2015

Clergy Tax Return Preparation Guide
for 2014 Returns

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Senior Editor, CHURCH LAW & TAX REPORT

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How to report employee business expenses

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Office in the home

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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 5861632 (7th Cir. 2014). The appeals court’s ruling means that the housing allowance remains valid, for now. This means that churches should designate a housing allowance for their ministers for 2015 by the end of 2014, as in prior years. Churches that fail to designate a housing allowance for 2015 by the end of 2014 may designate one in early 2015, but note that the allowance will only operate prospectively. The amount of a minister's 2015 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 or the church-designated allowance. It also means that the housing allowance exclusion is available to ministers in computing taxes for 2014.

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 claiming 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, or claim a housing allowance for 2014. The Foundation will need to designate a housing allowance by the end of 2014 for 2015, and then, when filing their 2015 tax returns that are due in April of 2016, the officers would claim a housing allowance exclusion. Second, the IRS would then need to select one of these returns for audit. The audit rate is currently one 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 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 ministers in all states if affirmed by the United States Supreme Court—an unlikely outcome because the Supreme Court accepts less than 1% 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.

**Part 1**

**Introduction**

All references in this publication to line numbers on IRS forms are for the “draft” versions of the 2014 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 2014 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—helps churches comply with
their federal tax reporting requirements.

Key Point
Congress, the courts, or the IRS may cause tax changes at any time, in some cases retroactively. This guide includes only the law in effect at the time of preparation. Be certain to refer to the final instructions to Form 1040 when completing your tax return. A number of tax provisions that expired at the end of 2013 were “extended” by Congress for another year in the closing days of 2014. These provisions, which now are available in reporting taxes for 2014, include: (1) The $250 above-the-line tax deduction for teachers for school expenses; (2) the election to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction permitted for state and local income taxes; (3) the above-the-line tax deduction for qualified higher education expenses; and (4) the deduction of distributions to charity of up to $100,000 from IRA accounts by persons age 70-1/2 or older.

This guide is divided into the following sections:

Part 1: Introduction – This section reviews tax highlights for 2014 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 ordained minister and spouse and for a retired minister and spouse.

Federal Reporting Requirements for Churches – This resource provides assistance to churches (especially treasurers and bookkeepers) in filing federal tax forms.

Tax highlights for 2014

1. Temporarily extend the American Opportunity 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 in excess of $80,000 ($160,000 for married couples filing jointly).

Congress has extended the American Opportunity Tax Credit through 2017.

2. Temporarily extend the "third-child" EITC
Congress has extended through 2017 an increase in the earned income tax credit for families with three or more children, and increased the phase-out range for all married couples filing a joint return.
3. **Deduction for certain expenses of elementary and secondary school teachers**
Congress has extended through 2014 the $250 above-the-line 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 by the educator in the classroom.

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 will help offset this disadvantage.

5. **Above-the-line deduction for qualified tuition related expenses**
Several years ago Congress created 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).

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 includible 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.

7. **The Affordable Care Act ("Obamacare")**
Those provisions of the Affordable Care Act that involve taxation, that have the greatest relevance to churches and church staff, and that affect tax reporting in 2014 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” are required to maintain “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 $95 or 1 percent of household income over a filing threshold for 2014 ($325 or 2 percent of income in 2015).
- The law implements reforms that prohibit insurance companies from refusing to sell coverage or renew policies because of an individual’s pre-existing conditions. Also, in the individual and small group market, the law eliminates the ability of insurance companies to charge
higher rates due to gender or health status.

- The law prohibits new plans and existing group plans from imposing annual dollar limits on the amount of coverage an individual may receive.

- Tax credits to make it easier for the middle class to afford insurance will become available for people with income between 100% and 400% of the poverty line who are not eligible for other affordable coverage. In 2014, 400% of the poverty line comes out to about $46,680 for an individual or $95,400 for a family of four. The tax credit is advanceable, so it can lower your premium payments each month, rather than making you wait for tax time. It’s also refundable, so even moderate-income families can receive the full benefit of the credit. These individuals may also qualify for reduced cost-sharing (copayments, co-insurance, and deductibles).

- For tax years beginning in 2014 or later, there are changes to the credit: (1) The maximum credit increases to 50 percent of premiums paid for small business employers and 35 percent of premiums paid for small tax-exempt employers.; (2) to be eligible for the credit, a small employer must pay premiums on behalf of employees enrolled in a qualified health plan offered through a Small Business Health Options Program (SHOP) Marketplace or qualify for an exception to this requirement; and (3) the credit is available to eligible employers for two consecutive taxable years.

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

There were several tax developments in 2014 that will affect tax reporting by both ministers and churches for 2014 and future years. Here is a rundown of some of the key provisions:

- You may be able to claim the earned income credit for 2014 if (1) you do not have a qualifying child and you earned less than $14,590 ($20,020 if married); (2) a qualifying child lived with you and you earned less than $38,511 ($43,941 if married filing jointly); (3) two qualifying children lived with you and you earned less than $43,756 ($49,186 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than $46,997 ($52,427 if married filing jointly). The maximum earned income credit for 2014 is (1) $496 with no qualifying child; (2) $3,305 with one qualifying child; (3) $5,460 with two qualifying children; and (4) $6,143 with three or more qualifying children.

- For contributions to a traditional IRA, the deduction phase-out range for an individual covered by a retirement plan at work begins at income of $96,000 for joint filers and $60,000 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 $17,500 in 2014. It increases to $18,000 for 2015.

- 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 2014. It increases to $6,000 for 2015.

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

- The standard business mileage rate was 56 cents per mile for business miles driven during 2014. The standard business mileage rate for 2015 is 57.5 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 ($3,490 per month for 2015). 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 2015 this annual amount is $15,720.

- For 2014 the following 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 $3,950.
  - The standard deduction is $12,400 for married couples filing a joint return, and $6,200 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.
  - 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.

10
Preliminary Questions

Below are several questions you should consider before preparing your 2014 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 2014 federal tax return is April 15, 2015.

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, 2015) to file your 2014 Form 1040 if you file Form 4868 by April 15, 2015 with the IRS service center for your area. Your Form 1040 can be filed at any time during the six month extension period. An extension only relieves you from the obligation to file your return; it is not an extension of the obligation to pay your taxes. You must make an estimate of your tax for 2014 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 2014, 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.

Ask local tax professionals if they work with ministers and, if so, with how many.

Ask local tax professionals a few questions to test their familiarity with ministers’ tax issues. For example, ask whether ministers are employees or self-employed for Social Security. Anyone familiar with ministers’ taxes will know that ministers are self-employed for Social Security with respect to their ministerial duties. Or, ask a tax professional if a minister’s church salary is subject to income tax withholding. The answer is no, and anyone familiar with ministers’ taxes should be able to answer this question.

Part 2

Special Rules for Ministers

Who is a minister for federal tax purposes?

Key Point

*The IRS has its own criteria for determining who is a minister for tax purposes.*

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

- eligibility for housing allowances;
- self-employed status for Social Security;
- exemption of wages from income tax withholding (ministers use the quarterly estimated tax procedure to 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 sacerdotal functions, and administer ordinances or sacraments according to the tenets and practices of that church or denomination. If a church or denomination ordains some ministers and licenses or commissions others, anyone licensed or commissioned must be able to perform sub-
stantially all the religious functions of an ordained minister to be treated as minister for Social Security. See IRS Publication 517.

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

Key Point

*Most ministers are considered employees for federal income tax purposes under the tests currently used by the IRS and the courts and should receive a Form W-2 from their church reporting their taxable income. However, ministers are self-employed for Social Security (with respect to services they perform in the exercise of their ministry).*

Ministers have a *dual* tax status. For federal income taxes they ordinarily are employees, but for Social Security they are self-employed with regard to services performed in the exercise of ministry. These two rules are summarized below:

Income taxes. For federal income tax reporting, most ministers are employees under the tests currently used by the IRS. This means that they should receive a Form W-2 from their church at the end of each year (rather than a Form 1099). It also means that they report their employee business expenses on Schedule A rather than on Schedule C. A few ministers are self-employed, such as some traveling evangelists and interim pastors. Also, many ministers who are employees of a local church are self-employed for other purposes. For example, the minister of a local church almost always will be an employee, but will be self-employed with regard to guest speaking appearances in other churches and services performed directly for individual members (such as weddings and funerals).

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

**Key Point**

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

$ Tax savings tip. Ministers and other church staff members should carefully review their W-2 form to be sure that it does not report more income than was 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 created a seven factor test for determining whether a minister is an employee or self-employed for federal income tax reporting purposes. The test requires consideration of the following seven factors: (1) the degree of control exercised by the employer over the details of the work; (2) which party invests in the facilities used in the work; (3) the oppor-
tunity of the individual for profit or loss; (4) whether or not the employer has the right to discharge the individual; (5) whether the work is part of the employer’s regular business; (6) the permanency of the relationship; and (7) the relationship the parties believe they are creating. Most ministers will be employees under this test.

Social Security. The tax code treats ministers as self-employed for Social Security with respect to services performed in the exercise of their ministry—even if they report their income taxes as an employee. This means that ministers must pay self-employment taxes (Social Security taxes for the self-employed) unless they have filed a timely exemption application (Form 4361) that has been approved by the IRS. As noted below, few ministers qualify for this exemption.

**Key Point**

*While most ministers are employees for federal income tax reporting purposes, they are self-employed for Social Security with respect to services they perform in the exercise of their ministry. This means that ministers are not subject to the employee’s share of Social Security and Medicare taxes, even though they report their income taxes as employees and receive a Form W-2 from their church. Rather, they pay the self-employment tax (SECA).*

**Exemption from Social Security (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 (or any other public insurance system that provides retirement or medical benefits). A minister who files the exemption application may still purchase life insurance or participate in retirement programs administered by nongovernmental institutions (such as a life insurance company).

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

The exemption is only effective when it is approved by the IRS. Few ministers qualify for exemption. Many younger ministers opt out of Social Security without realizing that they do not qualify for the exemption. A decision to opt out of Social Security is irrevocable. Congress did provide ministers with a brief “window” of time to revoke an exemption by filing Form 2031 with the IRS. This opportunity expired in 2002, and has not been renewed.

An exemption from self-employment taxes applies only to ministerial services. Ministers who have exempted themselves from self-employment taxes must pay Social Security taxes on any non-ministerial compensation they receive. And, they remain eligible for Social Security benefits based on their non-ministerial employment assuming that they have worked enough quarters. Generally, 40 quarters are required. Also, the Social Security Administration has informed the author of this text that ministers who exempt themselves from self-employment taxes may qualify for Social Security benefits (including retirement and Medicare) on the basis of their spouse’s coverage, if the spouse had enough credits. 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 2015 is $1,220. A quarter of coverage is the basic unit for determining whether a worker is insured under the Social Security program.

Key Point

Ministers who work after they retire must 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).

How do ministers pay their taxes?

Key Point

Ministers must prepay their income taxes and self-employment taxes using the estimated tax procedure, unless they have entered into a voluntary withholding arrangement with their church with respect to federal income tax only.

As noted above, ministers’ wages are exempt from federal income tax withholding. This means that a church does not have to withhold income taxes from a minister’s paycheck. And, since ministers are self-employed for Social Security with respect to their ministerial services, a church does not withhold the employee’s share of Social Security and Medicare taxes from a minister’s wages. Ministers must prepay their income taxes and self-employment taxes using the estimated tax procedure, unless they 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 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 2015 if you expect to owe at least $1,000 in tax for 2015 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 2015 tax return, or (2) 100 percent of the tax shown on your 2014 tax return (110 percent if adjusted gross income exceeds $150,000). Your 2014 tax return must cover all 12 months.

The four-step procedure for reporting and prepaying estimated taxes for 2015 is summarized below.

Step 1.
Obtain a copy of IRS Form 1040ES for 2015 before April 15, 2015. You can obtain forms by calling the IRS toll-free forms hotline at 800-TAX-FORM (800-829-3676), or from the IRS website (irs.gov). If you paid estimated taxes last year, you should receive a copy of your 2015 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 2015 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 2015 in each of four quarterly installments as follows:

<table>
<thead>
<tr>
<th>FOR THE PERIOD</th>
<th>DUE DATE</th>
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<tbody>
<tr>
<td>January 1 - March 31</td>
<td>April 15, 2015</td>
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<td>April 1 - May 31</td>
<td>June 15, 2015</td>
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<td>June 1 - August 31</td>
<td>September 15, 2015</td>
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<tr>
<td>September 1 - December 31</td>
<td>January 15, 2016</td>
</tr>
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You must send each payment to the IRS, accompanied by one of the four payment vouchers contained in Form 1040-ES.

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 you make it 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.

Step 4.
After the close of 2014, compute your actual tax liability on Form 1040. Only then will you know your actual income, deductions, exclusions, and credits. If you overpaid your estimated taxes (that is, actual taxes computed on Form 1040 are less than all of your estimated tax payments plus any withholding), you can elect to have the overpayment credited against your first 2015 quarterly estimated tax payment, or spread it out in any way you choose among any or all of your next four quarterly installments. Alternatively, you can request a refund of the overpayment. If you underpaid your estimated taxes (that is, your actual tax liability exceeds the total of your estimated tax payments plus any withholding), you may have to pay a penalty.

Key Point
Ministers who report their income taxes as employees can request that their employing church voluntarily withhold income taxes from their wages. Simply furnish the church with a completed W-4 (withholding allowance certificate). Since ministers are not employees for Social Security with respect to ministerial compensation, the church does not withhold the employee’s share of Social Security and Medicare taxes. However, ministers can request on Form W-4 (line 6) that an additional amount of income tax be withheld to cover their estimated self-employment tax liability for the year. The excess income tax withheld is a credit that is applied against the minister’s self-employment tax liability. Many churches understandably withhold Social Security and Medicare taxes in addition to income taxes for a minister who requests voluntary withholding. Such withholding must be reported as income tax withheld.

Part 3
Step-by-Step Tax Return Preparation
Tax forms and schedules
This step-by-step analysis covers these forms and schedules:
Form 1040 is the basic document you will use. It summarizes all of your tax information. Details are reported on supplementary schedules and forms.

Schedule A is for itemized deductions for medical and dental expenses, taxes, interest, 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 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.

Form 2106 is used to report expenses you incur in your capacity as an employee of the church.

These forms and schedules, along with others, are included in the illustrated example in Part 4 of this guide. These forms and schedules are the ones most commonly used by ministers, but you may have a need for others. These forms may be obtained at your local post office or IRS office. Or, you can obtain them by calling the IRS toll-free forms hotline at 800-TAX-FORM (800-829-3676). They also are available on the IRS website (irs.gov).

Form 1040

Step 1: Name and address
Print or type the information in the spaces provided. If you are married filing a separate return, enter your spouse’s name on line 3 instead of below your name. If you filed a joint return for 2013 and you are filing a joint return for 2014 with the same spouse, be sure to enter your names and Social Security numbers in the same order as on your 2013 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. This prevents delays in processing your return and issuing refunds. It also safeguards your future Social Security benefits.

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

Step 2: Filing status
Select the appropriate filing status from the five options listed in this section of the Form 1040.

In 2013 the United States Supreme Court struck down a provision in the Defense of Marriage Act (“DOMA”) defining marriage for purposes of federal law as a union between a man and woman. The
Court’s invalidation of DOMA means that the definition of “marriage” for purposes of federal law includes same-sex as well as opposite-sex couples in those states where same-sex marriages are legally valid. Following the Supreme Court’s decision, the U.S. Department of the Treasury and the Internal Revenue Service (IRS) announced that same-sex couples, legally married in jurisdictions that recognize their marriages, will be treated as married for federal tax purposes. The ruling applies regardless of whether the couple lives in a jurisdiction that recognizes same-sex marriage or a jurisdiction that does not recognize same-sex marriage. The ruling does not apply to registered domestic partnerships, civil unions, or similar formal relationships recognized under state law. Legally-married same-sex couples generally must file their 2014 federal income tax return using either the “married filing jointly” or “married filing separately” filing status.

**Step 3: Exemptions**

You generally are allowed one exemption for yourself. If you are married, you may be allowed on exemption for your spouse. These are called personal exemptions. Some restrictions apply (see IRS Publication 501).

You are allowed one exemption for each person you can claim as a dependent. The term "dependent" means a qualifying child or qualifying relative. To claim a dependency exemption for a qualifying child, the following tests must be met:

1. The child must be your son, daughter, stepchild, foster child, brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them.

2. The child must be (a) under age 19 at the end of the year and younger than you (or your spouse, if filing jointly), (b) under age 24 at the end of the year, a full-time student, and younger than you (or your spouse, if filing jointly), or (c) any age if permanently and totally disabled.

3. The child must have lived with you for more than half of the year.

4. The child must not have provided more than half of his or her own support for the year.

5. The child is not filing a joint return for the year (unless that return is filed only as a claim for refund).

If the child meets the rules to be a qualifying child of more than one person, only one person can actually treat the child as a qualifying child.

To claim a dependency exemption for a qualifying relative, the following tests must be met:

1. The person cannot be your qualifying child or the qualifying child of any other taxpayer.

2. The person either (a) must be your child, stepchild, foster child, or a descendant of any of them; your brother, sister, half brother, half sister, stepbrother, or stepsister; your father, mother, grandparent, or other direct ancestor, but not a foster parent; your stepfather or stepmother; a son or daughter of your brother or sister; a brother or sister of your father or mother; your son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law; or (b) must live with you all year as a member of your household (and your relationship must not violate local law).

