CLERGY/PASTOR HOUSING ALLOWANCE FAQ's

Q. What is a Housing Allowance?

A. A housing allowance is a portion of clergy income that may be excluded from income for federal income tax purposes (W-2 "Box 1" wages) under Section 107 of the Internal Revenue Code. To be eligible, the pastor/clergy must be a "minister of the gospel" and be ordained, licensed, or commissioned by a church, convention or association of churches.

Q. Can all church employees have a tax-free housing allowance?

A. No. Section 107 of the Internal Revenue Code allows only a "minister of the gospel" to have a housing allowance. Thus, only taxpayers who are serving as clergy under IRS rules for tax purposes are eligible for a housing allowance. These rules state that the person must be ordained, commissioned or licensed by the church or denominational authorities and should be performing "ministerial services" such as administering the sacraments, conducting religious worship, or demonstrating management responsibility in a local church or denomination, and be considered as a religious leader by the church and/or denomination. Therefore, a church custodian or secretary cannot have a housing allowance. (Lay employees do get the benefit of having the church pay one half their social security/Medicare taxes).

Q. Can clergy exclude from gross income the ENTIRE cost of owning, renting, and/or furnishing a home?

A. It depends. The amount that can be excluded from federal income tax is the ***lesser*** of:
(a) the amount designated as the housing allowance
(b) the amount of actual housing expenses, or
(c) the fair rental value of the property (furnished, plus utilities).

Q. How is the housing allowance set up?

A. A pastor's housing allowance must be established or designated by the church or denominational authority. The preferred way to do this is for the church council/board to adopt a housing allowance resolution prior to each calendar year (or prior to the arrival of a new pastor) and record the resolution in the minutes of the meeting. (Templates for a Housing Allowance Designation Request and official Designation are available at www.churchpaypros.com.)

In determining the amount of the housing allowance designation, past experience is the best indicator, with an added "cushion" included for unanticipated expenses (i.e. repair or replacement of household appliances, etc.) Adding this cushion allows the pastor to take full advantage of all federal tax savings. (Do keep in mind that designated housing allowance not used for household expenses becomes taxable. So, adding an excessive "cushion" may not be adviseable.) ChurchPay Pros' Housing Allowance Worksheet, is an excellent starting point for determining housing allowance amounts. The worksheet is available at www.churchpaypros.com.

Q. What types of housing related expenses can be included in the housing allowance?

A. While there is no list of allowance expenses provided by the IRS, it is understood that most reasonable household expenses can be included in the housing allowance. Some of these items include: down payment on a home, mortgage payments (including both interest and principal), home equity loan payments (assuming the loan proceeds are used for housing-related expenses), real estate taxes, homeowners' association dues, property insurance, utilities, furnishings and appliances (including repairs), structural repairs, remodeling, yard maintenance and improvements, pest control, snow removal, maintenance items, and trash pickup.

Note that the cost of food and/or clothing may not be included in the housing allowance. Also, housing-related expenses can only be included in the housing allowance for the year in which they are incurred.

Q. What type of housing expense records should clergy be keeping?

A. Ideally, clergy should keep careful housing expense records to determine whether expenses are greater or less than the annual designation. Records are also important for estimating a reasonable housing allowance for the next year. Original receipts, invoices, canceled checks, charge card records, etc. are all essential. To simplify record keeping, some pastors find it helpful to have one charge card or bank account dedicated solely to household expenses, while others simply use the "shoe box" method of collecting all applicable receipts in one handy place.

Q. What happens if the pastor doesn't spend all of the designated housing allowance on housing expenses?

A. As noted above, the exclusion from gross income cannot exceed the lesser of the designated housing allowance, the actual housing expenses, or the fair rental value of the property. In particular, the exclusion from gross income can never exceed the actual housing expenses. Therefore, any "unused" portion of the designated housing allowance must be included in the pastor's gross income when filing his annual tax return.

Q. Can the housing allowance resolution be adopted or amended mid-year?

A. Yes. The housing allowance resolution can be adopted or amended at any time. However, it can only be applied prospectively. That is why it is important for the housing allowance resolution to be adopted by the church council or annual charge conference prior to each new calendar year (or prior to the arrival of a new pastor) and for pastors to accurately estimate their housing expenses in advance.

Example: A local church waits until June 30 to establish its calendar year housing allowance of $10,000. In that case, at most $5,000 of the $10,000 housing allowance can be excluded from the pastor's gross income in that calendar year.

Q. Is the housing allowance also excluded from earnings subject to self-employment taxes?

A. No. The housing allowance exclusion only applies for federal income tax purposes. By law, clergy are considered "dual status" employees. This, in essence, means that while pastors receive W-2s from their employers, they are considered self-employed for the purpose of paying self-employment taxes – unless they have opted out using Form 4361. Therefore, housing allowance and/or the fair rental value of a parsonage provided to a pastor (including the cost of any utilities and furnishings provided) must be included as self-employment earnings subject to the self-employment tax. (See IRS Publication 517).

Example: A church pays its pastor an annual salary of $35,000 and provides him with the use of a church-owned parsonage. The church pays for all expenses of maintaining the home. The fair rental value of the parsonage (furnished, plus utilities) is $10,000 per year. The pastor's gross income for federal income tax purposes is $35,000, but for self-employment tax purposes his gross earnings are $45,000 ($35,000 salary + $10,000 fair rental value of the parsonage).

Some churches do establish a (taxable) "social security allowance," increasing the cash compensation of the pastor to help defray the extra cost of the self-employment tax.

Q. How is the housing allowance reported for social security purposes?

A. It is reported by the pastor on Schedule SE of Form 1040, line 2, together with salary. (ChurchPay Pros by AccuPay will provide the amount of a pastor's compensation designated as housing allowance in Box 14 of the pastor's W-2 to assist tax preparers.)

The information provided by ChurchPay Pros by AccuPay is general in nature and may not apply to your specific circumstances. You should consult with your CPA or tax advisor before implementing any ideas, comments or planning techniques.

ChurchPay Pros by AccuPay, Inc.

(317) 885-7600

www.churchpaypros.com

info@churchpaypros.com