



10 ESSENTIALS OF

SOCIAL SECURITY FOR MINISTERS

CHURCH

**ESSENTIALS
SERIES**

Introduction

Introduction

Social security rules are some of the most complicated, confusing, and challenging areas for many ministers in the United States. Here are just a few of the questions which can be confounding to ministers.

- Which type of social security tax, FICA or SECA, applies to ministers?
- Does the church or the minister pay the social security tax?
- What is the impact when a church pays all or a portion of a minister's social security tax?
- What income is subject to social security tax?
- Are there any deductions that may offset income subject to social security tax?

This resource addresses the most basic issues surrounding social security for ministers. If you understand the 10 Essentials discussed in this resource, you will have a good grasp of the major issues that often puzzle ministers.

These 10 Essentials come from trustworthy, biblically-informed advisors who seek to help you establish disciplined patterns that abide by U.S. tax laws. More importantly, attention to these 10 Essentials ensures that your practices bring honor to God.

***Listen to advice and accept discipline,
and at the end you will be counted among the wise.***

Proverbs 19:20

1

Differentiate
the Two Types of
Social Security Tax

Differentiate the Two Types of Social Security Tax

U.S. social security taxes are collected under two systems:

- 1. Social security for employees.** One type of social security applies to employees—those in an employee-employer relationship. The employee pays one-half of the tax through payroll withholding, and the employer pays the other half. This social security system is referred to as FICA, based on the Federal Insurance Contributions Act.
- 2. Social security for independent contractors.** The second type of social security applies to independent contractors—those workers not in an employee-employer relationship. This social security system is based on the Self-Employment Contributions Act (SECA). The SECA tax is calculated on Schedule SE with the tax amount carried forward to Form 1040.

If an individual qualifies as a “minister” under federal law and receives income for performing ministerial services, the income is subject to self-employment social security tax (unless the individual has met the stringent requirements to opt out of social security tax and has formally done so*). This is true even though the individual will often be considered an employee for income tax purposes. This is referred to as “dual-tax status” for ministers.

To say it another way, for social security purposes, ministers are always self-employed, subject to SECA. They are not subject to FICA-type social security taxes—even though they report their income taxes as employees and receive a Form W-2.

If a church is withholding FICA-type social security tax from a qualified minister’s pay, this practice should be discontinued, and a tax professional should be consulted to determine appropriate steps.

*Even if the individual has opted out of social security, only the income received for ministerial services is exempt. The exemption does not apply to any other income.

2

Delineate Income from Ministerial Services

Delineate Income from Ministerial Services

Income from ministerial services includes the following:

- **Most of the services performed as a minister.** These services include:
 - ▶ Performing sacerdotal functions
 - ▶ Conducting religious worship
 - ▶ Controlling, conducting, and maintaining religious organizations. (You are considered to control, conduct, and maintain a religious organization if you direct, manage, or promote the church's activities.)
- **Services for nonreligious organizations.** Your services for a nonreligious organization may be considered ministerial services if a church assigns or designates the services. Assigned or designated services qualify even if the services do not involve performing sacerdotal functions or conducting religious worship.

If your services are not assigned or designated by a church, they are ministerial services only if they significantly involve performing sacerdotal functions or conducting religious worship.

- **Services that are not part of your ministry.** Income from certain services may be subject to FICA-type social security. These include services you perform as an employee that are not ministerial in nature. This income is taxed under the rules that apply to employees in general. The following are not ministerial services:
 - ▶ Services you perform for nonreligious organizations other than under an assignment (see earlier discussion).
 - ▶ Services you perform as a duly ordained, commissioned, or licensed minister while an employee of the United States government, the District of Columbia, a foreign government, or any of their political subdivisions. This is true even if you are performing sacerdotal functions or conducting religious worship. (For example, if you perform services as a chaplain in the Armed Forces of the United States, those services are not ministerial services. They are taxed under FICA.)
 - ▶ Services you perform in a government-owned and operated hospital. (These services are considered to be performed by a government employee, not by a minister as part of a ministry.) However, services that you perform at a church-related hospital or health and welfare institution, or a private nonprofit hospital, are considered to be part of the ministry and are considered ministerial services. The important difference is whether the institution is government-owned.

