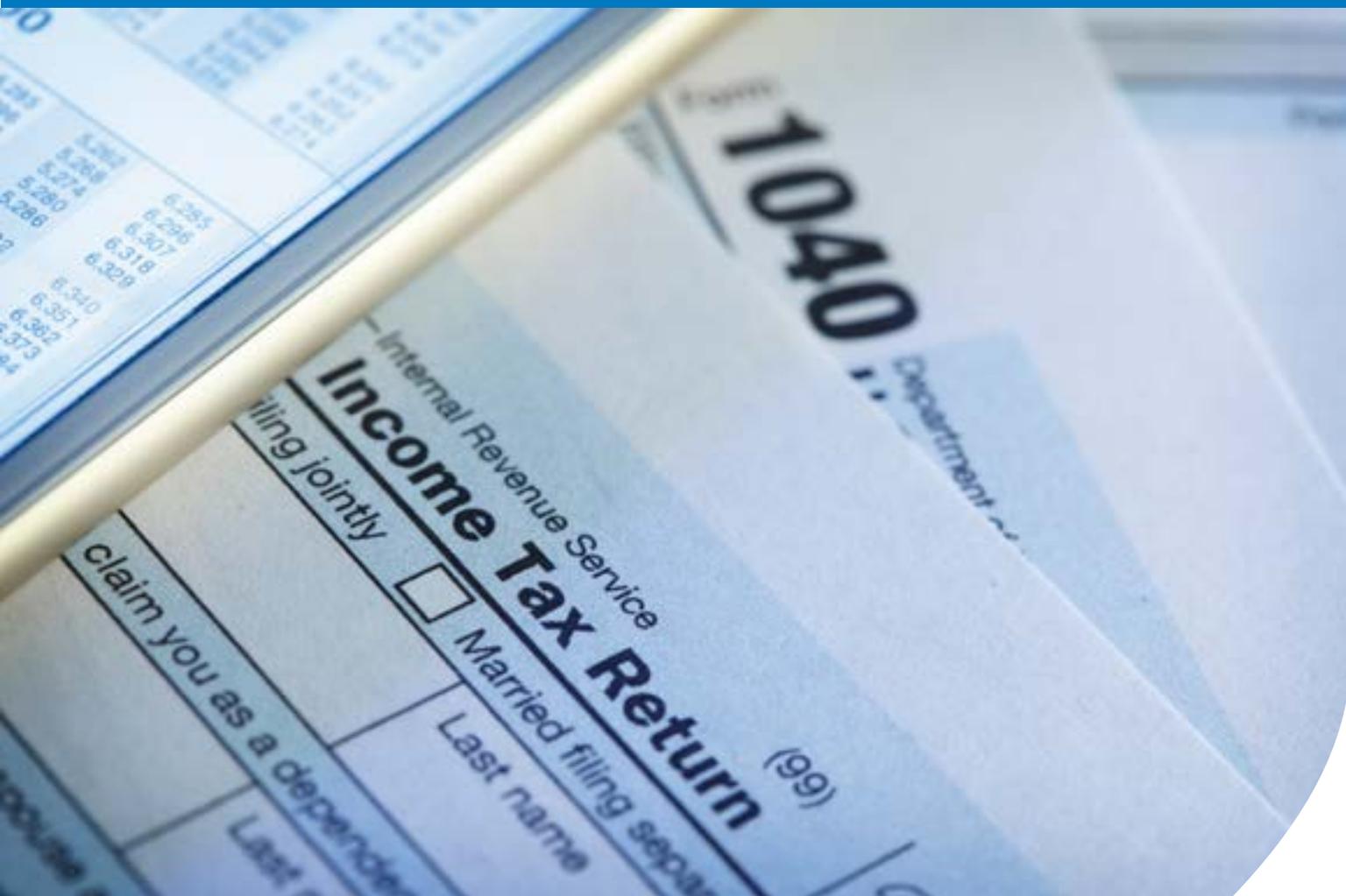


## 2021 Clergy Tax Return Preparation Guide



For 2020 Returns

## A Supplement to the 2021 Clergy Tax Return Preparation Guide for 2020 Returns

For the 2020 tax year, the Church Pension Group (CPG) is providing the *2021 Clergy Tax Return Preparation Guide for 2020 Returns* and the *2021 Federal Reporting Requirements for Episcopal Churches, Schools, and Institutions (Federal Reporting Requirements Guide)* as references to help clergy, treasurers and bookkeepers, and tax preparers in better understanding clergy taxes. These guides are available on CPG's website at [cpg.org](http://cpg.org).

This supplement complements the guides. The supplement is presented in two sections. First, a section on tax highlights addresses recent tax changes. Second, a question-and-answer format addresses key tax issues, and information provided in the guides and how it specifically applies to clergy of The Episcopal Church.

**Note:** If you have questions about clergy federal income taxes that are not covered here, please call CPG's Tax Hotline:

Nancy Fritschner, CPA (877) 305-1414

Mary Ann Hanson, CPA (877) 305-1415

Dolly Rios,\* CPA (833) 363-5751

\*Fluent in English and Spanish

Please note that the service these individuals will provide is of an informational nature. It should not be viewed as tax, legal, financial, or other advice. You must contact your tax advisor for assistance in preparing your tax returns or for other tax advice.

## Tax Highlights

The SECURE (Setting Every Community Up for Retirement Enhancement) Act of 2019 is now law. Most provisions in the law became effective January 1, 2020. Listed below are some of the most important changes that could have a significant impact on you.

- The Required Minimum Distribution (RMD) age has increased from age 70½ to 72. This change applies to anyone who will attain age 70½ on or after January 1, 2020. This means that anyone who attained age 70½ prior to December 31, 2019, will need to continue to take RMDs in 2020 and beyond. Note: The CARES Act suspends the requirement to take an RMD in 2020.
- Contributions to traditional IRAs after age 70½ are now allowed for anyone who is working and has earned income.
- Withdrawals of up to \$10,000 from Code Section 529 plans (tax-advantaged higher education savings accounts) to repay student loans are now permitted. The SECURE Act makes this change retroactive to distributions made after December 31, 2018.
- New parents, through birth or adoption, are eligible to withdraw \$5,000 penalty-free to offset the cost of qualified delivery or adoption expenses.
- “Stretch” provisions for beneficiaries of IRAs and defined contribution plans (such as the Code Section 403(b) arrangement known as The Episcopal Church Retirement Savings Plan (RSVP)) have been significantly modified. The SECURE Act now requires designated beneficiaries of IRAs and defined contribution plans to withdraw all amounts within 10 years after the account owner’s death. These provisions do not apply to the following “eligible designated beneficiaries”:
  - the surviving spouse of the deceased account owner,
  - a minor child of the deceased account owner (but only until the minor child reaches the age of majority),
  - a beneficiary who is no more than 10 years younger than the deceased account owner, or
  - a disabled or chronically ill beneficiary (as defined by the Internal Revenue Code).

A review of your financial and estate plans and IRA beneficiary elections, as well as a conversation with your financial professional, is strongly recommended.

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law on March 27, 2020. Here are some provisions of that act that may have affected you or your church or other institution during 2020.

### **1. Deferral of the payment of the employer’s share of Social Security**

**taxes:** Social Security taxes due from March 27, 2020, through December 31, 2020, can be deferred until 2021 and 2022. Half of the deferred taxes will be due December 31, 2021, and the remaining half due December 31, 2022.

**2. Use of retirement funds:** The bill waives the 10% early withdrawal penalty for distributions up to \$100,000 from IRAs and defined contribution qualified retirement plans (such as 403(b) plans, including the Church’s RSVP plan) for coronavirus-related purposes, on or after January 1, 2020, and before December 31, 2020. Withdrawals are still taxed, but taxes are spread over three years, or the taxpayer has the three-year period to recontribute to an eligible retirement plan without regard to that year’s cap on contributions.

**3. 401(k) Loans:** The loan limit is increased from \$50,000 to \$100,000.

**4. RMDs Suspended:** Required Minimum Distributions from IRAs and 401(k) plans are suspended.

**5. Charity:** There is a new provision that provides an above-the-line deduction up to \$300 per individual for charitable contributions; plus, the limit on charitable contributions to qualifying organizations is increased to 100% of AGI.

## Questions & Answers

### Eligibility



**Q1.** *For tax purposes, who is considered a minister in The Episcopal Church?*

**A1.** In The Episcopal Church, only bishops, priests, and deacons (ordained ministers, as opposed to lay ministers) meet the criteria for the IRS designation of “minister.” See the *2021 Clergy Tax Return Preparation Guide for 2020 Returns* (page 11) and the *Federal Reporting Requirements Guide* (page 2) for an explanation of the importance of understanding whether you qualify as a minister for tax purposes.

**Q2.** *What types of organizations qualify as Church organizations?*

**A2.** Church organizations include Episcopal parishes and missions, dioceses, schools, and institutions associated with The Episcopal Church. The approval of an Extension of Ministry under The Church Pension Fund Clergy Pension Plan does not automatically qualify a cleric for clergy tax treatment. Also, pay received for work performed for organizations not associated with the Church may not qualify as the “exercise of ministry.” Work performed directly for the Church is considered “exercise of ministry,” no matter the nature of the work. Generally, work for non-Church organizations does not qualify for the housing allowance unless that work is primarily sacerdotal.

### Basics of Clergy Taxation



**Q3.** *What are the key federal tax provisions that apply to clergy compensation?*

**A3.** The key provisions include the following:

**Self-employment tax.** Clergy are not eligible to have FICA taxes withheld from their church compensation. In lieu of FICA taxes, clergy pay self-employment tax, also known as Self-Employment Contributions Act tax (SECA). Reimbursements from an employer of SECA are taxable as wages and are assessable under The Church Pension Fund Clergy Pension Plan. Note, however, that even though clergy pay SECA tax, most ministers are considered employees and should receive a Federal Form W-2 from their employer.

**Estimated taxes.** Clergy must pay quarterly estimated taxes, or request that their employer voluntarily withhold income taxes. Clergy can request that an additional amount of income tax be withheld to cover their self-employment tax. The additional amount will be reported as federal income tax.

**Housing allowance.** A cleric can have a portion of his or her salary declared as a housing allowance, and thereby exempt the eligible amount from federal income tax. Note that under Section 107 of the Internal Revenue Code, clergy pension distributions can also be declared as a housing allowance. (This provision does not apply to the cleric’s surviving spouse.) For additional information, please refer to Part 3 of the *2021 Clergy Tax Return Preparation Guide for 2020 Returns*.

**CPF Form B immediately follows this supplement.** It explains how The Church Pension Fund (CPF) declares the full amount of all benefits paid from retirement and disability plans sponsored by CPF to retired and disabled clergy as a housing allowance, and how to apply it for tax purposes. We recommend that you place a copy of *CPF Form B* in your current tax file and provide it to your tax preparer.

**Q4.** *Should I prepare my own taxes?*

**A4.** No. Clergy tax issues are highly complex and not all tax software is capable of producing accurate results.

## How Can I...?



**Q5.** *How can I find a tax preparer?*

**A5.** Here are some tips to help you find a competent professional:

- Ask your diocesan finance officer for recommendations.
- Ask your clergy colleagues (not just Episcopal).
- Use a tax preparer who is familiar with the rules that apply to clergy.
- Ask local tax professionals whether they have worked with ministers and, if so, 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 and Medicare tax purposes. Anyone familiar with ministers' taxes will know that ministers always are self-employed for Social Security and Medicare tax purposes with respect to their ministerial duties. Or, ask a tax professional if a minister's church salary is subject to required income tax withholding.
- Often, tax preparers can readily familiarize themselves with clergy tax treatment by reviewing the *2021 Clergy Tax Return Preparation Guide for 2020 Returns*, calling CPG's Tax Hotline (see the first page), and/or referring to CPF Form B.

**Q6.** *How can I determine my housing allowance under Internal Revenue Code Section 107?*

**A6.** To establish a Section 107 housing allowance, your vestry or other church governing body must adopt a housing allowance resolution at the end of each calendar year for the following year. A church cannot designate a housing allowance retroactively. Please refer to the *Federal Reporting Requirements Guide* (pages 6-7) for additional information.

A cleric can consult with a realtor to obtain a written appraisal of the fair rental value of his or her furnished home. Adding utility costs to the realtor's appraisal, the cleric can recommend a housing allowance amount to the vestry. The vestry then can vote its approval of that housing allowance designation and document its action in the minutes of the meeting.

Note that only expenses incurred for the minister's primary residence are eligible for the housing allowance exclusion. Please be sure to consult your tax preparer regarding your housing allowance.

**Q7.** *How can I ensure that my expenses at a long-term care facility are eligible for the housing allowance exclusion?*

**A7.** If you are considering moving to a long-term care facility, make sure that it will give you a breakdown each year of the portions of your payments that represent the cost of housing, medical expenses, and other items. It is necessary to have such information to take proper advantage of your housing allowance and medical expense deductions on your income tax returns. Note that the IRS has ruled that the lump-sum entrance fee paid by a retired minister to gain admission to a long-term care facility can be treated as a housing expense only in the year it is actually paid and cannot be prorated over several years.

**Q8.** *How can I set up an accountable business expense reimbursement plan?*

**A8.** The Tax Cuts and Jobs Act of 2017 eliminated a taxpayer's ability to deduct unreimbursed business expenses. Therefore, clergy should ensure that their employer has established an accountable expense reimbursement plan. See the *Federal Reporting Requirements Guide* (pages 7-8) for more information.



- Q9.** How should I report business expenses and/or declare a housing allowance for interim cures in out-of-town locations?
- A9.** This situation presents unique issues, especially for retirees who are receiving a pension. The differences in tax treatment depend on the length of the cure, and taxpayers are advised to consider them carefully:

**Cures of one year or less.** If the interim job is for a set duration of one year or less, the housing at the temporary location is generally treated as a business expense that can be provided by or reimbursed by the employing church tax-free to the cleric. Also, the cleric can continue to apply his or her pension income toward the housing allowance for the permanent residence's expenses. Travel expenses to and from the permanent residence and the interim job location are also treated as business expenses.

**Cures of longer than one year (or uncertain period of time).** If the interim job is projected to last for more than a year or its term is uncertain (whether or not it turns out to be for less than a year is irrelevant), the cleric has generally been deemed to have moved the principal residence to the interim location. Therefore, the reimbursement of expenses relating to the temporary housing at the interim location is taxable for SECA/SET purposes and the cleric will not be able to claim a housing allowance as it relates to the housing expenses associated with his or her permanent residence.

**Q10.** *What should I understand about taxation of moving expenses?*

**A10.** Moving expenses can no longer be reimbursed tax-free or deducted on personal tax returns. Any payment of moving expenses or reimbursement to the cleric must be treated as taxable compensation and included as salary on *Federal Form W-2*. In addition, these amounts are assessable under The Church Pension Fund Clergy Pension Plan. Moving expenses are still eligible housing expenditures for purposes of the housing allowance.

**Q11.** *What rules apply to contributions to and withdrawals from The Episcopal Church Retirement Savings Plan (RSVP)?*

**A11.** The RSVP is a Code Section 403(b) defined contribution plan that may be funded by an individual with earnings received from services provided to the Church and/or employer contributions. Contributions by the cleric can be made only from earnings that are reported as taxable compensation (i.e., earnings that have not been applied toward the housing allowance).

For 2020, the maximum combined contribution (i.e., employer contributions and employee salary deferrals) was the lesser of 100% of taxable compensation or \$57,000 (\$63,500 for those ages 50 or older). For 2021, these amounts increase to \$58,000 (or \$64,500 for those ages 50 or older).

The maximum employee pre-tax salary deferral for 2020 was the lesser of 100% of taxable compensation or \$19,500 (\$26,000 for those ages 50 or older). For 2021, these amounts remain the same. If contributions made to a Section 403(b) account are more than these contribution limits, penalties may apply. Generally, annual contributions to a Section 403(b) plan cannot exceed either the limit on annual additions or the limit on elective deferrals. See IRS Publication 571 for details.

Before you make any withdrawals (including required minimum distributions) from the RSVP, be sure to contact Fidelity to inform them that you are a member of the clergy and are eligible to take the distribution as a clergy housing allowance. Distributions from the RSVP are eligible to be applied toward your declared housing allowance, if requested at the time of withdrawal.

**Q12.** *I will turn 70 this year. What should I know about taking distributions from The Episcopal Church Retirement Savings Plan (RSVP).*

**A12.** The SECURE Act has increased the Required Minimum Distribution (RMD) age from age 70½ to 72. This change applies to anyone who will attain age 70½ on or after January 1, 2020. This means that anyone who attained age 70½ prior to December 31, 2019, will need to continue to take RMDs in 2020. In addition, The Church Pension Fund requires that all RSVP participants begin to receive their RMD by April 1 following the year in which the cleric reaches age 72, regardless of whether his or her work status is active or retired. If you are actively employed by an Episcopal employer after age 70½, you are eligible to continue to make pre-tax contributions to the RSVP from current taxable earnings through the duration of your employment. The CARES Act suspends the requirement to take RMDs in 2020.

**Q13.** *Is the Resettlement Benefit payable to eligible clergy under The Church Pension Fund Clergy Pension Plan taxable?*

**A13.** If the Resettlement Benefit is distributed to the cleric, it is a taxable benefit. However, it may be eligible for the housing allowance exclusion (see question 3). To delay paying tax on the Resettlement Benefit, you can make a tax-free rollover of the Resettlement Benefit to The Episcopal Church Retirement Savings Plan (RSVP) or another tax-deferred savings vehicle.

**Q14.** *I received a gift from my parish at retirement. Is it taxable?*

**A14.** Many clergy receive retirement gifts. The tax treatment generally works as follows:

Gifts provided by the employer are taxable to the cleric and must be reported on Federal Form W-2 as wages, and are assessable wages for the Clergy Pension Plan.

Gifts funded by individuals directly to the cleric, or collected by the church as non-deductible personal gifts, are not taxable to the cleric, are not reported on Federal Form W-2 as wages, cannot be treated as tax-deductible by the giver, and are not assessable for pension purposes.

**Q15.** *I am Medicare-eligible, and recently returned to work after retirement. As a result, am I entitled to medical coverage as an active employee?*

**A15.** When a cleric is Medicare-eligible and working, he or she may legally be required to be on the employer's active health plan. For more information, you may want to contact your diocese or The Episcopal Church Medical Trust.

**Q16.** *Due to my conscientious objection to public insurance programs, I would like to opt out of Social Security. For the self-employment tax, is it permissible for me to take such an exemption?*

**A16.** Some denominations allow their clergy to opt out of Social Security as a conscientious objection to the receipt of social insurance. The Episcopal Church does not support this option on theological grounds. As a result, some Episcopal ministers have opted out of Social Security without realizing that they do not qualify for the exemption. It should be noted that, when signing *Federal Form 4361*, a minister must attest to its accuracy under penalty of perjury.

A minister's opposition must be to accepting benefits under Social Security (or any other public insurance program). Economic considerations, or any other non-religious considerations, are not a valid basis for the exemption, nor is opposition to paying the self-employment tax.

Note also that a decision to opt out of Social Security is irrevocable. Clergy who opt out of Social Security, especially those who have vested benefits with Social Security from previous employment outside the Church, may be subject to the windfall elimination provision. For more information, refer to *IRS Publication 963*, available at [irs.gov](https://www.irs.gov).

**Q17.** *How can I change my withholding amount when receiving my pension benefit in retirement?*

**A17.** Your monthly earnings statement provided by Northern Trust includes a section where you can enter an adjustment to your federal and state income tax withholding. Simply sign date and return it to CPG. You can, instead, submit a new CPF Substitute Form W-4P Federal Withholding Certificate. This form is available under Clergy Tax Forms and Resources at [cpg.org/retired-clergy/retirement/tax-resources](https://www.cpg.org/retired-clergy/retirement/tax-resources).

**Q18.** *How long must I retain my tax return and supporting records?*

**A18.** You should retain copies of your tax returns for your lifetime. Supporting documents can be destroyed after seven years.

The Consolidated Appropriations Act was signed into law on December 27, 2020. Here are some provisions of that Act that may affect you or your church or other institution.

1. **Payroll Protection Program**—The Act permits taxpayers whose PPP loans are forgiven to deduct the expenses relating to their loans to the extent they would otherwise qualify as ordinary and necessary business expenses. This rule applies retroactively to the effective date of the CARES Act so that expenses paid using funds from PPP loans previously issued under the CARES Act are deductible, regardless of when the loan was forgiven.  
  
