PART 1 *Introduction*

All references in this publication to line numbers on IRS forms are for the draft versions of the 2018 forms since the final forms had not been released by the IRS as of the date of publication.

HOW TO USE THIS GUIDE

This book contains the basic information you need to complete your 2018 federal income tax return. It gives special attention to several forms and schedules and the sections of each form most relevant to ministers. The companion resource — *Federal Reporting Requirements for Churches* — helps churches comply with their federal tax reporting requirements.

This guide is divided into the following sections:

- **Part 1: Introduction —** This section reviews tax highlights for 2018 and presents several preliminary questions you should consider before preparing your tax return.
- **Part 2: Special Rules for Ministers —** In this section, you learn whether or not you are a Minister for Tax Purposes, whether you are an employee or self-employed for both income tax and Social Security purposes, and how you pay your taxes.
- **Part 3: Step-by-Step Tax Return Preparation —** This section explains how to complete the most common tax forms and schedules for ministers.
- **Part 4: Comprehensive Examples and Sample Forms —** This section shows a sample tax return prepared for an active minister and spouse and for a retired minister and spouse.
- ***Federal Reporting Requirements for Churches* —** This resource provides assistance to churches (especially treasurers and bookkeepers) in filing federal tax forms.

TAX HIGHLIGHTS FOR 2018

1. The Tax Cuts and Jobs Act of 2017

On December 22, 2017, President Donald Trump signed into law the $1.5 trillion, 500-page Tax Cuts and Jobs Act of 2017 (TCJA). In brief, the TCJA amends the *Internal Revenue Code* to reduce tax rates and modify credits and deductions for individuals and businesses.

With respect to individuals, the bill:

- Replaces the seven existing tax brackets (10%, 15%, 25%, 28%, 33%, 35%, and 39.6%) with seven new and lower brackets (10%, 12%, 22%, 24%, 32%, 35%, and 37%).
- Temporarily increases (through 2025) the basic standard deduction to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other individuals.

  The significantly increased standard deduction will reduce the number of persons who are able to itemize deductions on *Schedule A (Form 1040)* from 30 percent to as few as 5 percent of all taxpayers. The result will be a significant decrease in the number of taxpayers who can claim a tax deduction for contributions they make to churches and other charities.
- Modifies section 529 plans to allow such plans to distribute **not more than $10,000** in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a **public, private, or religious elementary or secondary school.** The new rules apply to distributions made after December 31, 2017. A section 529 plan (also known as a qualified tuition plan) is a plan operated by a state or educational institution with tax advantages and potential other incentives to make it easier to save for college and other post-secondary training for a designated beneficiary, such as a child or grandchild. The main tax advantage of a 529 plan is that earnings are not subject to federal tax and generally are not subject to state tax when used for the qualified education expenses of the designated beneficiary, such as tuition, fees, books, as well as room and board.
- Repeals both the moving expense deduction and the exclusion of employer reimbursements of moving expenses under an accountable arrangement — except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order. This provision is effective for taxable years 2018 through 2025.
- Reduces the penalty amount of the Affordable Care Act's (ACA's) individual mandate to zero. Under the ACA, individuals must be covered by a health plan that provides at least minimum essential coverage or be subject to a penalty for failure to do so (commonly referred to as the individual mandate). For 2018, the penalty could be up to $2,085 for a family or $695 for an individual. The TCJA reduces the penalty amount of the ACA's individual mandate to zero with respect to health coverage status for months beginning after December 31, 2018.
- Removes the deductions for personal exemptions for taxable years 2018 through 2025. Under prior law, in determining taxable income, an individual reduced adjusted gross income (AGI) by any personal exemption deductions and either the applicable standard deduction or itemized deductions. Personal exemptions generally were allowed for the taxpayer, the taxpayer's spouse, and any dependents.

