

2013 Tax Guide For Episcopal Ministers For 2012 Tax Returns

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Mary Kate Wold
President and CEO

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Dear Friends,

The Church Pension Fund is pleased to provide this *2013 Clergy Tax Guide*, the fourteenth edition of a customized Episcopal document, to assist you in the preparation of your federal income tax returns. Tax laws and regulations affecting clergy have become extremely complex. Whether or not you prepare your own tax returns, it is essential that you understand the special tax rules pertaining to clergy. If another person prepares your tax returns, it is important that he or she study this publication, as well.

In addition to providing the information contained in this tax guide, we have arranged for Matthew Chew, CPA, a former trustee of the Church Pension Fund, and the Rev. Canon William Geisler, CPA, a regular lecturer on clergy and church tax issues, to be available by phone to answer your tax questions. You may call them at any time, using the toll-free 877 numbers listed on the following page, for answers to questions about your personal tax issues or those of your church. **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 advice relating to your situation.**

As part of CPG's efforts to be wise stewards of the financial resources entrusted to us, as well as to conserve natural resources, we have provided the *2013 Clergy Tax Guide* online via a downloadable, searchable PDF format. Simply go to www.cpg.org/taxpubs. Your accountant or tax advisor can access this publication there, too.

Of course, we realize that some people still prefer printed copies, and so we are also providing those "on demand." To request a printed copy, go to www.cpg.org/taxpubs or call (866) 802-6333. We hope all this will be helpful to you as you prepare your 2012 tax returns.

Faithfully,

A handwritten signature in blue ink that reads "Mary Kate Wold".

Mary Kate Wold
President and CEO

An Important Message from the Editors

The editors of the tax guide are pleased to bring you this fourteenth edition of our publication. We trust that it has proven helpful to you over the years in your tax planning and filing of returns.

This tax guide includes many changes you should be aware of during this filing season, including those changes resulting from the American Taxpayer Relief Act of 2012. We want to call your special attention to a few points.

- The IRS standard mileage rate for 2012 was 55.5 cents per mile. It is 56.5 cents per mile for 2013.
- For 2012, the federal estate tax rate exemption was \$5,120,000 with a tax rate of 35% on the excess over the exemption. For 2013 the federal estate tax exemption starts at \$5,250,000 and is indexed for inflation. The tax rate on the excess is 40% for 2013.
- As of January 1, 2013, the self-employment tax rate for clergy returned to 15.3%.
- On February 8, 2012, the Eleventh Circuit reversed a Tax Court ruling thereby holding that clergy may only claim one personal residence when applying the housing allowance. Please be sure to consult your tax preparer regarding your housing allowance.
- Please consider asking a professional tax preparer to help you with your tax returns. The tax laws become more complex every year. You can reduce the cost of such help by preparing your records for the tax preparer's use. Even your editors use other CPAs to prepare their own returns.
- Given the changeable legislative climate in Congress, it no longer is advisable to rely primarily upon the printed version of this (or any other) tax document, which may be out-of-date due to late-breaking changes in tax law by the time it is off press. Rely instead upon our online version, which is updated as changing legislation demands. To consult the online edition, go to www.cpg.org/taxpubs.
- You probably will benefit from calling one of us when preparing a letter of agreement or planning for retirement. Remember that it is usually easier to prevent tax problems than to correct them.

Sincerely,



Matthew K. Chew, CPA



The Rev. Canon William F. Geisler, CPA



James W. Dooley, CLU, ChFC, CASL



Nancy N. Fritschner, CPA

Tax Questions?

It is easier to prevent tax problems than to correct them

Call us for assistance with:

- Tax return preparation questions
- Compensation packages for new positions
- Housing allowance explanations
- Advantages of reimbursable expense allowances
- Saving through the RSVP program
- Tax considerations before retirement
- Tax considerations after retirement

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How to Use This Guide

The *2013 Clergy Tax Guide* is intended to familiarize clergy in the Episcopal Church with all the latest filing requirements for their 2012 federal income tax returns. It gives special attention to several forms and schedules and the sections of each form or schedule most relevant to ministers.

Key Point

If you are using a printed edition — rather than the online edition — of this tax guide, be sure that your copy is up to date before you make any important tax decisions. Consult the “publish date” on the cover of your printed copy, then go to www.cpg.org/taxpubs and open the online edition. If the online “publish date” is later than the date on your printed copy, then your printed copy no longer is completely current with the latest tax changes. Please remember that, in the changeable legislative climate in Congress today, it is inadvisable to rely primarily upon printed tax reference materials, which may be out-of-date by the time they reach you.

The *2013 Clergy Tax Guide* contains the following sections:

Getting Started

This section offers answers to frequently asked questions, lists tax highlights for 2012, and gives tips on how to find a competent tax professional. Also included are some special notes for new clergy and special notes for those receiving Church Pension Fund pensions.

Special Rules for Ministers

This section answers two important tax questions for ministers (as summarized below):

Q. Who is a minister for federal tax purposes?

A. *In the Episcopal Church, the answer is relatively simple: bishops, priests, and deacons working for the Episcopal Church in any capacity must file as ministers.*

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

A. *The answer is sometimes a source of confusion, because ministers are both: most are employees for federal income tax purposes and all are self-employed for Social Security purposes.*

Also included in “Special Rules for Ministers” is a four-step summary of how to go about paying your taxes.

Step-by-Step Tax Return Preparation

This section gives detailed explanations of the most common tax forms and schedules used by ministers. This step-by-step material serves informational purposes only, and does not represent any suggestion on the part of our authors — or of the Church Pension Fund — that you try filing your tax return yourself, i.e., without the assistance of a tax professional. In practice, our tax guide has made quite the opposite impression upon our users over the years. The more that ministers learn about the special complexities they face under current federal income tax and Social Security guidelines, the more convinced they become to seek competent professional tax assistance.

Comprehensive Examples and Sample Forms

This section offers two sample tax returns for:

1. a rector and spouse,
2. a retired minister and spouse,
3. a retired single minister.

Please note that this guide is provided to you for informational purposes only, and should not be viewed as tax, legal, financial, or other advice. If tax, legal, financial, or other expert assistance is required, seek the services of a competent professional.

Preliminary Q&A

To help get you started with your 2012 federal income tax return, here are answers to some frequently asked questions:

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.

Q. Can I use the simpler Forms 1040-A or 1040-EZ rather than the standard Form 1040?

A. Most ministers must use the standard Form 1040.

Q. What records should I keep?

A. You should keep all receipts, canceled checks, and other evidence to prove amounts you claim as deductions, exclusions, or credits.

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

A. April 15, 2013.

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, 2013) to file your 2012 Form 1040 if you file Form 4868 by April 15, 2013, 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. Therefore, you must make an estimate of your tax for 2012 and pay any balance due with your Form 4868.

Q. Should I prepare my own tax return?

A. Given the complexities of federal tax law, most ministers would be prudent to obtain professional tax assistance.

Finding a Tax Professional

If you decide to seek professional tax assistance, here are some tips that may help you find a competent professional:

- Ask other ministers in your community for their recommendations.
- Ask your diocesan finance officer for recommendations.
- If possible, 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. Anyone familiar with ministers' taxes will know that ministers always are self-employed for Social Security with respect to their ministerial duties. Or, ask a

tax professional if a minister's church salary is subject to required income tax withholding. The answer is no, and anyone familiar with ministers' taxes should be able to answer this question.

If your tax preparer needs a copy of this *2013 Clergy Tax Guide*, please support the Church Pension Fund's "Go Green" campaign to save paper (and money) by consulting the online (.pdf) version available at www.cpg.org/taxpubs.

Tax Highlights for 2012 and 2013

The following tax developments will affect clergy tax reporting at least through 2012 and, in some cases, beyond:

1. **Business mileage rate.** The IRS standard business mileage rate was 55.5 cents per mile for business miles driven during 2012. The standard business mileage rate for 2013 is 56.5 cents per mile.
2. **Income tax brackets.** Across-the-board tax rate increases scheduled for 2013 are repealed. Instead, the new law permanently retains the 10%, 15%, 25%, 28%, 33%, and 35% individual income tax rates. However, the top tax rate of 35% is boosted to a 39.6% rate for single filers with income above \$400,000 and joint filers with income above \$450,000.
3. **Long-term capital gains and qualified dividends.** The capital gains and dividend rates for taxpayers below the 25% income tax bracket is zero percent. For those in the 25% tax bracket and above, the capital gains and dividend rates are 15%. The maximum capital gains tax will rise from 15% in 2012 to 20% in 2013 only for individuals in the new top Income tax bracket.
4. **Child tax credit.** Generally, taxpayers with income below certain threshold amounts may claim the child tax credit to reduce federal income tax for each qualifying child under the age of 17. The credit is \$1,000.
5. **Dependent care credit.** The dependent care credit allows taxpayers a credit for a percentage of child care expenses for children under age 13 and disabled dependents. The amount of eligible expenses for one child is \$3,000 and for two or more children is \$6,000.
6. **Earned income tax credit.** Families with children may qualify for the earned income tax credit. The IRS maintains that a minister's housing allowance is "earned income" in determining eligibility for the earned income credit.
7. **Education Tax Breaks**
 - **Coverdell Education Savings Accounts.** Coverdell Education Savings Accounts are tax-exempt savings accounts used to pay the higher education expenses of a designated beneficiary. The annual contribution amount for 2012, 2013 and forward is \$2,000. The definition of education expenses includes elementary and secondary school expenses.

- **Employer-provided Education Assistance.** For 2012, 2013 and forward, an employee may exclude from taxable income up to \$5,250 per year of employer-provided education assistance. This incentive applies to undergraduate and graduate level education.
 - **American Opportunity Tax Credit.** The American Opportunity Tax Credit is available for up to \$2,500 for qualified higher education expenses paid during a taxable year per student. This credit is available in 2012 and 2013 and was extended through 2018. Taxpayers can receive a tax credit based on 100% of the first \$2,000 of tuition and related expenses and 25% on the next \$2,000 of those expenses paid during the taxable year. This tax credit is subject to a phase-out for single filers with a modified adjusted gross income of more than \$80,000 or \$160,000 for joint filers. Forty percent of this credit is refundable for individuals with no income tax liability. This credit is available for four tax years of higher education expenses per student.
 - **Lifetime Learning Credit.** The Lifetime Learning Credit is available for 20% of qualified education expenses up to \$10,000 for the taxpayer, the taxpayer's spouse and/or their dependents. This credit is available for 2012, 2013 and forward and is subject to a phase-out for single filers with a modified adjusted gross income of more than \$80,000 or \$160,000 for joint filers. This is a nonrefundable credit and can only be used to offset taxable federal income tax.
 - **Above-the-line deduction for qualified tuition and related expenses.** A deduction from total income of \$4,000 is available for 2012 and 2013 for qualified education expenses incurred by a taxpayer, the taxpayer's spouse or dependent. Qualified education expenses include tuition and certain related expenses required for enrollment or attendance at an eligible educational institution (college, university, vocational school or other post-secondary educational institution eligible to participate in a student aid program administered by the Department of Education). Student activity fees and expenses for course-related books, supplies and equipment are included in qualified education expenses if the fees and expenses had to be paid to the institution as a condition of enrollment or attendance.
 - **NOTE** — File form 8863 to claim the American Opportunity Tax Credit and the Lifetime Learning Credit. File form 8917 to claim the tuition and fees deduction. You cannot take both an education credit and the tuition and fees deduction for the same student for the same year. Also, you cannot take the American Opportunity Tax Credit and the Lifetime Learning Credit for the same student in the same year.
8. **Alternative minimum tax (AMT).** The AMT exemption amounts have been indexed for inflation for 2012, 2013, and going forward.
 9. **Deduction of state and local general sales taxes.** The optional state sales income tax deduction, which can be claimed in lieu of deducting state and local income taxes, is extended for 2012 and 2013.
 10. **Tax-free distributions from individual retirement plans ("IRAs") for charitable purposes.** In 2012 and 2013, a taxpayer may make tax-free distributions to a charity from an IRA of up to \$100,000 per taxable year but only if the distribution is a direct transfer from a custodian of the account to the charity. Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70½ and only to the extent that the distribution would be includible in gross income (without regard to this provision).
 11. **Payroll tax "holiday."** The Tax Relief Act provided a temporary payroll tax and self-employment tax "holiday" through 2012 of two percentage points off the employee share of Social Security tax and the Social Security component of self-employment taxes. This meant that the employee's share of Social Security taxes dropped from 6.2% to 4.2% of wages, and the Social Security component of self-employment taxes dropped from 12.4% to 10.4% of self-employment earnings for 2012. This provision expired on December 31, 2012. For 2013 the Social Security tax reverts to 6.2% of wages, and the Social Security component of self-employment tax reverts to 12.4%.
 12. **Dollar limit on 403(b).** The dollar limit on annual elective deferrals an individual may make to a 403(b) retirement plan was \$17,000 in 2012 and will be \$17,500 for 2013.
 13. **Catch-up limit on 403(b).** The catch-up contribution limit on elective deferrals to a 403(b) retirement plan for individuals who had attained age 50 by the end of the year was \$5,500 in 2012. It remains at \$5,500 for 2013.
 14. **Working during retirement.** Many churches employ persons who are receiving Social Security benefits. Persons younger than full retirement age may have their Social Security retirement benefits reduced if they earn more than a specified amount. Full retirement age (the age at which you are entitled to full retirement benefits) for persons born in 1943–1954 is 66 years. In the year you reach full retirement age, your monthly Social Security retirement benefits are reduced by \$1 for every \$3 you earn above a specified amount (\$3,340 per month for 2013). No reduction in Social Security benefits occurs for income earned in the month full retirement age is attained (and all future months). Persons who begin receiving Social Security retirement benefits prior to the year in which they reach full retirement age will have their benefits reduced by \$1 for every \$2 of earned income in excess of a specified amount. For 2012 this annual amount was \$14,640. For 2013 it is \$15,120. For more information on your situation, contact the Social Security Administration.

15. **Inflation adjustments.** For 2012 the following three inflation adjustments took effect:
- The amounts of income you need to earn to boost you to a higher tax rate were adjusted for inflation.
 - The value of each personal and dependency exemption, available to most taxpayers, increased to \$3,800.
 - The new standard deduction is \$11,900 for married couples filing a joint return, and \$5,950 for singles and married individuals filing separately. Nearly two out of three taxpayers take the standard deduction, rather than itemizing deductions, such as mortgage interest, charitable contributions, and state and local taxes.
16. **Church-related Schedule C income.** Some clergy earn Schedule C income from work for a church or church entity. Such clergy may be eligible to contribution to a 403b (RSVP).
17. **Withdrawals from RSVP.** Before you make any withdrawals (including required minimum distributions) from the Episcopal Church Retirement Savings Plan (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. Ask them to mark the taxable amount as “undetermined.”
18. **Same-sex couples in community property states.** Same-sex couples (either married or registered) in community property states are not at present recognized as married for federal income tax purposes. Consequently the income of the partners is divided under the community property rules and impacts the way in which each person must file his/her return. Such persons should consider using a tax preparer familiar with community property rules for the state in which they live. These rules are complex, and may impact the housing exclusion to which a cleric is entitled.
19. **Extension of Ministry.** Although clergy who work in non-church organizations and have successfully completed the Church Pension Fund’s Extension of Ministry process may pay assessments on their non-church work into the clergy pension plan, the Extension of Ministry designation does not automatically qualify them for a clergy housing allowance exclusion. Many Extension of Ministry positions are NOT eligible for the clergy housing allowance.
20. **Mortgage debt forgiveness.** Qualified principal residence debt forgiveness of up to \$2,000,000 as excluded from taxable income has been extended through the end of 2013.
21. **Personal Mortgage Insurance.** Individuals who are paying mortgage insurance premiums on their primary residence, also known as Personal Mortgage Insurance (PMI) may be able to deduct this amount if they itemize their deductions and have an adjusted gross income (AGI) of under \$110,000 for 2012 and 2013.
22. **Employer provided commuting expenses.** For 2012 and 2013, the exclusion for employer-provided parking reimbursement as well as van pooling and mass transit reimbursement will be \$240 and 245 per month respectively.
23. **Affordable Care Act.** In addition to the various provisions discussed above, new taxes also took effect January 1, 2013 as a result of The Patient Protection and Affordable Care Act:
- **Additional hospital insurance tax on high-income taxpayers.** The employee portion of the hospital insurance tax, normally 1.45% of covered wages for FICA purposes and 2.90% for self-employed earnings for SECA purposes, is increased by 0.9% on wages and self-employed earnings that exceed a threshold amount. The additional tax is imposed on the combined wages and self-employed earnings of both the taxpayer and the taxpayer’s spouse, in the case of a joint return. The threshold amount for this additional tax is \$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married individual filing a separate return, and \$200,000 for all others, including single taxpayers.
 - **Medicare tax on investment income.** An additional tax on individuals equal to 3.8% will apply to unearned income; specifically the lesser of the individual’s net investment income for the year or the amount by which an individual’s modified adjusted gross income (AGI) exceeds a threshold amount. The threshold amount for this additional tax is \$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married individual filing a separate return, and \$200,000 for all others, including single taxpayers. Net investment income means investment income reduced by deductions properly allocable to that income. Investment income includes income from interest, dividends, annuities, royalties, and rents, and net gain from disposition of property, other than such income derived in the ordinary course of a trade or business. However, income from a trade or business that is a passive activity is included in investment income.
 - **Medical care itemized deduction threshold.** The threshold for the itemized deduction for unreimbursed medical expenses has increased from 7.5% of AGI to 10% of AGI for regular income tax purposes. This is effective for all individuals, except, in the years 2013–2016, if either the taxpayer or the taxpayer’s spouse has turned 65 before the end of the tax year, the increased threshold does not apply and the threshold remains at 7.5% of AGI.
 - **Flexible spending arrangement.** Effective January 1, 2013, the maximum amount of salary reduction contributions that an employee may elect to have made to a flexible spending arrangement for any plan year is reduced to \$2,500.

Special Notes for New Clergy

Some of the tax tips that follow, intended specifically for new clergy, must be adopted before compensation is earned in any given year. In other words, they may not apply to your first year of reporting in 2012, but they will serve you well going forward.

- When negotiating your contract as a new minister, make certain that a proper housing allowance resolution has been adopted by the vestry (or other governing body) before compensation payments begin.
- Also when negotiating contracts, arrange for reimbursable expense plans for automobile and other necessary business expenses.
- Begin personal retirement savings through a Section 403(b) (salary reduction plan) as soon as possible.
- Discretionary funds are the property of your church employer. Be careful to use them only for proper purposes. You are accountable to the church for such funds.
- Make certain your compensation details have been properly reported to the Church Pension Fund, and that regular payments are being made by your church employer to the Church Pension Fund for the required pension assessments.

Special Notes for Those Receiving Church Pension Fund Distributions

Many retired clergy find it particularly advantageous to engage the services of a CPA, enrolled agent, or tax attorney for regular help in tax planning and return preparation. As you will discover going through the special notes provided below, tax planning for retired ministers is tricky and complicated.

- The pension received from the Episcopal Church by a minister, including the one-time resettlement benefit, are designated as a housing allowance for federal income tax purposes. To the extent that these amounts are spent for qualified expenses for your primary residence, they may be excluded from tax, subject to the housing allowance limitations.
- The total of all pensions received should be entered on line 16(a) on page one of Form 1040. The taxable portion, including the amount of any Church Pension Fund pensions not used for qualifying housing expenses should be reported on line 16(b). You must enter a number — even if it is “0” — on line 16(b).
- Earnings from ministerial services after retirement are also eligible for designation as housing allowance. Such designation should not be requested if your church pension is adequate to cover your qualified housing expenses.
- Self-employment tax (SECA) is due on all earned income, even while drawing Social Security and pension benefits. Include any housing allowance and the fair rental value of a rectory or other housing provided. Failure to include the proper value of such housing could result in additional tax liabilities, plus interest and penalties. If this income is not reported, the statute of limitations on assessing tax adjustments may not apply.

- Housing provided to ministers employed for a short time away from home (short time is generally considered to be a contract for one year or less) in some cases can be treated as a reimbursable business expense and not be subject to income tax or self-employment tax. Contracts for an indefinite period, or a specific period of more than one year, would not qualify for such exclusion. Such arrangements could result in moving your “tax home” (primary residence). Be very careful about the wording of interim ministry contracts.
- Pensions are not earned income and therefore are not subject to self-employment tax (SECA).
- It is unclear whether payments from a nonqualified deferred compensation plan are subject to SECA.
- Moving expenses are not deductible unless you are moving at least 50 miles to a new, full-time position. See Form 3903. The costs of moving to your retirement home are not tax-deductible, unless you meet the requirements for moving for a new full-time position.
- If you are covered by Medicare and accept a position that qualifies you for employer-provided medical insurance, it is important that you talk with a Medicare representative. It is likely that Medicare would expect the employer’s insurance to become your primary coverage. Likewise, when leaving such a position, it is again important that you contact Medicare to make sure you are properly covered.
- If you are considering moving to a long-term care facility, make certain that they 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.

