

"The #1 book for helping pastors use the compensation  
God has provided in the WISEST way and to the  
FULLEST extent possible."

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# How to Not Be a Broke Pastor

The definitive guide for understanding  
AND maximizing the benefits from  
your pastoral compensation

S.L. Potts

Author of *Structuring Pastoral Compensation*

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S.L. POTTS

2018 Edition

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*To my lovely wife, Jamie, who has stood by me through  
thick and thin, though richer or poorer, and has been my  
greatest earthly treasure.*

**TABLE OF CONTENTS**

**Chapter 1 Our Story ..... 5**

**Chapter 2 Understanding Taxes and SECA..... 11**

**Not All Taxes are the Same ..... 12**

        Federal Income Tax .....12

        Social Security Tax .....13

        Medicare Tax .....13

        State and Local Taxes .....13

**Employment Status ..... 14**

        FICA vs. SECA .....15

        Withholding Options.....16

## CHAPTER 1

### OUR STORY

I'll never forget that phone call.

I was sitting in my study, working on Sunday's sermon, when the phone rang. It was my wife. She had driven with another lady in our church to go to a women's Bible study and had decided to stop at the bank to get \$20 from the ATM.

For the very first time in our lives (before or since), we were overdrawn.

I had never experienced that feeling before – sickness and dread and fear all mingled together. To this day, I'm not sure what was worse – hearing the fear in her voice as she struggled to hold back the tears or the feeling of fear in my own heart as I was totally blindsided by the news.

How could this have happened?

As pastors, our time is very valuable. So, I'll get straight to the point: I want to help you avoid what my wife and I experienced that day.

I am writing this book because, while pastors may be very knowledgeable and capable when it comes to the Scriptures, to working with people, and to ministry . . . my experience is that far too many are completely clueless when it comes to their pastoral finances.

I know I was.

After four years of Bible college and four years of seminary, I became the lead pastor of a small, six-year-old church plant in September 2007. Even though the church was struggling in many ways, they wanted to do the best they could to help provide for us financially. They offered us a starting salary of \$48,000/year along with full health coverage for our family.

The best part was, they said, that our salary would be “tax-free” because I was a pastor. We were so excited! We decided to buy a house based on that information. We set our budget based on that information. In fact, we planned a lot of things based on that information.

However, when I got my first monthly paycheck, instead of receiving \$4,000, I received \$3,388. Something called SECA had taken 15.3% of my expected salary away.

We were devastated.

There we were, less than one month into pastoral ministry, and our plans, our budget, and our house payment were all in serious jeopardy . . . and there was nothing we could do about it.

Now, before continuing, let me be clear about something. The church had neither lied to us nor purposefully misled us. Have you ever heard

the old saying: “You don’t know what you don’t know”? Well, it’s true for both pastors and churches.

The church didn’t know enough about the unique intricacies of pastoral compensation to give us clear and accurate information. Technically, they were correct in saying that our salary would be “tax-free.” It was. But it was not “SECA-free.” And that distinction, or the lack thereof, took a 15.3% bite out of our paycheck and sent us into a financial tailspin.

Not only did the church not know these things, but I didn’t either. I had spent the previous eight years of my life studying Greek, Hebrew, theology, church history, preaching, and pastoral ministry, but had never once been told a thing about understanding pastoral compensation. It wasn’t that I had skipped that day of class. There was no class that taught these things.

And so . . . both I and the church were flying blind, totally unaware of what we didn’t know. But what we didn’t know was going to catch up to us quickly.

After assuring my wife that everything would be okay, I hung up the phone and just cried. For more than a year, I had been able to keep our budget somewhat on track by cutting every possible expense, using up all of our savings, and cashing in the small 401(k) I had gotten from a previous employer.

But we had now reached the end of those measures, and I had been caught off guard. I felt like such a failure.

As I sit here, over ten years later, and think back on these things, I am filled with a mix of both sadness and joy at the thought of them.



On the one hand, those are still painful memories for my wife and I, and even though God sustained us and provided for us through those times, there are pieces of our hearts that will likely always carry the scars of those days.

Yet, on the other hand, I can look back to those times and see the hand of God at work. By his grace, my family never went hungry. We were never homeless. In fact, after more than a decade of pastoral ministry, I can now see how God was using those things in our lives to not only better prepare us for ministry, but to also be a blessing to others. And for this, I am most joyful.

This is why I am writing.

I want to be a blessing to you and to prepare you for what I wasn't prepared for. It's often said that, in life, you can either do/learn things the easy way or the hard way. This is particularly true for pastors trying to understand and maximize the benefits from their compensation. I learned the hard way, but why should you?

In the chapters that follow, I will attempt to share with you what I, myself, have learned. I'm not going to share theory with you. I'm going to share my own experience.

