Welcome to the 2016 Tax Return Preparation and Federal Reporting Guide: Ministers’ Tax Guide for 2015 Returns, written exclusively for ministers and churches. As part of our ongoing commitment to advocate on behalf of our participants, we’re privileged once again to provide you with this useful guide to help you prepare your federal income tax forms.

It’s no secret that ministers’ tax preparation can be complicated. To help simplify the process, GuideStone provides the annual Ministers’ Tax Guide, which is written by noted attorney and CPA Richard Hammar. Our legal and compliance experts have reviewed the enclosed information to ensure it addresses specific tax issues that impact the ministers we are so privileged to serve.

In addition to this helpful guide, you can find further information at IRS.gov. For specific tax advice, you’ll want to consult an accountant or an attorney who is familiar with the specifics of ministers’ taxes.

Additional copies of this free resource may be viewed and downloaded at GuideStone.org/TaxGuide.

Once again, we are thankful to serve you with the annual Ministers’ Tax Guide, and we hope it will be a great resource for you. May God bless you in the ministry He has given you in 2016 and beyond!

Sincerely,

O.S. Hawkins
President – Chief Executive Officer
GuideStone Financial Resources of the Southern Baptist Convention


This publication is intended to provide a timely, accurate and authoritative discussion of tax reporting compliance and the impact of recent changes in the tax laws. It is not intended as a substitute for legal, accounting or other professional advice. If legal, tax or other expert assistance is required, the services of a competent professional should be sought. Although we believe this book provides accurate information, there may be changes resulting from IRS or judicial interpretations of the Tax Code, new tax regulations or technical corrections that occurred after the printing of this edition that are not reflected in the text.
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Current Status of the Parsonage and Housing Allowance Exclusions

By Richard R. Hammnar, J.D., LL.M., CPA

On November 13, 2014, a federal appeals court reversed a ruling by a federal district court in Wisconsin, striking down the housing allowance as an unconstitutional preference for religion. Freedom from Religion Foundation, Inc. v. Lew, 2014 WL 5861562 (7th Cir. 2014). The appeals court’s ruling means that the housing allowance remains valid, for now. This means that churches should continue to designate a housing allowance for their ministers as in prior years. Churches that fail to designate a housing allowance for 2016 by the end of 2015 may designate one in early 2016, but the allowance will only operate prospectively. The amount of a minister’s 2016 compensation designated by his or her employing church in advance as a housing allowance will remain nontaxable for income tax purposes so long as it is used for housing expenses and does not exceed either the fair rental value of a minister’s home (furnished, plus utilities) or the church-designated allowance. It also means that the housing allowance exclusion is available to ministers in computing taxes for 2015.

The appeals court concluded that the Freedom from Religion Foundation, and two of its officers, lacked standing to challenge the housing allowance. Standing is a constitutional requirement for anyone bringing a lawsuit in federal court and generally means that a plaintiff must experience a direct injury. The Wisconsin court concluded that the plaintiffs had standing due to their “injury” of being denied a housing allowance exclusion should they claim one on their tax returns. But the appeals court refused to base standing on theoretical injury.

The court noted that to have standing to challenge the housing allowance, the Freedom from Religion Foundation’s officers would have to file tax returns for prior years showing a housing allowance and then have their tax returns audited by the IRS and the housing allowance denied. Only then would their injury be sufficiently tangible to satisfy the standing requirement.

The Freedom from Religion Foundation and its two officers face two challenges. First, housing allowances cannot be designated retroactively, so it will not be possible for the officers to file amended tax returns for prior years showing a housing allowance for 2014. The Foundation will need to designate a housing allowance for a future year that is excluded from the officers’ tax returns. Second, the IRS would then need to select one of these returns for audit. The audit rate is currently 1 percent, so it is unlikely that this would happen, even if the officers claimed housing allowances for several years.