Key Point

If you have questions, it is always better to call these tax lines before taking action:

Matt Chew: (877) 305-1414

Bill Geisler: (877) 305-1415

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.

In the Episcopal Church, only bishops, priests, and deacons (*ordained* ministers as opposed to *lay* ministers) meet the criterion for the IRS designation of “minister.”

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 income tax law. These rules include:

1. eligibility for housing allowances;
2. self-employed status for Social Security purposes;
3. exemption of wages from income tax withholding (ministers may use the quarterly estimated tax procedure to pay their taxes, unless they elect voluntary withholding).

These special rules apply only with respect to compensation for services performed in the exercise of ministry. Pay received for work done for organizations not legally related to the church may not qualify you as a minister. Work done in the church is considered “exercise of ministry,” no matter the nature of the work. Work for non-church organizations must be primarily sacerdotal to qualify for the housing allowance. Pay for such work is subject to income tax and self-employment withholding.

📌 Example

John is a minister at his church. In addition, he works a second job for a secular employer. Assume that John qualifies as a minister for federal income tax purposes. Since his church duties constitute services performed in the exercise of ministry, the church can designate a housing allowance for him. However, the secular employer cannot designate any portion of John’s compensation as a housing allowance, since this work would not be service in the exercise of ministry.

Are Ministers Employees or Self-employed for Federal Tax Purposes?

There is much confusion regarding this issue. Most Episcopal ministers are considered employees for federal income tax purposes under the tests currently used by the IRS and the courts, and should receive IRS Forms W-2 from their churches or employers reporting their taxable incomes. However, all ministers are self-employed for Social Security purposes (with respect to services they perform in the exercise of their ministry).

📌 Key Point

Avoid confusion about your tax status by recognizing that ministers have a dual tax status. For federal income taxes, they ordinarily are employees, but for Social Security purposes they are self-employed with regard to services performed in the exercise of ministry.

These two rules are summarized under two headings in this section of the *2013 Clergy Tax Guide*: “Income Taxes: Ministers as Employees” and “Social Security: Ministers as Self-Employed.”

Income Taxes: Ministers as Employees

For federal income tax reporting, most Episcopal ministers are employees under the test currently used by the IRS. This means that they should receive Forms W-2 from their churches at the end of each year (rather than Forms 1099). Many ministers who are employees of a local church are self-employed for other purposes, such as weddings and funerals for individual members of their churches or guest speaking appearances in other churches.

📌 Example

Bob is a minister at Grace Church. He is an employee for federal income tax reporting purposes with respect to his church salary. However, he is self-employed with respect to honoraria he receives for speaking in other churches and for compensation church members give him for performing personal services such as weddings and funerals. The church issues Bob a Form W-2 reporting his church salary. Bob reports this amount as wages on line 7 of Form 1040. He reports his compensation from self-employment activities on Schedule C.

📌 Key Point

Most ministers will be better off being treated as employees, since the value of various fringe benefits will be tax free, the risk of an IRS audit is substantially lower, and reporting as an employee avoids the additional taxes and penalties that often apply to self-employed ministers who are audited by the IRS and reclassified as employees.

📌 Tax Savings Tip

Ministers and other church staff members should carefully review their Forms W-2 to ensure that the forms properly report the income actually received. If an error was made, the church should issue a corrected tax form (Form W-2c).

The Tax Court Test. The United States Tax Court has issued two rulings addressing the correct tax reporting status of ministers. In both cases the court applied a seven factor test for determining whether a minister is an employee or self-employed for federal income tax reporting purposes. These seven factors are:

1. the degree of control exercised by the employer over the details of the work;
2. which party (employer or employee) invests in the facilities used in the work;
3. the opportunity of the individual for profit or loss;
4. whether the employer has the right to discharge the employee;

5. whether the work is part of the employer's regular business;
6. the permanency of the relationship;
7. the relationship the parties (employer/employee) believe they are creating.

Most ministers will be employees under this test.

Social Security: Ministers as Self-Employed

Ministers are deemed to be self-employed by law with respect to services performed in the exercise of ministry — even if their income is reported as an employee by their church using IRS Form W-2. **This is an absolute rule — no exceptions!** All ministers must complete Schedule SE (to Form 1040) for all earned income from the church.

Key Point

While most ministers are employees for federal income tax reporting purposes, all ministers are self-employed for Social Security purposes (with respect to services they perform in the exercise of their ministry). In other words, ministers are not subject to Social Security and Medicare tax withholding, even though they report their income taxes as employees and receive a Form W-2 from their church. Rather, they pay the “self-employment tax” (SECA).

Key Point

Ministers who work after they retire must pay SECA on their wages (unless they exempted themselves from Social Security as a minister and they are employed in a ministerial capacity).

Key Point

Ministers who work at secular jobs will be treated as lay people in their secular employment.

Key Point

Remember that you must include the fair rental value, furnished, plus utilities, of church-owned housing and the cash paid as housing allowance in calculating your self-employment income.

Key Point

Some denominations allow their clergy to elect out of Social Security as a conscientious objection to receipt of social insurance. The Episcopal Church does not support this option on theological grounds.

Some Episcopal ministers have opted out of Social Security without realizing that they do not qualify for the exemption. Signing Form 4361 to opt out of Social Security may constitute an act of perjury for Episcopal clergy. 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 (WEP). Go to www.irs.gov and Publication 963 for more information.

Key Point

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.

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. Any voluntary withholding arrangement should include enough to cover both income tax and SECA, **although the employer should report the total amount withheld as income tax.**

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 Form W-4 (withholding allowance certificate). Since ministers are not employees for Social Security purposes, the church must not withhold the employee's share of Social Security and Medicare taxes. **However, ministers can request on Form W-4 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 can be applied against the minister's self-employment tax liability. Such withholding must be reported as income tax withheld on Form W-2.

Ministers must prepay their income taxes and self-employment taxes by using the estimated tax procedure, unless they have entered into a voluntary withholding arrangement with their church. Estimated taxes must be paid in quarterly installments. If your estimated taxes for the current year are less than your actual taxes, you may have to pay an underpayment penalty. You can change your estimated tax payments during the year if your circumstances change.

You will need to make estimated quarterly tax payments for 2013 if you expect to owe at least \$1,000 in tax for 2013 after subtracting your withholding and credits and if you expect your withholding and credits to be less than the smaller of:

- 90% of the tax to be shown on your 2013 tax return, or
- 100% of the tax shown on your 2012 tax return, or
- 110% if adjusted gross income exceeds \$150,000.

Four Steps: Paying Your Taxes

The four-step procedure for reporting and prepaying estimated taxes for 2013 is summarized below.

Step 1. Obtain a copy of IRS Form 1040-ES for 2013, before April 15, 2013. You can obtain forms by calling the IRS toll-free forms hotline at (800) TAX-FORM or (800) 829-3676, or from the IRS website: www.irs.gov.

Step 2. Compute your estimated tax for 2013 using the Form 1040-ES worksheet.

Step 3. Pay one-fourth of your total estimated taxes for 2013 in each of four quarterly installments as follows:

<i>For the period</i>	<i>Due date</i>
January 1–March 31	April 15, 2013
April 1–May 31	June 15, 2013
June 1–August 31	September 15, 2013
September 1–December 31	January 15, 2014

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

📌 Key Point

Most clergy will find it easier to have tax withheld and reported on the Form W-2 (for work-related income) or withheld from the pension and reported on the Form 1099-R from the Pension Fund (if retired). New retirees should reduce their withholding by the SE (self-employment) tax owed for work in the prior year. If managing this withholding procedure is difficult for your parish, you might consider a professional payroll service.

Step 4. Compute actual taxes at the end of the year. After the close of 2013, 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, if 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 2014 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, if your actual tax liability exceeds the total of your estimated tax payments plus any withholding), you may have to pay a penalty.

Tax Forms and Schedules

This step-by-step analysis covers these forms and schedules:

Form 1040 is the basic document you will use. It summarizes all of your tax information. Details are reported on supplementary schedules and forms.

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

Schedule B is for reporting dividend and interest income.

Schedule C-EZ is for reporting your income and expenses from business activities you conduct other than in your capacity as an employee. Examples would be fees received for guest speaking appearances in other churches or fees received directly from members for performing personal services, such as weddings and funerals.

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

These forms and schedules, along with others, are included in the illustrated examples beginning on page 32 of this guide. They are the ones most commonly used by ministers, but you may have a need for others. Forms are available on the IRS website, www.irs.gov. They may also be obtained at your local IRS office or by calling the IRS toll-free forms hotline at (800) TAX-FORM or (800) 829-3676.

Form 1040

Step 1: Name and address

Print or type information in the spaces provided. If you are married filing a separate return, enter spouse's name on line 3 instead of below your name. If you filed a joint return for 2011 and you are filing a joint return for 2012 with the same spouse, be sure to enter your names and social security numbers in the same order as on your 2011 return. If you plan to move after filing your return, use Form 8822 to notify the IRS of your new address. If you changed your name because of marriage, divorce, etc., be sure to report the change to the Social Security Administration (SSA) before filing your return. Enter your P.O. Box number only if your post office does not deliver mail to your home.

If you want \$3 to go to the presidential election campaign fund, check the box labeled "yes." Regardless of your answer, the amount of taxes you owe or the amount of refund you receive will not change.

Step 2: Filing status

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

Step 3: Exemptions

If you claim a dependency exemption for a qualifying child, the child must be a United States citizen or resident, and meet the following five tests:

1. **Relationship test.** The child must be your child (including an adopted child, stepchild, or eligible foster child), brother, sister, stepbrother, stepsister, or a descendant of any of them.
2. **Residency test.** The child must have lived with you more than half of 2012. An exception applies, in certain cases, for children of divorced or separated parents.
3. **Age test.** At the end of 2012, the child must be under age 19, or under age 24 and a student, or any age and permanently and totally disabled.
4. **Support test.** The child must not have provided over half of his or her own support in 2012.
5. **Special test.** If the child meets the rules to be a qualifying child of more than one person, you must be the person entitled to claim the child as a qualifying child.

To claim a dependency exemption for a qualifying relative, the relative must meet all of the following conditions:

1. The person must be either your relative (which the IRS defines as a brother, sister, stepbrother, stepsister, or a descendent of one of these relatives) or any other person (other than your spouse) who lived in your home all year as a member of your household. If the person is not your relative, your relationship must not violate local law.
2. The person cannot be your qualifying child (see above) or the qualifying child of another person in 2012.
3. The person must have gross income of less than \$3,800. If the person is permanently and totally disabled, certain income from a sheltered workshop may be excluded for this purpose.
4. You must have provided over half of the person's support in 2012. Exceptions apply, in certain cases, for children of divorced or separated parents and for a person supported by two or more taxpayers.

For more information on dependents, see IRS Publication 501.

Step 4: Income

Several items of income are reported on lines 7 through 21. The most important of these (for ministers) are discussed below.

Key Point

Some items, such as the housing allowance, are not reported as income. They are called exclusions and are explained below.

Line 7. Wages, salaries, tips, etc.

📌 Key Point

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

As an employee, you should receive a Form W-2 from your church reporting your wages at the end of each year. Report this amount on line 7. Then, determine if this amount reflects all of your church earnings. If it does not, report the remaining income on line 21 as other income.

Besides a salary, ministers' wages may include several other items, such as:

- bonuses;
- the cost of sending the minister to the Holy Land (if paid by the church);
- most Christmas and special occasion offerings to the minister;
- housing equity allowance paid directly to cleric's RSVP 403(b) account should not appear in box 1;
- retirement payments made from church funds;
- the portion of the minister's Social Security tax paid by a church as an offset;
- the value of the personal use of a church-provided car;
- purchases of church property for less than fair market value;
- reimbursements the church made for the minister's moving expenses (but not if the minister meets the requirements of Form 3903);
- church reimbursements of a spouse's travel expenses incurred while accompanying a minister on a business trip (this represents income to the minister unless the spouse's presence serves a legitimate business purpose and the spouse's expenses are reimbursed under an accountable arrangement);
- any funds of the church to which a minister has access (including the church's discretionary funds) and which are taxable income to the minister, if the minister is not accountable to the church for the expenditures;
- personal expenditures from church funds, which, even if accounted for, are taxable income to the minister;
- "below-market interest loans" to a minister of at least \$10,000, which create taxable income to the minister;
- forgiveness of a minister's debt to the church, which creates taxable income to the minister;
- severance pay;
- payment by the church of a minister's personal expenses;
- business expense reimbursements paid under a "nonaccountable plan" (a nonaccountable business expense reimbursement arrangement is one that does not require substantiation of business expenses, or does not require excess reimbursements to be returned to the church, or that reimburses expenses out of salary reductions);
- imputed cost of group term life insurance coverage exceeding \$50,000.

📌 Key Point

The costs of cell phones provided by the church for business purposes no longer are reported as wages as long as the personal use is minimal. As a result, the stringent record-keeping requirements of the past no longer apply to cell phones and similar devices.

📌 Key Point

The value of group term life insurance provided by the Church Pension Fund for active clergy will, in most cases, exceed \$50,000. This excess of up to \$50,000 will produce imputed income. Additional coverage from the parish or diocese may also produce imputed income. The value of this imputed income should be included in Box 1 of your Form W-2. Any amounts not included on Form W-2 should be reported on line 21.

If your church's per diem rate for expenses exceeds the federal per diem rate for expenses, the excess must be reported as income in Box 1 of Form W-2. Refer to IRS Publications 463 and 1542 for additional information.

📌 Key Point

The IRS can assess intermediate sanctions in the form of a substantial excise tax against a minister who is an officer or director of his or her employing church, and in some cases against church board members, if the minister is paid an excess benefit. Excess benefits may occur if a church pays a minister an excessive salary, makes a large retirement or other special occasion "gift" to a minister, gives church property (such as a rectory) to the minister, or sells church property to the minister at an unreasonably low price. A rebuttable presumption arises that compensation is reasonable if it is approved by an independent board on the basis of "comparable data" or independent compensation surveys and the basis for the board's decision is documented.

📌 Key Point

The IRS has ruled that "disqualified persons" receive "automatic" excess benefits resulting in intermediate sanctions, regardless of amount, if they use church assets (vehicles, homes, credit cards, computers, 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. A disqualified person is an officer or director of the employer, or a relative of such a person. The concept of automatic excess benefits will directly affect the compensation practices of most churches, and expose some ministers and church board members to intermediate sanctions.

If some of these items were not reported on your Form W-2, they still must be reported as income. Either have your church issue a "corrected" Form W-2 (Form W-2c) or report the items as other income on line 21. Be sure this oversight is addressed and corrected for future years.

Items not reported on line 7.

Some kinds of income are not taxable. These items are called exclusions. Most exclusions apply in computing both income taxes and self-employment taxes. The housing allowance is an example of an exclusion that applies only to income taxes and not to self-employment taxes.

Some of the more common exclusions are detailed below:

1. Gifts are excludable from taxable income so long as they are not in fact compensation for services performed. However, employers generally are not permitted to give tax-free gifts to employees.
2. Life insurance proceeds and inheritances are excludable.
3. Medical insurance premiums paid by an employer for employees (and their spouses and dependents) are excludable. This exclusion is not available to self-employed individuals.
4. Under Section 125, the Internal Revenue Code (“Tax Code”) permits employees to exclude from gross income any amounts received under an employer-financed “accident and health plan” as payments for permanent injury or loss of bodily function or as reimbursements of medical expenses. The payments can be made on behalf of a spouse or dependent of the employee. This exclusion assumes that the employer has established an “accident or health plan.” Such a plan requires professional assistance to establish. Unfortunately, the requirements for such a plan are not specified in the Tax Code. Employers may reimburse employee medical expenses under either a self-insured plan (for example, reimbursements that are paid out of the employer’s own funds rather than through an insurance policy) or an insured plan. However, if reimbursements are made under a self-insured plan, nondiscrimination rules apply. Generally, these rules require that the plan not discriminate in favor of highly compensated individuals with regard to either amount of benefits or eligibility to participate.
5. Under Section 105, the Tax Code permits employers to reimburse employee medical expenses under either a self-insured plan (for example, reimbursements that are paid out of the employer’s own funds rather than through an insurance policy) or an insured plan. However, if reimbursements are made under a self-insured plan, nondiscrimination rules apply. Generally, these rules require that the plan not discriminate in favor of highly compensated individuals with regard to either amount of benefits or eligibility to participate. For more information on health reimbursement arrangements, see Richard R. Hammar’s *Church & Clergy Tax Guide*.
6. Pursuant to Section 106 of the Tax Code, it is permissible for an employee to reduce his or her taxable compensation by the amount of medical insurance premiums paid by the church, either directly or through reimbursement of premiums paid by the

employee (this presumes that the church confirms, prior to the reimbursement, that the employee, in fact, paid the premiums).

7. 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.
8. The value of free child-care services provided by a church to its employees is excluded from employees’ income so long as the benefit is based on a written plan that does not discriminate in favor of highly compensated employees. Other conditions may apply.
9. Employees may exclude the cost of employer-provided group term life insurance so long as the amount of coverage does not exceed \$50,000.

There are four other exclusions that will be discussed separately — the housing allowance, tax-sheltered annuities (Section 403(b) Plans), qualified scholarships, and sale of one’s home.

Housing Allowance

The clergy housing allowance exclusion represents a potential federal income tax exclusion for all clergy who are compensated by the Episcopal Church for their ministerial services. This exclusion also is applicable to most — though not all — state income taxes. Note, however, that the clergy housing allowance never is excluded from self-employment taxes. The rules for claiming a housing allowance vary depending on whether your housing is owned/rented or church-provided.

📌 Key Point

Surviving spouses of clergy are not eligible to claim the housing allowance exclusion for income they receive from the Episcopal Church after the death of the cleric. However, income the cleric received from the Episcopal Church prior to the date of death is eligible to be excluded from income if used for qualified housing.

The housing allowance exclusion is the most important tax benefit available to ministers who own or rent their homes. 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 it:

- represents compensation for ministerial services;
- does not exceed the compensation for ministerial services;
- represents payment for actual qualified housing expenses (a list of which appears below);
- does not exceed the formally designated housing allowance amount approved by your vestry in advance of payment of your compensation;
- does not exceed the fair rental value of the home, furnished, plus utilities.

! Key Point

The last three bullets in the above list constitute the housing allowance “three-part test.” Clergy who work in the Episcopal Church are eligible to exclude a housing allowance that is the least of these three amounts: actual housing expenses; formally designated housing allowance approved by the vestry in advance of compensation; the fair rental value, furnished, plus utilities of the home.

! Key Point

To establish “fair rental value” for IRS documentation purposes, consider hiring a professional realtor who is familiar with your neighborhood to visit your home and give you a written appraisal of that value.

! Key Point

It is the responsibility of the cleric — not the church employer — to do the following: consult with a realtor to get a written appraisal of the fair rental value of the furnished home; establish the maximum allowable housing allowance (by adding utility costs to the realtor’s appraisal); and — based on those figures — recommend a housing allowance amount to the vestry. The vestry’s only responsibility is to vote its approval of that housing allowance designation and to document its action in the minutes of the meeting.

! Key Point

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.

Under no circumstances can a church designate a housing allowance retroactively.

Ministers who live in church-provided housing do not pay federal income taxes on the fair rental value of the housing. The fair rental value is not “deducted” from the minister’s income. Neither is it reported as additional income anywhere on Form W-2. However, the fair rental value of the housing (including utilities provided by the church) plus any cash housing allowance must be included in the self-employment tax computation.

Clergy in church-provided housing may request a formal housing allowance resolution that functions much like the one requested by clergy who own or rent, except that the cleric in church-provided housing should begin by asking a professional realtor for two written estimates: the fair rental value of the church-provided housing; and the value that his/her furnishings add to the fair rental value. It is this added-value figure that may be submitted to your vestry as your housing allowance resolution amount.

! Tax Savings Tip

Although this value-added housing allowance figure may not be as large as the housing allowance figure claimed by clergy who rent/own, it is nonetheless an important income tax benefit. Unfortunately many ministers in church-provided housing are not aware of this benefit and are not taking advantage of it.

! Key Point

Many ministers 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 to be qualified housing expenses that may count toward the fulfillment of their housing allowances. The Tax Court has ruled that this is permissible only to the extent that the loan proceeds were used for housing-related expenses.

! Key Point

Payment of debts secured by a mortgage on your home provides a significant part of the qualified expenses for the housing allowance exclusion. To enter retirement with this debt is a personal decision based on many financial and personal factors. Consult your tax preparer.

