

Ministers Parsonage Allowance

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2. Insert for Minutes of Meeting of Church Board:

The Chair informed the meeting that under the tax law, an ordained minister is: (1) not subject to federal income tax on a parsonage allowance paid to a minister “as part of the minister’s compensation to the extent used by the minister to rent or provide a home,” and (2) not subject to federal income tax on the rental value of a home supplied to the minister rent-free.

The Board of the _____ Church on the _____ day of _____, 20____, after considering the statement of Rev. _____ Estimated [he/she] will be required to spend to rent or provide a home for [him/herself] during the year 20____, on motion duly made and seconded, adopted the following resolution.

OR

The Board of the _____ Church on the _____ day of _____, 20____, after discussing the amount to be paid to Rev. _____ as parsonage allowance for the year 20____, and for every year thereafter unless otherwise provided.:

Resolved, that Rev. _____ receives compensation of \$ _____ for the year 20____ of which \$ _____ is designated as parsonage allowance for the year 20____, and for every year thereafter unless otherwise provided.

[If the minister will have the rent-free use of a home, also state:

Rev. _____ shall also have the rent-free use of the home located at _____ for the year 20____ and for every year thereafter as long as (he/she) is minister of _____ Church.]

The parsonage allowance [and rent-free use of a home] shall be so designated in the official church records.

adversely affect the parsonage allowance. Rental income received by a minister is generally included in gross income; some deductible expenses are allowable. See Internal Revenue Service (IRS) Publication 527, “Rental Property.”

Pointer

A minister who buys a house and wants to take maximum advantage of the parsonage allowance should try to arrange the financing so that the allowable costs (mortgage payments, interest, taxes, repairs, insurance, etc.) equal the home’s fair rental value.

A minister who owns a home free and clear might consider mortgaging the house or taking out a home equity loan and using the financing to provide housing. The financing must be used to provide housing in order to qualify as parsonage allowance.

C. While the parsonage allowance is not subject to income tax, if properly designated and accounted for, it is subject to Social Security Tax (see page 9, section G).

Ministers are permitted to deduct mortgage interest and real property taxes on their home even though their parsonage allowances are not includable in their taxable income.

2. The pension fund compensated the minister for his or her past service to the church and
3. The board of the pension fund designated a portion of the pension as a parsonage allowance in advance each year (*Rev. Rule 75-22*).

NOTE: *There is no exclusion for a parsonage allowance paid to the spouse-beneficiary of a deceased minister. This, for example, a rental allowance paid to a minister's surviving spouse is a part of his/her gross income and thus subject to tax.*



All retired ministers in the Pension Plan of the Christian Church are written every fall concerning their designations for the upcoming year. The Pension Fund automatically designates 60% as parsonage allowance. However, a larger or smaller amount can be designated - but must be substantiated if needed. It is possible to have an amount designated as parsonage allowance from a minister's tax deferred account if the allowance needed is greater than the retirement pension or the minister is not in the Pension Plan.

The parsonage allowances of retired ministers designated by their pension fund are not subject to self-employment (SECA) Social Security tax. The small Business Job Protection Act (1996) clarified this matter.

2. A minister isn't automatically entitled to exclude the fair rental value plus utilities, etc., but must automatically spend that amount. If audited, proof of all expenditures would be needed.
3. If the total amount spent for a down payment, mortgage payments, interest, taxes, utilities, etc., and other allowable costs of providing a home are less than or equal to the fair rental value, the minister can exclude the amounts actually spent for those items. Other excludable items include



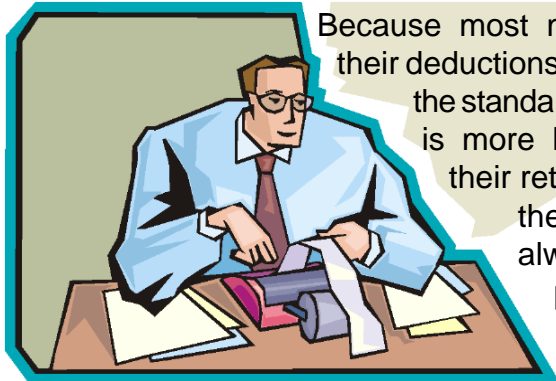
legal fees for acquiring the property, bank fees for obtaining the mortgage and title search fees - as long as those items (plus the down payment, mortgage payments, interest, taxes, utilities, etc.) don't exceed the fair rental value plus the cost of utilities.

4. Ministers who itemize their deductions (instead of taking the standard deduction) may also deduct their mortgage interest and real property taxes even though those items are excludable from income as parsonage allowance.

H. Record Keeping

A minister can exclude the parsonage allowance from gross income only to the extent that he/she uses it to provide a home. Upon examining a minister's income tax return, IRS may require proof that the entire amount was used for that purpose.

