

Tax Status of Deacons Q&As

The following questions and answers are intended to assist deacons and local churches in determining the proper tax treatment of deacons in the United Methodist Church. These Q&As should be read in conjunction with the Memorandum on the tax status of deacons, dated January 7, 1999, and the IRS Private Letter Ruling on deacons, dated December 10, 1998. (Both of these documents are included in the tax packet.) Also, at the end of this document are some examples that may be helpful. Deacons and local churches are urged to review these materials with their professional tax advisors.

1. What is a "private letter ruling"?

A private letter ruling is the IRS response to a request, on behalf of a single taxpayer, for the IRS's position on a particular tax issue. When the IRS issues a private letter ruling, it is always careful to note that no one other than the taxpayer who asked the question may rely on the private letter ruling as precedent. And, the IRS has been known to change its mind on an issue from time to time. With these caveats, it is very common for taxpayers and their tax advisors to rely on private letter rulings because they are a good indicator of how the IRS would respond in an audit or tax proceeding with regard to the particular question asked. As private letter rulings go, this one is relatively clear and easy to understand and will be helpful to the tax advisors of deacons and church organizations who have deacons on their staff.

2. After the private letter ruling, are all deacons in The United Methodist Church now considered to be "clergy" or "ministers of the gospel" for federal tax purposes?

Probably not. The same tests that are used to determine "clergy" or "minister of the gospel" status of elders for tax purposes should be used to determine the clergy status of deacons.¹ A deacon is ordained and then appointed by his/her bishop. The IRS's position, as articulated in the Private Letter Ruling, should apply to deacons appointed to the local church to do ministry with job functions similar to those outlined in the Private Letter Ruling - Minister of Music, Minister of Education, or Minister of Stewardship, if they perform religious and sacerdotal duties similar to those performed by the individuals discussed in the ruling

At the other extreme are the deacons who work in non-United Methodist and non-religious settings - physicians/nurses in for-profit hospitals, attorneys with private law firms, real estate agents or sales staff in a department store. While these deacons will have appointments to local churches (non-paid appointments), their primary appointment

¹ Under United Methodist polity, deacons and elders are both clergy. However, these Q&As address the issue of when deacons will be considered "clergy" by the Internal Revenue Service for federal tax purposes. Obviously, this is a different question. Also, the Internal Revenue Code uses the terms "minister" and "minister of the gospel" to reflect this special tax status. In these Q&As, we will sometimes use quotation marks to make it clear we are referring to the tax (not United Methodist) implications of these terms.

will not be in ministry settings. It is highly doubtful the IRS will consider individuals whose compensation is from these completely non-religious positions, outside of the control of The United Methodist Church, as "ministers of the gospel," regardless of the fact that they are ordained as deacons. The same would be true for most elders working in these non-religious settings and positions.

In between these two extremes will be many examples. The deacon appointed to serve at an annual conference or general church agency *should* be treated as clergy for federal tax purposes, although the Private Letter Ruling did not specifically address these employment settings. Previous IRS rulings and court cases have held that elders serving official church organizations are considered clergy for federal tax purposes, so the same analysis should apply to deacons. The deacon appointed to teach religion courses at a United Methodist college or seminary with some chaplain duties would have a strong basis for treatment as clergy for tax purposes, but again, the Private Letter Ruling did not specifically address this type of position outside the local church.

A more difficult example is the deacon appointed to serve in a social service agency in the inner-city, financially supported, although not affiliated with any United Methodist church organization nor considered by the bishop and annual conference/local church to be directly related to the mission of the Church. While it is clear from a "church" perspective that this deacon would be appointed for religious purposes to do the ministry of the Church, it is not at all clear from a "tax" perspective whether the IRS would agree. Again, the Private Letter Ruling did not specifically address (or come close to addressing) this type of ministry position outside of the local church and outside of the denomination. Deacons (and their salary paying unit) in these more unique positions will need to consult closely with their personal tax advisor to determine their reporting status as clergy or lay.

