Chapter 9 SOCIAL SECURITY FOR MINISTERS

If anyone does not provide for his relatives, and especially for his immediate family, he has denied the faith and is worse than an unbeliever.

1 Timothy 5:8

CHAPTER HIGHLIGHTS

- **TWO TAX SYSTEMS** Social Security taxes are paid under two tax systems. Employers and employees pay Social Security and Medicare taxes, which for 2017 and 2018 are 15.3 percent of each employee's wages (the employer and employee split the tax, with each paying 7.65 percent). Self-employed persons pay the self-employment tax, which for 2017 and 2018 is 15.3 percent of net self-employment earnings.

- **MAXIMUM WAGES SUBJECT TO SOCIAL SECURITY AND MEDICARE TAXES** The Social Security and Medicare tax rate (7.65 percent for both employers and employees, or a combined tax of 15.3 percent) does not change in 2018. The 7.65-percent tax rate is comprised of two components: (1) a Medicare hospital insurance tax of 1.45 percent and (2) an "old-age, survivor and disability" (Social Security) tax of 6.2 percent. There is no maximum amount of wages subject to the Medicare tax (the 1.45-percent tax rate). The tax is imposed on all wages, regardless of amount. For 2018 the maximum wages subject to the 6.2-percent Social Security tax increases to $128,700. Stated differently, employees who received wages in excess of $128,700 in 2018 pay the full 7.65-percent tax rate for wages up to $128,700 and the Medicare tax (1.45 percent) on all earnings above $128,700, regardless of amount. Employers pay an identical amount.

- **MAXIMUM COMPENSATION SUBJECT TO SELF-EMPLOYMENT TAX** The self-employment tax rate of 15.3 percent consists of two components: (1) a Medicare hospital insurance tax of 2.9 percent and (2) an "old-age, survivor and disability" (Social Security) tax of 12.4 percent. All net income from self-employment, regardless of amount, is subject to the Medicare tax of 2.9 percent. However, for 2018 the 12.4-percent Social Security tax rate only applies to the first $128,700 of net self-employment earnings. Stated differently, self-employed persons who received compensation in excess of $128,700 in 2018 pay the full 15.3-percent tax rate on net self-employment earnings up to $128,700 and the Medicare tax (2.9 percent) on all earnings above $128,700, regardless of amount.

- **MINISTERS CONSIDERED SELF-EMPLOYED** The tax code treats ministers (except for some chaplains) as self-employed for Social Security with respect to their ministerial services. This means they pay the self-employment tax, not the employee's share of Social Security and Medicare taxes, with respect to such income. Churches should not treat clergy as employees for Social Security even if they treat them as employees for federal income tax reporting.

- **CLERGY EXEMPTION** Clergy may exempt themselves from self-employment taxes with respect to their ministerial earnings if several requirements are met. Among other things, the exemption must be filed within a limited period of time, and it is available only to clergy who are opposed on the basis of *religious considerations* to the *acceptance* of public insurance benefits (including Social Security) based on their ministerial services. The exemption is effective when the IRS approves it and sends an approved copy (it is filed in triplicate) to the ministerial applicant. An approved exemption is effective for all tax years after 1967 in which a minister has $400 or more of net earnings from self-employment and any part of those earnings is for services as a member of the clergy.

- **EXEMPTION APPLICABLE ONLY TO MINISTERIAL SERVICES** An exemption from self-employment taxes only applies to ministerial services. Clergy who have exempted themselves from self-employment taxes must pay Social Security taxes on any nonministerial employment. They are eligible for Social Security benefits based on their nonministerial services (assuming that they have worked enough quarters in nonministerial employment).

- **REVOKING AN EXEMPTION** Many ministers who opted out of Social Security by filing a Form 4361 with the IRS have wanted to rejoin the program—often to qualify for Medicare benefits. In the past, ministers have not been permitted to revoke an exemption. The tax code specifies that such exemptions are irrevocable. Congress enacted legislation in the past giving ministers a limited opportunity to revoke an exemption from self-employment taxes. However, this option is not currently available.

- **COMPUTING THE SELF-EMPLOYMENT TAX** The self-employment tax is computed by multiplying net self-employment

earnings by the current self-employment tax rate. Net self-employment earnings consist of a minister's total church compensation, including a housing allowance or the annual rental value of a parsonage, reduced by most income tax exclusions and business expenses (whether unreimbursed or reimbursed under a nonaccountable plan).

■ **TWO DEDUCTIONS** Self-employed persons pay the entire combined Social Security and Medicare tax rate (15.3 percent) that is shared by employers and employees. To partly offset the tax burden that falls on self-employed persons, the law allows them two deductions: (1) an amount equal to 7.65 percent multiplied by their net self-employment earnings (without regard to this deduction) may be deducted in computing earnings subject to the self-employment tax, and (2) half of their self-employment tax is deductible as an adjustment in computing federal income taxes, regardless of whether they can itemize deductions on Schedule A.

■ **RELIGIOUS SECTS OPPOSED TO SOCIAL SECURITY COVERAGE** Members of certain religious sects that are opposed to Social Security coverage and that provide for the welfare and security of their members may become exempt from Social Security coverage if several conditions are met.

INTRODUCTION

The Social Security Act provides a variety of benefits that are designed to assist aged and disabled persons and their dependents. The four major benefits provided under the Social Security system are

- retirement benefits payable to a fully insured person,
- survivors benefits payable to the surviving spouse or dependent children of a deceased worker,
- disability benefits payable to a permanently disabled worker who is not able to engage in substantial gainful activity, and
- medical and hospital benefits payable at age 65 (the Medicare program).

These important benefits are financed primarily through two separate tax systems. Under the Federal Insurance Contributions Act (FICA), a tax is levied against employers and employees, representing a percentage of an employee's wages. Under the Self-Employment Contributions Act (SECA), a tax is levied against the net earnings of self-employed persons. FICA taxes are withheld by an employer from an employee's wages and paid to the government, along with the employer's share of the FICA tax, according to the payroll tax procedures summarized later in this chapter and in Chapter 11. Self-employment taxes are paid entirely by the self-employed worker and ordinarily are paid to the government through the estimated tax procedure (Form 1040-ES).

★ **KEY POINT** Throughout this chapter, FICA taxes will be referred to as Social Security and Medicare taxes. This is the terminology the IRS now uses on Form 941 and Form W-2.

A. MINISTERS DEEMED SELF-EMPLOYED

★ **KEY POINT** The tax code treats ministers (except for some chaplains) as self-employed for Social Security with respect to their ministerial services. This means they pay the self-employment tax, not Social Security and Medicare (FICA) taxes. Churches should not treat ministers as employees for Social Security, even if they report their income taxes as employees.

For Social Security, a duly ordained, commissioned, or licensed minister is treated as *self-employed* with respect to services performed in the exercise of ministry (with the exception of some chaplains). This is true even if a minister is an employee for income tax purposes. As a result, a minister reports and pays Social Security taxes as a self-employed person (and not as an employee) with respect to services performed in the exercise of ministry. *IRC 3121(b)(8)(A).*

▲ **CAUTION** Many churches withhold the employee's share of Social Security and Medicare taxes from ministers' compensation and then pay the employer's share. Such reporting is incorrect.

It is important to note that ministers are self-employed for Social Security purposes only with respect to *services performed in the exercise of ministry*. This significant term is explained fully in Chapter 3 (as is the term *minister*).

The treatment of ministers as self-employed for Social Security but as employees for income taxes has generated much confusion. In explaining the reason for treating ministers as self-employed for Social Security purposes, the Tax Court has observed: "Congress chose not to place the onus of participation in the old-age and survivors insurance program upon the churches, but to permit ministers to be covered on an individual election basis, as self-employed, whether, in fact, they were employees or actually self-employed." *Silvey v. Commissioner, 35 T.C.M. 1812 (1976).*

In other words, if ministers were treated as employees for Social Security, their employing churches would be required to pay the employer's share of the Social Security and Medicare tax, and this apparently

was viewed as inappropriate. This justification ceased to be valid in 1984, when church employees became covered under Social Security.

B. EXEMPTION OF MINISTERS FROM SOCIAL SECURITY COVERAGE

★ **KEY POINT** Ministers may exempt themselves from self-employment taxes with respect to services performed in the exercise of ministry if several requirements are met. Among other things, the exemption must be filed within a limited time period, and it is available only to ministers who are opposed on the basis of religious considerations to the acceptance of Social Security benefits based on their ministerial services. The exemption is only effective upon its approval by the IRS. IRS Form 4361 is the exemption application form. A copy of this form is included at the end of this chapter.

1. SIX REQUIREMENTS FOR EXEMPTION

Until 1968, services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of ministry were exempt from Social Security taxes. A minister could voluntarily elect to be covered under the Social Security program by filing a timely Form 2031 with the IRS.

Since January 1, 1968, ministers have been automatically *covered* under Social Security but may exempt themselves with respect to compensation earned in the performance of ministerial services if they meet the following conditions.

Condition 1—minister status

The minister must be an ordained, commissioned, or licensed minister of a church. Licensed ministers of a church or denomination that both licenses and ordains ministers are eligible for the exemption only if they perform substantially all the religious functions of an ordained minister under the tenets and practices of their church or denomination. *Revenue Ruling 78-301.* See Chapter 3 for a complete explanation of what persons qualify as an ordained, commissioned, or licensed minister.

Condition 2—tax-exempt religious organization

The minister must have been ordained, commissioned, or licensed by a tax-exempt church or convention or association of churches. *Revenue Ruling 80-59.* Form 4361 (the exemption application for ministers) specifies: "You must establish that the body that ordained, commissioned, or licensed you . . . is exempt from federal income tax . . . as a religious organization described in section 501(c)(3) of the Internal Revenue Code. *You must also establish that the body is a church (or convention or association of churches)*" (emphasis added).

Condition 3—filing a timely Form 4361

The minister must file a timely exemption application (Form 4361) in triplicate with the IRS. A minister certifies on Form 4361, "I am conscientiously opposed to, or because of my religious principles I am opposed to, the acceptance (for services I performed as a minister . . .) of any public insurance that makes payments in the event of death, disability, old age, or retirement, or that makes payments toward the cost of, or provides services for, medical care." The form states that "public insurance includes insurance systems established by the Social Security Act." Three factors are important to note:

1. Conscientious opposition based on religious belief

Section 1402(e) of the tax code and Form 4361 both specify that the exemption is available to a minister who is "conscientiously opposed to, or because of his religious principles is opposed to, the acceptance (with respect to services performed by him as such minister) of any public insurance that makes payments in the event of death, disability, old age, or retirement, or that makes payments toward the cost of, or provides services for, medical care." The regulations interpreting this language specify that

> *ministers . . . requesting exemption from Social Security coverage must meet either of two alternative tests:*
>
> *(1) a religious principles test which refers to the institutional principles and discipline of the particular religious denomination to which he belongs, or*
>
> *(2) a conscientious opposition test which refers to the opposition because of religious considerations of individual ministers . . . (rather than opposition based upon the general conscience of any such individual or individuals).* Treas. Reg. 1.1402(e)-2A(a)(2).

Note that under both the "religious principles" and "conscientious opposition" tests, a minister must have religion-based opposition to accepting Social Security benefits. The income tax regulations clearly reject the view that ministers can be eligible for exemption from Social Security coverage on the basis of conscientious opposition alone. The conscientious opposition must be rooted in religious belief. Section 1402(e) of the tax code specifically delegates to the Treasury Department the authority to adopt regulations prescribing the "form and manner" of filing exemption applications. Therefore, though the regulations' rejection of nonreligious conscientious opposition to Social Security benefits as a grounds for exemption

seems to contradict the plain meaning of the tax code, it is unlikely that a court would find the regulations to be invalid.

Clearly, economic or any other nonreligious considerations are not a valid basis for the exemption. Some ministers have been induced to exempt themselves from Social Security participation because of the recommendation of a financial counselor that they would be "better off financially." In many cases, counselors have recommended an alternative investment returning a commission or premium to themselves. Fortunately, such tactics have become less frequent because of the verification requirement for exemption, discussed later in this section.

The applicant qualifies for the exemption as long as he or she is *personally* opposed to accepting Social Security benefits on the basis of religious principles, even though his or her ordaining, commissioning, or licensing body is not officially opposed to Social Security participation (i.e., such an applicant would satisfy the conscientious opposition test described above).

2. Opposition to the acceptance of public insurance benefits

The exemption is available only if a minister is opposed on the basis of religious considerations to the *acceptance of public insurance benefits (including Social Security)*—not opposition to payment of Social Security taxes. A minister may have religious opposition to payment of the tax, but this alone will not suffice. The individual must have religious opposition to accepting Social Security benefits based on retirement or disability. This is an extraordinary claim that few ministers will be able to make in good faith.

★ **KEY POINT** Can ministers who exempt themselves from Social Security qualify for Medicare? The minister must file a timely exemption application (Form 4361) in triplicate with the IRS. A minister certifies on Form 4361, "I am conscientiously opposed to, or because of religious principles I am opposed to, the acceptance (for services I perform as a minister . . .) of any public insurance that makes payments in the event of death, disability, old age, or retirement; or that makes payments toward the cost of, or provides services for, medical care, including the benefits of any insurance system established by the Social Security Act." The form states that "public insurance includes insurance systems established by the Social Security Act."

3. Participation in private insurance programs permitted

The applicant's opposition must be to accepting benefits under the Social Security program (or any other public insurance system that provides retirement and other specified benefits). As a result, a minister who files the exemption application may still purchase life insurance or participate in retirement programs administered by nongovernmental institutions (such as a life insurance company). *T.A.M. 8741002.*

The income tax regulations specify that the term *public insurance* refers to "governmental, as distinguished from private, insurance and does not include insurance carried with a commercial insurance carrier." *Treas. Reg. 1.1402(e)-2A(a)(2); Revenue Ruling 77-78.* The regulation goes on to clarify that to qualify for the exemption, a minister "need not be opposed to the acceptance of all public insurance," but he "must be opposed *on religious grounds* to the acceptance of any such payment which, in whole or in part, is based on, or measured by earnings from, services performed by him in his capacity as a minister" (emphasis added).

The deadline for filing Form 4361 is the due date, including extensions, of the federal tax return for the second year in which a minister has net earnings from self-employment of $400 or more, any part of which derives from the performance of services in the exercise of ministry. In most cases, this means the form is due by April 15 of the third year of ministry.

EXAMPLE A federal appeals court ruled that ministers who opt out of Social Security by filing a timely Form 4361 will not be able to claim years later that they qualify for Social Security retirement benefits on the ground that their exemption application was filed after the deadline expired and should never have been approved by the IRS. The court noted that the minister "made a knowing waiver of his Social Security benefits in return for a tax exemption. . . . For over twenty years [he] did not pay self-employment tax and did not notify the IRS nor the Social Security Administration about the 'mistake' in granting his application. The government kept its part of the agreement, and the minister must keep his." *Yoder v. Barnhardt, 56 Fed. Appx. 728 (7th Cir. 2003).*

Condition 4—notifying the religious organization

Applicants for exemption must inform their "ordaining, commissioning, or licensing body" that they are opposed to Social Security coverage for services they perform in the exercise of ministry. *IRC 1402(e)(1).* By signing Form 4361, applicants verify that they have satisfied this requirement. Ministers who plan to apply for exemption from Social Security coverage must be sure to notify the church or denomination that ordained, commissioned, or licensed them regarding their opposition to Social Security coverage and presumably of their intention to file an exemption application. This notification must occur prior to the time the exemption application is filed.

Churches or religious denominations that ordain, commission, or license ministers should be aware that they must be informed by applicants for exemption from Social Security coverage that they are applying for exemption. This requirement apparently was designed to provide churches and denominations with an opportunity to counsel applicants regarding the desirability of seeking exemption. Further, knowledge that a particular minister has applied for exemption will assist the church or denomination in providing appropriate pension counseling to such a person. Churches and denominations

should prepare standardized responses, setting forth in detail their response to a minister's claim of exemption.