! Tax Savings Tip

Ministers should place the designation of a housing allowance for the next year on the agenda of a vestry meeting during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. Newly employed clergy should make sure that this designation is part of the letter of agreement.

If a minister continues to work after retirement, the minister must pay self-employment tax on earnings, including a housing allowance, and/or the fair rental value, furnished, plus utilities, of a rectory.

Housing expenses that qualify toward fulfilling your housing allowance exclusion

Ministers who own or rent their homes should take the following expenses into account when claiming their housing allowance exclusions:

- down payment on a home (but remember, a housing allowance is nontaxable only to the extent that it does not exceed the lesser of actual housing expenses or the fair rental value of a minister’s home, furnished, plus utilities);
- mortgage payments on a loan to purchase or improve your home (include interest, principal, and mortgage insurance);
- rent for home, storage, garage;
- real estate taxes;
- property insurance;
- utilities (electricity, gas, water, cable TV excluding paid-for-view, trash pickup, telephone charges, and internet);
- furnishings and appliances (purchase and repair);
- structural repairs and remodeling;
- yard maintenance and improvements;
- maintenance items (pest control, etc.);
- homeowners association dues.

Please note the following:

1. 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 their home, does not exceed the fair rental value of their home, furnished, plus utilities.

2. A housing allowance must be designated in advance. Retroactive designations of housing allowances will not be recognized as valid by the IRS.
3. Although many Episcopal institutions traditionally pass housing allowance resolutions at the end of one tax year in anticipation of the next, a housing allowance can be amended at any time during the year. However, an amendment that increases a housing allowance mid-year to take into account an unexpected increase in a cleric's housing expenses is only effective prospectively. Also, remember that it serves no purpose to amend a housing allowance to an amount greater than the fair rental value of a minister's home, furnished, plus utilities.
4. Some ministers routinely designate the IRS-allowed upper limit (which is the fair rental value, furnished, plus utilities) as their housing allowances, even in those years that actual housing expenses may not attain that figure. Their reasoning is simple: if unexpected housing expenses should occur, this maximum allowable amount will cover them; if actual expenses do not reach the claimed amount, then the excess may be reported on line 21 of Form 1040 as "UNUSED HOUSING ALLOWANCE." However, not all ministers are comfortable with claiming the maximum amount and then adjusting line 21 every year; this seems especially true for clerics whose actual housing expenses tend to be very low. Consider consulting a tax professional to determine a housing allowance strategy that works best for you.
5. If the housing allowance designated by the church exceeds the amount of qualified housing expenses that can be claimed, the excess housing allowance should be reported on line 21 of Form 1040, and designated on that line as "UNUSED HOUSING ALLOWANCE."
6. 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).

Example

St. Luke's Church designated \$20,000 of Donald's 2012 compensation as a housing allowance. Donald's housing expenses for 2012 were utilities of \$2,000, mortgage payments of \$8,000, property taxes of \$4,000, insurance payments of \$1,000, repairs of \$1,000, and furnishings of \$1,000. The fair rental value of the home (including furnishings) is \$12,000. Donald'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 his home, furnished, plus utilities. Stated differently, the nontaxable portion of a housing allowance is the least of the following three amounts:

- the housing allowance designated by the church (\$20,000);
- actual housing expenses (\$17,000);
- the fair rental value of the home, furnished (\$12,000) plus utilities (\$2,000) for a total of \$14,000.

In this case, the lowest of these three amounts is the fair market value of the home, furnished, plus utilities (\$14,000), and so this represents the nontaxable portion of Donald's housing allowance. Donald must report the difference between this amount and the housing allowance designated by his church (\$6,000) on line 21 of Form 1040.

Example

Same facts as the previous example, except that the church designated \$12,000 of Donald'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 Donald's actual housing expenses were more than the allowance, and so he was "penalized" because of the low allowance designated by his church.

Example

Yvonne owns a home and incurs housing expenses of \$12,000 in 2012. These expenses include mortgage principal and interest, property taxes, utilities, insurance, and repairs. The church designated (in advance) \$12,000 of Yvonne's 2012 compensation as a housing allowance. Yvonne is able to itemize expenses on Schedule A (Form 1040). She is able to claim itemized deductions on Schedule A for both her mortgage interest and her property taxes, even though her taxable income was already reduced by these items because of their inclusion in the housing allowance. This is often referred to as the "double deduction." In reality, it represents an exclusion and a deduction.

Example

In preparing his income tax return for 2012, Harry discovers that his church failed to designate a housing allowance for him for 2012. He asks his vestry to pass a resolution retroactively granting the allowance for 2012. Such a resolution is ineffective, and Harry will not be eligible for any housing allowance exclusion in 2012.

Key Point

The Sarbanes-Oxley Act makes it a federal 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 ministers. It is possible that the "backdating" of a vestry resolution to qualify for a housing allowance for the entire year violates this provision in the Sarbanes-Oxley

Act, exposing the vestry and minister to a fine or imprisonment. Even if the minister's action does not violate the act, it may result in civil or criminal penalties under the Tax Code.

⚠ Warning

If you are sharing the expenses of your principal residence with someone who is not your legal spouse according to federal law, you are entitled to claim an exclusion only for your portion of those expenses. State laws may vary.

💡 Tax Savings Tip

The IRS may recognize designations included in employment contracts and budget line items — assuming in each case that the designation was duly adopted in advance by the church.

⚠ Key Point

Expenditures for a potential primary residence, such as a down payment and other costs, may not qualify if the minister still lives in another house. You should consult with your tax preparer or advisor before taking action.

How much should your housing allowance be?

⚠ Key Point

The housing allowance should be based on an estimate of the fair rental value of the house, furnished, plus utilities. In the case of clergy living in church-provided housing, the resolution should be based on how much their furnishings add to the fair rental value of the housing.

⚠ Key Point

The housing allowance is available only if these conditions are met:

1. the recipient is a minister for tax purposes (as defined above); and
2. the allowance is compensation for services performed in the exercise of ministry within the Episcopal Church.

⚠ Warning

Please note that, although clergy who work in non-church organizations and have successfully completed the Church Pension Fund's Extension of Ministry process may pay assessments on their non-church work into the clergy pension plan, the Extension of Ministry designation does not automatically qualify them for a clergy housing allowance exclusion. Many Extension of Ministry positions are NOT eligible for the clergy housing allowance.

⚠ Key Point

Three things that parishes and vestries may not know about housing allowances:

1. parishes and vestries should not be in the business of determining the housing allowances for their ministers;

2. vestries should approve the housing allowance that each minister recommends (as long as it does not exceed that minister's compensation);

3. approving a housing allowance resolution costs the parish nothing.

Churches sometimes neglect to designate a housing allowance in advance of a new calendar year. For example, a church may discover on March 1, 2013, that it has failed to designate a housing allowance for 2013. It is not too late to act. The church should immediately designate a portion of its minister's remaining compensation in 2013 as a housing allowance. This unfortunate problem can be avoided by stipulating in each annual housing allowance designation that the allowance shall be for the current year and for all future years unless otherwise provided. If such a resolution had been adopted sometime before 2013, it would not matter that the church neglected to designate a minister's 2013 allowance until March of 2013, since the previous designation would have "carried over." Such "safety net" designations are not a substitute for annual housing allowances. Rather, they provide a basis for claiming a housing allowance if a church neglects to designate one.

Interim Clergy

Many active and retired clergy serve in interim positions that are far enough removed from their primary residences to require relocation. If such a position continues for one year or less, then the original home continues to be the primary residence for housing allowance purposes.

Active clergy may request the vestry of the interim church to designate a portion of their compensation as housing allowance based on their primary residence. In such cases the housing at the interim location will be treated as reimbursable business expenses rather than as compensation. Per diem meal allowances also will be excluded from compensation and reimbursed as a business expense. However, if the interim position is for an indefinite period or lasts for more than one year (even one day longer), the interim residence will be considered the primary residence for tax purposes from the first day in the position. Housing allowance will then be based solely on housing costs at the new location and will not be eligible for reimbursable "out of town" living expenses.

Similar provisions apply to retired clergy serving in interim positions except that, since they are receiving pensions from the Church Pension Fund, which are designated fully as housing allowance, they must look first to their pensions for the housing allowance benefit. Only if their pensions are not enough to cover their allowable housing expenses may they request that a portion of their compensation be designated as housing allowance.

Two Examples of Vestry Housing Resolutions:

Sample housing allowance resolution for a minister who owns or rents his home.

The following resolution was duly adopted by the vestry of Christ Church at a regularly scheduled meeting held on December 13, 2012, a quorum being present:

Whereas, the Reverend Samuel Johnson is compensated by Christ Church exclusively for the services as a minister of the gospel; and

Whereas, Christ Church does not provide Fr. Johnson with a rectory, therefore, it is hereby

Resolved, that the total compensation paid to Fr. Johnson for calendar year 2013 shall be \$50,000 of which \$15,000 is hereby designated to be a housing allowance; and it is further

Resolved, that the designation of \$15,000 as a housing allowance shall apply to calendar year 2013 and all future years unless otherwise provided.

Sample housing allowance resolution for a minister who lives in a church-provided rectory.

The following resolution was duly adopted by the vestry of Grace Church at a regularly scheduled meeting held on December 13, 2012, a quorum being present:

Whereas, the Reverend John Smith is compensated by Grace Church exclusively for services as a minister of the gospel; and

Whereas, Grace Church provides Fr. Smith with rent-free use of a church-owned rectory as compensation for services that he renders to the church in the exercise of his ministry; and

Whereas, Fr. Smith incurs expenses for living in church provided housing; therefore it is hereby

Resolved, that the annual compensation paid to Fr. Smith for calendar year 2013 shall be \$50,000, of which, \$5,000 is hereby designated to be a housing allowance pursuant to Section 107 of the Internal Revenue Code, and it is further

Resolved, that the designation of \$5,000 as a housing allowance shall apply to calendar year 2013 and all future years unless otherwise provided by the vestry; and it is further

Resolved, that as additional compensation to Fr. Smith for calendar year 2013 and for all future years unless otherwise provided for by this vestry, Fr. Smith shall be permitted to live in the church-owned rectory located at 123 Main Street, and that no rent or other fee shall be payable by Fr. Smith for such occupancy and use.

⚠ Key Point

Remember: churches cannot designate a housing allowance retroactively. A housing allowance may be increased during the year for the balance of the year, but it should not exceed the current fair rental value, furnished, plus utilities.

⚠ Key Point

The IRS has announced that retired ministers are eligible for a housing allowance exclusion if the following conditions are satisfied:

- a portion of a retired minister's pension income is designated as a housing allowance by the church pension board of a denominational pension fund;
- the retired minister has severed his or her relationship with the local church and relies on the fund for a pension.

The Church Pension Fund designates all retirement benefits paid to ministers (through the clergy plan, as well as the 403(b) plan [RSVP]) as housing allowance. It is the responsibility of the minister to determine the eligible housing expenses. (See CPF Form B, page 50 of this booklet.)

The self-employment tax does not apply to any retirement benefits received by a minister (except possibly retirement benefits paid from a nonqualified deferred compensation plan). Self-employment tax does apply to earned income, including the value of housing, if provided after retirement.

Keep in mind that your housing allowance is not counted as income when figuring federal income taxes but is included in figuring Social Security (SECA) on all earned income.

Tax-Sheltered Annuities: Section 403(b) Plans

Contributions made through salary reduction and/or payments from your employer are not reportable income for income tax purposes, subject to contribution limits.

⚠ Key Point

The Church Pension Fund offers a 403(b) plan, the Retirement Savings Program (RSVP), to both ordained and lay employees of the Church. For more information, contact us at (866) 802-6333 Monday – Friday, 8:30AM – 8:00PM ET.

Contribution limits

For 2012, total annual additions (employer contributions, salary reduction, and tax paid contributions) cannot exceed the lesser of 100% of your compensation (excluding a minister's housing allowance) or \$50,000 (\$51,000 for 2013). This rule is known as the "section 415(c) limit." If your annual addition exceeds this limit, then the excess amount plus earnings must be distributed and included in gross income. 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. Excess contributions can result in income tax, additional taxes, and penalties.

Note that you can continue to fund your 403(b) plan at any age from current church-earned income.

For purposes of determining the limits on contributions under section 415(c) of the Internal Revenue Code, amounts paid to an employee minister, as a tax-free housing allowance, may not be treated as compensation pursuant to the definitions of compensation under section 1.415-2(d) of the income tax regulations.

Salary reduction contributions, Section 402(g)

In addition to the section 415(c) limit there is an annual limit on elective deferrals. The limit applies to the total of all elective deferrals contributed (even if contributed by different employers) for the year on your behalf to a variety of retirement plans, including 403(b) plans, such as the one sponsored by the Church Pension Fund. Generally, you cannot defer more than an allowable amount each year for all plans covering you. For 2012, the allowable limit is \$17,000. If you defer more than the allowable amount for a tax year, you must include the excess in your taxable income for that year. The dollar limit on annual elective deferrals will be \$17,500 for 2013.

Key Point

Church employees can make a special election that allows their employer to contribute up to \$10,000 for the year, even if this is more than 100% of your compensation. The total contributions over your lifetime under this election cannot be more than \$40,000.

The limit on elective deferrals increases for individuals who have attained age 50 by the end of the year. The additional amount that may be made is the lesser of:

1. the “applicable dollar amount”; or
2. the participant’s compensation for the year reduced by any other elective deferrals of the participant for the year.

The applicable dollar amount is \$5,500 for 2012 and 2013. Catch-up contributions are not subject to any other contribution limits and are not taken into account in applying other contribution limits.

Retirement Savings Contributions Credit

The Tax Code allows a tax credit for eligible taxpayers for qualified retirement savings contributions. The maximum annual contribution eligible for the credit is \$2,000. The maximum credit amount is \$1,000. The credit rate depends on the adjusted gross income (AGI) of the taxpayer. Joint returns with AGI of \$55,000 or less, head of household returns of \$41,625 or less, and single returns of \$27,750 or less are eligible for the credit. 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. If you are eligible, take this credit on Form 1040, line 50. The amount of the credit for 2012 is described in the following table.

Adjusted Gross Income							Applicable Percentage
Joint Returns		Heads of Household		All Other Cases			
over	not over	over	not over	over	not over		
\$0	34,500	\$0	25,875	\$0	17,250	50%	
\$34,500	37,500	\$25,875	28,125	\$17,250	18,750	20%	
\$37,500	57,500	\$28,125	43,125	\$18,750	28,750	10%	
\$57,500	---	\$43,125	---	\$28,750	---	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.

Qualified Scholarships

Key Point

Qualified scholarships are excludable from taxable income.

Only 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 use the scholarship for such expenses and that the scholarship does not specify that it is to be used for nonqualified expenses (such as room and board).

Key Point

Amounts paid by a church for the education of a minister 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 minister or other church employee cannot be treated as a nontaxable scholarship if paid “as compensation for services.”

Example

St. Anne’s establishes a scholarship fund for seminary students. Robert is a member who is pursuing a master’s degree at a seminary. The church votes to award him a scholarship of \$1,500 for 2013. As long as Robert uses the scholarship award for tuition or other course-related expenses, he need not report it

as income on his federal income tax return, and the church need not issue him a 1099-MISC. The better practice would be for the church to stipulate that the scholarship is to be used for tuition or other course-related expenses (for example, fees, books, supplies), or for the church to pay the expenses directly to the educational institution. This will ensure that the scholarship does not inadvertently become taxable income because its specific use was not designated and the recipient used it for nonqualified expenses.

Sale or exchange of your principal residence

For sales of principal residences the following rules apply: An individual taxpayer can exclude up to \$250,000 (\$500,000 if married and filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who failed to meet these requirements by reason of a change of place of employment, health, or certain unforeseen circumstances could exclude an amount equal to the fraction of the \$250,000 (\$500,000 if married and filing a joint return) equal to the fraction of the two years that the ownership and use requirements were met.

! Key Point

The death of a spouse may give the surviving spouse a stepped-up basis in the cost of the house.

Any gain from the sale or exchange of a principal residence allocated to periods of nonqualified use is not excluded from gross income. The amount of gain allocated to periods of nonqualified use is the amount of gain multiplied by a fraction, the numerator of which is the aggregate periods of nonqualified use during the period the property was owned by the taxpayer, and the denominator of which is the period the taxpayer owned the property.

A period of nonqualified use means any period (not including any period before January 1, 2009) during which the property is not used by the taxpayer or the taxpayer's spouse or former spouse as a principal residence. For purposes of determining periods of nonqualified use, the following are not taken into account:

1. any period after the last date the property is used as the principal residence of the taxpayer or spouse (regardless of use during that period), and
2. any period (not to exceed two years) that the taxpayer is temporarily absent by reason of a change in place of employment, health, or certain unforeseen circumstances.

Line 8a. Taxable interest. Attach Schedule B if required

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

Line 9a. Ordinary dividends. Attach Schedule B if required

Complete this line only if you had dividend income. If you had dividend income of more than \$1,500, complete parts II and III of Schedule B. Report qualified dividend income on line 9b.

Line 10. Taxable refunds, credits, or offsets of state and local income taxes

If you took the itemized deduction on your 2011 taxes, you will need to complete the state and local tax worksheet to determine whether you need to report this as income for 2012. If you took the standard deduction, you do not include this amount.

Line 11. Alimony received

If you receive alimony payments, you will need to report them as taxable income. Child support payments are not taxable and should not be listed here.

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

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

- compensation reported to you on a Form 1099-MISC;
- fees received directly from church members for performing personal services (such as marriages and funerals);
- honoraria you received for guest speaking appearances in other churches.

If you received income from any of these kinds of activities, compute your net earnings on Schedule C or C-EZ and transfer this amount to line 12. Most ministers may use the simpler Schedule C-EZ if several conditions are met. See the instructions to Schedule C-EZ for details.

Line 13. Capital gain or loss. Attach Schedule D

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

Line 14. Other gains or losses

Use this line if you sold or exchanged assets that were used in a business.

Line 15b. IRA distributions taxable amount

Enter the taxable portion of your IRA distributions on this line. There are many types of distributions on multiple types of IRA accounts, including traditional, ROTH, SEP (simplified employee pension) or SIMPLE (savings incentive match plan for employees). Many are eligible for an exception to immediate taxation (such as rollovers from one IRA to another). If your distribution fits one of these exceptions, you will use box 15a for the gross distribution and box 15b for any taxable portion. Review IRS Publication 590, "Individual Retirement Arrangements" to get a better understanding of the taxability of these distributions. Consult your tax advisor.

Line 16a. Pensions and annuities

The retirement benefits you receive from the Church Pension Fund, Section 403(b) benefits such as RSVP, and other deferred compensation, are reportable under

federal and some state income tax laws. At your direction, the Church Pension Fund will withhold federal tax from your pension benefits. The 1099-R form you receive from Northern Trust (the agent for your clergy pension plan) or from Fidelity Investments (the agent for your RSVP plan) reports to the IRS the gross amount of the pension benefits and any amount withheld for income taxes.

Line 16b. Pensions and annuities taxable amount

The Church Pension Fund annually designates 100% of the pension, the resettlement benefit, and disability benefits for retired ministers as a qualified housing allowance. Consistent with that designation, if you are a minister, the 1099-R will show that the taxable amount of the pension income is “not determinable.” If you are a retired or disabled minister, you may exclude all or a portion of your pension or disability income from your gross income reported on line 16a of Form 1040 if:

1. you can document that the monies were actually spent on housing-related expenses during the tax year, and
2. the amount excluded does not exceed the fair market rental value of the home, furnished, plus utilities.

A copy of CPF Form B, which accompanied your 1099-R may also be found on page 50 of this guide.

⚠ Warning

Do not report any pension income as earned income in computing self-employment taxes. If you are using a computer program to prepare your taxes, be sure that it does not treat the nontaxable portion of your pension as being subject to the self-employment tax. Some programs will do so if you report the exclusion as a housing exclusion rather than as nontaxable pension.

📌 Key Point

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

⚠ Warning

Before you make any withdrawals (including required minimum distributions) from the Episcopal Church Retirement Savings Plan (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. Ask them to mark the taxable amount as “undetermined.”

📌 Key Point

All of the pension income reported on your Form 1099-R must be reported on line 16a. The taxable portion — even if “0” — must be reported on line 16b.

Some portion of your pension may be attributable to pension contributions you paid personally. If your Form 1099-R reports an amount of employee-paid contributions, you may be entitled to an exclusion of part of the pension benefits as your investment in the pension contract. See IRS Publication 571 for more information.