In summary, the same analysis set forth in the case law that has developed over the years in clergy tax cases of this nature, together with this Private Letter Ruling, should be used to analyze each unique deacon position, in consultation with a tax advisor, before forming any conclusion about clergy status for federal tax purposes. The IRS will be intolerant of abuse in this area.

3. What does it mean from a tax point of view to be considered "clergy" or a "minister of the gospel?"

There are several different tax issues involved:

- (A) There is an exclusion (for federal income tax purposes only) of housing allowances or the fair rental value of church-owned parsonages or housing provided to clergy rent-free.
- (B) Clergy are treated as self employed for Social Security taxes for their clergy income. This means deacons must pay all of the Social Security tax on their

income as "self-employment taxes." In other words, there is no "employer-paid" portion of Social Security for clergy.

- (C) Exemption of some clergy from social security, if they "opt out" of Social Security (note: the rules are very stringent for opting out; it is strongly discouraged).
- (D) Exemption of clergy wages from income tax withholding requirements. This also means that clergy must file quarterly estimated tax payments.
- (E) Even though clergy are treated as self-employed for purposes of Social Security taxes, they are typically considered to be employees, not independent contractors, for income tax purposes.

4. If I am the local church treasurer, does this mean the deacon at our church, who is similarly situated to the individuals in the Private Letter Ruling, is treated the same as our pastor for tax purposes?

Yes, unless there is some highly unique and unusual circumstance that would make your deacon different. Deacons and elders in full connection who are "Ministers of the Gospel" are treated the same for federal income tax and Social Security purposes. Therefore, all of the same steps you take for your pastor should be taken in relation to your deacon.

5. As a reminder, what are the responsibilities of the local church, including the local church treasurer, in relation to deacons and elders?

There are several requirements:

- (A) Deacons as clergy who are "Ministers of the Gospel" may be provided with a housing allowance. The housing allowance form needs to be completed prior to the beginning of each year, or prior to the start of employment.
- (B) The church must not do any Social Security withholding for clergy. Clergy are self employed for Social Security purposes and hence, it is impermissible for the church to withhold Social Security payments for them.
- (C) The church is not required to do any income tax withholding (clergy can request, by using an IRS W-4 form, that the church voluntarily do income tax withholding).
- (D) At year end, all clergy (deacons and elders) should be given a W-2 form and only box 1 should show income (boxes 2, 3, 4, 5, and 6 are blank).

6. What do we do about the housing allowance for deacons?

It is very important to have a housing allowance resolution adopted for the deacons at the start of each tax year. If you adopt a resolution on February 1, your deacon will be able to take advantage of the housing allowance only for 11 of the 12 months of the new year.

7. If the deacon is ordained in June 2001, can the housing allowance be applied retroactively?

A housing allowance cannot be written to apply retroactively.

8. Is it advantageous, from a financial perspective, for deacons now to be considered "Ministers of the Gospel?"

That depends on individual fact situations. Clearly, the tax-free housing allowance is a very significant benefit for most clergy. On the other hand, the requirement that clergy pay their own Social Security is a significant burden. Deacons must remember that they are now solely responsible for their Social Security tax payments to the IRS if they are treated as clergy for tax purposes.

9. Can a deacon decide to continue to be treated as a lay employee rather than a clergy employee?

The United Methodist Church made a decision in 1996 that all deacons were clergy under church polity. It would be inconsistent with this polity for deacons to pick and choose whether to be treated as "clergy" for federal tax purposes when they are appointed to serve in clergy positions within the denomination. Therefore, if a deacon is appointed and hired to do ministerial functions, as outlined in the Private Letter Ruling, the deacon should be treated as clergy for tax purposes.

10. May the salary-paying unit (local churches) give the deacon additional salary to cover the social security tax that the church no longer has to pay (and that the deacon now must pay on his/her own)?

Yes. This additional salary would be taxable income to the deacon.

11. What if the deacon files as a clergy person ("Minister of the Gospel") and is challenged by the Internal Revenue Service in an audit?