The Act permits an employer that receives a PPP loan to receive the employee retention tax credit. However, to prevent any double-dipping, an employer must either exclude “qualified wages” that allowed the employer to claim employee retention tax credits from “payroll costs” for purposes of determining its loan forgiveness under the PPP (so as to reduce the amount of loan forgiveness), or exclude “qualified wages” that qualified for PPP loan forgiveness from “payroll costs” (so as to reduce the employee retention tax credit).<sup>[5]</sup> This change applies retroactively to the effective date of the CARES Act.
2. **Recovery rebates**—The Act provides for a second round of payments to taxpayers of \$600 per taxpayer with a social security number, including \$600 per child up to age 17. Payments are made based on your 2019 Adjusted Gross Income (AGI) with the payments phasing out for AGI of \$75,000 for single filers, \$150,000 for married filing joint, and \$112,500 for head of household.
3. **Extends paid sick and family leave credits thru 3/31/21.**
4. **Above-the-line charitable deduction for cash donations to qualifying charities**—For non-itemizers, the maximum amount for 2020 is \$300 for single and married filing joint tax returns, \$150 for married filing separate returns. For 2021 the maximum is \$600 for married filing joint return, \$300 for single taxpayers, and \$300 for married filing separate returns. Non-cash donations do not qualify for this deduction.
5. **Defers employee-side payroll tax**—If the deferral was elected, the repayment is extended to 12/31/21 from 4/1/21.
6. **Makes permanent certain “tax extenders”**—
  - a. lowered the AGI threshold for medical expense deduction for itemized deductions to 7.5%
  - b. repealed the above-the-line deduction for education expenses after 2020, and increased the phase-out for Lifetime Learning Credit.
7. **Extends for 5 years to 1/1/25**—
  - a. employer credit for paid family and medical leave originally enacted as part of the Tax Cut and Jobs Act.
  - b. expanded exclusion for employer-provided educational assistance, including student loan repayment benefits from the CARES Act.
8. **Permits temporary 100% deduction for business meals**—The Tax Cuts and Jobs Act limited the deductibility of business meal expenses to 50% of the cost for food and beverages provided by a restaurant. The Consolidated Appropriations Act permits businesses to deduct 100% of these business meals expenses during 2021 and 2022.

## CPF FORM B

January 2021

In accordance with Section 107 of the Internal Revenue Code, all benefits paid from retirement and disability plans sponsored by The Church Pension Fund (CPF) to retired and disabled clergy have been designated as a housing allowance in 2021.

The amount of housing allowance that you may exclude from gross income for federal income tax purposes cannot exceed the lowest amount of:

1. actual housing expenses (the total amount you actually spend in a calendar year for items that directly relate to renting or providing for your primary home),
2. the fair rental value of your primary home (including furnishings) plus the cost of the utilities, or
3. your retirement and disability income provided by CPF plus any other compensation earned from an Episcopal employer which has been properly designated as a housing allowance

CPF has passed a similar resolution for 2020.

### For Surviving Spouses and Children:

The housing allowance exclusion is applicable to CPF benefits paid to the clergy who earned them. **Tax law does not allow a housing allowance for surviving spouses or dependents.**

### How to Calculate:

While further details are available in IRS Publication 517 and the *2021 Tax Guide for Episcopal Ministers*, the following list may assist you in determining the total actual expenses that relate to renting or providing your primary home:

- Mortgage payments, both principal and interest\*
- Real estate taxes and special assessments\*
- Fees paid for acquiring home titles, mortgages, etc.
- Home improvements and repairs
- Cost of moving your home furnishings
- Home furnishings that are primary and essential
- Fire and home liability insurance premiums
- Maintenance and upkeep of property including landscaping
- Utilities—electric, gas, oil, water, basic telephone, trash, cable television base rate (not including premium channels)
- Rental payments for home, garage, storage for household items, furnishings, etc.

### Importance of Records:

We strongly recommend that you keep good records, including all of your calculations and expense documents related to renting or providing your primary home. You may need them if questions or challenges to your housing allowance develop.

### How to Report:

The amount you decide to exclude from your gross income is not shown on your federal tax return because it is an “exclusion,” not a “deduction.” The total of all pension benefits received during the year (shown on Box 1 of your Form 1099-R) should be copied to Line 5a of your Federal Form 1040. The taxable portion of these benefits, determined by subtracting the amount you are excluding for housing purposes from the total, should be shown on Line 5b of your Federal Form 1040. Line 5b should not be left blank; if all amounts received are used for housing purposes, you should enter a zero (0) on that line.

**Please note that you may receive Form 1099-R and/or Form W-2 from Northern Trust and/or Aflac / Zurich as they are the paying agents for the retirement benefit and disability plans sponsored by CPF. You may also receive a Form 1099-R from Fidelity Investments and/or Church Life Insurance Corporation if you had any distributions from an Episcopal Church Retirement Savings Plan (“RSVP plan”), as they are the paying agents for that plan. In addition, for any distributions from the RSVP processed by Fidelity Investments, please contact Fidelity Investments to notify them that your distribution is eligible for the housing allowance.**

### SECA Tax:

Social Security Self-Employment tax (also called SECA tax) is not applicable to any qualified retirement benefit payments received from plans sponsored by CPF. However, if you have other earnings from self-employment after retirement (from the church or other sources), you may be required to pay SECA tax on those earnings and also on the fair rental value of housing provided by a church or other employer.

### Further Assistance:

We will, of course, assist in answering questions about specific retirement and disability benefits that you receive from plans sponsored by CPF; please contact the Client Services Department at 866-802-6333. However, we cannot advise as to personal tax matters. If legal, accounting, or other expert assistance is required in connection with your tax returns, the services of a competent professional should be sought. For general questions concerning clergy taxes, you may call Nancy Fritschner at (877) 305-1414, Mary Ann Hanson at (877) 305-1415, or Dolly Rios at (833) 363-5751 toll-free.

*\*Please note that in addition to being treated as housing expenses for the purpose of calculating the housing allowance exclusion, mortgage loan interest and real estate tax payments (up to \$10,000) are allowable as itemized deductions from gross income on Schedule A of Form 1040.*

# *2021 Clergy Tax Return Preparation Guide for 2020 Returns*

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## **ACKNOWLEDGEMENTS**

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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.

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# **PART 1**

## **INTRODUCTION**

*All references in this publication to line numbers on IRS forms are for the “draft” versions of the 2020 forms since the final forms had not been released by the IRS as of the date of publication.*

## **How to use this guide**

This book contains the basic information you need to complete your 2020 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 for Churches—helps churches comply with their federal tax reporting requirements.

**This guide is divided into the following sections:**

**Part 1: Introduction**—This section reviews tax highlights for 2020 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: 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 2020

### *1. The Tax Cuts and Jobs Act of 2017*

On December 22, 2017, President Donald Trump signed into law the \$1.5 trillion Tax Cuts and Jobs Act of 2017. In brief, the Act amends the Internal Revenue Code to reduce tax rates and modify credits and deductions for individuals and businesses.

With respect to individuals, the bill does the following:

- replaces the seven existing tax brackets (10, 15, 25, 28, 33, 35, and 39.6 percent) with seven new and lower brackets (10, 12, 22, 24, 32, 35, and 37 percent);
- substantially increases the standard deduction, thereby significantly reducing the number of taxpayers who will itemize deductions;
- repeals the deduction for personal exemptions;
- eliminates the deduction for moving expenses as well as the employer tax free reimbursement;
- allows taxpayers to deduct an amount for cash charitable contributions up to 60% of AGI;
- doubles the Child Tax Credit and establishes a new family tax credit;
- repeals most miscellaneous itemized deductions;
- limits the mortgage interest deduction for debt incurred after November 2, 2017, to mortgages of up to \$750,000 (previously \$1 million);
- caps the deduction for state and local income or sales taxes not paid or accrued in a

trade or business at \$10,000;

- consolidates and repeals several education-related deductions and credits;
- broadened the use of Section 529 plans for expenses below the college level of education;
- modifies the Alternative Minimum Tax (AMT) to make it apply to fewer taxpayers; and
- modifies the estate and generation-skipping transfer taxes to exempt most taxpayers.

## ***2. Other tax changes of interest to ministers and other church staff***

There were several tax developments in prior years that affect tax reporting by both ministers and churches for 2020 and future years. Here is a rundown of some of the key provisions:

- You may be able to claim the earned income credit for 2020 if (1) you do not have a qualifying child and you earned less than \$15,820 (\$21,710 if married); (2) a qualifying child lived with you and you earned less than \$41,756 (47,646 if married filing jointly); (3) two qualifying children lived with you and you earned less than \$47,440 (\$53,330 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than \$50,954 (\$56,844 if married filing jointly). The maximum earned income credit for 2020 is (1) \$538 with no qualifying child; (2) \$3,584 with one qualifying child; (3) \$5,920 with two qualifying children; and (4) \$6,660 with three or more qualifying children.
- For contributions in 2020 to a traditional IRA, the deduction phaseout range for an individual covered by a retirement plan at work begins at income of \$104,000 for joint filers and \$65,000 for a single person or head of household. These are 2020 amounts that increase to \$105,000 for joint filers and \$66,000 for a single person or head of household for 2021.
- The dollar limit on annual elective deferrals an individual may make to a 403(b) retirement plan is \$19,500 for 2020. It remains at \$19,500 for 2021.
- 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 \$6,500 for 2020. For 2021, the limit remains at \$6,500.
- 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 parsonage allowance.”

- The standard business mileage rate was 57.5 cents per mile for business miles driven during 2020. The standard business mileage rate for 2021 is == cents per mile.
- Many churches employ retired persons who are receiving Social Security benefits. 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. If you are under full retirement age for the entire year, \$1 is deducted from your benefit payments for every \$2 you earn above the annual limit. For 2021 that limit is \$18,960. In the year you reach full retirement age, your monthly benefit payments are reduced by \$1 for every \$3 you earn above a different limit. For 2021 that limit is \$50,520 (\$4,210 per month) but only earnings before the month you reach full retirement age are counted.
- 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.
- In March 2019 a three-judge panel of a federal appeals court (the Seventh Circuit Court of Appeals) unanimously affirmed the constitutionality of the housing allowance. *Gaylor v. Mnuchin*, 919 F.3d 420 (7th Cir. 2019).
- In the CARES Act of 2020 Congress enacted a provision in the legislation that allows non-itemizers an above-the-line “qualified charitable deduction” of up to \$300 for charitable contributions.

# Preliminary Questions

Below are several questions you should consider before preparing your 2020 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 to report their self-employment tax. Different rules apply to ministers who are exempt from self-employment taxes.

Q. What records should I keep?

A. You should keep all receipts, canceled checks, and other evidence to prove amounts you claim as deductions, exclusions or credits. Documentation should be maintained for six years from the time you file your tax return.

Q. What is the deadline for filing my federal income tax return?

A. The instructions to Form 1040 state that the deadline for filing Form 1040 for the 2020 tax year is April 15, 2021. As of this publication there are no congressional or executive discussions to extend this deadline.

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 15 to October 15, 2021) to file your 2020 Form 1040 if you file Form 4868 by April 15, 2021 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 2020 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. These rules are summarized in this document. Easily accessible tax software will also accommodate the unique rules applicable to ministers, but it does not relieve a minister from understanding the rules in order to accurately utilize the software. On the other hand, if you experienced unusual events in 2020, 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. However, the tax law is broad and complicated, so it should not be assumed that all CPAs are familiar with the unique rules applicable to ministers.
- 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 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 churches and denominations. 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;
- exemption of wages from income tax withholding (ministers use the quarterly estimated tax procedure to prepay their taxes, unless they elect voluntary withholding); and
- eligibility, under very limited circumstances, to exempt themselves from self-employment taxes.

These special rules only apply to persons qualifying as a minister and with respect to compensation received in the exercise of ministerial services.

**EXAMPLE** Pastor J is an ordained minister employed by a 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 his 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 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 tax purposes. See IRS Publication 517.

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

**KEY POINT** Most ministers are 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 their ministry. These two rules are summarized below:

### *Income taxes*

For federal income tax reporting, most ministers are employees under the tests 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). Formerly, it meant that they reported their employee business expenses on Schedule A rather than on Schedule C. (The deduction for employee business expenses as Miscellaneous Itemized Deductions on Schedule A is suspended through 2025, so employee business expenses are not deductible at this time.) A few ministers are self-employed, such as some traveling evangelists and some 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. She is an employee

for federal income tax reporting purposes with respect to her church salary. However, she is self-employed with respect to honoraria she receives for speaking in other churches and for compensation church members give her for performing personal services such as weddings and funerals. The church issues Pastor B a Form W-2 reporting her church salary. Pastor B reports this amount as wages on line 1 of Form 1040. She reports her compensation and expenses from the outside 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.

**KEY POINT** Ministers and other church staff members should carefully review their Form W-2 to be sure it does not report more income than was actually received or fails to report taxable benefits provided by the church. 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.

## ***Social Security***

The federal 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. A minister's Form W-2 should not report any amounts in Boxes 3, 4, 5 & 6. Rather, they pay the self-employment tax (SECA) by completing Schedule SE with their Form 1040.

## Exemption from self-employment (Social Security) 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). A minister who files the exemption application may still purchase life insurance or participate in retirement programs administered by nongovernmental institutions (such as a life insurance company). Additionally, the exemption does not require a minister to revoke all rights to Social Security benefits earned through their participation in the system through secular employment.

A minister's opposition must be to accepting benefits under Social Security (or any other public insurance program) which are related to services performed as a minister. 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 the exemption. Many younger ministers opt out of the self-employment tax without realizing that they do not qualify for the exemption. A decision to opt out of self-employment tax is irrevocable. But section 4.19.6.5.11.3 (02-15-2019) of the IRS *Internal Revenue Manual* explicitly recognizes that under some conditions ministers who have exempted themselves from self-employment taxes solely for economic reasons can

revoke their exemption. The IRS does have the authority to revoke a minister's decision to opt out of self-employment tax, if it is determined the decision is based on economic reasons rather than theological reasons. Check with a tax attorney or CPA for additional information.

An exemption from self-employment taxes applies only to compensation for 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.

**KEY POINT** The amount of earnings required for a quarter of coverage in 2021 is \$1,470. 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 continue to pay self-employment tax on their ministerial income and wages (unless they exempted themselves from self-employment tax as a minister and they are employed in a ministerial capacity). However, amounts received from retirement plans related to ministerial services are not subject to self-employment tax.

## 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 may not withhold income taxes from a minister's paycheck without specific written permission. 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 enter into a voluntary withholding arrangement with their church. Estimated taxes must be paid in quarterly installments. If your estimated tax paid for the current year is less than your actual tax, 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 or submit additional payments.

You will need to make estimated tax payments for 2021 if you expect to owe at least \$1,000 in tax for 2021 after subtracting your withholding and credits and if you expect your withholding and credits to be less than the smaller of (1) 90 percent of the tax to be shown on your 2021 tax return, or (2) 100 percent of the tax shown on your 2020 tax return (110 percent if adjusted gross income exceeds \$150,000, or if married filing separately, more than \$75,000). Your 2020 tax return must cover all 12 months.

The four-step procedure for reporting and paying estimated taxes for 2021 is summarized below.

## ***Step 1***

Estimated tax payments may be paid using either of the following methods:

- Obtain a copy of IRS Form 1040ES for 2021 before April 15, 2021. You can obtain forms by calling the *IRS toll-free forms hotline at 800-TAX-FORM (800-829-3676)*, or from the *IRS website (irs.gov)*. If you paid estimated taxes last year, you should receive a copy of your 2021 Form 1040-ES in the mail with payment vouchers preprinted with your name, address, and Social Security number; or
- Enroll in the Electronic Federal Tax Payment System at [www.eftps.gov](http://www.eftps.gov) and establish an online account to be used to submit payments. You may also use [IRS.gov/payments](http://IRS.gov/payments) to submit payments.

## ***Step 2***

Compute your estimated tax for 2021 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 2021 in each of four quarterly installments as follows:

<b>FOR THE PERIOD</b>	<b>DUE DATE</b>
January 1–March 31	April 15, 2021
April 1–May 31	June 15, 2021
June 1–August 31	September 15, 2021
September 1–December 31	January 18, 2022

You must send each payment to the IRS, accompanied by one of the four payment vouchers contained in Form 1040-ES. If enrolled in the EFTPS system, all four payments may be prescheduled for automatic payment at the schedule dates. A refund associated with an overpayment of your taxes for 2020 may be applied to your estimated tax payments due for 2021.

**Warning:** If your 2020 tax return is not completed by April 15, 2021, you must go ahead and begin making your estimated tax payments to avoid potential underpayment penalties. A tax refund on your 2020 tax return can be used to adjust any estimated tax payment not made at the time of the filing of the return. Do not wait until your 2020 return is completed to determine and pay your 2021 estimated tax payments.

## ***Step 4***

After the close of 2021, 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 2022 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) or other written authorization. Since ministers are not employees for Social Security with respect to ministerial compensation, the church does not withhold the employee's share of Social Security and Medicare taxes. However, ministers can request on Form W-4 (line 4c) 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 is 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. Withholding income tax is a preferential method of paying taxes, since it is considered to have been equally paid throughout the year, no matter the date it is actually withheld. This means, withholding can be adjusted later in the year and it is treated as if it was paid evenly throughout the year, thus avoiding potential underpayment penalties.

## **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, certain disaster related casualty losses and charitable contributions.

**KEY POINT** Beginning with tax year 2018 no miscellaneous itemized deductions that formerly were subject to a 2% of adjusted gross income limitation are allowed. This and other changes to Schedule A are addressed later in this guide.

**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 reporting Social Security taxes due on your self-employment income. Ministers use this schedule since they are deemed self-employed for Social Security with respect to ministerial services (unless they have obtained an approved Form 4361 from the IRS).

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. You can obtain them by calling the *IRS toll-free forms hotline at 800-TAX-FORM (800-829-3676)*. They also are available on the *IRS website (irs.gov)*.

## **Form 1040**

### ***Step 1: Filing status***

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

### ***Step 2: 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 in the space provided in the "Filing Status" section at the top of the Form 1040. If you filed a joint return for 2019 and you are filing a joint return for 2020 with the same spouse, be sure to enter your names and Social Security numbers in the same order as on your 2019 return.

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

If you (or your spouse) 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. If a name change with the SSA has not been completed, the name on SSA file must be used in filing your tax return.

Enter your P.O. Box number only if your post office does not deliver mail to your home.

For taxpayers with foreign mailing addresses, spaces have been added to include the name of the foreign country/province/state and a foreign postal code.

If you want \$3 to go to the presidential election campaign fund, check the box labeled “you.” If you are filing a joint return, your spouse can also have \$3 go to the fund (check “spouse”). If you check a box, your tax or refund will not change.

### ***Step 3: Dependents***

In the past taxpayers were allowed a personal exemption for themselves and certain dependents. While personal exemptions were repealed after 2017, it is still necessary to determine who qualifies as dependents and include them on the return. Dependents determine various credits, such as the child tax credit, as well as other tax related items such as educational credits, medical expenses, child care credit and earned income credit, just to name a few.

### ***Step 4: Income***

Several items of income are reported on lines 1 through 9 of Form 1040 including amounts carried over from Schedule 1, lines 1-9. 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 1. Wages, salaries, tips, etc.***

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 1.

***Determining church wages or salary.*** Besides a salary, ministers' wages reported on Form W-2 may include several other items, including the following:

- Bonuses
- The cost of sending a minister to the Holy Land (if paid by the church)
- Most Christmas and special occasion offerings
- Retirement gifts paid by a church
- The portion of a minister's self-employment tax paid by a church
- Personal use of a church-owned vehicle
- Purchases of church property for less than fair market value
- Business expense reimbursements under a nonaccountable plan
- Imputed cost of group term life insurance coverage exceeding \$50,000.
- Church reimbursements of a spouse's travel expenses incurred while accompanying a minister on a business trip (unless the spouse's presence serves a legitimate business purpose and the spouse's expenses are reimbursed under an accountable arrangement)
- "Discretionary funds" established by a church for a minister to spend on current needs—if the minister is allowed to distribute funds for his or her personal benefit or does not have to account for the funds in an arrangement similar to an accountable expense reimbursement plan
- "Imputed interest" from "below-market interest loans" of at least \$10,000 made by a church to a minister (some exceptions apply)
- Cancellation of a minister's debt to a church
- Severance pay
- Payment of a minister's personal expenses by the church

- “Love gifts”

**KEY POINT** The IRS can assess intermediate sanctions in the form of substantial excise taxes, i.e., monetary penalties, against ministers who benefit from an excess benefit transaction. Sanctions only apply to a minister who is a “disqualified person” (meaning an officer, director, or other control party as well as relatives of such persons). In some cases the IRS can assess additional penalties against members of a church board that approved an excess benefit transaction. Excess benefit transactions 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. Sanctions may be avoided, if a transaction or a item of compensation is approved by an independent board on the basis of outside “comparable data” such as independent compensation surveys or fair market evaluations, 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, etc.) for personal purposes, or receive nonaccountable 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 or her Form 1040, for the year in which the benefits are provided. The concept of automatic excess benefits directly affects the compensation practices of most churches, and exposes 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 were not reported on your Form W-2. If you receive a Form W-2c and 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. You, the taxpayer, have the ultimate responsibility to report all taxable income even if your church does not properly report the income.