Taxation of distributions from a 403(b) plan

Amounts you contribute through salary reduction, and the earnings attributable to these contributions, generally cannot be withdrawn before you reach age 59½, separate from service, die, or become disabled. In some cases of hardship, you may withdraw your own salary reduction contributions (but not the earnings on these) prior to the occurrence of any of the above events. In addition, if amounts are distributed prior to your reaching age 59½, you will be assessed an additional tax of 10% of the amount which is includable in income (computed on Form 5329), unless one of the following exceptions applies:

1. The distributions are part of a series of substantially equal periodic payments made over your life or the lives of your beneficiaries, and after you separate from service.
2. The distributions are made after you separate from service on or after age 55.
3. The distributions do not exceed the amount of unreimbursed medical expenses that you could deduct for the current year.
4. The distributions are made after your death, or after you become disabled.
5. The distributions are made to an alternate payee pursuant to a qualified domestic relations order.

⚠ Warning

Failure to meet scheduled payments of loans from 403(b) accounts will turn the remainder of any loans into taxable income.

Line 20a. Social Security benefits

📌 Key Point

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

If you received Social Security benefits other than Supplemental Security Income benefits (SSI) in 2012, part of the amount you received may be taxable. If you received Social Security benefits during 2012, you will receive (before January 31, 2013) Form SSA-1099 showing the amount of benefits you received. In determining whether or not your Social Security benefits received in 2012 are taxable, consider the following rules:

1. In general, if the only income you received during 2012 was your Social Security benefits, your benefits probably will not be taxable and you probably will not have to file a return.
2. If you received other income in addition to Social Security benefits in 2012, your benefits generally will not be taxable unless your income is over a certain amount.
3. Your Social Security benefits generally are not taxable if your “provisional income” (adjusted gross income plus tax-exempt interest and some other forms of tax-exempt income plus half of your Social Security benefits) received during the year is less than \$25,000,

if you are single, or \$32,000 if you are married and file a joint return. Use the provisional income worksheet in the Form 1040 Instructions. Your provisional income is considered \$0 if you are married, filing separately.

4. If your provisional income (defined above) received during the year is more than \$25,000 but less than \$34,000 if you are single, or more than \$32,000 but less than \$44,000 if you are married and file a joint return, some of your Social Security benefits are taxable. You are taxed on the lesser of:
 - half of your Social Security benefits, or
 - half of the amount by which your total income exceeds \$25,000 (if you are single) or \$32,000 (if you are married and file jointly).
5. If your provisional income (defined above) received during the year is more than \$34,000 if you are single, or more than \$44,000 if you are married and file a joint return, up to 85% of your benefits may be subject to tax.
6. Although the Social Security Administration has never officially addressed the issue, it is likely that a minister's housing allowance and/or rectory provided count as earnings for the purposes of the annual earnings tests.

Warning

Persons younger than full retirement age may have their Social Security retirement benefits reduced if they earn more than a specified amount. Consult your tax advisor.

Line 20b. Social Security taxable amount

After completing the Social Security Benefits Worksheet, enter any taxable amount of your Social Security on this line.

Line 21. Other income. List type and amount

Recommendation

If you have other income to report on line 21, consider enclosing an explanation of your other income with your Form 1040 or print a brief explanation in the space provided next to line 21. This will help to avoid confusion, particularly if the entries on line 21 include income subject to SECA and income not subject to SECA.

Complete this line only if you have other income, such as the following:

- imputed income from group term life insurance coverage not included on Form W-2;
- the amount by which your church-designated housing allowance exceeds the lower of your actual expenses, or the fair rental value of your housing, furnished, plus utilities;
- 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.

Step 5: Adjustments to income

You may deduct certain adjustments from gross income in computing your adjusted gross income. Report the adjustments on lines 23 through 36 of Form 1040. The most relevant adjustments to ministers are summarized below.

Line 23. Educator expenses

This benefit was restored through 2013 for up to \$250.

Line 24. Certain business expenses of reservists, performing artists, and fee-basis government officials

Some expenses incurred by Episcopal ministers who serve as reservist chaplains may be eligible for this deduction. See Form 2106 if you believe you may qualify.

Line 25. Health savings account deduction

You may be able to take this deduction if you made personal contributions to your Health Savings Account in 2012. Complete Form 8889 and attach to Form 1040.

Line 26. Moving expenses

Key Point

Allowable moving expenses apply only to those who are moving from one job to another. Allowable moving expenses do not apply to those moving to their retirement homes without a full-time job. The relocation allowance of the church pension is not a moving expense reimbursement.

If your "allowable moving expenses" are not reimbursed by your employer, or they are reimbursed under a nonaccountable plan, compute your moving expense deduction on Form 3903, and report your deduction on line 26. If your employer reimburses your allowable moving expenses under an accountable plan, the reimbursements are not reported by the employer as taxable income, and you have no deduction to report on line 26. To be an accountable plan, your employer's reimbursement arrangement must require you to meet all three of the following rules:

1. your expenses would have been deductible had you paid them yourself;
2. you must adequately account to your employer for these expenses within a reasonable period of time; and
3. you must return any excess reimbursement or allowance within a reasonable period of time.

Allowable moving expenses are expenses you incurred because of a change of jobs or your acceptance of a new job, if you satisfy the following conditions:

1. Your new job location is at least 50 miles farther from your former home than your old job location.

Example

If your old job was three miles from your former home, your new job must be at least 53 miles from that home (measured according to the shortest of the more commonly traveled routes between those points).

2. You must work full-time for at least 39 weeks during the first 12 months after you arrive in the general area of your new job location. You do not have to work for one employer for the 39 weeks. However, you must work full-time within the same general commuting area. If you are married and file a joint return and both you and your spouse work full-time, either of you may satisfy the full-time work test. However, you may not combine your weeks of work.
3. Your move must be closely related, both in time and place, to the start of work at your new job location. In general, moving expenses incurred within one year from the date you first reported to work are considered closely related in time to the start of work at the new location. It is not necessary that you make arrangements to work before moving to a new location, as long as you actually do go to work. If you do not move within one year, you ordinarily may not deduct the expenses unless you can show that circumstances existed that prevented the move within that time. A move is generally not closely related in place to the start of work if the distance from your new home to the new job location is greater than the distance from your former home to the new job location.

Deductible moving expenses include the following:

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

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

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

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

Line 27. Deductible part of self-employment tax.

📌 Key Point

Every minister who pays self-employment taxes on ministerial income qualifies for this deduction.

All ministers are self-employed for Social Security purposes with respect to their ministerial income. They can deduct half of their actual self-employment taxes as an adjustment on line 27 of Form 1040. Any other earnings subject to self-employment tax also qualify for this treatment.

Line 28. Self-employed SEP, SIMPLE, and qualified plans

You may be eligible to deduct contributions for these plans from your self-employment income that is reported on Schedule C. Most Episcopal priests are considered employees for federal income tax purposes and cannot use this deduction. Your contributions to 403(b) accounts, such as the Church Pension Fund's RSVP plan, are already deducted from your compensation before tax.

Taxpayers with Schedule C income may deduct from gross income 100% of their 2012 health insurance premiums for themselves, spouses, and dependents.

Line 29. Self-employed health insurance deduction

Taxpayers with Schedule C income may be able to deduct health insurance premiums, including qualified long-term care insurance, Medicare premiums, and group medical insurance premiums paid on behalf of themselves and their dependents.

Line 32. IRA deduction

An individual retirement account (IRA) is a savings plan that lets you set aside money for your retirement. Contributions to an IRA may be tax deductible, and earnings are not taxed until they are distributed to you. Anyone who has compensation is eligible to set up or contribute to an IRA. Compensation includes an employee's salary or a self-employed person's earnings, or any other amounts you receive for performing personal services. Compensation does not include rental income, interest income, dividend income, or any amount received as a pension, annuity, or deferred compensation. Further, compensation does not include a minister's housing allowance or the fair rental value of a church-provided house.

For 2012 the contribution ceiling for an IRA is the lesser of \$5,000 or 100% of your annual compensation. All IRA contributions must be made by the due date of your tax return, not including extensions. This means that your 2012 IRA contribution must be made by April 15, 2013, even if you obtain an extension for filing this return.

For 2012, if you file a joint return and your taxable compensation is less than that of your spouse, the most that can be contributed for the year to your IRA is the smaller of the following two amounts:

1. \$5,000 (\$6,000 if you are age 50 or older), or
2. the total compensation includable 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.

Warning

All IRA contributions must be made by the due date of your tax return, not including extensions. This means that your 2012 IRA contribution must be made by April 15, 2013, even if you obtain an extension for filing this return.

If you or your spouse were covered by an employer retirement plan at any time during 2012 and you made IRA contributions, your allowable IRA deduction may be less than your contributions. Your allowable deduction may be reduced or eliminated, depending on your filing status and the amount of your income. The deduction begins to decrease (phase out) when your income rises above a certain amount and is eliminated altogether when it reaches a higher amount (see IRS Publication 590). The amounts vary depending on your filing status. The Form W-2 you receive from your church or other employer has a box used to show whether you were covered for the year.

The “Pension Plan” box should have a mark in it if you were covered. Employer retirement plans include the pension plans and 403(b) tax-sheltered annuities sponsored by the Church Pension Fund.

Even if your spouse is covered by an employer-sponsored retirement plan, you may be able to deduct your contributions to an IRA for 2012 if you were not covered by an employer plan and your adjusted gross income was less than \$183,000 (\$188,000 for 2013).

Individuals who cannot claim a deduction for an IRA contribution still can make nondeductible IRA contributions, subject to the lesser of \$5,000 or earned income limits. Earnings on these amounts continue to accumulate on a tax-deferred basis. When distributions are made from the IRA, special rules apply in figuring the tax on the distributions when both deductible and 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% penalty tax that also applies to deductible IRA contributions. No further contributions to an IRA are permissible once you reach age 70½, and distributions from an IRA must begin no later than the end of the year in which you reach that age. The IRS has interpreted this rule to mean that distributions must begin by April 1 of the year following the year you reach age 70½. If this rule applies to you, you should consult your tax adviser.

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

1. Taxpayers can make early withdrawals from an IRA to pay for qualified higher education expenses of the taxpayer or the taxpayer’s spouse, child, grandchild, parent, or other ancestor — without triggering the 10% penalty that applies to early distributions from an IRA.
2. The deductible IRA “phase out” ranges are decreased if either you or your spouse is an active participant in an employer-sponsored retirement plan.

3. Subject to income limitations, taxpayers can make annual nondeductible contributions of up to \$5,000 to a Roth IRA, and distributions from such an IRA are not taxed if they are made after a five-year holding period and are made as a result of the account holder’s attaining age 59½ or older, death, disability, or purchase of a first home. Earnings on Roth IRAs accumulate tax-free.
4. Taxpayers can withdraw up to \$10,000 from their IRA prior to age 59½ for first-time homebuyer expenses without triggering the 10% penalty that applies to “premature distributions.”
5. Qualified charitable distributions of up to \$100,000 may be made from an IRA to a church or other charity. A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to a charitable organization, including a church, that is made on or after the date the IRA owner attains age 70½. This provision extends through 2013. See tax highlight #10.

Key Point

The maximum annual dollar contribution limit for IRA contributions is \$5,000 for 2012 and \$5,500 for 2013. Also, the contribution limit for an individual who has attained age 50 before the end of the taxable year increases by \$1,000.

Line 33. Student loan interest deduction

You may be able to deduct up to \$2,500 on qualified education loans if your income is below a certain threshold for your tax status.

Line 34. Tuition and fees. Attach Form 8917

You may be eligible for this deduction for up to \$4,000 if you paid qualified education expenses for yourself, your spouse, or other dependents. See Form 8917 for more details.

Tax Savings Tip

You may qualify for an even greater tax credit for these education expenses. Review the instructions and information for “Line 49. Education credits.”

Step 6: Adjusted Gross Income

Line 37. Compute adjusted gross income

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

Step 7: Tax computation

Line 40. Itemized deductions (from Schedule A) or your standard deduction

Itemize your deductions on Schedule A only if they exceed the standard deduction for your filing status. On line 40 you enter either your itemized deductions from Schedule A or a standard deduction amount. Itemized deductions are discussed under Schedule A, beginning on page 23 of this guide. For 2012, the standard deduction amounts are as follows:

Filing Status	Standard Deduction Amount
single	\$5,900
married filing jointly or qualifying widow(er)	\$11,900
married filing separately	\$5,950
head of household	\$8,700

Line 42. Personal exemptions

The 2012 personal exemption amount is \$3,800. Multiply this amount times the number of exemptions claimed on line 6d and enter the total on line 42. Personal exemptions are phased out for certain high-income taxpayers.

The instructions to Form 1040 contain a worksheet that should be used to compute this reduced exemption amount.

Line 44. Compute tax

Most ministers can use the tax tables to determine their income taxes. Some higher income ministers must use the tax rate schedules (a spouse's income is considered in deciding whether or not to use the tax rate schedules).

Step 8: Credits

Line 48. Credit for child and dependent care expenses: attach Form 2441

Complete this line if you are eligible for a credit for child or dependent care expenses.

Line 49. Education credits

Using Form 8863 to do the computation, complete this line if you are eligible for the Hope and Lifetime Learning Credit or the American Opportunity Tax Credit. See tax highlight #7.

Line 50. Retirement savings contributions credit

Complete this line if you are eligible for the retirement savings contributions credit.

Line 51. Child tax credit

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

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

Key Point

Even if you do not pay income taxes, you may be eligible for this refundable credit. Please review your situation with your tax preparer.

The child tax credit is in addition to the dependent care credit you can claim if you pay someone to care for your dependent child who is under age 13 (or a disabled dependent) so that you can work. See tax highlight #4.

Step 9: Other taxes

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

Line 56. Self-employment tax. Attach Schedule SE

Key Point

Ministers must pay self-employment taxes on compensation received from the exercise of their ministry, unless they have received IRS recognition of exempt status.

Ministers are self-employed for Social Security purposes with respect to their ministerial income. They compute their self-employment taxes on Schedule SE and report the total tax on line 56 of Form 1040. See tax highlight #11.

Step 10: Payments

Line 62. Federal income tax withheld from Forms W-2 and 1099

Ministers' wages are exempt from federal income tax withholding. As a result, only those ministers who have entered into a voluntary withholding arrangement with their church will have income taxes withheld and reported on line 61. The church should report the amount of voluntarily withheld taxes on the minister's Form W-2.

Key Point

Ministers who enter into voluntary withholding arrangements will have federal income taxes withheld from their wages. Under no circumstances should a church withhold the employee's share of Social Security and Medicare taxes from the wages of such a minister, since ministers are self-employed for Social Security purposes with respect to their ministerial duties. Ministers can request (on Form W-4) that their church withhold an additional amount of income taxes to cover their expected self-employment tax liability. These additional withholdings must be treated as income taxes withheld (on Form W-2 and 941 forms) rather than the employee's share of Social Security and Medicare taxes. These ministers must still complete Schedule SE.

Line 63. 2012 estimated tax payments

Compensation paid to ministers for ministerial duties is not subject to 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 on page 8 of this guide. The total amount of estimated tax payments made to the IRS is reported as a payment of taxes on line 63.

Line 64a. Earned income credit

The maximum earned income credit for 2012 is:

- \$475 with no qualifying child;
- \$3,169 with one qualifying child;
- \$5,236 with two qualifying children;
- \$5,891 with three or more qualifying children.

The earned income credit reduces tax you owe and may give you a refund even if you do not owe any tax. A number of technical requirements must be met in order to qualify

for this credit. Unfortunately, many taxpayers who qualify for the earned income credit do not claim it because it is so difficult to compute. In most cases, the amount of your earned income credit depends on:

1. whether you have no qualifying child, one qualifying child, two qualifying children, or three or more qualifying children;
2. the amount of your earned income and modified adjusted gross income.

You may be able to claim the earned income credit for 2012 if:

1. you do not have a qualifying child and you earned less than \$13,980 (\$19,190 if married);
2. a qualifying child lived with you and you earned less than \$36,920 (\$42,130 if married filing jointly);
3. two qualifying children lived with you and you earned less than \$41,952 (\$47,162 if married filing jointly); or
4. three or more qualifying children lived with you and you earned less than \$45,060 (\$50,270 if married filing jointly).

You can compute the credit yourself or the IRS will compute it for you. To figure the amount of your earned income credit, you must use the EIC Worksheet and EIC Table in the instructions for Form 1040, lines 64a and 64b. 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. See tax highlight #6.

Key Point

The instructions to Form 1040 (lines 64a and 64b) clearly state that a housing allowance, or fair rental value of a rectory, is included in the definition of earned income when computing the earned income credit for ministers who have not exempted themselves from self-employment taxes. Unfortunately, the instructions are less clear for ministers who have exempted themselves from self-employment taxes, but the instructions suggest that these ministers do not include a housing allowance or the fair rental value of a rectory in computing their earned income for purposes of the credit. Ministers who are affected by this issue should consult their own tax advisor for help. The IRS continues to take the position that a minister's housing allowance (fair rental value of a rectory) counts as earned income in determining eligibility for the earned income credit, but only for those ministers who have not opted out of Social Security by filing a timely Form 4361. Ministers who have opted out of Social Security do not treat the housing allowance (or fair rental value of a rectory) as earned income in computing the earned income credit. This understanding is reflected in the instructions to lines 64a and 64b of Form 1040.

Line 68. Amount paid with request for extension to file
See "Preliminary Q&A" section of this booklet, page 2.

Step 11: Refund or amount you owe

After totaling your payments, 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 payable to the "United States Treasury." Do not attach the check to your return. Include your daytime phone number, your Social Security number, and write "Form 1040 for 2012" on the check. You also may have to pay an underpayment penalty (refer to line 77 of Form 1040).

If you have overpaid your taxes, you have two options:

1. request a full refund, or
2. apply the overpayment to your 2013 estimated tax.

Step 12: Sign here

You must sign and date the return at the bottom of page 2. If you are filing a joint return, your spouse must also sign the return. In the "Your occupation" space, enter your occupation. Episcopal ministers should enter "minister." Please note that the person who signs a tax return does so under the penalty of perjury.

Key Point

If retired, enter "retired minister" so that the IRS will know that you still qualify for the housing allowance.

Other Forms and Schedules

Schedule A

Key Point

If your itemized deductions exceed your standard deduction, you should report your itemized deductions on Schedule A (Form 1040). This section will summarize the itemized deductions.

Step 1: Medical and dental expenses (lines 1–4)

You may deduct certain medical and dental expenses (for yourself, your spouse, and your dependents) if you itemize your deductions on Schedule A, but only to the extent that your expenses exceed 7.5% of your adjusted gross income. You must reduce your medical expenses by the amounts of any reimbursements you receive for those expenses before applying the 7.5% test. Reimbursements include amounts you receive from insurance or other sources for your medical expenses (including Medicare). It does not matter whether 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;
- meals and lodging provided by a hospital during medical treatment (subject to some limits);
- medical and hospital insurance premiums that you pay;
- 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;
- 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 and batteries, crutches, etc.);
- transportation for necessary medical care (for 2012, the standard mileage rate for medical travel was 23 cents per mile);
- medicines and drugs requiring a prescription;
- 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 (deduction is limited to the amount that exceeds the amount by which the improvement increases the value of the home);
- 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;

- 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;
- trips for general improvement of health.

Step 2: Taxes you paid (lines 5–9)

Generally, real estate, state and local income, and personal property taxes actually paid during 2012 are deductible. Ministers who own their homes and pay real property taxes can include the full amount of such taxes in computing their housing allowance exclusion. They may also fully deduct the amount of the taxes as an itemized deduction on Schedule A. Federal income tax and gasoline taxes are not deductible for federal income tax purposes.

You can elect to deduct state and local general sales taxes instead of state and local income taxes, as an itemized deduction on Schedule A (Form 1040), line 5. Generally, you can use either your actual expenses or the state and local sales tax tables to figure your sales tax deduction. See tax highlight #9.

Tax Tip

If you lived in more than one state during 2012, multiply the table amount for each state you lived in by the fraction of the year that you lived there.

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

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

- mortgages you took out on your main home on or before October 13, 1987;
- mortgages you took out on your main home after October 13, 1987, to buy, build, or improve your home, but only if these mortgages (plus any mortgages in the preceding category) total \$1 million or less throughout 2012, (\$500,000 if married filing separately);
- mortgages you took out after October 13, 1987, on your main home, other than to buy, build, or improve your home, but only if these mortgages total \$100,000 or less throughout 2012 (\$50,000 if married filing separately).

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

Key Point

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

The term “points” is sometimes used to describe certain charges paid by a borrower. They are also called loan origination fees, maximum loan charges, or premium charges. If the payment of any of these charges is only for the use of money, it ordinarily is interest paid in advance and must be deducted in installments over the life of the mortgage (not deducted in full in the year of payment). However, points are deductible in the year paid if the following requirements are satisfied:

1. your loan is secured by your primary residence;
2. paying points is an established business practice in your area;
3. the points you paid were not more than the points generally charged in your area;
4. you use the cash method of accounting;
5. the points were not paid in the place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, attorney fees, and property taxes;

6. you use your loan to buy or build your main home;
7. the points were computed as a percentage of the principal amount of the mortgage;
8. the amount is clearly shown on the settlement statement;
9. the funds you provided at or before closing, plus any points the seller paid, were at least as much as the points charged.

