CHURCH PENSION GROUP
Passionate About Our Purpose

A Supplement to the 2022 Clergy Tax Return Preparation Guide for 2021 Returns

For the 2021 tax year, the Church Pension Group (CPG) is providing the *2022 Clergy Tax Return Preparation Guide for 2021 Returns* and the *2022 Federal Reporting Requirements for Episcopal Churches, Schools, and Institutions* as references to help clergy, treasurers and bookkeepers, and tax preparers to better understand clergy taxes. These guides are available on CPG's website at *cpg.org*.

This supplement complements the guides. The supplement is presented in three sections. *New for 2021 Tax Returns* highlights recent tax changes, *Ongoing Tax-Reporting Issues for 2021 Returns* addresses topics that continue to be of interest, and *Questions & Answers* covers key tax issues and explains how information provided in the guides specifically applies to clergy of The Episcopal Church.

We use the word "church" to refer to Episcopal churches, schools, and institutions under the control of an Episcopal church or diocese.

Note: If you have questions about clergy federal income taxes that are not covered here, call CPG's Tax Hotline. Please keep in mind that questions to the Tax Hotline are for clergy-specific tax issues, not general tax questions.

Nancy Fritschner, CPA	(877) 305-1414
Mary Ann Hanson, CPA	(877) 305-1415
Dolly Rios, CPA	(833) 363-5751 *Fluent in English and Spanish*

Please note that the service these individuals will provide is of an informational nature. It should not be viewed as tax, legal, financial, or other advice. You must contact your tax advisor for assistance in preparing your tax returns or for other tax advice.

New for 2021 Tax Returns

- **Student loan forgiveness:** As of July 1, 2021, employees of faith-based entities, including ordained clergy, are able to participate in the federal public service loan forgiveness program. Under new regulations from the US Department of Education issued in response to a US Supreme Court decision in *Trinity Lutheran Church of Columbia Inc. v. Comer,* religiously-based 501(c)(3) employers are qualifying employers. Employees who meet the employer's definition of full-time employment or work at least 30 hours per week, whichever is greater, may qualify for loan forgiveness. Time spent on religious instruction, worship services, or any form of proselytizing may qualify as part of your job responsibilities may be counted toward meeting the full-time employment requirement. Eligible loans include any loan received under the William D. Ford Federal Direct Loan Program (Direct Loan) and other loans consolidated into a Direct Loan. For details and to see if you qualify for loan forgiveness, visit *Federal Student Aid.*
- **Economic Impact Payments:** The American Rescue Plan Act of 2021 (ARPA) authorized a third round of Economic Impact Payments to eligible individuals beginning in March 2021 and continuing through 2021 as tax returns were processed. All third Economic Impact Payments must have been issued by December 31, 2021. You may be eligible to claim a *Recovery Rebate Credit* on your 2021 federal tax return if you didn't get a third Economic Impact Payment or got less than the full amount. Visit *Third Economic Impact Payment* for more information.
- **Child Tax Credit:** The ARPA also expanded the Child Tax Credit for the tax year 2021 ***only.*** The tax credit increased from $2,000 per qualifying child to $3,600 for children ages five and under at the end of 2021 and $3,000 for children ages six through 17 at the end of 2021. Visit *2021 Child Tax Credit and Advance Child Tax Credit Payments* for more information.
- **Required minimum distributions:** The CARES Act suspension of the required minimum distributions (RMD) from most retirement plans for 2020 has ***not*** been extended into 2021.