In addition to what is reported on Form W-2 ( or Form W-2c), Line 1 will also report the

amount of excess housing allowance (the amount by which the housing allowance exceeds the lesser of the minister's housing expenses or the fair rental value of the minister's home plus utilities.) IRS Publication 517 states: "Include this amount in the total on . . . Form 1040, line 1. On the dotted line next to line 1, enter 'Excess allowance' and the amount."

***Items not reported on line 1.*** 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:

***Gifts.*** Gifts, as defined by the Internal Revenue Code and the courts, are excludable from taxable income so long as they are not compensation for services. However, employers are not permitted to give tax-free gifts to employees. Likewise, the IRS and the courts have ruled that gifts ministers receive directly from members of their congregations may not always be excluded as gifts from taxable income. Before excluding gifts from taxable income, the minister should consult with a CPA or a tax attorney.

***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.

***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.

***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.

***Lodging.*** The value of lodging furnished to a minister, i.e., a parsonage, is excluded from income. This exclusion is not available in the computation of self-employment taxes. The value of lodging furnished to a non-minister 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.

***Educational assistance.*** Amounts paid by an employer for an employee's tuition, fees, and books may be excludable from the employee's taxable income, if the church has

adopted a written educational assistance plan. The exclusion may not exceed \$5,250 per year.

*Employer-provided childcare.* An employer can exclude the value of benefits provided to an employee under a dependent care assistance program from the employee's wages if (1) the care was provided so you (and your spouse if filing jointly) could work or look for work; (2) the care must be for one or more qualifying persons; (3) the person who provided the care wasn't your spouse, the parent of your qualifying child, or a person whom you can claim as a dependent. If your child provided the care, he or she must have been age 19 or older by the end of 2020, and he or she can't be your dependent; and (4) you report the required information about the care provider on line 1 (Form 2441). An employee can generally exclude from gross income up to \$5,000 of benefits received under a dependent care assistance program each year. This limit is reduced to \$2,500 for married employees filing separate returns. However, the exclusion can't be more than the smaller of the earned income of either the employee or employee's spouse. You can't exclude dependent care assistance from the wages of a highly compensated employee unless the benefits provided under the program don't favor highly compensated employees. For this exclusion, a highly compensated employee for 2020 is an employee who received more than \$125,000 in pay for 2019. For 2021 plan year, an employee who earns more than \$130,000 in 2020. For more information on the earned income limit, see IRS Publication 503.

**KEY POINT** 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 are explained below—the housing allowance, tax-sheltered annuities, qualified scholarships, and sale of a home.

## *Housing Allowance*

**KEY POINT** The housing allowance was challenged in federal court as an unconstitutional preference for religion. In 2019, a federal appeals court rejected the challenge and affirmed the constitutionality of the 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.

A church cannot designate a housing allowance retroactively.

Some churches fail to designate housing allowances prospectively 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 cash compensation as a parsonage 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 an 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 proceeds were spent on housing-related expenses.

**TAX SAVINGS TIP** Ministers should be sure that the designation of a housing or parsonage 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.”

States vary in the tax treatment of the housing allowance, so ministers should check their state income tax rules to determine the housing allowance rules for state income taxes.

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:

- Down payment on a home (Since a housing allowance is nontaxable only to the extent that it does not exceed the lesser of the amount designated by their church, the actual housing expenses or the fair rental value of a minister's home, as furnished, plus utilities, it is often difficult to exclude the full amount of a down payment for a new home.)
- Mortgage payments on a loan to purchase or improve your home (include both interest and principal)
- Rent
- Real estate taxes
- Property insurance
- Utilities (electricity, gas, water, trash pickup, land-line telephone charges)

- Furnishings and appliances (purchase and repair)
- Structural repairs and remodeling
- Yard maintenance and improvements
- Maintenance items (pest control, etc.)
- Homeowners association dues

**KEY POINT** In 2007 the Tax Court characterized Internet expenses as utility expenses. This suggests that a housing allowance may be used to pay for Internet expenses (i.e., Internet access, cable television). Neither the IRS nor the Tax Court has addressed this issue directly, so be sure to check with a tax professional about the application of a housing allowance to these expenses.

**Please note the following:**

- A housing allowance must be designated in advance. Retroactive designations of housing allowances are not effective.
- The housing allowance designated by the church is not necessarily nontaxable. It is nontaxable (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 (as furnished, plus utilities).
- 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. But note that it serves no purpose to designate a housing allowance greater than the fair rental value of a minister's home (as furnished, plus utilities).
- 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 1 of Form 1040. IRS Publication 517 states: "Include this amount in the total on Form 1040, line 1. On the dotted line next to line 1, enter 'Excess allowance' and the amount."
- 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).

- 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 \$25,000 of Pastor D’s 2020 compensation as a housing allowance. Pastor D’s housing expenses for 2020 were utilities of \$4,000, mortgage payments of \$18,000, 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 \$19,000. Pastor D’s housing allowance is nontaxable 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 her home (furnished, plus utilities). Stated differently, the nontaxable 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; or (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 (\$23,000), and so this represents the nontaxable portion of Pastor D’s housing allowance. Pastor D must report the difference between this amount and the housing allowance designated by her church (\$2,000) as additional income on line 1 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 nontaxable amount. Note that the Pastor D’s actual housing expenses were more than the allowance, and so she was penalized because of the low allowance designated by her church.

**EXAMPLE** Pastor Y owns a home and incurred housing expenses of \$12,000 in 2020. These expenses include mortgage principal and interest, property taxes, utilities, insurance and repairs. The church designated (in advance) \$12,000 of Pastor Y’s 2020 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 (up to \$10,000), 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 fact, it represents an exclusion and a deduction.

**EXAMPLE** In preparing his income tax return for 2020, Pastor H discovers that his church failed to designate a housing allowance for him for 2020. He asks his church to pass a resolution retroactively granting the allowance for 2020. Such a resolution is ineffective, and Pastor H will not be eligible for any housing allowance exclusion in 2020.

**KEY POINT** Federal law 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 is fraud and 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 for tax fraud under the tax code.

**TAX SAVINGS TIP** Ministers should be sure that the designation of a housing or parsonage allowance for the next year is on the agenda of the church board or appropriate committee 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?***

The IRS has stated that there are no limitations on how much of a minister’s compensation can be designated by his or her employing church as a housing allowance. However, as noted above, this means little, since the nontaxable portion of a church-designated housing allowance for ministers who own or rent their home cannot exceed the lesser of (1) actual housing expenses, or (2) the fair rental value of the home (furnished, plus utilities).

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 anticipated 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 three conditions are met: (1) the recipient is a minister for tax purposes (as defined above), (2) the allowance is compensation for services performed in the exercise of ministry and (3) the allowance is properly designated by the church.

Churches sometimes neglect to designate a housing allowance in advance of a new calendar year. For example, a church board may discover in March of 2021 that it failed to designate a housing allowance for its pastor for 2021. It is not too late to act. The church should immediately designate a portion of its minister's remaining compensation for 2021 as a housing allowance. This problem can be avoided by stipulating in each annual housing allowance designation that the allowance is for the current year *and all future years unless otherwise provided*. If such a resolution had been adopted in the December 2019 board meeting (i.e., "for 2020 and future years") it would not matter that the church neglected to designate a minister's 2021 allowance until March of 2021, since the previous designation would have carried over. Such "safety net" designations are not a substitute for annual housing allowances (they have never been addressed or endorsed by the IRS or Tax Court). Rather, they provide a basis for claiming a housing allowance if a church neglects to designate one.

**KEY POINT** 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 or her church or the church pension board of a denominational pension fund; (2) the retired minister has severed his or her 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 an 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 or she 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 proceeds were spent on housing-related expenses.

## ***Section 403(b) plans***

Payments made by your church and your salary reduction contributions to a 403(b) plan are not reportable income for income tax or self-employment 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 2020 total annual additions (employer contributions, salary reduction and tax paid contributions) could not exceed the lesser of 100 percent of your compensation (excluding a minister’s housing allowance) or \$57,000. 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 403(b) plan or to an IRA.

**NEW IN 2021** The limit on annual additions is \$58,000 for 2021.

## ***Minister's housing allowance and contribution limits***

For 2020 the Section 415(c) limit restricts 403(b) contributions to the lesser of 100 percent of compensation or \$57,000. For 2021, this amount is \$58,000. 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:

*Question.* 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?

*Answer.* 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.

**KEY POINT** Churches that include the housing allowance as compensation when calculating the amount of the church’s contribution to 403(b) plans must perform an additional calculation to ensure the total contributions to the plan do not exceed the maximum contribution allowed under section 415(c).

## *Taxation of distributions from a 403(b) plan*

Amounts you contribute through employer discretionary contributions, employee salary reduction contributions, and the earnings attributable to these contributions, generally cannot be withdrawn until an employee:

- reaches age 59½
- has a severance from employment
- dies
- becomes disabled
- in the case of elective deferrals, encounters financial hardship

In some cases of financial hardship, you may withdraw your own salary reduction contributions (but not the earnings on them) prior to the occurrence of any of the above events. A 403(b) plan may make hardship distributions only if permitted by the plan.

Once amounts are distributed, they are generally taxable as ordinary income unless designated in advance 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 percent of the amount which is includable in income, unless one of the following exceptions applies:

- 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.
- The distributions are made after you separate from service in or after the year in which you reach age 55.
- The distributions do not exceed the amount of unreimbursed medical expenses that you could deduct for the current year.
- The distributions are made after your death, or after you become disabled.
- The distributions are made to an alternate payee pursuant to a qualified domestic relations order.

The additional tax is computed on Form 5329.

**NEW IN 2020** Distributions prior to age 59 ½ that do not satisfy one of the above exceptions are subject to an additional “tax on early distributions” of 10 percent multiplied by the amount of the distribution. However, the CARES Act (2020) provides that the 10 percent additional tax on early distributions does not apply to any coronavirus-related distribution of up to \$100,000 from a 403(b) plan and some other retirement plans. The CARES Act defines a coronavirus-related distribution as any distribution from an eligible retirement plan made on or after January 1, 2020, and before December 31, 2020, to a qualified individual. Distributions generally are included in income ratably over a three-year period, starting with the year in which you receive your distribution. For example, if you receive a \$9,000 coronavirus-related distribution in 2020, you would report \$3,000 in income on your federal income tax return for each of 2020, 2021, and 2022. However, you have the option of including the entire distribution in your income for the year of the distribution.

**NEW IN 2020** The SECURE Act (2020) waives the required minimum distribution (RMD) rules for certain defined contribution plans (including 403(b) plans) and IRAs for calendar year 2020. This provision provides relief to individuals who would otherwise be required to withdraw funds from such retirement accounts during the economic slowdown due to COVID-19.

**NEW IN 2020.** The SECURE Act changes the age on which the required beginning date for required minimum distributions is based, from the calendar year in which the employee attains 70 ½ years to the calendar year in which the employee attains 72 years. However, prior law continues to apply to employees and IRA owners who attain age 70 ½ prior to January 1, 2020. This provision is effective for distributions required to be made after December 31, 2019, for employees who attain age 70 ½ after December 31, 2019. In all other respects prior law treatment of RMDs is not affected.

### **Salary reduction contributions (Section 402(g))**

In addition to the section 415(c) limit there is an annual limit on elective deferral contributions. The limit applies to the total of all elective deferrals contributed (even if contributed through 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 2020 the allowable limit was \$19,500. 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 2021** The dollar limit on annual elective deferrals remains at \$19,500.

**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 percent of your compensation. The total contributions over your lifetime under this election cannot be more than \$40,000.

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 \$6,500 for 2020 and 2021. Catch-up contributions are not subject to any other contribution limits and are not taken into account in applying other contribution limits.

### **Qualified scholarships**

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).

In addition to these requirements, the scholarship must meet additional requirements if the recipient is an employee or a family member of an employee. Generally, the scholarship must be noncompensatory in nature, selected using nonemployment related criteria, and an independent committee must make the selection of the recipient. Additional requirements may also apply. The church should seek the advice of a CPA or tax attorney to determine the proper treatment of scholarships to employees and their children.

**KEY POINT** Amounts paid by a church for the education of a pastor or other church employee cannot be treated as a nontaxable 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 nontaxable 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 \$2,500 for 2021. 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. 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. As long as amounts are paid through a qualified scholarship plan, the church is not required to report the scholarship on Form 1099-MISC or 1099-NEC to the recipient.

**KEY POINT** A church may not establish a scholarship plan that is solely directed at a small group of potential candidates. For example, a church cannot set up a scholarship plan for its ministers or the children of its ministers. A smaller church may not even set up a plan for solely for its members. In order to navigate these essential rules, qualified counsel should be sought in developing any scholarship plan for the church.

### ***Sale or exchange of your principal residence***

A taxpayer who is an individual may 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 date of the sale or exchange.

A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or (to the extent provided under regulations) unforeseen circumstances, is able to exclude an amount equal to the fraction of the \$250,000 (\$500,000 if married filing a joint return) that is equal to the fraction of the two years that

the ownership and use requirements are met. The exclusion under this provision may not be claimed for more than one sale or exchange during any two-year period unless the special provisions for unforeseen circumstances apply.

**Line 2 (Form 1040). Interest income: attach Schedule B if over \$1,500**

Complete this line if you had interest income. Tax-exempt interest income is reported on Line 2a with taxable interest income reported on Line 2b. If you had taxable dividend and interest income of more than \$1,500, complete Schedule B.

**Line 3 (Form 1040). Dividend income; attach Schedule B if more than \$1,500.**

Complete this line only if you had dividend income. Qualified dividend income is reported on Line 3a and enter all dividend income on Line 3b. If you had dividend and interest income of more than that \$1,500, complete Schedule B.

**Line 4 (Form 1040). IRA distributions**

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.

**Line 5 (Form 1040). Pensions and annuities**

Pension and annuity payments include distributions from 401(k) and 403(b) plans. Do not include the following payments on lines 5a and 5b. Instead report them on line 1.

- 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 percent of pension and disability benefits paid to retired ministers as a housing allowance. In such cases the 1099-R form may show that the taxable amount of the pension income is “not determined” by checking the box on line 2b. 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 5 of Form 1040 if (1) you can document that the monies were actually spent on housing-related expenses during the tax year, (2) the amount excluded does not exceed the fair rental value of the home (furnished, including utilities) and (3) the applicable pension board designated the retirement payments as housing allowance.

IRS Publication 517 states: “If you are a retired minister, you can 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 of deceased ministers cannot exclude any portion of the benefits received from their deceased spouse’s 403(b) account as a housing allowance.

### **Line 6 (Form 1040). 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.

Some taxpayers have to pay federal income taxes on their Social Security benefits. This usually happens only if you have other substantial income in addition to your benefits (such as wages, self-employment, interest, dividends and other taxable income that must be reported on your tax return).

You generally will pay tax on only 50 percent or 85 percent of your Social Security benefit depending on the amount of your other income.

If you:

- **file a federal tax return as an "individual" or “married filing separately”** and your *combined income* is
  - between \$25,000 and \$34,000, you may have to pay income tax on up to 50 percent of your benefits.
  - more than \$34,000, up to 85 percent of your benefits may be taxable.
- **file a joint return**, and you and your spouse have a *combined income* that is
  - between \$32,000 and \$44,000, you may have to pay income tax on up to 50 percent of your benefits.
  - more than \$44,000, up to 85 percent of your benefits may be taxable.

Your combined income is your adjusted gross income plus non-taxable interest and ½ of your Social Security benefits.

Each January, you will receive a *Social Security Benefit Statement* (Form SSA-1099) showing the amount of benefits you received in the previous year. You can use this

*Benefit Statement* when you complete your federal income tax return to find out if your benefits are subject to tax.

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 [IRS.gov](http://IRS.gov).

### **Line 7 (Form 1040). Capital gain (or loss)**

Report on line 7 capital gains or losses (attach Schedule D) from the sale of capital assets. These include stocks, bonds, and property. Gain or loss is reported on Schedule D. You also may have to file Form 8949 (see the instructions to both forms for details).

**KEY POINT** Schedule D is for reporting capital gains and losses from investments. Schedule 1, line 4 (“other gains or losses”) is for reporting sales of capital assets such as equipment that are used in a business.

### **Line 8 (Form 1040). Other Income**

Income not reported on the Lines 1 through 7 is reported on Schedule 1 with the total reported on Schedule 1 reported on Line 8. The most important of these for ministers include:

#### *(1) Line 3 (Schedule 1). Business income*

Report self-employment earnings (from Schedule C). Self-employment earnings include:

- Compensation reported to you on a Form 1099-NEC
- Fees received directly from church members for performing personal services (such as marriages and funerals)
- Honoraria you received for guest speaking 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 3 of Schedule 1 (Form 1040).

#### *(2) Line 8 (Schedule 1). “Other income”*

“Other income” is reported on line 8 of Schedule 1 (Form 1040) and carried over to line 8 (Form 1040). Other income includes the following items:

- A canceled debt or a debt paid for you by another person (unless the person who canceled or paid your debt intended it to be a gift)
- 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)
- Most prizes and awards
- Some taxable distributions from a health savings account (HSA) or Archer MSA (see IRS Publication 969)
- Jury duty pay
- Recapture of a charitable contribution deduction if the charitable organization disposes of the donated property within 3 years of the contribution.
- Taxable benefits provided by the church but not included on Form W-2 or Form W-2c. (Also remember to include these benefits on Schedule SE for the calculation of self-employment tax.)

### **Line 9 (Form 1040). Total income**

Report “total income” on this line. This is the sum of the amounts reported on lines 1-8 of Form 1040, plus the additional categories of income reported on lines 1-9 of Schedule 1 (Form 1040).

### ***Line 10 (Form 1040) Adjustments to income***

#### ***Line 10b Charitable Deduction***

You can take up to a \$300 deduction for cash contributions made to church, charities or other qualified organizations in 2020 if you take the standard deduction and do not itemize on Schedule A (Form 1040).

You may deduct certain adjustments from total income (line 9) to compute your adjusted gross income. Report the adjustments on lines 10 through 22 of Form 1040 (Schedule 1). The total amount is subtracted from line 9 (Form 1040) to compute adjusted gross income

that is reported on line 11.

The two most relevant adjustments for ministers are the deduction for one-half of the self-employment tax, and payments to an individual retirement account (IRA). Both are summarized below.

*(1) Line 14 (Schedule 1) One-half of self-employment tax*

**KEY POINT** Every minister who pays self-employment 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 14 (Schedule 1) of Form 1040, whether they are able to itemize deductions on Schedule A or not.

*(2) Line 19 (Schedule 1). Payments to an individual retirement account (IRA)*

An individual retirement arrangement, or 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.

Prior to 2020, if you were 70 ½ or older, you could not make a regular contribution to a traditional IRA. However, you could contribute to a Roth IRA and make rollover contributions to a Roth or traditional IRA regardless of your age.

**NEW FOR 2020** For 2020 and later, there is no age limit on making regular contributions to traditional or Roth IRAs.

To contribute to a traditional IRA, 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 2020, 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) \$6,000 (\$7,000 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. (The contribution limits remain unchanged for 2021.)

All IRA contributions must be made by the due date of your tax return, not including extensions. This means that your 2020 IRA contribution must be made by April 15, 2021, even if you obtain an extension for filing this return.

**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 2021, the senior pastor can contribute \$7,000 to an IRA (maximum annual contribution of \$6,000 plus a “catch-up” contribution of \$1,000), and the youth pastor can contribute \$6,000.

Your allowable deduction may be reduced or eliminated, depending on your filing status, the amount of your income, and if you or your spouse are covered by an employer provided retirement plan. 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. The amounts vary depending on your filing status. For 2020, if you were covered by an employer provided retirement plan, then the deduction for contributions to your IRA are completely phased out when adjusted gross income reaches \$124,000 (MFJ) or \$75,000 (Single). (For 2021 the limits are \$125,000 (MFJ) and \$76,000 (Single))

If your spouse was covered by an employer retirement plan at any time during 2020 and you made contributions to your IRA, your allowable IRA deduction is completely phased out when adjusted gross income reaches \$206,000 (MFJ). (For 2021 the limit is \$208,000 (MFJ)). (See IRS Publication 590-A.) The Form W-2 you receive from your church or other employer has a box used to show whether you were covered by a retirement plan during the year. The “Retirement 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-A.