Even if these hurdles are overcome, and the officers meet the standing requirement, this simply gets them back into federal court. The appeals court did not address the constitutionality of the housing allowance in its ruling. It simply said that the plaintiffs lacked standing to challenge the constitutionality of the allowance. The appeals court ultimately may rule that the housing allowance is constitutional. Or it may decide that it is not. Either way, the ruling likely will be appealed to the United States Supreme Court, which will take even more time. Clearly, these steps will take considerable time, and, pursuant to the Wisconsin court’s original order, its ruling “will take effect at the conclusion of any appeals . . . or the expiration of the deadline for filing an appeal, whichever is later.”

Should the Freedom from Religion Foundation and its two officers ultimately prevail in their quest to strike down the housing allowance as an unconstitutional preference for religion, what would be the impact? A ruling by the Seventh Circuit Court of Appeals would apply to ministers in that circuit, which includes the states of Illinois, Indiana and Wisconsin. It would become a national precedent binding on churches that meet the standing requirement, this simply gets them back to federal court. The appeals court did not address the constitutionality of the housing allowance in its ruling. It simply said that the plaintiffs lacked standing to challenge the constitutionality of the allowance. The appeals court ultimately may rule that the housing allowance is constitutional. Or it may decide that it is not. Either way, the ruling likely will be appealed to the United States Supreme Court, which will take even more time. Clearly, these steps will take considerable time, and, pursuant to the Wisconsin court’s original order, its ruling “will take effect at the conclusion of any appeals . . . or the expiration of the deadline for filing an appeal, whichever is later.”

The Freedom from Religion Foundation and its two officers ultimately prevail in their quest to strike down the housing allowance as an unconstitutional preference for religion, what would be the impact? A ruling by the Seventh Circuit Court of Appeals would apply to ministers in that circuit, which includes the states of Illinois, Indiana and Wisconsin. It would become a national precedent binding on ministers in all states if affirmed by the United States Supreme Court — an unlikely outcome because the Supreme Court accepts less than 1 percent of all appeals. Note, however, that the IRS would have the discretion to follow or not follow such a ruling in other circuits and might be inclined to follow it to promote consistency in tax administration. In conclusion, ministers and churches should be aware that the housing allowance remains under attack and one day may be invalidated.

Should that occur, there are two actions that will need to be implemented quickly. First, ministers will experience an immediate increase in income taxes. As a result, they should be prepared to increase their quarterly estimated tax payments to reflect the increase in income taxes in order to avoid an underpayment penalty. Note that there will be no effect on self-employment taxes for which the housing allowance is not tax-exempt. And second, many churches will want to increase ministers’ compensation to offset the financial impact. Such an increase could be phased out over a period of years to minimize the impact on the church.

Key Point: Ministers should address the continuing availability of the housing allowance with a tax professional.

TAX HIGHLIGHTS FOR 2015

1. The American Opportunity Tax Credit

The American Opportunity Tax Credit is available for up to $2,500 of the cost of tuition and related expenses paid during the taxable year. Under this provision, taxpayers receive a tax credit based on 100 percent of the first $2,000 of tuition and related expenses (including course materials) paid during the taxable year and 25 percent of the next $2,000 of tuition and related expenses paid during the taxable year. Forty percent of the credit is refundable. This tax credit is subject to a phase out for taxpayers with adjusted gross income (AGI) in excess of $80,000 ($160,000 for married couples filing jointly).

In 2012, Congress extended the American Opportunity Tax Credit for five additional years, through 2017. The PATH Act of 2015 makes this credit permanent.

2. “Third-child” EIC enhancements

In 2012, Congress extended for five additional years, through 2017, the 2009 enhancements that increased the Earned Income Credit (EIC) for families with three or more children and increased the phase out range for all married couples filing a joint return.

The PATH Act of 2015 makes these enhancements permanent.

