Clergy Finance Letter
CLERGY FINANCIAL SERVICES
P.O. Box 6007, Grand Rapids, MI 49516
www.clergy-financial.com
Tax Preparation 2010

tax tax tax talk

WHAT'S NEW FOR YOUR 2009 RETURN?

As you begin your preparation of your federal tax return for 2009 it is important to note the changes that may affect your work. Here, as is our annual tradition, we flag the most important changes of interest to clergy.

1. **Bracket Adjustments**
   The base upon which you calculate your tax continues to be adjusted for inflation. Accordingly, your tax rates will not be increased merely because you received an increase in gross compensation. We say "rates" because most clergy pay tax calculated at several different rates. For example, a married pastor earns $69,000 of taxable income and is "in the 25% bracket." However, her tax rates are 10% on the first $16,700, 15% on the next $51,200 and 25% on the $1,100 within the 25% bracket. Here are the brackets that apply to most clergy.

	Joint	Single
10%	$0-16,700	$0-8,350
15%	$16,701-67,900	$8,350-33,950
25%	$67,901-137,050	$33,951-82,250
28%	$137,051-208,850	$82,251-171,550

2. **Personal Exemptions & Standard Deductions**
   Personal exemptions increase to $3,650 per person. This applies to you and any eligible dependents. This is also the earnings limit for those you claim as dependents other than your children. The dependency rules continue to be relaxed and allow you an exemption for your children in college or elsewhere who may be receiving scholarships or other benefits that reduce your percentage of support below 50%. As long as the children themselves do not provide more than 50% you may continue to claim the exemption. This is especially important where other parties provide partial support-grandparents, scholarships, etc. Standard Deductions increase to $11,400 for marrieds and $5,700 for singles. Head of household gets $8,350. **There is a new addition to the Standard Deduction that applies only to homeowners who do not itemize on Schedule A. If you qualify, you may deduct another $500 (single) or $1,000 (joint) on top of the other limits if you paid property taxes of at least that amount.**
3. **Standard Mileage Rates**
   The IRS standard mileage rate for professional driving had a rate during 2009 of 55 cents per business mile. Medical and moving rates during 2009 were 24 cents. **Note: The 2010 rate for professional travel drops back to $.50 per mile beginning January 1, '10. Medical/Moving drops to 16.5 cents. Charitable driving remains at 14 cents for both '09 and '10.**
4. **Higher 403b Contribution Limits**
   Uncle Sam wants you... to save more money. Tax Deferred Annuity elective deferral limits were increased in 2009. Clergy under age 50 can contribute up to $16,500 in a Tax Deferred Annuity (403b) and clergy age 50+ can add an additional $5,500 for a total deferral of $22,000. Clergy up to age 50 can contribute up to $5,000 in an IRA or a Roth IRA and 50+ can add an extra $1,000. Remember that IRA contributions can be made for 2009 up until April 15, 2010 or whenever you file your 2009 return. Tax Deferred Annuity payments, however, must be made by the end of the calendar year to qualify.
5. **New Making Work Pay Credit**
   The much-ballyhooed credit was implemented for most tax-payers this past spring as part of the Economic Stimulus package when the withholding tables were amended to return more money to the taxpayer. Clergy, however, may not have made the change if you did not adjust your withholding. Accordingly, if you have not already received it, you will be eligible for a credit of $400 for singles and $800 for couples. The credit is refundable meaning you can get it even if you owed no income tax at all. **Note: the credit has been extended through 2010 as well.**
6. **Higher Hope Education Credit**
   The non-refundable Hope Education Credit increased in 2009 to $2,500, up $700 from the previous year. Remember how Hope Credits are calculated. You get 100% of the first $2,000 in qualified expenses and 25% of the next $2,000 for a total credit of $2,500. The credit was "non-refundable" in that you only got it if you owed that much in federal income tax, but effective 2009, up to 40% of the credit is now refundable.
7. **First Time Homebuyer Credit**
   In an effort to stimulate real estate purchases, Congress improved the previous credit (which was really an interest-free loan) to make buyers eligible for an $8,000 credit for the purchase of a principal residence. Buyers must not have owned a home during the previous 36 months. Note: this credit is not for vacation homes or cottages, only a principal residence. Existing homeowners qualify for a $6,500 credit for homes purchased after Nov. 6, 2009.
8. **No Required Minimum Distribution from IRAs**
   Clergy over age 70 were forgiven the requirement to take a minimum distribution from IRAs and other tax-deferred accounts for 2009 only.
9. **Expiring Provisions Extended**
   Several existing incentives due to expire were extended, some of them retroactive to January 1, '09. The **Teacher Expense Deduction** for up to $250 for classroom expenses was extended through 2009. Similarly the deduction for **state sales tax** in lieu of state income tax lasts through '09.