Individuals who cannot claim a deduction for an IRA contribution still can make nondeductible IRA contributions, subject to the lesser of \$6,000 (for 2020 and 2021) 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 nondeductible contributions were made to the IRA. Form 8606 is used to designate a contribution as nondeductible and must be filed or the full amount of future withdrawals may be taxed. Withdrawals before age 59½ are subject to a 10 percent penalty tax that also applies to deductible IRA contributions.

Generally, the amounts an individual withdraws from an IRA or retirement plan before reaching age 59½ are called "early" or "premature" distributions. Individuals must pay an additional 10% early withdrawal tax unless an exception applies. However, the CARES Act (2017) temporarily waives the 10 percent early withdrawal penalty for coronavirus-related distributions (CRDs) made between January 1 and December 31, 2020.

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

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 nondeductible contributions to a Roth IRA. However, you may be limited in the amount of nondeductible contributions you may make to your Roth IRA due to your adjusted gross income (AGI). For those filing as married filing jointly, no contribution may be made to a Roth IRA in 2020 if your AGI, as modified, is \$206,000 or above. For those filing as single, no contribution may be made to a Roth IRA if your AGI, as modified, is \$139,000 or more. (For 2021, the Roth IRA contribution is phased out totally when AGI is \$208,000 for taxpayers married filing jointly and \$140,000 for singles and head of household filers.)

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-A for additional information on Roth IRA(s).

For information on conversions from a traditional IRA to a Roth IRA, refer to Publication

590-A.

In the past, if you were 70 ½ or older, you could not make a regular contribution to a traditional IRA. However, you could still contribute to a Roth IRA and make rollover contributions to a Roth or traditional IRA regardless of your age subject to the above described income limitations. For 2020 and later, there is no age limit on making regular contributions to traditional or Roth IRAs.

**Charitable contributions.** An IRA owner, age 70½ or over, can directly transfer, tax-free, up to \$100,000 per year to an eligible charity. Distributions from employer-sponsored retirement plans, including SIMPLE IRA plans and simplified employee pension (SEP) plans, are not eligible. To qualify, the funds must be transferred directly by the IRA custodian to the eligible charity. Distributed amounts may be excluded from the IRA owner's income, resulting in lower taxable income for the IRA owner. However, if the IRA owner excludes the distribution from income, no deduction, such as a charitable contribution deduction on Schedule A, may be taken for the distributed amount.

To report a qualified charitable distribution on your Form 1040 tax return, you generally report the full amount of the charitable distribution on the line for IRA distributions (line 4a, Form 1040). On the line for the taxable amount, enter zero if the full amount was a qualified charitable distribution. Enter "QCD" next to this line. See the Form 1040 instructions for additional information.

Not all charities are eligible. For example, donor-advised funds and supporting organizations are not eligible recipients.

Amounts transferred to a charity from an IRA are counted in determining whether the owner has met the IRA's required minimum distribution (RMD).

**KEY POINT** The QCD does need a qualifying receipt from the recipient charity with the mandated "no goods or services" statement. A church may include the gift on the IRA owner's regular giving statement in an attempt to fulfill this requirement, care should be taken to not take a deduction for the QCD if it is included on the regular giving statement. Best practice is for the recipient charity or church to issue a separate statement for the gift.

## **Line 11 (Form 1040). Adjusted gross income**

Adjusted Gross Income (AGI) is gross income minus adjustments to income. Gross income includes your wages, dividends, capital gains, business income, retirement

distributions as well as other income. Adjustments to income include such items as educator expenses, student loan interest, alimony payments, or contributions to a retirement account. Your AGI will never be more than your Gross Total Income on your return and in some cases may be lower. AGI is an important number since it is used to determine the amount of various deductions and credits.

## ***Tax computation***

### **Line 12 (Form 1040). 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 12 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 2020, the standard deduction amounts are as follows:

#### **FILING STATUS AND STANDARD DEDUCTION AMOUNT (2020)**

single.....	\$12,400
married filing jointly or qualifying widow(er).....	\$24,800
married filing separately .....	\$12,400
head of household .....	\$18,650

### **Line 13 (Form 1040). Qualified Business Income Deduction**

Ministers who have income from business activities (conducted other than in their capacity as an employee of the church) and report their income on Schedule C, may be entitled to a federal tax deduction of up to 20% of their qualified business income (QBI). This deduction is also referred to as the IRC Section 199A deduction. Section 199A limits the deduction to the lesser of 1) 20% of the qualified business income (QBI) less one-half of the self-employment tax directly related to the qualified business income, the self-employed health insurance deduction and the self-employed qualified plan contribution deduction related to the qualified business, or 2) 20% of taxable income before the qualified business income deduction less net capital gains.

Upon publication of this guide, it has been interpreted that the qualified business trade or business activities of a self-employed minister may be considered a “specified service

trade or business”. Thus, there may be an exception to the deductibility of the QBI deduction. If a minister’s income before this deduction (reported on line 9 of the Form 1040) exceed \$163,300 (\$326,600 married filing jointly) for 2020 then the deduction may be limited; if adjusted gross income exceeds \$213,300 (\$426,600 married filing jointly) for 2020 then the deduction is unavailable. Attach either the Form 8995 or 8995-A and possibly Schedules A, B and/or C (Form 8995-A), as needed.

### **Line 16 (Form 1040). 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).

## ***Credits***

A credit is a direct dollar-for-dollar reduction in your tax liability. It is much more valuable than deductions and exclusions, which merely reduce taxable income. On your 2020 Form 1040, nonrefundable credits (i.e., credits that do not generate a tax refund if the credit amount exceeds taxable income) are reported on lines 1-7 of Schedule 3, and the total amount for all credits is carried over to line 20 of Form 1040.

The more common and important credits for ministers are the child tax credit, the credit for child and dependent care expenses, and the retirement savings credit. Each of these is addressed below.

### **Lines 19 & 28 (Form 1040). Child tax credit and Additional Child Tax Credit**

The Tax Cuts and Jobs Act of 2017 temporarily increases the child tax credit to \$2,000 per qualifying child. The credit is further modified to temporarily provide for a \$500 nonrefundable credit for qualifying dependents other than qualifying children (such as aging parents). The provision generally retains the present-law definition of *dependent*.

If the child tax credit cannot be utilized against current taxes, a portion of the credit is refundable. This is referred to as the additional child tax credit. The maximum amount refundable may not exceed \$1,400 per qualifying child. In order to receive the child tax credit (i.e., both the refundable and non-refundable portion) a taxpayer must include a Social Security number for each qualifying child for whom the credit is claimed on the tax return. For these purposes, a Social Security number must be issued before the due date for the filing of the return for the taxable year. This requirement does not apply to a non-child dependent for whom the \$500 nonrefundable credit is claimed.

As a qualifying child is an individual who has not attained age 17 during the taxable year. The credit is subject to the adjusted gross income phaseout thresholds. The credit begins to phase out for taxpayers with adjusted gross income in excess of \$400,000 (in the case of married taxpayers filing a joint return) and \$200,000 (for all other taxpayers). These phaseout thresholds are not indexed for inflation.

The amount of the refundable portion of the child tax credit is based on a calculation of “earned income” that does not include housing allowance. Therefore, it is possible that having a portion of income designated as housing allowance may decrease the amount of the additional child tax credit (the refundable portion). Ministers should prepare tax estimates using a variety of scenarios to determine their best tax advantage. This nuance is especially pertinent to ministers who have several children and a potential to receive a substantial additional child tax credit.

These provisions are set to expire for taxable years beginning after December 31, 2025, unless extended by Congress.

### **Line 20 (from Form 1040, Schedule 3, line 2). 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. See the instructions to Form 1040, Schedule 3, line 2, for details and conditions or the instructions for Form 2441, Child and Dependent Care Expenses.

See IRS Publication 972 for additional information.

### **Line 20 (from Form 1040, Schedule 3, line 4). 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-A 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 percent or as high as 50 percent, 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.

The credit is available with respect to elective deferrals to a 401(k) plan, a 403(b)

annuity, 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 2020 is described in the following table.

<b>Adjusted Gross Income</b>			
joint returns	heads of household	single filers	amount of credit
\$1–\$39,000	\$1–\$29,250	\$1–\$19,500	50% of eligible contributions up to \$2,000 (\$1,000 maximum credit)
\$39,001–\$42,500	\$29,250–\$31,875	\$19,501–\$21,250	20% of eligible contributions up to \$2,000 (\$400 maximum credit)
\$42,501–\$65,000	\$31,876–\$48,750	\$21,251–\$32,500	10% of eligible contributions up to \$2,000 (\$200 maximum credit)
over \$65,000	over \$48,750	over \$32,050	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-A.

### ***Other taxes (Form 1040 line 23, from Schedule 2, line 10 (“other taxes”))***

On the Form 1040 for 2020, “other taxes” are derived from line 10 of Schedule 2 and the

total of all taxes is carried over to line 23 of Form 1040. These include self-employment taxes which ministers must pay on ministerial income (unless exempt).

## ***Payments***

On the 2020 Form 1040, amounts representing federal income tax withholding is reported on line 25 and estimated tax payments are reported on Line 26 as well as tax overpayments from the prior year applied to current year taxes. Other tax payments are reported on Schedule 3 and reported on Line 31 of Form 1040. The two most important categories of tax “payments” are withheld taxes and estimated tax payments, as noted below.

### **Line 25 (Form 1040). Federal income tax withheld**

Federal income tax may be withheld from several sources of income. For the first time, the Form 1040 separately reports withholding from these different potential sources.

#### Line 25a – Federal income tax withheld from Forms W-2

Ministers’ wages based on the performance of ministerial services 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. 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 and state income taxes withheld from their wages. However, a church does not withhold the employee’s share of Social Security and Medicare taxes, since ministers are self-employed for Social Security with respect to ministerial compensation. Ministers can request (on Form W-4 or through other written instructions) 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 Forms W-2 and 941) rather than the employee’s share of Social Security and Medicare taxes. They constitute a payment that can be applied to both income taxes and self-employment taxes. Ministers still must complete Schedule SE to report

their self-employment tax liability.

#### Line 25b – Federal income tax withheld from Forms 1099

Federal income tax may be withheld from pension payments or distributions reported on Form 1099-R or from social security payments reported on Form SSA-1099 or from other income reported on Form 1099-NEC. Other potential sources may be from interest and dividends reported on Form 1099-B.

#### Line 25c – Federal income tax withheld from other forms

Income tax withheld from gambling winnings reported on Form W-G or Additional Medicare Tax as calculated on Form 8959 is included on this line.

### **Line 26, (Form 1040). Estimated tax payments**

Compensation paid to ministers for ministerial duties is not subject to mandatory tax withholding. As a result, ministers must prepay 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 for the 2020 tax year is reported as a payment of taxes on line 26 of Form 1040. Additionally, any amount of an overpayment from 2019 applied to the 2020 estimated tax payments is included on this line.

### **Line 27 (Form 1040). Earned income credit**

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 2020 if you have non-retirement investment income of \$3,650 or less and (1) you do not have a qualifying child, at least age 25 and you earned less than \$15,820 (\$21,710 if married filing jointly); (2) a qualifying child lived with you and you earned less than \$41,756 (\$47,646 if married filing jointly); (3) two qualifying children lived with you and you earned less than \$47,440 (\$53,330 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than \$50,954 (\$56,844 if married filing jointly). The maximum earned income credit for 2020 is (1) \$538 with no qualifying child; (2) \$3,584 with one qualifying child; (3) \$5,920 with two qualifying children; and (4) \$6,660 with three or more qualifying children.

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 27. 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.

The credit is reported on line 27 of Form 1040.

IRS Publication 596 is a 40-page publication that explains the earned income credit. The 2019 edition (the most recent available at the time of publication of this text) states, in general: “The rental value of a home or a housing allowance provided to a minister as part of the minister’s pay generally isn’t subject to income tax but is included in net earnings from self-employment. For that reason, it is included in earned income for the EIC” except for ministers who have opted out of self-employment taxes by filing a timely Form 4361 exemption application with the IRS.

Excerpts from Publication 596 confirm that ministers who are employees for income tax reporting purposes and who have *not* exempted themselves from self-employment taxes by filing a timely Form 4361 with the IRS *include* their housing allowance or the fair rental value of a parsonage in computing earned income for purposes of the earned income credit.

But what about ministers who have exempted themselves from self-employment taxes by filing a timely Form 4361 with the IRS? Do they include a housing allowance or the rental value of a parsonage in computing their earned income for purposes of the earned income credit? As noted above, Publication 596 explicitly states, with regard to ministers

who have filed Form 4361, that “a nontaxable housing allowance or the nontaxable rental value of a home is not earned income.”

With respect to ministers who have filed a timely Form 4361, Publication 596 states:

Whether or not you have an approved Form 4361, amounts you received for performing ministerial duties as an employee count as earned income. This includes wages, salaries, tips, and other taxable employee compensation. If you have an approved Form 4361, a nontaxable housing allowance or the nontaxable rental value of a home isn't earned income. Also, amounts you received for performing ministerial duties, but not as an employee, don't count as earned income. Examples include fees for performing marriages and honoraria for delivering speeches.

Ministers who are affected by this issue should consult their tax professional for help.

**KEY POINT** The definition of “earned income” for the Earned Income Credit is not the same definition of “earned income” for the Additional Child Tax Credit discussed earlier in this publication.

**KEY POINT** Once again, tax benefits may be affected by the housing allowance. Ministers should consider these various provisions and determine if the housing allowance is beneficial for them in light of how it affects the Earned Income Credit and the Additional Child Tax Credit.

## ***Refund or amount you owe***

After totaling your payments, Form 1040 Line 33, you can calculate whether you owe the government, or a refund is due 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” or by making the payment through your EFTPS account or at *IRS.gov/payments*. There are also payments methods directly through the IRS available at [www.irs.gov/payments](http://www.irs.gov/payments) or practitioners can assist you in making a payment as a part of electronically filing your tax return. Do not attach the check to your return, but include it with a Form 1040-V. If you file your return electronically, the payment may be sent in separately using the Form 1040-V. Include your daytime phone number, your Social Security number, and write

“Form 1040 for 2020” on the check. If you owe taxes, you also may have to pay an underpayment penalty (refer to line 38 of Form 1040). If you are paying taxes after April 15, 2021, you may also owe late payment penalties.

If you have overpaid your taxes, you have two options: (1) request a full refund, or (2) apply the overpayment to your 2021 estimated tax (refer to line 36 of the Form 1040).

## ***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*.

If you or your spouse has been the victim of identity theft, the IRS will issue you an Identity Protection PIN that must also be entered in this section of the return.

# **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 percent 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 percent 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:*

- Fees for medical services
- Fees for hospital services

- Lodging at a hospital during medical treatment (subject to some limits)
- Medical and hospital insurance premiums that you pay (do not include amounts paid to health sharing arrangements)
- Special equipment
- Medicare A premiums you pay if you are exempt from Social Security and voluntarily elect to pay Medicare A premiums
- Medicare B premiums you pay
- Medicare D premiums you pay
- Medicare Supplement premiums you pay (or are deducted from your pension)
- Long-term care insurance premiums, subject to certain limitations on the amount that may be deducted
- Special items (false teeth, artificial limbs, eyeglasses, hearing aids, crutches, etc.)
- Transportation for necessary medical care. For 2020, the standard mileage rate for medical travel was 17 cents per mile (it increases to == cents for 2021)
- Medicines and drugs requiring a prescription, and insulin
- 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
- Wages of an attendant who provides medical care
- The cost of home improvements if the main reason is for medical care
- Program to stop smoking
- 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:*

- The cost of diet food
- Funeral services
- Health club dues (except as noted above)
- Household help
- Life insurance
- Maternity clothes
- Nonprescription medicines and drugs
- Nursing care for a healthy baby
- Toothpaste, cosmetics, toiletries
- Trip for general improvement of health
- Most cosmetic surgery

## **Step 2: Taxes you paid (lines 5–7)**

In the past, individuals were permitted a deduction for certain taxes paid or accrued, whether or not incurred in a taxpayer's trade or business. These taxes were:

- State and local real property taxes,
- State and local personal property taxes, and
- State and local income taxes.

At the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes. This provision was added to address the unequal treatment of taxpayers in the seven states that do not have an 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.

Taxpayers may claim an itemized deduction of up to \$10,000 (\$5,000 for married taxpayer filing a separate return) for the aggregate of:

- State and local property taxes, and
- State and local income taxes (or sales taxes in lieu of income taxes) paid or accrued in the taxable year.

The \$10,000 limitation applies until 2025.

Some states attempted to assist taxpayers in avoiding the above limitations by creating state-run charities that would grant “tax credits” in exchange for charitable contributions that would qualify for a tax deduction. The IRS issued regulations stating that to the extent a tax credit was granted, the charitable contribution would not be deductible.

### **Step 3: Interest you paid (lines 8-10)**

As a general matter, personal interest is not deductible. Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations. Qualified residence interest means interest paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness. A qualified residence means the taxpayer’s principal residence and one other residence of the taxpayer selected to be a qualified residence. A qualified residence can be a house, condominium, cooperative, mobile home, house trailer, or boat.

Acquisition indebtedness is indebtedness that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer and which secures the residence. Note the following two rules:

#### **Limit on loans taken out on or before December 15, 2017**

For qualifying debt taken out on or before December 15, 2017, you can only deduct home mortgage interest on up to \$1,000,000 (\$500,000 if you are married filing separately) of that debt. The only exception is for loans taken out on or before October 13, 1987 (see IRS Publication 936 for more information about loans taken out on or before October 13, 1987.)

See Publication 936 to figure your deduction if you have loans taken out on or before December 15, 2017, that exceed \$1,000,000 (\$500,000 if you are married filing separately).

#### **Limit on loans taken out after December 15, 2017**

For qualifying debt taken out after December 15, 2017, you can only deduct home mortgage interest on up to \$750,000 (\$375,000 if you are married filing separately) of that debt. If you also have qualifying debt subject to the \$1,000,000 limitation discussed above, the \$750,000 limit for debt taken out after December 15, 2017, is reduced by the amount of your qualifying debt subject to the \$1,000,000 limit. An exception exists for certain loans taken out after December 15, 2017, but before April 1, 2019. If the

exception applies, your loan may be treated in the same manner as a loan taken out on or before December 15, 2017. See IRS Publication 936 for more information about this exception. See Publication 936 to figure your deduction if you have loans taken out after October 13, 1987, that exceed \$750,000 (\$375,000 if you are married filing separately).

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. (Your main home is the one you ordinarily live in most of the time.)
2. Paying points is an established business practice in the area where the loan was made.
3. The points paid were not more than the points generally charged in that area.
4. You use the cash method of accounting. This means you report income in the year you receive it and deduct expenses in the year you pay them. Most individuals use this method.
5. The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
6. The funds you provided at or before closing, plus any points the seller paid, were at least as much as the points charged. The funds you provided are not required to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds you paid at or before closing for any purpose. You cannot have borrowed these funds from your lender or mortgage broker.
7. You use your loan to buy or build your main home.
8. The points were computed as a percentage of the principal amount of the mortgage.
9. The amount is clearly shown on the settlement statement (such as the Settlement Statement, Form HUD-1) as points charged for the mortgage. The points may be shown as paid from either your funds or the seller’s.

**KEY POINT** Points are not currently deductible when paid in association with the refinancing of the home. These points must be amortized over the life of the new mortgage.

Congress enacted legislation in 2019 that provides for the deductibility of mortgage insurance premiums (MIP) through 2020, and retroactively for tax years 2018 and 2019. Use Form 1098, Mortgage Interest Statement, to report MIP aggregating \$600 or more, that you received during the calendar year in the course of your trade or business from an individual, including a sole proprietor.

#### **Step 4: Gifts to charity (lines 11-14)**

Cash contributions to churches, schools, and most other public charities, that are U.S. organizations, are deductible up to 60 percent 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 11, while contributions of noncash property are reported on line 12. If you cannot itemize your deductions, a charitable contribution, up to \$300, is allowed on Form 1040, Line 10b.

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 2020 and 2021). 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. (A letter acknowledging the individual's service and containing the "no goods or services" statement should be obtained from the charity.) 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.

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 60 percent of adjusted gross income. In some cases, contributions that exceed these limits can be carried over and claimed on future returns for up to five years. Some charitable contributions are limited to 20 percent or 30 percent of adjusted gross income, depending on the recipient and the form of the contribution.

