

SOCIAL SECURITY TAXES

In the church environment

The Social Security system is a government sponsored program designed to provide financial and medical care assistance to people who are elderly or disabled and to their dependents. Although contributions to the program are mandatory for most taxpayers, clergy and churches may apply for exemption from the program. 'Opting out,' however, is subject to strict guidelines (discussed later).

The Social Security system is funded by two very different laws: The Federal Insurance Contributions Act (FICA) and the Self-Employment Contributions Act (SECA). Churches and clergy may be affected by both.

Federal Insurance Contributions Act (FICA)—FICA is the social security tax system for employees and their employers. Payment of FICA tax is mandatory for most classes of employees. Most taxpayers are somewhat familiar with FICA, at least to the extent that they recognize it as one of the taxes withheld from their paychecks. The one half of the tax is withheld from the employee's payroll and the employer is required to pay a matching amount into the employee's social security account. The FICA tax is divided into two parts, Social Security tax (sometimes also called Old-Age, Survivors and Disability Insurance tax (OASDI)) and the Medicare hospital insurance tax. Since 1991, the OASDI rate has been set at 12.4 percent. One-half of the OASDI tax (6.2 percent) is withheld from the employee's payroll and the employer pays a matching amount. The Medicare rate is set at 2.9 percent (1.45 percent for the employee and a like amount for the employer). All income below an annually adjusted limit is subject to OASDI. Income exceeding the limit is not subject to the OASDI portion of the tax. There is no limit on the amount of income subject to the Medicare portion of the tax.

Important note regarding the dual tax status of pastors

Although ministers employed by religious entities are usually considered common-law employees for income tax purposes, they are always considered self-employed for social security tax purposes. *Because self-employed persons are not subject to the provisions of FICA, FICA should never be withheld from the payroll of duly credentialed ministers functioning in a clergy capacity.*

Like most federal taxes, FICA taxes require that you 'pay-as-you-go'. Consequently, FICA withholding is mandatory on the payroll of each person who is considered an employee for Social Security tax purposes. FICA taxes withheld and matching employer contributions are deposited together with income taxes withheld according to a schedule outlined in IRS Pub 15 (also known as Circular E) which is issued annually by the IRS.

Church exemption from FICA rules. Under limited circumstances churches may request exemption from their obligations as an employer under the FICA program. Churches have a one-time, irrevocable option to exempt themselves if they certify a religious objection to payment of the employer's share of FICA. They must apply for the exemption by filing Form 8274, *Certification by Churches and Qualified Church-Controlled Organizations Electing Exemption from Employer Social Security Taxes*, before the deadline for filing their first Form 941 (*Employer's Quarterly Federal Tax Return*). Forms 941 are due on the last day of the month following the end of each calendar quarter. Consequently, the deadline has passed for any church that hired its first employee more than four months ago. Timely filing of Form 8274 relieves the church only of the FICA obligation (i.e., the obligation to withhold FICA and to match the amount withheld). It does not relieve the church of the obligation to withhold federal (and other) income taxes, of making deposits of the income taxes withheld, or of timely filing of Form 941. It will also place a heavier tax burden on employees because they are obligated to pay the higher SECA tax.

Self-Employment Contributions Act (SECA)—Earlier, it was stated that persons who are considered self-employed for Social Security tax purposes are covered by the SECA program. Since clergy are considered self-employed for social security tax purposes it follows that they are covered by SECA. All employees (clergy and non-clergy) of a church that has filed Form 8274 opting out of participation in the FICA

program are also considered self-employed for social security tax purposes. Remember, under the FICA system employers and employees each share half of the FICA tax burden. Self-employed persons have no one with whom to share the burden. Consequently, under SECA, self-employed persons must bear the entire Social Security tax burden alone.

The SECA tax rate is the same as the combined FICA rate of 15.3 percent. Because Congress thought it inappropriate that self-employed persons are required to pay twice the rate that employees pay they devised a slightly complicated two-stage means of providing some relief from this inequity. First, the amount of income subject to SECA tax is reduced by an amount equal to one-half of the full FICA rate. Second, federal gross income may be reduced by one-half of the SECA tax in computing Adjusted Gross Income (AGI). A sample SECA tax computation is presented at the end of this paper.

Like FICA, SECA tax is part OASDI tax and part Medicare tax. Net self-employment income up to an annually adjusted cap is subject to the OASDI portion. All self-employment income is subject to the Medicare portion of the tax.

