Chapter 2: Housing Allowance and Parsonage

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2.100: Introduction

The compensation package of an LCMS minister of religion—ordained or commissioned may include a parsonage (that is, the use of church-owned housing), or a housing allowance, or both.

Concerning their treatment for federal income tax purposes, the Internal Revenue Code Section 107 states the following:

In the case of a minister of the Gospel, gross income does not include:

1. The rental value of a home furnished to him/her as part of his/her compensation; or
2. The rental allowance paid to him/her to rent or provide a home (within certain limits).

Granted only to ministers (i.e., licensed, ordained, or commissioned in the exercise of their ministry), this favorable income tax relief dates from the earliest days of the United States and was a consideration given by Congress in exchange for the expectation that the clergy would provide sanctuary for the "deserving poor"—widows and orphans.

For this publication, references to "housing allowance" will include all allowances paid to a worker for providing a home. This includes housing allowance, utilities allowance and furnishings allowance. The two terms, "housing allowance" and "parsonage," are different and distinctive. They may be provided separately or in combination. Although neither is subject to income tax, they are subject to self-employment tax.

2.200: Eligibility

Pastors, certified teachers, DCEs, DCOs, deaconesses, parish assistants, certified lay ministers, directors of parish music and directors of family life ministry who are listed on the Synod's roster and are in ministry as described in paragraph 1.140 are eligible to be compensated with a housing allowance. Some or all of the housing allowance may be income tax free. These same workers are also eligible to be compensated with a parsonage and utilities paid for by the congregation. The fair rental value of the parsonage and paid-for utilities are entirely income tax-free as provided under Internal Revenue Code Sec. 107. A minister's widow is not eligible for this tax-free benefit. For retired ministers, see 1.425. As stated previously, either form of housing provided by the congregation is subject to self-employment tax.

2.300: Housing Allowance

A housing allowance neither increases nor decreases the cost of the worker to the congregation. It is a part of the worker's compensation that has been designated as housing allowance.

Housing allowance may be designated whether the minister lives in a home owned by the congregation, a rental dwelling, or owns his own home. The amount of allowance may vary with these circumstances.

If the furnished dwelling is owned by the congregation, but the minister pays the cost of the utilities or other expenses connected with the home, the employer may designate part of the minister's compensation as "parsonage allowance" to cover the cost of the utilities and other dwelling expenses.

Where an employer does not furnish a parsonage and the minister rents or provides his or her own home, the employer may designate an even greater part of his or her compensation as "housing allowance" which will be used for expenses related to home ownership, including furnishings and utilities.

2.310: Housing Allowance Income Tax Aspects

To the extent that a designated housing allowance is used to rent or provide a home and does not exceed the furnished home's fair rental value plus utilities, it is not subject to federal income tax. Read 2.320 for a clearer understanding of this statement.

2.320: Tax-free Limits

The housing allowance income tax exclusion is limited to the least of the three following amounts:

1. **Amount of the minister's compensation designated as housing allowance**, approved by official action taken by the governing body of the employer, and evidenced in the official minutes of the governing body.
2. **Amount expended or "used"** by the minister to provide a home during the year and properly substantiated.
3. **The fair rental value of the home (including garage, etc.), furnished, plus utilities.**

A minister cannot exclude from taxable income any amount of the designated allowance that exceeds the conditions in those "least of" rules outlined here. The excess taxable housing allowance must be reported by the minister on his or her IRS Form 1040, line 7.

The sections that follow provide further details concerning how each of these conditions may be separately calculated.

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2.321:
The Designated Amount

IRS assigns the minister's employer with the task of designating how much of his or her salary is believed will be used in providing a home. It must be "reasonable" in amount. In other words, the amount cannot be more than reasonable pay for a minister's services. Nor can any portion of the minister's salary being contributed to a 403(b) TSA also (concurrently) be designated as housing allowance.

The designation of the housing allowance must be pursuant to official action taken in advance of payment of the allowance. The designation should be in writing to avoid any confusion about its proof, preferably evidenced in the minutes of the appropriate governing body of the employer (e.g., board of directors, church council, voters' assembly, etc.). If not done by adoption of a formal resolution, designating the amount as a budget line item may be sufficiently "official."

The designation cannot be made retroactively. This is extremely important, as ministers have been required to pay taxes and penalties on housing allowances if they could not show proper pre-authorization.

The designation may take the form of a specific dollar amount (generally based upon the minister's estimate of the amount he or she believes will reasonably be excludible) or a percent of total compensation. There is no suggested percentage by the Synod or a limitation based on a percentage of compensation by the IRS.