Restricted 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. Restricted 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 canceled check or a receipt from the charity. Special rules govern the substantiation of individual contributions of cash or property of \$250 or more. The donor must substantiate these contributions with a qualifying receipt from the charity including a listing of the contributions and a statement that there were no goods or services provided in exchange for the contributions. These rules are further explained in the supplement to this guide entitled *Federal Reporting Requirements for Churches*.

**KEY POINT** It is the responsibility of the donor to confirm that all donations claimed are supported by qualifying receipts. The consequence of failure is a loss of any contribution not supported by a qualifying receipt. This error cannot be corrected if discovered after the tax return is filed. Some churches and charities fail to issue qualifying receipts, so donors must be vigilant in meeting this requirement, since this is not an error that can be corrected after your tax return is filed.

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. If several related items are given, each with a value of less than \$5,000, an appraisal may still be required since the group of items would be treated as one rather than on an individual basis.

Special rules apply to donations of cars, boats, and planes. A donation is not allowed if the value of the item is \$500 or more unless the donor has received Form 1098-C. 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 donated property, because he failed to attach a qualified appraisal summary (Form 8283) to the tax return on which the contribution was claimed.

**KEY POINT** In the CARES Act of 2020 Congress enacted a provision in the legislation that allows non-itemizers an above-the-line “qualified charitable deduction” of up to \$300 for charitable contributions.

### **Step 5: Casualty and theft losses (line 15)**

You can only deduct personal casualty and theft losses attributable to a federally declared disaster 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 discussed above) is more than 10% of the amount on Form 1040 or 1040-SR, line 11. See the Instructions for Form 4684 and Pub. 547 for more information.

### **NOTE: Job expenses and most other miscellaneous deductions**

Employee business expenses that are either unreimbursed, or reimbursed by an employer under a nonaccountable arrangement, are no longer deductible by an employee. This provision of the Tax Cuts and Jobs Act is effective for taxable years 2018 through 2025 unless extended by Congress.

The elimination of an itemized deduction for unreimbursed employee business expenses will hit some clergy hard. But this impact can be minimized if a church reimburses employees business expenses under an accountable expense reimbursement arrangement. To be accountable, a church's reimbursement arrangement must comply with all four of the following rules:

- Expenses must have a business connection—that is, the reimbursed expenses must represent expenses incurred by an employee while performing services for the employer.
- Employees are only reimbursed for expenses for which they provide an adequate accounting within a reasonable period of time (not more than 60 days after an expense is incurred).
- (Employees must return any excess reimbursement or allowance within a reasonable period of time (not more than 120 days after an excess reimbursement is paid).
- The income tax regulations caution that in order for an employer's reimbursement arrangement to be accountable, it must meet a "reimbursement requirement" in addition to the three requirements summarized above. The reimbursement requirement means that an employer's reimbursements of an employee's business expenses come out of the employer's funds and not by reducing the employee's salary.

Accountable expense reimbursement plans are always preferable for the employee. Ministers previously claiming expenses as miscellaneous deductions did not gain a full

tax deduction benefit from the process. The elimination of "all miscellaneous itemized deductions that are subject to the 2 percent floor under present law" (including unreimbursed employee business expenses, and employee expenses reimbursed under a nonaccountable plan) has encouraged many churches to move to accountable expense reimbursement plans, since section 62(a)(2)(A) of the tax code, which excludes from tax employer reimbursements of employee business expenses under an accountable plan (defined above) has not been modified.

## ***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 2020. Be sure the interest you report on line 1 corresponds to any 1099INT forms you received from such institutions. Do not include tax-exempt interest. Taxable interest income is carried over to line 2b of Form 1040.

### **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 2020. Be sure the dividends you report on line 5 correspond to any 1099-DIV forms you received from such institutions. Ordinary dividend income is carried over to line 3b of Form 1040.

### **Step 3: Foreign accounts and foreign trusts (lines 7-8)**

Be sure to complete this part of the schedule if you had more than \$1,500 of either taxable interest or ordinary dividends.

**KEY POINT** If you have foreign bank accounts, you may be subject to additional filings. This can also occur if your church has foreign bank accounts and you have signature authority on the accounts. Many times the foreign bank account reporting is overlooked by taxpayers. Failure to comply can create substantial penalties.

## *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 1 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 for guest speaking in other churches, and fees received directly from church members for performing personal services, such as weddings and funerals.

**KEY POINT** The IRS has discontinued the simplified Schedule C-EZ. Persons who used Schedule C-EZ in the past will now use Schedule C.

### **Step 1: Introduction**

Complete the first several questions on Schedule C. Ministers should list code 541990 on line B, since for many years this was the code the IRS used 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)**

**CAUTION** Many ministers continue to report their income taxes as self-employed. One perceived advantage of doing so is the ability to deduct business expenses on Schedule C (and avoid the nondeductibility of unreimbursed and nonaccountable reimbursed employee business expenses as itemized deductions on Schedule A). This advantage is often illusory. Most “self-employed” 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. The best way for 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 other expenses in the course of performing self-employment activities, you deduct these expenses on lines 8 through 27 of Schedule C. Self-employed persons can deduct only 50 percent of business meals and meals associated with entertainment.

**KEY POINT** Deductions are not allowed for expenses with respect to entertainment, amusement, or recreation. To clarify the application of this rule to meals related to entertainment, the IRS issued regulations clarifying that taxpayers may deduct 50 percent of an otherwise allowable business meal expense if (1) the expense is an ordinary and necessary expense paid or incurred during the taxable year in carrying on any trade or business; (2) the expense is not lavish or extravagant under the circumstances; (3) the taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages; (4) the food and beverages are provided to a current or potential business customer, client, consultant, or similar business contact; and (5) in the case of food and beverages provided during or at an entertainment activity, the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages. Note that this clarification does not benefit employees whose business expenses are not reimbursed by their employer, since such expenses are nondeductible.

Ministers may be required to reduce the expenses deducted on Schedule C, if a portion of the income is excluded from income as a housing allowance. The rules under IRC Section 265 state that expenses associated with tax-free income may not be deducted. Therefore, expenses on Schedule C may have to be allocated between taxable and non-taxable income. (Many refer to this rule as the Deason Rule.)

Report self-employment income from Schedule C on Schedule 1, line 3 (Form 1040) and carry over this and other items of additional income reported on Schedule 1 to line 8 of Form 1040.

## ***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 (except for some chaplains) are self-employed for Social Security with respect to their ministerial services. They pay self-

employment taxes, and not Social Security (“FICA”) and Medicare taxes, with respect to compensation from such services.

**KEY POINT** Ministers who have received IRS approval of an application for exemption from self-employment taxes (Form 4361) do not pay self-employment taxes on compensation received for their ministerial services. These ministers should enter “Exempt – Form 4361” on Form 1040, Schedule 2, line 4.

### **Step 1: Part I (line 2)**

Most ministers use the short Schedule SE rather than the long Schedule SE. This means that they complete Part I “Self-Employment Tax” on page 1 of the schedule rather than Part II. Ministers report their net self-employment earnings on line 2 of Part I. This amount is computed as follows:

Add the following to your church salary reported on Form W-2 in Box 1:

- other items of church income (including taxable fringe benefits)
- fees you receive for marriages, baptisms, funerals, masses, 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 nonaccountable 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:

- 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
- salary reduction contributions (elective deferrals) to a tax sheltered annuity plan (403(b) plan) if included in your gross income above
- pension payments or retirement allowances you receive for your past ministerial services
- unreimbursed employee business expenses (net of reimbursements & after 50% reduction in meal expenses.
- business expenses that were not deducted on Schedule C due to the allocation of a portion of the business expenses to the tax-free housing allowance pursuant to the requirements of IRC Section 265(a)(1), better known as the “Deason Rule”

### **Step 2: Part I (line 4)**

Ministers (and other taxpayers who are self-employed for Social Security) can reduce their taxable earnings by 7.65 percent, 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: Part I (line 12)**

The self-employment tax for 2020 is computed on this line. The self-employment tax rate for 2020 is 15.3 percent, which consists of the following two components:

1. a Medicare hospital insurance tax of 2.9 percent, and
2. an old-age, survivor and disability (Social Security) tax of 12.4 percent.

For 2020, the 2.9 percent Medicare tax applied to all net earnings from self-employment regardless of amount. For 2020, the 12.4 percent Social Security tax applied to only the first \$137,700 of net self-employment earnings. (For 2021, the maximum earnings subject to Social Security tax is \$142,800.)

## ***Form 8959, Additional Medicare Tax***

An additional Medicare tax is calculated on wages or self-employment income of higher income taxpayers. A Medicare (HI) tax of an additional tax of 0.9 percent on wages received in excess of certain amounts must be calculated. This additional tax applies to

ministers subject to self-employment tax. Unlike other Social Security and Medicare taxes, this additional tax is on the combined wages of a taxpayer and the taxpayer's spouse, in the case of a joint return. The threshold amount is \$250,000 in the case of a joint return or surviving spouse, and \$200,000 for single persons. The \$250,000 and \$200,000 amounts are not adjusted for inflation and remain the same for 2021.

Ministers who are a part of a two-earner family may be subject to this additional tax and should plan accordingly. Each working spouse may have wages and self-employment income of less than \$250,000, but when added together, the total exceeds the threshold. This additional tax should be considered in preparing estimated tax payments or withholding instructions.

## ***Form 2106***

**KEY POINT** In the past Form 2106 was used by employees to compute employee business expenses claimed on Schedule A. For most taxpayers this form is now obsolete because of the suspension of an itemized deduction for employee business expenses on Schedule A. Form 2106 is now used only by Armed Forces reservists, qualified performing artists, fee-basis state or local government officials, and employees with impairment-related work expenses.

## **PART 4**

# **COMPREHENSIVE EXAMPLE AND FORMS**

### **Example One: Active Minister**

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

### **Example Two: Retired Minister**

# CLERGY TAX REPORTING: ILLUSTRATED EXAMPLES

## Example One: Active Minister

Rev. John Michaels is the minister of the First United 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. None of the wages paid to Rev. Michaels during 2020 were related to a coronavirus leave of absence under the Families First Coronavirus Response Act. 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 parsonage allowance. The home's fair rental value is \$1,380 per month (including furnishings and utilities). Additionally, Rev. Michaels made cash charitable contributions of \$6,000 to Section 501(c)(3) public charities in 2020. Rev. Michaels has chosen not to defer payment of his self-employment taxes under special 2020 coronavirus relief legislation. Rev. Michaels received a coronavirus economic impact payment (stimulus check) in the amount of \$2,900 and therefore does not qualify for a recovery rebate credit.

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 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 parsonage 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. 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, "**Religious employment** – This income was 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 Parsonage or 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 (Form 1040)

*Note, for tax years 2019 and later, the IRS announced that it will not be issuing the Schedule C-EZ. Therefore, Schedule C will be used.*

Some of Rev. Michaels' entries on Schedule C are explained here.

Line 1. Rev. Michaels reports the \$4,000 from weddings, baptisms, and honoraria.

Lines 2 through 7. Rev. Michaels fills out these lines to report his gross income reported on line 7. Rev. Michael did not have any returns or allowances, cost of goods sold, or other income for the year. Therefore, the amount reported on line 7 is \$4,000.

Lines 8 – 27a. Rev. Michaels reports his expenses related to the line 1 amount. The total consisted of \$87 for marriage and family booklets and \$251 for 437 miles of business use of his car, mainly in connection with honoraria. Rev. Michaels used the standard mileage rate to figure his car expense. He multiplied the standard mileage rate of 57.5 cents by 437 miles for a total of \$251. These expenses total \$338 (\$251 + \$87).

Line 9. Rev. Michaels reports his car expenses on this line. 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 25% (or \$63) of his car expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the \$63 from the \$251 and enters the \$188 difference on line 9. Rev. Michaels also reports information regarding his vehicle on Part IV.

Line 27a. Rev. Michaels reports \$87 for marriage and family booklets. 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 25% (or \$22) of his expenses are not deductible because they are allocable to that tax-free allowance. He

subtracts the \$22 from the \$87 and enters the \$65 difference on line 27a. He also reports a description of the expense in Part V.

Line 28. Rev. Michaels enters his total expenses, less the 25% allocable to his tax-free parsonage allowance, (\$188 + \$65) on line 28.

Line 29 through 31. He enters his tentative profit of \$3,747 reported on line 29, less any expenses for business use of home on line 31. Rev. Michaels did not have any expenses for business use of home, therefore his net income is \$3,747. Net income on Schedule C is also reported on Schedule 1 (Form 1040), line 3.

Lines 43 through 47b. Rev. Michaels fills out these lines to report information about his car.

Line 48. Rev. Michaels reports the total other expenses included on line 27a.

Turbo Tax tips: Turbo Tax does not appear to calculate the nondeductible 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. Michaels prepares Schedule C, he fills out Schedule SE (Form 1040). Rev. Michaels is a minister, so his salary from the church is not considered church employee income. Additionally, Rev. Michaels did not apply for an exemption from SE tax by filing Form 4361 and therefore leaves the first box on Schedule SE unchecked. He fills out the following lines in Part I.

Line 2. Rev. Michaels attaches a statement (see Attachment 2, later) that explains how he figures the amount (\$63,826) he enters here. The calculation in Attachment 2 includes unreimbursed business expenses from his work for the church. Although unreimbursed business expenses are clearly no longer deductible on Schedule A as itemized deductions for federal income tax purposes, there is still some ambiguity as of the date of this writing as to whether these expenses remain deductible for self-employment tax purposes. Although not abundantly clear, language in IRS Publication 517 appears to allow a deduction of these expenses for self-employment tax purposes against wages earned by a minister as a common-law employee of a church. Based on the commentary in Chapter 9 and the underlying rulings discussed therein, the author has prepared this example assuming these expenses are deductible against self-employment earnings. Ministers should consult with their personal tax advisors regarding the deductibility of these expenses for purposes of self-employment tax on their 2020 Form 1040, in light of the developing nature of guidance in this area as of the date of this writing. Rev. Michaels records show that he drove 2,465 miles. He multiplies miles driven by the mileage rate of 57.5 cents. The combined result is \$1,417. Additionally, Rev. Michaels paid for \$219 of professional publications and booklets in connection with his work for the church. The total unreimbursed business expenses were \$1,636. After including the \$85 of Schedule C expenses allocable to tax-free income, the total deductions against self-employment income is \$1,721.

Line 4a through Line 6. He multiplies \$63,826 by .9235 to get his net earnings from self-employment (\$58,943). This amount is then carried through to line 6 since Rev. Michaels does not have any other adjustments.

Line 10. The amount on line 6 is less than \$137,700, so Rev. Michaels multiplies the amount on line 6 (\$58,943) by .124 to get the Social Security portion of the self-employment tax of \$7,309.

Line 11. He multiplies the amount on line 6 by .029 to calculate the Medicare portion of the self-employment tax of \$1,709.

Line 12. He adds the Social Security tax from line 10 and the Medicare tax on line 11 to determine his total self employment tax of \$9,018. Rev. Michaels enters that amount here and on Schedule 2 (Form 1040), line 4 and 10.

Line 13. Rev. Michaels multiplies the amount on line 12 by .50 to get his deduction for the employer-equivalent portion of self-employment tax of \$4,509. He enters that amount here and on Schedule 1 (Form 1040), line 14.

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 automatically 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. This can be done by going into the “Business Taxes” section, and selecting “Self-Employment Tax.” Choose “Make Adjustments,” and enter in the “Ministerial Business Expenses” item the additional expenses that were not deducted elsewhere on the return (\$1,721 in this example – see Attachment 2).

## Qualified Business Income Deduction (Form 8995)

*Ministers who have net profit reported on Schedule C for ministerial services and who have 2020 taxable income of less than \$163,300 (\$326,600 if married filing jointly) before the application of a qualified business income deduction may be eligible for the qualified business income deduction.*

After Rev. Michaels prepares Schedule SE, he fills out Form 8995.

Line 1i, Column (c). Rev. Michaels reports the net profit or (loss) from Schedule C, line 31 (\$3,747) less the portion of the deduction for self-employment taxes allocable to this net profit ( $\$3,747 * .9235 * .153 * .5 = \$265$ ) which results in \$3,482 on line 1i, Column (c). Since there are no other amounts listed on lines 1ii through line 1v, he also reports the amount on line 2.

Line 4. Rev. Michaels adds the total qualified business income or (loss) reported on line 2 (\$3,482) to any qualified business net losses carried forward from the prior year. Since there are no qualified business net losses carried forward from the prior year, he enters the amount on line 4.

Line 5. Rev. Michaels multiplies line 4 by 20% and enters the resulting amount (\$696) on line 5. Since there are no other amounts reported on lines 6-9, he also reports the amount on line 10.

Line 11. Rev. Michaels adds the total taxable income before qualified business income deduction (\$22,778) on line 11. This amount is equal to the total wages, salaries, and Schedule C income less the deductible amount of self-employment tax and standard deduction ( $\$48,640 + \$3,747 - \$4,509 - 300$ , the special charitable contribution deduction on Form 1040 line 10b - \$24,800, the standard deduction from line 9 of Form 1040). Since there is no other amounts reported on line 12, he also reports the amount on line 13.

Line 15. Rev. Michaels multiplies line 13 by 20% (\$4,556), which he reports on line 14. He then reports the lesser of line 10 or line 14 on line 15 (\$696). Rev. Michaels also enters this amount on Form 1040, line 13.

## Form 1040, Schedule 1 (Form 1040), and Schedule 2 (Form 1040)

After Rev. Michaels prepares the above schedules, he fills out Form 1040, along with Schedules 1 through 3 to the extent required. He files a joint return with his wife. First he fills out Form 1040, Page 1 and completes the appropriate lines for his filing status and exemptions. Then, he fills out the rest of the forms as follows:

Form 1040, Line 1. 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 parsonage 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.

Schedule 1 (Form 1040), Line 3. He reports his net profit of \$3,747 from Schedule C, line 31. Since no other amounts are reported on Schedule 1 (Form 1040), Lines 1-8, he also reports this amount on Line 9, and carries the figure to Form 1040, line 8.

Form 1040, Line 9. Rev. Michaels adds Form 1040 line 1 and the amount reported on Form 1040 line 8, and enters the total (\$52,387) on line 9.

Form 1040 Line 10a and 10b. Because Rev. Michaels has reported deductible self-employment tax on Schedule 1 (Form 1040) Line 14, Rev. Michaels goes to Schedule 1 (Form 1040) and completes Part II of the form. Since there are no other amounts listed on lines 10-21, Rev. Michaels reports \$4,509 on Line 22 and enters this amount on Form 1040, Line 10a. Additionally, in 2020, a maximum \$300 charitable contribution deduction is allowed on Form 1040, line 10b for qualifying charitable contributions. Since Rev. Michaels made cash contributions of \$6,000 to a qualifying 501(c)(3) public charity, he enters the maximum contribution deduction of \$300 on line 10b. Line 10a and line 10b are added and reported on line 10c (\$4,809). Line 10c is subtracted from line 9 and the result (\$447,578) is entered on Form 1040 Line 11. This is his adjusted gross income.

Form 1040, Line 12. He enters the standard deduction for married couples filing jointly (\$24,800) on Line 12.

Form 1040, Line 13. Rev. Michaels adds the qualified business income deduction on Form 8995 line 15, and enters the total on (\$696) on line 13.

Form 1040, Line 14. Rev. Michaels adds the amounts on Form 1040, Line 12 and Line 13, and enters the total (\$25,496) on line 14.

Form 1040 Line 15. Subtract line 14 from line 11. This is his taxable income.

Form 1040, Page 2, Line 16. Rev. Michaels uses the tax tables in the 2020 Form 1040 instructions to determine his applicable tax and enters the amount (\$2,254) on the space provided on Line 16.

Form 1040, Page 2, Line 19. 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 \$2,000 credit. Since there is no amount listed for Schedule 3, line 7 Rev. Michaels enters \$2,000 on line 19 and line 21. (Note: The Michaels are not required to attach Schedule 8812 to claim the child tax credit since they are not eligible for the additional child tax credit and their daughter does not have an individual taxpayer identification number (ITIN). The IRS issues ITINs to foreign nationals and others who have federal tax reporting or filing requirements and do not qualify for social security numbers (SSNs). Since Jennifer has a SSN, she is not required to obtain an ITIN and therefore Schedule 8812 is not applicable.)

Form 1040, Page 2, Line 23 and Schedule 2 (Form 1040). Rev. Michaels completes Schedule 2 (Form 1040). Since the only amount reported on Schedule 2 (Form 1040) is his

self-employment tax from Schedule SE, he reports the amount (\$9,018) on Schedule 2 (Form 1040), Line 10, and on Form 1040, Page 2, line 23.