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tax planning

HOW TO HANDLE PROFESSIONAL EXPENSES

Although ministry is not a "business" there are business-related expenses common to our profession. Travel, books, publications, continuing education, office equipment, vestments and a wide array of other "tools of the trade" all add to the cost of doing business as a clergy person.

Clergy Finance Letter continues to believe that the fairest method of handling professional expenses is to have the pastor fully reimbursed by the church. Under an accountable reimbursement plan the costs of ministry are properly absorbed by the church. This is the most tax-wise and cost equitable arrangement. We recommend reimbursement for the following four reasons.

1. Equity - the church only pays for actual expenses. The church never pays more than the cost of doing business and the pastor never has to underwrite the church's expenses.

2. Transactions of an accountable plan are free of tax without regard to issues of self-employment.

3. This avoids the 50% of cost limitations on the deductibility of certain expenses. Business meals and entertainment expenses may only be deducted at 50% of the actual costs whereas they may be fully reimbursed.

4. Reimbursement avoids running afoul of the court's recent Deason rule for allocating professional expenses. In Deason v. Commissioner the court declared that clergy receiving tax-free income such as housing must reduce the deductible amounts of professional expenses by the percentage of income received tax-free. While we believe the Deason ruling to be a misapplication of another case (Dalan), reimbursement avoids the problem entirely.

Receiving reimbursement through an "allowance," while often a well-intended effort, seldom accomplishes a tax-wise result. "Allowances" paid to the pastor without documentation requirements are not considered an accountable plan under IRC274. As far as the IRS is concerned your "travel allowance" is salary. It must be declared as taxable income.

If you receive reimbursement from a non-accountable plan (an arrangement where you receive a predetermined amount irrespective of your actual expenses) declare the income and deduct the expense.

Clergy who file as employees must use form 2106 "Employee Business Expense." The major problems with 2106 are that the deduction is taken on Schedule A, not available to non-itemizers, and that itemizers must still reduce the deductible total by an amount equal to 2% of your adjusted gross income (AGI). This 2% threshold is particularly unfair to clergy with employed spouses. Even if you had all the employee business expenses you must still reduce them by 2% of your joint income. (Pastors with high-income spouses may wish to explore filing separately.)

Reimbursement under an "accountable plan" is the only real solution for employee clergy. Your plan will be considered to be an acceptable "accountable plan" if it conforms to the following standards:

A. The policy of reimbursement must be established in advance. It is not necessary for the exact amount to be a line item in the budget. It is recommended, however, that the church budget for this in the same way that utilities and other variable expenses are handled.

B. Payments are made only where actual expenses are incurred. This should be documented with voucher or receipt. (Receipts are required for expenditures of $75.00 or more.)

C. Any balance in the account at year-end is forfeited. Receiving the balance either as a "bonus" or any other way renders the entire reimbursement taxable and no longer an "accountable" plan. Beware of the tax advisors who counsel that only the non-vouchered balance need to be declared as income. These advisors are confusing the tax treatment of clergy housing allowance with these professional expense accounts.

HOW TO HANDLE HONORARIA

Do you ever receive money for officiating at weddings, funerals, bar mitzvahs or other ceremonies? Most clergy do. The question is, are these payments "gifts" which have no tax consequence or are they "fees" which are taxable? The IRS is emphatic that such payments are *fees,* professional compensation, and are fully subject to both income and self-employment tax.

Declare these on Schedule C - line 6. This is necessary no matter how you disclose your salary; both employees and self-employed clergy are self-employed when it comes to honoraria.

Don't try to take the position that these payments are *"gifts"* just because you have no standard fee for weddings and the like. The IRS assumes that you would not have received the money at all if you had not performed the service — that makes it a *fee* and part of your taxable income.

If you are accustomed to endorsing the check over to the church you must still declare the income. Itemizers will be able to deduct this as a charitable contribution and avoid the income tax liability. Nevertheless, you will still have to pay the 15.3% self-employment tax on this money. A better way is to direct the funeral home or any wedding clients to make the check payable to the church. You will not have received any income and will not owe any tax.