3. The person’s gross income for the year must be less than $3,950.

4. You must provide more than half of the person’s total support for the year.

The following conditions apply both to the qualifying child or qualifying relative exemptions:
• You cannot claim any dependents if you, or your spouse if filing jointly, could be claimed as a dependent by another taxpayer.

• You cannot claim a married person who files a joint return as a dependent unless that joint return is only a claim for refund and there would be no tax liability for either spouse on separate returns.

• You cannot claim a person as a dependent unless that person is a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico, for some part of the year.

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.

Determining church wages or salary. Besides a salary, ministers’ wages may include several other items; some items are:

Bonuses
Excess housing allowance (the amount by which a housing allowance exceeds the lesser of a minister’s actual housing expenses or the fair rental value of the minister’s home)
The cost of sending a minister to the Holy Land (if paid by the church)
Most Christmas and special occasion offerings
Retirement gifts paid by a church
The portion of a minister’s Social Security tax paid by a church
Personal use of a church-provided car
Purchases of church property for less than fair market value
Business expense reimbursements under a nonaccountable plan
Reimbursements the church made for the minister’s moving expenses (but not if the minister substantiated the reimbursed expenses under an accountable arrangement)

Imputed cost of group term life insurance coverage (including death benefits under the Benefits Plan) exceeding $50,000 and cost of coverage of spouse and dependents if over $2,000 which is paid by the church.

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)

“Discretionary funds” established by a church for a minister to spend on current needs—if the minister is allowed to distribute funds for his or her personal benefit

“Below-market interest loans” of at least $10,000 made by a church to a minister (some exceptions apply)

Cancellation of a minister’s debt to a church

Severance pay

Payment of a minister’s personal expenses by the church

"Love gifts"

**Key Point**

*The IRS can assess intermediate sanctions in the form of substantial excise taxes 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 parsonage) 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 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. Your church should issue a "corrected" Form W-2 (Form W-2c) for the year in which one or more items of taxable income was not reported on your Form W-2. If you have filed an income tax return for the year
shown, you may have to file an amended return. Compare amounts on Form W-2c with those reported on your income tax return. If the corrected amounts change your U.S. income tax, file Form 1040X, Amended U.S. Individual Income Tax Return, with Copy B of Form W-2c to amend the return you previously filed.

*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 for ministers include:

**Gifts.** Gifts are excludable from taxable income so long as they are not compensation for services. However, employers generally are not permitted to give tax-free gifts to employees.

**Life insurance and inheritances.** Life insurance proceeds and inheritances are excludable from taxable income. Income earned before distributions of proceeds is generally taxable as income.

**Accident and health plans.** Amounts received by employees as reimbursements for medical care under an employer-financed accident and health plan are excludable from taxable income. This exclusion is not available to self-employed individuals.

**Employer-paid group life insurance.** Employees may exclude the cost of employer-provided group term life insurance so long as the amount of coverage does not exceed $50,000.

**Tuition reductions.** School employees may exclude from their taxable income a “qualified tuition reduction” provided by their employer. A qualified tuition reduction is a reduction in tuition charged to employees or their spouses or dependent children by an employer that is an educational institution.

**Lodging.** The value of lodging furnished to an employee on an employer’s premises and for the employer’s convenience may be excludable from taxable income if the employee is required to accept the lodging as a condition of employment. This exclusion is not available in the computation of self-employment taxes.

**Educational assistance.** Amounts paid by an employer for an employee’s tuition, fees, and books may be excludable from the employee’s taxable income. The exclusion may not exceed $5,250 per year.

**Employer-provided childcare.** The value of free childcare 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 apply.

**Nondiscrimination rules.** Many of the exclusions are not available to employees who are either “highly compensated employees” or “key employees” if the same benefit is not available on a nondiscriminatory basis to lower-paid employees. For 2015, a highly compensated employee is an employee whose compensation for the previous year was in excess of $120,000.

**Employee status.** Some exclusions are available only to taxpayers who report their income taxes as employees and not as self-employed persons. Many, however, apply to both employees and self-employed persons.
There are four other exclusions that will be discussed separately—the housing allowance, tax-sheltered annuities, qualified scholarships, and sale of one’s home.

**Housing Allowance**

**Key point.** 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. This case is summarized in a special section at the beginning of this tax guide.

The most important tax benefit available to ministers who own or rent their homes is the housing allowance exclusion. Ministers who own or rent their home do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a housing allowance, to the extent that (1) the allowance represents compensation for ministerial services, (2) it is used to pay housing expenses, and (3) it does not exceed the fair rental value of the home (furnished, plus utilities). Housing-related expenses include mortgage payments, rent, utilities, repairs, furnishings, insurance, property taxes, additions, and maintenance.

Under no circumstances can a church designate a housing allowance retroactively. Unfortunately, many churches fail to designate housing allowances and thereby deprive ministers of an important tax benefit.

Ministers who live in a church-owned parsonage do not pay federal income taxes on the fair rental value of the parsonage.

$ Tax savings tip. Ministers who live in a church parsonage and incur any out-of-pocket expenses in maintaining the parsonage (such as utilities, property taxes, insurance, furnishings, or lawn care) should be sure that their employing church designates in advance a portion of their annual compensation as a parsonage allowance. The amount so designated is not reported as wages on the minister’s Form W-2 at the end of the year (if the allowance exceeds the actual expenses, the difference must be reported as income by the minister). This is a very important tax benefit for ministers living in a church-provided parsonage. Unfortunately, many of these ministers are not aware of this benefit or are not taking advantage of it.

$ Tax savings tip. Ministers who own their homes lose the largest component of their housing allowance exclusion when they pay off their home mortgage loan. Many ministers in this position have obtained home equity loans, or a conventional loan secured by a mortgage on their otherwise debt-free home and have claimed their payments under these kinds of loans as a housing expense in computing their housing allowance exclusion. The Tax Court has ruled that this is permissible only if the loan was obtained for housing-related expenses.

$ Tax savings tip. Ministers should be sure that the designation of a housing or parsonage allowance for the next year is on the agenda of the church (or church board) for one of its final meetings during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items—assuming in each case that the designation was appropriately adopted in advance by the church and supported by underlying documentation as to each minister’s anticipated housing expenses.

The rental value of a parsonage, and a housing allowance, are exclusions only for federal income tax
reporting purposes. Ministers cannot exclude a housing allowance or the fair rental value of a parsonage when computing self-employment (Social Security) taxes unless they are retired. The tax code specifies that the self-employment tax does not apply to “the rental value of any parsonage or any parsonage allowance provided after the [minister] retires.”

The housing allowance is available to ministers whether they report their income taxes as employees or as self-employed (whether the church issues them a W-2 or a 1099).

**Housing expenses to include in computing your housing allowance exclusion**

Ministers who own or rent their home should take the following expenses into account in computing their housing allowance exclusion:

- Down payment on a home (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 both interest and principal)
- Rent
- Real estate taxes
- Property insurance
- Utilities (electricity, gas, water, trash pickup, local telephone charges)
- Furnishings and appliances (purchase and repair)
- Structural repairs and remodeling
- Yard maintenance and improvements
- Maintenance items (pest control, etc.)
- Homeowners’ association dues

**Key Point**

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

**Please note the following:**

- A housing allowance must be designated in advance. Retroactive designations of housing allowances are not effective.
- The housing allowance designated by the church is not necessarily nontaxable. It is nontaxable (for income taxes) only to the extent that it is used to pay for housing expenses, and, for ministers who own or rent their home, does not exceed the fair rental value of their home (furnished, plus utilities).
- A housing allowance can be amended during the year if a minister’s housing expenses are more than expected. However, an amendment is only effective prospectively. Ministers should notify their church if their actual housing expenses are significantly more than the housing allowance designated by their church. Remember, however, that it serves no purpose to designate a housing allowance greater than the fair rental value of a minister’s home (furnished, plus utilities).
- If the housing allowance designated by the church exceeds housing expenses or the fair rental value of a minister's home, the excess housing allowance should be reported on line 7 of Form 1040.
The housing allowance exclusion is an exclusion for federal income taxes only. Ministers must add the housing allowance as income in reporting self-employment taxes on Schedule SE (unless they are exempt from self-employment taxes).

The fair rental value of a church-owned home provided to a minister as compensation for ministerial services is not subject to federal income tax.

Example: A church designated $25,000 of Pastor D’s 2014 compensation as a housing allowance. Pastor D’s housing expenses for 2014 were utilities of $4,000, mortgage payments of $18,000, property taxes of $4,000, insurance payments of $1,000, repairs of $1,000, and furnishings of $1,000. The fair rental value of the home (including furnishings) is $15,000. Pastor D’s housing allowance is nontaxable in computing income taxes only to the extent that it is used to pay housing expenses and does not exceed the fair rental value of her home (furnished, plus utilities). Stated differently, the nontaxable portion of a housing allowance is the least of the following three amounts: (1) the housing allowance designated by the church; (2) actual housing expenses; (3) the fair rental value of the home (furnished, plus utilities). In this case, the lowest of these three amounts is the fair rental value of the home, furnished plus utilities ($19,000), and so this represents the nontaxable portion of Pastor D’s housing allowance. Pastor D must report the difference between this amount and the housing allowance designated by her church ($6,000) as additional income on line 7 of Form 1040.

Example: Same facts as the previous example, except the church designated $12,000 of Pastor D’s salary as a housing allowance. The lowest of the three amounts in this case would be $12,000 (the church designated housing allowance) and so this represents the nontaxable amount. Note that the Pastor D’s actual housing expenses were more than the allowance, and so she was penalized because of the low allowance designated by her church.

Example: Pastor Y owns a home and incurred housing expenses of $12,000 in 2014. These expenses include mortgage principal and interest, property taxes, utilities, insurance and repairs. The church designated (in advance) $12,000 of Pastor Y’s 2014 compensation as a housing allowance. Pastor Y is able to itemize expenses on Schedule A (Form 1040). He is able to claim itemized deductions on Schedule A for both his mortgage interest and his property taxes, even though his taxable income was already reduced by these items because of their inclusion in the housing allowance. This is often referred to as the “double deduction.” In fact, it represents an exclusion and a deduction.

Example: In preparing his income tax return for 2014, Pastor H discovers that his church failed to designate a housing allowance for him for 2014. He asks his church to pass a resolution retroactively granting the allowance for 2014. Such a resolution is ineffective, and Pastor H will not be eligible for any housing allowance exclusion in 2014.

Key Point

The Sarbanes-Oxley Act makes it a crime to knowingly falsify any document with the intent to influence “the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States . . . or in relation to or contemplation of any such matter or case,” and this provision contains no exemption for churches or pastors. It is possible that a pastor’s backdating of a board resolution to qualify for a housing allowance for the entire year violates this provision in the Sarbanes-Oxley Act, exposing the pastor to a fine or imprisonment. Even if the pastor’s action does not violate the Act, it may result in civil or criminal penalties under the tax code.

$ Tax savings tip. Ministers should be sure that the designation of a housing or parsonage allowance
for the next year is on the agenda of the church board for one of its final meetings during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items—assuming in each case that the designation was duly adopted in advance by the church.

How much should a church designate as a housing allowance?

Many churches base the housing allowance on their minister’s estimate of actual housing expenses for the new year. The church provides the minister with a form on which anticipated housing expenses for the new year are reported. For ministers who own their homes, the form asks for projected expenses in the following categories: down payment, mortgage payments, property taxes, property insurance, utilities, furnishings and appliances, repairs and improvements, maintenance, and miscellaneous. Many churches designate an allowance in excess of the anticipated expenses itemized by the minister. Basing the allowance solely on a minister’s actual expenses penalizes the minister if actual housing expenses turn out to be higher than expected. In other words, the allowance should take into account unexpected housing costs or inaccurate projections of expenses.

Key Point

*The housing allowance is available only if two 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.*

Churches sometimes neglect to designate a housing allowance in advance of a new calendar year. For example, a church board may discover in March of 2015, that it failed to designate a housing allowance for its pastor for 2015. It is not too late to act. The church should immediately designate a portion of its minister’s remaining compensation for 2015 as a housing allowance. This problem can be avoided by stipulating in each annual housing allowance designation that the allowance is for the current year and all future years unless otherwise provided. If such a resolution had been adopted in the December 2013 board meeting (i.e., "for 2014 and future years"), it would not matter that the church neglected to designate a minister’s 2015 allowance until March of 2015, since the previous designation would have carried over. Such “safety net” designations are not a substitute for annual housing allowances (they have never been addressed or endorsed by the IRS or Tax Court). Rather, they provide a basis for claiming a housing allowance if a church neglects to designate one.

Key Point

*Remember—churches cannot designate a housing allowance retroactively.*

Key Point

*The IRS has ruled that a retired minister is eligible for a housing allowance exclusion if the following conditions are satisfied: (1) a portion of the retired minister’s pension income is designated as a housing allowance by his or her church or the church pension board of a denominational pension fund; (2) the retired minister has severed his or her relationship with the local church and relies on the fund for a pension; (3) the pensions paid to retired ministers “compensate them for past services to the local churches of the denomination or to the denomination.”* Retired ministers who receive benefits from a denominational pension fund will be eligible in most cases to have some or all of their benefits designated in advance as a housing allowance. This is a very attractive benefit for retired ministers that is not available with some other kinds of retirement plans. Retired ministers also can exclude from their gross income the rental value of a home (plus utilities) furnished to them by their church as a part of their pay
for past services. A minister’s surviving spouse cannot exclude a housing allowance or rental value of a parsonage unless the allowance or parsonage is for ministerial services he or she performs or performed.

The self-employment tax does not apply to the rental value of a parsonage or a housing allowance provided after a minister retires.

**Key Point**

Ministers who own their homes lose the largest component of their housing allowance exclusion when they pay off their home mortgage loan. Many ministers in this position have obtained home equity loans—or a conventional loan secured by a mortgage on their otherwise debt-free home—and have claimed their payments under these kinds of loans as a housing expense in computing their housing allowance exclusion. The Tax Court has ruled that this is permissible only if the loan was obtained for housing-related expenses.

**Section 403(b) plans**

For 2014, payments made by your church and your salary reduction contributions to a 403(b) plan are not reportable income for income tax or SE tax purposes as long as the total amount credited to your retirement account does not exceed contribution limits under Sections 415(c) and 402(g) of the tax code.

**Contribution limits**

For 2014 total annual additions (employer contributions, salary reduction and tax paid contributions) could not exceed the lesser of 100 percent of your compensation (excluding a minister’s housing allowance) or $52,000. This rule is known as the “section 415(c) limit.” Excess contributions can result in income tax, additional taxes, and penalties. The effect of excess contributions depends on the type of excess contribution. The distributed excess amount may not be rolled over to another 403(b) plan or to an IRA.

**New in 2015.** The limit on annual additions increases to $53,000 for 2015.

**Minister’s housing allowance and contribution limits**

For 2014 the Section 415(c) limit restricts 403(b) contributions to the lesser of 100 percent of compensation or $52,000. For 2015, this amount increases to $53,000. Does the term “compensation” include a minister’s housing allowance? This is an important question for ministers, since the answer will determine how much can be contributed to a 403(b) plan. If the housing allowance is treated as compensation, then ministers will be able to contribute larger amounts. The tax code specifies that the term “compensation” for purposes of applying the section 415(c) limit to a 403(b)(3) plan “means the participant’s includible compensation determined under section 403(b)(3).” Section 403(b)(3) defines compensation to include “the amount of compensation which is received from the employer . . . and which is includible in gross income.” Section 107 of the tax code specifies that a minister’s housing allowance (or the annual rental value of a parsonage) is not included in the minister’s gross income for income tax reporting purposes. Therefore, it would appear that the definition of compensation for purposes of computing the Section 415(c) limit would not include the portion of a minister’s housing allowance that is excludable from gross income, or the annual rental value of a parsonage. For many years the IRS website included the following question and answer addressing this issue:

**Question:** I am an employee minister in a local church. Each year, my church permits $25,000 as a yearly tax-free housing allowance. I would like to use my yearly housing allowance as compensation to determine my annual contribution limits (to a TSA) under section 415(c) of the Internal Revenue Code. May I do so?
Answer: No. For purposes of determining the limits on contributions under section 415(c) of the Internal Revenue Code, amounts paid to an employee minister, as a tax-free housing allowance, may not be treated as compensation pursuant to the definitions of compensation under section 1.415-2(d) of the income tax regulations.

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. Generally, you cannot defer more than an allowable amount each year for all plans covering you. For 2014 the allowable limit was $17,500. If you defer more than the allowable amount for a tax year, you must include the excess in your taxable income for that year.

New in 2015. The dollar limit on annual elective deferrals is $18,000.

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

The limit on elective deferrals increases for individuals who have attained age 50 by the end of the year. The additional amount that may be made is the lesser of (1) the “applicable dollar amount,” or (2) the participant’s compensation for the year reduced by any other elective deferrals of the participant for the year. The applicable dollar amount is $5,500 for 2014 and $6,000 for 2015. Catch-up contributions are not subject to any other contribution limits and are not taken into account in applying other contribution limits.

Qualified scholarships

Key Point
Qualified scholarships are excludable from taxable income.

Amounts received as a qualified scholarship by a candidate for a degree may be excluded from gross income. A qualified scholarship is any grant amount that, in accordance with the conditions of the grant, is used for tuition and course-related expenses. Qualified tuition and related expenses are those used for (1) tuition and fees required for the enrollment or attendance at an educational institution or (2) fees, books, supplies, and equipment required for courses of instruction at the educational institution. The scholarship need not specify that it is to be used only for qualified tuition and related expenses. All that is required is that the recipient uses the scholarship for such expenses and that the scholarship does not specify that it is to be used for nonqualified expenses (such as room and board).