3. Deduction for certain expenses of elementary and secondary school teachers

In 2012, Congress extended for two years the $250 above-theline tax deduction for teachers and other school professionals for expenses paid or incurred for books, supplies (other than non-athletic supplies for courses of instruction in health or physical education), computer equipment (including related software and service), other equipment and supplementary materials used in the classroom.

This provision expired at the end of 2014, but was made permanent for 2015 and future years by the PATH Act of 2015. The Act also indexes the $250 maximum deduction amount for inflation and provides that expenses for professional development are also eligible expenses for purposes of the deduction. However, the provisions pertaining to indexing the $250 maximum deduction amount and qualifying professional development expenses apply to taxable years beginning after December 31, 2015.

4. Deduction for state and local general sales taxes

Congress enacted legislation in 2004 providing that, at the election of the taxpayer, an itemized deduction may be taken for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes. This provision was added to address the unequal treatment of taxpayers in the nine states that assess no income tax. Taxpayers in these states cannot take advantage of the itemized deduction for state income taxes. Allowing them to deduct sales taxes helps offset this disadvantage.
This provision expired at the end of 2014 but was made permanent for 2015 and future years by the PATH Act.

5. Above-the-line deduction for qualified tuition-related expenses

In the past, taxpayers could claim an above-the-line tax deduction for qualified higher education expenses. The maximum deduction was $4,000 for taxpayers with AGI of $65,000 or less ($130,000 for joint returns) or $2,000 for taxpayers with AGI of $80,000 or less ($160,000 for joint returns).

This deduction expired at the end of 2014, but was reinstated by the PATH Act of 2015 and extended through 2016.

6. Tax-free distributions from Individual Retirement Plans for charitable purposes

Congress enacted legislation in 2006 allowing tax-free qualified charitable distributions of up to $100,000 from an IRA to a church or other charity. Note the following rules and conditions:

- 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.
- A distribution will be treated as a qualified charitable distribution only to the extent that it would be includable in taxable income without regard to this provision.
- This provision applies only if a charitable contribution deduction for the entire distribution would be allowable under present law, determined without regard to the generally applicable percentage limitations. For example, if the deductible amount is reduced because the donor receives a benefit in exchange for the contribution of some or all of his or her IRA, or if a deduction is not allowable because the donor did not have sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

This provision expired at the end of 2014 but was made permanent by the PATH Act of 2015.

7. The Affordable Care Act

Those provisions of the Affordable Care Act (ACA) that involve taxation, that have the greatest relevance to churches and church staff, and that affect tax reporting in 2015 or future years, are summarized below:

- One of the most important and divisive provisions in the legislation is a requirement that, beginning in 2014, applicable individuals and their dependents have minimum essential health care coverage or pay a penalty. A requirement that persons failing to provide such coverage would be subject to imprisonment was dropped during final consideration. Failure to maintain minimum essential health care coverage will result in a penalty of the greater of $325 or 2 percent of household income over a filing threshold for applicable individuals and the IRS allowed deductible limits of all the forms issued to employees. And, as with Form W-2, the IRS can assess penalties for failure to comply with the new reporting obligations. Because of the similarities of the new reporting requirements to Form W-2, some are calling them the "health care W-2s." Of course, the analogy is not perfect. The Form W-2 reports compensation and tax withheld, while the new forms report health insurance information. They consist of the following forms:

  a) Providers of minimum essential coverage are required to file Forms 1095-B and 1095-C for 2015. Forms 1095-B and 1095-C are used to report certain information to the IRS and to employees about individuals who are covered by minimum essential coverage and therefore aren't liable for the individual shared responsibility payment.

  b) AEIs with 50 or more full-time employees (including full-time equivalent employees) in the previous year must file one or more Forms 1095-C (including a Form 1095-C designated as the Authoritative Transmittal, whether or not the participant is a full-time employee of the employer for any month of the calendar year). Generally, the employer is required to furnish a copy of the Form 1095-C (or a substitute form) to the employee.

