



MinistryWorks[®]
by Brotherhood Mutual

PAYROLL AND THE CHURCH
ANSWERS TO 5 COMMON QUESTIONS



PAYROLL CAN BE COMPLICATED. FOR THAT, THERE'S MINISTRYWORKS.

Whether you're a small church using a volunteer bookkeeper or a large organization with a dedicated finance staff, one common thread connects ministries of all sizes: Payroll is complicated.

Payroll requirements and regulations are becoming increasingly complex. It can be difficult to keep up with annual tax code changes. Unintentional mistakes can be costly to your ministry. Employee pay disputes can lead to fines, penalties, and loss of trust. Clergy can lose critical benefits.

The MinistryWorks® team understands the challenges that ministries face in complying with payroll tax regulations. This resource provides practical guidance and helpful tips about how to handle issues related to your ministry's payroll.



IS OUR MINISTER A "MINISTER FOR TAX PURPOSES?"

In the following document, you will see references to the phrase, "minister for tax purposes." According to the Internal Revenue Service, ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination. Ministers have the authority to conduct religious worship, perform pastoral functions, and administer ordinances or sacraments according to the prescribed tenets and practices of that church or denomination.

If a minister performs ministerial services, all earnings are subject to income tax. This includes wages, offerings, and fees received. A minister for tax purposes:

- Is eligible for a housing allowance.
- Is always self-employed for Social Security and Medicare purposes for ministerial income.
- Is exempt from automatic federal income tax withholding.

Remember that the criteria to determine whether an employee is a "minister for tax purposes" are different from those that determine whether an employee qualifies for the "ministerial exception" to the Fair Labor Standards Act. See how your minister measures up on page 8.



DOES MY PASTOR FILL OUT A W-4?

MINISTERS STILL PAY TAXES—BUT ARE EXEMPT FROM AUTOMATIC WITHHOLDING

Beware of this scenario: A payroll processor at another church suggests that your minister claim 15 dependents on a Form W-4 because that's how her church "has always done it." Why do this? The reasoning seems straightforward: a claim of 15 dependents would ensure that a minister's pay is not subject to federal income tax.

What's the harm?

Submitting an accurate Form W-4 is important; an inaccurate claim can have serious consequences. The problem with a minister declaring more dependents than he or she actually has just to avoid federal tax withholding is threefold:

- 1. It's an unnecessary risk.** Because ministers are exempt from federal income tax withholding, they are not required to complete a Form W-4 at all. However, as a matter of policy, your ministry may want to have your minister complete a W-4, documenting the decision not to withhold wages. To forgo withholding, simply have the minister write "exempt" in Box 7 of the Form W-4. This practice will be a more accurate statement than claiming "15" dependents.
- 2. It's a red flag.** The IRS may consider this false reporting. If the IRS suspects under-reporting, it could trigger a review, a mandatory withholding rate, or a fine.
- 3. It's simply untrue.** A signature on a W-4 declares that, "... I have examined this certificate, and to the best of my knowledge and belief, it is true, correct, and complete." It is never a good idea to submit intentionally inaccurate information to the Internal Revenue Service (IRS).

Opting in

While withholding federal income tax from paychecks is optional for ministers, it is important to note that ministers are required to pay these taxes like everyone else. A minister can "opt in" to withholding the required federal tax income amount by voluntarily completing a Form W-4. A set dollar amount or allowance is subtracted from each paycheck to cover annual taxes.

The IRS Withholding Calculator can help determine your minister's correct withholding amount. Remember, updating a Form W-4 requires a new form submission—changing or altering an existing form is not allowed.

Contact a licensed attorney or tax professional to ensure that any changes you want to make comply with federal law.

"I was looking for a payroll solution that helps with multi-state compliance. The knowledgeable staff at MinistryWorks® hold your hand through the onboarding process and welcome any questions you have. MinistryWorks payroll speaks for itself, but the customer service is the cherry on top!"