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

Any amount received in excess of the qualified tuition and related expenses, such as amounts received for room and board, is not eligible for this exclusion.
Any amount received that represents payment for teaching, research, or other services required as a condition for receiving a qualified scholarship cannot be excluded from gross income. In addition, amounts paid by a church for the education of a pastor or other church employee cannot be treated as a nontaxable scholarship if paid “as compensation for services.”

**Example:** First Church establishes a scholarship fund for seminary students. Robert is a church member who is pursuing a master’s degree at a seminary. The church votes to award him a scholarship of $2,500 for 2014. So long as Robert uses the scholarship award for tuition or other course-related expenses, he need not report it as income on his federal tax return, 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**

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

In most cases, gain from the sale or exchange of your main home will not qualify for the exclusion to the extent that the gains are allocated to periods of nonqualified use. Nonqualified use is any period after 2008 during which the property is not used as the main home.

The gain resulting from the sale of the property is allocated between qualified and nonqualified use periods based on the amount of time the property was held for qualified and nonqualified use. Gain from the sale or exchange of a main home allocable to periods of qualified use will continue to qualify for the exclusion for the sale of your main home. Gain from the sale or exchange of property allocable to nonqualified use will not qualify for the exclusion.

Gain is in most cases allocated to periods of nonqualified use based on the ratio which: (1) the aggregate periods of nonqualified use during the period the property was owned by you over (2) the total period the property was owned by you. You do not incorporate any period before 2009 for the aggregate periods of nonqualified use. Certain exceptions apply. For details, see IRS Publication 523.

A period of nonqualified use does not include: (1) Any portion of the 5-year period ending on the date of the sale or exchange after the last date you (or your spouse) use the property as a main home; (2) any period (not to exceed an aggregate period of 10 years) during which you (or your spouse) are serving on qualified official extended duty as a member of the uniformed services; (3) any other period of temporary absence (not to exceed an aggregate period of 2 years) due to change of employment, health conditions, or such other unforeseen circumstances as may be specified by the IRS.

**Line 8a. Interest income: attach Schedule B if over $1,500**

Complete this line only if you had taxable interest income. If you had taxable interest income of more than $1,500, complete Schedule B. Report tax-exempt interest income on line 8b.
Line 9a. "Ordinary" dividend income; attach Schedule B if more than $1,500.
Complete this line only if you had dividend income. If you had dividend income of more than that $1,500, complete Schedule B.

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 1099MISC
- 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 and transfer this amount to line 12. This guide includes more detailed information in the section on Schedule C. You may be able to 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. You also may have to file Form 8949 (see the instructions to both forms for details).

Line 16a. Total pensions and annuities
You should receive a Form 1099-R showing the total amount of your pension and annuity payments before income tax or other deductions were withheld. This amount should be shown in box 1 of Form 1099-R. Pension and annuity payments include distributions from 401(k) and 403(b) plans. Do not include the following payments on lines 16a and 16b. Instead, report them on line 7.

- Disability pensions received before you reach the minimum retirement age set by your employer.
- Corrective distributions (including any earnings) of excess salary deferrals or excess contributions to retirement plans. The plan must advise you of the year(s) the distributions are includible in income.

Many denominational pension funds annually designate 100 percent of pension and disability benefits paid to retired ministers as a housing allowance. In such cases the 1099-R form may show that the taxable amount of the pension income is “not determined” by checking the box on line 2b. If you are a retired or disabled minister, you may exclude all or a portion of your pension or disability income from your gross income reported on line 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 rental value of the home (furnished, including utilities).

IRS Publication 517 states: “If you are a retired minister, you can exclude from your gross income the rental value of a home (plus utilities) furnished to you by your church as a part of your pay for past services, or the part of your pension that was designated as a rental allowance. However, a minister’s surviving spouse cannot exclude the rental value unless the rental value is for ministerial services he or she performs or performed.”
Key Point

Surviving spouses of deceased ministers cannot exclude any portion of the benefits received from their deceased spouse’s 403(b) account as a housing allowance.

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.

Once amounts are distributed, they are generally taxable as ordinary income unless designated in advance as a minister’s housing allowance. In addition, if amounts are distributed prior to your reaching age 59½, you will be assessed an additional tax of 10 percent of the amount which is includable in income, unless one of the following exceptions applies:

The distributions are part of a series of substantially equal periodic payments made over your life or the lives of your beneficiaries and after you separate from service.

The distributions are made after you separate from service in or after the year in which you reach age 55.

The distributions do not exceed the amount of unreimbursed medical expenses that you could deduct for the current year.

The distributions are made after your death, or after you become disabled.

The distributions are made to an alternate payee pursuant to a qualified domestic relations order.

The additional tax is computed on Form 5329.

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 in 2014, you need to know whether or not these benefits are taxable. Here are several rules the IRS has formulated to assist Social Security beneficiaries in knowing if their benefits are taxable:

1) How much, if any, of your Social Security benefits are taxable depends on your total income and marital status.
2) Generally, if Social Security benefits were your only income for 2014, your benefits are not taxable and you probably do not need to file a federal income tax return.
3) If you received income from other sources, your benefits will not be taxed unless your modified adjusted gross income is more than the base amount for your filing status.
4) Your taxable benefits and modified adjusted gross income are computed on a worksheet in the instructions to Form 1040A and Form 1040.
5) You can do the following quick computation to determine whether some of your benefits may be taxable:
   First, add one-half of the total Social Security benefits you received to all your other income, including any tax exempt interest and other exclusions from income.
   Then, compare this total to the "base amount" for your filing status. If the total is more than your base amount, some of your benefits may be taxable.

6) The 2014 base amounts are:
   $32,000 for married couples filing jointly
   $25,000 for single, head of household, qualifying widow/widower with a dependent child, or married individuals filing separately who did not live with their spouses at any time during the year
   $0 for married persons filing separately who lived together during the year

7) For additional information on the taxability of Social Security benefits, see IRS Publication 915, Social Security and Equivalent Railroad Retirement Benefits. Publication 915 is available at IRS.gov.

While the Social Security Administration has never officially addressed the issue, it is likely that a minister’s housing allowance counts as earnings for purposes of the annual earnings test.

**Line 21. Other income: list the 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 write a brief explanation in the space provided next to line 21. This will help to avoid confusion.*

Complete this line only if you have other income. This includes the following items:

- A canceled debt or a debt paid for you by another person (unless the person who canceled or paid your debt intended it to be a gift)

- The fair market value of a free tour you receive from a travel agency for organizing a group of tourists (in some cases this may be reported on Schedule C)

- Most prizes and awards

- Taxable distributions from a health savings account (HSA) or Archer MSA

**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 37 of Form 1040. The most relevant adjustments to ministers
are summarized below.

**Line 26. Moving expenses**

If your “allowable moving expenses” are not reimbursed by your employer, or they are reimbursed under a nonaccountable plan, you compute your moving expense deduction on Form 3903 and report your deduction on line 26. 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 three conditions:

1) Your new job location is at least 50 miles farther from your former home than your old job location was. For 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) If you report your income taxes as an employee, 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.

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 must have a business connection—that is, you must have paid or incurred deductible expenses while performing services as an employee of your employer; (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. See IRS Publication 521 for details.

If for all reimbursements you meet the three rules for an accountable plan (listed earlier), your employer should *not* include any reimbursements of expenses in your income in box 1 of your Form W-2. Instead, your employer should include the reimbursements in box 12 (code P) of your Form W-2.

An employer’s reimbursements of an employee’s moving expenses under an arrangement that does not meet the three requirements of an accountable plan must be reported as wages in box 1 of the employee’s Form W-2.

**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 (1) the cost of storing and insuring household goods and personal effects for all or part of the time the new job location remains your main job location; and (2) reasonable expenses of moving your personal effects to and from storage.

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; 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; 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. One-half of self-employment tax

Key Point

Every minister who pays Social Security taxes on ministerial income qualifies for this deduction. Some are not claiming it.

All ministers are self-employed for Social Security with respect to their ministerial income. They can deduct half of their actual self-employment taxes as an adjustment on line 27 of Form 1040, whether or not they are able to itemize deductions on Schedule A.

Line 32. Payments to an individual retirement account (IRA)

An individual retirement arrangement, or IRA, is a personal savings plan which allows you to set aside money for retirement, while offering you tax advantages. You can set up different kinds of IRAs with a variety of organizations, such as a bank or other financial institution, a mutual fund, or a life insurance company.

The original IRA is referred to as a "traditional IRA." A traditional IRA is any IRA that is not a Roth IRA or a SIMPLE IRA. You may be able to deduct some or all of your contributions to a traditional IRA. You may also be eligible for a tax credit equal to a percentage of your contribution. Amounts in your traditional IRA, including earnings, generally are not taxed until distributed to you. IRAs cannot be owned jointly. However, any amounts remaining in your IRA upon your death can be paid to your beneficiary or beneficiaries.

To contribute to a traditional IRA, you must be under age 70½ at the end of the tax year. You, or your spouse if you file a joint return, must have taxable compensation, such as wages, salaries, commissions, tips, bonuses, or net income from self-employment. Compensation does not include earnings and profits from property, such as rental income, interest and dividend income, or any amount received as pension or annuity income, or as deferred compensation.

For 2014, 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)
$5,500 ($6,500 if you are age 50 or older), or (2) the total compensation includible in the gross income of both you and your spouse for the year, reduced by your spouse’s IRA contribution for the year to a traditional IRA and any contributions for the year to a Roth IRA on behalf of your spouse.

**New in 2015.** The maximum annual dollar contribution limit for IRA contributions is $5,500 for 2015. Also, the contribution limit for an individual who has attained age 50 before the end of the taxable year increases by $1,000.

All IRA contributions must be made by the due date of your tax return, not including extensions. This means that your 2014 IRA contribution must be made by April 15, 2015, 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 2014 and you made IRA contributions, your allowable IRA deduction may be less than your contributions. Even if your spouse is covered by an employer-sponsored retirement plan, you may be able to deduct part or all of your contributions to an IRA for 2014 if you were not covered by an employer plan and your adjusted gross income was less than $191,000 ($193,000 for 2015).

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 W-2 form 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 403(b) tax-sheltered annuities.

Figure your deduction using the worksheets in the instructions to Form 1040 or in Publication 590.

Individuals who cannot claim a deduction for an IRA contribution still can make nondeductible IRA contributions, subject to the lesser of $5,500 for 2014 or earned income limits. Earnings on these amounts continue to accumulate on a tax-deferred basis. When distributions are made from the IRA, special rules apply in figuring the tax on the distributions when both deductible and nondeductible contributions were made to the IRA. Form 8606 is used to designate a contribution as nondeductible and must be filed or the full amount of future withdrawals may be taxed. Withdrawals before age 59½ are subject to a 10 percent penalty tax that also applies to deductible IRA contributions.

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

Distributions made prior to age 59½ may be subject to a 10 percent additional tax. You also may owe an excise tax if you do not begin to withdraw minimum distributions by April 1st of the year after you reach age 70½.

A Roth IRA differs from a traditional IRA in several respects. A Roth IRA does not permit a deduction at the time of contribution. Regardless of your age, you may be able to establish and make nondeductible contributions to a Roth IRA. You do not report Roth contributions on your tax return. To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is set up. Like a traditional IRA, a Roth IRA can be set up but there are limitations on the amount that can be contributed and the time of year that contributions can be made. You do not include in your gross income qualified distributions or
distributions that are a return of your regular contributions from your Roth IRA. Refer to Publication 590 for additional information on Roth IRA(s).

For information on conversions from a traditional IRA to a Roth IRA, refer to Publication 590. No further contributions to a traditional IRA are permissible in the year you reach age 70½ or for any later year, and distributions from a traditional IRA must generally begin by April 1 of the year following the year in which you reach age 70½. However, you must receive at least a minimum amount for each year starting with the year you reach age 70½ (your "70½ year"). If you do not (or did not) receive that minimum amount in your 70½ year, then you must receive distributions for your 70½ year by April 1 of the next year. This means that you will have two required distributions in that year.

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

- Taxpayers can make early withdrawals from an IRA to pay for qualified higher education expenses of the taxpayer or the taxpayer’s spouse, or the taxpayer's or spouse's child, grandchild, parent or other ancestor—without triggering the 10 percent penalty that applies to early distributions from an IRA.

- Taxpayers can withdraw up to $10,000 from their IRA prior to age 59½ for first-time homebuyer expenses without triggering the 10 percent penalty that applies to premature distributions.

- Qualified charitable distributions of up to $100,000 could be made from an IRA to a church or other charity in 2013. A qualified charitable distribution was any distribution from an IRA directly by the IRA trustee to a charitable organization, including a church, that was made on or after the date the IRA owner attains age 70½. Unless extended by Congress, this provision is not available in 2014 or future years.

  **Example.** A church has a senior pastor who is 52 years old, and a youth pastor who is 30 years old. The church does not participate in a retirement program for its staff. In 2015 the senior pastor can contribute $6,500 to an IRA (maximum annual contribution of $5,500 plus a “catch-up” contribution of $1,000), and the youth pastor can contribute $5,500.

**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 or standard deduction**

**Key Point**

*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 in this guide. For 2014, the standard deduction amounts are as follows:
**Filing Status**

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Standard Deduction Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>single</td>
<td>$6,200</td>
</tr>
<tr>
<td>married filing jointly or qualifying widow(er)</td>
<td>$12,400</td>
</tr>
<tr>
<td>married filing separately</td>
<td>$6,200</td>
</tr>
<tr>
<td>head of household</td>
<td>$9,100</td>
</tr>
</tbody>
</table>

**Line 42. Personal exemptions**

For 2014, the personal exemption amount is $3,950. Multiply this amount times the number of exemptions claimed on line 6 and enter the total on line 42.

**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 49. 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 51. Retirement Savings Contributions Credit (“Saver’s Credit”)**

If you make eligible contributions to certain eligible retirement plans or to an individual retirement arrangement (IRA), you may be able to take a tax credit. The amount of the saver's credit you can get is generally based on the contributions you make and your credit rate. Refer to Publication 590 or the instructions for Form 8880 for more information. If you are eligible for the credit, your credit rate can be as low as 10 percent or as high as 50 percent, depending on your adjusted gross income. The lower your income, the higher the credit rate; your credit rate also depends on your filing status. These two factors will determine the maximum credit you may be allowed to take. You are not eligible for the credit if your adjusted gross income exceeds a certain amount.

The credit is available with respect to elective deferrals to a 401(k) plan, a 403(b) annuity, a SIMPLE or a simplified employee pension (SEP), contributions to a traditional or Roth IRA, and voluntary after-tax employee contributions to a 403(b) annuity or qualified retirement plan. The amount of the credit for 2014 is described in the following table.

<table>
<thead>
<tr>
<th>ADJUSTED GROSS INCOME</th>
<th>joint returns</th>
<th>heads of household</th>
<th>single filers</th>
<th>amount of credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1-36,000</td>
<td>$1-27,000</td>
<td>$1-18,000</td>
<td>$1-18,000</td>
<td>50% of eligible contributions up to $2,000 ($1,000 maximum credit)</td>
</tr>
<tr>
<td>$36,001-39,000</td>
<td>$27,001-29,250</td>
<td>$18,001-19,500</td>
<td>$18,001-19,500</td>
<td>20% of eligible contributions up to $2,000 ($400 maximum credit)</td>
</tr>
</tbody>
</table>
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.

**Line 52. Child tax credit**

An individual may claim a tax credit for each qualifying child under the age of 17 at the end of 2014. 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. A qualifying child is (1) a son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them for example, your grandchild, niece, or nephew; (2) who was under age 17 at the end of 2014; (3) did not provide over half of his or her own support for 2014; (4) lived with you for more than half of 2014; (5) is claimed as a dependent on your return; (6) does not file a joint return for the year; and (7) was a U.S. citizen, a U.S. national, or a U.S. resident alien.

You must reduce your child tax credit if either of the following exceptions applies:

1. The amount on Form 1040, line 46; Form 1040A, line 28; or Form 1040NR, line 44, is less than the credit. If this amount is zero, you cannot take this credit because there is no tax to reduce. But you may be able to take the additional child tax credit.

2. Your modified adjusted gross income (AGI) is above the following amounts:

   Married filing jointly – $110,000.

   Single, head of household, or qualifying widow(er) – $75,000.

   Married filing separately – $55,000.

For most taxpayers, modified AGI is generally the same as AGI. But see IRS Publication 972 for exceptions.

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 you can work.

An "additional child tax credit" exists for certain individuals who get less than the full amount of the child tax credit. The additional child tax credit may give you a refund even if you do not owe any tax. A worksheet in IRS Publication 972 will assist you in determining your eligibility for the additional child tax credit.

**Step 9: Other taxes**

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

**Line 57. Self-employment tax: attach Schedule SE (also see line 27)**
Key Point

All ordained 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 57 of Form 1040.

Step 10: Payments

Line 64. Federal income tax withheld
Ordained 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 64. 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 with respect to ministerial compensation. 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. They constitute a credit that can be applied to both income taxes and self-employment taxes. Ministers still must complete Schedule SE to report their self-employment tax liability.

Line 65. 2014 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 in Part 2 of this guide in the section “How do ministers pay their taxes?” The total amount of estimated tax payments made to the IRS is reported as a payment of taxes on line 65.