EXPENSE REIMBURSEMENT VOUCHER

Date ______________________________ Amount $ __________________

Pay: Name ____

Address ____

Nature of Expense____

____

Business Purpose of Expense ______________________________________

____

Location _________________________________ Time ______________

Receipt: ❑ Attached ❑ No

Budget Line Item # ____

Authorized Signature ____

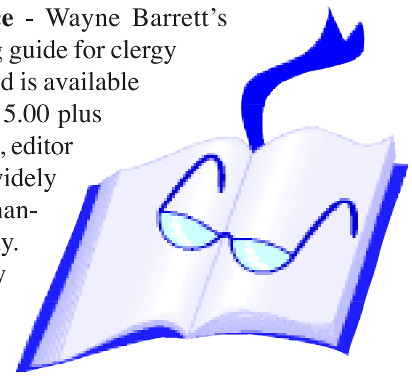
READ 'EM AND REAP!

Check out these resources to help in your tax planning and preparation. All are available exclusively from *Clergy Financial Services*. Use the handy order coupon below for ordering.

Clergy Tax Planning Manual - This resource, used by thousands of clergy across America is rapidly becoming recognized as the most reliable tax publication in the United Methodist Church and several other major denominations. The authors of this book have created an instrument that is praised for its clarity, authority, and absolute integrity. *Clergy Financial Services* is proud to be the national distributor of this manual and is now able to offer readers of *Clergy Finance Letter* a 20% discount off the national cover price of $15.00. Send only $12.00 for each manual (postage & handling extra) and we'll speed this helpful manual to you via first class mail. In a hurry? Order from our website www.clergy-financial.com and get your order even faster.

Exempt From What? - This local church guidebook was written by *Clergy Finance Letter* contributing editor Fred Leasure, CFRE, to help you and your church treasurer handle the many payroll management issues that occur between budget and W-2. In simple, straightforward language Leasure presents a helpful guide that can provide just the documentation your treasurer will appreciate to differentiate employees from independent contractors, housing compensation from wages, and fringe benefits from those subject to FICA and SECA. This booklet is a must for each local church treasurer and pastors should have their own copies as well.

Clergy Personal Finance - Wayne Barrett's best-selling financial planning guide for clergy has been up-dated for 2009 and is available for the discounted price of $15.00 plus shipping and handling. Barrett, editor of *Clergy Finance Letter*, is widely recognized as the leading financial voice in the church today. This resource will help early career pastors get control of their spending, mid-career pastors make sound saving/investment decisions, and pre-retirement pastors make wise decisions about retirement housing and other related matters. Clergy spouses testify to the helpfulness of Barrett's book as well.



Order Form Mail all orders to: CFS, PO Box 6007
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Clergy Tax Planning	Quantity______	@$12.00	_________
Exempt From What?	Quantity______	@$ 4.95	_________
Clergy Personal Finance	Quantity______	@$15.00	_________
		Total Purchases	_________

Name____________________________ S & H _________

Address__________________________ Total Payable _________

City/State__________________________ Zip_________

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CALCULATING SELF-EMPLOYMENT TAXES

Perhaps the most confusing component of clergy tax is the calculation of self-employment (social security) tax. Many of the rules that apply to federal income tax do not apply when it comes to social security taxes. For example, while courts consistently require clergy to file as employees for income tax purposes, all clergy are subject to self-employment tax. Similarly, while clergy housing income is exempt from income tax it is fully subject to social security tax - even that portion received in kind such as the rental value of a church-provided house. Here is a quick five-step process to follow in calculating your dreaded SECA.

STEP ONE: Calculate income subject to SECA

Begin with W-2 wages. Add net Schedule C income. Subtract any unreimbursed employee business expense. (Note that all are deductible for this purpose even though they may not be deductible on Schedule A.)

STEP TWO: Add any clergy housing income

Calculate Fair Rental Value of Parsonage/Manse. Add any church-paid parsonage utilities. Add any cash allowances paid for housing or furnishings.

STEP THREE: Reduce this subtotal by 7.65%

Since employer's share of FICA is exempt, self-employeds get a similar deduction here. (Hint: this calculation is easiest when multiplying subtotal by .9235.- 100% - 7.65%= .9235)

STEP FOUR: Multiply net taxable income by SECA rate - 15.3%

Determine your tax by multiplying income subject to SECA (the product of steps 1-3) by SECA rate of .153.

STEP FIVE: Remember to take Income Tax deduction for half of SECA

50% of your total self-employment tax is deductible from your taxable income for federal income tax purposes. Take this on line 27 of 1040.