— Sherry Davis, Chief Financial Officer, Virginia Baptist College

To learn more about us, talk to a MinistryWorks representative today.
Call **866.215.5540** or visit www.ministryworks.com.



WHY IS PAYING A PASTOR SO COMPLICATED?

WHAT DUAL TAX STATUS MEANS WHEN REPORTING A PASTOR'S WAGES

Under federal law, most ministers have dual tax status. Dual tax status means a minister is an employee of the church for federal income tax purposes and self-employed for Social Security and Medicare taxes. For ministers, wages are reported two different ways:

1. Federal Income Tax = Employee Status. Workers who meet the IRS definition of a minister (see page 2) are considered employees of the church for federal income tax purposes.

- Ministers are required to pay federal income taxes, although they are exempt from automatic federal income tax withholding from their paychecks.
- To cover any tax liability, the ministry can set up voluntary income tax withholding at the minister's request.
- All voluntary withholdings should be reported by the ministry in Box 2 of Form W-2 and forwarded to the U.S. Treasury.

It is possible, but much less common, for ministers to be designated as self-employed for federal income tax purposes. Before doing this, seek the advice of a local attorney or tax professional. These returns are more likely to be audited by the IRS because, often, they're not in compliance.

2. Social Security and Medicare Tax = Self-Employed Status. For Social Security and Medicare tax reporting purposes, the majority of ministers should be classified as self-employed with respect to income for pastoral duties. This means they are generally subject to the Self-Employment Contributions Act (SECA) tax. When this is the case:

- The church should not withhold Social Security and Medicare taxes from the minister's wages.
- The church should not make this payment for the minister.
- The minister is responsible for paying into the Social Security/Medicare system through SECA tax payments. Amounts are reported quarterly on Form 1040-ES.
- The minister is voluntarily allowed to withhold sufficient federal income taxes to cover any self-employment tax liability.

What's at stake?

It's important to correct a withholding error. A minister is at risk for losing his or her dual tax status or housing allowance if it's discovered that the ministry was withholding Social Security and Medicare taxes. If your church has withheld these taxes:

- Consult with a local attorney or tax consultant for advice concerning how far back corrections need to go.
- Correct quarterly Form 941s and issue a corrected Form W-2 to the minister.
- The minister should file an amended Form 1040 for each year a corrected Form W-2 was received.

Disclaimer: The information provided in this document is intended to be helpful, but it does not constitute legal advice and is not a substitute for the advice from a licensed attorney in your area. Please consult your attorney when creating, reviewing, or revising policies and procedures.



CAN WE GIVE EACH CHURCH STAFF MEMBER A HOUSING ALLOWANCE?

IT DEPENDS ON WHO YOU ARE

The IRS housing allowance benefit can result in significant tax savings for some ministry employees. Only those ministerial staff members who are licensed, ordained, or commissioned are eligible for the housing allowance benefits. See page 2 for the definition of a “minister for tax purposes.”

A housing allowance must:

- Be compensation for ministerial services.
- Not exceed the minister’s reasonable compensation.
- Be substantiated by actual expenses. If not, all or part of the housing allowance should be included in taxable income.

A housing allowance is available to ministers who own or rent a home, or live in a church-owned parsonage. Ministers can exclude the lowest of the following:

- The housing allowance amount designated by the church;
- Actual housing expenses, actual rental expenses, actual housing expenses paid by the church (including utilities, furnishings, repairs, and improvements); or
- The fair rental value of the home (furnished, including utilities).

If a housing allowance exceeds the minister’s actual housing expenses and fair rental value of a home, the “excess” housing allowance must be reported as wages for federal income tax purposes.

Ministers can exclude some or all of their designated housing allowance from their taxable income for federal income tax purposes. However, a housing allowance is always considered taxable income for Social Security and Medicare taxes. Check with a ministry tax specialist to see which expenses might count as “housing expenses.”

Handling housing income for non-ministerial staff

If you’ve determined that an employee does not meet the IRS definition of minister, treat any housing allowance offered to that employee as regular wages. Consequently, the ministry should include the housing allowance as regular wages with each paycheck and withhold the appropriate taxes.