It may be amended from time to time as necessary, but each amendment must be formally adopted by the employer and can only be effective for payments made after adoption by the appropriate body or voters' assembly.

2.322:
Use of Housing Allowance

To the extent that the designated housing allowance amount is used to rent or provide a home and *does not exceed the furnished home's fair rental value plus utilities*, it may be excluded by the minister of religion—ordained or commissioned from income tax. In determining the amount "used" to rent or provide a home, a minister may take into account all of his or her payments for repairs, real estate taxes, mortgage payments (both principal and interest), insurance, lawn care, utilities, furniture, remodeling and other home improvements.

The following worksheet has been designed to assist a minister in estimating his or her total amount of housing expenses. Its inclusion in this publication does not imply that the minister must disclose details of this kind to the governing board that makes the housing allowance designation. The amount a minister of religion requests of his or her congregation to pre-designate as housing allowance should consider all the housing allowance limitations (for a complete listing, see 2.320).

MINISTER'S ESTIMATE OF EXPENSE

ITEM	AMOUNT
1. Rent on home	$_____
2. Garage rental	_____
3. Down payment; legal, loan and title fees; and real estate commission on purchase of home	_____
4. Mortgage payments (principal and interest)	_____
5. Real estate taxes and assessments on home	_____
6. Property insurance (homeowner's or renter's)	_____
7. Utilities:	
Gas	_____
Electricity	_____
Water + sewer	_____
Heat	_____
Telephone (basic service)	_____
Trash pick-up, Environmental fees	_____
Storm drainage	_____
8. Furnishing and appliances (purchase and repair)	_____
9. Structural repairs and remodeling	_____
10. Lawn care and landscaping	_____
11. Maintenance items (household cleansers, light bulbs, pest control)	_____
12. Other allowable expenses (specify)	_____
13. Home Owner's Association dues	_____
TOTAL	$_____

2.323:
Fair Rental Value

Currently, IRS has no written procedures concerning the method or frequency for determining this value. In its *Audit Technique Guide for Ministers*, the IRS tells its agents that determining the fair rental value of a parsonage "is a question of all facts and circumstances based on the local market . . ." It also suggests the importance of "documentary evidence."

Some appraisal experts suggest approximating the annual rental value of a home by taking 1 percent of the home's fair market value and multiplying the product by 12. But this calculation doesn't always yield accurate results—and it doesn't consider the rental value of a *furnished* home.

The fair rental value of a home is generally the amount that houses of comparable size and quality in the same vicinity would rent for in an "arm's-length" transaction. It's probably a good idea to contact a local real-estate agent for help. Real estate agents often manage rental properties and know their local markets.

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As an alternative, look for relevant classified ads in the newspaper.

And, don't forget the home's furnishings. IRS hasn't provided guidance for determining these rental values, either. However, it may be reasonable to contact furniture-rental agencies for them. Such companies can usually quote rates by-the-room.

Finally, document how, when and with whose help you arrived at a fair rental value-and keep that information for future reference. This amount should be reviewed regularly and reasonably adjusted for changes. In complicated situations, seek the advice of a qualified tax professional.

2.330: "One" Home

There is another long-standing restriction IRS has imposed on the excludible portion of a minister's compensation received for housing, confirmed by the court. A minister of religion—ordained or commissioned can only exclude from gross income his or her housing allowance used in providing only "one" home. Generally, that home was the primary residence.

2.340: "Debt-Free" Home

As a matter of interest to ministers of religion--ordained or commissioned who own their home debt-free, they are usually not able to exclude as much of a housing allowance as those who own their homes subject to a debt. The reason, of course, is that they are not making principal and interest mortgage payments. Even though the fair rental value of the home may have appreciated, the "least of" rule limiting the tax-free portion of housing allowance (see 2.320) still applies. So when expenses on a debt-free home drop below the amount designated for housing allowance and home's fair rental value, then the exclusion is strictly limited to the homeowner's fewer expenses.

2.350: Home Equity or Second Mortgage Loans

As a homeowner, a minister of religion–ordained or commissioned may at some time take a second mortgage or home equity loan on his or her property. The purpose and use of this borrowed money will determine whether or not the payments can be considered "uses" of his or her housing allowance. If the borrowed funds were used to pay for home repairs, maintenance, or furnishings, payments (including principal and interest) will be considered a use of housing allowance. If they were partially used for another purpose (i.e., credit card debt, personal loans, education, etc.) you must prorate payments between housing and personal expenses.