Ministers are free to obtain an exemption (assuming that they otherwise qualify) even if their church or denomination is officially opposed to the exemption of ministers from Social Security coverage or has never taken a position one way or the other. Such churches and denominations should be sure to state, in detail, their reasons for urging an applicant to reconsider his or her decision to pursue exemption. At a minimum, a response should specify the various Social Security benefits that will be forfeited (i.e., retirement benefits, survivor benefits, disability benefits, and Medicare).

Some denominations have been sued for failing to adequately counsel younger ministers regarding the financial disadvantages that may be associated with an exemption from Social Security. Churches and denominations may wish to have applicants for exemption sign a form acknowledging that the church or denomination counseled against filing an exemption application and releasing the church or denomination from any liability that may arise out of financial hardships associated with exemption. Of course, these procedures will not be as critical if a church or denomination has no position regarding Social Security exemptions. Even in such cases, however, it may be prudent to point out the benefits that are being forfeited and the financial hardship that an exemption may create.

Condition 5—IRS verification

No application for exemption will be approved unless the IRS "has verified that the individual applying for the exemption is aware of the grounds on which the individual may receive an exemption . . . and that the individual seeks an exemption on such grounds." *IRC 1402(e)(2).* This verification requirement was adopted to prevent the widespread practice of ministers exempting themselves from Social Security coverage solely on the basis of financial considerations. The income tax regulations explain the verification procedure as follows:

> *Upon receipt of an application for exemption from self-employment taxes . . . the IRS will mail to the applicant a statement that describes the grounds on which an individual may receive an exemption under [the law]. The individual filing the application shall certify that he or she has read the statement and that he or she seeks exemption from self-employment taxes on the grounds listed in the statement. The certification shall be made by signing a copy of the statement under penalties of perjury and mailing the signed copy to the IRS Service Center from which the statement was issued not later than 90 days after the date on which the statement was mailed to the individual. If the signed copy of the statement is not mailed to the IRS Service Center within 90 days of the date on which the statement was mailed to the individual, that individual's exemption will not be effective until the date that the signed copy of the statement is received at the Service Center.* Treas. Reg. 1.1402(e)-5A.

In other words, the IRS satisfies the verification requirement by sending each applicant a statement reciting the grounds on which an exemption is available and having the applicant sign the statement, certifying under penalty of perjury that he or she is seeking exemption on the basis of an available ground. The statement must then be returned to the IRS within 90 days from the date it was originally sent by the IRS. Ministers who fail to return the signed statement within 90 days will delay recognition of their exemption until the date that the signed statement is received by the IRS.

★ **KEY POINT** If the IRS returns your application marked "approved" and your only self-employment income was from ministerial services, write "Exempt—Form 4361" on the self-employment tax line (line 57) in the "Other Taxes" section of Form 1040. If you had other self-employment income, see Schedule SE (Form 1040).

Condition 6—no disqualifying election

You cannot be exempt from self-employment tax if you made one of the following elections to be covered under Social Security. These elections are irrevocable.

- You elected to be covered under Social Security by filing Form 2031 (Revocation of Exemption from Self-employment Tax for Use by Ministers, Members of Religious Orders, and Christian Science Practitioners) for your 1986, 1987, 2000, or 2001 tax year.
- You elected before 1968 to be covered under Social Security for your ministerial services.

2. COMMON QUESTIONS

Some common questions pertaining to the exemption from self-employment taxes are addressed here.

When is an exemption effective?

Filing a timely exemption application does not necessarily qualify a minister for exemption. The income tax regulations specify that "the filing of an application for exemption on Form 4361 by a minister . . . does not constitute an exemption from the tax on self-employment income. . . . The exemption is granted only if the application is approved by an appropriate internal revenue officer." In practice, an exemption is effective only when an applicant receives back one of the three 4361 forms (it is filed in triplicate) from the IRS marked "approved." Ministers should be careful not to lose an approved Form 4361. *Treadway v. Commissioner, 47 T.C.M. 1375 (1984).*

An approved exemption is effective for all tax years after 1967 in which a minister has $400 or more of net earnings from self-employment and any part of those earnings is for services as a member of the clergy.

What if I cannot prove that I submitted a Form 4361?

TIP If you cannot remember whether you filed a timely Form 4361, contact the tax preparer you used to prepare and file your tax returns at the time the form would have been submitted. The preparer may have records that will indicate whether a Form 4361 was filed.

Some ministers claim to be exempt from self-employment taxes, but the IRS has no record of a Form 4361 ever having been filed or approved. Are such ministers exempt? Do they owe back taxes? As noted in the answer to the previous question, exemption from self-employment taxes generally is not effective until the IRS *approves* a minister's Form 4361. This poses a potential problem when ministers are audited and cannot produce a copy of their approved Form 4361 (and the IRS has no record of receiving or approving such a form). The courts have addressed this issue in five cases. Each case is summarized below.

Eade v. United States, 792 F. Supp. 476 (W.D. Va. 1991)

A federal court in Virginia ruled that a minister was entitled to exemption from self-employment taxes even though the IRS had no record of ever having received his exemption application (Form 4361). The minister was able to persuade a jury that he qualified for exemption and that he filed a timely exemption application. The court acknowledged that the income tax regulations specify that a minister's exemption is not effective until the IRS marks a copy of the exemption application "approved" and returns it to the minister. However, the court concluded that IRS approval of such applications is a perfunctory act involving no discretion. Accordingly, since the minister had done everything he was required to do in order to claim the exemption and was in fact qualified for it, he was entitled to the exemption despite the apparent mistake of the Post Office or the Internal Revenue Service.

The *Eade* case may resolve a dilemma for many ministers who have submitted a timely application for exemption from self-employment taxes (Form 4361) but who have never received a reply from the IRS. Many of these ministers have assumed that they are exempt. They become alarmed when they discover that the income tax regulations state that the exemption is effective only when the IRS stamps their application "approved" and returns it to them.

The *Eade* case gives hope to these ministers. They will not necessarily be liable for self-employment taxes (plus penalties and interest) for previous years. However, to achieve this result, they must (1) demonstrate that they were eligible for the exemption; (2) convince a jury that they mailed a timely Form 4361; and (3) persuade the court to apply the same reasoning as the Virginia federal district court (i.e., that IRS "approval" of an exemption is a perfunctory, administrative act that is not a requirement for exemption). As the court itself noted, not every minister will be able to persuade a jury that he or she mailed a timely Form 4361.

A few other points should be observed about the *Eade* case. First, the decision does not provide any relief to those ministers who would like to exempt themselves from self-employment taxes after the deadline has expired. Second, the decision does not liberalize the requirements for qualifying for exemption. To be eligible for the exemption from self-employment taxes, a minister must be opposed on the basis of religious considerations to the acceptance of Social Security benefits. This is an extraordinary claim that few ministers can satisfy. Nothing in the court's decision changes this. Third, the case will be of no help to ministers who cannot recall whether they filed a Form 4361. Fourth, the court in no way was encouraging ministers to opt out of Social Security. Again, few ministers will be able to satisfy the extraordinary requirements for exempt status. This has not changed.

Abdallah v. Commissioner, T.C. Summary Opinion 2002-132

Pastor B graduated from seminary in 1976 and was ordained in 1977. After his ordination, Pastor B served as the senior pastor of a church. In March 1977 Pastor B completed and signed Form 4361 in the presence of witnesses and mailed it to the IRS. The IRS has no record that the Form 4361 was filed, and Pastor B did not keep a copy of the form he submitted. The IRS audited Pastor B and determined that he was not exempt from self-employment taxes. It relied on a provision in the income tax regulations specifying that an exemption is not effective until approved by the IRS. Pastor B appealed to the Tax Court. Both he and the IRS agreed that a Form 4361 filed in March 1977 would have been timely. The only issue was whether the form was actually filed.

The court concluded that Pastor B was exempt from self-employment taxes:

> *We found [Pastor B's] evidence that he had filed for an exemption to be particularly credible. His testimony concerning the filing of the Form 4361 was straightforward and plausible. Further, his testimony was buttressed by the written statement of a witness who observed petitioner complete and sign the Form 4361 in 1977. With regards to whether the application was approved by [IRS], as required by the regulations . . . we believe that such approval must have been given. [Pastor B] consistently has not paid self-employment taxes on his ministerial earnings since 1977. . . . It seems highly peculiar that, if the approval had not been given, he would have filed for 21 years as being exempt without some dispute. Rather, it seems more likely that his file was misplaced at some point in time. Thus, we find that he prepared and filed the Form 4361 in 1977.*

The court acknowledged that Pastor B could not produce a copy of the Form 4361 that he allegedly filed, but it concluded that neither the tax code nor the regulations require ministers "to retain such a copy."

William and Cathy A. Bennett v. Commissioner, T.C. Memo. 2007-355 (2007)

In one case, a minister was commissioned and licensed by a church in 1996 and served as its senior pastor. He received net ministerial income of $400 or more for 1997 through 2002 (except for 2000). In 1998 he paid self-employment taxes on his ministerial income but did not do so for any of these other years based on his belief that he was exempt.

The IRS audited the minister's 2002 tax return and determined that he incorrectly claimed to be exempt from self-employment taxes. Self-employment taxes, plus interest, were assessed. The minister claimed that he was exempt from self-employment taxes, since (1) he filed a Form 4361 with the IRS in 1980 that the IRS approved, although he didn't have a copy of the form or the IRS approval; and (2) he filed a new Form 4361 with his tax returns for 1997, 1999, 2000, and 2002.

The IRS claimed that it never received the minister's 1980 exemption application and that the subsequent forms he submitted were all too late. The minister appealed his case to the United States Tax Court. The Tax Court agreed with the IRS that the minister failed to submit his Form 4361 on time.

The 1980 Form 4361. The court concluded that the following facts undermined the minister's claim that he owed no self-employment taxes in 2002 because he filed a timely Form 4361 in 1980 that was approved by the IRS:

- The minister produced no documentation to corroborate that in 1980 he filed a Form 4361.
- The IRS searched relevant files in its Ministerial Unit at the Philadelphia Service Center, which processes all Forms 4361 and which maintains individual folders containing Forms 4361 relating to all ministers, and the folder relating to the minister in this case did not contain any Form 4361 filed by him in 1980.
- The IRS also conducted a search of the minister's other files and archives for the allegedly filed Form 4361, but this search yielded no Form 4361 filed in 1980.
- The fact that, for 1998, the minister actually reported and paid self-employment taxes of $4,191 on his ministerial income undermined his claim that he believed that in 1980 he had filed a Form 4361 that was approved by the IRS.
- After approving or disapproving a Form 4361, the IRS is to submit to the Social Security Administration (SSA) a copy of the approved or disapproved Form 4361, and there is in evidence a Certificate of Lack of Record from the SSA, indicating that the SSA has no record of any Form 4361 filed by the minister in 1980.

The minister claimed that his failure to pay employment taxes in some years proved that in 1980 he must have received an approved ministerial exemption. The court noted that "his failure to pay employment taxes in some years could be attributed to a number of reasons (e.g., unemployment)."

The other Forms 4361. The court noted that the minister had income of at least $400 for both 1997 and 1998 from the exercise of ministry, and therefore the due date for his Form 4361 was April 15, 1999 (the due date for his federal tax return for the second year that he had net self-employment income of at least $400, any part of which derived from ministerial services). The minister insisted that he filed timely Forms 4361 (or letters containing the same information) in 1997, 1999, 2000, and 2002, and therefore his ministerial income was exempt from self-employment taxes for 2002. The court disagreed. It addressed each of the minister's submissions as follows:

- His 1997 tax return included a Form 4361, but this return was not submitted until 2000, a year after the filing deadline of April 15, 1999.
- His 1998 tax return was filed on April 15, 1999, and it included a letter requesting exemption from self-employment taxes, but the letter failed to include the certifications required for an exemption application. The court acknowledged that the IRS "may accept from a minister, in lieu of a Form 4361, a letter if the letter is timely filed and if the letter includes the required certification statements." Two such statements are required by the tax code: (1) a statement certifying that the minister is conscientiously, or on the basis of religious principles, opposed to the acceptance of public insurance such as Social Security and (2) an additional statement certifying that the minister "has informed the ordaining, commissioning, or licensing body of the church or order that he is opposed to such insurance." *Audit, Internal Revenue Manual, sec. 4.19.6.3.1(3), at 10,779-749-11.* Since the letter the minister enclosed with his 1998 tax return did not contain either of these certifications, it was not a valid application for exemption.
- His 1999 tax return included a Form 4361, but it was filed in 2000 (after the April 15, 1999, deadline for his Form 4361).
- His tax returns for 2000 and 2001 included a Form 4361, but these were filed after the April 15, 1999, deadline for filing his Form 4361.

The minister produced several additional copies of different Forms 4361 prepared and signed by him and dated prior to April 15, 1999, but he "produced no evidence that these Forms 4361 were ever properly addressed, stamped, mailed, and filed with the IRS prior to April 15, 1999."

The court stressed that (1) the Form 4361 filing deadline "is mandatory and is to be complied with strictly" and that (2) ministers "bear the burden of proof to establish that a Form 4361 or letter was timely filed."

Vigil v. Commissioner, T.C. Summary Opinion 2008-6 (2008)

In 1996, during an audit of his 1994 joint tax return, the taxpayer wrote a letter to the IRS stating that in 1987 he had filed a Form 4361 exemption application and that a copy of the approved Form 4361 had been returned to him. He requested that another copy of the approved application be sent to him and enclosed a copy of the signed (but unapproved) Form 4361 that he claimed he filed in 1987. The IRS received his request along with the copy of the unapproved Form 4361. It searched its document and computer files but did not find any record that the taxpayer had been approved for a ministerial exemption or any record that he had filed a request for a ministerial exemption before 1996. The IRS requested that the Social Security Administration search its records and learned that the SSA did not have any record of either the approval or the receipt of a Form 4361 from the taxpayer.

In 1997 the IRS informed the taxpayer of an adjustment to his 1994 federal income tax, together with a negligence penalty, resulting from nonpayment of self-employment taxes. However, a few months later, the IRS sent the taxpayer a letter stating that the 1994 examination resulted in no change to the taxes reported.

Several years later, the IRS audited the taxpayer's 2001 tax return and determined that he had underpaid his taxes by $12,118, mostly due to a failure to pay self-employment taxes. Again the IRS asserted that it could find no evidence that the taxpayer was exempt. The taxpayer appealed to the Tax Court.

The court noted that the tax code provides specific requirements for a minister to obtain an exemption from self-employment tax: "A minister seeking the exemption must file an application stating that he is opposed, because of religious principles or conscientious beliefs, to the acceptance of certain types of public insurance, such as that provided by the Social Security Act, attributable to his services as a minister. This application must be filed within the specific time limits. . . . Once properly obtained, the exemption from self-employment tax is irrevocable and remains effective for all succeeding taxable years."

The court noted that an application for exemption (Form 4361) must be filed "on or before the later of the following dates: (1) [t]he due date of the return (including any extensions) for the second taxable year for which the taxpayer has net earnings from self-employment of $400 or more, any part of which was derived from the performance of services as a minister, or (2) the due date of the return (including any extensions) for his second taxable year ending after 1967." The court stressed that it had "consistently held that the time limitations are mandatory and taxpayers must strictly comply with them." In addition, ministers bear the burden of proving that they are eligible for the exemption and that they filed a timely Form 4361. The court observed:

The IRS's "Ministerial Exemption Unit" had conducted a search to determine whether the taxpayer had previously filed a Form 4361 and whether it had been approved. A supervisor of this unit found the taxpayer's 1996 letter asserting that he filed Form 4361 in 1987, requesting another copy of the approved Form 4361, and enclosing a copy of the signed but unapproved Form 4361. The supervisor also found the case history sheet that was completed in 1996 when the IRS received the taxpayer's letter. The case history sheet documented the search at both the IRS and the SSA for any Form 4361 filed by the taxpayer and reflects that the IRS notified him in 1996 that neither the IRS nor the SSA found any record of a Form 4361 for him, either approved or denied. The supervisor queried the SSA again and received a certification, dated May 3, 2007, that the SSA had no record of the taxpayer submitting a Form 4361. Finally, she testified that the SSA retains such records for 75 years.