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

Cash contributions to churches, schools, and most public charities are deductible up to 50% of adjusted gross income. Contributions of property are subject to different limitations. See IRS Publication 526. Contributions of cash or checks are reported on line 16, while contributions of noncash property are reported on line 17. If you do not itemize deductions, you cannot deduct any of your charitable contributions.

The value of personal services is never deductible as a charitable contribution, but unreimbursed expenses incurred in performing services on behalf of a church or other charity may be. For example, if you drive to and from volunteer work on behalf of a charity, you may deduct the actual cost of gas and oil or you may claim the standard charitable mileage rate of 14 cents for each substantiated mile for 2012 and 2013. 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:

1. 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.
2. Or, these individuals could provide their church or charity with a travel report substantiating all travel expenses.

In such a case, the church or charity could issue the individual a charitable contribution receipt for the total amount of the substantiated travel expenses. Travel expenses that can be receipted include airfare, lodging, meals, and incidental expenses.

No charitable deduction is allowed for travel expenses incurred while away from home in performing services for a religious or charitable organization unless there is no significant element of personal pleasure, recreation, or vacation involved in the travel.

Example

Jack goes on a trip to Europe. He is in Europe for 10 days and conducts one-hour services on two of those days. Jack will not be able to claim a charitable contribution deduction for the travel expenses that he incurs in making this trip. The same rule would apply if Jack's spouse or children go along on the trip.

Charitable contributions must be claimed in the year they are delivered. Note that the delivery date of mailed contributions is determined by the IRS to be the postmark

date, not the actual arrival date. A contribution mailed and postmarked on December 31 applies to the year ending rather than to the new year in which it is received.

Charitable contributions generally are deductible only to the extent that 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 public charities are deductible up to a maximum of 50% of adjusted gross income. In some cases, contributions that exceed these limits can be carried over and claimed in future years. Some charitable contributions are limited to 20% or 30% of adjusted gross income, depending on the recipient and the form of the contribution.

Designated contributions are those that are made to a church with the stipulation that they be used for a specified purpose. If the purpose is an approved project or program of the church, the designation will not affect the deductibility of the contribution. An example is a contribution to a church building fund. However, if a donor stipulates that a contribution be spent on a designated individual, no deduction is allowed unless the church exercises full administrative control over the donated funds to ensure that they are being spent in furtherance of the church's exempt purposes. Designated contributions that ordinarily are not deductible include contributions to church benevolence or scholarship funds that designate a specific recipient. Contributions to benevolence or scholarship funds ordinarily are deductible if the donor does not earmark a specific recipient.

Contributions to a church or missions board that specify a particular missionary may be tax-deductible if the church or missions board exercises full administrative and accounting control over the contributions and ensures that they are spent in furtherance of the church's mission. Direct contributions to missionaries, or any other individual, are not tax-deductible, even if they are used for religious or charitable purposes.

Charitable contributions must be properly substantiated. All individual cash contributions must be substantiated by a canceled check or receipt from the charity. Current rules govern the substantiation of individual contributions of cash or property of \$250 or more. For more information (including substantiation requirements) see IRS Publication 526, "Charitable Contributions."

If you contribute property that you value at \$500 or more, you must include a completed Form 8283 with your Form 1040. Complete only section A if the value claimed is \$500 or more but less than \$5,000. If you claim a deduction of more than \$5,000 for a contribution of noncash property (other than publicly traded securities), then you must obtain a qualified appraisal of the property and include a qualified appraisal summary (section B of Form 8283) with your Form 1040. Special rules apply to donations of cars, boats, and planes. See the instructions to IRS Form 1098-C for details.

❗ Key Point

Paperwork is important! In one case, the Tax Court disallowed one donor's noncash charitable contribution deduction, not because of any dispute over the value of a \$10,000 property the donor had contributed to a church, but because the donor failed to attach a qualified appraisal summary (Noncash Charitable Contributions, Form 8283) to the tax return on which his contribution was claimed.

Step 5: Casualty and theft losses (line 20)

Most taxpayers have at some time suffered damage to their property as a result of hurricanes, earthquakes, tornadoes, fires, vandalism, car accidents, floods, or similar events. When property is damaged or destroyed by such events, it is called a casualty. If your property is stolen, you may also have a deductible theft loss. You must itemize your deductions on Schedule A to be able to claim a casualty or theft loss to nonbusiness property.

To determine your deduction, you must reduce the amount of your casualty and theft losses by any insurance or reimbursement you receive. No deduction is allowed for a casualty or theft loss that is covered by insurance unless a timely insurance claim for reimbursement has been filed.

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

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

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

To claim a casualty or theft loss, you must be able to show that the loss in fact occurred. In addition, the loss generally is defined as the lesser of:

1. the decrease in fair market value of the property as a result of the casualty or theft, or
2. your adjusted basis in the property before the casualty or theft.

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

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

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

- unreimbursed and nonaccountable reimbursed employee business expenses (discussed more fully below);
- professional society dues;
- safety deposit box rental;
- employee educational expenses;
- tax counsel and assistance;
- office;
- work-related home expenses;
- related supplies;
- expenses of looking for a new job;
- investment counsel fees;
- professional books and periodicals;
- investment expenses;
- 50% of unreimbursed business meals and entertainment;
- IRA custodial fees.

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

Step 7: Employee business expenses

❗ Key Point

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

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

Local transportation expenses

Expenses incurred in driving your car for business purposes within your community represent one of the most important business expenses for ministers. A common example would be driving your car from your church to a hospital to visit members. Commuting to and from work is never a business expense. However, if you drive to a hospital (or some other business location) on the way home from church, the expenses incurred in driving from the church to the second business location are business expenses even though you are on the way home. The remaining miles between the second business location and your home are nondeductible commuting expenses.

These expenses can be deducted using either a standard mileage rate or the actual costs of operating the car for business miles. Most ministers choose the standard mileage rate because of its simplicity. However, it is available only if it is selected for the first year a car is used in your trade or business. The actual expense method is very complex and is explained fully in IRS Publication 463.

The standard business mileage rate for 2012 was 55.5 cents per mile.

📌 Key Point

The standard business mileage rate for 2013 is 56.5 cents per mile.

Travel expenses

Travel expenses are the expenses that you incur while traveling away from home overnight for your work or business. A common example would be automobile, lodging, and meal expenses you incur in traveling to a convention or meeting. You can deduct these expenses if you can substantiate them, as explained below.

Deductible travel expenses include:

- air, rail, and bus fares;
- operating and maintaining your car;
- taxi fares or other costs of transportation between the airport or station and your hotel, or from one work site to another;
- meals and lodging while you are away from home on business for less than one year for a short-term position, such as an interim;
- cleaning and laundry expenses;
- telephone and telegraph expenses;
- tips.

The travel expenses of a spouse who accompanies a minister on a business trip are almost never deductible as a business expense, and cannot be reimbursed under an accountable arrangement. In rare cases, an employer's reimbursement of the travel expenses of an employee's spouse may qualify as a nontaxable *working condition fringe benefit* so long as these conditions are met: (1) the employer has not treated such amounts as compensation; (2) the amounts would be deductible as a business expense without regard to the limitation on the deductibility of a spouse's travel expenses, meaning that the spouse's presence on the trip is for a legitimate business purpose; and (3) the employee substantiates the expenses under an accountable arrangement. This is a highly aggressive position that should not be adopted without the advice of a tax professional.

Entertainment expenses

You may be able to deduct entertainment expenses you incur during your ministry. You may take the deduction only if you can demonstrate that the amounts spent are either:

1. directly related to the active conduct of your ministry, or
2. associated with the active conduct of your ministry, and the entertainment occurred directly before or after a substantial business discussion.

These two tests are summarized below:

Directly related test

To show that entertainment was directly related to the active conduct of your business, you ordinarily must be able to demonstrate that:

1. you had more than a general expectation of deriving income or some other specific business benefit at some indefinite future time;

2. you did engage in business during the entertainment period; and
3. the main purpose of the entertainment was the transaction of business.

Associated entertainment test

To show that entertainment was associated with the active conduct of your ministry, you must be able to demonstrate that:

1. you had a clear business purpose in incurring the expense; and that
2. the meal or entertainment directly preceded or followed a substantial business discussion.

Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation.

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

📌 Key Point

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

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

Entertainment expenses of spouses may also be deductible if their presence serves a legitimate business purpose or if it would be impractical under the circumstances to entertain the business associate without including his or her spouse. If a spouse's entertainment expenses are deductible because it is impractical to entertain his or her spouse without the spouse being included, your spouse's entertainment expenses incurred on the same occasion will also be deductible. For example, your spouse joins you because your business associate's spouse will be present.

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

📌 Example

Scott invites the members of the vestry to his home for dinner and a meeting. The expenses incurred by Scott and his guests for food and beverages ordinarily will constitute entertainment expenses.

Example

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

Example

Kitty is the head of staff of her church. She takes a prospect for a ministerial staff position out to dinner, during which they discuss the person's background and suitability for the position. The person's spouse comes along because it would be impractical to discuss the position solely with the prospect. Further, Kitty's spouse accompanies her because the other spouse is present. Kitty pays everyone's meal expense. The cost of the meals of all four people is an entertainment expense.

Educational expenses

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

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

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

Example

The minister at St. Michael's Church takes a counseling course at a local university. Expenses associated with the course are deductible educational expenses if the course maintains or improves job skills and is not a part of a program of study that will qualify the minister for a new trade or business.

Subscriptions and books

Ministers often subscribe to a number of periodicals. The cost of these is a legitimate business expense if the periodicals relate to the minister's duties at the church. Minister's journals and other specialized periodicals clearly satisfy this test. News magazines also may qualify if a minister can demonstrate that the information contained in such periodicals is related to his or her ministry (for example, sources of illustrations for sermons). The cost of a general circulation daily newspaper is not deductible. The unreimbursed cost of books that are related to your ministry is a professional business expense and accordingly is deductible.

Personal computers

Many ministers have purchased personal computers for use at home. Since computers lend themselves to personal as well as business use, they are singled out for special treatment. If you report your income taxes as an employee (or you report as self-employed but are reclassified as an employee by the IRS in an audit) and you purchase a home computer that you use in connection with your work, you must meet the following tests to claim any deduction:

1. Your use of the computer in your home must be for the convenience of your employer.

Key Point

The term "for the convenience of your employer" means that you clearly can demonstrate that you cannot perform your job without the home computer. The fact that the computer enables you to perform your work more easily and efficiently is not enough; you also must prove that the computers available at your place of employment are insufficient to enable you to perform your job properly. Obviously, this is a difficult test to satisfy.

2. Your use of the computer in your home is required as a condition of your employment.

Key Point

The term "required as a condition of your employment" means that you are unable to perform your duties properly without the computer. It is not necessary that your employer explicitly requires you to use the computer. On the other hand, it is not enough that your employer merely states that your use of the home computer is a condition of your employment. If you are an employee and these tests are not met, you cannot deduct any of the cost of your home computer.

3. If you are an employee and you meet both tests described above, you can claim a business deduction if you use your home computer more than 50% of the time during the year in your work.

Cell phones

The cost of employer-provided cell phones no longer need to be reported on the Form W-2 as income as long as the personal use is minimal.

Office in the home

Most ministers have an office in their home. For the costs of such an office to be deductible as a business expense, several conditions must be satisfied:

1. The costs must not have been excluded as minister's housing allowance.
2. The home office must be your principal place of business.
3. The home office must be used exclusively in your trade or business. This means that the home office must not be used by other family members (for example, to watch television or do homework). The use of a part of your home for both personal and business purposes does not meet the exclusive use test.

4. The home office must be used on a regular basis in your trade or business. This means that you must use the home office on a continuous basis for professional purposes (for example, preparing sermons, conducting counseling, doing research, contacting members, writing correspondence, preparing for church meetings). Occasional or incidental use of the office for such purposes is not enough, even if the office is used for no other purposes.
5. If you are an employee, the home office must be for the convenience of the employer. This means that the home office must do more than make the employee's job easier or efficient — it must be essential to the performance of your job.

Very few ministers will satisfy all of these conditions, which means that a home office deduction generally is not available.

Key Point

Operating expenses in connection with a church office at home, which have not already been excluded as a part of housing, may be taken as a miscellaneous itemized deduction on Schedule A.

How to report employee business expenses

This section addresses the tax treatment of business expenses for ministers who report their income taxes as employees. The tax treatment of business expenses for ministers with self-employment income is discussed below (under the section on Schedule C).

The business expenses of ministers who are employees for federal income tax reporting purposes should be handled in the following way:

Accountable reimbursement arrangement

The best way for ministers to handle business expenses is to have their employing church adopt an accountable business expense reimbursement arrangement. Under such an arrangement,

1. a church agrees to reimburse ministers (and other church workers, if desired) for those business expenses that are properly substantiated as to date, amount, place, and business purpose, and
2. ministers are required to return any excess reimbursements (in excess of substantiated expenses) to the church.

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

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

1. Condition the reimbursement of any expense on adequate substantiation. This will include written evidence for all expenses and receipts for expenses

of \$75 or more. The evidence must substantiate the amount, date, place, and business nature of each expense. The key point is this: a church must require the same degree of substantiation as would be required for a deduction on the minister's income tax return.

2. Expenses must be substantiated, and excess reimbursements returned to the church, within a reasonable time. Expenses will be deemed substantiated within a reasonable period of time if they are substantiated within 60 days. Excess reimbursements will be deemed to be returned to the employer within a reasonable period of time if they are returned within 120 days.
3. Business expense reimbursements cannot be funded under an accountable plan out of a minister's own salary (for example, through salary reductions).

Does this same prohibition apply to salary "restructuring" arrangements such as the one cited below?

Example

In December the vestry of St. Matthew's agrees to set aside \$50,000 for its minister's compensation package for the following year. The vestry adopts a resolution agreeing to pay the minister a "total compensation package" of \$50,000 consisting of salary of \$35,000, a housing allowance of \$10,000, and a business expense reimbursement account of \$5,000.

According to the IRS, the prohibition against using salary reductions to pay for reimbursements under an accountable expense reimbursement arrangement does apply to salary "restructuring." Therefore most tax specialists would not recommend the salary plan cited in the above example.

However, some churches are using a "two resolutions" approach to avoid this rule. Here is how it works: at the end of the year, when the vestry or compensation committee is considering a compensation package for its minister for the following year, it adopts a resolution that authorizes a salary and housing allowance of specified amounts, along with other fringe benefits (excluding any reference to business expenses). These various components of compensation are added and result in "total compensation" to be paid to the minister in the following year. The vestry or compensation committee then adopts a second resolution that sets aside a specified dollar amount in a "business expense reimbursement" account that can be used to pay for business expenses incurred by the minister that are "accounted for" within a reasonable time under an accountable reimbursement arrangement.

An argument can be made that this arrangement is not a salary reduction or salary restructuring arrangement, since the vestry elected to create the expense reimbursement account independently from its consideration of the minister's compensation. As a result, business expenses the minister incurs may be reimbursed by the church out of the expense reimbursement account if the requirements for

an accountable reimbursement arrangement are met, and such reimbursements will not represent taxable income to the minister. This approach has not been addressed by the IRS or any court, so it remains untested and aggressive. Ministers and church treasurers should not rely on this approach without the advice of a tax professional.

Example

Randolph is rector of Church of the Redeemer. He reports his federal income taxes as an employee, and the church reimburses him for all of his business and professional expenses (by means of a credit card or cash reimbursements). However, Randolph is not required to account for such expenses by providing the church treasurer with receipts documenting the amount, time and place, business purpose, and business relationship of each expense. Randolph simply informs the treasurer at the end of each month of the total expenses incurred during that month. Assume further that Randolph cannot itemize deductions on Schedule A (he does not have sufficient deductions). If Randolph received reimbursements of \$4,000 in 2012, the following would apply:

1. The church would report the entire reimbursements (\$4,000) as income on Randolph's W-2, and Randolph would report them as income (salary) on his Form 1040.
2. Randolph cannot deduct the reimbursed expenses as a miscellaneous itemized deduction on Schedule A, since he does not have sufficient expenses to itemize. In other words, all of Randolph's business expense reimbursements are includable in his income for tax purposes, but he cannot offset any of this income by deducting any portion of his business expenses. Even if Randolph could itemize deductions, his nonaccountable reimbursed expenses would be treated just like unreimbursed expenses, which are deductible only as miscellaneous itemized deductions, and then only to the extent that they (along with most other miscellaneous expenses) exceed 2% of his adjusted gross income.
3. Clearly, the tax impact of these rules can be costly for ministers who do not account to their employing church for their business expenses. Further, if the church and Randolph neglect to report the reimbursements as taxable income, the reimbursements become an "automatic excess benefit" triggering intermediate sanctions against both Randolph (assuming he is an officer or director, or the relative of one) of up to 225% of the excess benefit (\$9,000), and the vestry, up to a maximum penalty of \$20,000.

Example

Same facts as the previous example, except that the church adopts an accountable reimbursement arrangement, and Randolph is reimbursed for \$4,000 of substantiated expenses. Under these facts, the church would not report the \$4,000 of reimbursements

as income on Randolph's Form W-2, and Randolph would not have to report the reimbursements or claim the expenses on his Form 1040.

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

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

Deason Rule

Unreimbursed business expenses must be split between the deductible part allocated to taxable income, and the nondeductible part allocated to the housing exclusion. Both parts are deductible in calculating the self-employment tax. This reinforces the desirability of being reimbursed for your expenses, rather than taking them as deductions.

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 2012. Be sure the interest you report on line 1 corresponds to any 1099-INT forms you received from such institutions. Do not include tax-exempt interest.

Step 2: Dividend income (lines 5–6)

List (on line 5) the name of each institution that paid you dividends if you received more than \$1,500 in dividends in 2012. Be sure the dividends you report on line 1 correspond to any 1099-DIV forms you received from such institutions.

Step 3: Foreign accounts and foreign trusts

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

Schedule C

Ministers who deduct health insurance premiums may want to use Schedule C instead of Schedule C-EZ, because their expenses (including health insurance premiums) will exceed the \$5,000 maximum allowed on Schedule C.

Key Point

Most Episcopal ministers who serve local churches or church agencies are employees for federal income tax purposes, with respect to their church salary. They report their church salary on line 7 of Form 1040 and receive a Form W-2 from the church. They do not report their salary as self-employment earnings on Schedule C.

📌 Key Point

Use Schedule C to report income and expenses from ministerial activities you conduct other than in your capacity as a church employee. Examples would be fees received for guest speaking appearances in other churches, and fees received directly from church members for performing personal services, such as weddings and funerals.

Step 1: Introduction

Complete the first several questions on Schedule C. Ministers should list the code 541990 on line B. This is the code used for ministers and chaplains in the clergy tax illustrations found in IRS 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.

Step 2: Income

Report on line 1 your gross income from your self-employment activity.

Step 3: Expenses

Report any business expenses associated with your self-employment earnings on line 2. For example, if you incur transportation, travel, or entertainment expenses in the course of performing self-employment activities, you deduct these expenses on line 2 of Schedule C.

Schedule SE

📌 Key Point

Use Schedule SE to report Social Security taxes on any income you earned as a minister if you have not applied for and received IRS approval of an exemption application (Form 4361). Remember, ministers always are self-employed for Social Security purposes with respect to their ministerial services. They pay self-employment taxes, and never FICA taxes, with respect to such services.

📌 Key Point

You must report the fair market value of your rectory or your cash housing allowance received in the absence of a rectory when reporting your self-employment income. To do so you should prepare a supplemental schedule for the 1040SE, which lists your W-2 compensation, your Schedule C or C-EZ compensation, and your housing. The total of this compensation is then reported on line 2 of the 1040SE.

📌 Key Point

All earned income received by retirees is subject to self-employment tax.

Step 1: Section A (line 2)

Use Schedule A, page 1, not Schedule B on page 2. This amount is computed as follows:

1. Add the following to the church salary:
 - other items of church income (including taxable fringe benefits);

- self-employment earnings from outside businesses;
- fair rental value of house, or nontaxable portion of housing allowance;
- business expense reimbursements made under a nonaccountable plan.

2. Next, subtract the following from the above total:

- unreimbursed business expenses (disregard the Deason reduction rule);
- business expenses reimbursed under a nonaccountable plan (disregard the Deason reduction rule);
- most income tax exclusions other than the housing allowance, the fair rental value of a rectory, and the foreign earned income exclusion.

Attach a schedule to the Form 1040-SE, summarizing the above items.

Step 2: Section A (line 3)

Subtract the amount reported on Form 1040 line 29 to arrive at your self-employment income.