If a return is examined, the taxpayer has the burden of substantiating statements on the return. To substantiate an exclusion or reduction, the taxpayer must produce evidence. A minister proves that all of the parsonage allowance was spent to provide a home the same way every tax payer substantiates items on income tax returns: with written records, canceled checks, vouchers, paid bills, receipts, etc.



Because most ministers itemize their deductions (rather than take the standard deduction), IRS is more likely to examine their returns. Although the IRS may not always ask how the parsonage allowance was used, ministers

should keep complete records in case of an audit. Moreover, keeping records can result in a tax savings not available without records. For example: the amount of the parsonage allowance is generally estimated. Records of this year's costs can furnish a reliable guide to how much the church should designate. . .in advance . . . as the minister's parsonage allowance for next year.

A formal, written employment contract, although excellent for substantiating the designation of a minister's parsonage allowance, isn't necessary. But the church must take some "official action," as evidenced by minutes or a resolution of the appropriate church board or committee. Official action may also be shown by appropriate notations in the church's budget, setting forth the minister's compensation and parsonage allowance. At a minimum, the church's official action should be incorporated in some church document (see pages 13-15).

Important: Play it safe. To insure favorable tax treatment, a specific designation should be made in advance and in writing for each minister.

In the case of a minister who is employed and plans to continue as the church's minister, the church should take official action concerning the minister's compensation and parsonage allowance for the following year toward the end of the year. This action should be formalized in an appropriate church record or document. An oral agreement to continue the present compensation and parsonage allowance won't necessarily assure the exclusion of the minister's parsonage allowance.

For a newly called minister, official action appropriately recording the compensation and parsonage allowance should be taken before the minister begins work. The written designation or employment contract should specify the compensation and parsonage allowance for the remaining portion of the year, as well as include a provision for renewal in advance on a calendar-year basis.

C A church can provide its minister with a home rent-free and also designate a portion of the minister's compensation as parsonage allowance. As long as a minister uses that designated portion for the expenses of operating a home that is normally covered by the parsonage allowance, he/she does not have to include that portion in their gross income.

C When a minister rents or owns a home, part of his/her compensation can be designated as parsonage allowance. However, the amount to be excluded can't exceed the **lowest** of the following:

1. The fair rental value of the furnished home plus the cost of utilities; or
2. The actual expenses of operating the home (see page 5); or
3. The amount properly designated as parsonage allowance.

If a minister who owns a home doesn't spend the entire parsonage allowance in the year it is received, the excess must be reported as income.

A minister who owns a home but rents it to another individual for part of the year cannot exclude as parsonage allowance the costs of the home during the rental period. However, a minister's temporary absence from his or her home - without renting the home - should not

3. Notification by Employer:

Date_____

Dear Rev._____:

This is to advise you that at the meeting of the Board of the _____ Church, held on _____, your parsonage allowance for the year 20__ was officially designated and fixed in the amount of \$_____. Accordingly \$_____ will constitute a parsonage allowance and the balance will constitute salary [you will have rent-free use of the home located at_____

_____ for the year 20__]. Under Section 107 of the Internal Revenue Code, an ordained minister of the gospel is allowed to exclude from gross income the parsonage allowance paid to him/her as part of his/her compensation to the extent used by him/her to rent or provide a home [the minister may also exclude the rent-free use of a home].

You should keep an accurate record of your expenditures to rent or provide a home in order to substantiate any amounts excluded from gross income in filing your federal income tax return.

Sincerely,

Board Chair (or other official of the church)

D. Parsonage allowance is an amount designated to “provide a home.” IRS interprets that to mean more than just the bare walls of a house or apartment. It includes such things as a garage, sidewalks, and front and back yard maintenance. In addition to rent (or fair rental value, for a minister who owns a home), the parsonage allowance includes: garbage removal; furnishings; and other ordinary expenses of running a home (such as upkeep and maintenance). Remodeling expenses can also be excluded from the minister’s gross income. Remember, for a minister who owns a home, the cap on the parsonage allowance is the lesser of the actual expenses of operating the home, or the home’s fair rental value plus utilities, etc.

The parsonage allowance does not include a car allowance, food or the cost of domestic help. Further, if a minister rents, purchases or owns a farm or other business property in addition to a home, any portion of the parsonage allowance spent on the farm or business property can’t be excluded from the minister’s gross income.

E. Summary of Rules Regarding Amount of Your Parsonage Allowance Exclusion

1. The parsonage allowance exclusion is limited to the actual expense or the home’s fair rental value plus utilities, etc., whichever is less. In no event, however, can the parsonage allowance exceed the amount designated in advance by the church.