Ongoing Tax-Reporting Issues for 2021 Returns

The CARES Act

- **Deferral of Self-Employed Contributions Tax Act (SECA) tax payments:** The CARES Act allowed employers to defer the deposit and payment of the employer share of Social Security taxes and allowed self-employed individuals (clergy are considered self-employed for SECA tax purposes) to defer payment of certain self-employment taxes during the payroll tax deferment period, which began on March 27, 2020 and ended on December 31, 2020. If either an employer or clergy member took advantage of this deferral, 50% of the deferred taxes were required to be paid by December 31, 2021, and the remaining 50% must be paid by December 31, 2022. Visit *Coronavirus Tax Relief* for more information.
- **Withdrawal of retirement funds for coronavirus purposes:** If you withdrew retirement funds from IRAs and defined contribution qualified retirement plans (such as 403(b) plans, including the Church's RSVP plan for coronavirus purposes in 2020, the Act waives the 10% early withdrawal penalty for distributions up to $100,000. Withdrawals are still taxed, but taxes are spread over three years, or the taxpayer has the three-year period to recontribute to an eligible retirement plan without regard to that year's cap on contributions.
- **Extension of certain CARES Act provisions under the Consolidated Appropriations Act of 2021**
  - **Above-the-line deductions:** Individuals, married couples filing separate returns, and heads of household who plan to take the standard

deduction for their 2021 tax returns may claim an above-the-line deduction of up to $300 for cash donations to qualifying public charities, including churches. The amount is $600 for married couples filing jointly.

  - **Other charitable contribution provisions:** Donors may continue to receive a federal income tax deduction for charitable contributions of up to 100% of their adjusted gross income (AGI) for certain cash donations made during the calendar year 2021, up from 60% in 2020.

- **Moving expenses:** Under the Tax Cut and Jobs Act, for 2018 through 2025, qualified moving expenses can no longer be reimbursed taxfree or deducted on personal tax returns. Any direct payment of moving expenses or reimbursement to the clergy member must be treated as taxable compensation and included as salary on Form W-2. In addition, these amounts are assessable under The Church Pension Fund Clergy Pension Plan.

  Costs associated with moving your home furnishings are eligible to be claimed toward your housing allowance.

Questions & Answers

Eligibility

Q1. *For tax purposes, who is considered a minister in The Episcopal Church?*

A1. In The Episcopal Church, only bishops, priests, and deacons (ordained ministers, as opposed to lay ministers) meet the criteria for the IRS designation of "minister." See the *2022 Clergy Tax Return Preparation Guide for 2021 Returns* ("Who is a minister for federal tax purposes?") and the *Federal Reporting Requirements Guide* ("Definition of 'minister' for IRS tax purposes") for an explanation of the importance of understanding whether you qualify as a minister for tax purposes. Also see *IRS Publication 517* for details.

Q2. *What types of organizations qualify as church organizations?*

A2. Church organizations include Episcopal parishes and missions, dioceses, schools, and institutions associated with The Episcopal Church. The approval of an Extension of Ministry under The Church Pension Fund Clergy Pension Plan does not automatically qualify a clergy member for clergy tax treatment. Also, pay received for work performed for organizations not associated with the Church may not qualify as the "exercise of ministry." Work performed directly for the Church is considered "exercise of ministry," no matter the nature of the work. Generally, work for non-church organizations does not qualify for the housing allowance unless that work is primarily sacerdotal.

Basics of Clergy Taxation

Q3. *What are the key federal tax provisions that apply to clergy compensation?*

A3. The key provisions include the following:

Self-employment tax: Clergy are not eligible to have FICA taxes withheld from their church compensation. In lieu of FICA taxes, clergy pay self-employment tax, also known as Self-Employment Contributions Act tax (SECA). Reimbursements of SECA from an employer are taxable as wages and are assessable under The Church Pension Fund Clergy Pension Plan. *Note,* however, that even though clergy pay SECA tax, most ministers are considered employees and should receive a Federal Form W-2 from their employer.

Estimated taxes: Clergy must pay quarterly estimated taxes or request that their employer voluntarily withhold income taxes. Clergy can request that an additional amount of income tax be withheld to cover their self-employment tax. The additional amount will be reported as federal income tax.

Housing allowance: A clergy member can have a portion of their salary declared as a housing allowance and thereby exempt the eligible amount from federal income tax. Note that under Section 107 of the Internal Revenue Code, clergy pension distributions can also be declared as a housing allowance. (This provision does not apply to the clergy member's surviving spouse.) For additional information, please refer to Part 3 of the *2022 Clergy Tax Return Preparation Guide for 2021 Returns.*

Note that the housing allowance is applicable to clergy who live in their own housing and those who live "rent-free" in church-provided housing. See the discussion of clergy housing allowance below for more detail.

