

A Supplement to the 2021 Clergy Tax Return Preparation Guide for 2020 Returns

For the 2020 tax year, the Church Pension Group (CPG) is providing the *2021 Clergy Tax Return Preparation Guide for 2020 Returns* and the *2021 Federal Reporting Requirements for Episcopal Churches, Schools, and Institutions (Federal Reporting Requirements Guide)* as references to help clergy, treasurers and bookkeepers, and tax preparers in better understanding clergy taxes. These guides are available on CPG's website at cpg.org.

This supplement complements the guides. The supplement is presented in two sections. First, a section on tax highlights addresses recent tax changes. Second, a question-and-answer format addresses key tax issues, and information provided in the guides and how it specifically applies to clergy of The Episcopal Church.

Note: If you have questions about clergy federal income taxes that are not covered here, please call CPG's Tax Hotline:

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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.

Tax Highlights

The SECURE (Setting Every Community Up for Retirement Enhancement) Act of 2019 is now law. Most provisions in the law became effective January 1, 2020. Listed below are some of the most important changes that could have a significant impact on you.

- The Required Minimum Distribution (RMD) age has increased from age 70½ to 72. This change applies to anyone who will attain age 70½ on or after January 1, 2020. This means that anyone who attained age 70½ prior to December 31, 2019, will need to continue to take RMDs in 2020 and beyond. Note: The CARES Act suspends the requirement to take an RMD in 2020.
- Contributions to traditional IRAs after age 70½ are now allowed for anyone who is working and has earned income.
- Withdrawals of up to \$10,000 from Code Section 529 plans (tax-advantaged higher education savings accounts) to repay student loans are now permitted. The SECURE Act makes this change retroactive to distributions made after December 31, 2018.
- New parents, through birth or adoption, are eligible to withdraw \$5,000 penalty-free to offset the cost of qualified delivery or adoption expenses.
- “Stretch” provisions for beneficiaries of IRAs and defined contribution plans (such as the Code Section 403(b) arrangement known as The Episcopal Church Retirement Savings Plan (RSVP)) have been significantly modified. The SECURE Act now requires designated beneficiaries of IRAs and defined contribution plans to withdraw all amounts within 10 years after the account owner’s death. These provisions do not apply to the following “eligible designated beneficiaries”:
 - the surviving spouse of the deceased account owner,
 - a minor child of the deceased account owner (but only until the minor child reaches the age of majority),
 - a beneficiary who is no more than 10 years younger than the deceased account owner, or
 - a disabled or chronically ill beneficiary (as defined by the Internal Revenue Code).

A review of your financial and estate plans and IRA beneficiary elections, as well as a conversation with your financial professional, is strongly recommended.

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law on March 27, 2020. Here are some provisions of that act that may have affected you or your church or other institution during 2020.

1. Deferral of the payment of the employer’s share of Social Security

taxes: Social Security taxes due from March 27, 2020, through December 31, 2020, can be deferred until 2021 and 2022. Half of the deferred taxes will be due December 31, 2021, and the remaining half due December 31, 2022.

2. Use of retirement funds: The bill waives the 10% early withdrawal penalty for distributions up to \$100,000 from IRAs and defined contribution qualified retirement plans (such as 403(b) plans, including the Church’s RSVP plan) for coronavirus-related purposes, on or after January 1, 2020, and before December 31, 2020. 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.

3. 401(k) Loans: The loan limit is increased from \$50,000 to \$100,000.

4. RMDs Suspended: Required Minimum Distributions from IRAs and 401(k) plans are suspended.

5. Charity: There is a new provision that provides an above-the-line deduction up to \$300 per individual for charitable contributions; plus, the limit on charitable contributions to qualifying organizations is increased to 100% of AGI.

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 *2021 Clergy Tax Return Preparation Guide for 2020 Returns* (page 11) and the *Federal Reporting Requirements Guide* (page 2) for an explanation of the importance of understanding whether you qualify as a minister for tax purposes.

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 cleric 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 from an employer of SECA 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 cleric can have a portion of his or her 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 cleric’s surviving spouse.) For additional information, please refer to Part 3 of the *2021 Clergy Tax Return Preparation Guide for 2020 Returns*.