ALERT: HOUSING ALLOWANCE FACES LEGAL CHALLENGE

Recent legal challenges to the housing allowance could affect ministries in some states. Watch news headlines and stay in touch with trusted legal and tax advisors to remain aware of potential changes in the law.

“Time is important to us. Because the processes that we used before, it would literally take us about a day and a half to complete payroll. With MinistryWorks, it takes us about 3 hours now. It’s nice to have dedicated people who understand payroll. I just call them and they help.”

—Dora Turrietta, Finance Director, Legacy Church



WHY CAN'T WE PAY A SALARY TO EVERY EMPLOYEE?

YOU COULD BE MAKING A COMMON, AND COSTLY, MISCLASSIFICATION MISTAKE

Paying a salary to a non-exempt employee can be complicated. Many organizations—including ministries—often are unaware that employees who fit the non-exempt definition set by the Fair Labor Standards Act (FLSA) are entitled to minimum wage and overtime, even if the worker is paid a salary. To see if you have an employee who qualifies as exempt, see the FLSA Risk Assessment Chart on page 8.

Job titles do not create an exemption

It's a common mistake to classify a worker as exempt in order to pay the worker on a salaried basis. Be aware that a title alone—such as “administrative assistant”— does not create an exemption. Generally, the job duties and salary of support staff and clerical workers often do not meet the standard..

Note: *The job duties and salary of support staff and clerical workers often do not meet the standard.*

For non-exempt employees, hourly pay is the safer compensation method—it's a straightforward way to track regular and overtime hours, and may offer protection against pay disputes. However, if your ministry is strongly committed to paying non-exempt employees a salary, there are certain FLSA rules you must follow.

For non-exempt employees paid a salary, ministries should:

- **Determine the hourly rate of pay.** If your ministry chooses to pay a salary to a non-exempt employee, you'll still need to track the employee's work hours. For every work week, the employee must make at least the federal minimum wage as required by the FLSA. To calculate the hourly rate of pay each week, divide the salary amount by the number of hours worked in that seven-day period.
- **Check local minimum wage.** Your area's minimum wage requirements may be higher than federal standards—your local Wage and Hour Division office can offer guidance specific to your area. Consult with a local attorney when setting rates of pay.
- **Calculate overtime.** Generally, overtime is paid at one and a half times the regular rate for all hours worked over 40 in a seven-day, 168-hour work week. Note that the rate of overtime, and how it is calculated, can vary by state.
- **Know exceptions to the rule.** There are several exceptions to minimum wage standards, including full-time students and workers with disabilities. Consult with a local attorney to see if you have a worker who qualifies.
- **Avoid off-the-clock volunteering.** Ministries should avoid the practice of allowing non-exempt employees—whether paid a salary or an hourly wage—to volunteer to work unpaid job-related hours to help save the ministry money. Even if this is well-intentioned and the worker is willing, the ministry could end up owing back pay, tax withholdings, and steep penalties if an employee's pay falls below minimum wage.

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WHEN IS A GIFT NOT A GIFT?

THAT CASH GIFT COULD BE WRAPPED UP IN REPORTING REQUIREMENTS

Occasional gifts to ministers or other ministry employees are not always tax-free. Depending on the process used to collect and distribute the funds, these gifts may need to be reported to the IRS as part of the recipient's taxable income.

Is the gift taxable?

Generally, the extent of the ministry's involvement in the gift determines whether the gift is taxable.

The church is not involved. A gift card, personal check, or prepaid debit card given directly by a ministry participant to a minister or employee is generally considered non-taxable to the recipient. However:

- The intent of the giver and the amount of the gift is important. Amounts given for services, such as a wedding, may be considered taxable compensation.
- The gift likely cannot be reported as a tax deduction by the giver, regardless of taxability to the staff member.