These new reporting requirements are addressed further in the Federal Reporting Requirements for Churches section.

8. Other tax changes of interest to churches and church staff

There were several tax developments in 2015 that will affect tax reporting by both ministers and churches for 2015 and future years. Here is a rundown of some of the key provisions:

- You may be able to claim the earned income credit for 2015 if you do not have a qualifying child and you earned less than $14,820 ($20,330 if married), (2) a qualifying child lived with you and you earned less than $53,151 ($64,645 if married filing jointly), (3) qualifying children lived with you and you earned less than $44,454 (49,974 if married filing jointly), or (4) three or more qualifying children lived with you and you earned less than $44,454 (49,974 if married filing jointly).

- For contributors to a Traditional IRA, the deduction phase out range for an individual covered by a retirement plan at work begins at incomes of $89,000 for joint filers and $68,000 for a single person or head of household.

- The dollar limit on annual elective deferrals an individual may make to a 403(b) retirement plan is $18,000 for 2015. It remains at $18,000 for 2016.

- 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 2015. It remains at $6,000 for 2016.

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

- The standard business mileage rate was 57.5 cents per mile for business miles driven during 2015. The standard business mileage rate for 2016 is 54 cents per mile.

- The IRS maintains that a minister's housing allowance is "earned income" in determining eligibility for the earned income credit for ministers who have not opted out of Social Security by filing a timely Form 4361. For ministers who have opted out of Social Security, the law is less clear and the IRS has not provided guidance.

- 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 who are receiving Social Security benefits. Persons younger than full retirement age may have their Social Security retirement benefits cut if they earn more than a specified amount. Full retirement age (the age at which you are entitled to full retirement benefits) for persons born in 1943–1954 is 66 years. 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 ($4,900 for 2016). No reduction in Social Security benefits occurs if income earned in the month full retirement age is attained (and all future months). Persons who begin receiving Social Security benefits at ages of 62, 63, or 64 are subject to reduction in benefits that depend on the age at which they begin receiving Social Security benefits.
Preliminary Questions

Here are some considerations for preparing your 2015 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. Different rules apply to some ministers who are exempt from self-employment taxes.

Q. Can I use the simpler Forms 1040A or 1040EZ 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. The deadline for filing your 2015 federal income tax return is April 18, 2016.

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 18 to October 17, 2016) to file your 2015 Form 1040 if you file Form 4868 by April 18, 2016 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 only relieves you from the obligation to file your return; it is not an extension of the obligation to pay your taxes. You must make an estimate of your tax for 2015 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. This is not hard. These rules are summarized in this document. On the other hand, if you experienced unusual events in 2015, 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 likely 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 recommendations.
• If possible, use a certified public accountant (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.
• 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. Anyone familiar with ministers’ taxes should be able to answer these questions correctly.

Key point:

- If you are unsure whether you should file Form 1040 or Form 1040-A, please consult your tax professional.

Key Point: The IRS has its own criteria for determining who is a Minister for Tax Purposes.

The criteria the IRS uses to determine who is a minister are not necessarily the same as those used by churches and denominations. Whether or not one qualifies as a Minister for Tax Purposes is a very important question, since special tax and reporting rules apply to ministers under federal tax law. These rules include:

• eligibility for housing allowances;
• self-employed status for Social Security;
• exemption of wages from income tax withholding (ministers use the quarterly estimated tax procedure to pay their taxes, unless they elect voluntary withholding);
• eligibility under very limited circumstances to exempt themselves from self-employment taxes.

These special rules only apply with respect to services performed in the exercise of ministry.

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

According to the IRS, ministers are individuals who are duly ordained, commissioned or licensed by a religious body constituting a church or church denomination. They are given the authority to conduct religious worship, perform sacramental functions and administer ordinances or sacraments according to the tenets and practices of that church or denomination. If a church or denomination ordains some ministers and licenses or commissions others, anyone licensed or commissioned must be able to perform substantially all the religious functions of an ordained minister to be treated as a minister for Social Security. See IRS Publication 517.