Please know that I am not a lawyer. I am not an accountant. I am not a tax professional. I am not a financial planner. I'm just an average pastor of an average church who has spent ten years trying to understand the best way to be "wise as a serpent and innocent as a dove" when it comes to my pastoral compensation. **That said, before implementing any of the things discussed in this book, you should consult with and get counsel from the professionals listed above to ensure that you are doing and structuring things**

**correctly, ethically, and within the bounds of the law.** More on that in Chapter 12.

Three final thoughts, and we'll get started.

First, I've arranged this book in two main sections. In the first section, we'll consider some of the nuts and bolts of understanding pastoral compensation – from taxes to retirement and everything in between. Once we've laid a solid foundation, I'll suggest a few thoughts about how to put all of those pieces together into an actionable plan that will help you get the maximum benefit from your total compensation package.

In the second section, I'll address a few additional topics that I wish I had known about ten years ago that would have better prepared me to handle my pastoral finances wisely and to the benefit of my family.

Second, I have written two different versions of this book, one geared towards pastors – *How to Not Be a Broke Pastor* - and one geared towards church decision makers (i.e. Sessions, Elder boards, Deacon boards, Trustees, committees, congregations, etc.) – *Structuring Pastoral Compensation*. While there are similarities between the two books in terms of content, each covers topics specific to the audience at hand, and each is structured differently in terms of application.

If you are a pastor – particularly, if you are the lead pastor of your church, you should probably read both books so that you can understand both sides of the coin. But at the very least, you need to make sure that the people within your church who make decisions about pastoral compensation read *Structuring Pastoral Compensation*. More on that in Chapter 13.

Finally, after ten years of pastoring and of meeting other pastors, I've yet to meet a single one who has dedicated their life to vocational ministry for the purpose of getting rich. In fact, the more common experience is meeting pastors who, if they were in the secular workforce, would make much more money than they do as pastors.

None of us entered pastoral ministry to get rich, and this book is not intended to help you get rich - not in the slightest. If you feel that desire in your heart, see Paul's warning in 1 Timothy 6:6-10 and reconsider why you are reading this book!

My desire is not to help pastors get rich. As I said at the beginning, my sole desire is to be a blessing to you by sharing my own experience in the very unique world of pastoral compensation so that you can make wise financial decisions for yourself, your family, and your church . . . and thus be a blessing to others.

May God use these feeble words in ways I would never dream or imagine.

## CHAPTER 2

# UNDERSTANDING TAXES AND SECA

*“Therefore, render to Caesar the things that are Caesar’s, and  
to God the things that are God’s.”*

*-Matthew 22:21-*

• • •

So, let’s go back to what I was told by our church when they first informed me about my salary ten years ago. They said that I would receive \$48,000/year “tax-free.” Was this statement true or false?

The answer is: YES!

If you are a pastor of an average-sized church in America receiving an average-sized pastoral income, generally speaking, all income that you will receive for your duties in the ministry will very likely be free from income tax.

However, while this statement is technically true, there are a number of things which impact how this actually works on Tax Day.

## NOT ALL TAXES ARE THE SAME

People often tend to think of taxes as the lump sum of all money taken out of their paycheck before they get it. When people complain about taxes, they usually don't make any distinction between the multiple components of taxation that each worker pays. However, it is important to understand the four main components.

### *Federal Income Tax*

This is the amount that actually goes toward paying the taxes you owe based on your income level and claimed deductions. This amount is affected by the number of personal allowances you take when you fill out your W4, and it is also the amount that you can possibly get a refund on when you file your 1040 at the end of the year.

As pastors, we only pay federal income taxes on our salary, and not on our housing allowance.<sup>1</sup>

As stated earlier, if you are an average pastor of an average-sized church in America who receives your pastoral income in an average way, you will likely (for the most part) be completely free from federal income taxes. Of course, this depends somewhat on your situation and salary level. If you become the pastor of a large and generous church that pays you \$250,000/year, then you may likely pay federal income taxes on at least some portion of your salary.

Regardless of whether or not you have to pay income taxes, it is important to note that there is no official exemption from paying federal income tax for pastors (or anyone else for that matter).

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<sup>1</sup> See Chapter 4 for more information.

*Social Security Tax*

Social Security Tax makes up the majority of what is often referred to as FICA.<sup>2</sup> FICA taxes are collected at a rate of 7.65% on gross income up to \$127,200 in 2017 for non-ministerial employees. Of that 7.65%, 6.2% goes towards Social Security.

As pastors, we must pay Social Security taxes on both our salary and our housing allowance, but we can file for an official exemption from paying Social Security tax by submitting Form 4361 in a timely manner.<sup>3</sup>

*Medicare Tax*

Medicare Tax makes up the remainder of FICA at 1.45% of gross income for non-ministerial employees.

As pastors, we must pay Medicare taxes on both our salary and our housing allowance, but we can file for an official exemption from paying Medicare tax by submitting Form 4361 in a timely manner.<sup>4</sup>

*State and Local Taxes*

Obviously, laws regarding ministerial income and state/local taxes vary by state. You will need to ask a local accountant or tax professional about any special tax issues related to ministerial income in your state of residence. Having said that, generally speaking, if you are free from paying federal income taxes, you may possibly be free from paying state income taxes as well.

