

The Internal Revenue Code provides that for purposes of the Social Security tax (called "FICA" plus the Medicare tax), persons employed as ordained congregational clergy are not treated as "employees," and are instead treated as "self-employed."

In the case of an ordinary (non-clergy) employee, the employer congregation would pay its 50% of the Social Security tax, and the employee would pay the other 50% (through paycheck withholding by the employer). In this normal case, half the cost is borne by the employer, and half by the employee.

In contrast, self-employed persons are responsible for 100% of the social security and Medicare tax (called the "Self-Employment" tax). Because congregational clergy are treated as self-employed for social security tax purposes, they must bear 100% of this tax cost, which is double what the normal congregational employee pays, and the congregation saves the 50% that it would pay on account of a normal employee.

To relieve this additional tax imposed on congregational clergy, many congregations use this savings to pay additional compensation to their clergy. Although this additional compensation is sometimes thought of as "reimbursement" of the clergy person's self-employment tax, the additional compensation is actually taxable to the clergy person just like the rest of his/her salary, and the aggregate amount (the base salary plus the additional compensation) would be reported by the congregation on the Form 1099 issued to the clergy person each year.

Recognizing that this still leaves the clergy person with the additional burden of paying income tax and self-employment tax on this "reimbursement" amount, some congregations increase ("gross-up") the reimbursement so that this additional tax burden is also offset, taking into account both the extra payments and the taxes on those extra payments. This total grossed-up amount is usually figured by dividing the initial 50% of self-employment tax by a fraction that is 100% minus the applicable combined income and self-employment tax rate.