Step 3: Section A (line 4)

Ministers (and other taxpayers who are considered self-employed for Social Security purposes) can reduce their taxable earnings by 7.65%, which is half the Social Security and Medicare tax paid by employers and employees. To do this, multiply net earnings from self-employment times 0.9235 on line 4. Self-employment taxes are paid on the reduced amount.

Step 4: Section A (line 5)

The self-employment tax for 2012 is computed on this line:

- a Medicare hospital insurance tax of 2.9% and;
- an old-age, survivor and disability (Social Security) tax of 10.4%.

For 2012, the 2.9% Medicare tax applies to all net earnings from self-employment regardless of amount. The 10.4% Social Security component of the self-employment tax applies only to the first \$110,100 of net self-employment earnings in 2012.

📌 Key Point

If you live in a rectory, be sure to include the fair rental value of the rectory when calculating your compensation for the SE tax.

📌 Key Point

For 2013, the self-employment tax rate for clergy returns to 15.3%

Special Note:

The tax form examples (beginning on page 32) will illustrate—to you and also your tax preparer—some “average” tax scenarios for both active and retired clergy. These examples address federal Tax Code provisions only. No attempt has been made to address the Tax Code requirements of states or other localities. The complexities of local taxes far exceed the scope of this publication, and represent yet another reason why you should you consult a tax professional.

Example One: Rector

The Reverend Jerome L. Scott is rector of St. Michael’s Church. He has served in that position for the past seven years. He is married to Jane T. Scott, who is employed as an accountant by a local firm. The Scotts have two children, Andrew and Amy, aged 22 and 19, respectively. He and his wife file a joint federal income tax return. Listed below are several facts concerning Fr. Scott’s income and expenses for 2012, along with several pertinent items of information. Thereafter, the Scott’s federal income tax return for 2012 is reproduced. Note that Fr. Scott reports his income taxes as an employee.

**The Reverend Jerome L. and Mrs. Jane T. Scott
Income**

Fr. Scott

- church salary.....\$44,000.00*
- church designated housing allowance (separate from church salary)..... 26,000.00
- contribution to 403(b) (excluded from church salary)..... 6,000.00
- honoraria for speaking at other churches..... 1,500.00
- honoraria for performing weddings, funerals, etc. ... 900.00
- Christmas gift from the church (salary) 600.00
- imputed cost of excess life insurance 240.00

* housing allowance (\$26,000) and salary reduction contribution to 403(b) retirement account (\$6,000) not included in church wages since both are excluded from gross income of \$76,000.

Jane T. Scott

- salary as accountant..... \$45,000.00
- interest earnings at First United Bank..... 125.00

Housing Expenses paid in 2012

- mortgage payments12,000.00
- utilities (paid by the Scotts)..... 4,100.00
- home insurance.....1,100.00
- real property taxes2,600.00
- new furniture.....2,000.00
- miscellaneous.....1,500.00
- repairs..... 1,800.00
- Total 25,100.00**

Retirement savings contributions, 403(b)

- Fr. Scott.....6,000.00

Medical expenses not covered by insurance

- combined expenses..... 1,500.00

Taxes

- state income taxes 2,400.00

[Exceeds state and local sales taxes for the year]

- real estate taxes 2,600.00

Interest

- mortgage interest on home..... 9,200.00
- interest on credit cards and a car loan 500.00

Charitable Contributions

- cash contributions to St. Michael’s.....9,000.00
- miscellaneous cash contributions 900.00

[The Scotts have written receipts substantiating all of their charitable contributions.]

Travel expenses associated with Fr. Scott’s honoraria (unreimbursed)

- \$500 travel and lodging plus \$250 meals..... 750.00

Miscellaneous data

1. In general, Fr. Scott reports his federal income taxes as an employee. However, note that:
 - A. All clergy, including those who report their federal income taxes as employees, are considered to be self-employed for Social Security purposes with respect to their ministerial services. There is nothing that Fr. Scott, or the church, can do to change this. As a result, the church should not withhold the employee’s share of Social Security and Medicare taxes (the reduced amount of 5.65% of wages in 2012) from his compensation, and there are no employer contributions that the church is required to make. Rather, Fr. Scott must pay the “self-employment tax”—the Social Security tax for those considered self-employed for Social Security purposes. Fr. Scott must use Schedule SE to compute his self-employment tax.
 - B. Clergy who report their income taxes as employees are exempt by law from the income tax withholding requirements. They use the quarterly estimated tax procedure to prepay their income taxes and self-employment taxes. Alternatively, they can select “voluntary withholding.” Fr. Scott has been using the estimated tax procedure. In 2013, he again plans to pay estimated tax payments of \$4,000 (\$1,000 per quarter) in light of the substantial American Opportunity Credit refund he received in 2012, and which he anticipates receiving again in 2013 (thanks to having two children in college).

Total estimated tax payments for 2012 were \$4,000 (\$1,000 per quarter).

Jane Scott had \$8,100 in federal income taxes withheld from her wages as an accountant. Total withholdings (Form 1040, line 62) equal \$8,100.

St. Michael’s Church issued Fr. Scott a W-2 on January 28, 2013, listing salary and wages of \$44,840 in Box 1, housing allowance of \$26,000 in Box 14, 403(b) retirement savings of \$6,000 in Box 12, and imputed cost of excess life insurance of \$240 in Box 12.

2. **Housing.** Fr. Scott is not furnished a rectory by St. Michael’s Church. However, as requested by Fr. Scott, the church does designate a housing allowance each year to enable Fr. Scott to pay for his own home. In December of 2011 the vestry of St. Michael’s Church determined that Fr. Scott’s 2012 church compensation would be \$76,000, of which Fr. Scott asked that \$26,000 be designated as a housing allowance and \$50,000 be designated as salary. Assume that the annual fair rental value of Fr. Scott’s home, furnished, plus the cost of utilities, is \$27,000.
3. **403(b) contributions:** Fr. Scott contributed though salary reductions totaling \$6,000 to this RSVP account with the Church Pension Fund .
4. Andrew Scott continued college at UCLA. The Scotts paid \$6,500 in qualified expenses toward his education in 2012. Amy started college at California State Community College and the Scotts paid \$4,500 in qualified expenses for her education in 2012.
5. **Personal interest.** Neither the Scotts’ interest on credit cards nor their car loan is tax-deductible.
6. **Health care coverage cost.** As an employee benefit to Fr. Scott, St. Michael’s pays 100% of the health care coverage cost for the Scott family.

For the year Jan. 1–Dec. 31, 2012, or other tax year beginning , 2012, ending , 20 See separate instructions.

Your first name and initial Last name Your social security number
Jerome L. Scott 1 0 0 2 2 1 2 3 4
If a joint return, spouse's first name and initial Last name Spouse's social security number
Jane T. Scott 1 0 0 1 2 1 2 3 4

Home address (number and street). If you have a P.O. box, see instructions. Apt. no.
415 Walnut Street Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). Presidential Election Campaign
Anytown, CA 94567 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.
Foreign country name Foreign province/state/county Foreign postal code [X] You [X] Spouse

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

Exemptions 6a [X] Yourself. If someone can claim you as a dependent, do not check box 6a.
b [X] Spouse
c Dependents: (1) First name Last name (2) Dependent's social security number (3) Dependent's relationship to you (4) [X] if child under age 17 qualifying for child tax credit (see instructions)
Andrew Scott 0 0 1 1 1 0 1 2 3 child []
Amy Scott 0 0 1 1 2 1 2 3 4 child []
d Total number of exemptions claimed 4

Income 7 Wages, salaries, tips, etc. Attach Form(s) W-2 7 89,840 00
8a Taxable interest. Attach Schedule B if required 8a 125 00
b Tax-exempt interest. Do not include on line 8a 8b
9a Ordinary dividends. Attach Schedule B if required 9a
b Qualified dividends 9b
10 Taxable refunds, credits, or offsets of state and local income taxes 10
11 Alimony received 11
12 Business income or (loss). Attach Schedule C or C-EZ 12 1,775 00
13 Capital gain or (loss). Attach Schedule D if required. If not required, check here [] 13
14 Other gains or (losses). Attach Form 4797 14
15a IRA distributions 15a b Taxable amount 15b
16a Pensions and annuities 16a b Taxable amount 16b
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E 17
18 Farm income or (loss). Attach Schedule F 18
19 Unemployment compensation 19
20a Social security benefits 20a b Taxable amount 20b
21 Other income. List type and amount Unused Housing Allowance 21 900 00
22 Combine the amounts in the far right column for lines 7 through 21. This is your total income 22 92,640 00

Adjusted Gross Income 23 Educator expenses 23
24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ 24
25 Health savings account deduction. Attach Form 8889 25
26 Moving expenses. Attach Form 3903 26
27 Deductible part of self-employment tax. Attach Schedule SE 27 5,129 00
28 Self-employed SEP, SIMPLE, and qualified plans 28
29 Self-employed health insurance deduction 29
30 Penalty on early withdrawal of savings 30
31a Alimony paid b Recipient's SSN 31a
32 IRA deduction 32
33 Student loan interest deduction 33
34 Tuition and fees. Attach Form 8917 34
35 Domestic production activities deduction. Attach Form 8903 35
36 Add lines 23 through 35 36 5,129 00
37 Subtract line 36 from line 22. This is your adjusted gross income 37 87,511 00

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form 1040 (2012)

Tax and Credits

Table with 3 columns: Line number, Description, and Amount. Includes lines 38-55 for Tax and Credits, such as Adjusted Gross Income, Itemized Deductions, Exemptions, Taxable Income, and Total Credits.

Standard Deduction for - People who check any box on line 39a or 39b or who can be claimed as a dependent, see instructions. All others: Single or Married filing separately, \$5,950. Married filing jointly or Qualifying widow(er), \$11,900. Head of household, \$8,700.

Other Taxes

Table with 3 columns: Line number, Description, and Amount. Includes lines 56-61 for Other Taxes, such as Self-employment tax, Unreported social security and Medicare tax, and Total Tax.

Payments

Table with 3 columns: Line number, Description, and Amount. Includes lines 62-72 for Payments, such as Federal income tax withheld, 2012 estimated tax payments, and Total Payments.

If you have a qualifying child, attach Schedule EIC.

Refund

Table with 3 columns: Line number, Description, and Amount. Includes lines 73-74a for Refund, such as Amount you overpaid and Amount you want refunded to you.

Direct deposit? See instructions.

Table with 3 columns: Line number, Description, and Amount. Includes lines 75-77 for Refund continuation and Amount You Owe.

Amount You Owe

Third Party Designee

Form for Third Party Designee with fields for name, phone number, and 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.

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

Signature section with fields for taxpayer and spouse signatures, dates, occupations, and phone numbers.

Paid Preparer Use Only

Form for Paid Preparer Use Only with fields for preparer name, signature, date, firm name, EIN, and phone number.

**SCHEDULE A
(Form 1040)**

Department of the Treasury
Internal Revenue Service (99)

Name(s) shown on Form 1040

Itemized Deductions

► Information about Schedule A and its separate instructions is at www.irs.gov/form1040.

► Attach to Form 1040.

OMB No. 1545-0074

2012

Attachment
Sequence No. **07**

Jerome L. and Jane T. Scott

Your social security number

100-22-1234

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30						
Medical and Dental Expenses	Caution. Do not include expenses reimbursed or paid by others.																																				
	1 Medical and dental expenses (see instructions)						1,500																														
	2 Enter amount from Form 1040, line 38	2	87,510	70																																	
	3 Multiply line 2 by 7.5% (.075)	3					6,563																														
	4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-																																				
Taxes You Paid	5 State and local (check only one box):																																				
	a <input checked="" type="checkbox"/> Income taxes, or	5					2,400																														
	b <input type="checkbox"/> General sales taxes																																				
	6 Real estate taxes (see instructions)	6					2,600																														
	7 Personal property taxes	7																																			
	8 Other taxes. List type and amount	8																																			
	9 Add lines 5 through 8																																				
Interest You Paid	10 Home mortgage interest and points reported to you on Form 1098	10					9,200																														
	11 Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address	11																																			
	Note. Your mortgage interest deduction may be limited (see instructions).																																				
	12 Points not reported to you on Form 1098. See instructions for special rules	12																																			
	13 Mortgage insurance premiums (see instructions)	13																																			
	14 Investment interest. Attach Form 4952 if required. (See instructions.)	14																																			
	15 Add lines 10 through 14																																				
Gifts to Charity	16 Gifts by cash or check. If you made any gift of \$250 or more, see instructions.	16					9,900																														
	17 Other than by cash or check. If any gift of \$250 or more, see instructions. You must attach Form 8283 if over \$500	17																																			
	18 Carryover from prior year	18																																			
	19 Add lines 16 through 18																																				
Casualty and Theft Losses	20 Casualty or theft loss(es). Attach Form 4684. (See instructions.)	20																																			
Job Expenses and Certain Miscellaneous Deductions	21 Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See instructions.)	21																																			
	22 Tax preparation fees	22																																			
	23 Other expenses—investment, safe deposit box, etc. List type and amount	23																																			
	24 Add lines 21 through 23	24																																			
	25 Enter amount from Form 1040, line 38	25																																			
	26 Multiply line 25 by 2% (.02)	26																																			
	27 Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-	27																																			
Other Miscellaneous Deductions	28 Other—from list in instructions. List type and amount	28																																			
Total Itemized Deductions	29 Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40	29																																			
	30 If you elect to itemize deductions even though they are less than your standard deduction, check here <input type="checkbox"/>																																				

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 17145C

Schedule A (Form 1040) 2012

**SCHEDULE C-EZ
(Form 1040)**

Department of the Treasury
Internal Revenue Service (99)
Name of proprietor

Net Profit From Business
(Sole Proprietorship)

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

OMB No. 1545-0074

2012
Attachment
Sequence No. **09A**

Jerome L. Scott

Social security number (SSN)
100-22-1234

Part I General Information

**You May Use
Schedule C-EZ
Instead of
Schedule C
Only If You:**

- Had business expenses of \$5,000 or less.
- Use the cash method of accounting.
- Did not have an inventory at any time during the year.
- Did not have a net loss from your business.
- Had only one business as either a sole proprietor, qualified joint venture, or statutory employee.

And You:

- Had no employees during the year.
- Are not required to file **Form 4562**, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, to find out if you must file.
- Do not deduct expenses for business use of your home.
- Do not have prior year unallowed passive activity losses from this business.

A Principal business or profession, including product or service	B Enter business code (see page 2) 5 4 1 9 9 0
C Business name. If no separate business name, leave blank.	D Enter your EIN (see page 2)
E Business address (including suite or room no.). Address not required if same as on page 1 of your tax return. City, town or post office, state, and ZIP code	
F Did you make any payments in 2012 that would require you to file Form(s) 1099? (see the Schedule C instructions) <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
G If "Yes," did you or will you file required Forms 1099? <input type="checkbox"/> Yes <input type="checkbox"/> No	

Part II Figure Your Net Profit

1 Gross receipts. Caution. If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see <i>Statutory Employees</i> in the instructions for Schedule C, line 1, and check here <input type="checkbox"/>	1	2,400	00
2 Total expenses (see page 2). If more than \$5,000, you must use Schedule C	2	625	00
3 Net profit. Subtract line 2 from line 1. If less than zero, you must use Schedule C. Enter on both Form 1040, line 12 , and Schedule SE, line 2 , or on Form 1040NR, line 13 and Schedule SE, line 2 (see instructions). (Statutory employees, do not report this amount on Schedule SE, line 2.) Estates and trusts, enter on Form 1041, line 3	3	1,775	00

Part III Information on Your Vehicle. Complete this part **only** if you are claiming car or truck expenses on line 2.

4 When did you place your vehicle in service for business purposes? (month, day, year) ▶ _____

5 Of the total number of miles you drove your vehicle during 2012, enter the number of miles you used your vehicle for:

a Business _____ **b** Commuting (see page 2) _____ **c** Other _____

6 Was your vehicle available for personal use during off-duty hours? Yes No

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

8a Do you have evidence to support your deduction? Yes No

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

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

Cat. No. 14374D

Schedule C-EZ (Form 1040) 2012

**SCHEDULE SE
(Form 1040)**

Self-Employment Tax

OMB No. 1545-0074

Department of the Treasury
Internal Revenue Service (99)

► Information about Schedule SE and its separate instructions is at www.irs.gov/form1040.

2012

► Attach to Form 1040 or Form 1040NR.

Attachment
Sequence No. **17**

Name of person with self-employment income (as shown on Form 1040)

Social security number of person
with self-employment income ►

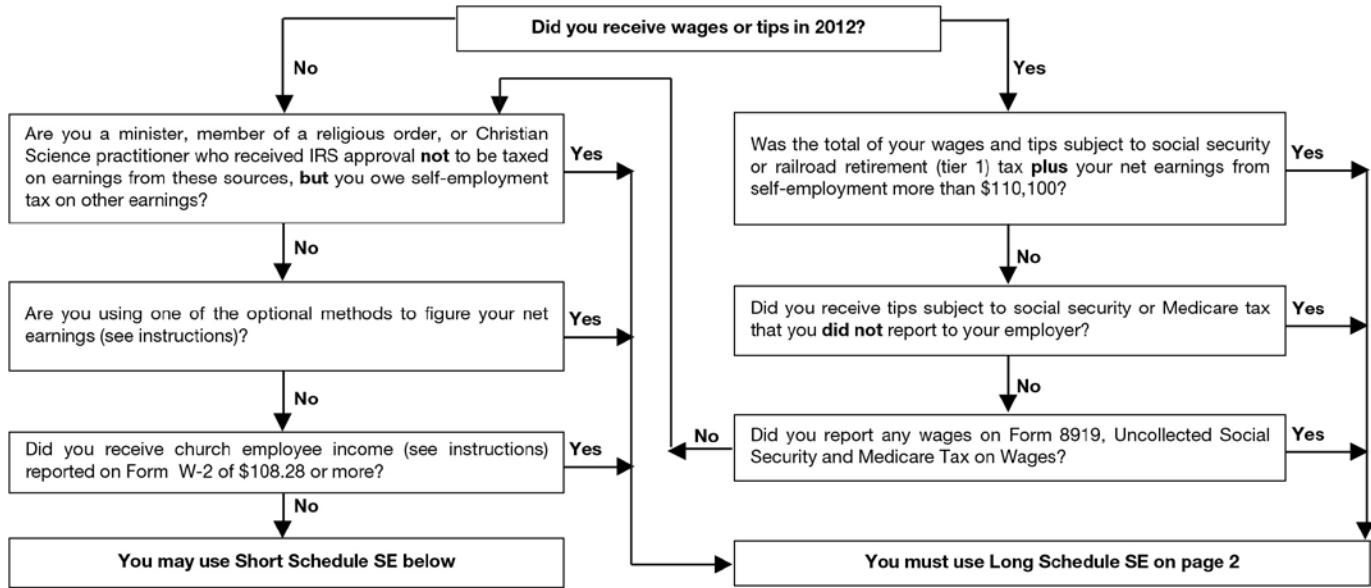
Jerome L. Scott

100-22-1234

Before you begin: To determine if you must file Schedule SE, see the instructions.

May I Use Short Schedule SE or Must I Use Long Schedule SE?

Note. Use this flowchart **only** if you must file Schedule SE. If unsure, see *Who Must File Schedule SE* in the instructions.



Section A—Short Schedule SE. Caution. Read above to see if you can use Short Schedule SE.

1a	Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A		
b	If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code Y		
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report	72,615	00
3	Combine lines 1a, 1b, and 2	72,615	00
4	Multiply line 3 by 92.35% (.9235). If less than \$400, you do not owe self-employment tax; do not file this schedule unless you have an amount on line 1b ►	67,059	95
5	Self-employment tax. If the amount on line 4 is: • \$110,100 or less, multiply line 4 by 13.3% (.133). Enter the result here and on Form 1040, line 56 , or Form 1040NR, line 54 • More than \$110,100, multiply line 4 by 2.9% (.029). Then, add \$11,450.40 to the result. Enter the total here and on Form 1040, line 56 , or Form 1040NR, line 54	8,918	97
6	Deduction for employer-equivalent portion of self-employment tax. If the amount on line 5 is: • \$14,643.30 or less, multiply line 5 by 57.51% (.5751) • More than \$14,643.30, multiply line 5 by 50% (.50) and add \$1,100 to the result. Enter the result here and on Form 1040, line 27 , or Form 1040NR, line 27	5,129	30

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

Cat. No. 11358Z

Schedule SE (Form 1040) 2012

Education Credits
(American Opportunity and Lifetime Learning Credits)

▶ See separate instructions to find out if you are eligible to take the credits.
 ▶ Instructions and more are at www.irs.gov/form8863. Attach to Form 1040 or Form 1040A.

Name(s) shown on return

Your social security number

Jerome L. and Jane T. Scott

100 | 22 | 1234



Complete a separate Part III on page 2 for each student for whom you are claiming either credit before you complete Parts I and II.