The taxpayer's testimony regarding when he filed Form 4361 was vague and inconsistent; he was certain it was filed in the 1980s, but he thought it might have been a couple of years after he was licensed. He signed the Form 4361 on April 7, 1987. The form states that he was licensed in January 1979. His testimony was confusing on this issue; he stated that he was licensed around 1980, but could not say exactly when. He also testified that he worked part time as a minister in 1979 and full time starting in 1980. The Form 4361 states that the first 2 years in which he had net self-employment earnings in excess of $400, at least some of which came from services as a minister, were 1979 and 1980. We find that the taxpayer was licensed in 1979 and that his first 2 earning years as a minister were 1979 and 1980. We conclude that his Form 4361 was due on the due date of his tax return for 1980; i.e., April 15, 1981, with extensions. He signed the Form 4361 and gave it to their certified public accountant (CPA). However, he has not demonstrated that he submitted a Form 4361 to the IRS before his letter in May of 1996 or that an application for exemption was ever approved. Because a search of IRS and SSA records by the IRS for the taxpayer's Form 4361 failed to discover the original form, and since he failed to carry his burden of proving that the form was filed, we find that he did not timely file a request for exemption as required by law.

The taxpayer claimed that his CPA showed the signed Form 4361 to the IRS agent examining his 1994 return and that this documentation ultimately resulted in the no-change letter from the IRS for 1994. He insisted that the decision by the IRS not to change his taxes for 1994 proved that it accepted his exemption for 1994 and established that the application form was on file at that time and, by implication, was approved. As a result, the IRS was barred from denying his exemption. The court disagreed: "It is well established that each tax year stands on its own. Furthermore, errors of law in prior years do not stop the IRS from correcting those errors in later years. In view of the apparent failure of the taxpayer to file Form 4361 timely, acquiescence by IRS agents in accepting his claim of exemption in 1994 was an error of law. Such a mistake does not

prevent correction of the error as to 2001. [The tax code] imposes time limitations, and IRS agents have neither the authority nor the power to grant an exemption not complying with the statute."

Corso v. Commissioner, T.C. Sum. Op. 2014-3 (2014)

A minister (the "petitioner") has been an ordained member of the clergy since 1992. She began to derive income from her performance of services in her capacity as an ordained minister in 1993. The first two years after ordination in which the petitioner derived net self-employment earnings of $400 or more from ministerial services were 1993 and 1994.

The petitioner timely filed her 1994 Form 1040, U.S. Individual Income Tax Return, on October 16, 1995. She claimed that she submitted a Form 4361 with her 1994 tax return and that the form was approved by the IRS and returned to her. The petitioner's copies of her 1993 through 1998 tax returns were destroyed in a basement flood. As a result, she does not have a copy of the Form 4361 that she claims she filed with her 1994 tax return. Further, the tax returns the petitioner filed for the years 1993 through 2002 have been destroyed by the IRS pursuant to normal procedures.

In reliance on the fact that her Form 4361 exemption application had been approved by the IRS in 1994, the petitioner had not paid self-employment taxes on any ministerial income since 1994. The petitioner's tax returns for 2000 and 2002 were audited by the IRS, but in both cases, the IRS accepted the petitioner's status as exempt from self-employment taxes.

However, in 2012 the IRS informed the petitioner that she owed self-employment taxes for 2007 and 2008 (the years under investigation), based, in part, on the fact that the IRS ministerial waivers unit's file for the petitioner did not contain a Form 4361 that was filed in 1994. The petitioner appealed to the United States Tax Court.

The Tax Court began its opinion by noting that the "petitioner bears the burden of proving that her Form 4361 was properly filed and approved and that the IRS determination is erroneous." The court noted that "the mere filing of a Form 4361 does not constitute an exemption. The exemption is granted only if the application is approved by an appropriate internal revenue officer." *Treas. Reg. 1.1402(e)-2A(c).* The court continued:

> *The first two years after ordination in which petitioner derived net self-employment earnings of $400 or more from ministerial services were 1993 and 1994. As a result, in order for petitioner to be exempt from self-employment tax for the years at issue, she must have filed a Form 4361 no later than the due date of her 1994 Federal income tax return. Petitioner stated that she attached a completed Form 4361 to her 1994 tax return and that such form was approved by the IRS and returned to her in 1995. The IRS argues that petitioner did not prove she had filed a Form 4361 with her 1994 tax return and that the IRS has no record of an approved Form 4361 from that period. We must determine whether petitioner attached her Form 4361 with her timely filed 1994 tax return and whether the IRS approved such form.*
>
> *The parties stipulated that petitioner's copy of her 1994 Federal income tax return was destroyed in a flood along with copies of her 1993 and 1995 through 1998 tax returns. Petitioner stated that the Form 4361 approved by the IRS in 1995 was attached to the destroyed return. Petitioner argues that the examinations of her federal income tax return for the taxable years 2000 and 2002 in which the IRS determined she owed no self-employment tax is circumstantial evidence that at the time of the two examinations the IRS had evidence of petitioner's approved Form 4361. . . .*
>
> *For the taxable years 2000 and 2002 the IRS examined petitioner's tax returns and agreed with petitioner that no self-employment tax was owed. The only issue relative to the exemption was whether petitioner had timely filed a Form 4361 that had been approved by the IRS. This creates an inference that on at least two occasions the IRS determined that petitioner had filed a Form 4361 with her 1994 tax return and that such form had been approved. The IRS determinations during the two examinations are consistent with petitioner's assertion that the Form 4361 she filed with her 1994 tax return had been approved. Petitioner has consistently reported that she was exempt because she had filed Form 4361. Petitioner's reporting of no self-employment tax for these taxable years is consistent with her position that the Form 4361 filed with her 1994 tax return was approved by the IRS. Over the course of multiple examinations petitioner has consistently stated that she filed a Form 4361 with her 1994 tax return and that such form had been approved. On two previous occasions the IRS apparently agreed. Based upon the evidence we find that, more likely than not, petitioner filed a Form 4361 with her 1994 federal income tax return and that such form was approved by the IRS. Accordingly, we hold that petitioner is not liable for self-employment tax for the years at issue.*

Will I receive a refund of self-employment taxes I paid before filing Form 4361?

Ministers who file an exemption application close to the deadline will have paid self-employment taxes on their ministerial income for two years. IRS Publication 517 contains the following instructions for claiming a refund of these taxes:

> *If, after receiving an approved Form 4361, you find that you overpaid SE tax, you can file a claim for refund on Form 1040X. Generally, for a refund, you must file Form 1040X within 3 years from the date you filed the return or within 2 years from the date you paid the tax, whichever is later. A return you filed, or tax you paid, before the due date is considered to have been filed or paid on the due date.*

If you file a claim after the 3-year period but within 2 years from the time you paid the tax, the credit or refund will not be more than the tax you paid within the 2 years immediately before you file the claim.

Can the period for filing an exemption application be extended or renewed?

As noted above, an exemption application must be submitted by the due date, including extensions, of the federal tax return for the second year in which a minister receives net earnings from self-employment of $400 or more, any portion of which comes from the exercise of ministry. Many ministers have asked, "Is there any way I can submit an exemption application after this deadline has expired?" Consider the following.

Exemption application rules

The general rule—no extension or renewal allowed. A number of ministers have attempted to file exemption applications after the filing deadline expired. However, the courts have never permitted any exceptions to the filing deadline rules—except in one case discussed below.

To illustrate, a number of ministers who failed to file a timely exemption application have argued that their constitutional right to freely exercise their religion is violated if they are forced to pay Social Security taxes against their will. This contention has been consistently rejected by the courts. The United States Supreme Court has observed that "if we hold that ministers have a constitutional right to opt out of the Social Security system when participation conflicts with their religious beliefs, that same right should extend as well to persons with secular employment and to other taxes, since their right to freely exercise their religion is no less than that of ministers." *United States v. Lee, 455 U.S. 252 (1982).*

Other ministers have argued that (1) they were unaware of the deadline; (2) they were certain (but could not prove) that they had filed a timely election; (3) they were given incorrect advice by IRS employees regarding the requirements for exemption; or (4) their opposition to participation in the Social Security program did not arise until after the deadline for filing an exemption application had passed. The courts have rejected all of these arguments. *See, e.g., Ballinger v. Commissioner, 728 F.2d 1287 (10th Cir. 1984); Olsen v. Commissioner, 709 F.2d 278 (4th Cir. 1983); Keaton v. Commissioner, T.C. Memo. 1993-365; Paschall v. Commissioner, 46 T.C.M. 1197 (1983); Hess v. Commissioner, 40 T.C.M. 415 (1980).*

Change of faith accompanied by an untimely exemption application. The general rule applies, and the period for filing an exemption application will not be renewed. In 1984 a federal appeals court ruled that the deadline for filing an application for exemption from self-employment taxes is not renewed or extended simply because a minister undergoes a change of faith. *Ballinger v. Commissioner, 728 F.2d 1287 (10th Cir. 1984).* In the *Ballinger* case, a minister was ordained by a Baptist church in 1969 and served as a minister of that church from 1969 through 1972. He did not apply for an exemption from self-employment tax. He became a minister in another faith in 1973 and performed services as a minister of a church affiliated with his new faith in 1973, 1974, and 1975. He paid the appropriate self-employment tax on such earnings during each of these years. In 1978 the minister was formally ordained by his new church, and in the same year, he submitted an exemption application (Form 4361) to the IRS claiming that he followed his new church's teachings in opposition to accepting public or private insurance benefits, such as Social Security benefits in the event of death, disability, or old age.

The IRS denied this application for exemption, and the Tax Court agreed. The Tax Court refused to interpret the time requirements for filing an exemption application as allowing an exemption after a second ordination. The minister appealed this decision to a federal appeals court, which agreed with the IRS and Tax Court. However, it insisted that it did not agree with the Tax Court's sweeping conclusion that an exemption is never permissible in cases of second ordinations. The court observed:

The statute makes no distinction between a first ordination and subsequent ordinations. Not all churches or religions have a formally ordained ministry, whether because of the nature of their beliefs, the lack of a denominational structure or a variety of other reasons. Courts are not in a position to determine the merits of various churches nor an individual's conversion from one church to another. Thus, we cannot hold that an individual who functions as a minister in a church which does not ordain, license or commission that individual in a traditional or legally formal manner is not entitled to the exemption. Nor can we hold that an individual who has a change of belief accompanied by a change to another faith is not entitled to the exemption. We interpret Congress' language providing an exemption for any individual who is "a duly ordained, commissioned or licensed minister of a church" to mean that the triggering event is the assumption of the duties and functions of a minister.

Since the minister in this case began his duties with his new church in 1973, his deadline for filing an exemption application was April 15, 1975. It did not matter that he was not ordained until 1978, since the critical event according to this court is the date a person begins performing the duties of a minister.

Minister who remains in the same church but does not develop religious-based opposition to the acceptance of Social Security benefits until after the deadline has expired. The general rule applies here as well, and an exemption application will be denied. The federal appeals court in the *Ballinger* case (see above) observed:

The more difficult question is whether an individual, who has already assumed the duties of a minister, belatedly acquires a

belief in opposition to the acceptance of public insurance and that change in belief is not accompanied by a change in faiths, is entitled to the exemption if he files within the statutory time frame after acquiring his new belief. We find that the statute does not provide for an exemption in that situation. The triggering event for measuring the statutory time period is the assumption of ministerial duties, combined with earning a particular amount of income. Thus, the statute does not provide for an exemption where a minister belatedly acquires a belief in opposition to public insurance apart from conversion to another faith. The [minister] did not file for the exemption within the applicable time frame.

Possible exception to the general rule—a second ordination in another faith accompanied by a timely exemption application. In 1994 a federal appeals court for the 10th circuit (Colorado, Kansas, New Mexico, Oklahoma, Utah, and Wyoming) ruled that the deadline for filing an exemption application had to be recomputed after a minister left the ministry for five years and was then reordained by another church. *Hall v. Commissioner, 30 F.3d 1304 (10th Cir. 1994).* Pastor Hall served as a Methodist minister in 1980 and 1981, and he received net earnings from self-employment in both years of at least $400 from the exercise of his ministry. As a result, the deadline for filing an application for exemption from self-employment taxes was April 15, 1982. During this time, however, Pastor Hall was not opposed to the acceptance of Social Security or other public insurance benefits and did not file for exemption. He left the ministry and worked as an engineer. Five years later, he was ordained as a minister by another denomination and immediately filed an application for exemption from self-employment taxes. He insisted that he developed an opposition to accepting Social Security benefits as a result of the influence of his new denomination.

The IRS denied Pastor Hall's exemption application, concluding that the deadline was April 15, 1982. On appeal, the Tax Court agreed with the IRS and denied Pastor Hall's exemption application. The court noted that the tax code does not make any provision for a second application period following a second ordination. Pastor Hall appealed, and a federal appeals court concluded that the deadline for filing an exemption application is renewed when a minister is reordained by another church. The court observed:

The question before us is whether the taxpayer's return to the ministry after a five-year absence, combined with his ordination in a new church and his acceptance of a new belief in opposition to public insurance, provides an opportunity to opt out of the Social Security system. . . . Without performing a detailed analysis, we express concern that the Tax Court's interpretation of [the deadline requirement] could arbitrarily and unconstitutionally interfere with the adherence to sincere religious beliefs by individuals, such as the taxpayer in this case, who undergo a genuine religious conversion, are ordained in a second church, and act within the defined statutory period to exempt themselves from tax on their self-employment income. . . . The plain language of the statute extends the exemption to "any individual who is a duly ordained, commissioned, or licensed minister of a church . . . upon filing an application . . . together with a statement that either he is conscientiously opposed to, or because of religious principles he is opposed to, the acceptance . . . of any public insurance." [Pastor Hall] fits that profile exactly. The code also requires an applicant

THE IRS INTERNAL REVENUE MANUAL

Section 4.19.6.3.18 (November 1, 2007) of the IRS *Internal Revenue Manual* addresses how the IRS responds to ministers who have no record that they filed a timely Form 4361 that was approved by the IRS:

When Taxpayer Claims Form 4361 Previously Approved—Internal Revenue Service Has No Record

When a taxpayer indicates Form 4361 was previously filed, but the Internal Revenue Service has no record of it, research history file for Form 4361 MF indicator for approved or disapproved code. If necessary take the following actions:

1. *Contact SSA for a copy of the Form 4361. See LEM 4.19.6.*
2. *If SSA responds they do have an approved exemption, process the copy from SSA as approved.*
3. *If SSA responds they do not have an approved exemption, instruct taxpayer to forward a new Form 4361 and/or a copy of their duplicate approved exemption. If a copy of approved exemption is received, process it as approved.*
4. *Process reapplication, except for timeliness criteria. Determine if exemption was allowed on prior year returns, either through normal processing or examination. If an assessment is necessary forward a copy to Examination.*
5. *Disallow reapplication for exemption as not being timely if taxpayer has not claimed exemption previously or Examination function specifically disallowed exemption because taxpayer did not qualify.*

Note:
Taxpayer bears burden of providing information or verification concerning previously filed Form 4361. An affidavit stating application was filed previously is ***not*** *sufficient to grant an exemption. Minister must show that he/she was eligible at time of filing the previous form.*

for exemption to file on or before "the due date of the return . . . for the second taxable year for which he has net earnings from self-employment [from his ministerial services] of $400 or more." As recited above, [Pastor Hall] filed during the first taxable year in which his self-employment income from his new ministry exceeded $400. When an individual enters the ministry anew in a new church, having adopted a new set of beliefs about the propriety of accepting public insurance, it is logical and consistent with the [language of the tax code] to characterize that individual as a "new" minister for the purposes of seeking an exemption. The plain language does not preclude this sensible reading.

