

INCOME TAXATION FOR FULLTIMERS

Tax Year 2022

I. Status

- A. For income tax purposes, fulltimers are generally considered self-employed ministers and report their income on Schedule C (Profit or Loss from Business). Those who are serving in an organization (e.g., Bibles for America) are generally considered employees. Some fulltimers on campus teams may also be considered employees.
- B. If you received a W-2, you are an employee and this information does not apply to you.

II. Income

- A. Income includes all payments for services performed, regardless of what the payments are called (gift, support, etc.). This includes regular support, conferences, weddings, etc. It includes all income received whether reported on a 1099 or not.
- B. Cars – A car given to a fulltimer by a church – whether to use or to keep – is income. The amount of income is the fair market value or fair lease value of the car.
- C. Housing – Housing provided free to a fulltimer is income. However, it is probably excludable from income. See *Housing Allowance* below.
- D. Offerings from individuals or from the offering box are generally not income unless they are because of services provided, e.g., at a wedding.

III. Housing Allowance (parsonage allowance)

- A. Amounts received as housing allowance are excludable from income for income tax only; they must be included in income for self-employment tax and the earned income credit.
- B. The amount excludable for housing allowance is the lesser of three amounts: (1) the amount designated as housing allowance; (2) the amount actually spent on housing costs; or (3) the fair rental value of the (furnished) housing.
- C. Housing costs include your entire mortgage payment, rent, utilities, insurance, association dues, repairs and improvements, furnishings and appliances, decorating, and household supplies. It does not include food, maid service or a gardener. It also does not include home equity loan payments unless the proceeds were used for home improvements.
- D. Mortgage interest and real estate taxes are deductible as itemized deductions on Schedule A even though they were excluded from income as part of the housing allowance.

IV. Expense Allocation

- A. Overriding principle: Expenses relating to non-taxable income are not deductible.
- B. The housing allowance is non-taxable income, so the related expenses are not deductible. Therefore, all expenses on the Schedule C must be allocated between deductible (allowed) and non-deductible (disallowed) expenses.
- C. Compute the unallowable percentage by dividing the housing allowance by the total income. Either deduct that percentage from each expense, or list the total disallowed portion as a negative expense.

V. Expenses

A. Auto expense

- 1. Business mileage is deductible, but written evidence of the business use is required by law. Keep a log!
- 2. Commuting (home to work and back) is never deductible. Business mileage is from the first work stop to the last work stop. Home is a work stop only if you have an allowable home office. To be allowable, a home office must (1) be used regularly and exclusively for business and (2) be the principal place of business (i.e., where your most important work is done and where the most time is spent), and you have no other regular place of business. Most fulltimers do not have a home office for tax purposes.
- 3. Travel to a temporary place of business is always deductible even if you go there from your home. Temporary is defined as fewer than 35 times in a year. More than 35 times makes it a regular place of business. Trips from home to a regular place of business are not deductible.
- 4. Auto expense can be figured two ways: (1) the standard mileage rate times the number of business miles; or (2) the business percentage of your actual car expenses (gas, repairs, insurance, license, car washes, motor club, interest on car loan, lease payments, depreciation).
- 5. The standard rate changes every year and can be found on this website on the Fulltimers page or on the IRS web site (www.irs.gov). It can be used for cars that are owned or leased.
- 6. Upon choosing a method in the first year you use a car, you generally must use that method every year. The exception is if you own your car and choose the standard rate in the first year, you can switch between methods.
- 7. There are limits on depreciation. The general rule is to apply the business percentage to the maximum allowed depreciation. If your business percentage is less than 50%, there are additional limitations.
- 8. The business portion of lease payments is included in auto expenses, but there is a lease inclusion amount that must be added back to income.

9. If you keep your car for fewer than five years, or your usage drops below 50%, recapture of some of the depreciation will be required. This can generally be avoided by using the standard mileage method.

Author's note: I strongly recommend using the standard method. It is much simpler, it almost always yields a better result, and it avoids recapture and other complications when the car is disposed of.

B. Meals and Travel

1. In general, 50% of business meals is deductible, including the tip. Keep records! Written documentation of the date, place, amount, and business purpose is required! The easiest way is to make a note on the receipt about who you were with and the business purpose. To qualify as a business meal, you must discuss business before, during, or after the meal. Beginning in 2018, entertainment expenses (other than meals) are not deductible.
2. For 2021 and 2022 only, 100% of business meals is deductible for meals provided by a restaurant, regardless of whether the food and beverages are consumed on the restaurant premises. A restaurant does not include a business that primarily sells prepackaged food, such as a convenience store or a grocery store.
3. Providing meals at home can also be deductible – 50% of the cost of the meal (unless it is from a restaurant, in which case it would be 100% deductible for 2021 and 2022) – if it is a business meal. Either use actual receipts, or use a fixed amount per person (based on your costs). Only business meals go on *Schedule C*. Church-assigned hospitality is deductible as a contribution on *Schedule A (Itemized Deductions)*.
4. Business travel expenses are deductible –airfares, meals (50%, or 100% for restaurant provided meals in 2021 and 2022), and incidentals, e.g., taxi, laundry, telephone.
5. For out-of-town meals, you can use your actual expenses or a per diem amount for meals and incidentals. (In either case, only 50% is deductible except for 2021 and 2022 when 100% is deductible.) Links to the per diem amounts are available on the Fulltimers page. You must use the same method for all your travel in a year. You may not use the per diem for lodging.