Part I Refundable American Opportunity Credit

1	After completing Part III for each student, enter the total of all amounts from all Parts III, line 30	1	5,000	00
2	Enter: \$180,000 if married filing jointly; \$90,000 if single, head of household, or qualifying widow(er)	2	180,000	00
3	Enter the amount from Form 1040, line 38, or Form 1040A, line 22. If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter	3	87,510	70
4	Subtract line 3 from line 2. If zero or less, stop ; you cannot take any education credit	4	92,489	30
5	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	5	20,000	
6	If line 4 is: • Equal to or more than line 5, enter 1.000 on line 6 • Less than line 5, divide line 4 by line 5. Enter the result as a decimal (rounded to at least three places)	6	1 . 000	
7	Multiply line 1 by line 6. Caution: If you were under age 24 at the end of the year and meet the conditions described in the instructions, you cannot take the refundable American opportunity credit; skip line 8, enter the amount from line 7 on line 9, and check this box <input type="checkbox"/>	7	5,000	00
8	Refundable American opportunity credit. Multiply line 7 by 40% (.40). Enter the amount here and on Form 1040, line 66, or Form 1040A, line 40. Then go to line 9 below.	8	2,000	00

Part II Nonrefundable Education Credits

9	Subtract line 8 from line 7. Enter here and on line 8 of the Credit Limit Worksheet (see instructions)	9	3,000	000
10	After completing Part III for each student, enter the total of all amounts from all Parts III, line 31. If zero skip lines 11 through 17, enter -0- on line 18, and go to line 19	10		
11	Enter the smaller of line 10 or \$10,000	11		
12	Multiply line 11 by 20% (.20)	12		
13	Enter: \$124,000 if married filing jointly; \$62,000 if single, head of household, or qualifying widow(er)	13		
14	Enter the amount from Form 1040, line 38, or Form 1040A, line 22. If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter	14		
15	Subtract line 14 from line 13. If zero or less, skip lines 16 and 17, enter -0- on line 18, and go to line 19	15		
16	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	16		
17	If line 15 is: • Equal to or more than line 16, enter 1.000 on line 17 and go to line 18 • Less than line 16, divide line 15 by line 16. Enter the result as a decimal (rounded to at least three places)	17	.	
18	Multiply line 12 by line 17. Enter here and on line 1 of the Credit Limit Worksheet (see instructions) ▶	18		
19	Nonrefundable education credits. Enter the amount from line 13 of the Credit Limit Worksheet (see instructions) here and on Form 1040, line 49, or Form 1040A, line 31	19	3,000	00

Name(s) shown on return

Jerome L. and Jane T. Scott

Your social security number

100 | 22 | 1234



Complete Part III for each student for whom you are claiming either the American opportunity credit or lifetime learning credit. Use additional copies of Page 2 as needed for each student.

Part III Student and Educational Institution Information
See instructions.

20 Student name (as shown on page 1 of your tax return) Amy Scott	21 Student social security number (as shown on page 1 of your tax return) 001 12 1234
---	---

22 Educational institution information (see instructions)	
a. Name of first educational institution California State Community College (1) Address. Number and street (or P.O. box). City, town or post office, state, and ZIP code. If a foreign address, see instructions. 123 State Street Anywhere, CA 22222 (2) Did the student receive Form 1098-T from this institution for 2012? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No (3) Did the student receive Form 1098-T from this institution for 2011 with Box 2 filled in and Box 7 checked? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If you checked "No" in both (2) and (3) , skip (4) . (4) If you checked "Yes" in (2) or (3) , enter the institution's federal identification number (from Form 1098-T). 1 0 - 1 2 3 4 5 6 7	b. Name of second educational institution (if any) (1) Address. Number and street (or P.O. box). City, town or post office, state, and ZIP code. If a foreign address, see instructions. (2) Did the student receive Form 1098-T from this institution for 2012? <input type="checkbox"/> Yes <input type="checkbox"/> No (3) Did the student receive Form 1098-T from this institution for 2011 with Box 2 filled in and Box 7 checked? <input type="checkbox"/> Yes <input type="checkbox"/> No If you checked "No" in both (2) and (3) , skip (4) . (4) If you checked "Yes" in (2) or (3) , enter the institution's federal identification number (from Form 1098-T). - - - - -

23 Has the Hope Scholarship Credit or American opportunity credit been claimed for this student for any 4 prior tax years?	<input type="checkbox"/> Yes — Stop! Go to line 31 for this student. <input checked="" type="checkbox"/> No — Go to line 24.
24 Was the student enrolled at least half-time for at least one academic period that began in 2012 at an eligible educational institution in a program leading towards a postsecondary degree, certificate, or other recognized postsecondary educational credential? (see instructions)	<input checked="" type="checkbox"/> Yes — Go to line 25. <input type="checkbox"/> No — Stop! Go to line 31 for this student.
25 Did the student complete the first 4 years of post-secondary education before 2012?	<input type="checkbox"/> Yes — Stop! Go to line 31 for this student. <input checked="" type="checkbox"/> No — Go to line 26.
26 Was the student convicted, before the end of 2012, of a felony for possession or distribution of a controlled substance?	<input type="checkbox"/> Yes — Stop! Go to line 31 for this student. <input checked="" type="checkbox"/> No — See <i>Tip</i> below and complete either lines 27-30 or line 31 for this student.



When you figure your taxes, you may want to compare the American opportunity credit and lifetime learning credits, and choose the credit for each student that gives you the lower tax liability. You cannot take the American opportunity credit and the lifetime learning credit for the same student in the same year. If you complete lines 27 through 30 for this student, do not complete line 31.

American Opportunity Credit	
27 Adjusted qualified education expenses (see instructions). Do not enter more than \$4,000	27 4,000
28 Subtract \$2,000 from line 27. If zero or less enter -0-	28 2,000
29 Multiply line 28 by 25% (.25)	29 500
30 If line 28 is zero, enter the amount from line 27. Otherwise, add \$2,000 to the amount on line 29 and enter the result. Skip line 31. Include the total of all amounts from all Parts III, line 30 on Part I, line 1	30 2,500

Lifetime Learning Credit	
31 Adjusted qualified education expenses (see instructions). Include the total of all amounts from all Parts III, line 31, on Part II, line 10	31

Complete a separate Part III for each student.

Notes (not to be attached to your return)

Jerome L. and Jane T. Scott
2012 tax return

Form 1040

Line 7:

Fr. Scott's church salary	\$44,000*
Christmas gift from church	600
Imputed cost of excess life insurance	240
Jane Scott's salary	45,000
Total.....	\$89,840

* Housing allowance (\$26,000) and salary reduction contributions to his RSVP account (403(b)) (\$6,000) are not included in church wages since both are excluded from gross income; neither is the salary reduction contribution to his RSVP account (403(b))(\$6,000) included in calculating Fr. Scott's self-employment tax on Schedule SE.

Line 21:

A minister's housing allowance is nontaxable to the extent it does not exceed either actual housing expenses or the annual fair rental value of the minister's home. In other words, the nontaxable amount is the lowest of the following three amounts:

1. church-designated housing allowance..... \$26,000
2. actual expenses incurred in owning or maintaining a home 25,100
3. annual fair rental value of home including utilities..... 27,000

The lowest of these amounts is Fr. Scott's actual expenses of \$25,100. This represents the amount that can be excluded from gross income in computing federal income taxes. However, since Fr. Scott's Form W-2 and Form 1040 (line 7) were reduced by the amount of the church designated housing allowance (\$26,000), Fr. Scott reports on Form 1040 (line 21) the excess by which the church designated housing allowance exceeds his actual housing expenses: church designated allowance (\$26,000) less actual expenses incurred in owning and maintaining a home (\$25,100) = excess allowance reported as income (\$900).

Schedule A

Lines 6 and 10:

Ministers are permitted to fully deduct real estate and mortgage interest payments as itemized expenses on Schedule A even though both items were included in computing the housing allowance exclusion.

Schedule C-EZ

Line 2:

Meals (\$250) must be reduced by 50% leaving \$125, plus lodging expenses of \$500, totals \$625.

Note to be attached to Schedule SE

Jerome L. Scott 100-22-1234
2010 Federal 1040

Explanation of Line 2

Compensation per W-2	\$44,840*
Parsonage (Housing) Allowance (Section 107).....	26,000
Schedule C net earnings	1,775
Line 2.....	\$72,615

* Christmas gift and imputed tax on life insurance are included.

Example Two: A Retired Minister

The Reverend William K. Green is a retired priest. He is 70 years old. He is married to Sarah J. Green, who is 68 years old and retired from her career as a school teacher. Fr. Green receives \$31,000 in pension income, all of which is designated in advance by the Church Pension Fund as a housing allowance. Fr. Green asked the Church Pension Fund to withhold \$100 a month (\$1,200 a year) of his pension for his estimated federal taxes for 2012. Fr. Green had \$23,000 of housing expenses for 2012, of which \$2,800 was real estate taxes. Housing allowances for retired ministers are not taxable in computing federal income tax to the extent that they are used to pay for housing-related expenses that do not exceed the fair rental value of the home, furnished, plus utilities. The fair rental value of Fr. Green's home, furnished, plus utilities was \$25,000. As a result, only \$8,000 of his pension is subject to income taxation. His wife Sarah also has a small pension of \$9,000 a year. Their combined taxable pension amount will be \$17,000.

Note: Pensions are not earned income (wages) and therefore are not subject to self-employment tax.

Fr. Green turned 70½ in 2012 and needs to take his first required minimum distribution (RMD) from his Individual Retirement Account (IRA) with the Church Life Insurance Corporation. With an account balance of \$150,000 as of December 31, 2011, and dividing by the IRS uniform life expectancy table Church Life calculated that Fr. Green needed to take \$5,660 to comply and he took that distribution quarterly during the year. His wife Sarah, who transferred her IRA to Church Life during 2012, took an additional \$3,000 from her account during the year. These distributions are fully taxable and should be reported on line 15a and 15b.

Fr. Green received \$3,000 from occasional guest preaching engagements. He incurred \$1,425 in expenses as a result of these activities (\$1,250 in travel expenses and \$350 for meals). Only 50% of the meals expense is deductible. Note: The net income of \$1,575 from Fr. Green's preaching engagements represents earned income and, unlike his pension, is therefore subject to self-employment tax.

The Greens each paid \$110 per month for the Church Pension Fund's Plus Medicare Supplement Plans and \$60 per month each for the Basic Dental Plan, a yearly total of \$4,080. Since Fr. Green had \$1,575 of self-employment income, then \$1,575 of these premiums are deductible on Form 1040, line 29, page 1.

Fr. Green received \$18,000 in Social Security benefit payments in 2012 and his wife Sarah received \$10,000 in her benefit payments for 2012. The Greens had to calculate how much of their Social Security benefits may be subject to tax by using the worksheet on page 29 of the Form 1040 instructions. See the sample worksheet following their tax examples.

Note that, although the worksheet is used to calculate lines 20a and 20b on Form 1040, the worksheet itself is not filed with the IRS.

The Greens also had \$225 of taxable interest from their bank accounts in 2012.

Father and Mrs. Green, because they are both over age 65, take advantage of the increased Standard Deduction for 2012 of \$14,200 instead of itemizing their deductions in 2012.

For the year Jan. 1–Dec. 31, 2012, or other tax year beginning _____, 2012, ending _____, 20

Your first name and initial: **William K** Last name: **Green** Your social security number: **2 0 2 | 2 0 2 | 0 0 2**

If a joint return, spouse's first name and initial: **Sarah J** Last name: **Green** Spouse's social security number: **3 0 3 | 3 0 3 | 0 0 3**

Home address (number and street). If you have a P.O. box, see instructions. **787 Adams Street** Apt. no. _____

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). **Anytown, NY 11012**

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

Filing Status

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

Check only one box.

Exemptions

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

c Dependents:		(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)
(1) First name	Last name			
				<input type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>

If more than four dependents, see instructions and check here

d Total number of exemptions claimed **2**

Boxes checked on 6a and 6b **2**
No. of children on 6c who:
 • lived with you
 • did not live with you due to divorce or separation (see instructions)
Dependents on 6c not entered above
Add numbers on lines above **2**

Income		7	8a	9a	10	11	12	13	14	15a	15b	16a	16b	17	18	19	20a	20b	21	22	
7	Wages, salaries, tips, etc. Attach Form(s) W-2																				
8a	Taxable interest. Attach Schedule B if required		225																		
b	Tax-exempt interest. Do not include on line 8a																				
9a	Ordinary dividends. Attach Schedule B if required																				
b	Qualified dividends																				
10	Taxable refunds, credits, or offsets of state and local income taxes																				
11	Alimony received																				
12	Business income or (loss). Attach Schedule C or C-EZ						1575														
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>																				
14	Other gains or (losses). Attach Form 4797																				
15a	IRA distributions	15a	8660	00	b Taxable amount					15b	8660	00									
16a	Pensions and annuities	16a	40000	00	b Taxable amount					16b	17000	00									
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E																				
18	Farm income or (loss). Attach Schedule F																				
19	Unemployment compensation																				
20a	Social security benefits	20a	28000	00	b Taxable amount					20b	3887	00									
21	Other income. List type and amount																				
22	Combine the amounts in the far right column for lines 7 through 21. This is your total income ▶																				31347 00

Adjusted Gross Income		23	24	25	26	27	28	29	30	31a	32	33	34	35	36	37
23	Educator expenses															
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ															
25	Health savings account deduction. Attach Form 8889															
26	Moving expenses. Attach Form 3903															
27	Deductible part of self-employment tax. Attach Schedule SE					112	00									
28	Self-employed SEP, SIMPLE, and qualified plans															
29	Self-employed health insurance deduction							1575	00							
30	Penalty on early withdrawal of savings															
31a	Alimony paid b Recipient's SSN ▶															
32	IRA deduction															
33	Student loan interest deduction															
34	Tuition and fees. Attach Form 8917															
35	Domestic production activities deduction. Attach Form 8903															
36	Add lines 23 through 35														1687	00
37	Subtract line 36 from line 22. This is your adjusted gross income ▶															29660 00

Tax and Credits

Standard Deduction for—

• People who check any box on line 39a or 39b or who can be claimed as a dependent, see instructions.
• All others:

Single or Married filing separately, \$5,950

Married filing jointly or Qualifying widow(er), \$11,900

Head of household, \$8,700

38	Amount from line 37 (adjusted gross income)	38	29660	00
39a	Check <input checked="" type="checkbox"/> You were born before January 2, 1948, <input type="checkbox"/> Blind. <input checked="" type="checkbox"/> Spouse was born before January 2, 1948, <input type="checkbox"/> Blind. Total boxes checked ▶ 39a 2			
b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b <input type="checkbox"/>			
40	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	40	14200	00
41	Subtract line 40 from line 38	41	15460	00
42	Exemptions. Multiply \$3,800 by the number on line 6d.	42	7600	00
43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43	7860	00
44	Tax (see instructions). Check if any from: a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972 c <input type="checkbox"/> 962 election	44	788	00
45	Alternative minimum tax (see instructions). Attach Form 6251	45		
46	Add lines 44 and 45	46	788	00
47	Foreign tax credit. Attach Form 1116 if required	47		
48	Credit for child and dependent care expenses. Attach Form 2441	48		
49	Education credits from Form 8863, line 19	49		
50	Retirement savings contributions credit. Attach Form 8880	50		
51	Child tax credit. Attach Schedule 8812, if required.	51		
52	Residential energy credits. Attach Form 5695	52		
53	Other credits from Form: a <input type="checkbox"/> 3800 b <input type="checkbox"/> 8801 c <input type="checkbox"/>	53		
54	Add lines 47 through 53. These are your total credits	54		
55	Subtract line 54 from line 46. If line 54 is more than line 46, enter -0-	55	788	00
56	Self-employment tax. Attach Schedule SE	56	194	00
57	Unreported social security and Medicare tax from Form: a <input type="checkbox"/> 4137 b <input type="checkbox"/> 8919	57		
58	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required	58		
59a	Household employment taxes from Schedule H	59a		
b	First-time homebuyer credit repayment. Attach Form 5405 if required	59b		
60	Other taxes. Enter code(s) from instructions	60		
61	Add lines 55 through 60. This is your total tax	61	982	00
62	Federal income tax withheld from Forms W-2 and 1099	62	1200	00
63	2012 estimated tax payments and amount applied from 2011 return	63		
64a	Earned income credit (EIC)	64a		
b	Nontaxable combat pay election 64b	64b		
65	Additional child tax credit. Attach Schedule 8812	65		
66	American opportunity credit from Form 8863, line 8.	66		
67	Reserved	67		
68	Amount paid with request for extension to file	68		
69	Excess social security and tier 1 RRTA tax withheld	69		
70	Credit for federal tax on fuels. Attach Form 4136	70		
71	Credits from Form: a <input type="checkbox"/> 2439 b <input checked="" type="checkbox"/> Reserved c <input type="checkbox"/> 8801 d <input type="checkbox"/> 8885	71		
72	Add lines 62, 63, 64a, and 65 through 71. These are your total payments	72	1200	00
73	If line 72 is more than line 61, subtract line 61 from line 72. This is the amount you overpaid	73	218	00
74a	Amount of line 73 you want refunded to you . If Form 8888 is attached, check here <input type="checkbox"/>	74a	218	00
b	Routing number	c	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
d	Account number			
75	Amount of line 73 you want applied to your 2013 estimated tax ▶ 75	75		
76	Amount you owe. Subtract line 72 from line 61. For details on how to pay, see instructions ▶	76		
77	Estimated tax penalty (see instructions)	77		

Third Party Designee

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

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

Sign Here

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

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

Your signature <i>William H Green</i>	Date 3-12-13	Your occupation retired minister	Daytime phone number 888-888-8888
Spouse's signature. If a joint return, both must sign. <i>Sarah J Green</i>	Date 3-12-13	Spouse's occupation retired teacher	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
Firm's name ▶	Firm's EIN ▶			
Firm's address ▶	Phone no.			

**SCHEDULE C-EZ
(Form 1040)**

Department of the Treasury
Internal Revenue Service (99)

Name of proprietor

William K. Green

Net Profit From Business

(Sole Proprietorship)

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

OMB No. 1545-0074

2012
Attachment
Sequence No. **09A**

Social security number (SSN)

202-20-2002

Part I General Information

**You May Use
Schedule C-EZ
Instead of
Schedule C
Only If You:**

- Had business expenses of \$5,000 or less.
- Use the cash method of accounting.
- Did not have an inventory at any time during the year.
- Did not have a net loss from your business.
- Had only one business as either a sole proprietor, qualified joint venture, or statutory employee.

And You:

- Had no employees during the year.
- Are not required to file **Form 4562**, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, to find out if you must file.
- Do not deduct expenses for business use of your home.
- Do not have prior year unallowed passive activity losses from this business.

A Principal business or profession, including product or service

B Enter business code (see page 2)

► 5 | 4 | 1 | 9 | 9 | 0

C Business name. If no separate business name, leave blank.

D Enter your EIN (see page 2)

E Business address (including suite or room no.). Address not required if same as on page 1 of your tax return.

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

F Did you make any payments in 2012 that would require you to file Form(s) 1099? (see the Schedule C instructions)

Yes No

G If "Yes," did you or will you file required Forms 1099?

Yes No

Part II Figure Your Net Profit

1	Gross receipts. Caution. If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see <i>Statutory Employees</i> in the instructions for Schedule C, line 1, and check here	<input type="checkbox"/>	1	3000	00
2	Total expenses (see page 2). If more than \$5,000, you must use Schedule C		2	1425	00
3	Net profit. Subtract line 2 from line 1. If less than zero, you must use Schedule C. Enter on both Form 1040, line 12 , and Schedule SE, line 2 , or on Form 1040NR, line 13 and Schedule SE, line 2 (see instructions). (Statutory employees, do not report this amount on Schedule SE, line 2.) Estates and trusts, enter on Form 1041, line 3		3	1575	00

Part III Information on Your Vehicle. Complete this part **only** if you are claiming car or truck expenses on line 2.

