Helping Boards Set Pastoral Compensation

What church leaders should know about paying pastors.

By Bob Smietana

When Steve Hoden first became pastor of Salem Covenant Church in Oakland, Nebraska, he had one request for the church board: take care of his family.

The church board knew the cost to live in the rural community. So Hoden trusted the board members to do the right thing when it came to setting his compensation. The church, he said, always did.

“We’ve never talked money for 14 years,” said Hoden, who recently retired.

Now the church is looking for Hoden’s successor. That includes figuring out how much to pay the new pastor. It’s a complicated task. And the church can use all the help it can get, said Jim Goth, chairman of Salem Covenant.

“We’re starting all over,” he said. “I have no idea what the starting salary for a new pastor should be.”

Many churches are in a similar position. Compensation setting is complex, and treasurers and other financial managers must walk alongside board members as they learn how to navigate these complexities. With that in mind, Church Finance Today asked several financial experts and church leaders for their insights into what boards and finance committees need to know about setting pay for pastors.

Look at the big picture

Dan Busby, president of the Evangelical Council for Financial Accountability and an editorial advisor for Church Finance Today, said the first step in setting pastoral compensation is to look at the big picture. That includes looking at the church’s budget, the cost of living in the church’s community, and the goals for the church’s ministry. Using that data, the church can develop a philosophy of compensation that fits their context, Busby said.

Next, he said, they should ask this question: “How do we compensate the pastor so that they want to stay and so that they are not stressed out every minute?”

The goal is to set a compensation package that helps a pastor focus on the church’s ministry—and not on how to come up with the money to pay this month’s bills.
The church has had several long-term pastors in a row and recently called a new one, said Mike Gilliland, chair of the deacons.
The deacons looked at their budget and decided on what percentage they wanted to designate for their pastor. They also talked to their local Baptist association about guidelines on details like pension, insurance, and a housing allowance.
Then they negotiated with their new pastor, figuring out what he needed to make a move to the new church. And they had a frank discussion over what they could afford to pay the pastor for the long haul.
Both the pastor and the deacons wanted to be sure that the compensation level was sustainable, said Gilliland.
When a new pastor is hired, he or she often expects a fairly complicated compensation package. Along with salary, many get a designated housing allowance, along with allowances for a vehicle, books, and continuing education.
Often a church may set an overall amount for compensation and then defer to the pastor when deciding how to split up the compensation. But Sommerville suggested that churches should take an active role in the process.
For example, a pastor can set the level of the housing allowance—although the allowance cannot be over fair market value. But the church also needs to approve and document the reasons for the amount, she said.
At the Seven Mile family of churches, the pastors fill out a form designating their housing allowances. A compensation committee then approves them.
Another part of compensation may be providing health insurance for a pastor, which can be complicated as well. Some churches have access to a denominational health insurance plan. Others don’t. Some are large enough to buy a group policy for their pastors and staff. Others aren’t and have to provide individual plans to cover employees.
At Salem Covenant, the church didn’t provide a health insurance plan for their former pastor. Instead, he got insurance through his wife’s job. Instead of paying for a policy, Salem Covenant reimbursed Holden for out of pocket medical expenses, Goth said.
Some churches go one step further and simply give the pastor the money that they would have spent on a health insurance policy. But Sommerville cautioned that there are risks to doing that. If a pastor gets the cash equivalent to the cost of his or her health insurance, instead of receiving group insurance, this can jeopardize the tax-free status of the provision of group health insurance offered to other staff members. Both the pastor and the rest of the staff then could be required to pay taxes on their health benefits, Sommerville said.
“It ruins the tax benefits for the rest of the staff,” she said.
Overall, church leaders must retain control over the compensation for pastors. Failing to do so puts them at risk, said Sommerville.
“Compensation is highly regulated, complicated, and the number one area where a church could pay a monetary penalty,” Sommerville said. She suggested that churches consult experts when working on compensation, so they know their responsibilities and risks.