Line 66. Earned income credit
The earned income credit reduces tax you owe and may give you a refund even if you do not owe any tax. A number of technical requirements must be met in order to qualify for this credit. Unfortunately, many taxpayers who qualify for the earned income credit do not claim it because it is so difficult to compute. In most cases, the amount of your earned income credit depends on: (1) whether you have no qualifying child, one qualifying child, two qualifying children, or three or more qualifying children; and (2) the amount of your earned income and modified adjusted gross income.

You may be able to claim the earned income credit for 2014 if (1) you do not have a qualifying child and you earned less than $14,590 ($20,020 if married); (2) a qualifying child lived with you and you earned less than $38,511 ($43,941 if married filing jointly); (3) two qualifying children lived with you and you earned less than $43,756 ($49,186 if married filing jointly); or (4) three or more qualifying children lived with you and you earned less than $46,997 ($52,427 if married filing jointly).
The maximum earned income credit for 2014 is (1) $496 with no qualifying child; (2) $3,305 with one qualifying child; (3) $5,460 with two qualifying children; and (4) $6,143 with three or more qualifying children.

You can compute the credit yourself or the IRS will compute it for you. To figure the amount of your earned income credit, you must use the EIC Worksheet and EIC Table in the instructions for Form 1040, line 66a. 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.

**Key Point**

*The instructions to Form 1040, line 66, state that a housing allowance, or fair rental value of a parsonage, are 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 parsonage 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.*

**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 in the amount you owe 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 2014 on the check. You also may have to pay an underpayment penalty (refer to line 79 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 2015 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—*minister.*

**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 10 percent of your adjusted gross income. You must reduce your medical expenses by the amounts of any reimbursements you receive for those expenses before applying the 10 percent test. Reimbursements include amounts you receive from insurance or other sources for your medical expenses (including Medicare). It does not matter if the reimbursement is paid to the patient, the doctor, or the hospital.
**Key point.** If either you or your spouse is age 65 or older, the medical expense deduction is allowed for expenses exceeding 7.5 percent of AGI. If you are claiming the 7.5 percent threshold amount for medical and dental expenses, make sure you check the appropriate box(es) on line 39a of Form 1040 for your situation.

The following expenses ARE deductible as medical expenses:

- Fees for medical services
- Fees for hospital services
- Meals and lodging at 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 (or are deducted from your pension)
- Long-term care insurance premiums, subject to certain limitations on the amount that may be deducted
- Special items (false teeth, artificial limbs, eyeglasses, hearing aids, crutches, etc.)
- Transportation for necessary medical care. For 2014, the standard mileage rate for medical travel was 23.5 cents per mile
- Medicines and drugs requiring a prescription, and insulin
- The portion of a life-care fee or founder’s fee paid either monthly or in a lump sum under an agreement with a retirement home that is allocable to medical care
- Wages of an attendant who provides medical care
- The cost of home improvements if the main reason is for medical care
- Program to stop smoking
- Exercise expenses (including the cost of equipment to use in the home) if required to treat an illness (including obesity) diagnosed by a physician, and the purpose of the expense is to treat a disease rather than to promote general health and the taxpayer would not have paid the expense but for this purpose

The following items are NOT deductible as medical expenses:

- Funeral services
- Health club dues (except as noted above)
Step 2: Taxes you paid (lines 5-9)

Generally, real estate, state and local income, and personal property taxes actually paid during 2014 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.

Congress enacted legislation in 2004 that provided an itemized deduction for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes. Taxpayers could deduct the total amount of general state and local sales taxes paid by accumulating receipts showing general sales taxes paid, or they could use tables created by the IRS. This provision was adopted to address the unequal treatment of taxpayers in the nine states that have no income tax. Taxpayers in these states could not take advantage of the itemized deduction for state income taxes. Allowing them to deduct sales taxes helped offset this disadvantage.

This deduction expired at the end of 2013 and will not be available for 2014 or future years unless extended by Congress.

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 2014 ($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 2014 ($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 cate-
The term “points” is sometimes used to describe certain charges paid by a borrower. They are also called loan origination fees, maximum loan charges, or premium charges. If the payment of any of these charges is only for the use of money, it ordinarily is interest paid in advance and must be deducted in installments over the life of the mortgage (not deducted in full in the year of payment). However, points are deductible in the year paid if the following requirements are satisfied: (1) your loan is secured by your main home; (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 other public charities are deductible up to 50 percent of adjusted gross income. Contributions of property are subject to different limitations. See IRS Publication 526. Contributions of cash or checks are reported on line 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 2014 and 2015). Unreimbursed travel expenses incurred while away from home (whether within the United States or abroad) in the course of donated services to a tax-exempt religious or charitable organization are deductible as a charitable contribution. There are two ways to do this.

Individuals performing the charitable travel can keep track of their own travel expenses and then claim a charitable contribution for the total on Schedule A. 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. Pastor J goes on a trip to Europe. She is in Europe for 10 days and conducts one-hour services on two of those days. Pastor J will not be able to claim a charitable contribution deduction for the travel expenses that she incurs in making this trip. The same rule would apply if Pastor J’s spouse or children go along on the trip.**
Charitable contributions must be claimed in the year they are delivered. One exception is a check that is mailed to a charity—it is deductible in the year the check is mailed (and postmarked), even if it is received early in the next year.

Charitable contributions generally are deductible only to the extent they exceed the value of any premium or benefit received by the donor in return for the contribution.

There are limits on the amount of a contribution that can be deducted. Generally, cash contributions to churches, schools, and other public charities are deductible up to a maximum of 50 percent 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 percent or 30 percent 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. Individual cash contributions of less than $250 may be substantiated by a canceled check or a receipt from the charity. Special rules govern the substantiation of individual contributions of cash or property of $250 or more. These rules are explained in the supplement to this guide entitled Federal Reporting Requirements for Churches.

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**

_The Tax Court ruled that a donor who contributed property worth more than $10,000 to a church was not eligible for a charitable contribution deduction, even though there was no dispute as to the value of the property, because he failed to attach a qualified appraisal summary (Form 8283) to the tax return on which the contribution was claimed._

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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 percent of the amount on Form 1040, line 38.

The 10 percent 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 non-business casualty and theft losses on Form 4684, and report them on Schedule A as an itemized deduction.

Key point. Losses that do not qualify for a casualty loss deduction include money or property misplaced or lost; breakage of china, glassware, furniture, and similar items under normal conditions; progressive damage to property (buildings, clothes, trees, etc.) caused by termites, moths, other insects, or disease.

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 two percent of adjusted gross income. Miscellaneous expenses subject to the two percent floor include:

- Unreimbursed and nonaccountable reimbursed employee business expenses (discussed more fully below)
- Professional society dues
- Safety deposit box rental
- Employee educational expenses
- Tax preparation fees
- Home office used regularly and exclusively for work
Tools and supplies used in your work
Expenses of looking for a new job
Investment counsel fees
Professional books and periodicals
Investment expenses
50 percent of unreimbursed business meals and entertainment
IRA custodial fees

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

**Employee business expenses**

**Key Point**

*Most ministers incur business expenses. How these expenses are handled, by both the minister and the church, significantly impacts whether (and to what extent) they are deductible.*

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

**Local transportation expenses**

These expenses include the cost of transportation by air, rail, bus, taxi, etc. and the cost of driving and maintaining your car. Transportation expenses include:

- the ordinary and necessary costs of getting from one workplace to another in the course of your ministry when you are traveling within the city or general area of your home.
- visiting church members.
- going to business meetings away from your regular workplace.

Transportation expenses do not include expenses you incur in traveling away from home overnight. Those expenses are travel expenses (see below).

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. If you have an office in your home (see below) that you use as your principal place of business for your church, you may deduct the cost of traveling between your home office and work places associated with your employment.

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 ac-
tual expense method is very complex and is explained fully in IRS Publication 463.

The standard business mileage rate for 2014 was 56 cents per mile. The standard business mileage rate is 57.5 cents per mile for 2015.

**Key Point**

*The standard business mileage rate for 2015 is 57.5 cents per mile.*

Ministers should consider the advantages of using a church-owned car for their business travel. This will eliminate most record-keeping and reporting requirements. Some conditions apply. See the illustration at the end of this guide for a summary of the various tax options pertaining to business use of a car.

**Travel expenses**

Travel expenses are the ordinary and necessary expenses of traveling away from your “tax home” (your regular place of business) on ministry-related business. You are traveling away from home if your duties require you to be away from the general area of your tax home substantially longer than an ordinary day’s work, and you need to sleep or rest to meet the demands of your work while away from home.

*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
- Cleaning and laundry expenses
- Telephone 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 primarily 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.

One way for the *unreimbursed* travel expenses of a non-employee spouse to be deductible would be if the spouse performed substantial church-related activities during the trip. Under these circumstances, the spouse’s unreimbursed travel expenses may qualify for a charitable contribution deduction.

**Entertainment expenses**

You may be able to deduct entertainment expenses you incur for your ministry. You may take the de-
duction 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) the main purpose of the entertainment was the transaction of business; (2) you did engage in business during the entertainment period; and (3) you had more than a general expectation of deriving income or some other specific business benefit at some indefinite future time.

**Associated entertainment.** To show that entertainment was associated with the active conduct of your ministry, you must be able to demonstrate that you had a clear business purpose in incurring the expense, and that 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 expenses 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, the deacons, etc.), or meeting with members at a restaurant for counseling purposes.

**Key Point**

You may deduct only 50 percent of your business-related entertainment expenses, including meals. This 50 percent 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 (described elsewhere in this guide).

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.

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

**Example.** Pastor S invites the members of the church board to his home for dinner and a meeting. The expenses incurred by Pastor S and his guests for food and beverages ordinarily will constitute entertainment expenses.

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

**Example.** Pastor K is the head of staff of his church. He takes a prospect for a ministerial staff position out to dinner, where they discuss the person’s background and suitability for the position.
person’s spouse comes along because it would be impractical to discuss the position solely with the prospect. Further, Pastor K’s spouse accompanies her husband because the other spouse is present. Pastor K pays everyone’s meal expense. The cost of the meals of all four people is an entertainment expense. This result is based on the following example in IRS Publication 463: "You entertain a customer. The cost is an ordinary and necessary business expense and is allowed under the entertainment rules. The customer's spouse joins you because it is impractical to entertain the customer without the spouse. You can deduct the cost of entertaining the customer's spouse. If your spouse joins the party because the customer's spouse is present, the cost of the entertainment for your spouse is also deductible."

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 First Church takes a class 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.

Employer-paid educational expenses are excludable from the gross income and wages of an employee if provided under an educational assistance program. Employees are limited to an exclusion of up to $5,250 of the benefits they receive during a calendar year. This exclusion applies to both income tax and Social Security tax.

An educational assistance program in the context of church employers is a separate written plan of an employer for the exclusive benefit of its employees to give them educational assistance; that does not have eligibility requirements that discriminate in favor of officers or highly compensated employees or their dependents; that does not provide eligible employees with a choice between educational assistance and cash; and that provides for reasonable notification of the availability and the terms of the program to eligible employees.

Subscriptions and books

Ministers often purchase books and subscribe to journals and other periodicals that are directly relevant to the performance of their professional duties. The income tax regulations specify that “a professional man may claim as deductions the cost of . . . subscriptions to professional journals [and] amounts currently paid for books . . . the useful life of which is short.”
The cost of a subscription will be deductible as a business expense if it is related to the conduct of a minister’s trade or business. Professional clergy journals and specialized clergy periodicals clearly satisfy this test. News magazines may also qualify if a minister can demonstrate that the information contained in such periodicals is related to his or her ministry (e.g., 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 one’s ministry is a business expense. The same is true for the cost of books reimbursed by the church under a nonaccountable arrangement. Deduct the cost of any book that you acquired for use in your ministry and that has a useful life (not the same as its physical life) of less than one year. For example, the cost of a book that you purchase and read, but have no intention of using again, can be deducted in full in the year of purchase.

The unreimbursed cost of commentaries or theological dictionaries and encyclopedias that are acquired for extended reference use also may be deducted fully in the year of purchase. Alternatively, ministers can allocate the purchase price of reference books to their useful life by means of annual depreciation deductions. The depreciation deduction is computed using the Modified Accelerated Cost Recovery System (MACRS) method. See IRS Publication 946 for details.

**Personal computers**

Church employees who purchase a computer that is used for business as well as personal use may be entitled to deduct the cost of the computer in the year of purchase or claim an annual depreciation deduction over the useful life of the computer. However, note that personal computers are “listed property” and, as a result, are subject to strict substantiation requirements regarding business use. Here are the rules that apply:

You can claim a deduction for the entire purchase price in the year of purchase (you do not need to depreciate the computer). The price must be reduced by the percentage of use that is personal as opposed to business related. This is the option used by most ministers because of its simplicity.

Alternatively, you can claim a depreciation deduction for the cost of a computer that you use in your work as an employee if its use is:

- For the convenience of your employer, and
- Required as a condition of your employment

*For the convenience of your employer* means that you can clearly 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. Further, you must prove that the computers available at your place of employment are insufficient to enable you to properly perform your job. Obviously, this is a difficult test to satisfy.

*Required as a condition of your employment* means that you must not be able to properly perform your duties 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.

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 percent of the time during the year in your work.
Example. You occasionally take work home at night rather than work late at the office. You own and use a computer that is similar to the one you use at the office to complete your work at home. Since your use of the computer is not for the convenience of your employer and is not required as a condition of your employment, you cannot claim a depreciation deduction for it.

The depreciation method you use depends on whether you meet the more-than-50 percent-use test. You meet this test if you use the computer more than 50 percent in your work. If you meet this test, you may be able to take the *section 179 deduction* for the year you place the item in service. This means that you can deduct in the year of purchase the portion of the purchase price that corresponds to the percentage of business use. If you do not meet the more-than-50 percent-use test, you are limited to the straight line method of depreciation and you cannot claim the section 179 deduction for the cost of the computer in the year of purchase. The more-than-50 percent-use test does not apply to a computer used only in a part of your home that meets the requirements of a home office. You may be able to take a section 179 deduction for the year you place the computer in service.

Your use of a computer in connection with investments does not count as use in your work. However, you can combine your investment use with your work use in figuring your depreciation deduction.

For more information on depreciation and the section 179 deduction for computers and other items used in a home office, see Publication 946.

You must keep records to prove your percentage of business and investment use.

**Cell phones**

The value of an employer-provided cell phone, provided primarily for noncompensatory business reasons, is excludable from an employee’s income as a working condition fringe benefit. *Personal use* of an employer-provided cell phone, provided primarily for noncompensatory business reasons, is excludable from an employee’s income as a de minimis fringe benefit. You provide a cell phone primarily for noncompensatory business purposes if there are substantial business reasons for providing the cell phone. Examples of substantial business reasons include the employer’s need to contact the employee at all times for work-related emergencies. However, you cannot exclude from an employee’s wages the value of a cell phone provided as a means of providing additional compensation to an employee.

**Office in the home**

The IRS audit guidelines for ministers instruct IRS agents to take the position that a minister who excludes all of his or her housing expenses as a housing allowance exclusion has, in effect, already deducted all of the expenses associated with an office in the home and should not be able to claim any additional deduction of these expenses as an itemized (home office) deduction on Schedule A.

**How to report employee business expenses**

The deductibility of your business expenses depends on whether you are an employee or self-employed, whether or not the expenses are reimbursed by the church, and whether any reimbursed expenses are paid under an accountable or a nonaccountable reimbursement plan. 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 later (under the section on Schedule C).

The business expenses of ministers who are employees for federal income tax reporting purposes (this includes most ministers as explained earlier) can be handled in any of the following three ways:
Method 1: Accountable reimbursed expenses
The best way for ministers to handle business expenses is to have their employing church adopt an accountable business expense reimbursement arrangement. To be an accountable plan, your employer’s reimbursement or allowance arrangement must include all of the following four rules:

1. Your expenses must have a business connection—that is, you must have paid or incurred deductible expenses while performing services as an employee of your employer.

2. You must adequately account to your employer for these expenses within a reasonable period of time (generally, within 60 days after they are paid or incurred).

3. You must return any excess reimbursement or allowance within a reasonable period of time (generally, within 120 days after the expense was paid or incurred). An excess reimbursement or allowance is any amount you are paid that is more than the business-related expenses that you adequately accounted for to your employer.

4. Business expense reimbursements must be paid for by the employer, and cannot be funded out of an employee's salary (for example, through salary reductions).

Reimbursements of business expenses under such an arrangement are not reported as taxable income on a 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:

   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. For most business expenses, 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.

Example. Pastor R is senior minister at First Church. 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, Pastor R is not required to account for such expenses by providing the church treasurer with receipts documenting the amount, time and place, business purpose (and, for entertainment expenses, the business relationship) of each expense. Pastor R simply informs the treasurer at the end of each month of the total expenses incurred during that month. Assume further that Pastor R cannot itemize deductions on Schedule A (he does not have sufficient deductions). If Pastor R received reimbursements of $4,000 in 2014: (1) the church would report the entire reimbursements ($4,000) as income on Pastor R’s W-2, and Pastor R would report them as income (salary) on his Form 1040; and (2) Pastor R 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 Pastor R’s business expense reimbursements are includable in his income for tax purposes, but he cannot offset any of this income by deducting his business expenses. Even if Pastor R could itemize deductions, his nonaccountable reimbursed expenses would be treated just like unreimbursed expenses—they are deductible only as miscellaneous itemized deductions, and only to the extent that they (along with most other miscellaneous expenses) exceed two percent of his adjusted gross income. 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 Pastor R neglect to report
the reimbursements as taxable income, the reimbursements become an “automatic excess benefit” that may trigger costly penalties against Pastor R (assuming he is an officer or director, or the relative of one) and possibly members of the church board.