Sample Forms to Properly Designate Your Parsonage Allowance

1. Letter to church from minister requesting parsonage allowance:

To: Name of Church or Organization
 From: Rev. _____
 Subject: Parsonage Allowance for 20____

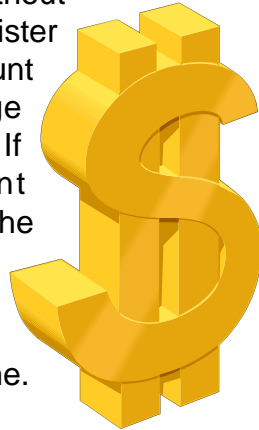
The following amounts are an estimate of the payment I expect to make during 20 ____ to provide a home.

COSTS and EXPENSES	AMOUNT
1. Rent on leased premises or mortgage payments	\$ _____
2. Garage Rental (if not included in above)	_____
3. Utilities (gas, electricity, water, heat, etc.)	_____
4. Insurance	_____
5. Repairs and maintenance	_____
6. Furnishings	_____
7. Any other allowable expenses (specify)	_____
Fair Rental Value of Home Plus Cost of Utilities	\$ _____

 (Date)

 (Minister’s Signature)

5. A minister doesn't report the parsonage allowance on his or her federal income tax return. Nor does the minister report the rental value of a home owned by the church that he or she is allowed to occupy without cost. Nevertheless, the minister must actually spend the amount designated as parsonage allowance by the church. If less than the amount designated is spent, or if the amount designated exceeds the fair rental value of the home plus the cost of utilities, the excess is reportable income.



F. Designation of Your Parsonage Allowance

The church must identify the parsonage allowance part of your compensation in advance. There should be a written designation stating that you will receive X amount as an annual compensation, of which Y amount is designated as the parsonage allowance that you'll use to provide a home.

A retroactive designation won't satisfy the requirements - even if it's in writing. *The official action designating the parsonage allowance must be made in advance.*

I. Qualification for the Parsonage Allowance

Not all ministers who receive a housing or rental allowance may exclude it from gross income under IRC Section 107. Treasury says a minister must be ordained, commissioned or licensed. Where a church or church denomination ordains some ministers and licenses or commissions others, the licensed or commissioned ministers qualify for the parsonage allowance only if they perform substantially all the religious functions within the scope of the tenets and practices of the religious denomination. If you aren't ordained, check with your regional or area minister.

To qualify for the income tax exclusion, the minister must satisfy the definition of "minister of the gospel" and receive the parsonage allowance (or rent-free use of a home) as remuneration for services that are ordinarily rendered by a minister of the gospel.

J. Retired Minister's Parsonage Allowance

Retired ordained ministers are occasionally given homes or parsonage allowances by their churches in recognition of past services. In 1975, IRS determined that a retired minister could exclude a portion of his/her church pension as parsonage allowance if the following conditions are met:

1. Effective with retirement, the minister severed his or her employment relationship with the church and relied upon the denomination pension fund for his or her pension;

Example: A minister is called by a church to start performing services on September 1, at an annual salary of \$30,000, of which \$12,000 is agreed upon as parsonage allowance. The agreement should provide that, for the remainder of the year, the minister shall receive \$10,000, of which, \$4,000 is the parsonage allowance. Thereafter, the minister's annual compensation (and parsonage allowance) will be agreed upon and designated in advance of each calendar year.

The parsonage designation, regardless of where it is actually made (i.e., in an employment contract or in minutes), should be prospective. That way, a safety net is created in case the designation is overlooked in a subsequent year. See the "Insert for Minutes of the Meeting of Church Board" for an example of a prospective designation (see page 14) The parsonage allowance designation can be amended during the year if the original allowance is too low. However, the amended allowance will also only operate prospectively.

Reporting by the Church. . . . IRS recommends that churches provide their ministers with parsonage allowance information in one of these ways:

1. Show the amount of parsonage allowance in a separate written statement attached to Form W-2;
2. Show the allowance on Form W-2 in any of the boxes designated for state or local income and withholding, if those boxes aren't filled in;

3. If all the state or local income and withholding boxes are filled, don't show the parsonage allowance on Copy A of For W-2, but instead show it in an empty block (except those showing FICA wages and withholdings) on copies B, C and D.

Note: These reporting methods are not requirements; they are contained in IRA's instructions to its agents.

G. Income Tax/Social Security Implications

A minister's remuneration for services "in the exercise of his or her ministry" isn't subject to income tax withholding, even if the minister is considered an "employee" for income tax purposes.

However, a minister may enter into a voluntary withholding agreement with his or her employer to cover any income and self-employment tax due. If you wish to have taxes withheld from your remuneration, furnish your church with a completed Form W-4, "Employee Withholding Certificate." The withheld amounts will be reflected on your form W-2.

For Social Security purposes, the fair rental value of a church provided parsonage or parsonage allowance **must be included** in your self-employment earnings on Schedule SE (Form 1040) when completing Social Security tax liability.