Don’t overlook these details
Other: issues to be aware of when looking at compensation:

• Ministers are not eligible to pay into the social security system through FICA. A pastor must pay into the social security system through self-employment taxes with an option to opt-out under certain circumstances, said Sommerville. But they can’t have the church withhold and match through the FICA program, if they perform ministerial duties. “It is not a call made by the church,” Sommerville said.

• Expenses need approval. A church can reimburse a pastor for expenses, such as mileage, books, or continuing education. If a pastor submits receipts for expenses, which are then approved by the church, those reimbursements can be tax-free. If the church provides an allowance for expenses like a car or books—without having to turn in receipts—that allowance is taxable.

• Keeping clear records is crucial. Church leaders should keep minutes for their meeting when setting compensation for both pastors and nonclergy. They should also have detailed records for the amounts
of any housing allowances and reimbursable expenses.

- **Don’t be afraid to ask for help.** Denominations often offer advice and information for churches on how to set compensation—including guidelines for benefits as well as survey data on pastoral compensation. Other national organizations and publications also provide survey data and guidelines. And a local tax attorney or financial professional with nonprofit expertise can provide guidance.

- **Be careful when calculating pensions.** Some churches or denominations include a pastor’s housing allowance when calculating pension contributions. That’s tricky, Sommerville said. The IRS says that only taxable compensation should be considered as part of pension calculations. And churches should be careful not to exceed the IRS’s limits when deciding how much to pay into a pastor’s pension plan. For example, “If a pastor has designated 100 percent of their salary as housing allowance, they’ve removed their wage base for retirement contributions,” Sommerville said.

- **Understand possible liability for excessive compensation.** Board and finance committee members must understand that they could be held liable for giving excessive compensation to a pastor. In fact, they could face a tax penalty of “225 percent of the amount of compensation the IRS determines to be in excess of reasonable compensation,” said attorney Richard R. Hammar in the January/February 2017 *Church Law & Tax Report.*

**Find an advocate for the pastor**

ECFA’s Busby suggested that every pastor needs an advocate when it comes to setting compensation. A pastor’s intimate relationship with the congregation can create a conflict when it comes to compensation, including any negotiation the pastor desires to ensure the overall package is fair, he said. It’s hard for pastors to advocate on their own behalf during the process, knowing they have to maintain a long-term, close relationship with church members. And every dollar that goes to their salary is a dollar that can’t be spent on other ministry.

The best advocate would be someone on the church board who has the pastor’s trust and who has the respect of fellow board members, said Busby.

“Every pastor needs a champion, someone who understands their situation and who can advocate for them,” Busby said. “That way, when the doors are closed and the pastor is out of the meeting while their salary is being discussed, someone can plead their case.”

**Q: How should items donated for a silent auction be treated for tax purposes?**

**A:** Items donated to a silent auction are treated the same as other noncash contributions to the church. Under current federal tax law, donors are responsible for determining the value of their noncash gifts and the proper amounts to deduct as a charitable contribution. Unfortunately, no charitable contribution deduction is allowed for donated services or for a gift of the right to use property (such as the use of a vacation cottage).

Donors who contribute noncash items valued at more than $500 must generally file a Form 8283 with their tax return. Depending upon the type of item contributed and the amount claimed as a deduction by the donor, the donor may be required to obtain a church official’s signature on the Form 8283 confirming receipt of the donation. If, within three years of the date of the contribution, the church sells, exchanges, or otherwise disposes of a donated item for which it signed a Form 8283, the church is required to file a Form 8282 with the IRS within 125 days. A copy of the Form 8282 filed should be provided to the donor.

Special rules apply to contributions of vehicles (cars, boats, or airplanes). See IRS Publication 4303 for more information on vehicle donations.