We are not concerned that our decision will open the floodgates for conniving Elmer Gantrys to dupe the Internal Revenue Service and opt out of the Social Security system without documenting a legitimate religious or conscientious reason to justify their exemption from the self-employment tax. It seems unlikely that individuals will forgo the retirement security represented by the Social Security system without a sincere religious objection. Ministers who do not switch churches may not belatedly opt out of the system. Ministers who do switch will still have a limited time frame in which to file for exemption following their assumption of the duties and functions of the new ministry. And once ministers elect exemption, that exemption is irrevocable.

The court's decision in the *Hall* case has not opened the floodgates to other ministers. For the vast majority of ministers who fail to file an exemption application by the deadline summarized above, there is no second chance. They will never be able to exempt themselves from Social Security coverage.

The court's decision in the *Hall* case is a narrow one and applies only to those few ministers who

- change their church affiliation;
- are reordained;
- develop an opposition, based on their new religious convictions, to the acceptance of Social Security benefits; and
- submit an exemption application (Form 4361) by the due date, including extensions, of the federal tax return for the second year in which they have net self-employment earnings of $400 or more, any part of which comes from the performance of ministerial services in their new faith.

Few ministers will satisfy these requirements. The ruling will *not* apply to ministers who do not change their church affiliation or doctrine. Ministers who did not file an exemption application within the prescribed period and who have served a local church for several years are not given a second chance to opt out of Social Security by this ruling. The court agreed with its decision in an earlier case denying an exemption from Social Security to a minister who changed his religious beliefs, was reordained, and then waited five years before submitting an exemption application. *Ballinger v. Commissioner, 728 F.2d 1287 (10th Cir. 1984).*

★ **KEY POINT** The *Hall* case was a decision by a federal appeals court in the 10th federal circuit, which includes the states of Colorado, Kansas, New Mexico, Oklahoma, Utah, and Wyoming. In other states, it is at best a persuasive, but not binding, precedent. While its authority may have been enhanced by its recognition in IRS Chief Council Advice 200404048 (see below), it is still possible that other federal appeals courts and the Tax Court would reach different conclusions. Despite its limitations, the *Hall* case represents the most authoritative judicial precedent on the question addressed in this section.

Chief Counsel Advice 200404048

The IRS chief counsel issued an opinion in 2003 addressing two questions pertaining to the exemption from self-employment taxes. The questions and the IRS chief counsel's responses are noted below.

Question 1. Pastor G is a duly ordained minister of a church who is not opposed to the acceptance of public insurance. Pastor G subsequently has a change of faith and is ordained as a minister in another church, which results in a change in belief by Pastor G to being opposed to the acceptance of public insurance. Pastor G seeks exemption from self-employment tax.

The chief counsel correctly noted that the *Hall* case (see above) addressed this issue and concluded that a minister under these circumstances would requalify for exemption from Social Security. The chief counsel explained that the *Hall* case "provides that when an individual enters the ministry anew in a new church, having adopted a new set of beliefs about the propriety of accepting public insurance, it is logical and consistent with the [language of the tax code] to characterize that individual as a 'new' minister for the purposes of seeking an exemption." As a result, the chief counsel concluded that "a minister seeking exemption from self employment tax who has a change of faith that results in a change in belief to opposing the acceptance of public insurance . . . merely needs to sign the Form 4361."

Question 2. Pastor T is a duly ordained minister of a church who, because of religious principles, is opposed to the acceptance of public insurance. Pastor T filed a Form 4361 that the IRS did not approve for reasons of late filing. Pastor T subsequently has a change of faith and is ordained as a minister in another church and has no resulting change in belief regarding public insurance (taxpayer continues to be opposed to the acceptance of public insurance). May the taxpayer file another Form 4361?

The chief counsel answered no to this question. The chief counsel's opinion applied the *Ballinger* and *Hall* cases (see above) to this question and concluded:

As in Ballinger and Hall, the taxpayer had a change of faith. But unlike these cases, he did not have a change of belief in opposing the acceptance of public insurance. He has consistently opposed such insurance beginning with his first ministry. When an individual enters the ministry anew in a new church, having adopted a new set of beliefs about the propriety of accepting public insurance, it is logical and consistent with the [language of the tax code] to characterize that individual as a "new" minister for the purposes of seeking an exemption. Under the facts and circumstances presented, however, the taxpayer had his opportunity based on his beliefs to apply for an exemption after the first ordination, but the exemption was denied because he did not file the application timely as is required under the statute. The tax code does not give him a second opportunity to file a Form 4361 in the stated circumstances due only to a change in faith and entering the ministry in a new church

★ **KEY POINT** In a 1979 General Counsel Memorandum, the IRS concluded that "the clear purpose of [the exemption] is to allow ministers who are opposed to the acceptance of public insurance because of religious principles . . . to be exempt from self-employment tax, provided that the minister claims exemption within the prescribed period." *GCM 38,210 (1979).* It stated that the purposes of the statute are served by allowing a minister who is ordained by a second church and who previously "was not conscientiously opposed to the acceptance of public insurance to qualify for the self-employment tax exemption, by claiming exemption within the prescribed period after the second ordination. Denying exemption in such a situation on the basis that the minister should have requested exemption when ordained by the first church would be unreasonable because the minister was not opposed then to public insurance and thus did not qualify at that time."

Four years later, the IRS reversed its opinion on the grounds that the plain language and legislative history of the tax code provided no grounds for such a position. *GCM 39,042 (1983).* This memorandum expressed no concern for burdens on changed religious beliefs, concluding that even if the minister's first church did not oppose public insurance, the minister could have filed for exemption based on personal views.

How far back can the IRS assess Social Security taxes?

This question is relevant whenever a minister has unreported or underreported self-employment taxes. This condition can occur in several ways, including the following:

- A minister submits a timely exemption application (Form 4361) but never receives back an approved copy. The minister assumes that he or she is exempt from self-employment taxes from the date the application is submitted and does not pay self-employment taxes. The IRS has rejected the *Eade* case (discussed above).
- Some ministers assume they are automatically exempt from self-employment taxes and so do not submit a Form 4361.
- Some ministers who have submitted a timely exemption application that has been approved by the IRS are later audited, and the validity of their exemption is challenged.
- Some ministers underreport their self-employment taxes because they fail to include their housing allowance (or the fair rental value of a church-provided parsonage) in their taxable income when computing self-employment taxes.

Under any of these circumstances, can the IRS assess back taxes and penalties all the way back to the first year of the person's ministry? Section 6501(a) of the tax code specifies that taxes must be assessed within three years after a return is filed, though taxes may be assessed at any time in the case of failure to file a return, a willful attempt to evade, or a false return. Also, section 6501(e) specifies:

If the taxpayer omits from gross income an amount properly includible therein and—(i) such amount is in excess of 25 percent of the amount of gross income stated in the return, or (ii) such amount—(I) is attributable to one or more assets with respect to which information is required to be reported under section 6038D (or would be so required if such section were applied without regard to the dollar threshold specified in subsection (a) thereof and without regard to any exceptions provided pursuant to subsection (h)(1) thereof), and (II) is in excess of $5,000, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time within six years after the return was filed.

EXAMPLE A farmer filed a timely Form 1040 for several years, on which he correctly reported his income tax liability but failed to attach a Schedule SE or report or pay any self-employment tax (i.e., Social Security tax for self-employed persons) for any of those years. The question presented to the IRS was whether self-employment taxes could be assessed for *all* of the years in question. The IRS noted that section 6501(a) of the tax code specifies that taxes must be assessed within three years after a return is filed and concluded that "self-employment taxes are not separate and distinct from individual income taxes" but rather are "in all particulars an integral part of the income tax." Accordingly, "the filing of a Form 1040 that fully reports all income but contains no entry with respect to self-employment tax will be treated as the filing of a valid self-employment tax return," and therefore the "self-employment tax may not be assessed later than three years after the taxpayer files a Form 1040 and fully reports all income but makes no entry with respect to self-employment tax." *Revenue Ruling 82-185. See also Hoffa v. Commissioner, 50 T.C.M. 869 (1985).*

EXAMPLE Pastor W was ordained in 1990 but has never paid Social Security taxes because of his belief that he submitted a

timely exemption application (Form 4361) to the IRS. However, he does not have in his possession a copy of the exemption application, and he does not recall ever receiving back an approved copy from the IRS. In May 2018, he learns that an exemption from Social Security is not effective unless the applicant receives back from the IRS an approved copy of the exemption application. Pastor W is afraid to contact the IRS or Social Security Administration to confirm his exemption out of fear that he will be told that he is not exempt and that he will have to pay Social Security taxes all the way back to 1990 (with penalties and interest).

According to Revenue Ruling 82-185 (see previous example), Pastor W will not be assessed Social Security taxes later than three years after he files a Form 1040 and fully reports all income (but makes no entry with respect to self-employment tax). This means that if Pastor W filed a Form 1040 for each year since 1990, and fully reported all income in each year, he cannot be assessed Social Security taxes for any year prior to 2014 (i.e., three years from the filing deadline for Pastor W's 2014 income tax return would have been April 17, 2018, so it is too late in May 2018 for the IRS to assess taxes for 2014 or any preceding year).

EXAMPLE In 1993 the Tax Court ruled that a minister, who had not paid self-employment taxes for the years 1983 through 1987 on the ground that the IRS had "improperly denied" his 1980 and 1983 applications for exemption from self-employment taxes, was liable for self-employment taxes for all of the years in question. It is unclear how the IRS could assess back taxes for five years, and for years that clearly were more than three years prior to the IRS audit. In fact, 1983 (one of the years for which the IRS was demanding back taxes) was a decade prior to the court's decision, and nearly a decade prior to the IRS audit. *Reeder v. Commissioner, T.C. Memo. 1993-287.*

Is an exemption from Social Security coverage irrevocable?

The tax code clearly states that ministers who exempt themselves from self-employment taxes cannot revoke their exemption. The decision to become exempt from self-employment taxes is "irrevocable." *IRC 1402(e)(4).* Form 4361 itself warns that "once the application is approved, you cannot revoke it." However, both Congress and the IRS have created limited exceptions as noted below.

Congressional relief

Congress has created three limited windows of time since 1977 to allow exempt ministers to revoke their exemption.

1977 legislation. Congress allowed ministers who were exempt as of December 20, 1977, to revoke their exemption by the due date of their federal income tax return for 1977 (April 15, 1978) by filing a Form 4361-A.

1987 legislation. The Tax Reform Act of 1986 gave exempt ministers another limited opportunity to revoke an exemption from self-employment taxes by filing a Form 2031 with the IRS by the due date for their federal income tax return for 1987 (April 15, 1988). The decision to revoke an exemption from self-employment tax was irrevocable. Ministers who revoked an exemption did not become liable for self-employment taxes all the way back to the date of their original exemption. Rather, they were required to pay self-employment taxes effective January 1, 1986, or January 1, 1987. Few exempt ministers revoked their exemption under this legislation, because most waited until the deadline and discovered that a revocation of their exemption would obligate them to pay several quarters of back taxes. On modest income, this was a crushing liability that few could afford.

1999 legislation. At the end of 1999, Congress enacted legislation giving ministers the option to revoke an exemption from Social Security by filing Form 2031 with the IRS by April 15, 2002 (August 15, 2002, for ministers who obtained a four-month extension to file their federal tax return by filing a timely Form 4868 with the IRS). Ministers could revoke their exemption beginning on either January 1, 2000, or January 1, 2001. Ministers who revoked an exemption are not permitted to apply for exemption at a later time. The decision to revoke an exemption is irrevocable.

EXAMPLE Pastor D revoked his exemption from self-employment taxes in April 2003. In 2018 he decides that revoking the exemption was a bad idea, and he wants to revert back to exempt status. He will not be permitted to do so. A decision to revoke an exemption is irrevocable.

★ **KEY POINT** Will Congress give ministers another opportunity to revoke an exemption from Social Security? It does not look likely, at least for now. No bill has been introduced in Congress since 2005 that would allow ministers a limited time to revoke an exemption from Social Security, and the 2005 bill attracted no cosponsors.

Revoking exemptions based on economic considerations

Many ministers exempted themselves from self-employment taxes solely for economic reasons. Since this is not a valid basis for exemption, can these ministers revoke their exemption and begin paying self-employment taxes? In a 1970 ruling, the IRS allowed an exempt minister to revoke his exemption on the ground of mistake. *Revenue Ruling 70-197.* The minister filed a timely Form 4361 with the IRS certifying that he was opposed on the basis of his religious convictions to the acceptance of Social Security or any other public insurance benefits. However, he later explained that he filed the Form 4361 based on erroneous advice and that his filing was based solely on a personal decision that private insurance programs were financially preferable to participation in the Social Security program. The IRS ruled that such a minister was *not legally exempt from self-employment tax*:

In this case the taxpayer filed the Form 4361 solely for economic considerations and not because he was conscientiously opposed to, or because of religious principles opposed to, the acceptance of any public insurance of the type described on the form. Accordingly, it is held that the taxpayer did not qualify for the exemption since the Form 4361 filed solely for economic reasons is a nullity. Therefore, his net earnings from the exercise of his ministry . . . are subject to the [self-employment] tax.

According to this ruling, which has never been withdrawn or modified by the IRS, a Form 4361 that is filed "solely for economic reasons" is a "nullity."

Section 4.19.6.3.17.1 of the IRS *Internal Revenue Manual* explicitly recognizes that under some conditions, ministers who have exempted themselves from self-employment taxes based solely on economic considerations can revoke their exemption. The manual states:

1. *If taxpayer requests a revocation of his/her exemption because application was made solely for economic considerations rather than religious opposition, take the following actions:*

   A. *Advise taxpayer that exemption has been revoked because it was originally based on economic considerations.*
   B. *Notify SSA and forward copies of all material related to revocation.*
   C. *Refer case to Examination function for assessment of tax.*
   D. *Associate all material related to revocation with a copy in the permanent file, noting change.*

2. *If application was not made solely for economic considerations, process request for revocation as follows:*

   If original copy is in permanent file, then advise taxpayer that it is irrevocable.

   If original copy is not in permanent file, then (1) check open cases; (2) if found, return application to taxpayer with no further action.

   If original copy is not in either the permanent file or open cases, (1) send a request to SSA for verification of exemption; (2) once verified, advise taxpayer exemption is irrevocable; (3) send a copy of letter and taxpayer's request to the campus that issued original exemption.

3. *In all cases, attach a copy of the request and a copy of our letter to the original copy in the permanent file.*

What is the legal effect of an exemption based on economic considerations?

See the discussion of *Internal Revenue Manual* section 4.19.6.3.17.1 and Revenue Ruling 70-197 in the previous subsection.

Can ministers who have opted out of Social Security receive retirement and Medicare benefits based on the fully insured status of their spouse?

The Social Security Administration has informed the author of this tax guide that ministers who have opted out of Social Security can become eligible to receive retirement or Medicare benefits based on their spouse's Social Security coverage. This makes sense. A minister's decision to opt out of Social Security is based on religious opposition to the acceptance of Social Security benefits *payable as a result of the minister's services performed in the exercise of ministry*. To the extent that a minister's spouse is fully insured under Social Security as a result of nonministerial services, Social Security benefits the minister receives as a result of the spouse's Social Security coverage are not based on services performed by the minister in the exercise of ministry and so are not covered by the minister's exemption.

★ **KEY POINT** Ministers who exempted themselves from self-employment taxes and who receive benefits based on their spouse's Social Security coverage may have their benefits reduced substantially under the so-called windfall elimination provision. Under this provision, the Social Security Administration can reduce the benefits of persons who did not pay Social Security taxes, such as exempt ministers seeking benefits on the basis of their spouse's coverage. For more information, see "The Windfall Elimination Provision" on page 510.

Can ministers who have opted out of Social Security purchase Medicare insurance after they reach age 65?

Possibly. Ministers who have opted out of Social Security and who have less than 40 quarters of secular earnings (and whose spouse has less than 40 quarters of nonministerial earnings subject to Social Security and Medicare taxes) may be able to obtain coverage by paying a Part A premium. The Part A monthly premium for 2018 is $413. A reduced monthly premium of $226 applies to persons with 30–39 quarters of Social Security and Medicare coverage. These amounts are adjusted annually for inflation.

