



Federal Income Tax (FIT)

The United States Federal Income Tax (FIT) is a tax levied by the Internal Revenue Service (IRS) on the annual earnings of individuals, corporations, trusts, and other legal entities. Federal income taxes apply to all forms of earnings that make up a taxpayer's taxable income, including wages, salaries, commissions, bonuses, tips, investment income, and certain types of unearned income.

In the United States, federal income tax rates for individuals are progressive, meaning that as taxable income increases, so does the tax rate. Federal income tax rates range from 10% to 37% and kick in at specific income thresholds. The income ranges that rates apply are called tax brackets. Income that falls within each bracket is taxed at the corresponding rate.

It is important to distinguish between the general idea of state income tax and federal income tax. In the United States, state governments may also incur income taxes in addition to federal income taxes.

Not all states have state-level income taxes. Currently, Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming do not have an income tax.

Federal Insurance Contributions Act/Self-Employment Contributions Act (FICA/SECA)

Social Security taxes are contributions collected under the Federal Insurance Contributions Act (FICA) and the Self-Employment Contributions Act (SECA). Many people refer to contributions to Social Security as either FICA or SECA taxes.

While FICA and SECA may sound similar, they are just two different ways for the government to collect Social Security and Medicare taxes. The big difference between the two is who pays the taxes and the rate.

The Federal Insurance Contributions Act (FICA) is a federal law that requires employers to withhold two different types of employment taxes from their employee's paychecks. FICA is the system for non-clergy employees, where the church and employer each pay half (7.65%) of the 15.3% in taxes due. These taxes include 12.4% of compensation in Social Security taxes (6.2% per employee) and 2.9% (1.45% per employee) of salary in Medicare taxes, totaling 15.3% of each paycheck.

The Self Employment Contribution Act (SECA) is the system for clergy and other self-employed people, where they pay the entire tax (15.3%) since they are essentially paying both the employer and employee portion.

Any money you earn will be taxed under one of the two systems, but not both.

Ministers have what is commonly referred to as “dual tax status.” For federal income tax purposes, a minister is generally treated as a common law employee. For payments into Social Security, the minister is always self-employed and subject to SECA. This is an IRS regulation and not an election.

Many churches are unaware that section 3121(b)(8)(A) prohibits the church from withholding Social Security and Medicare tax (FICA) on the wages earned by a minister. It is the responsibility of the minister to pay SECA tax on salary and housing allowance unless they have received an approved exemption.

Note: In regards to unemployment taxes, churches are exempt from Federal Unemployment Taxes (FUTA) and State Unemployment Taxes (SUTA).

Housing Allowance

A licensed, commissioned, or ordained minister who performs ministerial services as an employee may be able to exclude from gross income the fair rental value of a home provided as part of compensation (a parsonage) or a housing allowance provided as compensation if it is used to rent or otherwise provide a home. A minister who is furnished a parsonage may exclude from gross income the fair rental value of the parsonage, including utilities.

A minister who receives a housing allowance may exclude the allowance from gross income to the extent it's used to pay expenses in providing a home. Generally, those expenses include rent, mortgage interest, utilities, and other expenses directly relating to providing a home. The amount excluded can't be more than reasonable compensation for the minister's services.

If you own your home, you may still claim deductions for mortgage interest and real property taxes. If your housing allowance is more than the lesser of your reasonable compensation, the fair rental value of the home, or your actual expenses directly relating to providing the home, you must include the amount of the excess in income.

In order to be able to exclude the housing allowance from income, the minister's employing organization must officially designate the housing allowance as such before paying it to the minister.

The fair rental value of a parsonage or the housing allowance is excludable only for income tax purposes. The minister must include the amount of the fair rental value of a parsonage or the housing allowance for social security coverage purposes.

When reporting gross income for federal income tax purposes, clergy can exclude a portion of their income designated by their church or salary paying unit as a “housing allowance” under Section 107 of the Internal Revenue Code (IRC). To be excluded, amounts designated as a

housing allowance must be used to provide housing. In addition, there are limits on the amount that can be excluded. What makes the housing allowance unique is that some of the income used to provide housing can be excluded from gross income for federal income tax purposes.

Also, clergy who live in a parsonage provided by the church do not have to report the fair rental value of the parsonage as income. (Note this “free” housing provided to clergy generally would be taxable compensation for lay employees.) The housing allowance is sometimes called a “parsonage allowance” for clergy who are provided with a parsonage and a “rental allowance” for clergy who rent their home.