Here's a worksheet to assist with calculations associated with steps one and two. (Note: you may wish to share this information with your personnel committee to help them appreciate that clergy housing income is not really "tax free").

Self-Employment Tax Worksheet

Net Salary (W-2)	________________
Plus Housing:	
1. Housing Allowance	________________
2. Utilities Paid by Church	________________
3. Rental Value of Parsonage	________________
Plus Schedule C income (if any)	________________
Less unreimbursed Business Expenses	________________
Total Self-Employment Income	________________

Note: You may want to add a similar worksheet to your 1040)

The Best Tax Advice of All ...WRITE IT DOWN!

Good Records Make All The Difference

How Long Should Tax Records Be Kept?

As many of you already know, the IRS has three years in which to challenge a tax return. This does not automatically imply that records be kept for only three years, however. Clergy Finance Letter recommends that you retain all tax records for seven years or more. Here's why:

In addition to the automatic three years for challenge of a return, the Service may go back six years for substantially understated income. For example, an auditor rules that your current method of keeping travel documentation is inadequate. In addition reducing your travel deductions for the current year you may have to substantiate all travel deductions for the past six years. Without records you may have no substantiated deductions at all - a huge tax bill.

Moral of the story? Keep records for seven years and copies of your returns indefinitely. Oh yes, one more thing. If the IRS suspects fraud (failure to pay SECA on housing, for instance) there is no time limit on the number of years that can be included in such an audit.

Do it right the first time and keep your records. Then relax. Otherwise, that ticking sound you hear may be an old tax return.

housing

CLERGY HOUSING ALLOWANCE EXCLUSION

The *Clergy Housing Allowance Exclusion* (sometimes referred to as parsonage allowance, furniture and furnishings allowance, etc.) is a way in which qualifying clergy can receive housing, whether it be in kind or by allowance without having to pay income tax on this form of compensation.

It should be clearly understood that this provision of the IRS Code is an "exclusion" and not a "deduction" from income.

Section 107 of the Internal Revenue Code of 1986 provides that:

"In the case of a minister of the gospel, gross income does not include -

(1) the rental value of a home furnished as part of compensation; or

(2) the rental allowance paid as part of compensation, to the extent used to rent or provide a home and to the extent that such allowance does not exceed the fair value of the home, inlcuding furnishing and appurtenances such as a garage, plus the cost of utilities"

The only items which the Internal Revenue Service has specifically said can *not* be excluded are the cost of food and domestic help.

Because the IRS has taken a rather broad interpretation of this provision, "provide a home" has been understood to include almost anything connected with living in a home. The list of possibilities includes but is not necessarily limited to:

Insurance - tenant or home owner's

Repairs - to the home, appliances, lawn equipment, TV, etc.

Furniture - appliances, TV, VCR, stereo, bed, desk, etc.

Decorating accessories - drapes, pictures, rugs, linens, lamps, ect.

Utilities - garbage, sewage, cable TV, telephone, gas, water, electricity, etc.

Miscellaneous ~ lawn care, snow removal, tools, plants, etc.

It is absolutely vital that this allowance for furnishings/housing be properly established. Here's how.

1. Allowance must be established in advance. It is not possible to create this relationship retroactively. You will need a resolution declaring a portion of your compensation to be an "Allowance For Housing/Furnishing.

2. To qualify for the housing exclusion the funds must actually be expended for the intended purpose. This means that simply calling your salary a "housing allowance" will not, by that action, exclude it from tax. You must keep careful records of all housing/furnishing expenditures. If you fail to spend all of your allowance, the unused balance must be declared as additional taxable income. Conversely, expenditures in excess of the pre-established amount do not qualify for the exclusion. **NOTE:** in spite of what some tax advisors are advocating, the expenditure requirement seemingly would invalidate attempts to take a "rental allowance" for existing furniture. This strategy attempts to shelter income with a type of depreciation for furniture purchased in prior years. While seemingly convincing arguments may be presented for the alleged equity of this arrangement, Clergy Finance Letter believes that the strategy fails the "expense test" since no expenditure is made.

3. Excluded amounts may not exceed the "fair rental value" of the property. For furnishings this suggests that the maximum amount excludable in a given year would be the fair rental value of all your furniture.

It is important to recognize that this amount is an "exclusion," not a deduction. This means that the allowance for housing/furnishings should NOT be included on a church-provided W-2 or a 1099.