The church is involved. A gift collection taken and distributed by the ministry may be taxable to the minister or employee. Keep in mind:

- Even love offerings and minister or employee gifts for birthdays, retirement, and anniversary are taxable if given using this method.
- Taxable income to the minister or employee must be included in Box 1 of the W-2 and Form 1040 of the staff member who received it.
- The employee and the ministry could be held liable in an audit for incorrectly reporting taxable income.

Benevolent gifts to employees

Benevolent gifts given by the ministry to a staff member are taxable. It doesn't matter if the ministry gives the funds to the employee to make a bill payment or if the ministry directly pays a bill. The dollar amount should be included on the employee's W-2 as taxable income.

Be aware that any gifts to employees should follow the ministry's public benevolence policies. Employees in a leadership position have additional requirements. Such gifts should be reasonable and approved in writing by ministry leadership. Done incorrectly, benevolence giving can result in substantial tax penalties to the employee and the loss of the ministry's tax exemption. Talk to a locally licensed attorney or tax professional to ensure that you follow all appropriate procedures.

Processing mistakes can have costly consequences.

MinistryWorks® gives you payroll confidence. We offer:

- The full spectrum of payroll processing and reporting services—from accrual tracking to workers' compensation audit reports.
- A dedicated payroll professional to guide you through ministry staffing complexities.
- Affordable pricing that fits every budget, every size church.

Call for a free quote today

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FLSA Risk Assessment Chart

When an employer misclassifies an employee as “exempt,” the risk of an employment-related lawsuit increases. Determining whether a position should or can be classified exempt is a complicated process that must be applied to each individual position. While no concrete test exists to determine whether an exemption is met, this tool can help you assess the risk involved when classifying an employee as exempt.

To weigh the risk, answer the statements in each column as true or false. Count the number of “true” statements in the column and compare to the meter near the bottom of the column.

Does the position qualify for the ministerial exception?	Is the position specifically exempted from FLSA requirements?	Does the position fail to require regular and recurrent participation in interstate commerce?	Does this position meet the Salaried Level test AND:																												
The individual was hired based “largely on religious criteria.”	The individual is a teacher, academic advisor, or admissions counselor employed by an elementary school, secondary school, or institution of higher education.	The position does not require the employee to make interstate phone calls on at least a weekly basis.	The position meets the “executive” exemption qualifications under FLSA regulations.																												
The ministry authorizes the individual to perform ceremonies (baptism, weddings, communion) of the church.	The individual is a preschool or kindergarten teacher whose primary duty is teaching, not caring for the physical needs of children.	The position does not require regular travel outside of the state.	The position meets the “administrative” exemption qualifications under FLSA regulations.																												
The ministry holds the individual out as a member of clergy (more than just title).	The employee serves in a medical position requiring a valid medical license or certificate.	The position does not require the employee to send or receive interstate mail at least weekly.	The position meets the “learned professional” exemption qualifications under FLSA regulations.																												
The individual regularly engages in religious or ecclesiastical activities and “attends to the religious needs of the faithful” as part of their job function.	The position pays a total annual compensation of \$100,000 and primary duty is exempt-level work.	The position does not require the employee to order materials from another state regularly.	The position meets the “creative professional” exemption qualifications under FLSA regulations.																												
The position requires the individual complete a formal process such as ordination, licensure, divinity degree, etc. in order to perform the position.	The position requires either a CPA or a JD (law degree) to perform the job.	The position does not require the employee to interact with people in other states via the internet on at least a weekly basis.	The position meets the “computer employee” exemption qualifications under FLSA regulations.																												
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If you determine the position meets the ministerial exception, the FLSA would not apply.	If you determine that the position qualifies under at least one of the above tests, the FLSA likely would not apply.	If you determine that the position does not require regular and recurrent participation in commerce, the FLSA likely would not apply.	If you determine that the position qualifies for one of the white-collar exemptions, and the employee exceeds the salary level, the FLSA likely would not apply.																												

If a position does not pass any of the above assessments, it likely should be classified as non-exempt and the FLSA rules should be applied. When in doubt, it’s best to err on the side of non-exempt. Consult a locally licensed attorney before classifying an employee as exempt.