Form 1040, Page 2, Line 24. He adds the amount reported on line 22 and the self employment taxes reported on line 23. This represents his total tax obligation.

Form 1040, Page 2, Line 25a and 25d. He enters the federal income tax shown in box 2 of his Form W-2 from the college.

Form 1040, Page 2, Line 26. Rev. Michaels enters the \$12,000 estimated tax payments he made for the year on line 26.

Form 1040, Page 2, Line 33. He adds the amount reported on line 25d and line 26 to show the total tax payments made on line 33 (\$12,272).

Form 1040, Page 2, Line 34. Rev. Michaels totals his overpayment by subtracting line 33 from line 24 (\$3,000).

		<b>a</b> Employee's social security number <b>011-00-1111</b>		OMB No. 1545-0008		Safe, accurate, <b>FAST! Use</b>				Visit the IRS website at <a href="http://www.irs.gov/efile">www.irs.gov/efile</a>	
<b>b</b> Employer identification number (EIN) <b>00-0246810</b>				<b>1</b> Wages, tips, other compensation <b>45,000.00</b>		<b>2</b> Federal income tax withheld					
<b>c</b> Employer's name, address, and ZIP code <b>First United Church</b> <b>1042 Main Street</b> <b>Hometown, Texas 77099</b>				<b>3</b> Social security wages		<b>4</b> Social security tax withheld					
				<b>5</b> Medicare wages and tips		<b>6</b> Medicare tax withheld					
				<b>7</b> Social security tips		<b>8</b> Allocated tips					
<b>d</b> Control number				<b>9</b>		<b>10</b> Dependent care benefits					
<b>e</b> Employee's first name and initial		Last name		Suff.		<b>11</b> Nonqualified plans		<b>12a</b> See instructions for box 12			
<b>John E.</b>		<b>Michaels</b>				<b>13</b> Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>		<b>12b</b>			
<b>1040 Main Street</b>		<b>Hometown, Texas 77099</b>				<b>14</b> Other <b>Parsonage Allowance</b> <b>\$16,800</b>		<b>12c</b>			
<b>f</b> Employee's address and ZIP code								<b>12d</b>			
<b>15</b> State Employer's state ID number		<b>16</b> State wages, tips, etc.		<b>17</b> State income tax		<b>18</b> Local wages, tips, etc.		<b>19</b> Local income tax		<b>20</b> Locality name	

Form **W-2** Wage and Tax Statement

**2020**

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.

		<b>a</b> Employee's social security number <b>011-00-1111</b>		Safe, accurate, <b>FAST! Use</b>				Visit the IRS website at <a href="http://www.irs.gov/efile">www.irs.gov/efile</a>		
<b>b</b> Employer identification number (EIN) <b>00-1357913</b>				<b>1</b> Wages, tips, other compensation <b>3,400.00</b>		<b>2</b> Federal income tax withheld <b>272.00</b>				
<b>c</b> Employer's name, address, and ZIP code <b>Hometown College</b> <b>40 Honor Road</b> <b>Hometown, Texas 77099</b>				<b>3</b> Social security wages <b>3,400.00</b>		<b>4</b> Social security tax withheld <b>210.80</b>				
				<b>5</b> Medicare wages and tips <b>3,400.00</b>		<b>6</b> Medicare tax withheld <b>49.30</b>				
				<b>7</b> Social security tips		<b>8</b> Allocated tips				
<b>d</b> Control number				<b>9</b>		<b>10</b> Dependent care benefits				
<b>e</b> Employee's first name and initial <b>John E.</b>		Last name <b>Michaels</b>		Suff.		<b>11</b> Nonqualified plans		<b>12a</b> See instructions for box 12 C o d e		
<b>1040 Main Street</b> <b>Hometown, Texas 77099</b>				<b>13</b> Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>		<b>12b</b> C o d e				
				<b>14</b> Other		<b>12c</b> C o d e				
						<b>12d</b> C o d e				
<b>f</b> Employee's address and ZIP code										
<b>15</b> State Employer's state ID number		<b>16</b> State wages, tips, etc.		<b>17</b> State income tax		<b>18</b> Local wages, tips, etc.		<b>19</b> Local income tax		<b>20</b> Locality name

Form **W-2** Wage and Tax Statement

**2020**

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.

Filing Status [ ] Single [ ] Married filing jointly [ ] Married filing separately (MFS) [ ] Head of household (HOH) [ ] Qualifying widow(er) (QW)
Check only one box. If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent

Your first name and middle initial Last name Your social security number
If joint return, spouse's first name and middle initial Last name Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. Apt. no.
City, town, or post office. If you have a foreign address, also complete spaces below. State ZIP code
Foreign country name Foreign province/state/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

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? [ ] Yes [ ] No

Standard Deduction Someone can claim: [ ] You as a dependent [ ] Your spouse as a dependent
[ ] Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness You: [ ] Were born before January 2, 1956 [ ] Are blind Spouse: [ ] Was born before January 2, 1956 [ ] Is blind

Table with 6 columns: (1) First name, Last name, (2) Social security number, (3) Relationship to you, (4) Child tax credit, Credit for other dependents. Includes instructions for dependents.

Main income table with columns 1-15. Includes rows for Wages, salaries, tips, etc.; Tax-exempt interest; Qualified dividends; IRA distributions; Pensions and annuities; Social security benefits; Capital gain or (loss); Other income from Schedule 1, line 9; Adjustments to income; Standard deduction or itemized deductions; Qualified business income deduction; Taxable income.

16	Tax (see instructions). Check if any from Form(s): 1 <input type="checkbox"/> 8814 2 <input type="checkbox"/> 4972 3 <input type="checkbox"/>	16
17	Amount from Schedule 2, line 3	17
18	Add lines 16 and 17	18
19	Child tax credit or credit for other dependents	19
20	Amount from Schedule 3, line 7	20
21	Add lines 19 and 20	21
22	Subtract line 21 from line 18. If zero or less, enter -0-	22
23	Other taxes, including self-employment tax, from Schedule 2, line 10	23
24	Add lines 22 and 23. This is your <b>total tax</b>	24
25	Federal income tax withheld from:	
a	Form(s) W-2	25a
b	Form(s) 1099	25b
c	Other forms (see instructions)	25c
d	Add lines 25a through 25c	25d
26	2020 estimated tax payments and amount applied from 2019 return	26
27	Earned income credit (EIC)	27
28	Additional child tax credit. Attach Schedule 8812	28
29	American opportunity credit from Form 8863, line 8	29
30	Recovery rebate credit. See instructions	30
31	Amount from Schedule 3, line 13	31
32	Add lines 27 through 31. These are your <b>total other payments and refundable credits</b>	32
33	Add lines 25d, 26, and 32. These are your <b>total payments</b>	33

• If you have a qualifying child, attach Sch. EIC.  
 • If you have nontaxable combat pay, see instructions.

**Refund**

34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you <b>overpaid</b>	34
35a	Amount of line 34 you want <b>refunded to you</b> . If Form 8888 is attached, check here <input type="checkbox"/>	35a
b	Routing number	c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings
d	Account number	
36	Amount of line 34 you want <b>applied to your 2021 estimated tax</b>	36

**Amount You Owe**

For details on how to pay, see instructions.

37	Subtract line 33 from line 24. This is the <b>amount you owe now</b>	37
<b>Note:</b> Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.		
38	Estimated tax penalty (see instructions)	38

**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 <i>John Michaels</i>	Date 3/15/21	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.) <input type="text"/>
Spouse's signature. If a joint return, <b>both</b> must sign. <i>Susan Michaels</i>	Date 3/15/21	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.) <input type="text"/>
Phone no. <input type="text"/>	Email address <input type="text"/>		

**Paid Preparer Use Only**

Preparer's name	Preparer's signature	Date	PTIN	Check if: <input type="checkbox"/> Self-employed
Firm's name <input type="text"/>	Firm's address <input type="text"/>			Phone no. <input type="text"/>
Firm's EIN <input type="text"/>				

**SCHEDULE 1  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**Additional Income and Adjustments to Income**

▶ **Attach to Form 1040, 1040-SR, or 1040-NR.**  
▶ **Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.**

OMB No. 1545-0074

**2020**  
Attachment  
Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

Your social security number

**Part I Additional Income**

<b>1</b>	Taxable refunds, credits, or offsets of state and local income taxes . . . . .	<b>1</b>	
<b>2a</b>	Alimony received . . . . .	<b>2a</b>	
<b>b</b>	Date of original divorce or separation agreement (see instructions) ▶ _____		
<b>3</b>	Business income or (loss). Attach Schedule C . . . . .	<b>3</b>	
<b>4</b>	Other gains or (losses). Attach Form 4797 . . . . .	<b>4</b>	
<b>5</b>	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E . . . . .	<b>5</b>	
<b>6</b>	Farm income or (loss). Attach Schedule F . . . . .	<b>6</b>	
<b>7</b>	Unemployment compensation . . . . .	<b>7</b>	
<b>8</b>	Other income. List type and amount ▶ _____	<b>8</b>	
<b>9</b>	Combine lines 1 through 8. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8 . . . . .	<b>9</b>	

**Part II Adjustments to Income**

<b>10</b>	Educator expenses . . . . .	<b>10</b>	
<b>11</b>	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 . . . . .	<b>11</b>	
<b>12</b>	Health savings account deduction. Attach Form 8889 . . . . .	<b>12</b>	
<b>13</b>	Moving expenses for members of the Armed Forces. Attach Form 3903 . . . . .	<b>13</b>	
<b>14</b>	Deductible part of self-employment tax. Attach Schedule SE . . . . .	<b>14</b>	
<b>15</b>	Self-employed SEP, SIMPLE, and qualified plans . . . . .	<b>15</b>	
<b>16</b>	Self-employed health insurance deduction . . . . .	<b>16</b>	
<b>17</b>	Penalty on early withdrawal of savings . . . . .	<b>17</b>	
<b>18a</b>	Alimony paid . . . . .	<b>18a</b>	
<b>b</b>	Recipient's SSN . . . . . ▶ _____		
<b>c</b>	Date of original divorce or separation agreement (see instructions) ▶ _____		
<b>19</b>	IRA deduction . . . . .	<b>19</b>	
<b>20</b>	Student loan interest deduction . . . . .	<b>20</b>	
<b>21</b>	Tuition and fees deduction. Attach Form 8917 . . . . .	<b>21</b>	
<b>22</b>	Add lines 10 through 21. These are your <b>adjustments to income</b> . Enter here and on Form 1040, 1040-SR, or 1040-NR, line 10a . . . . .	<b>22</b>	

**SCHEDULE 2  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**Additional Taxes**

▶ **Attach to Form 1040, 1040-SR, or 1040-NR.**  
▶ **Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.**

OMB No. 1545-0074

**2020**  
Attachment  
Sequence No. **02**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

Your social security number

**Part I Tax**

<b>1</b>	Alternative minimum tax. Attach Form 6251 . . . . .	<b>1</b>
<b>2</b>	Excess advance premium tax credit repayment. Attach Form 8962 . . . . .	<b>2</b>
<b>3</b>	Add lines 1 and 2. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 17 . . . . .	<b>3</b>

**Part II Other Taxes**

<b>4</b>	Self-employment tax. Attach Schedule SE . . . . .	<b>4</b>
<b>5</b>	Unreported social security and Medicare tax from Form: <b>a</b> <input type="checkbox"/> 4137 <b>b</b> <input type="checkbox"/> 8919 . . . . .	<b>5</b>
<b>6</b>	Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required . . . . .	<b>6</b>
<b>7a</b>	Household employment taxes. Attach Schedule H . . . . .	<b>7a</b>
<b>b</b>	Repayment of first-time homebuyer credit from Form 5405. Attach Form 5405 if required . . . . .	<b>7b</b>
<b>8</b>	Taxes from: <b>a</b> <input type="checkbox"/> Form 8959 <b>b</b> <input type="checkbox"/> Form 8960 <b>c</b> <input type="checkbox"/> Instructions; enter code(s) _____	<b>8</b>
<b>9</b>	Section 965 net tax liability installment from Form 965-A . . . . .	<b>9</b>
<b>10</b>	Add lines 4 through 8. These are your <b>total other taxes</b> . Enter here and on Form 1040 or 1040-SR, line 23, or Form 1040-NR, line 23b . . . . .	<b>10</b>

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71478U

Schedule 2 (Form 1040) 2020

**SCHEDULE A**  
**(Form 1040)**

**Itemized Deductions**

OMB No. 1545-0074

**2020**

Attachment  
Sequence No. **07**

Department of the Treasury  
Internal Revenue Service (99)

▶ Go to [www.irs.gov/ScheduleA](http://www.irs.gov/ScheduleA) for instructions and the latest information.

▶ Attach to Form 1040 or 1040-SR.

**Caution:** If you are claiming a net qualified disaster loss on Form 4684, see the instructions for line 16.

Name(s) shown on Form 1040 or 1040-SR

Your social security number

**Medical and Dental Expenses**

**Caution:** Do not include expenses reimbursed or paid by others.

<b>1</b>	Medical and dental expenses (see instructions)		
<b>2</b>	Enter amount from Form 1040 or 1040-SR, line 11	<b>2</b>	
<b>3</b>	Multiply line 2 by 7.5% (0.075)		
<b>4</b>	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-		<b>4</b>

**Taxes You Paid**

<b>5</b>	State and local taxes.		
<b>a</b>	State and local income taxes or general sales taxes. You may include either income taxes or general sales taxes on line 5a, but not both. If you elect to include general sales taxes instead of income taxes, check this box <input type="checkbox"/>	<b>5a</b>	
<b>b</b>	State and local real estate taxes (see instructions)	<b>5b</b>	
<b>c</b>	State and local personal property taxes	<b>5c</b>	
<b>d</b>	Add lines 5a through 5c	<b>5d</b>	
<b>e</b>	Enter the smaller of line 5d or \$10,000 (\$5,000 if married filing separately)	<b>5e</b>	
<b>6</b>	Other taxes. List type and amount ▶	<b>6</b>	
<b>7</b>	Add lines 5e and 6		<b>7</b>

**Interest You Paid**

**Caution:** Your mortgage interest deduction may be limited (see instructions).

<b>8</b>	Home mortgage interest and points. If you didn't use all of your home mortgage loan(s) to buy, build, or improve your home, see instructions and check this box <input type="checkbox"/>		
<b>a</b>	Home mortgage interest and points reported to you on Form 1098. See instructions if limited	<b>8a</b>	
<b>b</b>	Home mortgage interest not reported to you on Form 1098. See instructions if limited. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ▶	<b>8b</b>	
<b>c</b>	Points not reported to you on Form 1098. See instructions for special rules	<b>8c</b>	
<b>d</b>	Mortgage insurance premiums (see instructions)	<b>8d</b>	
<b>e</b>	Add lines 8a through 8d	<b>8e</b>	
<b>9</b>	Investment interest. Attach Form 4952 if required. See instructions.	<b>9</b>	
<b>10</b>	Add lines 8e and 9		<b>10</b>

**Gifts to Charity**

**Caution:** If you made a gift and got a benefit for it, see instructions.

<b>11</b>	Gifts by cash or check. If you made any gift of \$250 or more, see instructions	<b>11</b>	
<b>12</b>	Other than by cash or check. If you made any gift of \$250 or more, see instructions. You <b>must</b> attach Form 8283 if over \$500.	<b>12</b>	
<b>13</b>	Carryover from prior year	<b>13</b>	
<b>14</b>	Add lines 11 through 13		<b>14</b>

**Casualty and Theft Losses**

<b>15</b>	Casualty and theft loss(es) from a federally declared disaster (other than net qualified disaster losses). Attach Form 4684 and enter the amount from line 18 of that form. See instructions		<b>15</b>
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**Other Itemized Deductions**

<b>16</b>	Other—from list in instructions. List type and amount ▶		<b>16</b>
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**Total Itemized Deductions**

<b>17</b>	Add the amounts in the far right column for lines 4 through 16. Also, enter this amount on Form 1040 or 1040-SR, line 12		<b>17</b>
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**18** If you elect to itemize deductions even though they are less than your standard deduction, check this box

**SCHEDULE C  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Profit or Loss From Business  
(Sole Proprietorship)**

▶ Go to [www.irs.gov/ScheduleC](http://www.irs.gov/ScheduleC) for instructions and the latest information.

▶ Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships generally must file Form 1065.

OMB No. 1545-0074

**2020**

Attachment  
Sequence No. **09**

Name of proprietor <b>John E. Michaels</b>		Social security number (SSN) <b>011-00-1111</b>
A Principal business or profession, including product or service (see instructions) <b>Minister</b>		B Enter code from instructions ▶ <b>5 4 1 9 9 0</b>
C Business name. If no separate business name, leave blank.		D Employer ID number (EIN) (see instr.)
E Business address (including suite or room no.) ▶ <b>1042 Main Street</b> City, town or post office, state, and ZIP code <b>Hometown, Texas 77099</b>		
F Accounting method: (1) <input checked="" type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶		
G Did you "materially participate" in the operation of this business during 2020? If "No," see instructions for limit on losses		<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
H If you started or acquired this business during 2020, check here		<input type="checkbox"/>
I Did you make any payments in 2020 that would require you to file Form(s) 1099? See instructions		<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
J If "Yes," did you or will you file required Form(s) 1099?		<input type="checkbox"/> Yes <input type="checkbox"/> No

**Part I Income**

1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked . . . . . ▶ <input type="checkbox"/>	<b>1</b>	<b>4,000</b>
2	Returns and allowances . . . . .	<b>2</b>	
3	Subtract line 2 from line 1 . . . . .	<b>3</b>	<b>4,000</b>
4	Cost of goods sold (from line 42) . . . . .	<b>4</b>	
5	<b>Gross profit.</b> Subtract line 4 from line 3 . . . . .	<b>5</b>	<b>4,000</b>
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions) . . . . .	<b>6</b>	
7	<b>Gross income.</b> Add lines 5 and 6 . . . . . ▶	<b>7</b>	<b>4,000</b>

**Part II Expenses.** Enter expenses for business use of your home **only** on line 30.

8	Advertising . . . . .	<b>8</b>		18	Office expense (see instructions)	<b>18</b>	
9	Car and truck expenses (see instructions). . . . .	<b>9</b>	<b>188</b>	19	Pension and profit-sharing plans . . . . .	<b>19</b>	
10	Commissions and fees . . . . .	<b>10</b>		20	Rent or lease (see instructions):		
11	Contract labor (see instructions)	<b>11</b>		a	Vehicles, machinery, and equipment	<b>20a</b>	
12	Depletion . . . . .	<b>12</b>		b	Other business property . . . . .	<b>20b</b>	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions). . . . .	<b>13</b>		21	Repairs and maintenance . . . . .	<b>21</b>	
14	Employee benefit programs (other than on line 19) . . . . .	<b>14</b>		22	Supplies (not included in Part III) . . . . .	<b>22</b>	
15	Insurance (other than health)	<b>15</b>		23	Taxes and licenses . . . . .	<b>23</b>	
16	Interest (see instructions):			24	Travel and meals:		
a	Mortgage (paid to banks, etc.)	<b>16a</b>		a	Travel . . . . .	<b>24a</b>	
b	Other . . . . .	<b>16b</b>		b	Deductible meals (see instructions) . . . . .	<b>24b</b>	
17	Legal and professional services	<b>17</b>		25	Utilities . . . . .	<b>25</b>	
				26	Wages (less employment credits) . . . . .	<b>26</b>	
				27a	Other expenses (from line 48) . . . . .	<b>27a</b>	<b>65 *</b>
				b	<b>Reserved for future use</b> . . . . .	<b>27b</b>	

28	Total expenses before expenses for business use of home. Add lines 8 through 27a . . . . . ▶	<b>28</b>	<b>253</b>
29	Tentative profit or (loss). Subtract line 28 from line 7 . . . . .	<b>29</b>	<b>3,747</b>

30 Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions.  
**Simplified method filers only:** Enter the total square footage of (a) your home: \_\_\_\_\_ and (b) the part of your home used for business: \_\_\_\_\_. Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30 . . . . .

<b>30</b>		<b>0</b>
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31 **Net profit or (loss).** Subtract line 30 from line 29.

- If a profit, enter on both **Schedule 1 (Form 1040), line 3**, and on **Schedule SE, line 2**. (If you checked the box on line 1, see instructions). Estates and trusts, enter on **Form 1041, line 3**.
- If a loss, you **must** go to line 32.

<b>31</b>		<b>3,747</b>
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32 If you have a loss, check the box that describes your investment in this activity. See instructions.