Example. Same facts as the previous example, except that the church adopts a reimbursement plan that meets the requirements of an accountable plan, and Pastor R is reimbursed for $4,000 of substantiated expenses. Under these facts, the church would not report the $4,000 of reimbursements as income on Pastor R’s Form W-2, and Pastor R would not have to report the reimbursements or claim the expenses on his Form 1040. Further, the excess benefit penalties would be avoided.

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 plan of an employer. Stricter substantiation rules apply to transportation, travel, and entertainment expenses.

Method 2: Nonaccountable reimbursed expenses

**Key Point**

Ministers who are employees for income tax reporting purposes deduct any business expenses reimbursed by their church under a nonaccountable reimbursement plan on Schedule A if they are able to itemize and only to the extent that such expenses exceed two percent of adjusted gross income. The full amount of the church’s reimbursements must be included in the minister’s income whether or not the expenses are deductible. A church has a nonaccountable plan if it reimburses ministers (or other employees) for business expenses without requiring adequate substantiation of the amount, date, place, and business purpose of the expenses, or not requiring excess reimbursements to be returned to the church.

A nonaccountable plan is a reimbursement arrangement that does not meet one or more of the four rules listed earlier under Method 1. In addition, even if your employer has an accountable plan, the following payments will be treated as being paid under a nonaccountable plan:

- Excess reimbursements you fail to return to your employer, and
- Reimbursement of nondeductible expenses related to your employer’s business.

An arrangement that repays you for business expenses by reducing the amount reported as your wages, salary, or other pay will be treated as a nonaccountable plan. This is because you are entitled to receive the full amount of your pay whether or not you have any business expenses.

It is common for churches to reimburse a minister’s business expenses without requiring any substantiation of actual expenses or a return of reimbursements in excess of substantiated expenses (for example, excess reimbursements). The most common example is the monthly car allowance. Many churches pay their minister a monthly allowance to cover business use of an automobile, without requiring any substantiation of actual expenses or a return of the amount by which the allowances exceed actual expenses. Such a reimbursement arrangement is called nonaccountable since the minister is not required to account
for (substantiate) the actual amount, date, place, and business purpose of each reimbursed expense. Another common example would be a church that reimburses expenses that are claimed by a minister without adequate substantiation.

For ministers who are employees, the full amount of the church’s reimbursements or allowances must be reported as income on the minister’s Form W-2 (and 1040). The minister can deduct actual expenses only as a miscellaneous itemized deduction on Schedule A to the extent these expenses exceed two percent of adjusted gross income. The church’s reimbursements are fully reported as income to the minister who in many cases is unable to claim any deduction because of insufficient itemized expenses to use Schedule A.

*Caution.* Nonaccountable expense reimbursements of a "disqualified person" that are not reported as taxable income by the recipient or employer are classified as “automatic excess benefits” by the IRS, triggering the imposition of substantial excise taxes (called “intermediate sanctions”) of up to 225 percent of the amount of the excess benefit. Disqualified persons include officers or directors, including any minister who is an officer or director, and their relatives, This penalty then pertains to most senior or lead pastors, as well as any of their relatives, such as a youth pastor who is the senior pastor’s child. In some cases board members who approve such an arrangement may face penalties of up to $20,000 (collectively).

**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 plan. 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 IRS has advised ministers to comply with the so-called *Deason* allocation rule when computing deductions for unreimbursed business expenses as well as business expenses reimbursed by a church under a nonaccountable arrangement. This rule requires ministers to reduce their business expense deduction by the percentage of their total compensation that consists of a tax-exempt housing allowance. This rule does not apply to the computation of self-employment taxes since the housing allowance is not deductible in computing these taxes. The *Deason* rule can be avoided if a church adopts an accountable business expense reimbursement arrangement.

**Key Point**

*The IRS audit guidelines for ministers instruct agents to apply the so-called Deason allocation rule when auditing ministers.*

**Method 3: Unreimbursed expenses**

**Key Point**

*Unreimbursed expenses are expenses that are not reimbursed by the church. They may be deducted only as a miscellaneous itemized deduction on Schedule A to the extent they exceed two percent of a minister’s adjusted gross income.*
Many ministers incur unreimbursed business expenses. These are expenses that are not reimbursed by the church. Ministers who are employees for income tax reporting purposes claim their unreimbursed business expenses on Schedule A—if they are able to itemize, and only to the extent that such expenses exceed two percent of adjusted gross income.

**Key Point**

*Ministers who are employees for income tax reporting purposes cannot claim any deduction for unreimbursed employee business expenses for which an employer reimbursement was available.*

**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 2014. Be sure the interest you report on line 1 corresponds to any 1099INT forms you received from such institutions. Do not include tax-exempt interest.

**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 2014. 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**

**Key Point**

*Most ministers who serve local churches or church agencies are employees for federal income tax purposes with respect to their church salary. They report their church salary on line 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.*

**Recommendation**

*Some ministers are eligible to use the simpler Schedule C-EZ.*
Step 1: Introduction

Complete the first several questions on Schedule C. Ministers should list code 541990 on line B, since this is the code the IRS uses in a clergy tax illustration in Publication 517. Some ministers who report their church compensation as self-employed point to this code as proof that ministers serving local churches can report as self-employed. This is not so. This code applies to the incidental self-employment activities of ministers who report their church salaries as employees. It also applies to those few ministers who are self-employed, such as traveling evangelists.

Step 2: Income (lines 1-7)

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

Step 3: Expenses (lines 8-27)

Warning. Many ministers continue to report their income taxes as self-employed. One perceived advantage of doing so is the ability of the minister to fully deduct business expenses on Schedule C whether or not the minister can itemize deductions on Schedule A. This advantage is often illusory. Most ministers, if audited by the IRS, would be reclassified as employees and their Schedule C deductions disallowed. This could result in substantial additional taxes, penalties, and interest, especially if the minister is not able to itemize expenses on Schedule A. The best way for ministers to handle their business expenses is through an accountable expense reimbursement arrangement.

Report any business expenses associated with your self-employment earnings on lines 8 through 27. For example, if you incur transportation, travel or entertainment expenses in the course of performing self-employment activities, you deduct these expenses on lines 8 through 27 of Schedule C.

Since self-employed ministers list only their net self-employment earnings (that is, after deducting all business expenses) as a component of gross income on line 12 of Form 1040, they in effect are able to deduct 100 percent of their business and professional expenses even if they do not have enough itemized deductions to use Schedule A.

Self-employed persons can deduct only 50 percent of business meals and entertainment. Further, self-employed persons who use Schedule C to report their business deductions are not subject to the two percent floor that applies to the deduction of employee business and professional expenses that are either unreimbursed or reimbursed under a nonaccountable reimbursement plan. In addition, ministers who report their church income as self-employed are taxed on the value of certain fringe benefits (including employer-paid medical insurance).

Key Point

One of the reasons the audit rate is higher for self-employed taxpayers is that only 30 percent of all taxpayers have sufficient itemized expenses to use Schedule A. If the IRS can reclassify taxpayers from self-employed to employee status, it will generate more tax dollars since only 30 percent of taxpayers can itemize deductions on Schedule A. Business expenses that could have been claimed by a self-employed taxpayer on Schedule C are lost if that taxpayer is reclassified as an employee and has insufficient expenses to itemize on Schedule A.

Example. Pastor M reports her income taxes as a self-employed person. She has $4,000 of business expenses in 2014 that were not reimbursed by her church. She deducted all of them on Schedule C. She did not have enough expenses to itemize deductions on Schedule A. Pastor M is later audited by the IRS,
and she is reclassified as an employee. She will not be able to deduct any of the $4,000 of business expenses since they are deductible, by an employee, only as an itemized deduction on Schedule A. Further, Pastor M will have to pay interest and possibly penalties in addition to the additional taxes.

**Schedule C-EZ**

The IRS has released a simpler form of Schedule C that can be used by some people with self-employment earnings. The new Schedule C-EZ can be used instead of Schedule C if you meet all of these requirements:

- You had business expenses associated with your trade or business of $5,000 or less in 2014.
- You use the cash rather than the accrual method of accounting.
- You did not have an inventory at any time during the year.
- You did not have a net loss from your trade or business.
- You had only one business as a sole proprietor.
- You had no employees.
- You do not use Form 4562 to compute a depreciation deduction with regard to your trade or business.
- You do not claim a deduction for the business use of your home.

Many ministers who report their church compensation as employees will be able to use this form to report small amounts of self-employment earnings they receive during the course of a year as honoraria for occasional guest speaking appearances or as fees received directly from church members for services rendered on their behalf (for example, marriages and funerals).

**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**

*Ministers who have received IRS approval of an application for exemption from self-employment taxes (Form 4361) do not pay any Social Security taxes on compensation received for their ministerial services. They do not use Schedule SE.*

**Step 1: Section A (line 2)**

Most ministers use the short Schedule SE rather than the long Schedule SE. This means that they complete section A on page 1 of the schedule rather than Section B on page 2.

Ministers report their net self-employment earnings on line 2 of Section A. This amount is computed as
follows:

Add the following to the church salary:

- other items of church income (including taxable fringe benefits)
- fees you receive for marriages, baptisms, funerals, masses, etc.
- self-employment earnings from outside businesses
- annual rental value of a parsonage, including utilities paid by church (unless you are retired)
- a housing allowance (unless you are retired)
- business expense reimbursements (under a nonaccountable plan)
- the value of meals served on the church’s premises for the convenience of the employer
- any amount a church pays toward your income tax or self-employment tax

And then deduct the following:

- most income tax exclusions other than meals or lodging furnished for the employer’s convenience, and the foreign earned income exclusion
- annual fair rental value of a parsonage provided to you after you retire
- housing allowance provided to you after you retire
- contributions by your church to a tax-sheltered annuity plan set up for you, including any salary reduction contributions (elective deferrals) that are not included in your gross income
- pension payments or retirement allowances you receive for your past ministerial services
- net self-employment earnings (without regard to this deduction) multiplied by 7.65 percent

Unreimbursed, and nonaccountable reimbursed, expenses. The clear implication of the tax code and IRS Revenue Ruling 80-110 is that unreimbursed business expenses, and reimbursed business expenses under a nonaccountable plan, are deductible by pastors in computing their self-employment tax liability even if they are not able to deduct these expenses in computing their income tax liability because they do not have enough itemized expenses to use Schedule A. This understanding is clearly reflected in IRS Publication 517.

However, this understanding is contradicted by the following statement in the instructions to Schedule SE: “If you were a duly ordained minister who was an employee of a church and you must pay SE tax, the unreimbursed business expenses that you incurred as a church employee are allowed only as an itemized deduction for income tax purposes.” This statement implies that unreimbursed employee business expenses are never deductible in computing net earnings from SE, regardless of whether they can be claimed as itemized deductions on Schedule A. This statement is clearly wrong, since section 1402 says that self-employed persons can reduce self-employment earnings in computing their self-employment tax liability by “the deductions attributable to the trade or business.” This clearly includes unreimbursed business expenses.

Because of the confusion caused by the instructions to Schedule SE, ministers should consult with a tax professional before claiming unreimbursed expenses and nonaccountable reimbursed expenses as deductions in computing self-employment tax liability on Schedule SE.
Step 2: Section A (line 4)
Ministers (and other taxpayers who are self-employed for Social Security) can reduce their taxable earnings by 7.65 percent, which is half the Social Security and Medicare tax paid by employers and employees. To do this, multiply net earnings from self-employment times 0.9235 on line 4. Self-employment taxes are paid on the reduced amount.

Step 3: Section A (line 5)
The self-employment tax for 2014 is computed on this line. The self-employment tax rate for 2014 is 15.3 percent, which consists of the following two components:

(1) a Medicare hospital insurance tax of 2.9 percent, and

(2) an old-age, survivor and disability (Social Security) tax of 12.4 percent.

For 2014, the 2.9 percent Medicare tax applied to all net earnings from self-employment regardless of amount. The 12.4 percent Social Security tax applied to only the first $117,000 of net self-employment earnings.

Form 2106

Key Point
Use Form 2106 to compute your employee business expenses claimed on Schedule A.

Step 1: Enter your expenses
On lines 1 through 6, you report your employee business expenses. For most ministers, the most significant employee business expense is the business use of a car. This expense is computed on Part II (side 2) of Form 2106 and then reported on line 1 of Part I. Ministers may use the actual expense method of computing their car expenses, or the standard mileage rate. Most ministers elect the standard mileage rate. Under this method, substantiated business miles are multiplied times the current standard mileage rate (56 cents per mile for business miles driven during 2014). You compute your vehicle expenses using the standard mileage rate in Section B of Part II (line 22).

Key Point
The business standard mileage rate for 2015 is 57.5 cents per mile.

Those ministers using the actual expense method compute their car expenses in Section C of Part II. Some restrictions apply to use of the standard mileage rate. First, you must maintain adequate records to substantiate your business miles, and second, you must use the standard mileage rate for the first year you began using your car for business purposes.

On line 3, you report your travel expenses incurred while away from home overnight on business. This would include travel to other cities to perform weddings or funerals, or trips to denominational meetings. Do not include meals and entertainment on line 3 (these items are reported separately on line 5). On line 4, report business expenses other than local transportation, overnight travel, and meals and entertainment. This would include education, publications, and the other kinds of business expenses discussed previously in this guide.
Step 2: Enter amounts your employer gave you for expenses listed in Step 1
If your employer (church) reimbursed some or all of your business expenses and does not report them as income in box 1 of your Form W-2, report the amount of these reimbursements on line 7. This would include any amount reported under code L in box 12 of your Form W-2 (substantiated car expense reimbursements up to the standard business mileage rate).

Step 3: Figure expenses to deduct on Schedule A (Form 1040)
On lines 8 through 10, you compute the amount of your business expense deduction to be claimed on Schedule A. The deduction will be limited to the amount that exceeds two percent of your adjusted gross income.

Form 2106-EZ
Employees can use a simplified Form 2106-EZ to compute their business expense deduction for 2014 if their employer did not reimburse business expenses and they use the standard mileage rate for computing automobile expenses.

Part 4
Comprehensive example and forms
Example One: Active Minister

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

Rev. John Michaels is the minister of the First United Church. He is married and has one child. The child is considered a qualifying child for the child tax credit. Mrs. Michaels is not employed outside the home. Rev. Michaels is a common-law employee of the church, and he has not applied for an exemption from SE tax. The church paid Rev. Michaels a salary of $45,000. In addition, as a self-employed person, he earned $4,000 during the year for weddings, baptisms, and honoraria. He made estimated tax payments during the year totaling $12,000. He taught a course at the local community college, for which he was paid $3,400. Rev. Michaels owns a home next to the church. He makes a $1,125 per month mortgage payment of principal and interest only. His utility bills and other housing-related expenses for the year totaled $1,450, and the real estate taxes on his home amounted to $1,750 for the year. The church paid him $1,400 per month as his parsonage allowance. The home’s fair rental value is $1,380 per month (including furnishings and utilities).

The parts of Rev. and Mrs. Michaels’ income tax return are explained in the order they are completed. They are illustrated in the order that Rev. Michaels will assemble the return to send it to the IRS.

Form W–2 from Church
The church completed Form W–2 for Rev. Michaels as follows:
Box 1. The church entered Rev. Michaels’ $45,000 salary.
Box 2. The church left this box blank because Rev. Michaels did not request federal income tax withholding.
Boxes 3 through 6. Rev. Michaels is considered a self-employed person for purposes of Social Security and Medicare tax withholding, so the church left these boxes blank.
Box 14. The church entered Rev. Michaels’ total parsonage allowance for the year and identified it.
Turbo Tax tips: Listed below are tips for ministers who use Turbo Tax to complete their returns. We have listed our recommended responses to some of the questions asked by the software when entering your W–2 from your church. These tips should not be construed as an endorsement or recommendation of the Turbo Tax software.

1. “Do any of these apply to this W–2?”
   Be sure to check the box that says, “Religious employment – This income was for religious employment (clergy, nonclergy, religious sect).”

2. “About your religious employment.”
   Please note that ministers fall under the category of clergy employment.

3. “Tell us about your clergy housing.” Turbo Tax then asks for the Parsonage or Housing Allowance, as well as the amount of qualifying expenses.
   The amount you should enter for qualifying expenses is the lesser of your actual housing expenses, the annual fair rental value of your home (including furnishings and utilities), or the amount of your pay that was designated as ministerial housing allowance by your Church.

4. “How would you like us to calculate clergy self-employment tax?”
   Please note that self-employment tax should be paid on wages and housing allowance. See Schedule SE Turbo Tax Tip for additional information.

Form W–2 from College
The community college gave Rev. Michaels a Form W–2 that showed the following.
   Box 1. The college entered Rev. Michaels’ $3,400 salary.
   Box 2. The college withheld $272 in federal income tax on Rev. Michaels’ behalf.
   Boxes 3 and 5. As an employee of the college, Rev. Michaels is subject to Social Security and Medicare withholding on his full salary from the college.
   Box 4. The college withheld $210.80 in Social Security taxes.
   Box 6. The college withheld $49.30 in Medicare taxes.