- Eliminates the deductions for miscellaneous itemized deductions. Under prior law, individuals could claim itemized deductions for certain miscellaneous expenses. Certain of these expenses were not deductible unless, in aggregate, they exceeded 2 percent of the taxpayer's AGI. The deductions described below were subject to the aggregate 2 percent floor:
    - Appraisal fees for a casualty loss or charitable contribution
    - Casualty and theft losses from property used in performing services as an employee
    - Clerical help and office rent in caring for investments
    - Hobby expenses, but generally not more than hobby income
    - Investment fees and expenses
    - Safe deposit box rental fees, except for storing jewelry and other personal effects
    - Trustee's fees for an Individual Retirement Account (IRA), if separately billed and paid
    - Tax preparation expenses
    - Job search expenses in the taxpayer's present occupation
    - Licenses and regulatory fees
    - Passport fees for a business trip
    - Tools and supplies used in the taxpayer's work
    - Unreimbursed employee business expenses (see below). Unreimbursed employee business expenses subject to the 2 percent AGI floor include such items as:
        - Overnight out-of-town travel
        - Local transportation
        - Meals (subject to a 50 percent AGI floor)
        - Entertainment (subject to a 50 percent AGI floor)
        - Home office expenses
        - Business gifts
        - Dues to professional societies
        - Work-related education
        - Work clothes and uniforms if required and not suitable for everyday use
        - Malpractice insurance
        - Subscriptions to professional journals and trade magazines related to the taxpayer's work
        - Equipment and supplies used in the taxpayer's work

☞ **Key Point:** The IRS announced late in 2017 that for the upcoming 2018 filing season it will not accept electronically filed tax returns if the taxpayer does not address the health coverage requirements of the Act. The IRS will not accept the electronic tax return until the taxpayer indicates whether they had coverage, had an exemption, or will make a shared responsibility payment. Returns filed on paper that do not address the health coverage requirements may be suspended pending the receipt of additional information, and any refunds may be delayed.

2. Other Tax Changes of Interest to Churches and Church Staff

There were several tax developments in 2018 that will affect tax reporting by both ministers and churches for 2018 and future years. Here is a rundown of some of the key provisions:

- You may be able to claim the earned income credit (EIC) for 2018 if (1) you do not have a qualifying child and you earned less than $15,270 ($20,950 if married filing jointly); (2) a qualifying child lived with you and you earned less than $40,320 ($46,010 if married filing jointly); (3) two qualifying children lived with you and you earned less than $45,802 ($51,492 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than $49,194 ($54,884 if married filing jointly). The maximum EIC for 2018 is (1) $519 with no qualifying child; (2) $3,461 with one qualifying child; (3) $5,716 with two qualifying children; and (4) $6,431 with three or more qualifying children.

- For contributions in 2018 to a Traditional IRA, the deduction phaseout range for an individual covered by a retirement plan at work begins at income of $101,000 for joint filers and $63,000 for a single person or head of household. These are 2018 amounts that increase to $103,000 for joint filers and $64,000 for a single person or head of household for 2019.

- The dollar limit on annual elective deferrals an individual may make to a 403(b) retirement plan is $18,500 for 2018. It increases to $19,000 for 2019.

- The catch-up contribution limit on elective deferrals to a 403(b) retirement plan for individuals who had attained age 50 by the end of the year was $6,000 for 2018. It remains at $6,000 for 2019.

- The IRS has announced that it will not issue private letter rulings addressing the question of "whether an individual is a minister of the gospel for federal tax purposes." This means taxpayers will not be able to obtain clarification from the IRS in a letter ruling on their status as a minister for any one or more of the following matters: (1) eligibility for a parsonage exclusion or housing allowance; (2) eligibility for exemption from SECA; (3) self-employed status for Social Security; or (4) exemption of wages from income tax withholding. The IRS also has announced that it will not address "whether amounts distributed to a retired minister from a pension or annuity plan should be excludible from the minister's gross income as a parsonage allowance."