- If you checked 32a, enter the loss on both **Schedule 1 (Form 1040), line 3**, and on **Schedule SE, line 2**. (If you checked the box on line 1, see the line 31 instructions). Estates and trusts, enter on **Form 1041, line 3**.
- If you checked 32b, you **must** attach **Form 6198**. Your loss may be limited.

	32a <input type="checkbox"/> All investment is at risk.	
	32b <input type="checkbox"/> Some investment is not at risk.	

For Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11334P

Schedule C (Form 1040) 2020

\* See statement attached.

**Part III Cost of Goods Sold** (see instructions)

**33** Method(s) used to value closing inventory:    **a**  Cost    **b**  Lower of cost or market    **c**  Other (attach explanation)

**34** Was there any change in determining quantities, costs, or valuations between opening and closing inventory?  
If "Yes," attach explanation . . . . .  **Yes**     **No**

<b>35</b> Inventory at beginning of year. If different from last year's closing inventory, attach explanation . . .	<b>35</b>	
<b>36</b> Purchases less cost of items withdrawn for personal use . . . . .	<b>36</b>	
<b>37</b> Cost of labor. Do not include any amounts paid to yourself . . . . .	<b>37</b>	
<b>38</b> Materials and supplies . . . . .	<b>38</b>	
<b>39</b> Other costs . . . . .	<b>39</b>	
<b>40</b> Add lines 35 through 39 . . . . .	<b>40</b>	
<b>41</b> Inventory at end of year . . . . .	<b>41</b>	
<b>42</b> <b>Cost of goods sold.</b> Subtract line 41 from line 40. Enter the result here and on line 4 . . . . .	<b>42</b>	

**Part IV Information on Your Vehicle.** Complete this part **only** if you are claiming car or truck expenses on line 9 and are not required to file Form 4562 for this business. See the instructions for line 13 to find out if you must file Form 4562.

**43** When did you place your vehicle in service for business purposes? (month/day/year)    ▶ 7 / 15 / 13

**44** Of the total number of miles you drove your vehicle during 2020, enter the number of miles you used your vehicle for:

**a** Business 437    **b** Commuting (see instructions) 0    **c** Other 7,478

**45** Was your vehicle available for personal use during off-duty hours? . . . . .  **Yes**     **No**

**46** Do you (or your spouse) have another vehicle available for personal use?. . . . .  **Yes**     **No**

**47a** Do you have evidence to support your deduction? . . . . .  **Yes**     **No**

**b** If "Yes," is the evidence written? . . . . .  **Yes**     **No**

**Part V Other Expenses.** List below business expenses not included on lines 8–26 or line 30.

Marriage and family booklets		65
-----		
-----		
-----		
-----		
-----		
-----		
-----		
<b>48</b> <b>Total other expenses.</b> Enter here and on line 27a . . . . .	<b>48</b>	65

**SCHEDULE SE  
(Form 1040)**

**Self-Employment Tax**

OMB No. 1545-0074

**2020**  
Attachment  
Sequence No. **17**

Department of the Treasury  
Internal Revenue Service (99)

► Go to [www.irs.gov/ScheduleSE](http://www.irs.gov/ScheduleSE) for instructions and the latest information.  
► Attach to Form 1040, 1040-SR, or 1040-NR.

Name of person with self-employment income (as shown on Form 1040, 1040-SR, or 1040-NR)

Social security number of person  
with **self-employment** income ►

**Part I Self-Employment Tax**

**Note:** If your only income subject to self-employment tax is **church employee income**, see instructions for how to report your income and 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 . . . . .

Skip lines 1a and 1b if you use the farm optional method in Part II. See instructions.

**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 AH . . . . . **1b** ( )

Skip line 2 if you use the nonfarm optional method in Part II. See instructions.

**2** Net profit or (loss) from Schedule C, line 31; and Schedule K-1 (Form 1065), box 14, code A (other than farming). See instructions for other income to report or if you are a minister or member of a religious order . . . . . **2**

**3** Combine lines 1a, 1b, and 2 . . . . . **3**

**4a** If line 3 is more than zero, multiply line 3 by 92.35% (0.9235). Otherwise, enter amount from line 3 . . . . . **4a**

**Note:** If line 4a is less than \$400 due to Conservation Reserve Program payments on line 1b, see instructions.

**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 don't 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% (0.9235). 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 6.2% portion of the 7.65% railroad retirement (tier 1) tax for 2020 . . . . . **7** 137,700

**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 \$137,700 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 12.4% (0.124) . . . . . **10**

**11** Multiply line 6 by 2.9% (0.029) . . . . . **11**

**12 Self-employment tax.** Add lines 10 and 11. Enter here and on **Schedule 2 (Form 1040), line 4** . . . . . **12**

**13 Deduction for one-half of self-employment tax.**  
Multiply line 12 by 50% (0.50). Enter here and on **Schedule 1 (Form 1040), line 14** . . . . . **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<sup>1</sup> wasn't more than \$8,460, **or (b)** your net farm profits<sup>2</sup> were less than \$6,107.

**14** Maximum income for optional methods . . . . . **14** 5,640

**15** Enter the **smaller** of: two-thirds (<sup>2</sup>/<sub>3</sub>) of gross farm income<sup>1</sup> (not less than zero) **or** \$5,640. Also, include this amount on line 4b above . . . . . **15**

**Nonfarm Optional Method.** You may use this method **only** if **(a)** your net nonfarm profits<sup>3</sup> were less than \$6,107 and also less than 72.189% of your gross nonfarm income,<sup>4</sup> **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 (<sup>2</sup>/<sub>3</sub>) of gross nonfarm income<sup>4</sup> (not less than zero) **or** the amount on line 16. Also, include this amount on line 4b above . . . . . **17**

<sup>1</sup> From Sch. F, line 9; and Sch. K-1 (Form 1065), box 14, code B. <sup>3</sup> From Sch. C, line 31; and Sch. K-1 (Form 1065), box 14, code A.  
<sup>2</sup> 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. <sup>4</sup> From Sch. C, line 7; and Sch. K-1 (Form 1065), box 14, code C.

**Part III Maximum Deferral of Self-Employment Tax Payments**

If line 4c is zero, skip lines 18 through 20, and enter -0- on line 21.

<b>18</b>	Enter the portion of line 3 that can be attributed to March 27, 2020, through December 31, 2020 . . .	<b>18</b>	
<b>19</b>	If line 18 is more than zero, multiply line 18 by 92.35% (0.9235); otherwise, enter the amount from line 18	<b>19</b>	
<b>20</b>	Enter the portion of lines 15 and 17 that can be attributed to March 27, 2020, through December 31, 2020 . . . . .	<b>20</b>	
<b>21</b>	Combine lines 19 and 20 . . . . .	<b>21</b>	
If line 5b is zero, skip line 22 and enter -0- on line 23.			
<b>22</b>	Enter the portion of line 5a that can be attributed to March 27, 2020, through December 31, 2020 . . .	<b>22</b>	
<b>23</b>	Multiply line 22 by 92.35% (0.9235) . . . . .	<b>23</b>	
<b>24</b>	Add lines 21 and 23 . . . . .	<b>24</b>	
<b>25</b>	Enter the smaller of line 9 or line 24 . . . . .	<b>25</b>	
<b>26</b>	Multiply line 25 by 6.2% (0.062). Enter here and see the instructions for line 12e of Schedule 3 (Form 1040) . . . . .	<b>26</b>	

**Qualified Business Income Deduction  
Simplified Computation**

Department of the Treasury  
Internal Revenue Service

▶ **Attach to your tax return.**

Attachment  
Sequence No. **55**

▶ **Go to [www.irs.gov/Form8995](http://www.irs.gov/Form8995) for instructions and the latest information.**

Name(s) shown on return

Your taxpayer identification number

**Note.** You can claim the qualified business income deduction **only** if you have qualified business income from a qualified trade or business, real estate investment trust dividends, publicly traded partnership income, or a domestic production activities deduction passed through from an agricultural or horticultural cooperative. See instructions.  
Use this form if your taxable income, before your qualified business income deduction, is at or below \$163,300 (\$326,600 if married filing jointly), and you aren't a patron of an agricultural or horticultural cooperative.

1	(a) Trade, business, or aggregation name	(b) Taxpayer identification number	(c) Qualified business income or (loss)
i			
ii			
iii			
iv			
v			
2	Total qualified business income or (loss). Combine lines 1i through 1v, column (c)	2	
3	Qualified business net (loss) carryforward from the prior year	3 ( )	
4	Total qualified business income. Combine lines 2 and 3. If zero or less, enter -0-	4	
5	Qualified business income component. Multiply line 4 by 20% (0.20)		5
6	Qualified REIT dividends and publicly traded partnership (PTP) income or (loss) (see instructions)	6	
7	Qualified REIT dividends and qualified PTP (loss) carryforward from the prior year	7 ( )	
8	Total qualified REIT dividends and PTP income. Combine lines 6 and 7. If zero or less, enter -0-	8	
9	REIT and PTP component. Multiply line 8 by 20% (0.20)		9
10	Qualified business income deduction before the income limitation. Add lines 5 and 9		10
11	Taxable income before qualified business income deduction	11	
12	Net capital gain (see instructions)	12	
13	Subtract line 12 from line 11. If zero or less, enter -0-	13	
14	Income limitation. Multiply line 13 by 20% (0.20)		14
15	Qualified business income deduction. Enter the lesser of line 10 or line 14. Also enter this amount on the applicable line of your return ▶		15
16	Total qualified business (loss) carryforward. Combine lines 2 and 3. If greater than zero, enter -0-		16 ( )
17	Total qualified REIT dividends and PTP (loss) carryforward. Combine lines 6 and 7. If greater than zero, enter -0-		17 ( )

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

		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)	<u>\$ 240</u>	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		<u>4,000</u>		<u>4,000</u>
Ministerial Income		<u>\$ 49,240</u>	<u>\$ 16,560</u>	<u>\$ 65,800</u>
% of nondeductible expenses: \$16,560/\$65,800 = 25%				

<b>Schedule C Deduction Computation</b>		
Marriage and family booklets		\$ 87
Minus: Nondeductible part of marriage and family booklets (25% x \$87)		<u>\$ (22)</u>
Total marriage and family booklets (Line 27a)		<u>\$ 65</u>
Business use of car:		
437 miles x 57.5¢		\$ 251
Minus: Nondeductible part of business use of car (25% x \$251)		<u>\$ (63)</u>
Total business use of car (Line 9)		<u>\$ 188</u>
Schedule C deductions (line 28)		<u>\$ 253</u>

**Attachment 2. Attachment to Schedule SE (Form 1040)**

Church wages		\$ 45,000
Parsonage allowance		16,800
Net profit from Schedule C		<u>3,747</u>
		65,547
Less:		
Schedule C expenses allocable to tax-free income	\$ 85	
Ministerial employee unreimbursed business expenses		
Car expenses for church business:		
2,465 miles x 57.5¢		1,417
Publications and booklets		<u>219</u>
Net Self-Employment Income		<u>(1,721)</u>
Schedule SE, line 2		<u>\$ 63,826</u>

## 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 2020, Rev. Green received \$15,000 in annuity income, all of which was designated in advance by the Board of Pensions 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 2020, 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 2020, Rev. Green received \$2,000 from occasional guest preaching engagements. He incurred \$586 in expenses as a result of these activities (\$436 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. Rev. Green made cash contributions of \$3,500 to qualifying 501(c)(3) public charities during 2020. Rev. Green has chosen not to defer payment of his self-employment taxes under special 2020 coronavirus relief legislation. Rev. Green received a coronavirus economic impact payment (stimulus check) in the amount of \$2,400 and therefore does not qualify for a recovery rebate credit.

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 the Board of Pensions

The Board of Pensions completed Form 1099-R for Rev. Green as follows:

Box 1. The \$15,000 pension income Rev. Green receives from the Board of Pensions.

Box 2b. Taxable amount not determined. – The Board of Pensions 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 (Form 1040)** *Note, for 2019 and later tax years, the IRS announced that it will not be issuing the Schedule C-EZ. Therefore, Schedule C will be used.*

Some of Rev. Green's entries on Schedule C are explained here.

Line 1. Rev. Green reports the \$2,000 from occasional guest preaching engagements.

Lines 2 through 7. Rev. Green fills out these lines to report his gross income reported on line 7. Rev. Green did not have any returns or allowances, cost of goods sold, or other income for the year. Therefore, the amount reported on line 7 is \$2,000.

Line 9. Rev. Green reports his car expenses on this line. Rev. Green incurred 758 miles of business use of his car, in connection with guest preaching. Rev. Green used the standard mileage rate to figure his car expense. He multiplied the standard mileage rate of

57.5 cents by 758 miles for a total of \$436. 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 \$331) of his expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the \$331 from the \$436 and enters the \$105 difference on line 9.

Line 24b. Rev. Green also incurred \$75 ( $\$150 \times 50\%$  nondeductible) in business meal expenses in connection with guest preaching engagements. 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 \$57) of his business meal expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the \$57 from the \$75 and enters the \$18 difference on line 24b.

Line 28. Rev. Green enters his total expenses, less the 76% allocable to his tax-free parsonage allowance ( $\$105 + \$18$ ) on line 28.

Line 29 through 31. He enters his tentative profit of \$1,877 on line 29 and 31 (since Rev. Green did not have any expenses for the business use of his home). The net income from Schedule C is also reported on Schedule 1 (Form 1040), line 3.

Lines 43 through 47b. 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. These tips should not be construed as an endorsement or recommendation of the Turbo Tax software.

Turbo Tax does not appear to calculate the nondeductible 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 he fills out Schedule SE (Form 1040). Ministers are not church employees under this definition. Additionally, Rev. Green did not apply for an exemption from SE tax by filing Form 4361 and therefore leaves the first box on Schedule SE unchecked. He fills out the following lines in Part I.

Line 2. Rev. Green attaches a statement (see Attachment 2, later) that calculates his net profit of \$1,489 and he enters that amount here.

Line 4a through 6. He multiplies the \$1,489 by .9235 to get his net earnings from self-employment (\$1,375). This amount is then carried through to line 6.

Line 10. The amount on line 6 is less than \$137,700, so Rev. Michaels multiplies the amount on line 6 (\$1,375) by .124 to get his self-employment Social Security tax of \$171.

Line 11. He multiplies the amount on line 6 by .029 to calculate the Medicare portion of the self-employment tax to be \$40.

Line 12. He adds the Social Security tax from line 10 and the Medicare tax on line 11 to determine his total self employment tax of \$211. Rev. Michaels enters that amount here and on Schedule 2 (Form 1040), line 4 and 10.

Line 13. Rev. Michaels multiplies the amount on line 12 by .50 to get his deduction for the employer-equivalent portion of self-employment tax of \$106. He enters that amount here and on Schedule 1 (Form 1040), line 14.

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.

## Qualified Business Income Deduction (Form 8995)

*Ministers who have net profit reported on Schedule C for ministerial services and who have 2020 taxable income less than \$163,300 (\$326,600 if married filing jointly) before the application of a qualified business income deduction may be eligible for such a deduction. However, since the Greens' taxable income before the application of a qualified business income deduction is \$0 (see completion of Form 1040 section below), the Greens are not eligible for such a deduction in 2020.*

## Form 1040, Schedule 1 (Form 1040), and Schedule 2 (Form 1040)

After Rev. Green prepares Schedule C, and Schedule SE, he fills out Form 1040, along with Schedules 1 through 3 to the extent required. Rev. Green files a joint return with his wife. First he fills out Form 1040, Page 1 and completes the appropriate lines for his filing status, including checking the appropriate boxes indicating that he and his wife were born before January 2, 1956. Then, he fills out the rest of the form as follows:

Form 1040, Line 5a. Rev. Green reports his total annuity income of \$15,000 on line 5a. He reports the taxable amount (\$2,000) as computed on Attachment 1 (shown later) on line 5b.

Form 1040, Line 6a and 6b. Since none of Rev. Green's Social Security benefits are taxable, he does not report any amount on line 6b.

Schedule 1 (Form 1040), Line 9. He reports his net profit of \$1,877 from Schedule C, line 31 on Schedule 1, line 3. Since no other amounts are reported on Schedule 1 (Form 1040), Lines 1-8, he also reports this amount on Line 9, and carries the figure to the blank space on Form 1040, line 8.

Form 1040, Line 9. Rev. Green adds Form 1040 line 5b and the amount reported on Form 1040, line 8, and enters the total (\$3,877) on line 9.

Form 1040, Line 10a and Line 10b. Because Rev. Green has reported deductible self-employment tax of \$106 on Schedule 1 (Form 1040) Line 14, Rev. Green goes to Schedule 1 (Form 1040) and completes the bottom section of the form. Since there are no other amounts listed on lines 10-21, Rev. Green reports \$106 on Line 22 and carries this amount to line 10a of Form 1040. Additionally, in 2020, a maximum \$300 charitable contribution deduction is allowed on Form 1040, line 10b for qualifying charitable contributions. Since Rev. Green made cash contributions of \$3,500 to qualifying 501(c)(3) public charities, he enters the maximum contribution deduction of \$300 on line 10b. Line 10a and line 10b are added and reported on line 10c (\$406). Line 10c is subtracted from Line 9, and the result (\$3,471) is entered on Form 1040, line 11. This is his adjusted gross income.

Form 1040, Line 12. Rev. Green enters his standard deduction of \$27,400 (which takes into consideration the fact he and his wife were born before January 2, 1955) on line 12. Since there is no amount listed for qualified business income deduction on line 13, Rev Green reports \$27,400 on line 14.

Form 1040, Line 15. Rev. Green has no taxable income.

Form 1040, Page 2, Line 23 and Schedule 2 (Form 1040). Rev. Green completes Schedule 2 (Form 1040). Since the only amount reported on Schedule 2 (Form 1040) is his self-employment tax from Schedule SE, he reports the amount (\$211) on Schedule 2 (Form 1040), Line 10, and on Form 1040, line 23.

Form 1040, Line 25b. Rev. Green did not have any income tax withheld from his pension.

Form 1040, Line 37. Amount Rev. Green owes to the IRS.

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and phone no. <b>The Board of Pensions of the Presbyterian Church (USA)</b> 2000 Market Street Philadelphia, PA 19103-3298 1-800-773-7752			<b>1</b> Gross distribution <b>\$ 15,000.00</b>	OMB No. 1545-0119  <b>2020</b>  Form <b>1099-R</b>	<b>Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.</b>
			<b>2a</b> Taxable amount \$	<b>2b</b> Taxable amount not determined <input type="checkbox"/> Total distribution <input type="checkbox"/>	
PAYER'S TIN <b>23-1352040</b>	RECIPIENT'S TIN <b>202-20-2002</b>		<b>3</b> Capital gain (included in box 2a) \$	<b>4</b> Federal income tax withheld \$	<b>Copy B</b> <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.</b>  This information is being furnished to the IRS.
RECIPIENT'S name <b>William K. Green</b>			<b>5</b> Employee contributions/ Designated Roth contributions or insurance premiums \$	<b>6</b> Net unrealized appreciation in employer's securities \$	
Street address (including apt. no.) <b>787 Adams Street</b>			<b>7</b> Distribution code(s) IRA/SEP/SIMPLE <input type="checkbox"/>	<b>8</b> Other \$ %	
City or town, state or province, country, and ZIP or foreign postal code <b>Anytown, NY 10002</b>			<b>9a</b> Your percentage of total distribution %	<b>9b</b> Total employee contributions \$	
<b>10</b> Amount allocable to IRR within 5 years \$	<b>11</b> 1st year of desig. Roth contrib.	<b>12</b> FATCA filing requirement <input type="checkbox"/>	<b>14</b> State tax withheld \$	<b>15</b> State/Payer's state no.	<b>16</b> State distribution \$
Account number (see instructions)		<b>13</b> Date of payment	<b>17</b> Local tax withheld \$	<b>18</b> Name of locality	<b>19</b> Local distribution \$

Filing Status [ ] Single [x] Married filing jointly [ ] Married filing separately (MFS) [ ] Head of household (HOH) [ ] Qualifying widow(er) (QW)
Check only one box. If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent

Your first name and middle initial: William K. Last name: Green. Your social security number: 202202002. Spouse's social security number: 303303003. Home address: 787 Adams Street. City: Anytown, State: New York, ZIP code: 10002.

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? [ ] Yes [x] No

Standard Deduction Someone can claim: [ ] You as a dependent [ ] Your spouse as a dependent [ ] Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness You: [x] Were born before January 2, 1956 [ ] Are blind Spouse: [x] Was born before January 2, 1956 [ ] Is blind

Table with 6 columns: (1) First name, Last name, (2) Social security number, (3) Relationship to you, (4) Child tax credit, Credit for other dependents. Includes instructions for dependents.