★ **KEY POINT** In 2018 a quarter of coverage is received for each $1,300 of wages or self-employment income earned during the year.

Part A coverage is for hospital benefits. Most people get Part A benefits once they turn age 65 because they paid Social Security and Medicare taxes for at least 40 quarters while gainfully employed. No additional premium must be paid. However, they must apply for this coverage after reaching age 65.

Medicare Part B helps pay for doctors' services, outpatient hospital care, and some other medical services that Part A does not cover, such as the services of physical and occupational therapists and some home health care. Part B coverage is optional. It can be purchased for a monthly premium. The amount of the premium

depends on a number of variables, including personal income. The standard Medicare Part B monthly premium will be $134 in 2018 (or higher, depending on income).

The Part B premium a beneficiary pays each month is based on his or her annual income. Specifically, if a beneficiary's modified adjusted gross income is greater than the legislated threshold amounts $85,000 in 2018 for a beneficiary filing an individual income tax return or married and filing a separate return, and $170,000 for a beneficiary filing a joint tax return), the beneficiary is responsible for a larger portion of the estimated total cost of Part B benefit coverage.

In addition to the standard Part B premium, affected beneficiaries must pay an income-related monthly adjustment amount. About 4 percent of current Part B enrollees are expected to be subject to these higher premium amounts.

However, note that the exemption application (Form 4361) used by ministers to apply for exemption from self-employment taxes requires a minister to certify that "I am conscientiously opposed to, or because of religious principles I am opposed to, the acceptance (for services I perform as a minister . . .) of any public insurance that makes payments in the event of death, disability, old age, or retirement; or that makes payments toward the cost of, or provides services for, medical care." The form states that "public insurance includes insurance systems established by the Social Security Act." The question that arises is how a minister can apply for exemption from self-employment taxes based on opposition to receiving public insurance benefits deriving from ministerial services and then turn around and acquire Medicare coverage by voluntarily paying premiums. The IRS has not addressed the consequences, if any, of this apparent contradiction. A similar issue is whether exempt ministers can qualify for Social Security benefits based on their spouse's income. It is clear that this is allowed (assuming the spouse is not a minister), since the minister's eligibility for exemption from self-employment taxes only requires religiously based opposition to receiving public insurance benefits that derive from the performance of ministerial services. This issue is addressed under "Can ministers who have opted out of Social Security receive retirement and Medicare benefits based on the fully insured status of their spouse?" on page 493.

3. CONSTITUTIONAL CHALLENGES

Several constitutional challenges have been brought against the exemption of ministers from Social Security coverage. So far, none has been successful. The courts have consistently held that the exemption of ministers who are opposed to participation on the basis of religious principles is mandated by the First Amendment guaranty of religious freedom. To illustrate, a federal appeals court has explained the basis for the exemption as follows: "Congress provided the exemption for ministers to accommodate the free exercise and establishment clauses of the First Amendment to the extent compatible with a comprehensive national insurance program." *Blakely v. Commissioner, 720 F.2d 411 (5th Cir. 1983).*

In its 2013 ruling striking down the ministers' housing allowance as an unconstitutional preference for religion, a Wisconsin federal district court suggested that the exemption of ministers from self-employment taxes was a permissible accommodation of religion because it is limited to "those who have a religious objection to receiving public insurance" and "limits the exemption to those whose religious exercise would be substantially burdened." *Freedom from Religion Foundation, Inc. v. Lew, 983 F. Supp. 2d 1051 (W.D. Wis. 2013).*

4. EXAMPLES

The coverage and exemption rules summarized under "Exemption of Ministers from Social Security Coverage" (beginning on page 481) are illustrated by the following examples.

Basis for exemption

EXAMPLE Pastor D, an ordained minister, is opposed to Social Security on the basis of economic considerations. He is not eligible for the exemption.

EXAMPLE Pastor L is opposed on the basis of nonreligious conscientious objection to the acceptance of Social Security benefits. He is not eligible for an exemption from Social Security coverage. *Revenue Ruling 75-189.*

EXAMPLE Pastor N is opposed on the basis of religious principles to paying Social Security taxes. He does not qualify for the exemption, since the opposition must be to the acceptance of benefits.

EXAMPLE In 1995 the Tax Court upheld the revocation of a minister's exemption from Social Security on the ground that he did not qualify. This case is important, since it illustrates that while ministers cannot revoke an exemption from self-employment taxes, the IRS may do so if it can establish that a minister did not qualify for exemption.

The Tax Court noted that a minister's exemption application had been filed on time, but it concluded that the minister was not eligible for exemption because of comments he made during his trial. Among other things, the minister gave the following response when asked whether he was opposed to accepting Social Security benefits on the basis of religious principles (as required by law to qualify for the exemption): "No. I am not opposed to the—to that, as a religious issue, no. We were advised to—by our accountant, to file for an exemption with the state, providing the state would allow it. And we asked the state to allow it, which they did."

This is an extraordinary ruling that is significant for younger ministers who are trying to decide whether to file an application for exemption from self-employment taxes (Form 4361). The ruling indicates that filing a timely Form 4361—which contains a certification by the applicant that he or she meets all of the eligibility requirements—may not be enough. The IRS or the courts may later question whether the minister was eligible for the exemption when the Form 4361 was filed.

The court struggled with this conclusion. It acknowledged that the minister "signed an exemption application stating that he was opposed to public insurance because of his religious principles." However, it found the minister's "trial testimony to be more compelling." This conclusion was reinforced by the mistakes that appeared on the Form 4361, which suggested to the court that the minister had not read the form and was not aware that he was ineligible for exemption.

Many ministers have filed a Form 4361 without being eligible for the exemption from self-employment taxes. These ministers must recognize that the validity of their exemption may be questioned in an audit. *Hairston v. Commissioner, T.C. Memo. Dec. 51,025(M) (1995).*

Filing deadline

EXAMPLE Pastor G graduated from seminary in May 2016 and accepted an associate pastoral position in July of the same year. Assuming that he earns at least $400 in self-employment earnings in 2016 and subsequent years, he must file an exemption application (Form 4361) no later than April 17, 2018 (the due date for the federal income tax return for the second year in which he had net earnings from self-employment of $400 or more, any part of which derived from ministry). If Pastor G obtains an automatic six-month extension for filing his 2018 income tax return by filing a timely Form 4868, his Form 4361 is not due until October 15, 2018.

EXAMPLE The Tax Court ruled that a minister was not exempt from Social Security, since his exemption application was filed too late. While enrolled in college, a student (John) was licensed as a "student local pastor" for the United Methodist Church ("the Church") and served in a local church in 1983 and 1984. His earnings exceeded $400 each year. John thereafter attended seminary, and during this time, he was licensed and served as the local pastor of a church from 1985 to 1987. In 1987 he was ordained as a deacon in the Church. In 1990 he was ordained as an elder. The ordained ministry of the Church consists of deacons and elders. In 1989 John filed an application for exemption from Social Security (self-employment) taxes by filing a Form 4361 with the IRS. He noted on the form that he had been ordained in 1987, when he was ordained as a deacon. Therefore, the form was filed prior to the deadline.

The Tax Court ruled that John's application for exemption had been filed too late, since the duties he performed as a licensed pastor in 1983 and 1984 (when a student) were the performance of services as a minister. The court noted that as a licensed local pastor in 1983 and 1984, John was authorized to preside over the ministration of sacerdotal functions, such as baptism, communion, and marriage, and he conducted religious worship. Therefore, "for those years [he] acted in a manner consistent with the performance of service by a duly ordained, commissioned, or licensed minister within the meaning of [the tax code]."

The court conceded that, as a licensed pastor, John had no voice or vote on official matters of his denomination. But it noted that "to perform services in the control, conduct, and maintenance of the church or organizations within the church, the minister need only have some participation in the conduct, control, and maintenance of the local church or denomination." It concluded that during 1983 and 1984, as a licensed local pastor, John served "in the control, conduct, and maintenance" of his local church even though, as a licensed local pastor, he might not have done so with respect to his national denomination. Since John had net earnings of at least $400 derived from the performance of services as a minister in 1983 and 1984, his application for exemption from self-employment tax should have been filed prior to the due date of his 1984 federal income tax return (April 15, 1985). Because it was not, it was filed too late and was not deemed to be effective. *Brannon v. Commissioner, T.C. Memo. 1999-370 (1999).*

The IRS provides the following three examples in Publication 517 that illustrate the filing deadline (dates have been updated):

EXAMPLE 1 Rev. Lawrence Jaeger, a clergyman ordained in 2016, has net self-employment earnings as a minister of $450 in 2016 and $500 in 2017. He must file his application for exemption by the due date, including extensions, for his 2017 income tax return. However, if Rev. Jaeger doesn't receive IRS approval for an exemption by April 17, 2018, his SE tax for 2017 is due by that date.

EXAMPLE 2 Rev. Louise Wolfe had only $300 in net self-employment earnings as a minister in 2016 but earned more than $400 in 2015 and expects to earn more than $400 in 2017. She must file her application for exemption by the due date, including extensions, for her 2017 income tax return. However, if she doesn't receive IRS approval for an exemption by April 17, 2018, her SE tax for 2017 is due by that date.

EXAMPLE 3 In 2015 Rev. David Moss was ordained a minister and had $700 in net self-employment earnings as a minister. In 2016 he received $1,000 as a minister, but his related expenses were over $1,000. Therefore, he had no net self-employment earnings as a minister in 2016. Also in 2016, he opened a

bookstore and had $8,000 in net self-employment earnings from the store. In 2017 he had net self-employment earnings of $1,500 as a minister and $10,000 net self-employment earnings from the store. Rev. Moss had net earnings from self-employment in 2015 and 2017 that were $400 or more each year, and part of the self-employment earnings in each of those years was for his services as a minister. Thus, he must file his application for exemption by the due date, including extensions, for his 2017 income tax return.

Eligibility requirements

EXAMPLE Pastor M accepts his first pastoral assignment in January 2018. He has decided to exempt himself from self-employment taxes but wants to be sure all of the eligibility requirements are satisfied. He must obtain an exemption application (Form 4361) containing a statement that he has notified his ordaining, commissioning, or licensing body of his opposition to Social Security coverage. Also, his application will not be approved unless the IRS verifies that Pastor M is aware of the basis for the exemption and is claiming the exemption on that basis. This is done by sending Pastor M a statement reciting the grounds on which an exemption is available and having him sign the statement, certifying under penalty of perjury that he is seeking exemption on the basis of an available ground. The statement must then be returned to the IRS within 90 days from the date it was originally sent by the IRS. If Pastor M fails to return the signed statement within 90 days, he will delay recognition of his exemption until the date the signed statement is received by the IRS.

EXAMPLE Pastor B is a licensed minister in a denomination that also ordains ministers. Pastor B is eligible for the exemption from Social Security coverage only if he is able to perform substantially the same religious duties as an ordained minister under the tenets and practices of his denomination. *IRS Letter Ruling 9221025.*

EXAMPLE Pastor H testified that he filed a timely exemption application, despite IRS assertions that the form was never received. Pastor H's wife testified that she distinctly remembered signing the application along with her husband. The Tax Court, in rejecting Pastor H's testimony, concluded that he had not been a "credible or convincing witness" and noted in particular that "his wife's signature was neither required nor provided for on the application form." *Holland v. Commissioner, 47 T.C.M. 494 (1983).*

Filing an exemption application after the deadline

EXAMPLE Pastor F was ordained in 1994. In 2018 he becomes convinced, on the basis of religious principles, that he should not accept Social Security benefits, and he submits an exemption application to the IRS. His exemption will not be accepted, and this will not violate his constitutional rights.

EXAMPLE Pastor P became convinced that accepting Social Security benefits violated his understanding of the Bible. However, this conviction developed only after the deadline for filing an exemption application (Form 4361) had expired. He is not eligible for the exemption. *Paschall v. Commissioner, 46 T.C.M. 1197 (1983).*

When an exemption takes effect

EXAMPLE Pastor O filed an exemption application (Form 4361) with the IRS within a year of his ordination in 1995, and he quit paying Social Security taxes that year. Pastor O never received back a copy of his application marked "approved" by the IRS. Even though Pastor O is sure he submitted the form, the income tax regulations specify that "the filing of an application for exemption on Form 4361 by a minister . . . does not constitute an exemption from the tax on self-employment income. . . . The exemption is granted only if the application is approved by an appropriate internal revenue officer." As a result, Pastor O has never been exempt from Social Security coverage.

Note, however, that a federal court in Virginia has concluded that ministers may qualify for exemption if they (1) demonstrate that they were eligible for the exemption when they submitted an exemption application, (2) convince a jury that they mailed a timely Form 4361, and (3) persuade the IRS or a court to apply the same reasoning as the Virginia federal district court (i.e., that IRS "approval" of an exemption is a perfunctory, administrative act that is not a requirement for exemption). *Eade v. United States, 792 F. Supp. 476 (W.D. Va. 1991) (discussed above).*

Change of faith

EXAMPLE Pastor B has served as senior pastor of a church for many years. He did not apply for exemption from Social Security before the deadline for doing so expired several years ago, because he was not opposed to receiving Social Security benefits based on his ministerial employment at that time. This year, however, Pastor B learns of IRS Counsel Advice 200404048 (see above) and begins to rethink his position on Social Security. He concludes that he is opposed on the basis of religious convictions to receiving Social Security benefits, and he would like to submit a Form 4361 to claim exemption. He cannot do so. In the *Hall* case (which served as the basis for the chief counsel advice memorandum), a federal appeals court concluded that "ministers who do not switch churches may not belatedly opt out of the system."

EXAMPLE Pastor G has served as associate pastor of a church for many years. He did not apply for exemption from Social Security before the deadline for doing so expired, because no one told him about this option. However, he was never opposed

on the basis of religious convictions to receiving Social Security benefits based on his ministerial employment. This year Pastor G learns of IRS Chief Counsel Advice 200404048 (see above) and views this as an opportunity to "save taxes." He is ineligible to file a Form 4361 for two reasons. First, he does not qualify for exemption, since a desire to "save taxes" is not a valid basis for exemption. Second, in the *Hall* case (which served as the basis for the chief counsel advice memorandum), a federal appeals court concluded that "ministers who do not switch churches may not belatedly opt out of the system."

EXAMPLE Pastor D has served as senior pastor of a church for many years. He did not apply for exemption from Social Security before the deadline for doing so expired, because he was not opposed to receiving Social Security benefits based on his ministerial employment. However, over the years, Pastor D did develop a sincere opposition, based on religious convictions, to accepting any form of public insurance, including Social Security. He learns of IRS Chief Counsel Advice 200404048 (see above) and plans to file a Form 4361 exemption application. He is not eligible to do so. In the *Hall* case (which served as the basis for the chief counsel advice memorandum), a federal appeals court concluded that "ministers who do not switch churches may not belatedly opt out of the system."

EXAMPLE Pastor J has served as senior pastor of a church for many years. He did not apply for exemption from Social Security before the deadline for doing so expired, because he was not opposed to receiving Social Security benefits based on his ministerial employment. However, last year Pastor J resigned his pastoral position, joined a new faith, and was ordained as a minister of the new faith. The new faith teaches opposition to receiving any form of public assistance, including Social Security. Pastor J adopts this teaching. He learns of IRS Chief Counsel Advice 200404048 (see above) and plans to file a Form 4361 exemption application this year.

Pastor J is eligible to do so, since he meets all the requirements for renewal of exemption listed by the court in the *Hall* case and in the chief counsel advice memorandum: (1) change of church affiliation; (2) reordination by the new church; (3) development of opposition, based on one's new faith, to the acceptance of Social Security benefits; and (4) submission of an exemption application (Form 4361) by the due date of the federal tax return for the second year in which one has net self-employment earnings of $400 or more, any part of which comes from the performance of ministerial services in one's new faith.