CPF Form B immediately follows this supplement. It 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 as a housing allowance, and how to apply it 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. No. Clergy tax issues are highly complex and not all tax software is capable of producing accurate results.

How Can I...?



Q5. *How can I find a tax preparer?*

A5. 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 *2021 Clergy Tax Return Preparation Guide for 2020 Returns*, calling CPG's Tax Hotline (see the first page), and/or referring to CPF Form B.

Q6. *How can I determine my housing allowance under Internal Revenue Code Section 107?*

A6. 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* (pages 6-7) for additional information.

A cleric can consult with a realtor to obtain a written appraisal of the fair rental value of his or her furnished home. Adding utility costs to the realtor's appraisal, the cleric can 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 minister's primary residence are eligible for the housing allowance exclusion. Please be sure to consult your tax preparer regarding your housing allowance.

Q7. *How can I ensure that my expenses at a long-term care facility are eligible for the housing allowance exclusion?*

A7. 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.

Q8. *How can I set up an accountable business expense reimbursement plan?*

A8. 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* (pages 7-8) for more information.



- Q9.** How should I report business expenses and/or declare a housing allowance for interim cures in out-of-town locations?
- A9.** 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, the housing at the temporary location is generally treated as a business expense that can be provided by or reimbursed by the employing church tax-free to the cleric. Also, the cleric can continue to apply his or her pension income toward the housing allowance for the permanent residence's expenses. Travel expenses to and from the permanent residence and the interim job location are also treated as business expenses.

Cures of longer than one year (or 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 cleric has generally been deemed to have moved the principal residence to the interim location. Therefore, the reimbursement of expenses relating to the temporary housing at the interim location is taxable for SECA/SET purposes and the cleric will not be able to claim a housing allowance as it relates to the housing expenses associated with his or her permanent residence.

Q10. *What should I understand about taxation of moving expenses?*

A10. Moving expenses can no longer be reimbursed tax-free or deducted on personal tax returns. Any payment of moving expenses or reimbursement to the cleric must be treated as taxable compensation and included as salary on *Federal Form W-2*. In addition, these amounts are assessable under The Church Pension Fund Clergy Pension Plan. Moving expenses are still eligible housing expenditures for purposes of the housing allowance.

Q11. *What rules apply to contributions to and withdrawals from The Episcopal Church Retirement Savings Plan (RSVP)?*

A11. 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 cleric can be made only from earnings that are reported as taxable compensation (i.e., earnings that have not been applied toward the housing allowance).

For 2020, the maximum combined contribution (i.e., employer contributions and employee salary deferrals) was the lesser of 100% of taxable compensation or \$57,000 (\$63,500 for those ages 50 or older). For 2021, these amounts increase to \$58,000 (or \$64,500 for those ages 50 or older).

The maximum employee pre-tax salary deferral for 2020 was the lesser of 100% of taxable compensation or \$19,500 (\$26,000 for those ages 50 or older). For 2021, these amounts remain the same. 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.

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.

Q12. *I will turn 70 this year. What should I know about taking distributions from The Episcopal Church Retirement Savings Plan (RSVP).*

A12. The SECURE Act has increased the Required Minimum Distribution (RMD) age from age 70½ to 72. This change applies to anyone who will attain age 70½ on or after January 1, 2020. This means that anyone who attained age 70½ prior to December 31, 2019, will need to continue to take RMDs in 2020. In addition, The Church Pension Fund requires that all RSVP participants begin to receive their RMD by April 1 following the year in which the cleric reaches age 72, regardless of whether his or her work status is active or retired. If you are actively employed by an Episcopal employer after age 70½, you are eligible to continue to make pre-tax contributions to the RSVP from current taxable earnings through the duration of your employment. The CARES Act suspends the requirement to take RMDs in 2020.

Q13. *Is the Resettlement Benefit payable to eligible clergy under The Church Pension Fund Clergy Pension Plan taxable?*

A13. If the Resettlement Benefit is distributed to the cleric, it is a taxable benefit. However, it may be eligible for the housing allowance exclusion (see question 3). To delay paying tax on the Resettlement Benefit, you can make a tax-free rollover of the Resettlement Benefit to The Episcopal Church Retirement Savings Plan (RSVP) or another tax-deferred savings vehicle.