Main income table with columns 1-15. Includes rows for Wages, Tax-exempt interest, Qualified dividends, IRA distributions, Pensions and annuities, Social security benefits, Capital gain or (loss), Other income, Total income, Adjustments to income, Adjusted gross income, Standard deduction, and Taxable income.

16	Tax (see instructions). Check if any from Form(s): 1 <input type="checkbox"/> 8814 2 <input type="checkbox"/> 4972 3 <input type="checkbox"/>		16	
17	Amount from Schedule 2, line 3		17	
18	Add lines 16 and 17		18	
19	Child tax credit or credit for other dependents		19	
20	Amount from Schedule 3, line 7		20	
21	Add lines 19 and 20		21	
22	Subtract line 21 from line 18. If zero or less, enter -0-		22	
23	Other taxes, including self-employment tax, from Schedule 2, line 10		23	211
24	Add lines 22 and 23. This is your <b>total tax</b>		24	211
25	Federal income tax withheld from:			
a	Form(s) W-2	25a		
b	Form(s) 1099	25b		
c	Other forms (see instructions)	25c		
d	Add lines 25a through 25c	25d		0
26	2020 estimated tax payments and amount applied from 2019 return		26	0
27	Earned income credit (EIC)	27		
28	Additional child tax credit. Attach Schedule 8812	28		
29	American opportunity credit from Form 8863, line 8	29		
30	Recovery rebate credit. See instructions	30		
31	Amount from Schedule 3, line 13	31		
32	Add lines 27 through 31. These are your <b>total other payments and refundable credits</b>		32	0
33	Add lines 25d, 26, and 32. These are your <b>total payments</b>		33	0

Refund

34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you <b>overpaid</b>		34	
35a	Amount of line 34 you want <b>refunded to you</b> . If Form 8888 is attached, check here <input type="checkbox"/>		35a	
b	Routing number	c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
d	Account number			
36	Amount of line 34 you want <b>applied to your 2021 estimated tax</b>	36		

Amount You Owe

For details on how to pay, see instructions.

37	Subtract line 33 from line 24. This is the <b>amount you owe now</b>		37	211
<b>Note:</b> Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.				
38	Estimated tax penalty (see instructions)	38		

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 Retired Minister	If the IRS sent you an Identity Protection PIN, enter it here (see inst.) <input type="text"/>
Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation Retired	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.) <input type="text"/>
Phone no.	Email address		

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: <input type="checkbox"/> Self-employed
Firm's name	Firm's address			Phone no.
				Firm's EIN

**SCHEDULE 1  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**Additional Income and Adjustments to Income**

▶ Attach to Form 1040, 1040-SR, or 1040-NR.  
▶ Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

OMB No. 1545-0074

**2020**

Attachment  
Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

William K. Green

Your social security number

202-20-2002

**Part I Additional Income**

<b>1</b>	Taxable refunds, credits, or offsets of state and local income taxes . . . . .	<b>1</b>	
<b>2a</b>	Alimony received . . . . .	<b>2a</b>	
<b>b</b>	Date of original divorce or separation agreement (see instructions) ▶		
<b>3</b>	Business income or (loss). Attach Schedule C . . . . .	<b>3</b>	1,877
<b>4</b>	Other gains or (losses). Attach Form 4797 . . . . .	<b>4</b>	
<b>5</b>	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E . . . . .	<b>5</b>	
<b>6</b>	Farm income or (loss). Attach Schedule F . . . . .	<b>6</b>	
<b>7</b>	Unemployment compensation . . . . .	<b>7</b>	
<b>8</b>	Other income. List type and amount ▶	<b>8</b>	
<b>9</b>	Combine lines 1 through 8. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8 . . . . .	<b>9</b>	1,877

**Part II Adjustments to Income**

<b>10</b>	Educator expenses . . . . .	<b>10</b>	
<b>11</b>	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 . . . . .	<b>11</b>	
<b>12</b>	Health savings account deduction. Attach Form 8889 . . . . .	<b>12</b>	
<b>13</b>	Moving expenses for members of the Armed Forces. Attach Form 3903 . . . . .	<b>13</b>	
<b>14</b>	Deductible part of self-employment tax. Attach Schedule SE . . . . .	<b>14</b>	106
<b>15</b>	Self-employed SEP, SIMPLE, and qualified plans . . . . .	<b>15</b>	
<b>16</b>	Self-employed health insurance deduction . . . . .	<b>16</b>	
<b>17</b>	Penalty on early withdrawal of savings . . . . .	<b>17</b>	
<b>18a</b>	Alimony paid . . . . .	<b>18a</b>	
<b>b</b>	Recipient's SSN . . . . . ▶		
<b>c</b>	Date of original divorce or separation agreement (see instructions) ▶		
<b>19</b>	IRA deduction . . . . .	<b>19</b>	
<b>20</b>	Student loan interest deduction . . . . .	<b>20</b>	
<b>21</b>	Tuition and fees deduction. Attach Form 8917 . . . . .	<b>21</b>	
<b>22</b>	Add lines 10 through 21. These are your <b>adjustments to income</b> . Enter here and on Form 1040, 1040-SR, or 1040-NR, line 10a . . . . .	<b>22</b>	106

**SCHEDULE 2  
(Form 1040)**

**Additional Taxes**

OMB No. 1545-0074

**2020**

Attachment  
Sequence No. **02**

Department of the Treasury  
Internal Revenue Service

▶ **Attach to Form 1040, 1040-SR, or 1040-NR.**  
▶ **Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

William K. Green

**Your social security number**

202-20-2002

**Part I Tax**

<b>1</b>	Alternative minimum tax. Attach Form 6251 . . . . .	<b>1</b>	
<b>2</b>	Excess advance premium tax credit repayment. Attach Form 8962 . . . . .	<b>2</b>	
<b>3</b>	Add lines 1 and 2. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 17 . . . . .	<b>3</b>	

**Part II Other Taxes**

<b>4</b>	Self-employment tax. Attach Schedule SE . . . . .	<b>4</b>		211
<b>5</b>	Unreported social security and Medicare tax from Form: <b>a</b> <input type="checkbox"/> 4137 <b>b</b> <input type="checkbox"/> 8919 . . . . .	<b>5</b>		
<b>6</b>	Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required . . . . .	<b>6</b>		
<b>7a</b>	Household employment taxes. Attach Schedule H . . . . .	<b>7a</b>		
<b>b</b>	Repayment of first-time homebuyer credit from Form 5405. Attach Form 5405 if required . . . . .	<b>7b</b>		
<b>8</b>	Taxes from: <b>a</b> <input type="checkbox"/> Form 8959 <b>b</b> <input type="checkbox"/> Form 8960 <b>c</b> <input type="checkbox"/> Instructions; enter code(s)_____	<b>8</b>		
<b>9</b>	Section 965 net tax liability installment from Form 965-A . . . . .	<b>9</b>		
<b>10</b>	Add lines 4 through 8. These are your <b>total other taxes</b> . Enter here and on Form 1040 or 1040-SR, line 23, or Form 1040-NR, line 23b . . . . .	<b>10</b>		211

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71478U

Schedule 2 (Form 1040) 2020

**SCHEDULE C  
(Form 1040)**

**Profit or Loss From Business  
(Sole Proprietorship)**

OMB No. 1545-0074

**2020**  
Attachment  
Sequence No. **09**

Department of the Treasury  
Internal Revenue Service (99)

▶ Go to [www.irs.gov/ScheduleC](http://www.irs.gov/ScheduleC) for instructions and the latest information.

▶ Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships generally must file Form 1065.

Name of proprietor <b>William K. Green</b>		Social security number (SSN) <b>202-20-2002</b>
<b>A</b> Principal business or profession, including product or service (see instructions) <b>Minister</b>	<b>B</b> Enter code from instructions ▶ <b>5 4 1 9 9 0</b>	
<b>C</b> Business name. If no separate business name, leave blank.	<b>D</b> Employer ID number (EIN) (see instr.)	
<b>E</b> Business address (including suite or room no.) ▶ <b>87 Adams Street</b> City, town or post office, state, and ZIP code <b>Anytown, New York 10002</b>		
<b>F</b> Accounting method: (1) <input checked="" type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶		
<b>G</b> Did you "materially participate" in the operation of this business during 2020? If "No," see instructions for limit on losses		<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
<b>H</b> If you started or acquired this business during 2020, check here		<input type="checkbox"/>
<b>I</b> Did you make any payments in 2020 that would require you to file Form(s) 1099? See instructions		<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>J</b> If "Yes," did you or will you file required Form(s) 1099?		<input type="checkbox"/> Yes <input type="checkbox"/> No

**Part I Income**

<b>1</b> Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked . . . . . ▶ <input type="checkbox"/>	<b>1</b>	<b>2,000</b>
<b>2</b> Returns and allowances . . . . .	<b>2</b>	
<b>3</b> Subtract line 2 from line 1 . . . . .	<b>3</b>	<b>2,000</b>
<b>4</b> Cost of goods sold (from line 42) . . . . .	<b>4</b>	
<b>5</b> <b>Gross profit.</b> Subtract line 4 from line 3 . . . . .	<b>5</b>	<b>2,000</b>
<b>6</b> Other income, including federal and state gasoline or fuel tax credit or refund (see instructions) . . . . .	<b>6</b>	
<b>7</b> <b>Gross income.</b> Add lines 5 and 6 . . . . . ▶	<b>7</b>	<b>2,000</b>

**Part II Expenses.** Enter expenses for business use of your home **only** on line 30.

<b>8</b> Advertising . . . . .	<b>8</b>		<b>18</b> Office expense (see instructions)	<b>18</b>	
<b>9</b> Car and truck expenses (see instructions). . . . .	<b>9</b>	<b>105</b>	<b>19</b> Pension and profit-sharing plans . . . . .	<b>19</b>	
<b>10</b> Commissions and fees . . . . .	<b>10</b>		<b>20</b> Rent or lease (see instructions):		
<b>11</b> Contract labor (see instructions)	<b>11</b>		<b>a</b> Vehicles, machinery, and equipment	<b>20a</b>	
<b>12</b> Depletion . . . . .	<b>12</b>		<b>b</b> Other business property . . . . .	<b>20b</b>	
<b>13</b> Depreciation and section 179 expense deduction (not included in Part III) (see instructions). . . . .	<b>13</b>		<b>21</b> Repairs and maintenance . . . . .	<b>21</b>	
<b>14</b> Employee benefit programs (other than on line 19) . . . . .	<b>14</b>		<b>22</b> Supplies (not included in Part III) . . . . .	<b>22</b>	
<b>15</b> Insurance (other than health)	<b>15</b>		<b>23</b> Taxes and licenses . . . . .	<b>23</b>	
<b>16</b> Interest (see instructions):			<b>24</b> Travel and meals:		
<b>a</b> Mortgage (paid to banks, etc.)	<b>16a</b>		<b>a</b> Travel . . . . .	<b>24a</b>	
<b>b</b> Other . . . . .	<b>16b</b>		<b>b</b> Deductible meals (see instructions) . . . . .	<b>24b</b>	<b>18 *</b>
<b>17</b> Legal and professional services	<b>17</b>		<b>25</b> Utilities . . . . .	<b>25</b>	
<b>28</b> <b>Total expenses</b> before expenses for business use of home. Add lines 8 through 27a . . . . . ▶	<b>28</b>	<b>123</b>	<b>26</b> Wages (less employment credits) . . . . .	<b>26</b>	
<b>29</b> Tentative profit or (loss). Subtract line 28 from line 7 . . . . .	<b>29</b>	<b>1,877</b>	<b>27a</b> Other expenses (from line 48) . . . . .	<b>27a</b>	
<b>30</b> Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions. <b>Simplified method filers only:</b> Enter the total square footage of (a) your home: _____ and (b) the part of your home used for business: _____. Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30 . . . . .	<b>30</b>	<b>0</b>	<b>27b</b> <b>Reserved for future use</b> . . . . .	<b>27b</b>	
<b>31</b> <b>Net profit or (loss).</b> Subtract line 30 from line 29. • If a profit, enter on both <b>Schedule 1 (Form 1040), line 3</b> , and on <b>Schedule SE, line 2</b> . (If you checked the box on line 1, see instructions). Estates and trusts, enter on <b>Form 1041, line 3</b> . • If a loss, you <b>must</b> go to line 32.	<b>31</b>	<b>1,877</b>			
<b>32</b> If you have a loss, check the box that describes your investment in this activity. See instructions. • If you checked 32a, enter the loss on both <b>Schedule 1 (Form 1040), line 3</b> , and on <b>Schedule SE, line 2</b> . (If you checked the box on line 1, see the line 31 instructions). Estates and trusts, enter on <b>Form 1041, line 3</b> . • If you checked 32b, you <b>must</b> attach <b>Form 6198</b> . Your loss may be limited.					<b>32a</b> <input type="checkbox"/> All investment is at risk. <b>32b</b> <input type="checkbox"/> Some investment is not at risk.

For Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11334P

Schedule C (Form 1040) 2020

\* See statement attached.



**SCHEDULE SE  
(Form 1040)**

**Self-Employment Tax**

OMB No. 1545-0074

Department of the Treasury  
Internal Revenue Service (99)

▶ Go to [www.irs.gov/ScheduleSE](http://www.irs.gov/ScheduleSE) for instructions and the latest information.

▶ Attach to Form 1040, 1040-SR, or 1040-NR.

**2020**  
Attachment  
Sequence No. **17**

Name of person with self-employment income (as shown on Form 1040, 1040-SR, or 1040-NR)

Social security number of person  
with self-employment income ▶

William K. Green

202-20-2002

**Part I Self-Employment Tax**

**Note:** If your only income subject to self-employment tax is **church employee income**, see instructions for how to report your income and 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 . . . . . ▶

Skip lines 1a and 1b if you use the farm optional method in Part II. See instructions.

<b>1a</b> Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A . . . . .	<b>1a</b>	
<b>b</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 AH . . . . .	<b>1b</b> ( )	

Skip line 2 if you use the nonfarm optional method in Part II. See instructions.

<b>2</b> Net profit or (loss) from Schedule C, line 31; and Schedule K-1 (Form 1065), box 14, code A (other than farming). See instructions for other income to report or if you are a minister or member of a religious order . . . . .	<b>2</b>	1,489
<b>3</b> Combine lines 1a, 1b, and 2 . . . . .	<b>3</b>	1,489
<b>4a</b> If line 3 is more than zero, multiply line 3 by 92.35% (0.9235). Otherwise, enter amount from line 3 . . . . .	<b>4a</b>	1,375
<b>Note:</b> If line 4a is less than \$400 due to Conservation Reserve Program payments on line 1b, see instructions.		
<b>b</b> If you elect one or both of the optional methods, enter the total of lines 15 and 17 here . . . . .	<b>4b</b>	
<b>c</b> Combine lines 4a and 4b. If less than \$400, <b>stop</b> ; you don't owe self-employment tax. <b>Exception:</b> If less than \$400 and you had <b>church employee income</b> , enter -0- and continue . . . . . ▶	<b>4c</b>	1,375

<b>5a</b> Enter your <b>church employee income</b> from Form W-2. See instructions for definition of church employee income . . . . .	<b>5a</b>	0
<b>b</b> Multiply line 5a by 92.35% (0.9235). If less than \$100, enter -0- . . . . .	<b>5b</b>	0

<b>6</b> Add lines 4c and 5b . . . . .	<b>6</b>	1,375
<b>7</b> Maximum amount of combined wages and self-employment earnings subject to social security tax or the 6.2% portion of the 7.65% railroad retirement (tier 1) tax for 2020 . . . . .	<b>7</b>	137,700

<b>8a</b> Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) and railroad retirement (tier 1) compensation. If \$137,700 or more, skip lines 8b through 10, and go to line 11 . . . . .	<b>8a</b>	
<b>b</b> Unreported tips subject to social security tax from Form 4137, line 10 . . . . .	<b>8b</b>	
<b>c</b> Wages subject to social security tax from Form 8919, line 10 . . . . .	<b>8c</b>	
<b>d</b> Add lines 8a, 8b, and 8c . . . . .	<b>8d</b>	0

<b>9</b> Subtract line 8d from line 7. If zero or less, enter -0- here and on line 10 and go to line 11 . . . . . ▶	<b>9</b>	137,700
<b>10</b> Multiply the <b>smaller</b> of line 6 or line 9 by 12.4% (0.124) . . . . .	<b>10</b>	171
<b>11</b> Multiply line 6 by 2.9% (0.029) . . . . .	<b>11</b>	40
<b>12 Self-employment tax.</b> Add lines 10 and 11. Enter here and on <b>Schedule 2 (Form 1040), line 4</b> . . . . .	<b>12</b>	211

<b>13 Deduction for one-half of self-employment tax.</b> Multiply line 12 by 50% (0.50). Enter here and on <b>Schedule 1 (Form 1040), line 14</b> . . . . .	<b>13</b>	106
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**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<sup>1</sup> wasn't more than \$8,460, **or (b)** your net farm profits<sup>2</sup> were less than \$6,107.

<b>14</b> Maximum income for optional methods . . . . .	<b>14</b>	5,640
<b>15</b> Enter the <b>smaller</b> of: two-thirds (2/3) of gross farm income <sup>1</sup> (not less than zero) <b>or</b> \$5,640. Also, include this amount on line 4b above . . . . .	<b>15</b>	

**Nonfarm Optional Method.** You may use this method **only** if **(a)** your net nonfarm profits<sup>3</sup> were less than \$6,107 and also less than 72.189% of your gross nonfarm income,<sup>4</sup> **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.

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

<sup>1</sup> From Sch. F, line 9; and Sch. K-1 (Form 1065), box 14, code B.

<sup>3</sup> From Sch. C, line 31; and Sch. K-1 (Form 1065), box 14, code A.

<sup>2</sup> 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.

<sup>4</sup> From Sch. C, line 7; and Sch. K-1 (Form 1065), box 14, code C.

**Part III Maximum Deferral of Self-Employment Tax Payments**

If line 4c is zero, skip lines 18 through 20, and enter -0- on line 21.

<b>18</b>	Enter the portion of line 3 that can be attributed to March 27, 2020, through December 31, 2020 . . . . .	<b>18</b>	
<b>19</b>	If line 18 is more than zero, multiply line 18 by 92.35% (0.9235); otherwise, enter the amount from line 18 . . . . .	<b>19</b>	
<b>20</b>	Enter the portion of lines 15 and 17 that can be attributed to March 27, 2020, through December 31, 2020 . . . . .	<b>20</b>	
<b>21</b>	Combine lines 19 and 20 . . . . .	<b>21</b>	
If line 5b is zero, skip line 22 and enter -0- on line 23.			
<b>22</b>	Enter the portion of line 5a that can be attributed to March 27, 2020, through December 31, 2020 . . . . .	<b>22</b>	
<b>23</b>	Multiply line 22 by 92.35% (0.9235) . . . . .	<b>23</b>	
<b>24</b>	Add lines 21 and 23 . . . . .	<b>24</b>	
<b>25</b>	Enter the smaller of line 9 or line 24 . . . . .	<b>25</b>	
<b>26</b>	Multiply line 25 by 6.2% (0.062). Enter here and see the instructions for line 12e of Schedule 3 (Form 1040) . . . . .	<b>26</b>	

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

<b><u>% of Nondeductible Expenses</u></b>				
		<u>Taxable</u>	<u>Tax-Free</u>	<u>Total</u>
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)	<u>\$ 2,000</u>	\$ 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		<u>\$ 4,000</u>	<u>\$ 13,000</u>	<u>\$ 17,000</u>
% of nondeductible expenses: \$13,000/\$17,000 = 76%				

<b><u>Schedule C Deduction Computation</u></b>			
Business use of car:			
758 miles x 57.5¢			\$ 436
Minus: Nondeductible part of business use of car (76% x \$436)			\$ (331)
Total business use of car (Line)			<u>\$ 105</u>
Meal expenses (\$150 less 50% reduction)			
Minus: Nondeductible part of meals & entertainment (76% x \$75)			\$ (57)
Total meal expenses (Line)			<u>\$ 18</u>
Schedule C deductions, line 28			
			<u>\$ 123</u>
None of the other deductions claimed in the return are allocable to tax-free income.			

**Attachment 2. Computation of Net Earnings from Self-Employment**

<b><u>Computation for Schedule SE (Form 1040)</u></b>			
Gross income from Schedule C			\$ 2,000
Less:			
Unadjusted Schedule C business use of car expenses		(436)	
Unadjusted Schedule C meal expenses		<u>(75)</u>	<u>(511)</u>
Net Self-Employment Income			
Schedule SE, line 2			<u>\$ 1,489</u>