

Housing Allowance Q & A

How have recent court decisions affected the minister's housing allowance exclusion?

On Friday, November 22, 2013, a judge in the Western Federal District Court of Wisconsin ruled the housing allowance unconstitutional. However, the judge in the case stayed the decision (meaning it will not go into effect) pending appeals. Had the decision not been stayed, it would have only applied to ministers in certain areas under the court's jurisdiction and not apply nationwide. We do expect that this case could possibly wind its way to the U.S. Supreme Court in the coming months or years. GuideStone, along with many others in the church community, will continue to monitor this case and plan to file a brief with the court to seek to preserve and protect the minister's housing allowance.

What is the minister's housing allowance?

The minister's housing allowance is the most important tax benefit available to ministers. Section 107 of the Internal Revenue Code allows "ministers of the gospel" to exclude some or all of their ministerial income designated by their church or church-related employer as a housing allowance from income for federal income tax purposes. Rules and limits are discussed below.

Is a housing allowance counted as income for self-employment (SECA) taxes?

Yes. A housing allowance may be excluded from income for federal income tax purposes, but not for SECA tax purposes.

Example: Reverend Smith's designated housing allowance is 40% (\$16,000) of his \$40,000 salary. Assuming he can exclude the full amount designated by the church, he will not report the \$16,000 as income for federal income tax purposes. But he will have to count the \$16,000 as income for purposes of SECA taxes. Yes. A housing allowance may be excluded from income for federal income tax purposes, but not for SECA tax purposes.

What are ministers' responsibilities about the housing allowance?

As taxpayers, ministers must determine if they are eligible for a housing allowance, understand the limits and follow all the rules. They must keep records to substantiate the cost of everything they exclude from income as housing expenses. If a church designates more than a minister can claim as a housing allowance, the minister is responsible for reporting and paying taxes on the correct amount of income. Any excess housing allowance should be reported as income on the minister's tax return. Ministers must also pay SECA taxes on the fair rental value of their homes.

Can ministers deduct mortgage interest on their homes if they have a housing allowance?

Yes. Ministers who itemize deductions and have a housing allowance may deduct mortgage interest and real estate taxes. Sometimes this is mistakenly called a “double deduction.” But a housing allowance is an exclusion from income, and mortgage interest is a deduction.

Who is eligible for the minister’s housing allowance?

Only “ministers for tax purposes” are eligible for a housing allowance on their ministerial earnings. Church custodians, secretaries and “ministerial staff” who are not ministers for tax purposes are not eligible for a housing allowance. A church may call someone a “minister,” but the IRS may not treat that person as a minister for tax purposes — that depends on individual facts and circumstances. The IRS will consider most ordained ministers to be ministers for tax purposes and therefore eligible for a housing allowance on their ministerial income. Licensed and commissioned ministers are less likely to be treated as ministers for tax purposes by the IRS, but it depends on their individual facts and circumstances.

Are bivocational ministers eligible for a housing allowance?

Churches may designate a housing allowance for bivocational ministers who are ministers for tax purposes. A minister’s housing allowance can be designated for ministerial income only. Secular employers cannot designate a housing allowance for ministers who are paid for working in non-ministerial jobs.

How much can ministers who own their own homes exclude as a housing allowance from income for federal income tax purposes?

Ministers who own their homes can exclude the lowest of the following three amounts from income for federal income tax purposes when their church employer properly designates a housing allowance for them:

1. The housing allowance designated by their church; or
2. Actual housing expenses (including mortgage payments, utilities, property taxes, insurance, furnishings, repairs and improvements); or
3. The fair rental value of the home (furnished, including utilities).

Example: Reverend Smith owns his own home, and his church designated 40% (\$16,000) of his \$40,000 salary as an annual housing allowance in advance. His actual housing expenses for the year were \$15,000. The fair rental value of his home (furnished, including utilities) was \$17,000. Reverend Smith can exclude \$15,000 from income because his actual housing expenses were lower than both the amount designated by the church and the fair rental value of his home.

Are ministers who pay off their mortgages eligible for a housing allowance?

Ministers who pay off their mortgages may have a housing allowance for other eligible expenses of maintaining a home such as utilities, taxes and repairs. With no mortgage payment, their expenses are likely to be much lower. Some ministers mistakenly think that they can exclude the “fair rental value” of their home if they have paid it off. That is not true. The limits discussed above apply to ministers who own their own homes, even if they have paid off their mortgage.

How much can ministers who rent their homes exclude from income for federal income tax purposes?

Ministers who rent their homes can exclude the lower of these two amounts:

1. The amount designated by their church; or
2. Actual housing expenses (including rent, renter’s insurance, utilities, furnishings, repairs and improvements).

Can ministers who live rent-free in a parsonage owned by a church have a housing allowance?

Churches can designate a housing allowance for a minister who lives in a parsonage if the minister pays for utilities, repairs, furnishings or other eligible expenses. Ministers who live rent-free in a church-owned parsonage should not include the fair rental value of the parsonage in income for federal income taxes. But they should include the fair rental value of the parsonage in income for SECA taxes. Ministers who live rent-free in a church-owned parsonage may exclude the lower of these two amounts:

1. The housing allowance designated by their church; or
2. Actual housing expenses not paid by the church (including utilities, furnishings, repairs and improvements).

What housing expenses are eligible to be excluded from income?

Eligible expenses include mortgage payments (principal and interest); rent payments; real estate taxes; property insurance; utilities (gas, electricity, water, sewer, garbage pickup, local telephone service); appliances and furniture (purchase or rental cost and repairs); remodeling expenses; homeowners’ dues; and pest control.

What housing expenses are not eligible to be excluded from income?