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<sup>2</sup> See FICA vs. SECA below for more information.

<sup>3</sup> See Chapter 3.

<sup>4</sup> Again, see Chapter 3.

## EMPLOYMENT STATUS

A second thing you need to understand about how taxes affect pastoral compensation is your employment status. Your employment status in a secular job is crystal clear: you are either self-employed or you are an employee of someone else. Unfortunately, for pastors, the issue of employment status is not so clear-cut.

IRS Tax Topic 417 (Earnings for Clergy) will illustrate the complexity of this issue:

A licensed, commissioned, or ordained minister is generally the common law employee of the church, denomination, sect, or organization that employs him or her to provide ministerial services. However, there are some exceptions, such as traveling evangelists who are independent contractors (self-employed) under the common law. If you're a minister performing ministerial services, all of your earnings, including wages, offerings, and fees you receive for performing marriages, baptisms, funerals, etc., are subject to income tax, whether you earn the amount as an employee or self-employed person. However, how you treat expenses related to those earnings differs if you earn the income as an employee or as a self-employed person.

For social security and Medicare tax purposes, regardless of your status under the common law, the services you perform in the exercise of your ministry are considered self-employment earnings and are generally subject to self-employment tax. See Publication 517, *Social Security and Other*

*Information for Members of the Clergy and Religious Workers*, for limited exceptions from self-employment tax.<sup>5</sup>

If you can translate and understand ancient Hebrew texts with ease, but feel incapable of translating and understanding IRS regulations, here is what this means: **most pastors will be treated BOTH as an employee and as a self-employed contractor at the same time and for the same job by the IRS.** Or, to put it in a more commonly used term, pastors are considered “dual-status employees.”

Now, this isn’t always the case, and you will need to clarify your employment status as soon as possible in the early days of your ministry. Some pastors choose to act and be treated as a self-employed contractor across the board (though, I think this is rare).

Normally, you will be considered an employee of the church for federal income tax purposes and a self-employed contractor for Social Security and Medicare purposes. This distinction is important to understand because of the differences between FICA and SECA and because of how it affects your withholdings for your ministerial pay.

### *FICA vs. SECA*

What is the difference between FICA and SECA? FICA is an acronym for the Federal Insurance Contributions Act. SECA is an acronym for the Self-Employment Contributions Act. Both do the same thing – they extract money from your paycheck to cover Social Security and Medicare taxes.

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<sup>5</sup> <https://www.irs.gov/taxtopics/tc417.html>.



However, even though they do the same thing, the differences they make on a pastor's paycheck can be significant.

Under FICA, you and your employer split the cost of coverage 50/50. You pay 7.65% out of your gross income, and your employer pays a matching amount out of their own pocket for a grand total payment equal to 15.3% of your gross annual income. So, for example, if you make \$50,000/year, you will pay \$3,825 in FICA taxes, and your employer will pay an additional \$3,825 in FICA taxes for a total FICA payment of \$7,650. However, because you only paid half of that amount, your net income for the year would be \$46,175 (not including income taxes or any other deductions).

But if you are self-employed, you don't have an employer to pay that other half. Does the government just allow self-employed individuals to pay half? No. Under SECA, you pay the full cost of your Social Security and Medicare tax, yourself . . . 15.3%! Again, for example, let's say that you make \$50,000/year in self-employment income. Under SECA, you will have to pay the full \$7,650 yourself – leaving you with \$42,350 in net income (not including income taxes or any other deductions).

Under SECA, allowances are made to help balance the differences from FICA (to a point), but in the end, you will likely be paying a large portion of your salary into SECA. While your ministerial income may be, effectively, free from federal income taxes, it is not free from SECA unless you file for an exemption.

### *Withholding Options*

Another area where your employment status matters is in the issue of paycheck withholdings. As an employee of a secular company, your payroll department deducts the proper amount of federal and state

income taxes, as well as FICA payments, from each paycheck automatically. They then turn that money over to the IRS to be “credited to your account.”

People who are self-employed have to do that for themselves (or pay an accountant to do it for them) and must send their payments to the IRS on, at least, a quarterly basis. . .

**END OF SAMPLE**

Most pastors "don't know what they don't know" about the unique and confusing world of pastoral compensation.

# What do you know?

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- What is the difference between taxes, FICA, and SECA, and why does it matter so much for pastors?
- Do you understand what can and cannot factor into the, potentially, life-changing decision to opt out of Social Security?
- What is the difference between a pastor's salary and housing allowance, and why is the balance between these two things so critical to so many other aspects of a pastor's finances?
- How could a parsonage be one of the worst things a church could ever provide for its pastor?
- From medical insurance to paid time off, does your benefits package really make sense for both you and your church?
- Are you taking advantage of one of the best arrangements the IRS provides for tax free "compensation"?
- How are you planning for retirement, and how is your church helping with that plan?
- Do you have a strategy for handling your own pastoral compensation that is truly maximizing every possible benefit that could be yours?



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