Schedule C–EZ (Form 1040)
Some of Rev. Michaels’ entries on Schedule C–EZ are explained here.
   Line 1. Rev. Michaels reports the $4,000 from weddings, baptisms, and honoraria.
   Line 2. Rev. Michaels reports his expenses related to the line 1 amount. The total consisted of $87 for marriage and family booklets and $253 for 452 miles of business use of his car, mainly in connection with honoraria. Rev. Michaels used the standard mileage rate to figure his car expense. He multiplied the standard mileage rate of 56 cents by 452 miles for a total of $253. These expenses total $340 ($253 + $87). However, he cannot deduct the part of his expenses allocable to his tax-free parsonage allowance. He attaches the required statement, Attachment 1 (shown later) to his return showing that 25% (or $85) of his business expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the $85 from the $340 and enters the $255 difference on line 2.
   Line 3. He enters his net profit of $3,745 both on line 3 and on Form 1040, line 12.
   Lines 4 through 8b. Rev. Michaels fills out these lines to report information about his car.

Turbo Tax tips: Turbo Tax does not appear to calculate the nondeductible portion of the expenses which should be allocated to the tax-free portion of the housing allowance. The taxpayer will need to adjust the expenses (as shown in Attachment 1) and input the reduced figure into the software.
Form 2106–EZ

Rev. Michaels fills out Form 2106–EZ to report the unreimbursed business expenses he had as a common-law employee of First United Church.

Line 1. Before completing line 1, Rev. Michaels fills out Part II because he used his car for church business. His records show that he drove 2,553 business miles, which he reports in Part II. On line 1, he multiplies 2,553 miles driven by the mileage rate of 56 cents. The combined result of $1,430 is reported on line 1.

Line 4. He enters $219 for his professional publications and booklets.

Line 6. Before entering the total expenses on line 6, Rev. Michaels must reduce them by the amount allocable to his tax-free parsonage allowance. On the required Attachment 1 (shown later), he shows that 25% (or $412) of his employee business expenses are not deductible because they are allocable to the tax-free parsonage allowance. He subtracts $412 from $1,649 and enters the result, $1,237, on line 6. He also enters $1,237 on line 21 of Schedule A (Form 1040).

Turbo Tax tips: Turbo Tax does not appear to calculate the nondeductible portion of the expenses which should be allocated to the tax-free portion of the housing allowance. The taxpayer will need to adjust the expenses (as shown in Attachment 1) and input the reduced figure into the software.

Schedule A (Form 1040)

Rev. Michaels fills out Schedule A as explained here.

Line 5. Rev. and Mrs. Michaels do not pay state income tax, and as of the date of this publishing, the deduction for state and local general sales taxes is not available for 2014, unless Congress extends this particular tax break. For the purpose of this example, the author did not include an amount on Schedule A.

Line 6. Rev. Michaels deducts $1,750 in real estate taxes.

Line 10. He deducts $6,810 of home mortgage interest.

Line 16. Rev. and Mrs. Michaels contributed $4,800 in cash during the year to various qualifying charities. Each individual contribution was less than $250. For each contribution, Rev. and Mrs. Michaels maintain the required bank record (such as a cancelled check) or written communication from the charity showing the charity’s name, the amount of the contribution and the date of the contribution. (This substantiation is required in order for any contribution of money (cash, check, or other monetary instrument) made in 2007 and thereafter to be deductible.)


Lines 25, 26, and 27. He can deduct only the part of his employee business expenses that exceeds 2% of his adjusted gross income. He fills out these lines to figure the amount he can deduct.

Line 29. The total of all the Michaels’ itemized deductions is $13,639, which they enter on line 29 and on Form 1040, line 40.

Schedule SE (Form 1040)

After Rev. Michaels prepares Schedule C–EZ and Form 2106–EZ, he fills out Schedule SE (Form 1040). He reads the chart on page 1 of the schedule which tells him he can use Section A—Short Schedule SE to figure his self-employment tax. Rev. Michaels is a minister, so his salary from the church is not considered church employee income. Thus, he does not have to use Section B—Long Schedule SE. He fills out the following lines in Section A.

Line 2. Rev. Michaels attaches a statement (see Attachment 2, later) that explains how he figures the amount ($63,811) he enters here.

Line 4. He multiplies $63,811 by .9235 to get his net earnings from self-employment ($58,929).

Line 5. The amount on line 4 is less than $113,700, so Rev. Michaels multiplies the amount on line 4 ($58,929) by .153 to get his self-employment tax of $9,016. He enters that amount here and on Form 1040, line 57.
Line 6. Rev. Michaels multiplies the amount on line 5 by .50 to get his deduction for the employer-equivalent portion of self-employment tax of $4,508. He enters that amount here and on Form 1040, line 27.

**Turbo Tax tips:** The software asks about self-employment tax on clergy wages. The taxpayer should check the box to pay self-employment tax on wages and housing allowance (assuming, as shown in this example, that the minister has not applied for exemption from the SE tax). Please note that the software does not appear to automatically reduce self-employment wages by the business expenses allocated to tax free income. The taxpayer will need to adjust net self-employment income (as shown in Attachment 2) and input the reduced figure into the software. This can be done by going into the “Business Taxes” section, and selecting “Self-Employment Tax.” Choose “Make Adjustments,” and enter in the “Ministerial Business Expenses” item the additional expenses that were allocable to tax-free income ($1,734 in this example – see Attachment 2).

**Form 1040**

After Rev. Michaels prepares Form 2106–EZ and the other schedules, he fills out Form 1040. He files a joint return with his wife. First he fills out the address area and completes the appropriate lines for his filing status and exemptions. Then, he fills out the rest of the form as follows:

Line 7. Rev. Michaels reports $48,640. This amount is the total of his $45,000 church salary, $3,400 college salary, and $240, the excess of the amount designated and paid to him as a parsonage allowance over the lesser of his actual expenses and the fair rental value of his home (including furnishings and utilities). The two salaries were reported to him in box 1 of the Forms W–2 he received.

Line 12. He reports his net profit of $3,745 from Schedule C–EZ, line 3.

Line 27. He enters $4,508, the deductible part of his SE tax from Schedule SE, line 6.

Line 37. Subtract line 36 from line 22. This is his adjusted gross income and he carries this amount forward to line 38.

Line 40. He enters the total itemized deductions from Schedule A, line 29.

Line 42. He multiplies the number of exemptions claimed (3 from Line 6d) by $3,950 and enters an exemption amount of $11,850 on line 42.

Line 52. The Michaels can take the child tax credit for their daughter, Jennifer. Rev. Michaels figures the credit by completing the Child Tax Credit Worksheet (not shown) contained in the Form 1040 general instructions. He enters the $1,000 credit. (Note: The Michaels are not required to attach Schedule 8812 to claim the child tax credit since their daughter does not have an individual taxpayer identification number (ITIN). The IRS issues ITINs to foreign nationals and others who have federal tax reporting or filing requirements and do not qualify for social security numbers (SSNs). Since Jennifer has a SSN, she is not required to obtain an ITIN and therefore Schedule 8812 is not applicable.)

Line 57. He enters the self-employment tax from Schedule SE, line 5.

Line 64. He enters the federal income tax shown in box 2 of his Form W–2 from the college.

Line 65. He enters the $12,000 estimated tax payments he made for the year.
<table>
<thead>
<tr>
<th>(a) Employee’s social security number</th>
<th>011-00-1111</th>
</tr>
</thead>
<tbody>
<tr>
<td>(b) Employer Identification number (EIN)</td>
<td>00-0246810</td>
</tr>
<tr>
<td>(c) Employer’s name, address, and ZIP code</td>
<td></td>
</tr>
<tr>
<td>First United Church</td>
<td></td>
</tr>
<tr>
<td>1042 Main Street</td>
<td></td>
</tr>
<tr>
<td>Hometown, Texas 77099</td>
<td></td>
</tr>
<tr>
<td>(d) Control number</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td></td>
</tr>
<tr>
<td>(e) Employee’s first name and initial  Last name</td>
<td></td>
</tr>
<tr>
<td>John B. Michaels</td>
<td></td>
</tr>
<tr>
<td>1040 Main Street</td>
<td></td>
</tr>
<tr>
<td>Hometown, Texas 77099</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(f) Employee’s address and ZIP code</th>
</tr>
</thead>
</table>

| (g) Wages, tips, other compensation | 45,000.00 |
| (h) Federal income tax withheld |
| 3 Social security wages |
| 4 Social security tax withheld |
| 5 Medicare wages and tips |
| 6 Medicare tax withheld |
| 7 Social security tips |
| 8 Allocated tips |

| (i) Nonqualified plans |
| 11 |

| (j) See Instructions for box 12 |
| 12a |

| (k) Parsonage Allowance |
| 14 |

| (l) $16,800 |
| 12b |

| (m) State |
| 15 |

<table>
<thead>
<tr>
<th>(n) Employer’s state ID number</th>
</tr>
</thead>
</table>

| (o) State wages, tips, etc. |
| 16 |

| (p) State income tax |
| 17 |

| (q) Local wages, tips, etc. |
| 18 |

| (r) Local income tax |
| 19 |

| (s) Locally name |
| 20 |

Form W-2 Wage and Tax Statement 2014

Copy B—To Be Filed With Employee’s FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.
<table>
<thead>
<tr>
<th>Box</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Wages, tips, other compensation</td>
<td>3,400.00</td>
</tr>
<tr>
<td>2</td>
<td>Federal income tax withheld</td>
<td>272.00</td>
</tr>
<tr>
<td>3</td>
<td>Social security wages</td>
<td>3,400.00</td>
</tr>
<tr>
<td>4</td>
<td>Social security tax withheld</td>
<td>210.80</td>
</tr>
<tr>
<td>5</td>
<td>Medicare wages and tips</td>
<td>3,400.00</td>
</tr>
<tr>
<td>6</td>
<td>Medicare tax withheld</td>
<td>49.30</td>
</tr>
<tr>
<td>7</td>
<td>Social security tips</td>
<td>0.00</td>
</tr>
<tr>
<td>8</td>
<td>Allocated tips</td>
<td>0.00</td>
</tr>
<tr>
<td>9</td>
<td>Control number</td>
<td>0.00</td>
</tr>
<tr>
<td>10</td>
<td>Dependent care benefits</td>
<td>0.00</td>
</tr>
<tr>
<td>11</td>
<td>Nonqualified plans</td>
<td>0.00</td>
</tr>
<tr>
<td>12a</td>
<td>See instructions for box 12</td>
<td>0.00</td>
</tr>
<tr>
<td>12b</td>
<td></td>
<td>0.00</td>
</tr>
<tr>
<td>13</td>
<td>Statutory employee</td>
<td>0.00</td>
</tr>
<tr>
<td>13a</td>
<td>Retirement plan</td>
<td>0.00</td>
</tr>
<tr>
<td>13b</td>
<td>Non-qualified stock options</td>
<td>0.00</td>
</tr>
<tr>
<td>14</td>
<td>Other</td>
<td>0.00</td>
</tr>
<tr>
<td>14a</td>
<td></td>
<td>0.00</td>
</tr>
<tr>
<td>14b</td>
<td></td>
<td>0.00</td>
</tr>
<tr>
<td>14c</td>
<td></td>
<td>0.00</td>
</tr>
<tr>
<td>14d</td>
<td></td>
<td>0.00</td>
</tr>
</tbody>
</table>

**Form W-2 Wage and Tax Statement 2014**

*Copy B—To be filed with Employee's FEDERAL Tax Return. This information is being furnished to the Internal Revenue Service.*
**Form 1040**

**Department of the Treasury — Internal Revenue Service**

**U.S. Individual Income Tax Return**

**2014**

**OMB No. 1545-0074**

**IRIS Use Only — Do not write or staple in this space.**

**For the year Jan. 1-Dec. 31, 2014, or any other tax year beginning**

**Your first name and initial**

John E.

**Last name**

Michaels

**If a joint return, spouse’s first name and initial**

Susan R.

**Last name**

Michaels

**Home address (number and street). If you have a P.O. box, see instructions.**

1040 Main Street

**Apt. no.**


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

Hometown, Texas 77099

**Foreign country name**


**Foreign province/state/country**


**Foreign postal code**


**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 not yet your dependent, enter this child’s name here. ▶

5 [ ] Qualifying widower(w)er with dependent child

**Check only one box.**

**Exemptions**

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

6b [ ] Spouse

6c [ ] Dependents:

<table>
<thead>
<tr>
<th>First name</th>
<th>Last name</th>
<th>Social security number</th>
<th>Relationship to you</th>
<th>Child under age 17 qualifying for child tax credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jennifer</td>
<td>Michaels</td>
<td>0 1 1 0 0 0 3 3 3 3 3 3</td>
<td>Daughter</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>

If more than four dependents, see instructions and check here ▶

**Boxes checked on 6a and 6b.**

2

**No. of children on 6c who: ▶**

1 lived with you
3 did not live with you due to divorce or separation (see instructions)

**Dependents on 6c not entered above ▶**

**Total number of exemptions claimed ▶**

8

**Income**

7 Wages, salaries, tips, etc. Attach Form(s) W-2

8a [ ] Taxable interest. Attach Schedule B if required

8b [ ] Tax-exempt interest. Do not include on line 8a

9a [ ] Ordinary dividends. Attach Schedule B if required

9b [ ] 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

13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶

14 Other gains or (losses). Attach Form 4797

15a [ ] IRA distributions

15b [ ] Taxable amount

16a [ ] Pensions and annuities

16b [ ] Taxable amount

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

20b [ ] Taxable amount

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 ▶

23

**Adjusted Gross Income**

23

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

28 Self-employed SEP, SIMPLE, and qualified plans

29 Self-employed health insurance deduction

30 Penalty on early withdrawal of savings

31a [ ] Alimony paid

31b [ ] Recipient’s SSN ▶

31c [ ] (Last 4 digits)

32 [ ] IRA deduction

33 [ ] Student loan interest deduction

34 [ ] (Last 4 digits)

35 [ ] (Last 4 digits)

36 Add lines 23 through 35 ▶

37 Subtract line 36 from line 22. This is your adjusted gross income ▶

22

47,877

**For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions.**

Cat. No. 11320B

Form 1040 (2014)
### SCHEDULE A (Form 1040)

#### Itemized Deductions

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Medical and dental expenses (see instructions)</td>
<td>1</td>
</tr>
<tr>
<td>2. Enter amount from Form 1040, line 38</td>
<td>2</td>
</tr>
<tr>
<td>3. Multiply line 2 by 10% (0.10). But if other you or your spouse was</td>
<td>3</td>
</tr>
<tr>
<td>born before January 2, 1955, multiply line 2 by 7.5% (0.075) instead</td>
<td></td>
</tr>
<tr>
<td>4. Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-</td>
<td>4</td>
</tr>
<tr>
<td><strong>Taxes You Paid</strong></td>
<td></td>
</tr>
<tr>
<td>a. Income taxes</td>
<td>5</td>
</tr>
<tr>
<td>b. RESERVED</td>
<td></td>
</tr>
<tr>
<td>6. Real estate taxes (see instructions)</td>
<td>6</td>
</tr>
<tr>
<td>7. Personal property taxes</td>
<td>7</td>
</tr>
<tr>
<td>8. Other taxes. List type and amount</td>
<td>8</td>
</tr>
<tr>
<td>9. Add lines 5 through 8</td>
<td>9</td>
</tr>
<tr>
<td><strong>Interest You Paid</strong></td>
<td></td>
</tr>
<tr>
<td>10. Home mortgage interest and points reported to you on Form 1098</td>
<td>10</td>
</tr>
<tr>
<td>11. Home mortgage interest not reported to you on Form 1098. If paid</td>
<td>11</td>
</tr>
<tr>
<td>to the person from whom you bought the home, see instructions and</td>
<td></td>
</tr>
<tr>
<td>show that person’s identity, and address</td>
<td></td>
</tr>
<tr>
<td><strong>Gifts to Charity</strong></td>
<td></td>
</tr>
<tr>
<td>12. Points not reported to you on Form 1098. See Instructions for</td>
<td>12</td>
</tr>
<tr>
<td>special rules</td>
<td></td>
</tr>
<tr>
<td>13. RESERVED</td>
<td>13</td>
</tr>
<tr>
<td>14. Investment Interest. Attach Form 4952 if required. (See Instructions.)</td>
<td>14</td>
</tr>
<tr>
<td>15. Add lines 10 through 14</td>
<td>15</td>
</tr>
<tr>
<td><strong>Casualty and Theft Losses</strong></td>
<td></td>
</tr>
<tr>
<td>16. Gifts by cash or check. If you made any gift of $250 or more,</td>
<td>16</td>
</tr>
<tr>
<td>see instructions.</td>
<td></td>
</tr>
<tr>
<td>17. Other than by cash or check. If any gift of $250 or more, see</td>
<td>17</td>
</tr>
<tr>
<td>instructions. You must attach Form 8283 if over $500</td>
<td></td>
</tr>
<tr>
<td>18. Carryover from prior year</td>
<td>18</td>
</tr>
<tr>
<td>19. Add lines 16 through 18</td>
<td>19</td>
</tr>
<tr>
<td><strong>Job Expenses and Certain Miscellaneous Deductions</strong></td>
<td></td>
</tr>
<tr>
<td>20. Casualty or theft losses. Attach Form 4684. (See Instructions.)</td>
<td>20</td>
</tr>
<tr>
<td>21. Unreimbursed employee expenses—job travel, union dues, job</td>
<td></td>
</tr>
<tr>
<td>education, etc. Attach Form 2106 or 2106-EZ if required. (See Instructions.)</td>
<td>21</td>
</tr>
<tr>
<td>22. Tax preparation fees</td>
<td>22</td>
</tr>
<tr>
<td>23. Other expenses—investment, safe deposit box, etc. List type and</td>
<td>23</td>
</tr>
<tr>
<td>amount</td>
<td></td>
</tr>
<tr>
<td>24. Add lines 21 through 23</td>
<td>24</td>
</tr>
<tr>
<td>25. Enter amount from Form 1040, line 38</td>
<td>25</td>
</tr>
<tr>
<td>26. Multiply line 25 by 2% (0.02)</td>
<td>26</td>
</tr>
<tr>
<td>27. Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-</td>
<td>27</td>
</tr>
<tr>
<td><strong>Other Miscellaneous Deductions</strong></td>
<td></td>
</tr>
<tr>
<td>28. Other—from list in instructions. List type and amount</td>
<td>28</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
</tr>
<tr>
<td>29. Is Form 1040, line 38, over $152,525?</td>
<td>29</td>
</tr>
<tr>
<td><strong>Itemized Deductions</strong></td>
<td></td>
</tr>
<tr>
<td>22. Yes. Your deduction may be limited. See the Itemized Deductions</td>
<td></td>
</tr>
<tr>
<td>Worksheet in the instructions to figure the amount to enter.</td>
<td></td>
</tr>
<tr>
<td>30. If you elect to itemize deductions even though they are less than your</td>
<td></td>
</tr>
<tr>
<td>standard deduction, check here.</td>
<td></td>
</tr>
</tbody>
</table>

*For Paperwork Reduction Act Notice, see Form 1040 instructions.*

*Cat. No. 17146C*

*Schedule A (Form 1040) 2014*
### SCHEDULE C-EZ (Form 1040)

#### Net Profit From Business

**General Information**

**Part I**

**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.

<table>
<thead>
<tr>
<th>Principal business or profession, including product or service</th>
<th>Enter business code (see page 2)</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>A</em> Minimum: 54 1 9 0</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Business name. If no separate business name, leave blank.</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>B</em> Business name: John E. Michaels</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Business address (including suite or room no.). Address not required if same as on page 1 of your tax return.</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>C</em> 1042 Main Street, Hometown, Texas 77099</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Did you make any payments in 2014 that would require you to file Form(s) 1099? (see the Schedule C instructions)</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>F</em> Yes [ ]  No [ ]</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>If “Yes,” did you or will you file required Forms 1099?</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>G</em> Yes [ ]  No [ ]</td>
</tr>
</tbody>
</table>

#### 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 Statutory employees in the instructions for Schedule C, line 1, and check here.