2.360: Home Loan Between Church and Minister

Congregations may elect to assist a minister with the purchase of a home by means of a direct loan. Forgiveness of debt or interest free loans could result in additional income for the worker (see 1.310).

The congregation is required to report the interest payments made by the minister on Form 1098 *(Exhibit 2)*. The Form 1098 must also be submitted to the IRS with a Form 1096 (see Exhibit 7-R). The box for Form 1098 must be checked on the Form 1096.

Principal and interest payments made by the minister may be a qualified use of housing allowance as provided in this chapter.

A home or former parsonage being purchased by a minister is usually not exempt from property tax. Check the applicable laws in your state.

8181 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone number		OMB No. 1545-0901 2013 Form 1098	Mortgage Interest Statement
RECIPIENT'S federal identification no.	PAYER'S social security number	1 Mortgage interest received from payer(s)/borrower(s) $	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2013 General Instructions for Certain Information Returns.
PAYER'S/BORROWER'S name		2 Points paid on purchase of principal residence $	
Street address (including apt. no.)		3 Refund of overpaid interest $	
City or town, province or state, country, and ZIP or foreign postal code		4 Mortgage insurance premiums $	
Account number (see instructions)		5	

Form 1098 Cat. No. 14402K www.irs.gov/form1098 Department of the Treasury - Internal Revenue Service

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Exhibit 2

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2.370:
Itemized Deductions

Although mortgage interest and real estate taxes are generally a housing allowance use that is excluded from the minister's gross income for income tax purposes, he or she may also claim deductions for the same if itemizing them on his or her tax return. This example of "double dipping" is a matter of law and another special tax benefit to ministers of religion–ordained or commissioned.

2.500:
Parsonage

Where an employer furnishes a minister of religion–ordained or commissioned with a dwelling, a parsonage, the fair rental value of the housing, including any employer-paid utilities, is not part of the taxable compensation for income tax purposes. The same applies to the furniture, garage, repairs and maintenance, if furnished by the employer. *(Note: The home's fair rental value and utility expenses paid for by the employer are included in income for self-employment tax computation.)*

2.510:
Parsonage Income Tax Aspects

Unlike with housing allowance, there are no limitations with respect to the employer-provided housing that is excludible from the minister's gross income for income tax purposes. Plainly speaking, 100 percent of a parsonage's value is income tax-free. However, IRS could assess the congregation's officers and the minister both with severe monetary penalties (intermediate sanctions) if the value of the housing in combination with his or her salary is highly unreasonable compensation for his or her services.

2.600:
Substantiation and Disclosure

Whether a minister of religion–ordained or commissioned is provided with a parsonage or receives a housing allowance as part of his or her earnings, he or she must understand there are certain substantiation and disclosure requirements that must be followed to ensure their income tax benefit.

In order to exclude any amount of the housing allowance, proof of housing-related expenditures in the form of receipts or cancelled checks should be retained by the minister. IRS does not require this information to be shared with the employer.

In addition to substantiating how the housing allowance was used, it is also recommended that the minister document when and how he/she determined his or her home's annual fair rental value, furnished. If the congregation owns the dwelling, the employer and minister should openly discuss and agree on determining that amount. See how the amount might be determined at 2.323.

As another practical matter, the minister should also ask for and keep a copy of his or her housing allowance designation. The designation may appear in the minister's call documents, employment contract, the church minutes, the church budget, or any other document indicating official action. Having a copy in-hand helps to reassure the minister that this action was actually taken by his or her employer.

If the IRS suspects that a taxpayer has omitted a substantial (25 percent or more) amount of income on his or her tax return, the Service has up to six years to audit and assess an additional tax. However, an item is not considered omitted if its existence has been disclosed in the return, or in a statement attached to the return, in a manner that apprises the IRS of the nature and amount of the item. Since a minister's housing allowance (or annual fair rental value of a parsonage) is likely to be a substantial portion of a minister's income, it is recommended that he or she disclose having received the earnings and explain its excludible nature. A Form W-2 showing the nature of the income and excludible amount in Box 14 will probably be sufficient in meeting this disclosure requirement and thus avoid the six-year statute of limitations. However, some employers may not show that information in this manner. In that case, the minister should consider preparing a statement with this information himself and attach it to the return. Otherwise, he or she should keep all housing allowance and/or parsonage information related to a tax return for six years after the return's due date.