If that situation should arise, the deacon can and should refer to the attached Private Letter Ruling and make it available to the Internal Revenue Service, although he or she technically cannot rely on it as a binding precedent. Again, the deacon should consult with his/her own tax advisor before utilizing the Private Letter Ruling and when problems arise. In addition, deacons are encouraged to contact the General Board of Higher Education and Ministry or the General Council on Finance and Administration for discussion if this type of problem arises. While those two church agencies can supply names of possible contacts with the national office of the Internal Revenue Service, they

are neither a guarantor of the right of each individual deacon to be treated as clergy for tax purposes, nor can they provide legal representation.

12. Does this Private Letter Ruling apply to the tax status of United Methodist diaconal ministers or non-United Methodist staff who are clergy in another denomination and are hired by (not appointed to) the local church to serve as ministers of music, education, stewardship etc.?

No. This ruling only applies to United Methodist Deacons.

13. What are the options for deacons who wish to participate in the pension plan or other benefits offered by the General Board of Pension and Health Benefits?

You need to consult with your local church (or other salary-paying unit) and the General Board of Pension and Health Benefits regarding what options are available to you.

14. What are some tax strategies deacons can use in light of their new status?

A deacon may submit an IRS form W-4 requesting the local church do voluntary income tax withholding, much like the withholding that is done for lay employees. This can, if done correctly, avoid the need for the deacon to make quarterly estimated tax payments. You should consult with your own tax advisor.

15. As a clergy person, can deacons now opt out of Social Security?

We discourage this practice for all clergy. First, United Methodist polity does not support conscientious objection to receiving public insurance or governmental benefits. Second, there are many advantages to Social Security beyond retirement benefits — there are disability benefits, hospitalization and medical benefits (Medicare), as well as educational benefits for dependents in the event of death. Third, opting out is a technical process, and we have seen clergy make serious mistakes in the opt out process.

16. Are there any special tax resources for clergy that might be beneficial to deacons?

Yes. Your conference treasurer has tax resource materials for clergy. Also, the GCFA tax packet has information on housing allowances and other tax issues for clergy. IRS Publication 517 (Social Security and Other Information for Members of the Clergy and Religious Workers) is also helpful. As always, you should consult with your own tax advisor regarding your particular situation.

Examples of Clergy Tax Status for Deacons

What are some examples of deacons who are probably “clergy” for federal tax purposes?

- (A) Deacon appointed to local church to serve as Minister of Education, Music or Stewardship who is responsible for the worship life in the church, performs marriages and funerals, assists in sacerdotal functions of baptism and communion and is considered a clergy person at the church (this is the United Methodist Private Letter Ruling scenario).
- (B) Deacon who is appointed to a general agency of The United Methodist Church probably would be considered clergy for tax purposes (this is similar to an ordained elder who works for an agency or other controlled entity and is considered clergy for IRS tax purposes).
- (C) Deacon who teaches at a United Methodist seminary and only occasionally preaches and occasionally assists in the administering of sacraments (just as with the above example, the deacon probably would be treated the same as an elder in this situation and considered clergy because of the work done for a United Methodist seminary).

What are some examples of deacons who are probably not “clergy” for federal tax purposes?

- (A) A deacon goes to work at private counseling center.
- (B) A deacon is employed as a professor at a private school.
- (C) A deacon is a minister of administration. This deacon never conducts worship, preaches sermons, conducts a funeral or assists in communion or baptism. In a letter ruling with similar facts, the IRS found this individual was not clergy (IRS letter ruling 8442130).
- (D) A deacon serves part-time at a United Methodist local church and qualifies as a minister of the gospel under the Private Letter Ruling for the income earned as a part-time deacon. The deacon also works part time as a counselor at a for-profit clinic. None of that income qualifies for the housing allowance or other clergy tax treatment.

These Q&As are intended provide general information regarding the proper tax treatment of deacons in The United Methodist Church. But each factual situation is unique and it is important to examine the facts closely to determine the correct result. The General Council on Finance and Administration and the General Board of Higher

Education and Ministry are not engaged in providing legal, accounting, or other professional services or advice. If you have any questions about your particular situation, you should seek the services of a professional tax adviser.