How to pay SECA taxes. Taxpayers who are self-employed for Social Security tax purposes generally must make quarterly payments directly to the IRS for estimated income and SECA taxes. A popular alternative employed by many clergy is to ask the employing church to increase federal income tax withholding by an amount equal to the estimated SECA tax liability (this is accomplished by filing Form W4 on which the extra tax withholding is requested). Failure to pay in the amount due either by making quarterly estimated tax payments or by withholding extra federal income tax can result in substantial balances due at tax time which, in turn, can result in substantial penalties.

How to determine the SECA tax. Correctly determining the amount of income that is subject to SECA tax is of obvious importance. Net self-employment income usually includes all business income less all business deductions allowed for income tax purposes. Generally, the amount that is subject to SECA tax is comprised of the following components:

- a) Clergy salary (the amount reported on Form W-2 box 1)
- b) Add: taxable fringe benefits not reported on Form W2
- c) Add: housing allowance or parsonage allowance
- d) Add: fair rental value of church-provided parsonage
- e) Add: all other self-employment net income (from Schedule C)
- f) Add: all farm net income (from Schedule F)
- g) Add: some partnership net income and farm partnership net income (from Schedule K-1)
- h) Less: unreimbursed employee business expenses (from Form 2106)
- i) Less: the net of a) - h) multiplied by 7.65 percent (0.0765)

The resulting amount is multiplied by the SECA tax rate (15.3 percent) to determine the SECA tax

Clergy exemption from SECA tax: Ministers may request exemption from SECA tax provided they meet several conditions: 1) they must be ordained, licensed, or commissioned by a tax-exempt religious organization that is listed in IRS Publication 78, 2) the minister must inform the organization that ordained him of his objection (there is no requirement that the ordaining body agree with or sustain the objection), 3) the minister must file Form 4361, *Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners*, affirming a religious objection to accepting public insurance benefits for services performed as a minister. General objections to payment of the tax or the idea that one 'could do better elsewhere' or any other reason are not valid. The deadline for applying is the due date of the federal income tax return for the second year in which the minister has \$400 or more of ministry related net income (including parsonage or housing allowance), 4) the IRS must verify in writing that the applicant is "aware of the grounds on which the individual may receive an exemption . . . and that the individual seeks an exemption on such grounds." Exemption is granted only when a copy of the Form 4361 stamped 'Approved' is received by the taxpayer. It is important to note that approved applications exempt ministers only from SECA tax on income earned from services performed in the exercise of ministry. Income earned from other sources remains subject to SECA or FICA taxes (depending on the taxpayer's employment status). Exemptions are irrevocable.

Example of SECA tax computation—the following example assumes these facts:

- 1) Rev. I. M. Blessed is an ordained minister serving as pastor of the Church of the Eternal Vine.
- 2) Pastor Blessed is considered a common-law employee of the church. His salary totals \$35,000 per year of which \$10,000 is designated as a housing allowance. His Form W-2 reports taxable income totaling \$25,000.
- 3) Pastor Blessed officiated at several weddings and funerals for which he was paid a total of \$800. He had expenses directly related to those services of \$50. Accordingly, he reported net self employment income of \$750 on Schedule C of his federal income tax return.
- 4) Pastor Blessed reported \$850 in unreimbursed employee business expenses on Form 2106 of his federal income tax return.
- 5) Pastor Blessed did not opt out of the social security system by filing Form 4361.

As an ordained minister serving as pastor of a church, Rev. Blessed has a dual tax status. Although he is considered an employee of the church for federal income tax purposes, he is considered self-employed for social security tax purposes. Therefore, he is covered by the provisions of SECA. His SECA tax is computed as follows (all amounts are rounded to the nearest dollar):

Amount subject to SECA tax:

Base salary from Form W-2	\$25,000
Add: housing allowance	10,000
Add: net self-employment income	750
Less: unreimbursed employee business expenses	850
<i>AMOUNT SUBJECT TO SECA TAX</i>	<u>\$34,900</u>

SECA tax computation

Amount subject to SECA tax	\$34,900
Net earning- multiply amount subject to SECA tax by .9235	32,230
SECA tax- multiply net earnings by .153	\$4,931

SECA tax adjustment computation: This amount is recorded as an adjustment to income on Form 1040 (the federal tax form). Together with several other adjustments, it is subtracted from gross income to determine adjusted gross income. It represents a tax savings for most taxpayers.

Reduction of gross income- multiply SECA tax by .5	\$2,466
--	---------

Ministry Consulting Group LLC

107 W Main St; Fulton OH 43321

614-743-2106

info@ministryconsulting.net

© 1995—2008 Jerry Stephens All rights reserved. Permissible use policy: The original purchaser or donee (by the author) of this document may reproduce it for non-commercial use within one local church. Other use/distribution requires the explicit permission of the author.