2.700:
Self-Employment Tax

Although neither the minister's excludible housing allowance or employer-provided housing is subject to income tax, they are subject to self-employment tax. For this reason, it's important to communicate these amounts to the minister. The section that follows describes how this information should be reported. The reported value has no relationship to the 25 percent allocation for a person living in church-supplied housing used by Concordia Plan Services for benefit computation. In order to report an accurate amount of employer-furnished housing, it is important to have the home's fair rental value assessed (see 2.323). Also, keep a record of any utility payments made with respect to the property. IRS expects that the amount reported is a figure "agreed on" by the church and minister and that documentary evidence in this regard exists.

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2.800: Reporting Requirements

There are various ways the housing allowance of the minister of religion–ordained or commissioned may be reported for tax purposes. Two common ways are listed as follows:

1. **"Estimated Exclusion Method"**
   Generally the most commonly used method by congregations of The Lutheran Church—Missouri Synod, it requires the least amount of congregational involvement in determining what portion of the minister's designated housing allowance is actually excludible from federal income tax. Before the beginning of the year, the minister presents the governing body with an estimated amount of his or her housing allowance needs (refer to 2.322 for an understanding how a minister might estimate this amount). The church board adopts a resolution designating the housing allowance based on that estimate. At year-end, the treasurer prepares the W-2 by reporting the net salary (gross salary less housing allowance) in Box 1 and the housing allowance in Box 14 or on a separate statement. The minister then considers the "least of" rule shown in 2.320 and reports any unused housing allowance on his or her Form 1040, line 7.
2. Before the beginning of the year, the governing body may designate the housing allowance as a reasonable stated percentage of compensation in lieu of the minister's estimation. At year-end, the treasurer tests to ensure the amount of gross salary being excluded as housing allowance on the minister's wage statement is consistent with the congregation's designation (gross salary multiplied by the stated percent). The treasurer and minister then follow the same IRS-reporting procedures as described under method 1.

According to IRS Publication 15-A, the rental value of housing provided to a minister may be reported to him or her on a separate statement or in box 14 on Form W-2. In this regard, do not mistakenly label this amount as a "housing allowance" as that may cause the minister to improperly calculate his or her income tax liability. Report only the amount agreed upon between you and the minister. See 2.323 for guidance concerning how that amount might be determined. The reported value has no relationship to the 25 percent allocation for a person living in church-supplied housing used by Concordia Plan Services for benefit computation.

2.900: Sample Housing Allowance Resolutions

This section contains sample resolutions that may be used by a congregation in setting the housing allowance for minister employees. However, make sure the congregation thoroughly understands the rules applicable to designating one before its adoption (refer to 2.321, The Designated Amount). Although each is written in "standing" form, the congregation could adopt one annually to reflect revised requests for housing allowance amounts by the minister. Congregations should recognize the needed amounts for housing allowance will vary greatly among their eligible workers. Therefore, sample resolutions 1, 3 and 4 will assure the most favorable tax treatment for their workers.

SAMPLE 1
All Employed Ministers—Stated Dollar Amount
RESOLUTION

RESOLVED, that ***(name of congregation)***, authorizes and establishes the following individual(s) housing allowance for the year 20xx:
Name_____ Amount_____
Name_____ Amount_____
The housing allowance will be paid from _____, 20xx, to December 31, 20xx.

SAMPLE 2
All Employed Ministers—Stated Percentage
RESOLUTION

RESOLVED, that ***(name of congregation)***, as a standing resolution to remain in force and effect until such time as amended or revoked, hereby authorizes and establishes a housing allowance for each ordained or commissioned minister of religion at any time serving it in an amount each year equal to _____ percent of that person's gross annual compensation. Annual gross compensation comprised of ***(Congregation should designate what is included in gross annual compensation.)***

SAMPLE 3
Individual Minister—Stated Dollar Amount
RESOLUTION

RESOLVED, that ***(name of congregation)***, as a standing resolution to remain in force and effect until such time as amended or revoked, hereby authorizes and establishes a housing allowance for ***(individual's name)*** at any time serving it in the amount of $_____ per year.

SAMPLE 4
Individual Minister—Stated Percentage
RESOLUTION

RESOLVED, that ***(name of congregation)***, as a standing resolution to remain in force and effect until such time as amended or revoked, hereby authorizes and establishes a housing allowance for ***(individual's name)*** for the duration of service in an amount each year equal to _____ percent of that person's annual compensation. Annual gross compensation comprised of ***(Congregation should designate what is included in gross annual compensation.)***

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