<table>
<thead>
<tr>
<th>Gross receipts</th>
<th>1</th>
<th>4,000</th>
</tr>
</thead>
</table>

2. Total expenses (see page 2). If more than $5,000, you must use Schedule C.

<table>
<thead>
<tr>
<th>Total expenses</th>
<th>2</th>
<th>255</th>
</tr>
</thead>
</table>

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.

<table>
<thead>
<tr>
<th>Net profit</th>
<th>3</th>
<th>3,745</th>
</tr>
</thead>
</table>

#### Part III Information on Your Vehicle

4. When did you place your vehicle in service for business purposes? (month, day, year) 07/15/09

5. Of the total number of miles you drove your vehicle during 2014, enter the number of miles you used your vehicle for:

<table>
<thead>
<tr>
<th>a Business</th>
<th>452</th>
</tr>
</thead>
<tbody>
<tr>
<td>b Commuting (see page 2)</td>
<td>0</td>
</tr>
<tr>
<td>c Other</td>
<td>7,466</td>
</tr>
</tbody>
</table>

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

8b. If “Yes,” is the evidence written? [ ] Yes [ ] No

For Paperwork Reduction Act Notice, see the separate instructions for Schedule C (Form 1040).

Cat. No. 14374D Schedule C-EZ (Form 1040) 2014

* See statement attached.
Section B—Long Schedule SE

Part I Self-Employment Tax

Note. If your only income subject to self-employment tax is church employee income, see instructions. Also see instructions for the definition of church employee income.

A. If you are a minister, member of a religious order, or Christian Science practitioner and you filed Form 4361, but you had $400 or more of other net earnings from self-employment, check here and continue with Part I. □

1a. Net farm profit or (loss) from Schedule F, lines 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A. Note. Skip lines 1a and 1b if you use the farm optional method (see instructions).

1b. ( )

2. Net profit or (loss) from Schedule C, line 11; Schedule C-EZ, line 3; and 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. Note. Skip this line if you use the nonfarm optional method (see instructions).

3. Combine lines 1a and 1b.

4a. If line 3 is more than zero, multiply line 3 by 0.35% (.0035). Otherwise, enter amount from line 3.

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

4b. ( )

4c. Exception. If line 4b is less than $400 and you had church employee income, enter -0- and continue ▶

5a. Enter your church employee income from Form W-2. See instructions for definition of church employee income.

5b. Multiply line 5a by 0.26% (.0026). If less than $100, enter -0-.

6. Add lines 4c and 5b.

7. Maximum amount of combined wages and self-employment earnings subject to social security tax or the 6.2% portion of the 7.65% railroad retirement (fear 1) tax for 2014. ▶

8a. Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) and railroad retirement (fear 1) compensation. If $117,000 or more, skip lines 8b through 10, and go to line 11.

8b. Unreported tips subject to social security tax (from Form 4137, line 10)

8c. Wages subject to social security tax (from Form 8919, line 10)

8d. ( )

9. Subtract line 8d from line 7. If zero or less, enter -0- and go to line 10 and go to line 11 ▶

10. Multiply the smaller of line 8d or line 9 by 12.4% (.124).

11. Multiply line 8d by 2.9% (.029).

12. Self-employment tax. Add lines 10 and 11. Enter here and on Form 1040, line 57, or Form 1040NR, line 55.

13. Deduction for one-half of self-employment tax. Multiply line 8d by 50% (.50). Enter the result here and on Form 1040, line 65, or Form 1040NR, line 65.

Part II Optional Methods To Figure Net Earnings (see instructions)

Farm Optional Method. You may use this method only if (a) your gross farm income was not more than $7,200, or (b) your net farm profits were less than $5,196.


15. Enter the smaller of: two-thirds (⅔) of gross farm income (not less than zero) or $4,800. Also include this amount on line 4b above.

Nonfarm Optional Method. You may use this method only if (a) your net nonfarm profits were less than $5,196 and also less than 72.19% of your gross nonfarm income, and (b) you had no earnings from self-employment of at least $400 in 2 of the prior 3 years. Caution. You may use this method no more than five times.


17. Enter the smaller of: two-thirds (⅔) of gross nonfarm income (not less than zero) or the amount on line 16. Also include this amount on line 4b above.
Form 2106-EZ
Unreimbursed Employee Business Expenses

Department of the Treasury
Internal Revenue Service

Information about Form 2106 and its separate instructions is available at www.irs.gov/form2106.

Your name
John E. Michaels

Occupation in which you incurred expenses
Minister

Social security number
011 00 1111

You Can Use This Form Only if All of the Following Apply.

• You are an employee deducting ordinary and necessary expenses attributable to your job. An ordinary expense is one that is common and accepted in your field of trade, business, or profession. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.

• You do not get reimbursed by your employer for any expenses (amounts your employer included in box 1 of your Form W-2 are not considered reimbursements for this purpose).

• If you are claiming vehicle expense, you are using the standard mileage rate for 2014.

Caution: You can use the standard mileage rate for 2014 only if (a) you owned the vehicle and used the standard mileage rate for the first year you placed the vehicle in service, or (b) you leased the vehicle and used the standard mileage rate for the portion of the lease period after 1997.

Part I Figure Your Expenses

1 Complete Part II. Multiply line 8a by 56c (56). Enter the result here.

2 Parking fees, tolls, and transportation, including train, bus, etc., that did not involve overnight travel or commuting to and from work.

3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. Do not include meals and entertainment.

4 Business expenses not included on lines 1 through 3. Do not include meals and entertainment.

5 Meals and entertainment expenses: $ x 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses incurred while away from home on business by 80% (.80) instead of 50%. For details, see instructions.)

6 Total expenses. Add lines 1 through 5. Enter here and on Schedule A (Form 1040), line 21 (or on Schedule A (Form 1040NR), line 7). (Armed Forces reservists, fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter this amount.)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1,430</td>
</tr>
<tr>
<td>2</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>219</td>
</tr>
<tr>
<td>5</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>1,237</td>
</tr>
</tbody>
</table>

Part II Information on Your Vehicle. Complete this part only if you are claiming vehicle expense on line 1.

7 When did you place your vehicle in service for business use? (month, day, year) 07 / 15 / 08

8 Of the total number of miles you drove your vehicle during 2014, enter the number of miles you used your vehicle for:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
<td>2,553</td>
</tr>
<tr>
<td>b</td>
<td></td>
</tr>
<tr>
<td>c</td>
<td>5,365</td>
</tr>
</tbody>
</table>

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

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

11a Do you have evidence to support your deduction?  □ Yes □ No

11b If “Yes,” is the evidence written?  □ Yes □ No

For Paperwork Reduction Act Notice, see your tax return instructions.
Attachment 1. Computation of expenses, allocable to tax-free ministerial income, that are nondeductible.

<table>
<thead>
<tr>
<th>Description</th>
<th>Taxable</th>
<th>Tax-Free</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary as a minister</td>
<td>$45,000</td>
<td>$45,000</td>
<td></td>
</tr>
<tr>
<td>Parsonage allowance:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount designated and paid by church ($1,400 x 12)</td>
<td>$16,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actual expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Mortgage $1,125 x 12, Utilities/other $1,450, Real estate taxes $1,750)</td>
<td>16,700</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair rental value of home (including furnishings and utilities) ($1,380 x 12)</td>
<td>16,560</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable portion of allowance</td>
<td></td>
<td>240</td>
<td>240</td>
</tr>
<tr>
<td>(excess of amount designated &amp; paid over lesser of actual expenses or fair rental value)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax-free portion of allowance</td>
<td>16,560</td>
<td>16,560</td>
<td></td>
</tr>
<tr>
<td>Gross income from weddings, baptisms, and honoraria</td>
<td>4,000</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>Ministerial income</td>
<td>$49,240</td>
<td>$16,560</td>
<td>$65,800</td>
</tr>
<tr>
<td>% of nondeductible expenses: $16,560/$65,800 = 25%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Schedule C-EZ Deduction Computation

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Marriage and family booklets</td>
<td></td>
<td>$87</td>
<td></td>
</tr>
<tr>
<td>Business use of car:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>452 miles x 56¢</td>
<td>$253</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unadjusted Schedule C-EZ expenses</td>
<td>340</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minus:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nondeductible part of Schedule C-EZ expenses (25% x $340)</td>
<td>(85)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Schedule C-EZ deductions (line 2)</td>
<td>$258</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Form 2106-EZ - Employee Business Expense Deduction Computation

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Car expenses for church business:</td>
<td></td>
<td>$1,430</td>
<td></td>
</tr>
<tr>
<td>2,533 miles x 56¢</td>
<td></td>
<td>219</td>
<td></td>
</tr>
<tr>
<td>Publications and booklets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unadjusted Form 2106-EZ expenses</td>
<td>1,649</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minus:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nondeductible part of Form 2106-EZ expenses (25% x $1,649)</td>
<td>(412)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee business expense deduction - Form 2106-EZ line 6</td>
<td>$1,237</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

None of the other deductions claimed in the return are allocable to tax-free income.

Attachment 2. Attachment to Schedule SE (Form 1040)

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Church wages</td>
<td></td>
<td>$45,000</td>
<td></td>
</tr>
<tr>
<td>Parsonage allowance</td>
<td></td>
<td>16,800</td>
<td></td>
</tr>
<tr>
<td>Net profit from Schedule C-EZ</td>
<td></td>
<td>3,745</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>65,545</td>
<td></td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Schedule C-EZ expenses allocable to tax-free income</td>
<td>$85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministerial employee business expenses</td>
<td></td>
<td>1,649</td>
<td></td>
</tr>
<tr>
<td>(unadjusted Form 2106-EZ expenses)</td>
<td></td>
<td>(1,734)</td>
<td></td>
</tr>
<tr>
<td>Net Self-Employment Income</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Schedule SE, Section A, line 2</td>
<td></td>
<td>$63,811</td>
<td></td>
</tr>
</tbody>
</table>
Example Two: Retired Minister

Rev. William K. Green is a retired minister. He is 69 years old. He is married to Sarah J. Green. She is 65 years old and is also retired. For 2014, Rev. Green received $15,000 in annuity income, all of which was designated in advance by the Board of Pensions as a housing allowance. Rev. Green had housing expenses of $13,000. The home’s fair rental value is $1,200 per month (including furnishings and utilities). Housing allowances for retired ministers are not taxable in computing federal income tax to the extent that they do not exceed the lesser of actual housing expenses or the annual fair rental value of the home (including furnishings and utilities). Retirement benefits, whether or not designated in advance as a housing allowance, are not subject to self-employment taxes.

Rev. Green received $12,000 of Social Security benefits in 2014, and his wife received $6,000. None of this income is taxable, however, because the Green’s income is not enough to expose their Social Security benefits to tax.

In 2014, Rev. Green received $2,000 from occasional guest preaching engagements. He incurred $590 in expenses as a result of these activities ($440 of travel expenses, and $150 of meal expenses). Note that Rev. Green will pay self-employment tax on this income (see Schedule SE), since it represents compensation from active ministry.

The parts of Rev. and Mrs. Green’s income tax return are explained in the order they are completed. They are illustrated in the order that the Rev. Green will assemble the return to send it to the IRS.

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

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

Box 2b. Taxable amount not determined. – The Board of Pensions designated in advance 100% of pension income as a housing allowance. It is not taxable to the extent that it does not exceed the lesser of actual housing expenses or the annual fair rental value of the home (including furnishings and utilities).

Box 7. Rev. Green’s pension income is a normal distribution.

Schedule C–EZ (Form 1040)
Some of Rev. Green’s entries on Schedule C–EZ are explained here.

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

Line 2. Rev. Green reports his expenses related to the line 1 amount. He drove 786 miles of business use of his car, in connection with guest preaching. Rev. Green used the standard business mileage rate to figure his car expense. He multiplied the standard mileage rate of 56 cents by 786 miles for a total of $440. He also incurred $75 ($150 x 50% nondeductible) in meal expenses in connection with the guest preaching for total expenses of $515. However, he cannot deduct the part of his expenses allocable to his tax-free parsonage allowance. He attaches the required statement, Attachment 1 (shown later) to his return showing that 76% (or $391) of his business expenses are not deductible because they are allocable to that tax-free allowance. He subtracts the $391 from the $515 and enters the $124 difference on line 2.

Line 3. He enters his net profit of $1,876 both on line 3 and on Form 1040, line 12.

Lines 4 through 8b. Rev. Green fills out these lines to report information about his car.

Turbo Tax tips: Listed below are tips for ministers who use Turbo Tax to complete their returns. These tips should not be construed as an endorsement or recommendation of the Turbo Tax software.

Turbo Tax does not appear to calculate the nondeductible portion of the expenses which should be allocated to the tax-free portion of the housing allowance. The taxpayer will need to adjust the expenses (as shown in Attachment 1) and input the reduced figure into the software.
Schedule SE (Form 1040)

After Rev. Green prepares Schedule C–EZ he fills out Schedule SE (Form 1040). He reads the chart on page 1 of the schedule, which tells him he can use Section A – Short Schedule SE to figure his self-employment tax. Ministers are not church employees under this definition. He fills out the following lines in Section A.

Line 2. Rev. Green attaches a statement (see Attachment 2, later) that calculates his net profit of $1,485 and he enters that amount here.

Line 4. He multiplies the $1,485 by .9235 to get his net earnings from self-employment ($1,371).

Line 5. The amount on line 4 is less than $113,700, so Rev. Green multiplies the amount on line 4 ($1,371) by .153 to get his self-employment tax of $210. He enters that amount here and on Form 1040, line 57.

Line 6. Rev. Green multiplies the amount on line 5 by .50 to get his deduction for the employer-equivalent portion of self-employment tax of $105. He enters that amount here and on Form 1040, line 27.

Turbo Tax tips: The software does not appear to reduce self-employment wages by the business expenses allocated to tax free income. The taxpayer will need to adjust net self-employment income (as shown in Attachment 2) and input the reduced figure into the software.

Form 1040

After Rev. Green prepares Schedule C–EZ and Schedule SE, he fills out Form 1040. Rev. Green files a joint return with his wife. First he fills out the address area and completes the appropriate lines for his filing status and exemptions. Then, he fills out the rest of the form as follows:

Line 12. He reports his net profit of $1,876 from Schedule C–EZ, line 3.

Line 16a and 16b. Rev. Green reports his total annuity income of $15,000 on line 16a. He reports the taxable amount ($2,000) as computed on Attachment 1 (shown later) on line 16b.

Line 20a and 20b. Since none of Rev. Green’s Social Security benefits are taxable, he does not report any amounts on line 20a or 20b.

Line 27. He enters $105, the deductible part of his SE tax from Schedule SE, line 6.

Line 37. Subtract line 36 from line 22. This is his adjusted gross income and he carries this amount forward to line 38.

Line 39a. He checks the boxes indicating that he and his wife were born before January 2, 1950 and enters “2” in the “total” box.

Line 40. Rev. Green enters his standard deduction of $14,800 which takes into consideration the fact he and his wife were born before January 2, 1950.

Line 42. He multiplies the number of exemptions claimed (2 from Line 6d) by $3,950 and enters an exemption amount of $7,900 on line 42.

Line 43. Rev. Green has no taxable income.

Line 57. He enters the self-employment tax from Schedule SE, line 5.