3

Churches
Determine
Ministerial Status

Churches Determine Ministerial Status

The church or other employer determines whether an individual worker qualifies for ministerial tax status—not the other way around. The individual must always be ordained, licensed, or commissioned, and there may be additional requirements for ministerial tax status, depending on the nature of the employer.

If the employer determines that the individual qualifies for ministerial tax status, FICA-type social security tax is not withheld from pay nor matched by the employer. Conversely, if the employer determines the individual does not qualify for ministerial tax status, the employer must withhold and match FICA-type social security. This is true even if the individual opted out of social security based on previous ministerial status; the employer must still withhold FICA-type social security because of the current non-ministerial status.

If the individual does qualify for ministerial tax status, he or she must calculate the social security tax due under the Self-Employment Contributions Act (SECA) by completing Schedule SE and carrying the calculated tax forward to Form 1040.

Example 1: An individual has received a ministerial license from a religious denomination. However, the denomination only recognizes ordained ministers as qualifying for ministerial tax status. This denomination considers all licensed ministers to be lay employees. Because of the denomination's position on ministerial tax status, the individual is subject to FICA, not SECA-type social security.

Example 2: An individual is an ordained minister and the employing church recognizes this person as qualifying for ministerial tax status. He or she asks the employer to withhold FICA-type social security from his or her pay. The employing church has no basis to withhold FICA and should not do so. Improperly withholding and matching FICA-type tax results in passing through a tax-free benefit (the employer's FICA match) to the individual, since any matching of social security for ministers is a fully taxable event.

4

Compute
Ministerial
Self-Employment
Tax

Compute Ministerial Self-Employment Tax

The net earnings (gross earnings less related expenses) for self-employment tax purposes include gross income earned from services performed in the exercise of ministry.

The following are subject to self-employment taxes on Schedule SE:

- Ministerial compensation reported on Form W-2, Box 1 (the designated housing allowance should have been excluded from this box)
- Housing allowance excluded from Form W-2, Box 1
- The net profit or loss from Schedule C relating to ministerial income (for example, fees received for conducting marriages, baptisms, and funerals)
- The fair rental value of employer-provided housing amounts that were erroneously omitted from Form W-2, Box 1, such as:
 - ▶ Business expense reimbursements made under a nonaccountable plan
 - ▶ Self-employment social security tax reimbursement or allowance
 - ▶ Any amount an employer pays toward your income tax (other than withholding)
 - ▶ Love offerings facilitated by the employer

Amounts not included in determining self-employment net earnings are:

- Contributions by the employer to a 403(b) or 401(k) plan that the employer established, including any salary reduction contributions (elective deferrals) that are not included in gross income
- Pension payments or retirement allowances received for past ministerial services
- The rental value of a parsonage received while actively serving a church or a parsonage allowance provided after retirement

Unreimbursed business expenses are deductible in determining the income subject to SECA. Ministers may deduct unreimbursed business expenses even if the deductions were not itemized on Form 1040 by filing a Schedule A.

Moving expenses do not qualify as business expenses. Therefore, moving expenses are not deductible when computing self-employment tax.

Example: A minister's salary from a church is \$70,000, plus a housing allowance is \$20,000; net Schedule C income related to special speaking engagements, weddings, and funerals is \$2,000; and Schedule A employee business expense is \$1,000.