Q14. *I received a gift from my parish at retirement. Is it taxable?*

A14. Many clergy receive retirement gifts. The tax treatment generally works as follows:

Gifts provided by the employer are taxable to the cleric and must be reported on Federal Form W-2 as wages, and are assessable wages for the Clergy Pension Plan.

Gifts funded by individuals directly to the cleric, or collected by the church as non-deductible personal gifts, are not taxable to the cleric, are not reported on Federal Form W-2 as wages, cannot be treated as tax-deductible by the giver, and are not assessable for pension purposes.

Q15. *I am Medicare-eligible, and recently returned to work after retirement. As a result, am I entitled to medical coverage as an active employee?*

A15. When a cleric is Medicare-eligible and working, he or she may legally be required to be on the employer's active health plan. For more information, you may want to contact your diocese or The Episcopal Church Medical Trust.

Q16. *Due to my conscientious objection to public insurance programs, I would like to opt out of Social Security. For the self-employment tax, is it permissible for me to take such an exemption?*

A16. 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*, available at [irs.gov](https://www.irs.gov).

Q17. *How can I change my withholding amount when receiving my pension benefit in retirement?*

A17. 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 at [cpg.org/retired-clergy/retirement/tax-resources](https://www.cpg.org/retired-clergy/retirement/tax-resources).

Q18. *How long must I retain my tax return and supporting records?*

A18. You should retain copies of your tax returns for your lifetime. Supporting documents can be destroyed after seven years.

The Consolidated Appropriations Act was signed into law on December 27, 2020. Here are some provisions of that Act that may affect you or your church or other institution.

1. **Payroll Protection Program**—The Act permits taxpayers whose PPP loans are forgiven to deduct the expenses relating to their loans to the extent they would otherwise qualify as ordinary and necessary business expenses. This rule applies retroactively to the effective date of the CARES Act so that expenses paid using funds from PPP loans previously issued under the CARES Act are deductible, regardless of when the loan was forgiven.

The Act permits an employer that receives a PPP loan to receive the employee retention tax credit. However, to prevent any double-dipping, an employer must either exclude “qualified wages” that allowed the employer to claim employee retention tax credits from “payroll costs” for purposes of determining its loan forgiveness under the PPP (so as to reduce the amount of loan forgiveness), or exclude “qualified wages” that qualified for PPP loan forgiveness from “payroll costs” (so as to reduce the employee retention tax credit).^[5] This change applies retroactively to the effective date of the CARES Act.
2. **Recovery rebates**—The Act provides for a second round of payments to taxpayers of \$600 per taxpayer with a social security number, including \$600 per child up to age 17. Payments are made based on your 2019 Adjusted Gross Income (AGI) with the payments phasing out for AGI of \$75,000 for single filers, \$150,000 for married filing joint, and \$112,500 for head of household.
3. **Extends paid sick and family leave credits thru 3/31/21.**
4. **Above-the-line charitable deduction for cash donations to qualifying charities**—For non-itemizers, the maximum amount for 2020 is \$300 for single and married filing joint tax returns, \$150 for married filing separate returns. For 2021 the maximum is \$600 for married filing joint return, \$300 for single taxpayers, and \$300 for married filing separate returns. Non-cash donations do not qualify for this deduction.
5. **Defers employee-side payroll tax**—If the deferral was elected, the repayment is extended to 12/31/21 from 4/1/21.
6. **Makes permanent certain “tax extenders”**—
 - a. lowered the AGI threshold for medical expense deduction for itemized deductions to 7.5%
 - b. repealed the above-the-line deduction for education expenses after 2020, and increased the phase-out for Lifetime Learning Credit.
7. **Extends for 5 years to 1/1/25**—
 - a. employer credit for paid family and medical leave originally enacted as part of the Tax Cut and Jobs Act.
 - b. expanded exclusion for employer-provided educational assistance, including student loan repayment benefits from the CARES Act.
8. **Permits temporary 100% deduction for business meals**—The Tax Cuts and Jobs Act limited the deductibility of business meal expenses to 50% of the cost for food and beverages provided by a restaurant. The Consolidated Appropriations Act permits businesses to deduct 100% of these business meals expenses during 2021 and 2022.