CPF Form B explains how The Church Pension Fund (CPF) declares the full amount of all benefits paid from retirement and disability plans sponsored by CPF to retired and disabled clergy are eligible to be claimed as a housing allowance and how to apply that for tax purposes. We recommend that you place a copy of CPF Form B in your current tax file and provide it to your tax preparer.

Q4. *Should I prepare my own taxes?*

A4. It is not recommended. Clergy tax issues are highly complex, and not all tax software is capable of producing accurate results.

The Clergy Housing Allowance Exemption

Q5. *How can I determine my housing allowance under Internal Revenue Code Section 107?*

A5. To establish a Section 107 housing allowance, your vestry or other church-governing body must adopt a housing allowance resolution at the end of each calendar year for the following year. A church cannot designate a housing allowance retroactively. Please refer to the *Federal Reporting Requirements Guide* ("Housing Allowance") for additional information. The housing allowance should equal the fair rental value of the clergy's primary residence furnished plus estimated utilities, or anticipated housing expenses, whichever is lower. Any excess housing allowance must be reported by the clergy member as taxable income on their Form 1040.

Clergy can consult with a realtor to obtain a written appraisal of the fair rental value of their furnished home. The clergy member can add utility costs to the realtor's appraisal to recommend a housing allowance amount to the vestry. The vestry then can vote its approval of that housing allowance designation and document its action in the minutes of the meeting.

Note that only expenses incurred for the clergy's primary residence are eligible for the housing allowance exclusion. Please be sure to consult your tax preparer regarding your housing allowance.

Q6. *To what taxes does the clergy housing allowance exemption apply?*

A6. Qualified housing expenses for clergy who own or rent their primary residence, or the fair rental value of "rent-free" church-provided housing, are treated as a reduction of taxable earnings when computing federal income taxes and most—though not all—state income taxes, but they are not treated as a reduction of taxable earnings when computing self-employment taxes. Clergy who own or rent their primary residence may not exclude housing allowance amounts from income when computing self-employment taxes.

Q7. *How do I report my housing allowance for an interim cure in an out-of-town location?*

A7. This situation presents unique issues, especially for retirees who are receiving a pension. The differences in tax treatment depend on the length of the cure, and taxpayers are advised to consider them carefully.

Cures of one year or less: If the interim job is for a set duration of one year or less and does in fact not exceed one year, the housing at the temporary location is generally treated as a business expense that can be provided by or reimbursed by the employing church taxfree to the cleric. An active clergy member can declare a portion of the interim compensation as a housing allowance and apply it to the clergy member's permanent residence. Also, a retired clergy member can continue to apply pension income toward the housing allowance for the expenses of the clergy member's permanent residence. Travel expenses to and from the permanent residence and the interim job location are treated as business expenses.

Cures of longer than one year (or an uncertain period of time): If the interim job is projected to last for more than a year, or its term is uncertain (whether or not it turns out to be for less than a year is irrelevant), the clergy member has generally been deemed to have moved their principal residence to the interim location. Therefore, the reimbursement of expenses relating to the temporary housing at the interim location is taxable for Self-Employed Contributions Act/Self-Employment Tax (SECA/SET) purposes and the clergy member will not be able to claim a housing allowance as it relates to the housing expenses associated with the clergy member's permanent residence.

Q8. *How do I report my housing allowance when I live "rent-free" in church-provided housing?*

A8. Clergy who live "rent-free" in church-provided housing should have a portion of their cash compensation designated by the vestry or other church governing body as a housing allowance for housing-related expenses they pay, such as utilities, repairs, and furnishings. This exclusion works like the housing allowance for clergy who own or rent their homes. The portion of the fair rental value test that applies is the portion not provided by the church. Therefore, if the church provides the house and pays the utilities, the value added for furnishings is the only relevant amount to be used in determining the amount eligible for the clergy housing allowance.