- 4** When did you place your vehicle in service for business purposes? (month, day, year) ►
- 5** Of the total number of miles you drove your vehicle during 2012, enter the number of miles you used your vehicle for:
- a** Business **b** Commuting (see page 2) **c** Other
- 6** Was your vehicle available for personal use during off-duty hours? Yes No
- 7** Do you (or your spouse) have another vehicle available for personal use? Yes No
- 8a** Do you have evidence to support your deduction? Yes No
- b** If "Yes," is the evidence written? Yes No

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

Cat. No. 14374D

Schedule C-EZ (Form 1040) 2012

**SCHEDULE SE
(Form 1040)**

Department of the Treasury
Internal Revenue Service (99)

Self-Employment Tax

▶ Information about Schedule SE and its separate instructions is at www.irs.gov/form1040.
▶ Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074

2012
Attachment
Sequence No. **17**

Name of person with self-employment income (as shown on Form 1040)

William K Green

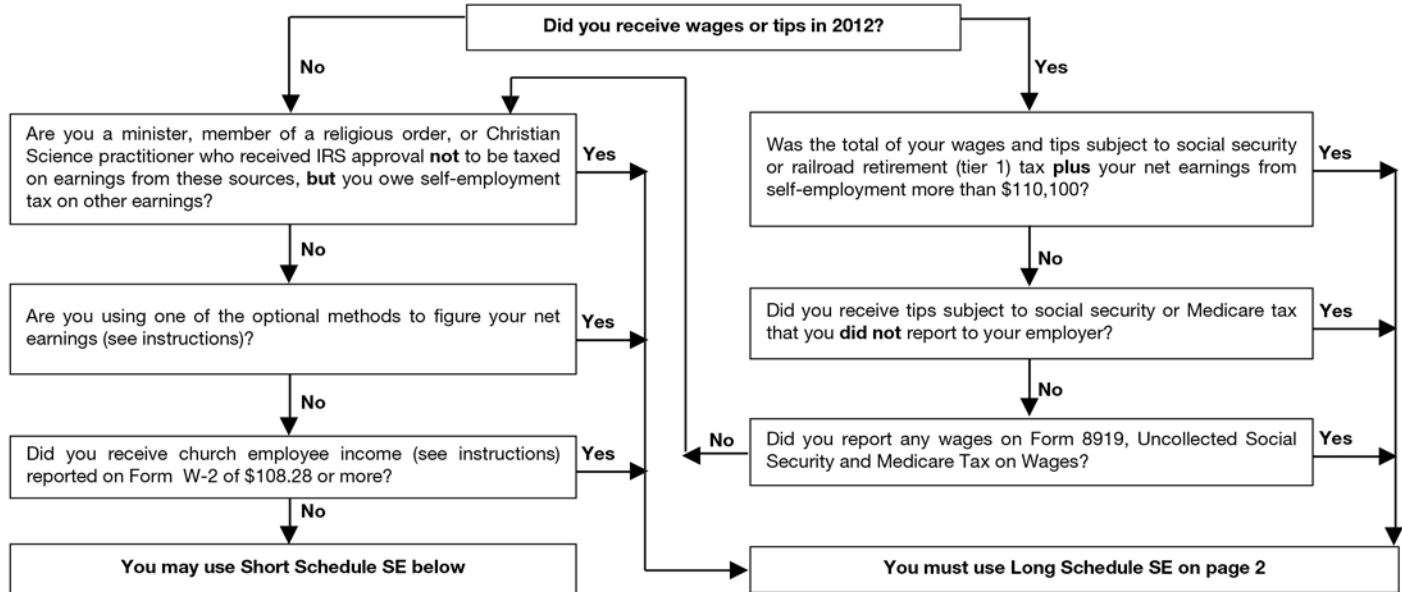
Social security number of person
with self-employment income ▶

202-20-2002

Before you begin: To determine if you must file Schedule SE, see the instructions.

May I Use Short Schedule SE or Must I Use Long Schedule SE?

Note. Use this flowchart **only** if you must file Schedule SE. If unsure, see *Who Must File Schedule SE* in the instructions.



Section A—Short Schedule SE. Caution. Read above to see if you can use Short Schedule SE.

1a Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A	1a		
b If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code Y	1b	()
2 Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report	2	1575	00
3 Combine lines 1a, 1b, and 2	3	1575	00
4 Multiply line 3 by 92.35% (.9235). If less than \$400, you do not owe self-employment tax; do not file this schedule unless you have an amount on line 1b ▶	4	1455	00
Note. If line 4 is less than \$400 due to Conservation Reserve Program payments on line 1b, see instructions.			
5 Self-employment tax. If the amount on line 4 is: • \$110,100 or less, multiply line 4 by 13.3% (.133). Enter the result here and on Form 1040, line 56, or Form 1040NR, line 54 • More than \$110,100, multiply line 4 by 2.9% (.029). Then, add \$11,450.40 to the result. Enter the total here and on Form 1040, line 56, or Form 1040NR, line 54.	5	194	00
6 Deduction for employer-equivalent portion of self-employment tax. If the amount on line 5 is: • \$14,643.30 or less, multiply line 5 by 57.51% (.5751) • More than \$14,643.30, multiply line 5 by 50% (.50) and add \$1,100 to the result. Enter the result here and on Form 1040, line 27, or Form 1040NR, line 27	6	112	00

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

Cat. No. 11358Z

Schedule SE (Form 1040) 2012

Social Security Benefits Worksheet—Lines 20a and 20b

Keep for Your Records



This worksheet is for your use and your records only. Do **NOT** file it with the IRS.

Before you begin:

- ✓ Complete Form 1040, lines 21 and 23 through 32, if they apply to you.
- ✓ Figure any write-in adjustments to be entered on the dotted line next to line 36 (see the instructions for line 36).
- ✓ If you are married filing separately and you lived apart from your spouse for all of 2012, enter “D” to the right of the word “benefits” on line 20a. If you do not, you may get a math error notice from the IRS.
- ✓ Be sure you have read the **Exception** in the line 20a and 20b instructions to see if you can use this worksheet instead of a publication to find out if any of your benefits are taxable.

<p>1. Enter the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099. Also, enter this amount on Form 1040, line 20a</p>	1.	28,000.00	
2. Enter one-half of line 1	2.	14,000.00	
3. Combine the amounts from Form 1040, lines 7, 8a, 9a, 10 through 14, 15b, 16b, 17 through 19, and 21	3.	27,460.00	
4. Enter the amount, if any, from Form 1040, line 8b	4.		
5. Combine lines 2, 3, and 4	5.	41,460.00	
6. Enter the total of the amounts from Form 1040, lines 23 through 32, plus any write-in adjustments you entered on the dotted line next to line 36	6.	1,687.00	
7. Is the amount on line 6 less than the amount on line 5?			
<input type="checkbox"/> No. None of your social security benefits are taxable. Enter -0- on Form 1040, line 20b.			
<input checked="" type="checkbox"/> Yes. Subtract line 6 from line 5	7.	39,773.00	
8. If you are:			
<ul style="list-style-type: none"> • Married filing jointly, enter \$32,000 • Single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2012, enter \$25,000 • Married filing separately and you lived with your spouse at any time in 2012, skip lines 8 through 15; multiply line 7 by 85% (.85) and enter the result on line 16. Then go to line 17 	}	32,000.00	8.
9. Is the amount on line 8 less than the amount on line 7?			
<input type="checkbox"/> No. None of your social security benefits are taxable. Enter -0- on Form 1040, line 20b. If you are married filing separately and you lived apart from your spouse for all of 2012, be sure you entered “D” to the right of the word “benefits” on line 20a.			
<input checked="" type="checkbox"/> Yes. Subtract line 8 from line 7	9.	7,773.00	
10. Enter: \$12,000 if married filing jointly; \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2012	10.	12,000.00	
11. Subtract line 10 from line 9. If zero or less, enter -0-	11.	0	
12. Enter the smaller of line 9 or line 10	12.	7,773.00	
13. Enter one-half of line 12	13.	3,887.00	
14. Enter the smaller of line 2 or line 13	14.	3,887.00	
15. Multiply line 11 by 85% (.85). If line 11 is zero, enter -0-	15.	0	
16. Add lines 14 and 15	16.	3,887.00	
17. Multiply line 1 by 85% (.85)	17.	23,800.00	
18. Taxable social security benefits. Enter the smaller of line 16 or line 17. Also enter this amount on Form 1040, line 20b	18.	3,887.00	

TIP If any of your benefits are taxable for 2012 and they include a lump-sum benefit payment that was for an earlier year, you may be able to reduce the taxable amount. See Pub. 915 for details.

Use this worksheet (see page 29 of Form 1040 Instructions) to calculate how much of your Social Security benefit is subject to tax.

Example Three: Retired Single Minister

The Reverend Philip S. Hoffmann, age 65, retired January 1, 2012 after 28 years in the Church. Fr. Hoffmann took the Single Life Option for his pension that paid him \$31,025 for 2012. He had earned the maximum resettlement benefit of \$20,000, which he directed into his RSVP account. Fr. Hoffmann started taking his Social Security on January 1, 2012, also, and he received \$21,000 for the year.

Fr. Hoffmann also received \$255 in taxable interest from his bank accounts and \$500 in tax- exempt interest from a tax-exempt bond he holds in a personal brokerage account.

Fr. Hoffmann has federal income tax due of \$189 for 2012 and does not have any tax penalty due because his total tax liability was under \$1,000. He also has \$150,000 in an IRA account from which he took \$6,000 in 2012.

Fr. Hoffmann decided to rent when he retired and took a two bedroom condo in Florida that with all eligible expenses cost him \$24,200 in 2012. A local realtor gave him an estimate of \$25,000 for the fair rental value of this condo fully furnished. As a result he only had to declare \$6,825 of his pension as taxable income for 2012 ($\$31,025 - \$24,200 = \$6,825$)

As a result of only having to pay tax on \$6,825 of his pension benefit, Fr. Hoffmann did not have to include any of his Social Security benefit in his tax computation, because the total of all his provisional income, income from all sources was less than \$25,000.

For the year Jan. 1–Dec. 31, 2012, or other tax year beginning _____, 2012, ending _____, 20____ See separate instructions.

Your first name and initial Philip S	Last name Hoffmann	Your social security number 9 8 7 6 5 4 3 2 1
If a joint return, spouse's first name and initial	Last name	Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. **70 Centenarian Place** Apt. no. **101**

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). **Anycity, FL 34543**

Foreign country name _____ Foreign province/state/county _____ Foreign postal code _____

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

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

Filing Status

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

Check only one box.

Exemptions

6a Yourself. If someone can claim you as a dependent, **do not** check box 6a } **Boxes checked on 6a and 6b** **1**
 b Spouse } **No. of children on 6c who:**
 • **lived with you** _____
 • **did not live with you due to divorce or separation (see instructions)** _____

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)
				<input type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>

If more than four dependents, see instructions and check here

d Total number of exemptions claimed **1**

Add numbers on lines above ▶ **1**

Income	7 Wages, salaries, tips, etc. Attach Form(s) W-2	7		
	8a Taxable interest. Attach Schedule B if required	8a	255	00
	b Tax-exempt interest. Do not include on line 8a 8b 500 00			
	9a Ordinary dividends. Attach Schedule B if required 9a			
	b Qualified dividends 9b			
	10 Taxable refunds, credits, or offsets of state and local income taxes 10			
	11 Alimony received 11			
	12 Business income or (loss). Attach Schedule C or C-EZ 12			
	13 Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/> 13			
	14 Other gains or (losses). Attach Form 4797 14			
	15a IRA distributions 15a 6000 00 b Taxable amount 15b 6000 00			
	16a Pensions and annuities 16a 31025 00 b Taxable amount 16b 6825 00			
	17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E 17			
	18 Farm income or (loss). Attach Schedule F 18			
	19 Unemployment compensation 19			
	20a Social security benefits 20a 21000 00 b Taxable amount 20b 0 00			
	21 Other income. List type and amount 21			
	22 Combine the amounts in the far right column for lines 7 through 21. This is your total income ▶ 22 13080 00			

Adjusted Gross Income	23 Educator expenses 23			
	24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ 24			
	25 Health savings account deduction. Attach Form 8889 25			
	26 Moving expenses. Attach Form 3903 26			
	27 Deductible part of self-employment tax. Attach Schedule SE 27			
	28 Self-employed SEP, SIMPLE, and qualified plans 28			
	29 Self-employed health insurance deduction 29			
	30 Penalty on early withdrawal of savings 30			
	31a Alimony paid b Recipient's SSN ▶ 31a			
	32 IRA deduction 32			
	33 Student loan interest deduction 33			
	34 Tuition and fees. Attach Form 8917 34			
	35 Domestic production activities deduction. Attach Form 8903 35			
	36 Add lines 23 through 35 36 0 00			
	37 Subtract line 36 from line 22. This is your adjusted gross income ▶ 37 13080 00			

Tax and Credits

Standard Deduction for -

• People who check any box on line 39a or 39b or who can be claimed as a dependent, see instructions.
• All others:
Single or Married filing separately, \$5,950
Married filing jointly or Qualifying widow(er), \$11,900
Head of household, \$8,700

Table with 3 columns: Line number, Description, and Amount. Rows include 38 (Amount from line 37), 39a (Check boxes for birth date), 40 (Itemized deductions), 41-53 (Credits), 54 (Total credits), and 55 (Subtract line 54 from line 46).

Other Taxes

Table with 3 columns: Line number, Description, and Amount. Rows include 56 (Self-employment tax), 57 (Unreported social security and Medicare tax), 58 (Additional tax on IRAs), 59a (Household employment taxes), 59b (First-time homebuyer credit), 60 (Other taxes), and 61 (Total tax).

Payments

If you have a qualifying child, attach Schedule EIC.

Table with 3 columns: Line number, Description, and Amount. Rows include 62 (Federal income tax withheld), 63 (2012 estimated tax payments), 64a (Earned income credit), 64b (Nontaxable combat pay election), 65 (Additional child tax credit), 66 (American opportunity credit), 67 (Reserved), 68 (Amount paid with request for extension), 69 (Excess social security and tier 1 RRTA tax withheld), 70 (Credit for federal tax on fuels), 71 (Credits from Form), and 72 (Total payments).

Refund

Direct deposit? See instructions.

Table with 3 columns: Line number, Description, and Amount. Rows include 73 (If line 72 is more than line 61), 74a (Amount of line 73 you want refunded), 74b (Routing number), 74c (Type: Checking/Savings), 74d (Account number), and 75 (Amount of line 73 you want applied to your 2013 estimated tax).

Amount You Owe

Table with 3 columns: Line number, Description, and Amount. Rows include 76 (Amount you owe) and 77 (Estimated tax penalty).

Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see instructions)? Yes/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.

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

Your signature (Philip S. Hoffmann), Date (3-12-13), Your occupation (Retired priest), Daytime phone number (704-355-4657), Spouse's signature, Spouse's occupation, Identity Protection PIN.

Paid Preparer Use Only

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

Federal Income Tax Status of Church Pension Fund Benefits

The General Rule:

In accordance with Section 107 of the Internal Revenue Code, the Church Pension Fund, as it had done in 2012, has once again designated the full amount of each pension to be paid to retired and disabled **clergy** in 2013 including distributions from the RSVP Plan, the Extra Christmas Benefit and bridge benefit, as a housing allowance. However, the amount of housing allowance that you may exclude from gross income for Federal income tax purposes cannot exceed the lesser of (1) the total amount you actually spend in a calendar year for items that directly relate to renting or providing a home, or (2) the fair rental value of your home (including garage and furnishings) plus the cost of the utilities.

For Surviving Spouses and Children:

The housing allowance exclusion is applicable to Church Pension Fund benefits paid to the clergy who earned them.

Tax law does not allow such an exclusion for surviving spouses or dependents.

How to Calculate:

While further details are available in IRS Publication 517 and the *2013 Tax Guide for Episcopal Ministers*, the following list may assist you in determining the total actual expenses that relate to renting or providing your home:

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

Resettlement Benefit May Qualify:

The Resettlement Benefit paid by the Church Pension Fund at the time of your retirement has also been designated as housing allowance. It may be excluded from gross income to the extent that it is used in the taxable year in which it is received for the purpose of renting or providing a home, subject to the rules described above.

Importance of Records:

We strongly recommend that you keep good records, including all your calculations and expense records related to renting or providing your home. You may need them if tax questions or challenges 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 16a of your Federal Form 1040 [Line 12a of Federal 1040A]. 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 16b of your Federal Form 1040 [Line 12b of Federal 1040A]. Line 16b should not be left blank, so if all amounts received are used for housing you should enter a zero (0) on that line. **Please note that you will receive the Form 1099-R from Northern Trust as they are the paying agent for the plan. You may also receive a Form 1099-R from Fidelity Investments if you had any distributions from an RSVP plan, as they are the paying agent for that plan.**

SECA Tax:

Social Security Self-Employment tax (also called SECA tax) is not applicable to any part of the qualified retirement benefits paid by the Church Pension Fund. This interpretation was confirmed by Federal tax legislation in 1996. However, if you have other earnings from self-employment after retirement (from the church or other source), 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:

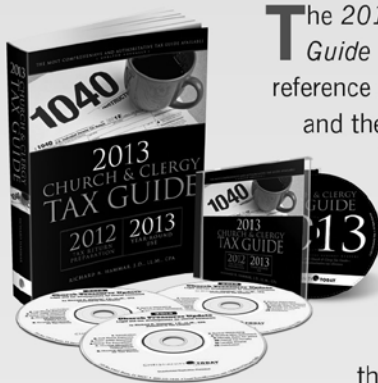
We will, of course, assist in answering questions about specific benefits that you receive from the Church Pension Fund; please contact the Pension Services Department at 866-802-6333. However, we cannot advise as to personal tax problems. If legal, accounting or other expert assistance is required in connection with your tax returns, the services of a competent professional should be sought. For general questions concerning clergy taxes, you may call Matt Chew at 877-305-1414 or Bill Geisler at 877-305-1415, 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 are allowable as itemized deductions from gross income on Schedule A of Form 1040.

Richard Hammar's

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Meet Richard Hammar ▶

Richard Hammar is an attorney, CPA, and best-selling author specializing in legal and tax issues for churches and clergy. A graduate of Harvard Law School, he is the author of more than 100 books, including *Pastor, Church & Law* and the annual *Church and Clergy Tax Guide*. He also is a frequent conference speaker.

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March 15–16	Nebraska	October 4–5	Central New York
April 12–13	Rochester	November 1–2	Missouri
April 19–20	Rio Grande	November 22–23	East Tennessee

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About the Principal Editors

Canon Matthew K. Chew, CPA (retired) lives in Scottsdale, Arizona. His practice concentrated on tax, retirement, and estate planning. He served as a trustee of the Church Pension Fund from 1988 to 2000. Since 1996, he has participated in the CPF's Planning For Tomorrow conferences. He is one of the editors of this annual Tax Guide For Episcopal Ministers as well as Federal Reporting Requirements for Episcopal Churches, and also provides assistance via the Tax Response phone line. As the recently retired Treasurer of the Diocese of Arizona, he has a great deal of experience in church financial matters. Other services to the Church have included serving on the PB&F, Executive Council, and Church Deployment Board, and as trustee of Church Divinity School of the Pacific (CDSP). He has been a deputy to 13 General Conventions, and was a faculty member of CREDO from its inception until the end of 2009. Matt received an honorary doctorate from CDSP in 2008.

The Rev. Canon William F. Geisler, CPA holds an A.B. from Harvard College and an M.B.A. from the Harvard Business School. He was ordained in 1969. He has served as a trustee of Grace Cathedral both as a lay person and a cleric. He was Controller for the Diocese of California for 31 years. His private practice specialized in consulting and tax. He has served as treasurer of the Conference of Diocesan Executives, and a member of the Church Pension Fund Committee on Medical Insurance. He is a tax and financial consultant on clergy and churches for the Church Pension Fund, is one of the editors of this annual Tax Guide For Episcopal Ministers as well as Federal Reporting Requirements for Episcopal Churches, and has been a presenter at various clergy financial planning seminars and parish financial leadership training for over 30 years. He has provided assistance via the Tax Response phone line since its inception.

James W. Dooley is Vice President for Financial Planning in the Church Pension Fund's Department of Pastoral Care & Education. He has 28 years of experience in the insurance and investment fields, the last 17 years with the Church Pension Group. Prior to joining the Church Pension Group, Jim served for six years as Superintendent of Agencies with the New York subsidiary of Franklin Life. He is a Chartered Underwriter (CLU) and Chartered Financial Consultant (ChFC). Jim completed his CASL (Chartered Advisor for Senior Living) designation in 2006.

Nancy N. Fritschner, CPA, is a partner in the accounting firm of Fritschner & Bremer, LLC, located in Auburn, Alabama. Her firm has a particular interest in clergy taxes as both partners are clergy spouses. Nancy graduated from the University of Kentucky with a BS in Accounting and has worked for various CPA firms in Kentucky, Tennessee, South Carolina and Alabama. She taught accounting at The University of the South and has been a finance faculty member of CREDO for over ten years. She has recently joined the staff of the Planning for Tomorrow conferences presented by CPG. Nancy has developed and presented courses on *Clergy taxes and Church Accounting* for national and diocesan church events and for the Office of Professional and Continuing Education at Auburn University.

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Throughout this document tax examples are given that include fictional first names of clergy, lay employees, and parish names. The names for the persons and places in these examples were chosen at random, and do not refer to any particular clergy, lay employees, parishes, or institutions of the Episcopal Church.



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