C. Other Expenses

1. Telephone

- a. Business calls are deductible - toll calls, long distance, pay phones, phone cards.

b. If the same line is used for both personal and business use, no part of the basic rate is deductible. Additional charges and long distance calls related to your business are deductible.

c. Business use of a cell phone, pager, fax, and Internet use is also deductible. The IRS requires allocation between business and personal use even if the cost is a flat fee.

2. **Conference Fees** – Fees paid for trainings or conferences are deductible if there is a business purpose. If the conference or training is for your personal development or benefit, the fees are not deductible.
3. **Books** – Business books are deductible; hardbound sets may need to be depreciated. However, you may make a de minimis safe harbor election to expense up to \$2500 per asset.
4. **Library** – An existing library converted to business use when you begin to serve fulltime must be depreciated. Estimate the fair market value, i.e. what you could sell the books for. The Section 179 election to expense an asset is not available.
5. **Furniture and equipment** – Equipment or furniture used for business is deductible up to \$2500 for each asset if you make the de minimis safe harbor election. Otherwise they must be depreciated. The Section 179 election is available. With this election, you can deduct the cost of business assets up to \$1,050,000 per year. Office furniture for your office is generally fully deductible. A computer is deductible to the extent it is used for business.
6. **Supplies** – Supplies for business use are deductible.
7. **Contributions** – Contributions are NEVER deductible on Schedule C. They can only be deducted on Schedule A, Itemized Deductions.

VI. Disallowed Expenses

As explained above in IV. Expense Allocation, the portion of business expenses related to the non-taxable housing allowance is not deductible. Each expense can be reduced by the disallowed portion, or the disallowed portion of the total expenses can be subtracted as a “negative” expense.

VII. Self-Employment (SE) Tax

- A. SE Tax is Social Security and Medicare. It is deducted from employees' paychecks, but self-employed people pay it with their income tax return.
- B. An exemption is available only for religious reasons, e.g., if your religious beliefs prohibit your accepting payments from the government or you are conscientiously opposed to public insurance for religious reasons. You cannot request exemption solely for economic reasons. Apply on Form 4361 by the filing date of the second year with SE income over \$400, and pay the SE tax until notified that your exemption has been granted.
- C. The amount that goes on Line 2 of Schedule SE is the net income from Schedule C (Line 31), plus the housing allowance deducted on Schedule C (Line 2), minus the disallowed portion of the expenses on Schedule C.
- D. If you use computer software to prepare your return, be sure to enter the housing allowance and disallowed expenses or override the amount on Line 2.

VIII. Qualified Business Income Deduction (QBID)

- A. Beginning in 2018, there is a Qualified Business Income (QBI) Deduction equal to 20% of your QBI, which is the net income or loss with respect to a trade or business within the United States.
- B. Generally, fulltimers in the US will have QBI if they are filing a Schedule C. If they receive a W-2, it is not QBI. Fulltimers serving abroad are not eligible for the QBID.
- C. QBI is the net income from Schedule C minus the SE tax deduction, self-employed retirement plans, and self-employed health insurance (Form 1040, Schedule 1, lines 14-16).
- D. If your total income for 2022 is over \$340,100 for married filing joint or \$170,050 for all other taxpayers, there are additional limitations to the deduction.
- E. The deduction is also limited by taxable income – it cannot be more than 20% of your taxable income before QBID less net capital gains.
- F. Use Form 8995 or 8995A to calculate the QBID.

VIII. Estimated Taxes (Form 1040ES)

- A. Taxes are required to be paid during the year either through withholding or through estimated payments. A penalty will be assessed if less than 90% of your total tax was paid in during the year and you owe more than \$1,000 on your tax return. The penalty is computed on Form 2210.
- B. If your withholdings (plus those of your spouse) do not cover 90% of your total tax, estimated payments are required. These are to be paid in four quarterly payments due April 15, June 15, Sept. 15, and January 15. Estimate your income for the next year, compute the tax, and divide by four.

- C. There is a safe harbor method available. If you make payments equal to your total tax for the previous year (Form 1040, Line 24 on the 2021 form), no penalty will be assessed. If you did not file a return the previous year or if the prior year's tax was zero, the safe harbor does not apply.

IX. Federal 1099 and California W-2

If you received a Federal Form 1099 and a California W-2 for your fulltimer's income, you will fill out the federal return as described above. Then you will need to make the following adjustments on Form 540 Schedule CA:

- Add your wages from your W-2
- Subtract your net business income (from Schedule C)
- Subtract the self-employment tax deduction (from Form 1040, Schedule 1, line 14)
- Subtract the self-employed health insurance (from Form 1040, Schedule 1, line 16)
- Add your Unreimbursed Employee Expenses (the expenses from Schedule C using CA law) to your Itemized Deductions

X. Everything else

- A. All other items on the tax return follow the general tax laws. No adjustments are necessary for California for the items covered here except that California does not have a Qualified Business Income Deduction (QBID). That is probably the same for other states, but check to be sure. The tax laws change frequently. Read the instructions thoroughly or get competent help.
- B. Suggested references: IRS Publication 17 - Your Federal Income Tax
IRS Publication 334 - Tax Guide for Small Business
- C. All forms and publications are free and available on the web. For federal forms go to <https://www.irs.gov/>; for California go to <https://www.ftb.ca.gov/>.