EXAMPLE Pastor T was an associate pastor of a church for many years. She did not apply for exemption from Social Security before the deadline for doing so expired, because she was not opposed to receiving Social Security benefits based on her ministerial employment. Five years ago, Pastor T resigned her pastoral position, joined a new faith, and was ordained as a minister of the new faith. The new faith teaches opposition to receiving any form of public assistance, including Social Security. Pastor T adopted this teaching but did not file an exemption application (Form 4361). This year she learns of IRS Chief Counsel Advice 200404048 (see above) and plans to file a Form 4361 exemption application. She is not eligible to do so, since the deadline for filing a new application for exemption has expired.

EXAMPLE Pastor K is the senior pastor of a church. He did not apply for exemption from Social Security before the deadline for doing so expired, because he was not opposed to receiving Social Security benefits based on his ministerial employment. However, last year Pastor K resigned his pastoral position and ordination and became associated with a new faith that teaches opposition to receiving any form of public assistance, including Social Security. The new faith does not ordain ministers, but Pastor K serves as a minister in one of its churches. Pastor K adopts the teaching of his new faith regarding Social Security. He learns of IRS Chief Counsel Advice 200404048 (see above) and plans to file a Form 4361 exemption application this year. It is likely, but not certain, that Pastor K is eligible to do so.

In the *Hall* case, a federal appeals court ruled that the following requirements must be met in order to requalify for exemption from Social Security: (1) change of church affiliation; (2) reordination by the new church; (3) development of an opposition, based on one's new faith, to the acceptance of Social Security benefits; and (4) submission of an exemption application (Form 4361) by the due date of the federal tax return for the second year in which one has net self-employment earnings of $400 or more, any part of which comes from the performance of ministerial services in one's new faith.

Pastor K meets all of these requirements except for the second one (reordination by the new church). The *Hall* case explicitly requires that a minister not only change faiths to requalify for exemption after the original deadline has expired but also that the minister be reordained by the new faith. IRS Chief Counsel Advice 200404048 (see above) contains the same language. It states that the *Hall* case "provides that when an individual enters the ministry anew in a new church, having adopted a new set of beliefs about the propriety of accepting public insurance, it is logical and consistent with the [language of the tax code] to characterize that individual as a 'new' minister for the purposes of seeking an exemption." This language strongly supports the conclusion that reordination is required.

On the other hand, in the *Ballinger* case (discussed above), a federal appeals court made the following observation: "Not all churches or religions have a formally ordained ministry, whether

because of the nature of their beliefs, the lack of a denominational structure or a variety of other reasons. Courts are not in a position to determine the merits of various churches nor an individual's conversion from one church to another. Thus, we cannot hold that an individual who functions as a minister in a church which does not ordain, license or commission that individual in a traditional or legally formal manner is not entitled to the exemption. Nor can we hold that an individual who has a change of belief accompanied by a change to another faith is not entitled to the exemption. We interpret Congress' language providing an exemption for any individual who is 'a duly ordained, commissioned or licensed minister of a church' to mean that the triggering event is the assumption of the duties and functions of a minister."

EXAMPLE Pastor M is the senior pastor of a church. He did not apply for exemption from Social Security before the deadline for doing so expired, because he was not opposed to receiving Social Security benefits based on his ministerial employment. This year he learns about IRS Chief Counsel Advice 200404048 (see above) and is told by another pastor that if he "switches churches," the deadline for filing an exemption application (Form 4361) will be reset. This advice is incorrect. A change of faiths is only one requirement to requalify for exemption after the original deadline has expired. The other requirements, as noted above, are reordination by the new church; acquiring an opposition, based on one's new faith, to the acceptance of Social Security benefits; and submitting an exemption application (Form 4361) by the due date, including extensions, of the federal tax return for the second year in which one has net self-employment earnings of $400 or more, any part of which comes from the performance of ministerial services in one's new faith. If these additional requirements are not met, Pastor M will not requalify for exemption even if he does change faiths.

EXAMPLE Pastor L was an associate pastor of a church for many years. This year she accepts a position as senior pastor in a different church associated with the same faith. Pastor L did not apply for exemption from Social Security before the deadline for doing so expired, because she was not opposed to receiving Social Security benefits based on ministerial employment. She learns about IRS Chief Counsel Advice 200404048 (see above) and is told by another pastor that by accepting the new pastoral position, she requalifies for opting out of Social Security if she so chooses. This advice is incorrect. Pastor L does not requalify for exemption, since she has not had a change of faith or been reordained in a new faith.

EXAMPLE Pastor G has served as senior pastor of a church for many years. He did not apply for exemption from Social Security before the deadline for doing so expired, because he was not opposed to receiving Social Security benefits based on his ministerial employment. However, last year Pastor G resigned his pastoral position, joined a new faith, and was ordained as a minister of the new faith. The new faith has no position on participation in Social Security. This year Pastor G learns of IRS Chief Counsel Advice 200404048 (see above) and sees it as an opportunity to be relieved of the burden of paying self-employment taxes. He does not requalify for exemption, for two reasons:

First, he has not been reordained by a faith that is opposed to the acceptance of public insurance benefits (including Social Security). The chief counsel advice memorandum states, "When an individual enters the ministry anew in a new church, having adopted a new set of beliefs about the propriety of accepting public insurance, it is logical and consistent with the [language of the tax code] to characterize that individual as a 'new' minister for the purposes of seeking an exemption." This language indicates that a change of belief about the propriety of accepting public insurance benefits must reflect the views of one's new faith.

Second, Pastor G's desire to be relieved of the burden of paying self-employment taxes does not qualify as a basis for exemption.

5. IRS AUDIT GUIDELINES FOR MINISTERS

In 2009 the IRS issued updated audit guidelines for its agents to follow when auditing ministers. The guidelines inform agents that in order for ministers to claim exemption from self-employment tax, they must satisfy the following requirements:

- Be an ordained, commissioned, or licensed minister of a church or denomination.
- File Form 4361. This is an application for exemption from self-employment tax for use by ministers.
- Be conscientiously opposed to public insurance (Medicare/Medicaid and Social Security benefits) because of religious beliefs.
- File for exemption for reasons other than economic.
- Notify the church or order that they are opposed to public insurance.
- Establish that the organization that ordained, licensed, or commissioned the minister is a tax-exempt religious organization.
- Establish that the organization is a church or a convention or association of churches.

OBSERVATION The guidelines fail to clarify that a minister must be opposed to the acceptance of benefits under a public insurance program. Opposition to the program is not sufficient.

The guidelines further clarify that

> *Form 4361 must be filed by the due date of the Form 1040 (including extensions) for the second tax year in which at least $400 in*

self-employment ministerial earnings was received. The 2 years do not have to be consecutive. An approved Form 4361 is effective for all tax years after 1967 for which a minister received $400 or more of self-employed income for ministerial services.

The exemption from self-employment tax applies only to services performed as a minister. The exemption does not apply to other self-employment income. To determine if a minister is exempt from self-employment tax, request that he or she furnish a copy of the approved Form 4361 if it is not attached to the return. If the taxpayer cannot provide a copy, order a transcript for the year under examination. The ADP and IDRS Information handbook shows where the ministers' self-employment exemption codes are located on the transcripts and what the codes mean. Transcripts will not show exemption status prior to 1988. If the transcript does not show a MIN SE indicator and the taxpayer still claims that he or she is exempt from self-employment tax, the Taxpayer Relations Branch at the Service Center where the Form 4361 was filed can research this information and provide the taxpayer with a copy. The Social Security Administration in Baltimore also can provide the information on exemption for an individual.

OBSERVATION Many ministers who claim they are exempt from self-employment tax cannot prove that they are exempt. Ministers who file a timely application for exemption that is approved by the IRS will be sent a copy of their exemption application marked "approved." Many ministers who have filed a timely exemption application cannot produce the approved copy of their application. In some cases they have mislaid the application, but in others they mistakenly believe they filed the application many years ago, when in fact they did not. In either case, they may not pay self-employment taxes for several years. If they are audited and asked to verify their exemption from self-employment tax, they may be unable to do so. The guidelines contain some helpful information for ministers in this situation, for they reveal the procedure IRS agents are instructed to follow if a minister who claims to be exempt from self-employment taxes cannot produce an approved application. A number of recommendations are in place that agents can pursue in verifying the exempt status of a minister who cannot produce a copy of an approved exemption application.

The guidelines contain the following four examples (dates have been updated):

EXAMPLE H had ministerial earnings of $400 in 2016 and $1,800 in 2017. He has until April 17, 2018 (if no extension has been filed), to file Form 4361. If he files for exemption but does not receive the approved Form 4361 back from the IRS by the due date for his 2017 tax return, the self-employment tax for 2017 is still due by that date. If he later receives the approved 4361, he may amend his 2017 return.

EXAMPLE J earned $500 in 2015, $300 in 2016, and $6,000 in 2017 from ministry. She has until April 17, 2018 (if no extension has been filed), to file Form 4361. If she files for exemption but does not receive the approved Form 4361 back from the IRS by April 17, 2018, she must pay the self-employment tax with her 2017 return but may file an amended return after the exemption is approved. J may file a claim for refund (an amended tax return) within three years from the time the return was filed or within two years from the time the tax was paid, whichever is later.

EXAMPLE K, ordained in 2016, has $7,500 in net earnings as a minister in both 2016 and 2017. He files Form 4361 on March 5, 2018. If the exemption is granted, it is effective for 2016 and all following years.

EXAMPLE L, an ordained minister, has applied for and received exemption from self-employment tax for his services as a minister. In 2018 he has ministerial income of $12,000 and income from his shoe repair business, a sole proprietorship, of $9,000. He must compute self-employment tax on the $9,000.

★ **KEY POINT** The audit guidelines assist IRS agents in the examination of ministers' tax returns. They alert agents to the key questions to ask, and they provide background information along with the IRS position on a number of issues. It is therefore important for ministers to be familiar with these guidelines.

C. SERVICES TO WHICH EXEMPTION APPLIES

★ **KEY POINT** An exemption from self-employment taxes only applies to ministerial services. Ministers who have exempted themselves from self-employment taxes must pay Social Security taxes on any nonministerial employment. They are eligible for Social Security benefits based on their nonministerial services (assuming that they have worked enough quarters in nonministerial employment).

A minister whose exemption application is duly approved by the IRS is exempt from paying Social Security taxes on compensation earned from the performance of services in the exercise of ministry. The term *services performed in the exercise of ministry* is a technical one that is defined fully in Chapter 3 of this text.

★ **KEY POINT** Some ministers who have exempted themselves from Social Security coverage have worked previously in secular employment. Does their exemption prevent them from ever receiving any

Social Security benefits? The answer is no. An approved exemption only exempts a minister from Social Security taxes and benefits with respect to services performed in the exercise of ministry. The exemption does not apply to secular earnings, so ministers who have the requisite number of quarters of secular earnings and taxes will qualify for benefits. However, the amount of those benefits in most cases will be reduced by the number of years a minister is exempt.

The income tax regulations specify that "a minister performing service in the exercise of his ministry may be eligible to file an application for exemption on Form 4361 even though he is not opposed to the acceptance of benefits under the Social Security Act with respect to service performed by him which is not in the exercise of his ministry." *Treas. Reg. 1.1402(e)-2A(a)(2).* As a result, a minister whose exemption application (Form 4361) has been approved by the IRS will be eligible to receive Social Security benefits based on earnings not covered by the exemption, assuming that such earnings are sufficient to entitle the minister to the benefits. Note also that the longer a minister is exempt from Social Security coverage, the lower his or her Social Security retirement benefits will tend to be.

EXAMPLE A pastor of a local church also operated a private business as a handyman. The pastor, who had filed for exemption from self-employment taxes, assumed that the exemption applied to his handyman income. As a result, he did not pay self-employment tax on these earnings. The IRS audited his tax return and determined that the secular earnings were subject to the self-employment tax. The Tax Court agreed, noting that "although the income [the pastor] derived from his handyman business may have enabled him to sustain his ministry at [his church] and to fulfill the obligation of supporting his family, those reasons or motives do not cause the handyman business to be integral to the conduct of his ministry." The court acknowledged that ministers can exempt themselves from self-employment taxes if they meet several conditions, but the exemption applies only to "services performed in the exercise of ministry." Such services did not include the pastor's work as a handyman. *Williams v. Commissioner, T.C. Memo. 1999-105.*

D. COMPUTING SELF-EMPLOYMENT TAX

★ **KEY POINT** The self-employment tax is reported on Schedule SE and is computed by multiplying net self-employment earnings by the current self-employment tax rate. Net self-employment earnings consist of a minister's total church compensation, including the annual fair rental value of a parsonage or a housing allowance, reduced by most income tax exclusions and business expenses (whether unreimbursed or reimbursed under a nonaccountable plan). Two deductions are allowed in computing net earnings from self-employment (see the next paragraph).

★ **KEY POINT** Self-employed persons pay the combined Social Security and Medicare tax rate (15.3 percent) that is shared by employers and employees. To partly offset the tax burden that falls on self-employed persons, the law allows them two deductions: (1) an amount equal to 7.65 percent multiplied by their net self-employment earnings (without regard to this deduction) may be deducted in computing earnings subject to the self-employment tax, and (2) half their self-employment tax is deductible as an adjustment in computing income taxes, regardless of whether they can itemize deductions on Schedule A (Form 1040).

★ **KEY POINT** For 2018 the maximum earnings subject to self-employment taxes is $128,700. In addition, all self-employment earnings, regardless of amount, are subject to the 2.9-percent Medicare component of the self-employment tax.

In most cases, ministers must pay self-employment tax on salaries and other income for services performed as a minister. But if you filed Form 4361 and received IRS approval, you will be exempt from paying SE tax on those net earnings. If you had no other income subject to SE tax, enter "Exempt—Form 4361" on Form 1040, line 57. However, if you had other net earnings of $400 or more subject to SE tax, see line A at the top of "long" Schedule SE.

The Social Security tax for ministers who have not filed a timely exemption application is computed by multiplying the applicable self-employment tax rate by the minister's net earnings from self-employment. The computation of self-employment earnings for ministers is summarized in the sidebar "Clergy Self-Employment Earnings" on page 502.

1. UNREIMBURSED BUSINESS EXPENSES AND NONACCOUNTABLE REIMBURSEMENTS OF BUSINESS EXPENSES

In computing their self-employment tax liability, can ministers deduct their unreimbursed business expenses and business expenses reimbursed by their employing church under a nonaccountable plan? This question has been addressed by the IRS in Revenue Ruling 80-110, Publication 517, the IRS audit guidelines for ministers, and the instructions to Schedule SE (Form 1040), as noted below.

Revenue Ruling 80-110

In Revenue Ruling 80-110, the IRS addressed the following question: can a pastor who is unable to deduct unreimbursed business expenses of $500 in computing income taxes, since he was unable

to itemize deductions on Schedule A (Form 1040), deduct the expenses in computing self-employment taxes on Schedule SE (Form 1040)? The IRS concluded that he could. It noted that section 1402 of the tax code specifies that ministers are self-employed for Social Security purposes with respect to compensation received from the performance of ministerial services, and they can reduce self-employment earnings in computing their self-employment tax liability by "the deductions attributable to the trade or business." There is no requirement here that the minister be able to itemize deductions on Schedule A—that limitation only pertains to the deductibility of business expenses in computing *income taxes*. *IRC 62.* It follows that ministers can deduct any expenses associated with their ministry (their "trade or business"), including unreimbursed and nonaccountable reimbursed expenses, even if these same expenses are not deductible in computing income taxes.

The limitation on deducting these expenses in computing income taxes (the taxpayer must be able to itemize expenses on Schedule A) does not pertain to self-employment tax deductions. There is no requirement in section 1402 that only expenses qualifying for an income tax deduction reduce self-employment earnings.

The IRS observed:

> *Section 1402(c)(2)(D) of the tax code provides that the term "trade or business," when used with reference to self-employment income, does not include the services of an employee other than the performance of service by a duly ordained minister of a church in the exercise of the ministry. Section 1402(a) provides that the term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by the individual,* less the deductions attributable to the trade or business. . . . The trade and business deductions of a minister are allowable as deductions for purposes of computing the tax on self-employment income. [Therefore] the $500 is deductible on the Schedule SE (Form 1040) in computing the minister's self-employment tax. *[Emphasis added.]*

Revenue Ruling 80-110 has never been modified or repealed by the IRS.