Note that clergy who live "rent-free" in church-provided housing that is provided as compensation for ministerial services do not include the annual fair rental value of church-provided housing as income in computing federal income taxes. The annual fair rental value is not "deducted" from the clergy's income as housing allowance, nor is it reported as additional taxable compensation on *IRS Form W-2*.

Note also that clergy who live "rent-free" in church-provided housing will ***not*** be allowed to claim a housing allowance for any other real property that they own or rent while living "rent-free" in church-provided housing. This is because the "rent-free" church-provided housing will be considered their primary residence for tax purposes.

Q9. *Do mortgage and refinancing costs qualify as part of the housing allowance?*

A9. Although the costs of a mortgage may qualify as part of the housing allowance, costs associated with refinancing a principal residence or obtaining a home equity loan qualify only if the proceeds are specifically used for acquiring, improving, or maintaining a principal residence.

Q10. *Do the costs of a home office qualify as part of the housing allowance?*

A10. If an office-in-the-home deduction is taken on a Schedule C for a business in the home, those amounts should be excluded from the actual expenses used for qualified housing expenses. A clergy receiving a *Form W-2* will no longer get a tax benefit for federal income tax from taking a home-office deduction; however, these expenses could be deducted from self-employment taxable income when calculating SECA tax.

Q11. *How can I ensure that my expenses at a long-term care facility are eligible for the housing allowance exclusion?*

A11. If you are considering moving to a long-term care facility, make sure that it will give you a breakdown each year of the portions of your payments that represent the cost of housing, medical expenses, and other items. It is necessary to have such information to take proper advantage of your housing allowance and medical expense deductions on your income tax returns. Note that the IRS has ruled that the lump-sum entrance fee paid by a retired minister to gain admission to a long-term care facility can be treated as a housing expense only in the year it is actually paid and cannot be prorated over several years.

How Can I...?

Q12. *How can I set up an accountable business expense reimbursement plan?*

A12. The Tax Cuts and Jobs Act of 2017 eliminated a taxpayer's ability to deduct unreimbursed business expenses. Therefore, clergy should ensure that their employer has established an accountable expense reimbursement plan. See the Federal Reporting Requirements Guide ("Accountable Business Expense Reimbursement Plan") for more information.

Q13. *How can I find a tax preparer?*

A13. Here are some tips to help you find a competent professional:

- Ask your diocesan finance officer for recommendations.
- Ask your clergy colleagues (not just Episcopal).
- Use a tax preparer who is familiar with the rules that apply to clergy.
- Ask local tax professionals whether they have worked with ministers and, if so, 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 and Medicare tax purposes. Anyone familiar with ministers' taxes will know that ministers always are self-employed for Social Security and Medicare tax purposes with respect to their ministerial duties. Or ask a tax professional if a minister's church salary is subject to required income tax withholding.
- Often, tax preparers can readily familiarize themselves with clergy tax treatment by reviewing the 2022 Clergy Tax Return Preparation Guide for 2021 Returns, calling CPG's Tax Hotline (see the first page), and/or referring to CPF Form B.

Q14. *How can I change my withholding amount when receiving my pension benefit in retirement?*

A14. Your monthly earnings statement provided by Northern Trust includes a section where you can enter an adjustment to your federal and state income tax withholding. Simply sign, date, and return it to CPG.

You can, instead, submit a new CPF Substitute Form W-4P Federal Withholding Certificate. This form is available under *Clergy Tax Forms and Resources*.

Contributions to and Withdrawals from The Episcopal Church Retirement Savings Plan (RSVP)

Q15. *What are the contribution limits to my RSVP?*

A15. The RSVP is a Code Section 403(b) defined contribution plan that may be funded by an individual with earnings received from services provided to the church and/or employer contributions. Contributions by the clergy can be made only from earnings that are reported as taxable compensation (i.e., earnings that have not been applied toward the housing allowance).