Cleaning services, food and domestic help are not eligible to be excluded as income as part of a housing allowance. A housing allowance is available only for a principal residence, not for a second home, vacation home, business property or a farm. Home equity loan payments can be excluded as part of a housing allowance only if the loan is

used to pay for housing expenses such as remodeling. Home equity loan payments used for college tuition or anything other than eligible housing expenses cannot be excluded from income as a housing allowance.

Are down payments on homes eligible housing expenses?

A down payment on a home may be excluded from income as a housing allowance, assuming it does not cause the regular limits to be exceeded.

Example: Reverend Black made a \$50,000 down payment on a home in 2005. His church designated \$55,000 of his \$60,000 salary as a housing allowance. Reverend Black had other housing expenses of \$10,000, but the fair rental value of the home (furnished, including utilities) was \$25,000. He can only exclude \$25,000 because the fair rental value was less than the church-designated amount or his actual expenses, including the down payment. If he had made a down payment of \$12,000, his total housing expenses would have been \$22,000. He could have excluded \$22,000 because that amount is lower than the church-designated amount and the fair rental value.

How should a church designate a housing allowance?

Churches should designate a housing allowance in writing before the beginning of a calendar year. Although the IRS has recognized oral designations, they are difficult to prove. The “governing board” of the church should designate the allowance. In many churches, this is the congregation in a regular or called meeting. But in some churches the deacons, a finance committee or trustees may have the authority to make the designation. A line item in a church budget can be used to designate housing, but a resolution is much better.

When can churches designate a housing allowance?

Churches can designate a housing allowance only prospectively, not retroactively. In other words, the church must designate the housing allowance before the minister earns the income on which the church designates the housing allowance.

What happens if a church forgets to designate a housing allowance?

A minister cannot exclude income as a housing allowance unless the church designated it before the minister earned income for ministerial services. In other words, it has to be designated in advance (prospectively), not retroactively. However, a church may change a housing allowance during the year as long as the change is prospective.

Example: Reverend Smith’s church forgot to designate a housing allowance for him in 2005, and doesn’t discover the problem until 2006. It is too late for the church to designate an allowance for the 2005 tax year, and Rev. Smith cannot exclude any expenses he spent on housing from income on his 2005 tax return.

Example: Reverend Smith's church discovers in October of 2005 that it forgot to designate a 2005 housing allowance for him. The church can designate a housing allowance for him for the rest of the year. But the church can't designate more than he'll earn for ministerial services the rest of the year. Designations have to be made before ministers earn compensation (prospectively), not retroactively.

What can a church do to ensure that a minister always has some amount designated as a housing allowance?

Churches should consider designating a housing allowance by adopting a statement "for the current year and for all future years unless otherwise provided." This "safety net" allows a designation to carry over from year to year, preventing problems if a church forgets to designate an allowance one year. However, safety net allowances should not be viewed as a substitute for designating a housing allowance each year.

Is there a limit on the amount of a minister's salary that a church can designate as a housing allowance?

There is no limit on the amount of a minister's salary that a church can designate as a housing allowance. In appropriate situations, a church could designate 100% of a minister's salary as housing allowance. But remember that the amount the minister can exclude from income taxes is limited by the rules discussed above.

What if the church designates more than the minister can claim as a housing allowance?

If the church designates more than the minister can claim as a housing allowance, the minister is responsible for reporting and paying federal income taxes on the correct amount of income.

Should a church report a housing allowance on a minister's Form W-2?

The housing allowance does not need to be reported on a Form W-2, although some churches choose to report it. For more information, see our annual *Ministers Tax Guide* or call **1-888-98-GUIDE** (1-888-984-8433) for a free copy.

Can retired ministers receive some or all of their retirement benefits from GuideStone as a housing allowance?

Yes. Revenue Ruling 63-156 allows denominational pension boards such as GuideStone to designate a housing allowance for retired minister receiving benefits. Retired ministers may ask GuideStone to designate up to 100% of their retirement benefits as housing. But retired ministers must continue to follow the housing allowance rules and limits discussed above.

How will GuideStone know how much to designate as housing?

Ministers will ask GuideStone to designate an amount on their benefit applications. They can also ask GuideStone to change that amount prospectively by filling out a form. Ministers are always responsible as taxpayers for following the housing allowance rules and reporting the correct amount of income, regardless of what they ask GuideStone to designate.

Do retired ministers have to pay SECA taxes on their retirement benefits?

Retired ministers may be eligible to receive favorable SECA tax treatment on their benefits designated as housing allowance by GuideStone. In other words, “retired” ministers may not have to pay SECA taxes on their benefits designated as housing allowance. What constitutes “retirement” for purposes of these rules about SECA tax and the housing allowance depends on an individual’s particular facts and circumstances. Ministers with questions about whether they are “retired” for this purpose should consult their tax advisors. Ultimately, the minister must make this decision. Many facts and circumstances may be relevant in determining whether retirement has occurred. For example, if a minister is receiving retirement benefits from a plan and is making contributions to the same plan, the IRS may not consider that minister retired for purposes of the housing allowance and the favorable SECA tax treatment.

Similarly, the IRS may view ministers as not retired if they have not had a meaningful break in service or change in work duties. Ministers and their tax advisors should work together to address the relevant facts and circumstances of each individual case.

Can surviving spouses of retired ministers receive some or all of their benefits from GuideStone as a housing allowance?

Ministers are eligible for housing allowance with respect to ministerial services they provide. The Internal Revenue Code does not contemplate that one person can receive housing allowance based upon another person’s service. It would appear unlikely that a surviving spouse could receive housing allowance that is attributable to ministerial service of the other person. But a surviving spouse who is a minister for tax purposes may be eligible to receive housing allowance with respect to their own ministerial service. Surviving spouses should seek legal or tax advice before asking GuideStone to designate a housing allowance on their