IRS Publication 517

The current edition of Publication 517 states:

> *When figuring your net earnings from self-employment, deduct all your expenses related to your ministerial services performed as a self-employed person. These are ministerial expenses you incurred while working other than as a common-law employee of the church. They include expenses incurred in performing marriages and baptisms, and in delivering speeches. Deduct these expenses on Schedule C or C-EZ (Form 1040), and carry the net amount to line 2 of Schedule SE (Form 1040), Section A or B.*
>
> *Wages earned as a common-law employee (explained earlier) of a church are generally subject to self-employment tax unless an exemption is requested. . . . Subtract any allowable expenses (including unreimbursed employee business expenses) from those wages, include the net amount on line 2 of Schedule SE (Form 1040), Section A or B, and attach an explanation. Don't complete Schedule C or C-EZ (Form 1040). However, for income tax purposes, the expenses are allowed only as an itemized deduction on Schedule A (Form 1040) to the extent they exceed 2 percent of adjusted gross income. . . .*
>
> *Because reimbursements under a nonaccountable plan are included in your gross income, you can deduct your related expenses (for SE and income tax purposes) regardless of whether they are more than, less than, or equal to your reimbursement.*

IRS audit guidelines for ministers

The revised audit guidelines for ministers that were issued by the IRS in 2009 contain the following example:

> **EXAMPLE** M receives a salary from the church of $20,000. His parsonage/housing allowance is $12,000. The church withholds federal income tax (by mutual agreement) and issues him a Form W-2. He has unreimbursed employee business expenses (before excluding nondeductible amounts attributable to his exempt income) of $5,200. His net earnings for self-employment tax are $26,800 ($20,000 + $12,000 – $5,200). Note that all of M's unreimbursed business expenses are deductible for self-employment tax purposes, although the portion attributable to the exempt housing allowance is not deductible for federal income tax purposes.

This example states that unreimbursed employee business expenses are deductible in computing self-employment taxes. The example does not indicate that this result assumes that the expenses are deductible as an itemized expense on Schedule A (Form 1040) in computing income taxes.

Schedule SE instructions

Self-employment taxes are computed on Schedule SE (Form 1040). The instructions to Schedule SE provide: "If you were a duly ordained minister who was an employee of a church and you must pay SE tax, the unreimbursed business expenses that you incurred as a church employee are allowed only as an itemized deduction for income tax purposes. However, when figuring SE tax, subtract on line 2 the allowable expenses from your self-employment earnings and attach an explanation." In prior years, the instructions to Schedule SE (Form 1040) added: "Please note that the unreimbursed employee business expenses that you incurred as an employee of the church are not allowable expenses for SE tax purposes, and are allowed only as an itemized deduction for income tax purposes." With or without this statement, the instructions are clear that unreimbursed employee

business expenses are deductible only as an itemized business expense in computing income taxes and not as a Schedule SE deduction in computing SE tax. However, any other expenses incurred in the production of self-employment income reduce the amount of earnings reported on line 2 of Schedule SE.

Conclusion

In summary, the clear implication of the tax code and Revenue Ruling 80-110 is that unreimbursed business expenses and reimbursed business expenses under a nonaccountable plan *are* deductible by ministers in computing their self-employment tax liability even if they are not able to deduct these expenses in computing their income tax liability because they do not have enough itemized expenses to use Schedule A. The key point is that there is no requirement under section 1402, as there is under section 62, that only those business expenses that can be claimed as itemized deductions on Schedule A are deductible in computing net earnings from self-employment. This understanding is clearly reflected in Publication 517 and the IRS audit guidelines for ministers.

However, this understanding is contradicted by the following statement in the instructions to Schedule SE: "If you were a duly ordained minister who was an employee of a church and you must pay SE tax, the unreimbursed business expenses that you incurred as a church employee are allowed only as an itemized deduction for income tax purposes." This statement implies that unreimbursed employee business expenses are never deductible in computing net earnings from SE, regardless of whether they can be claimed as itemized deductions on Schedule A. This statement is clearly wrong, since section 1402 says that self-employed persons can reduce self-employment earnings in computing their self-employment tax liability by "the deductions attributable to the trade or business." This includes unreimbursed business expenses.

Because of the confusion caused by the instructions to Schedule SE, ministers should consult with a tax professional before claiming unreimbursed expenses and nonaccountable reimbursed expenses as deductions in computing self-employment tax liability on Schedule SE.

CLERGY SELF-EMPLOYMENT EARNINGS

Clergy are deemed to be self-employed for Social Security with respect to services they perform in the exercise of their ministry. This means they pay the self-employment tax rather than the employee's share of Social Security and Medicare taxes. The self-employment tax for 2018 is computed by multiplying net self-employment earnings (up to $128,700) by the self-employment tax rate of 15.3 percent. Only the Medicare component (2.9 percent) of self-employment taxes applies to self-employment earnings in excess of $128,700. Net self-employment earnings are computed as follows:

(1) Church salary

(2) Plus

- other items of church income (including taxable fringe benefits) described in Chapter 4
- fees you receive for marriages, baptisms, funerals, masses, etc.;
- self-employment earnings from outside businesses;
- annual rental value of a parsonage, including utilities paid by church (unless you are retired)
- a housing allowance (unless you are retired)
- business expense reimbursements (under a nonaccountable plan)
- the value of meals served on the church's premises for the convenience of the employer
- any amount a church pays toward your income tax or self-employment tax

(3) Reduced by

- most income tax exclusions (see Chapter 5) other than meals or lodging furnished for the employer's convenience, and the foreign earned income exclusion
- annual fair rental value of a parsonage provided to you after you retire
- housing allowance provided to you after you retire
- contributions by your church to a tax-sheltered annuity plan set up for you, including any salary reduction contributions (elective deferrals) that are not included in your gross income
- pension payments or retirement allowances you receive for your past ministerial services
- net self-employment earnings (without regard to this deduction) multiplied by 7.65 percent

Note: It may be possible to reduce self-employment earnings by unreimbursed business expenses and business expenses reimbursed by an employing church under a nonaccountable plan even if these expenses cannot be claimed as an income tax deduction due to an inability to itemize deductions. See "Computing Self-Employment Tax" on page 500 for more information.

2. THE DEASON RULE

The IRS has acknowledged that the *Deason* rule does not apply to the deductibility of business expenses on Schedule SE. This means that ministers do not need to reduce their business expense deduction on Schedule SE by the percentage of their total church compensation that consists of a housing allowance. The reason is that the housing allowance is not an exclusion in computing self-employment taxes on Schedule SE. This position is reflected in IRS Publication 517 and the IRS audit guidelines for ministers:

- IRS Publication 517 states: "Reduce your otherwise deductible expenses only in figuring your income tax, not your SE tax."
- The IRS audit guidelines for ministers include the following example:

EXAMPLE M receives a salary from the church of $20,000. His parsonage/housing allowance is $12,000. The church withholds federal income tax (by mutual agreement) and issues him a Form W-2. He has unreimbursed employee business expenses (before excluding nondeductible amounts attributable to his exempt income) of $5,200. His net earnings for self-employment tax are $26,800 ($20,000 + $12,000 – $5,200). Note that all of M's unreimbursed business expenses are deductible for self-employment tax purposes, although the portion attributable to the exempt housing allowance is not deductible for federal income tax purposes. IRC § 265, regarding the allocation of business expenses related to exempt income, relates to income tax computations but not self-employment tax computations.

The *Deason* rule is explained fully under "The Deason Rule" on page 354.

3. EXCLUSIONS

The income tax regulations specify that "income which is excludable from gross income under any provision of subtitle A of the Internal Revenue Code is not taken into account in determining net earnings from self-employment," with certain exceptions. *Treas. Reg. 1.1402(a)-2(a).* This means that most income tax exclusions (see Chapter 5) are also excludable in computing self-employment taxes. The exceptions, which are included in income when computing self-employment taxes, include (1) the housing allowance (unless provided to a retired minister), (2) the fair rental value of a church-provided home (unless provided to a retired minister), (3) the foreign earned income exclusion, and (4) meals and lodging provided for the convenience of an employer. Apart from these exceptions, the general rule is that the exclusions discussed in Chapter 5 are excludable in computing both income taxes and self-employment taxes.

EXAMPLE A church provided free meals to ministers who were required to reside in housing on the church's premises in order to fulfill their duties. The IRS concluded that the value of the meals was taxable income to the ministers in computing self-employment taxes. It noted that section 1402(a)(8) of the tax code prevents the exclusion of meals "for the convenience of the employer" (under section 119) from reducing a minister's net earnings. Thus, the value of meals and cash reimbursements for groceries furnished by the church to its ministers "must be included in the ministers' net earnings from self-employment" for self-employment tax purposes. *IRS Letter Ruling 9129037.*

4. PARSONAGES AND HOUSING ALLOWANCES

The definition of net earnings from self-employment includes the fair rental value of a church-owned parsonage provided without charge to a minister, as well as a housing allowance paid to a minister who owns or rents a home. The fair rental value of a parsonage is the fair rental value of a furnished parsonage. This is often a difficult amount to compute. See Chapter 6 for a discussion of this important term.

★ **KEY POINT** If a church pays the utilities of a minister who lives in a church-owned parsonage, the amount paid must be included in the minister's income when computing self-employment taxes.

★ **KEY POINT** As noted under "Housing Allowances" on page 530, the annual rental value of a parsonage is not included in net earnings when computing the self-employment tax of retired ministers.

5. FRINGE BENEFITS

Generally, the taxable fringe benefits discussed in Chapter 4 are included in a minister's income when computing self-employment taxes.

6. EARNINGS SUBJECT TO THE SELF-EMPLOYMENT TAX

The 15.3-percent self-employment tax rate consists of two components: (1) a Medicare hospital insurance tax of 2.9 percent and (2) an "old-age, survivor and disability" (Social Security) tax of 12.4 percent. For 2017 the Medicare component of the self-employment tax (the 2.9-percent tax rate) applied to all net earnings from self-employment, regardless of amount, while the Social Security component (the 12.4-percent tax rate) applied to net earnings

HOUSING ALLOWANCES AND THE ANNUAL EARNINGS TEST

If a minister elects to receive Social Security retirement benefits prior to full retirement age, does the amount of the minister's compensation designated as a housing allowance count toward the earnings test? To illustrate, assume that Pastor J begins drawing Social Security retirement benefits during 2018, when he is 63 years of age, and continues to work for the church. The church pays Pastor J total compensation of $30,000 for 2018, of which $15,000 is designated as a housing allowance. If the housing allowance is included in applying the earnings test, then Pastor J has earned $12,960 over the earnings test exempt amount ($17,040 for 2018), meaning that his Social Security retirement benefits will be reduced by $6,480 ($1 for every $2 of earned income in excess of $17,040). On the other hand, if the housing allowance is *not* counted in applying the earnings test, then Pastor J's earnings are $15,000. Since this amount is less than the exempt amount ($17,040), there will be no reduction in Pastor J's Social Security benefits. Obviously, the answer to this question can have a significant financial impact.

Unfortunately, there is no definitive answer to this question. It is likely, however, that a minister's housing allowance *should* be included in applying the earnings test. This conclusion is based on section 1811 of the current *Social Security Handbook*, which states that "the following types of earnings count for earnings test purposes: (A) All wages for employment covered by Social Security . . . (F) All net earnings from self-employment." Since the duties of ministers in the exercise of ministry are not "employment covered by Social Security" (see "Exemption of Ministers from Social Security Coverage" on page 481), a minister's earnings for purposes of the annual earnings test are limited to "net earnings from self-employment." This important term is defined by section 1402 of the code as follows: "[A]n individual who is a duly ordained, commissioned, or licensed minister of a church . . . shall compute his net earnings from self-employment derived from the performance of service [as a minister] without regard to section 107 (relating to rental value of parsonages)."

In summary, the best evidence supports the conclusion that ministers *should* include housing allowances (and the annual rental value of parsonages) in applying the annual earnings test, since such items are *not* excluded from the definition of net earnings from self-employment under section 1402 of the tax code. Neither the IRS, the Social Security Administration, nor any court has ever addressed this issue directly, but the conclusion summarized above seems to be the most likely result.

The elimination of the annual earnings test for persons who are full retirement age and older has diminished the importance of this question, since few ministers who are under their full retirement age have any desire to begin receiving Social Security retirement benefits and continue working at the same time (since their benefits are reduced by $1 for every $2 they earn above $17,040 in 2018).

from self-employment up to $127,200. As a result, persons who received compensation in excess of $127,200 in 2017 paid the full 15.3-percent tax rate for net self-employment earnings up to $127,200 and the Medicare rate of 2.9 percent on all net earnings, regardless of amount. This provision directly impacts ministers, who always are considered self-employed for Social Security with respect to their ministerial services.

★ **KEY POINT** The $127,200 amount increases to $128,700 for 2018.

7. TWO SPECIAL DEDUCTIONS FOR THE SELF-EMPLOYED

Self-employed persons pay the entire Social Security and Medicare tax rate of 15.3 percent. Unlike employees, they do not split the cost with an employer. Because of the unfair burden this places on self-employed persons, the tax code gives them two deductions:

- Persons who are self-employed for Social Security purposes (including ministers, with respect to their ministerial income) can reduce their taxable earnings by 7.65 percent (half of the self-employment tax rate). This is done by multiplying net earnings from self-employment by 0.9235 on line 4 of Schedule SE (Form 1040).
- Persons who are self-employed for Social Security purposes (including ministers, with respect to their ministerial income) can deduct half of their actual self-employment taxes as an adjustment on line 27 of Form 1040, regardless of whether they are able to itemize deductions on Schedule A.

In explaining these changes, Congress stated that its purpose was "to achieve parity between employees and the self-employed" for Social Security purposes.

A minister's calculation of estimated taxes should incorporate (1) the application of the Medicare component of the self-employment tax (the 2.9-percent tax rate) to all net earnings from self-employment, regardless of amount, and (2) the two special deductions described above. Some ministers fail to take these rules into account in calculating their estimated taxes.

8. CHURCHES THAT PAY HALF OF A PASTOR'S SELF-EMPLOYMENT TAXES

Many churches agree to pay half of their ministers' self-employment taxes in order to achieve parity with their treatment of nonminister employees for whom they pay half of their Social Security and Medicare taxes. Any church considering this practice should note two points. First, the two special deductions summarized above make it difficult, if not impossible, to determine in advance what "half" of a minister's self-employment tax will be.

Second, "half" of a minister's self-employment tax liability for a particular year will not be known until the minister files a tax return (Form 1040, Schedule SE) reporting actual self-employment taxes. Because of these issues, church leaders should consider the following alternatives:

- Pay half of the estimated self-employment taxes paid by a minister each quarter. Only when the minister computes his or her actual self-employment tax liability on Schedule SE (Form 1040) after the end of the year will the church know what half of the self-employment taxes actually was. If actual self-employment taxes are more than the quarterly estimates, then the church would need to pay half of the difference in order to pay half of the minister's self-employment tax liability for the year. If actual self-employment taxes are less than the quarterly estimates, then the church has paid more than half of the minister's self-employment taxes. It could either request a refund of the difference or report the difference as additional taxable income.
- A church could pay a specified additional amount of compensation to a pastor for the express purpose of assisting with the payment of self-employment taxes. The amount specified could be based on a reasonable estimate of what the pastor's self-employment tax liability for the year will be, keeping in mind that self-employment taxes are assessed against both salary and housing allowances (or the fair rental value of a parsonage).

Churches that pay half of a minister's self-employment tax are putting the minister in a better position than nonminister staff, since the minister can claim the two special deductions summarized above.

9. SCHEDULE SE

Ministers report their self-employment taxes on Schedule SE (Form 1040). Most ministers use the "short" Schedule SE rather than the "long" form. This means that they complete Section A on page 1 of the schedule rather than Section B on page 2. Ministers report their net self-employment earnings on line 2 of Section A.