Salary from church on Form W-2, Box 1	\$70,000
Church-designated housing allowance excluded from salary on Form W-2	20,000
Schedule C net earnings from sources other than church employment	2,000
Employee business expenses eligible for deduction on Schedule A	<u>(1,000)</u>
Total claimed as subject to self-employment social security tax on Schedule SE	\$91,000

Self-Employment Social Security Tax Worksheet

Inclusions:

Salary paid by church as reflected on Form W-2, Box 1 \$ _____

Net profit or loss as reflected on Schedule C
(includes speaking honoraria, offerings you receive for
marriages, baptisms, funerals, and other fees) _____

Housing allowance excluded from salary on Form W-2 _____

Fair rental value of church-provided housing (including paid utilities) _____

Nonaccountable business expense reimbursements
(if not included on Form W-2) _____

Reimbursement of self-employment taxes (if not included on Form W-2) _____

Other amounts that should have been included on Form W-2, Box 1,
such as love offerings _____

Deductions:

Unreimbursed ministerial business and professional expenses or reimbursed
expenses paid under a nonaccountable plan not deducted on Schedule C _____

Net earnings from self-employment (to Schedule SE) \$ _____

Note 1: Your net earnings from self-employment are not affected by the foreign earned income exclusion or the foreign housing exclusion or deduction if you are a U.S. citizen or resident alien who is serving abroad and living in a foreign country.

Note 2: Amounts received as pension payments or annuity payments related to a church-sponsored tax-sheltered annuity by a retired minister are generally considered to be excluded from the social security calculation.

5

Consider SECA
Payment Options

Consider SECA Payment Options

Ministerial self-employment social security tax (SECA), as well as federal income tax, is generally paid in one of three ways:

- 1. Estimated taxes.** Form 1040-ES is filed quarterly by ministers with payments of estimated taxes.
- 2. Voluntary withholding agreement.** Under a voluntary withholding agreement, a minister asks the church to withhold additional federal income taxes to cover self-employment taxes (and perhaps enough to cover federal, state, and local income taxes). This is not a mandatory withholding concept. Under such an arrangement, the church must report all amounts withheld as federal income taxes on Forms 941 and W-2.
- 3. Payroll withholding.** Under this approach, the church does not remit the amounts withheld to the IRS. The amounts are paid to the minister quarterly, and the minister then files Form 1040-ES and remits the money to the IRS.

Example: A minister projected that he will owe \$1,000 in federal income tax and \$3,000 in self-employment social security tax for a total tax obligation of \$4,000. The minister and his spouse do not have withholding from nonchurch employment. They do not qualify for the earned income tax credit.

1. The minister could file Forms 1040-ES on April 15, June 15, September 15, and January 15, submitting payments of \$1,000 per filing (or payments that totaled \$4,000).
2. The minister could enter into a voluntary withholding agreement whereby the church would withhold federal income taxes from each paycheck so that by the end of the tax year, the entire \$4,000 had been withheld (and reported on Form W-2, Box 2). No FICA-type social security tax is withheld from the minister's pay since he is subject to the SECA-type social security.
3. The minister asks the church to make payroll withholding for federal taxes. The church remits the amount withheld to the minister, who, in turn, pays the IRS.

6

Calculate Available Deductions

Calculate Available Deductions

Ministers, as self-employed individuals, can claim a deduction equal to one-half of the amount of self-employment tax because of a special provision in the tax code available to all self-employed individuals. The deduction is claimed against gross income on Form 1040, Schedule 2.

Ministers also may deduct a portion of their self-employment tax liability in calculating self-employment tax. This deduction, made on Schedule SE, is taken by applying 92.35% times the net self-employment income. The result is subject to the self-employment tax rate.

These deductions equalize the taxes paid by (and for) persons with equivalent income, whether they are employees or self-employed.

7

Evaluate Employer
Reimbursements of
Social Security Tax
Expenses

Evaluate Employer Reimbursements of Social Security Tax Expenses

Some ministers are reimbursed by the employing church for the SECA tax they have to pay as “ministers” under the federal tax law. The reimbursements may offset a portion or all of the self-employment tax. The employer sometimes calls the payments “allowances,” but they result in taxable income and must be claimed as such in the year in which they are received.