- The standard business mileage rate was 54.5 cents per mile for business miles driven during 2018. The standard business mileage rate for 2019 is 58 cents per mile.
- Recent tax law changes will result in lower taxes and lower estimated tax payments for many taxpayers. Be sure your estimated tax calculations or withholdings take into account the most recent tax law changes.
- Many churches employ retired persons receiving Social Security benefits. Persons younger than full retirement age may have their Social Security retirement benefits cut if they earn more than a specified amount. Full retirement age (the age at which you are entitled to full retirement benefits) for persons born in 1943–1954 is 66 years. If you are under full retirement age for the entire year, $1 is deducted from your benefit payments for every $2 you earn above the annual limit. For 2019 that limit is $17,640. In the year you reach full retirement age, your monthly benefit payments are reduced by $1 for every $3 you earn above a different limit. For 2019 that limit is $46,920 ($3,910 per month), but only earnings before the month you reach full retirement age are counted.
- Will Congress give ministers another opportunity to revoke an exemption from Social Security? It does not look likely, at least for now. No legislation is pending that would provide ministers with this option.
- The housing allowance is being challenged in federal court as an unconstitutional preference for religion. This development is addressed fully at the beginning of this text.
- A provision in the comprehensive tax reform legislation enacted by Congress in 2017 (TCJA) imposes a tax (the unrelated business income tax) of 21 percent on expenses associated with benefits provided to employees through a qualified transportation fringe benefit program as defined by IRC section 132(f). These benefits include employer-provided parking, mass transit passes and commuter vans. Churches providing these benefits must file *Form 990-T* to report the costs and the related tax. The provision of parking to employees may come through payment of parking fees for employees or by provision of parking on the church's premises. While there has been much debate over the application of the new law to on-site employer-provided parking, the current consensus is that the new tax applies to employers whose on-site parking provided to employees has value because parking in the area is provided only on a paid basis. The protest from nonprofit organizations, including churches, has been great during 2018. Petitions have been submitted to Congress requesting repeal of the provision, and several bills have been introduced to repeal the provision. However, until Congress or the IRS provides relief, churches should prepare to comply with the new law by reporting expenses associated with qualified transportation fringe benefits on *Form 990-T* and paying the unrelated business income tax (21 percent) on this income. Future developments will be reported on *ChurchLawandTax.com*.

PRELIMINARY QUESTIONS

Below are several questions you should consider before preparing your 2018 federal tax return.

Q. Must ministers pay federal income taxes?

A. Yes. Ministers are not exempt from paying federal income taxes.

Q. How much income must I earn to be required to file a tax return?

A. Generally, ministers are required to file a federal income tax return if they have earnings of $400 or more to report their SECA. Different rules apply to ministers who are exempt from SECA.

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

A. All taxpayers use the newly redesigned *Form 1040* for 2018 and future years. *Forms 1040A* and *1040EZ* no longer will be used.

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. The instructions to *Form 1040* state that the deadline for filing *Form 1040* for the 2018 tax year is April 15, 2019. If you live in Maine or Massachusetts, you have until April 17, 2019, because of the Patriots' Day (April 15, 2019) and Emancipation Day (April 16, 2019) holidays.

Q. What if I am unable to file my tax return by the deadline?

A. You can obtain an automatic 6-month extension (from April 15 to October 15, 2019) to file your 2018 *Form 1040* if you file *Form 4868* by April 15, 2019, with the IRS service center for your area. Your *Form 1040* can be filed at any time during the 6-month extension period. **An extension relieves you from only the obligation to file your return; it is not an extension of the obligation to pay your taxes.** You must make an estimate of your tax for 2018 and pay the estimated tax with your *Form 4868*.

Q. Should I prepare my own tax return?

A. The answer depends on your ability and experience in working with financial information and in preparing tax returns. Keep in mind: Ministers' taxes present a number of unique rules, but these rules are not complex. Many ministers will be able to prepare their own tax returns if they understand the unique rules that apply. These rules are summarized in this document. Easily accessible tax software will also accommodate the unique rules applicable to ministers, but it does not relieve a minister from understanding the rules in order to accurately utilize the software. On the other hand, if you experienced unusual events in 2018, such as the sale or purchase of a home or the sale of other capital assets, it may be prudent to obtain professional tax assistance. The IRS provides a service called Taxpayer Assistance, but it is not liable in any way if its agents provide you with incorrect answers to your questions. Free taxpayer publications are available from the IRS, and many of these are helpful to ministers.

➤ **Recommendation:** If you need professional assistance, here are some tips that may help you find a competent tax professional:

- Ask other ministers in your community for their recommendations.
- If possible, use a CPA who specializes in tax law and who is familiar with the rules that apply to ministers. A CPA has completed a rigorous educational program and is subject to strict ethical requirements. However, the tax law is broad and complicated, so it should not be assumed that all CPAs are familiar with the unique rules applicable to ministers.
- Ask local tax professionals if they work with ministers and, if so, with how many.
- Ask local tax professionals a few questions to test their familiarity with ministers' tax issues. For example, ask whether ministers are employees or self-employed for Social Security. Anyone familiar with ministers' taxes will know that ministers are self-employed for Social Security with respect to their ministerial duties. Or, ask a tax professional if a minister's church salary is subject to income tax withholding. The answer is no, and anyone familiar with ministers' taxes should be able to answer this question.