If you are actively employed by an Episcopal institution, you are eligible to continue to make pre-tax contributions to the RSVP from current taxable earnings through the duration of your employment, even after you are required to begin taking distributions.

For 2021, the maximum combined contribution (i.e., employer contributions and employee salary deferrals) was the lesser of 100% of taxable compensation or $58,000 ($64,500 for those ages 50 or older). For 2022, these amounts increase to $61,000 (or $67,500 for those ages 50 or older).

The maximum employee pre-tax salary deferral for 2021 was the lesser of 100% of taxable compensation or $19,500 ($26,000 for those ages 50 or older). For 2022, the maximum amount increased by $1,000 to $20,500 ($27,000 for those ages 50 or older). If contributions made to a Section 403(b) account are more than these contribution limits, penalties may apply. Generally, annual contributions to a Section 403(b) plan cannot exceed either the limit on annual additions or the limit on elective deferrals. See *IRS Publication 571* for details.

Q16. *What should I know about taking distributions from my RSVP?*

A16. The RSVP is an IRS Code Section 403(b) defined contribution plan. The SECURE Act increased the required minimum distribution (RMD) age to 72 for anyone born after June 30, 1949. The RMD age remains 70½ for anyone born before July 1, 1949. Required minimum distributions must commence by April 1 of the year following the year in which a participant reaches the required minimum distribution age.

While the IRS permits RMDs on 403(b) accounts to be delayed until the actual date of retirement, the Church Pension Fund requires that all RSVP participants begin to receive their RMD by April 1 following the year in which the clergy member reaches age 72, regardless of whether the clergy member's work status is active or retired.

Note that if you defer your first withdrawal until April of the following year, you will also need to make a current withdrawal by the end of that same year. Therefore, you will have two taxable withdrawals in one year and possibly a larger tax liability.

Before you make any withdrawals (including required minimum distributions) from the RSVP, be sure to contact Fidelity to inform them that you are a member of the clergy and are eligible to take the distribution as a clergy housing allowance. Distributions from the RSVP are eligible to be applied toward your declared housing allowance if requested at the time of withdrawal.

General Tax Questions

Q17. *Is the Resettlement Benefit payable to eligible clergy under The Church Pension Fund Clergy Pension Plan taxable?*

A17. If the Resettlement Benefit is distributed to the clergy member, it is a taxable benefit. However, it may be eligible for the housing allowance exclusion (see question 5). To delay paying tax on the Resettlement Benefit, you can make a taxfree rollover of the Resettlement Benefit to The Episcopal Church Retirement Savings Plan (RSVP) or another tax-deferred savings vehicle.

Q18. *I received a gift from my parish at retirement. Is it taxable?*

A18. Many clergy receive retirement gifts. The tax treatment generally works as follows:

- Gifts provided by the employer are taxable to the clergy. They must be reported on Form W-2 as wages and are assessable wages for The Church Pension Fund Clergy Pension Plan.
- Gifts funded by individuals directly to the clergy, or collected by the church as non-deductible personal gifts, are not taxable to the clergy member, are not reported on Form W-2 as wages, cannot be treated as tax-deductible by the giver, and are not assessable for pension purposes.

Q19. *How long must I retain my tax return and supporting records?*

A19. You should retain copies of your tax returns for your lifetime. Supporting documents can be destroyed after seven years.

Q20. *Due to my conscientious objection to public insurance programs, I would like to opt out of Social Security. Is it permissible for me to take such an exemption for my self-employment taxes?*

A20. Some denominations allow their clergy to opt out of Social Security as a conscientious objection to the receipt of social insurance. The Episcopal Church does not support this option on theological grounds. As a result, some Episcopal ministers have opted out of Social Security without realizing that they do not qualify for the exemption. It should be noted that, when signing Federal Form 4361, a minister must attest to its accuracy under penalty of perjury.

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

Note also that a decision to opt out of Social Security is irrevocable. Clergy who opt out of Social Security, especially those who have vested benefits with Social Security from previous employment outside the Church, may be subject to the windfall elimination provision. For more information, refer to *IRS Publication 963*.