Preliminary Questions

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• eligibility under very limited circumstances to exempt themselves from self-employment taxes.

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According to the IRS, ministers are individuals who are duly ordained, commissioned or licensed by a religious body constituting a church or church denomination. They are given the authority to conduct religious worship, perform sacramental functions and administer ordinances or sacraments according to the tenets and practices of that church or denomination. If a church or denomination ordains some ministers and licenses or commissions others, anyone licensed or commissioned must be able to perform substantially all the religious functions of an ordained minister to be treated as a minister for Social Security. See IRS Publication 517.

Find IRS forms, instructions and publications at IRS.gov or call 1-800-TAX-FORM.
EXEMPTION FROM SELF-EMPLOYMENT TAXES

If ministers meet several requirements, they may exempt themselves from self-employment taxes with respect to their ministerial earnings. Among other things, the exemption application (Form 4361) must be submitted to the IRS within a limited time period. The deadline is the due date of the federal tax return for the second year in which a minister has net earnings from self-employment of $400 or more, any part of which comes from ministerial services. Further, the exemption is available only to ministers who are opposed on the basis of religious considerations to the acceptance of benefits under the Social Security program and who request a tax form (Form W-2c) that provides for withholding retirement and Medicare taxes on the basis of their spouse’s coverage, if the spouse had enough credits. However, the amount of these benefits will be reduced by the so-called “windfall elimination provision.” Contact a Social Security Administration office for details.

Key Point: The amount of earnings required for a quarter of coverage in 2016 is $1,020. A quarter of coverage is the basic unit for determining whether a worker is insured under the Social Security program.

Ministers who work after they retire may pay Social Security tax 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 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. Estimated taxes must be paid on a quarterly basis. If your estimated taxes for the current year are less than your actual taxes, you may have to pay an underpayment penalty. You can amend your estimated tax payments during the year if your circumstances change. For example, if your income or deductions increase unexpectedly, you should refigure your estimated tax liability for the year and amend your remaining quarterly payments accordingly.

You will need to make estimated tax payments for 2016 if you expect to owe at least $1,000 in tax for 2016 after subtracting your withholding and credits and if you expect your withholding and credits to be less than the smaller of (1) 90 percent of the tax to be shown on your 2016 tax return or (2) 100 percent of the tax shown on your 2015 tax return (110 percent if AGI exceeds $150,000). Your 2015 tax return must cover all 12 months.

The four-step procedure for reporting and prepaying estimated taxes for 2016 is summarized below.

Step 1. Obtain a copy of Form 1040-ES for 2016 before April 18, 2016. You can obtain forms by calling the IRS toll-free forms hotline at 1-800-TAX-FORM (1-800-829-3676) or by accessing the IRS website (IRS.gov). If you paid estimated taxes last year, you should receive a copy of your 2016 Form 1040-ES in the mail with payment vouchers preprinted with your name, address, and Social Security number.

Step 2. Compute your estimated tax for 2016 using the Form 1040-ES worksheet. Ministers’ quarterly estimated tax payments should take into account both income taxes and self-employment taxes.

Step 3. Pay one-fourth of your total estimated taxes for 2016 in each of four quarterly installments as follows:

<table>
<thead>
<tr>
<th>For the Period</th>
<th>Due Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1–March 31</td>
<td>April 18, 2016</td>
</tr>
<tr>
<td>April 1–May 31</td>
<td>June 15, 2016</td>
</tr>
<tr>
<td>June 1–August 31</td>
<td>September 15, 2016</td>
</tr>
<tr>
<td>September 1–December 31</td>
<td>January 17, 2017</td>
</tr>
</tbody>
</table>

You must send each payment to the IRS, accompanied by one of the four payment vouchers contained in Form 1040-ES.