Line 64. Rev. Green did not have any income tax withheld from his pension.

Line 78. Amount Rev. Green owes to the IRS.
**PAYER’S name, street address, city or town, state or province, country, and ZIP or foreign postal code**
The Board of Pensions of the Presbyterian Church (USA)  
2000 Market Street  
Philadelphia, PA 19103-3298  
1-800-773-7752

**RESPONDENT’S name**
William K. Green

**Street address (including apt. no.)**
787 Adams Street

**City or town, state or province, country, and ZIP or foreign postal code**
Anytown, NY 10002

<table>
<thead>
<tr>
<th>Gross distribution</th>
<th>15,000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable amount</td>
<td>$</td>
</tr>
<tr>
<td>2a Taxable amount</td>
<td>$</td>
</tr>
<tr>
<td>2b Taxable amount</td>
<td>$</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2014</th>
</tr>
</thead>
</table>

**Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.**

<table>
<thead>
<tr>
<th>Copy B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Report this income on your federal tax return. If this form shows federal income tax withheld in box 4, attach this copy to your return.</td>
</tr>
</tbody>
</table>

This information is being furnished to the Internal Revenue Service.

| 10 Amount allocable to IRR within 5 years | $ |
| 11 1st year of design. Roth contrib. | $ |
| 12 State tax withheld | $ |
| 13 State/Payer’s state no. | $ |
| 14 State distribution | $ |
| 15 Local tax withheld | $ |
| 16 Name of locality | $ |
| 17 Local distribution | $ |

Form 1099-R  
www.irs.gov/form1099r  
Department of the Treasury - Internal Revenue Service
Form 1040
Department of the Treasury—Internal Revenue Service

For the year Jan. 1-Dec. 31, 2014, or any other tax year beginning
See separate instructions.

Your first name and initial
William K.
Sarah J.

Last name
Green

If a joint return, spouse’s first name and initial
Last name

Home address (number and street). If you have a P.O. box, see instructions.
787 Adams Street
Anytown, New York 10002

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

Foreign country name

Foreign province/state/county

Foreign postal code

Apt. no.

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

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.

Check only one box.
5 [ ] Qualifying widow(er) with dependent child

Exemptions

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

c Dependents:
(1) First name
(2) Social security security number
(3) Relationship to you

If more than four dependents, see instructions and check here ▶

Total number of exemptions claimed

Boxes checked on 6a and 6b

7 [ ] Wages, salaries, tips, etc. Attach Form(s) W-2
8a [ ] Taxable interest. Attach Schedule B if required
8b [ ] Tax-exempt interest. Do not include on line 8a
9a [ ] Ordinary dividends. Attach Schedule B if required
9b [ ] 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
13 [ ] Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶
14 [ ] Other gains or (losses). Attach Form 4797
15a [ ] IRA distributions
15a[ ] Taxable amount
15b [ ] Pensions and annuities
16a [ ] Social security benefits
16b [ ] Taxable amount
16b[ ] Taxable amount
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 [ ] Taxable amount
20b [ ] Social security benefits
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 ▶

23 [ ] Reserved
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
28 [ ] Self-employed SEP, SIMPLE, and qualified plans
29 [ ] Self-employed health insurance deduction
30 [ ] Penalty on early withdrawal of savings
31a [ ] Alimony paid
31a[ ] Recipient’s SSN ▶
32 [ ] IRA deduction
33 [ ] Student loan interest deduction
34 [ ] Reserved
35 [ ] Domestic production activities deduction. Attach Form 8903
36 [ ] Add lines 23 through 35. This is your adjusted gross income ▶
37 [ ] Subtract line 36 from line 22. This is your adjusted gross income ▶

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 11302B
Form 1040 (2014)
**Form 1040 (2014)**

### Tax and Credits

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>38</td>
<td>Amount from line 37 (adjusted gross income)</td>
<td>3,771</td>
</tr>
<tr>
<td>39a</td>
<td>You were born before January 2, 1950, or Blind. Total boxes checked</td>
<td>2</td>
</tr>
<tr>
<td>40</td>
<td>Itemized deductions (from Schedule A) or your standard deduction (see left margin)</td>
<td>14,800</td>
</tr>
<tr>
<td>41</td>
<td>Exemptions. If line 38 is $152,525 or less, multiply $3,950 by the number on line 6d. Otherwise, see instructions</td>
<td>7,900</td>
</tr>
<tr>
<td>42</td>
<td>Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter 0.</td>
<td>0</td>
</tr>
<tr>
<td>43</td>
<td>Tax (see instructions). Check if any from: a Form(s) 8814</td>
<td>0</td>
</tr>
<tr>
<td>44</td>
<td>b Form 4972</td>
<td>0</td>
</tr>
<tr>
<td>45</td>
<td>c Alternative minimum tax (see instructions). Attach Form 6251</td>
<td>0</td>
</tr>
<tr>
<td>46</td>
<td>Excess advance premium tax credit repayment. Attach Form 8862</td>
<td>0</td>
</tr>
<tr>
<td>47</td>
<td>Add lines 44, 45, and 46.</td>
<td>0</td>
</tr>
<tr>
<td>48</td>
<td>Foreign tax credit. Attach Form 1116 if required.</td>
<td>48</td>
</tr>
<tr>
<td>49</td>
<td>Education credits from Form 8863, line 19</td>
<td>49</td>
</tr>
<tr>
<td>50</td>
<td>Education credits from Form 8880, line 19</td>
<td>50</td>
</tr>
<tr>
<td>51</td>
<td>Retirement savings contributions credit. Attach Form 8880, line 51</td>
<td>51</td>
</tr>
<tr>
<td>52</td>
<td>Child tax credit. Attach Schedule 8912 if required.</td>
<td>52</td>
</tr>
<tr>
<td>53</td>
<td>Residential energy credit. Attach Form 5695</td>
<td>53</td>
</tr>
<tr>
<td>54</td>
<td>Other credits from: a Form 8814</td>
<td>54</td>
</tr>
<tr>
<td>55</td>
<td>b Form 8812</td>
<td>55</td>
</tr>
<tr>
<td>56</td>
<td>c Form 8814</td>
<td>56</td>
</tr>
<tr>
<td>57</td>
<td>Self-employment tax. Attach Schedule SE</td>
<td>210</td>
</tr>
<tr>
<td>58</td>
<td>Unreported social security and Medicare tax from Form: a 4137</td>
<td>58</td>
</tr>
<tr>
<td>59</td>
<td>b 8919</td>
<td>59</td>
</tr>
<tr>
<td>60</td>
<td>Additional tax on IRA, other qualified retirement plans, etc. Attach Form 5329 if required</td>
<td>0</td>
</tr>
<tr>
<td>60a</td>
<td>Household employment taxes from Schedule H</td>
<td>60a</td>
</tr>
<tr>
<td>60b</td>
<td>a First-time homebuyer credit repayment. Attach Form 5405 if required</td>
<td>60b</td>
</tr>
<tr>
<td>61</td>
<td>Health care: individual responsibility (see instructions). Full-year coverage</td>
<td>61</td>
</tr>
<tr>
<td>62</td>
<td>b Taxes from: a Form 8814</td>
<td>62</td>
</tr>
<tr>
<td>63</td>
<td>b Form 8860</td>
<td>63</td>
</tr>
<tr>
<td>64</td>
<td>c Instructions; enter code(s)</td>
<td>63</td>
</tr>
<tr>
<td>65</td>
<td>d Add lines 48 through 63. These are your total credits</td>
<td>64</td>
</tr>
<tr>
<td>66a</td>
<td>Earned income credit (EIC)</td>
<td>65</td>
</tr>
<tr>
<td>66b</td>
<td>b Not taxable combat pay election</td>
<td>66b</td>
</tr>
<tr>
<td>67</td>
<td>Additional child tax credit. Attach Schedule 8912</td>
<td>67</td>
</tr>
<tr>
<td>68</td>
<td>American opportunity credit from Form 8863, line 8</td>
<td>68</td>
</tr>
<tr>
<td>69</td>
<td>Net premium tax credit. Attach Form 8862</td>
<td>69</td>
</tr>
<tr>
<td>70</td>
<td>Amount paid with request for extension to file</td>
<td>70</td>
</tr>
<tr>
<td>71</td>
<td>Excess social security and tier 1 RRTA tax withheld</td>
<td>71</td>
</tr>
<tr>
<td>72</td>
<td>Credit for federal tax on fuels. Attach Form 4136</td>
<td>72</td>
</tr>
<tr>
<td>73</td>
<td>Credits from: a 0493</td>
<td>73</td>
</tr>
<tr>
<td>74</td>
<td>b 0494</td>
<td>74</td>
</tr>
<tr>
<td>75</td>
<td>c Reaxed</td>
<td>75</td>
</tr>
<tr>
<td>76</td>
<td>d Reaxed d</td>
<td>76</td>
</tr>
<tr>
<td>77</td>
<td>Add lines 64, 65, 66, and 67 through 73. These are your total payments.</td>
<td>77</td>
</tr>
</tbody>
</table>

### Refund

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>76</td>
<td>If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you overpaid</td>
<td>76</td>
</tr>
<tr>
<td>76a</td>
<td>Amount of line 75 you want refunded to you. If Form 8888 is attached, check here</td>
<td>76a</td>
</tr>
<tr>
<td>77</td>
<td>Amount of line 76 you want applied to your 2015 estimated tax</td>
<td>77</td>
</tr>
</tbody>
</table>

### Amount You Owe

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>78</td>
<td>Amount you owe. Subtract line 74 from line 63. For details on how to pay, see instructions</td>
<td>78</td>
</tr>
</tbody>
</table>

### Third Party Designee

- **Designee's name:** William Green
- **Date:** 3/15/15
- **Your occupation:** Retired Minister
- **Daytime phone number:** 212-333-4444
- **Spouse's signature:** Sarah Green
- **Date:** 3/15/15
- **Spouse's occupation:** Retired
- **Check if self-employed:** No
- **PTIN:** 44-7765-1234

**Paid Preparer Use Only**

- **Preparer's name:**
- **Preparer's signature:**
- **Date:**
- **Firm's name:**
- **Firm's address:**
- **Firm's EIN:**
- **Phone no.:**
SCHEDULE C-EZ
(Net Profit From Business
(Sole Proprietorship))

William K. Green

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.

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 Statutory employees in the instructions for Schedule C, line 1, and check here.

   1 2,000

2. Total expenses (see page 2). If more than $5,000, you must use Schedule C.

   2 124

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.)

   3 1,876

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) 7/15/2008

5. Of the total number of miles you drove your vehicle during 2014, enter the number of miles you used your vehicle for:
   a. Business 786
   b. Commuting (see page 2) 0
   c. Other 12,711

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 the separate instructions for Schedule C (Form 1040). Cat. No. 14374D Schedule C-EZ (Form 1040) 2014

* See statement attached.
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.

Did you receive wages or tips in 2014?

- No
  - Are you a minister, member of a religious order, or Christian Science practitioner who received IRS approval not to be taxed on earnings from these sources, but you owe self-employment tax on other earnings?
    - No
      - Are you using one of the optional methods to figure your net earnings (see instructions)?
        - Yes
          - Did you receive wages or tips subject to social security or Medicare tax that you did not report to your employer?
            - Yes
              - Did you report any wages on Form W-2, Uncollected Social Security and Medicare Tax on Wages?
                - No
                  - You may use Short Schedule SE below
                - Yes
                  - Did you receive church employee income (see instructions) reported on Form W-2 of $100,000 or more?
                    - No
                      - You must use Long Schedule SE on page 2
                    - Yes
                      - Was the total of your wages and tips subject to social security or railroad retirement (tier 1) tax plus your net earnings from self-employment more than $117,000?
                        - Yes
                          - Did you receive wages or tips subject to social security or Medicare tax that you did not report to your employer?
                            - Yes
                              - Did you report any wages on Form W-2, Uncollected Social Security and Medicare Tax on Wages?
                                - No
                                  - You may use Short Schedule SE below
                                - Yes
                                  - You must use Long Schedule SE on page 2
                        - No
                          - You must use Long Schedule SE on page 2

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.

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 1,485 *

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

3 1,485

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 1,371

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:
  - $117,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on Form 1040, line 57, or Form 1040NR, line 55
  - More than $117,000, multiply line 4 by 2.9% (.029). Then, add $14,508 to the result.

5 210

6 Deduction for one-half of self-employment tax.

6 105

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

* See statement attached.
Section B—Long Schedule SE

Part I Self-Employment Tax

Note. If your only income subject to self-employment tax is church employee income, see instructions. Also see instructions for the definition of church employee income.

A If you are a minister, member of a religious order, or Christian Science practitioner and you filed Form 4861, but you had $400 or more of other net earnings from self-employment, check here and continue with Part I.

1a Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A. Note. Skip lines 1a and 1b if you use the farm optional method (see instructions).

1b 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. Minors and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report. Note. Skip this line if you use the nonfarm optional method (see instructions).

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

3 If line 3 is more than zero, multiply line 3 by 92.35% (.9235). Otherwise, enter amount from line 3.

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

4b If you elect one or both of the optional methods, enter the total of lines 15 and 17 here.

4c Combine lines 4a and 4b. If less than $400, stop; you do not owe self-employment tax. Exception. If less than $400 and you had church employee income, enter -0- and continue.

5a Enter your church employee income from Form W-2. See instructions for definition of church employee income.

5b Multiply line 5a by 92.35% (.9235). If less than $100, enter -0-.

6 Add lines 4c and 5b.

7 Maximum amount of combined wages and self-employment earnings subject to social security tax or the 6.2% portion of the 7.65% railroad retirement (tier 1) tax for 2014.

8a Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) and railroad retirement (tier 1) compensation.

8b Unreported tips subject to social security tax (from Form 4137, line 10).

8c Wages subject to social security tax (from Form 8919, line 10).

8d Add lines 8a, 8b, and 8c.

9 Subtract line 8d from line 7. If zero or less, enter -0- here and on line 10 and go to line 11.

10 Multiply the smaller of line 10 or line 9 by 10.34% (.1034).

11 Multiply line 6 by 2.9% (.029)

12 Self-employment tax. Add lines 10 and 11. Enter here and on Form 1040, line 57, or Form 1040NR, line 55.

13 Deduction for one-half of self-employment tax. Multiply line 12 by 50%. (50%). Enter the result here and on Form 1040, line 27, or Form 1040NR, line 27.

Part II Optional Methods To Figure Net Earnings

See instructions.

Farm Optional Method. You may use this method only if (a) your gross farm income was not more than $7,200, or (b) your net farm profits were less than $5,198.

14 Maximum income for optional methods.

15 Enter the smaller of: two-thirds (⅔) of gross farm income (not less than zero) or $4,800. Also include this amount on line 4b above.

Nonfarm Optional Method. You may use this method only if (a) your net nonfarm profits were less than $5,198 and also less than $77,870 of your gross nonfarm income, and (b) you had no earnings from self-employment of at least $400 in any of the prior 3 years. Caution. You may use this method no more than five times.

16 Subtract line 15 from line 14.

17 Enter the smaller of: two-thirds (⅔) of gross nonfarm income (not less than zero) or the amount on line 16. Also include this amount on line 4b above.

1 From Sch. F, line 9, and Sch. K-1 (Form 1065), box 14, code B.
2 From Sch. F, line 34, and Sch. K-1 (Form 1065), box 14, code A—minus the amount you would have entered on line 1b had you not used the optional method.
3 From Sch. C, line 51; Sch. C-EZ, line 3; Sch. K-1 (Form 1065), box 14, code A; and Sch. K-1 (Form 1065-B), box 9, code J1.
4 From Sch. C, line 7; Sch. C-EZ, line 1; Sch. K-1 (Form 1065), box 14, code C; and Sch. K-1 (Form 1065-B), box 9, code J2.
Attachment 1. Computation of expenses, allocable to tax-free ministerial income, that are nondeductible.

<table>
<thead>
<tr>
<th>% of Nondeductible Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parsonage allowance:</td>
</tr>
<tr>
<td>Ministerial retirement benefits designated as housing allowance</td>
</tr>
<tr>
<td>Actual expenses</td>
</tr>
<tr>
<td>Fair rental value of home (including furnishings and utilities) ($1,200 x 12)</td>
</tr>
<tr>
<td>Taxable portion of allowance (excess of amount designated &amp; paid over lesser of actual expenses or fair rental value)</td>
</tr>
<tr>
<td>Tax-free portion of allowance (lesser of amount designated, actual expenses or fair rental value)</td>
</tr>
<tr>
<td>Gross income from occasional guest preaching engagements</td>
</tr>
<tr>
<td>Ministerial Income</td>
</tr>
</tbody>
</table>

% of nondeductible expenses: $13,000/$17,000 = 76%

Schedule C-EZ Deduction Computation

- Business use of car: 786 miles x 56c | $440
- Meal expenses ($150 less 50% reduction) | 75
- Unadjusted Schedule C-EZ expenses | $515
- Nondeductible part of expenses: $515 x 76% | (391)
- Schedule C-EZ deductions, line 2 | $124

None of the other deductions claimed in the return are allocable to tax-free income.

Attachment 2. Computation of Net Earnings from Self-Employment

<table>
<thead>
<tr>
<th>Computation for Schedule SE (Form 1040)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Income from Schedule C-EZ</td>
</tr>
<tr>
<td>Less:</td>
</tr>
<tr>
<td>Unadjusted Schedule C-EZ expenses</td>
</tr>
<tr>
<td>Net Self Employment Income, Schedule SE, Line 2</td>
</tr>
</tbody>
</table>