An "optional nonfarm" method for computing Social Security earnings is available for up to five years. Several conditions apply. See the Social Security Administration website or the instructions to Schedule SE (Form 1040) for details.

10. IRS AUDIT GUIDELINES FOR MINISTERS

The IRS has issued audit guidelines for its agents to follow when auditing ministers. The guidelines inform agents that "to compute self-employment tax, allowable trade or business expenses are subtracted from gross ministerial earnings, then the appropriate rate is applied." The guidelines instruct agents to include the following items in a minister's gross income for self-employment tax:

- salaries and fees for services, including offerings and honoraria received for marriages, funerals, baptisms, etc. (Include gifts that are considered income, as discussed under the section on income.);
- any housing allowance or utility allowances;
- the fair rental value (FRV) of a parsonage, if provided, including the cost of utilities and furnishings provided;
- any amounts received for business expenses treated as paid under a nonaccountable plan, such as an automobile allowance; and
- the income tax or self-employment tax obligation of the minister that is paid by the church.

The guidelines provide the following examples:

EXAMPLE M receives a salary from the church of $20,000. His parsonage/housing allowance is $12,000. The church withholds federal income tax (by mutual agreement) and issues him a Form W-2. He has unreimbursed employee business expenses (before excluding nondeductible amounts attributable to his exempt income) of $5,200. His net earnings for self-employment tax are $26,800 ($20,000 + $12,000 – $5,200). Note that all of M's unreimbursed business expenses are deductible for self-employment tax purposes, although the portion attributable to the exempt housing allowance is not deductible for federal income tax purposes. IRC § 265, regarding the allocation of business expenses related to exempt income, pertains to income tax computations but not self-employment tax computations.

EXAMPLE G received a salary of $12,000 and a housing allowance of $9,000 and earned $3,000 for various speaking engagements, weddings, funerals, etc., all related to her ministry. She reports her salary as "wages" on page 1 of her Form 1040 and her fees on Schedule C. Because her actual housing costs ($6,000) were less than her housing allowance and the FRV of her home for the year, she must include $3,000 of her housing allowance as "other income" for income tax purposes. Her total business expenses are $4,500. . . . G computes her self-employment taxable income as follows: $12,000 salary plus $9,000 housing allowance plus $3,000 Schedule C income less $4,500 total business expenses equals $19,500 self-employment income.

● **OBSERVATION** The first example illustrates an important point. Ministers' business expenses should not be reduced in computing their self-employment taxes, since the housing allowance does not represent tax-exempt income when computing self-employment taxes. The so-called *Deason* reduction rule applies only to the computation of income taxes.

11. ADDITIONAL HOSPITAL INSURANCE TAX ON HIGH-INCOME TAXPAYERS

The FICA tax rate (7.65 percent for both employers and employees, or a combined tax of 15.3 percent) is comprised of a Medicare hospital insurance (HI) tax of 1.45 percent and a Social Security (old-age, survivor, and disability) tax of 6.2 percent. The self-employment tax rate (SECA) is comprised of a Medicare hospital insurance tax of 2.9 percent and an old-age, survivor, and disability (Social Security) tax of 12.4 percent.

Beginning in 2013, the health care reform legislation (Affordable Care Act of 2010) increases the employee portion of the Medicare (HI) tax by an additional tax of 0.9 percent on wages received in excess of the threshold amount. However, unlike the general 1.45-percent HI tax on wages, this additional tax is on the combined wages of the employee and the employee's spouse, in the case of a joint return. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case (including single persons).

★ **KEY POINT** The $250,000, $200,000, and $125,000 amounts are not adjusted for inflation and remain the same for 2018.

In determining the employer's requirement to withhold and liability for the tax, only wages the employee receives from the employer in excess of $200,000 for a year are taken into account, and the employer must disregard the amount of wages received by the employee's spouse. Thus, the employer is only required to withhold on wages in excess of $200,000 for the year, even though the tax may apply to a portion of the employee's wages at or below $200,000, if the employee's spouse also has wages for the year, they are filing a joint return, and their total combined wages for the year exceed $250,000.

EXAMPLE In 2018 a pastor earns $100,000 in church compensation. His wife, a physician, earns $200,000. The combined income of the husband and wife exceeds the threshold amount of $250,000, and so they are liable for an additional Medicare tax of 0.9 percent times compensation in excess of $250,000. However, neither spouse's employer is required to withhold any portion of this additional tax from their wages, even though the combined wages of the taxpayer and the taxpayer's spouse are over the $250,000 threshold, since neither earned compensation of more than $200,000.

The employee is also liable for this additional 0.9-percent HI tax to the extent the tax is not withheld by the employer. The amount of this tax not withheld by an employer must also be taken into account in determining a taxpayer's liability for estimated tax. This same additional HI tax (0.9 percent) applies to the HI portion of SECA tax on self-employment income in excess of the threshold amount. As in the case of the additional HI tax on employee wages, the threshold amount for the additional SECA HI tax is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case. The threshold amount is reduced (but not below zero) by the amount of wages taken into account in determining the FICA tax with respect to the taxpayer. No deduction is allowed for the additional SECA tax, and the deduction under 1402(a)(12) is determined without regard to the additional SECA tax rate.

E. WORKING AFTER YOU RETIRE

Many churches employ persons who are receiving Social Security retirement benefits. But persons younger than full retirement age may have their Social Security retirement benefits cut if they earn more than a specified amount. Full retirement age (the age at which you are entitled to full retirement benefits) for persons born in 1943 through 1954 is 66 years. Table 9-1 shows the full retirement ages based on year of birth.

You can collect Social Security retirement benefits and work at the same time. However, if you are younger than full retirement age and make more than the yearly earnings limit, your benefit will be reduced. Starting with the month you reach full retirement age, your benefits will not be reduced no matter how much you earn.

The Social Security Administration (SSA) uses the following earnings limits to reduce your benefits:

If you are under full retirement age for the entire year, it deducts $1 from your benefit payments for every $2 you earn above the annual limit. For 2018 that limit is $17,040.

In the year you reach full retirement age, your benefits are reduced $1 for every $3 you earn above a different limit. Only earnings before the month you reach your full retirement age are counted. If you will reach full retirement age in 2018, the limit on your earnings for the months before full retirement age is $45,360.

Starting with the month you reach full retirement age, you can collect your benefits no matter how much you earn from working. In addition, the SSA will recalculate your benefit amount to leave out the months when it reduced or withheld benefits due to your excess earnings.

When the SSA figures out how much to deduct from your benefits, it counts only the wages you make from your job or your net profit if you are self-employed. Also included are bonuses and vacation pay. Not counted are pensions, annuities, investment income, interest, veterans, or other government or military retirement benefits.

Your benefits may increase when you work. As long as you continue to work, even if you are receiving benefits, you will continue to pay Social Security taxes on your earnings. However, the SSA will check your record every year to see whether the additional earnings you had will increase your monthly benefit. If there is an increase, it will send you a letter informing you of your new benefit amount.

Some people who retire in mid-year have already earned more than their yearly earnings limit. A special rule applies in this situation, which is usually the first year of retirement. The special rule lets the SSA pay a full Social Security check for any whole month that it considered you retired, regardless of your earnings from working. If you will be under full retirement age for all of 2018, you are considered retired in any month that your earnings are $1,420 or less and you did not perform substantial services in self-employment. If you reach full retirement age in 2018, you are considered retired in any month that your earnings are $3,780 or less and you did not perform substantial services in self-employment. Substantial services in self-employment means that you devote more than 45 hours per month to the business or between 15 and 45 hours to a business in a "highly skilled" occupation.

TABLE 9-1

FULL RETIREMENT AGE

YEAR OF BIRTH	FULL RETIREMENT AGE
1937 or before	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943–1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

F. EXEMPTION OF MEMBERS OF CERTAIN RELIGIOUS FAITHS

★ **KEY POINT** Members of certain religious sects that are opposed to Social Security coverage and that provide for the welfare and security of their members may become exempt from Social Security coverage if several conditions are met.

Section 1402(g) of the tax code permits self-employed members (whether ministers or laypersons) of certain religious faiths to exempt themselves from Social Security coverage if the following conditions are satisfied:

- the member belongs to a recognized religious sect;
- the sect is opposed to the acceptance of "the benefits of any private or public insurance which makes payments in the event of death, disability, old-age, or retirement or makes payments toward the cost of, or provides services for, medical care (including the benefits of any insurance system established by the Social Security Act)" on the basis of its established tenets or teachings;
- the member adheres to the sect's tenets or teachings relating to Social Security coverage;
- the member files an exemption application (Form 4029);

- the member's exemption application is accompanied by evidence of his membership in and adherence to the tenets or teachings of the sect;
- the member waives his right to all Social Security benefits; and
- the Secretary of the Department of Health and Human Services finds that the sect (1) does, in fact, have established tenets or teachings in opposition to Social Security coverage; (2) makes provision for the financial support of its dependent members; and (3) has been in existence continually since December 31, 1950.

Such an application for exemption, if granted, is irrevocable unless the member ceases to be a member of the sect or no longer adheres to the sect's tenets or teachings pertaining to participation in the Social Security system.

The regulations interpreting this statute specify that a member is eligible for the exemption even if he or she is not opposed to obtaining personal liability or property insurance.

The United States Supreme Court emphasized in a 1982 ruling that the exemption applied only to self-employed persons. Accordingly, an Amish employer who employed several persons to work on his farm and in his carpentry shop was not eligible for the exemption despite the fact that both he and his Amish employees were opposed to Social Security coverage on the basis of well-established Amish religious beliefs. *United States v. Lee, 455 U.S. 252 (1982).* The court accepted the contention that compulsory participation in the Social Security program would interfere with the right of the Amish employer and employees to freely exercise their religion. This, however, was only the beginning and not the end of the court's inquiry, since "the state may justify a limitation on religious liberty by showing that it is essential to accomplish an overriding governmental interest." It concluded that the government's interest in "assuring mandatory and continuous participation in and contribution to the Social Security system" was an interest of sufficient magnitude to override the interest of Amish employers and employees in freely exercising their religion.

Congress amended the law in 1988 to extend this exemption to *employees* for tax years beginning in 1989 (in effect, overruling the Supreme Court's decision in *United States v. Lee*). However, the exemption applies only if the employee and employer are both members of a qualifying religious sect (as described above). The exemption is available to both the employer and employee portion of Social Security and Medicare taxes. No time restriction is imposed on the filing of employee exemption applications, and the law prospectively amended section 1402(g)(2) by eliminating the time restrictions on filing exemption applications by self-employed persons. *IRC 3127.*

The courts have strictly enforced the requirement that the member belong to a religious sect having established tenets or teachings in opposition to Social Security coverage and that provides for its dependent members. To illustrate, a Seventh-Day Adventist was denied an exemption despite his claim that he was personally opposed to Social Security coverage on the basis of religious beliefs, since the Seventh-Day Adventist Church had no established tenets or teachings against Social Security coverage and made no provision for the support of its dependent members. *Varga v. United States, 467 F. Supp. 1113 (D. Md. 1979).*

The exemption has been challenged on the ground that it unconstitutionally discriminates against persons who personally are opposed on the basis of religious beliefs to Social Security coverage but who are not members of a religious sect that has established tenets or teachings in opposition to Social Security coverage and that provides for its dependent members. Such challenges thus far have failed. One court has stated:

> *The limitation by Congress of the exemption of members of certain religious sects with established tenets opposed to insurance and which made reasonable provisions for their dependent members was in keeping with the overall welfare purpose of the Social Security Act. This provision provided assurance that those qualifying for the exemption would be otherwise provided for in the event of their dependency.* Palmer v. Commissioner, 52 T.C. 310 (1969). See also Bethel Baptist Church v. United States, 822 F.2d 1334 (3rd Cir. 1987); May v. Commissioner, T.C. Memo. Dec. 51,242(M) (1996).

G. CHECKING YOUR SOCIAL SECURITY EARNINGS

The easiest way to access your Social Security account information is to open a *my* Social Security account with the Social Security Administration. Doing so is easy. Just go to ssa.gov/myaccount and select "Create an Account" to get started. You must be 18 years old and have a valid Social Security number, U.S. mailing address (or a military address if deployed overseas), and e-mail address.

In some cases—such as if credit card fraud was reported under your name or Social Security number—you may have to contact your local Social Security office to open a *my* Social Security account.

Once registered, you can

- verify your earnings history,
- view estimated Social Security benefits based on your past earnings,

- view Social Security and Medicare taxes you've paid over your lifetime,
- print your current Social Security Statement, and
- request a replacement Social Security card (in some states).

If you're currently receiving benefits, you can

- view benefit payment information,
- change your address and phone number,
- start or change electronic payments,
- get a replacement Medicare card,
- get a replacement Form SSA-1099 for tax season, and
- get a benefit verification letter.

H. SOCIAL SECURITY AS AN INVESTMENT

Is Social Security a good investment? Many ministers ask this question when considering filing for exemption from self-employment taxes. Of course, in one sense, such a question is irrelevant, since ministers are subject to self-employment taxes unless they are opposed to the acceptance of Social Security benefits on the basis of religious principles and they file a timely exemption application. Whether Social Security is a "good investment" has nothing to do with this decision.

Historically, Social Security has been a good investment for most workers, including ministers. But benefits received in the past were based on a larger percentage of workers and a smaller percentage of beneficiaries. In the future, fewer workers will be supporting larger numbers of beneficiaries. Undoubtedly, changes will have to be made, which likely will include one or more of the following:

- Social Security, Medicare, and self-employment taxes will increase.
- Benefits will be cut or their rate of increase reduced.
- Benefits will be "means tested," meaning that they will be reduced or denied altogether for persons above a specified level of income or net worth.
- The minimum retirement age will increase.

These potential changes suggest that Social Security should be viewed as a supplemental benefit plan, as it was originally intended, rather than as an exclusive source of retirement income.

Social Security coverage provides several benefits, including retirement, survivors, disability, and Medicare. While some ministers who have filed an exemption application conceivably could have duplicated the coverage Social Security provides, this is unlikely. Most exempt ministers only think of duplicating the retirement benefits through some form of retirement arrangement, forgetting that Social Security coverage provides more than these benefits. Social Security benefits have the additional advantages of being inflation-indexed and nontaxable (for most persons).

2018 SOCIAL SECURITY AMOUNTS

	2018
Tax rate—employees	7.65%*
Tax rate—self-employed	15.3%
Maximum taxable earnings (Social Security tax only)	$128,700
Maximum taxable earnings (Medicare tax)	No limit
Retirement earnings tax-exempt amount (for workers under full retirement age)†	$17,040

* *Churches and their nonminister employees are subject to Social Security and Medicare taxes (except for churches that exempted themselves from these taxes by filing a timely Form 8274 with the IRS, in which case their nonminister employees are treated as self-employed for Social Security purposes). The combined Social Security and Medicare tax rate is 15.3 percent of each employee's wages. This rate is paid equally by the employer and employee, with each paying a tax of 7.65 percent of the employee's wages. This 7.65-percent rate is comprised of two components: (1) a Medicare hospital insurance (HI) tax of 1.45 percent and (2) an old-age, survivor, and disability (Social Security) tax of 6.2 percent.*

† *Your Social Security retirement benefits are reduced if your earnings exceed a certain level, called a "retirement earnings test exempt amount," and if you are under your "normal retirement age" (NRA). NRA, also referred to as "full retirement age," varies from age 65 to age 67 by year of birth. For persons born in 1943–1954, NRA is 66 years. For people attaining NRA after 2018, the annual exempt amount in 2018 is $17,040, meaning that you can earn up to this amount with no reduction in Social Security retirement benefits. For every $2 earned above this amount, Social Security retirement benefits are reduced by $1. A modified annual earnings test applies in the year a worker attains full retirement age. Social Security benefits are reduced by $1 for every $3 of earnings above a specified amount for each month prior to full retirement age. (This amount is $45,360 for 2018.) Beginning with the month an individual attains full retirement age, no reduction in Social Security retirement benefits occurs, no matter how much the person earns.*