Example 1: A minister pays \$3,000 in SECA social security tax for Year 1, as calculated on Form 1040, Schedule SE. The employing church decides to provide a 50% allowance starting in Year 2, so it pays her \$1,500 on December 31. The allowance is fully taxable for the minister, both for income and for social security (SECA) tax purposes and should be reported on Form W-2, Box 1 for Year 2.

Example 2: Same facts as Example 1 except the employing church pays the social security tax allowance to the clergy quarterly during Year 1. In this instance, each allowance paid in the calendar year should be should be totaled and reported on Form W-2, Box 1 for Year 1.

8

Understand
the Opt Out
Requirements

Understand the Opt Out Requirements

All ministers are automatically covered by SECA-type social security for services performed in the exercise of ministry. However, the IRS may approve an exemption in very limited situations based on the filing of Form 4361.

To claim the exemption from self-employment tax, a minister must:

- File Form 4361, Application for Exemption from Self-Employment Tax by Ministers, Members of Religious Orders, and Christian Science Practitioners;
- Be conscientiously opposed to public insurance, with respect to services performed as a minister (which includes insurance systems established by the Social Security Act that helps pay for or provides services for medical care, such as Medicare) because of your individual religious considerations (not because of your general conscience), or because of the principles of your religious denomination (either opposition must be based on religious belief);
- File for other than economic reasons. There is no basis to opt out of social security based on the belief that it is not financially advantageous to participate in social security;
- Inform the ordaining, commissioning, or licensing body of your church or religious order that you are opposed to public insurance;
- Establish that the religious organization that ordained, commissioned, or licensed you is a church or a convention or association of churches; and
- Sign and return the statement the IRS mails to you to verify that you are requesting an exemption based on the grounds listed in the statement.

Form 4361 must be filed by the date your income tax return is due, including extensions, for the second tax year in which you have net earnings (gross earnings less related expenses) of at least \$400 from self-employment. This is true if any part of your net earnings from each of the two years came from ministerial services. The two years do not have to be consecutive tax years.

Example 1: Rev. Samuel Smith, a minister ordained in Year 1, has net self-employment earnings of \$450 in Year 1 and \$500 in Year 2. He must file his Form 4361 application for exemption by the due date, including extensions, for his Year 2 income tax return. However, if Rev. Smith does not receive IRS approval for an exemption by April 15, Year 3, his self-employment tax for Year 2 is due by that date.

Example 2: Rev. Samantha Crowell has \$300 in net self-employment earnings as a minister in Year 2, but earned more than \$400 in Year 1 and expects to earn more than \$400 in Year 3. She must file her application for exemption by the due date, including extensions, for her Year 3 income tax return. However, if she does not receive IRS approval for an exemption by April 15, Year 4, her self-employment tax for Year 2 is due by that date.

The IRS will return a copy of Form 4361 to you indicating whether your exemption has been approved. If it is approved, keep that copy in your permanent records.

9

Recognize the
Challenge of
Opting Back Into
Social Security

Recognize the Challenge of Opting Back Into Social Security

In the past, the U.S. Congress has periodically provided a special window to opt back into social security. However, there is currently no formal method available for ministers to opt back into social security until Congress provides another window of opportunity.

If a minister who has opted out of social security begins to voluntarily pay self-employment social security tax in an effort to informally opt back in, the minister should be aware that the IRS could require payment of the social security tax for all the years open under the statute of limitations—generally three years.

10

Apply for Social
Security Benefits

Apply for Social Security Benefits

The earliest age you can begin receiving social security retirement benefits is 62.

You should apply for benefits no more than four months before the date you want your benefits to start. Benefits are paid the month after they are due. In other words, if your benefits start in April, you will receive your first benefit payment in May.

If you are not receiving social security and you are not ready to retire, you should still sign up for Medicare four months before your 65th birthday.