In spite of the fact that housing, received in a parsonage or through an allowance, is excluded from income for income tax purposes it is subject to social security tax. This means that the amount of income you declare on Form 1040 SE will be higher than the amount declared on the front of 1040 (line 7 or 13).

SAMPLE CLERGY HOUSING ALLOWANCE RESOLUTION

The_________________________________ Church of _________________________ has established the cash salary for the Rev. _____________________________ to be $__________ for the period from _________ to _________. In addition to the cash salary, the church will also provide a parsonage located at _________________ ________________________

and all utilities.

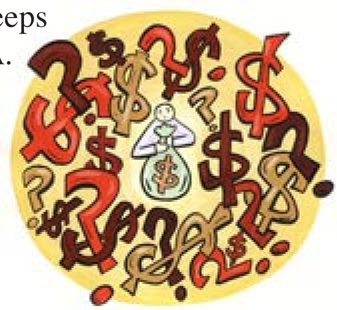
Whereas Section 107 of the Internal Revenue Code of 1986 has provided that a minister of the Gospel may exclude from gross income the rental value of a home provided and any allowance to provide a home;

Therefore be it resolved that the use of the parsonage located at _____________________________, plus all utilities, and $ _____________ of the cash salary of $ _________, provided to Rev. __________________ to the extent it is used to provide a home, be considered to be Clergy Housing Allowance Exclusion and excluded from reportable compensation under Section 107 of the Internal Revenue Code of 1986.

(Signed and Dated by Board Chair and Secretary)

Q A A Q questions & answers

Q: The teller at my bank keeps urging me to open an IRA. I have always done my retirement investing through my 403b account at the Board of Pensions. Should I open a separate account in an IRA too?



A: Probably not. You get all the advantages of an IRA (tax deferred compounding and exemptions for certain withdrawals like higher education and home purchases) with your 403b tax-deferred annuity. In addition you get some benefits the IRA can't offer. Unlike contributions to an IRA 403b contributions are not subject to self-employment tax, an immediate savings of 15.3% on every dollar you put in. That's like a guaranteed first-year return of 15.3% on top of whatever the market will give you. In addition, distributions from your pension fund may qualify for treatment as a housing allowance so the money may never be taxed, something the IRA can't offer.

Q: We recently purchased long-term care insurance. Can we deduct the premiums?

A: Yes, within certain limits. Taxpayers age 61-70 can deduct up to $3,180 per person while those 51-60 can deduct up to $1,190. This is taken on Schedule A so you will need to itemize to get this deduction.

TAX PLANNING FOR 2010

While 2009 brought plenty of changes, 2010 will also offer several changes worth noting. Here are a few of the major ones. As always, if additional changes occur during the year, we'll alert you immediately.

1. Standard Mileage Rates - As we alerted you on Page 1 a new rate for profession driving becomes effective January 1, '10. The professional rate is 50 cents per mile and the medical and moving rates are 16.5 cents.

2. Higher Tax Deferred Annuity Contribution Limits- The government continues to encourage us to save our own money for retirement. (Does Social Security look more "iffy" to you too?) For 2010 the elective deferral limit continues at $16,500 and the age 50+ catch-up addition increases to $5,500 so a pastor who has reached the age of 50 could contribute $22,000 to their account in 2010. While this doesn't look like a change, it required a repeal of the inflation-indexing that would have reduced the limit. For 2010 you may contribute $16,500.

3. Sale of Personal Residence- Non-qualified use of a cottage or vacation home will reduce the capital gain tax exclusion that might otherwise apply. Beginning 1/1/09 any use of the property other than as your principal residence will reduce the exclusion. For example, let's say you have a vacation home or lakeside cottage that you use occasionally. When you retire you expect to live in the property as your residence. Previously you could live in the house for as little as two years and sell it with no capital gains taxes due on profits up to $500,000 for couples. Now any non-principal residential use will be subject to capital gains taxes. For example, let's say the house is currently worth $200,000. You use it only for occasional get-aways for the remainder of your clergy career, let's say 5 years. Then you retire and move into your vacation home. After three years you sell the house for $400,000. Is the gain taxable? Let's do the math. You owned the house for 96 months after January 1, 2009. Of that time you only used the property as your principal residence for 36 months. Accordingly, you may only exclude 37.5% of the gain from tax, $200,000 x .375 = $75,000. The remainder of your profit, $125,000, is subject to applicable federal capital gains taxes. Although rates could change, the current capital gain rate is 15% so you would need to pay $18,750 of tax on your sale even if you bought another property for more money.