The contribution acknowledgment issued by the church to the donor should include the date of the gift, a description of the property donated, and a statement that the donor received no goods or services in exchange for the gift (if true). If the donor received goods or services in exchange for the gift, the acknowledgment should indicate the value of items received by the donor and a statement noting that federal tax law permits the donor to deduct a charitable contribution only the excess (if any) of the amount of the gift over the value of items received in exchange. The church is not required to, and should not attempt to, provide the value of a noncash gift on the donor’s acknowledgment. The church may acknowledge gifts of services or the use of property, but should indicate on the acknowledgment that such gifts are generally not tax-deductible, and the donor should consult his or her tax advisor regarding the tax implications of such a gift.

Chapter 8 of the 2018 *Church & Clergy Tax Guide* (ChurchLawAndTaxStore.com) provides further information regarding charitable contributions.

—Kaylyn A. Varnum, CPA with Batts Morrison Wales & Lee, P.A.
Notes & Numbers

4 Positive Ways to Approach Major Gift Campaigns

1. Givers tend to make major gifts by drawing from different sources of funds. Major gifts, including legacy gifts, typically are made from accumulated assets. By encouraging people to tap their accumulated assets, you not only open a new source of giving for the church, but you help people understand that they are called to be stewards of all they have, not just what they earn.

2. It's an opportunity to talk individually with people about their giving. A periodic major gift campaign provides the opportunity to have personal one-on-one conversations about giving and the importance of the church's mission. And any fundraiser will tell you that asking people to give in the context of a personal conversation is the most effective form of fundraising.

3. Some people are highly motivated to give toward capital needs. There are some donors who are particularly motivated to give to "brick and mortar" needs because those needs are tangible, easily communicated, and often of lasting value. One benefit of a capital campaign is that it connects with those givers who have a deeply felt concern for facilities.

4. A major gift campaign expands people's capacity for giving. Church members who stretch themselves to support a major giving campaign often discover they can give more—and continue to do so. Making a major investment in their church generates a sense of ownership and enthusiasm. So, it's not unusual for annual giving to increase, not decrease, following a capital campaign.

—Ann A. Michel on ChurchLeadership.com, adapted

What Counts as a Charitable Contribution?
Charitable contributions are limited to gifts of cash or property, but almost any kind of property will qualify—including cash, charges to a bank card, real estate, promissory notes, stocks and bonds, automobiles, art objects, books, buildings, materials, collections, jewelry, easements, insurance policies, and inventory.
However, no deduction is allowed for contributions of services. Church members who donate labor to their church may not deduct the value of their labor. While personal services are never deductible as a charitable contribution, expenses incurred in performing services on behalf of a church may be.
Church Law & Tax created a bulletin insert to help answer your congregants' common year-end questions about contributions and tax law. You can purchase the 2018 Charitable Contributions Bulletin Inserts (for the 2017 returns) at ChurchLawAndTax.com.
—Richard R. Hammar

Free Richard Hammar Webinar! As the end of the year approaches, you undoubtedly have many questions about charitable contributions, taxes, and key financial duties. As a Church Finance Today subscriber, you can find answers in a live, free webinar with attorney Richard Hammar at 11 a.m. (Central) on Wednesday, November 8, 2017. Sign up at ChurchLawAndTax.com/Webinar.

Key Tax Deadline

December 15, 2017

A clergy and other church staff should complete all year-end transactions to be sure such transactions are reportable on their income tax returns.

A church must make quarterly estimated tax payments if it expects an unrelated business income tax liability for the year to be $500 or more. Use IRS Form 990-W to figure your estimated taxes. Quarterly estimated tax payments of one-fourth of the total tax liability are due by April 15, June 15, September 15, and December 15, 2017, for churches on a calendar-year basis. Deposit quarterly tax payments electronically using the EFTPS system.

The free Tax Calendar—available on ChurchLawAndTax.com/tc—provides reminders about regular, semimonthly, and monthly withholding requirements, plus other upcoming dates and deadlines related to church taxes.

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