The age for collecting your full social security benefit used to be 65—but no longer. Full retirement gradually increases from age 65 to 67.

Here, by year of birth, is the age at which you can expect to collect your full social security retirement benefit:

Year of Birth	Age for Collecting Full Retirement Benefit
Before 1938	65
1938	65 and two months
1939	65 and four months
1940	65 and six months
1941	65 and eight months
1942	65 and ten months
1943-1954	66
1955	66 and two months
1956	66 and four months
1957	66 and six months
1958	66 and eight months
1959	66 and ten months
1960 and later	67

Income taxes on benefits. Social security benefits are income-tax free for the majority of beneficiaries. However, those with high total incomes must include up to 85% of their benefits as income for federal income tax purposes. Special step-rate “thresholds” determine the amount on which you may be taxed.

Working after you reach retirement age. If a minister is working and below full retirement age (FRA), \$1 of social security benefits will be lost for every \$2 you earn over a certain limit, which increases annually. Once you reach FRA, you can earn as much as you like with no reduction in benefits. The earnings test takes into account only money you earn from a job or self-employment, not income from investments or other sources. However, dollars from income excluded because of the housing allowance are included in the earnings test.

Checking on your benefits. Complete a request for an earnings and benefit estimate statement every three years. You can access this information by setting up an account at ssa.gov/myaccount. Notify the Social Security Agency of any discrepancies.

It is also important not to overlook the possibility of errors in your church retirement plan. Get a summary plan description and look over your annual statement summary.

Now What?

Action Steps
to Excellence

Now What? Action Steps to Excellence

Action Steps for Churches

- Determine which staff members perform ministerial services, and are therefore subject to self-employment type social security (SECA), and are not subject to FICA-type withholding.
- Be diligent to document which of the ministers' duties qualify as "ministerial services" (and therefore subject to SECA) versus non-ministerial services which may instead be subject to FICA.
- Review your records for each staff member to ensure that the church is not withholding FICA-type social security tax when SECA should apply, and vice-versa.
- Assist your ministers in computing the ministerial self-employment tax using the formula: Ministerial salary compensation + church-designated housing allowance (if excluded from salary) + any net profit or loss from schedule C, less any deductible, unreimbursed business expenses (Form on Page 12).
- Decide whether to reimburse ministers for a portion or all of their SECA tax, being aware that any reimbursements or allowances are considered taxable income.
- Discuss with your ministers a long-term plan for retirement and applying for social security benefits. This may occur as early as age 62, with full retirement age occurring at age 65-67 depending on the minister's year of birth. Be sure to encourage ministers to take into account any tax implications or penalties that may apply based on income level and/or whether they intend to continue working.

Action Steps for Ministers

- Understand your church's decision as to whether you perform ministerial services, and are therefore subject to self-employment type social security (SECA), and are not subject to FICA-type withholding.
- Determine your income from ministerial services, which may include services for non-religious organizations if those services were assigned or designated by the church.
- Determine any income from services that are not part of your ministry, such as those not assigned by the church, or services performed for a government or military agency, or in a government-owned and operated institution. This figure will likely be subject to FICA.
- Compute the ministerial self-employment tax using the formula: Ministerial salary compensation + church-designated housing allowance (if excluded from salary) + any net profit or loss from Schedule C, less any deductible, unreimbursed business expenses (Form on Page 13).
- Determine how to pay your SECA taxes using one of the three acceptable methods.
- Calculate available deductions on the self-employment tax.
- Discuss with your church whether you will be reimbursed for a portion or all of your SECA tax, being aware that any reimbursements or allowances of this kind are considered taxable income.
- You may apply for your social security benefits beginning at age 62. The age for full retirement benefits varies from age 65 to age 67 depending on the year of your birth. Be sure to take into account any tax implications or penalties that may apply based on your income level and/or whether you intend to continue working.

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