



MM POSITION PAPER: MINISTERIAL HOUSING ALLOWANCE

Miller Management position papers are a compilation of our staff's research, education, training classes and seminars attended, over 30 years field experience, and interpretation of current laws as we understand them. The information contained in this paper is not legal advice and is intended to be used as general information to help formulate your organization's guidelines. It is understood that your organization is legally responsible for all policies and procedures, and their legal basis.

It should be noted that the constitutionality of IRC Section 107(2) was recently under review by the U.S Court of Appeals for the Seventh Circuit. A decision was made March 15, 2019 that the ministerial housing allowance is constitutional.

What is a housing allowance?

A housing allowance is an annual amount of compensation that is set aside by the church to cover the cost of housing related expenses for its ministers. The amount spent on housing reduces a qualifying minister's federal and state income tax burden. Section 107 of the Internal Revenue Code (IRC) states that:

“In the case of a minister of the gospel, gross income does not include—(1) the rental value of a home furnished to him as part of his compensation; or (2) the rental allowance paid to him as a part of his compensation, to the extent used by him to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities.”

Who qualifies?

To be classified as a minister for federal tax purposes and thus be able to claim a housing allowance, there is one primary requirement along with a set of secondary requirements:

Primary Requirement: a person must be ordained, commissioned, or licensed as a minister by a church, body of churches, or a religious order.

Secondary Requirements: an ordained, commissioned, or licensed minister must meet most of the following:

- + Administer sacraments/ordinances of the church (provide communion, water baptism, and/or solemnize marriages).
- + Conduct religious worship: music, preaching, teaching, or prayer.

- + Have management responsibility in a local church or religious denomination.
- + Be considered a religious leader by his or her church or denomination.

The IRS applies the secondary requirements as a “balancing test” to determine if the job duties of the individual are ministerial in nature. Although some case law indicates that the IRS may allow a minister to meet only one or two of the secondary requirements, other case law suggest that at least three points are needed to qualify a person to receive the tax benefits of a housing allowance. Based on our interpretation of the law, we feel it is difficult to meet “most” of the secondary requirements without including at least three of them. Therefore, we recommend a minister meets at least three of the secondary requirements in addition to the primary requirement to safely satisfy the requirements.

Bi-vocational ministers can have a housing allowance as well, but only from their ministerial income. Secular employers cannot give an employee that also works as a minister a tax-free housing allowance generally.

Retired ministers are also eligible to receive a housing allowance. Additionally, retired ministers can request that distributions from their 403(b) Retirement Savings Plan be treated up to 100 percent as housing allowance. The IRS has generally not differentiated between a taxpayer’s church-employed status and church-retired status for housing allowance purposes. The same housing allowance rules apply to both current and retired ministers unless noted otherwise.

How does it work?

Each year, the minister estimates the amount of eligible housing expenses to be incurred during the following year. This amount is submitted to the governing body of the church for approval in the year prior to the year claimed. When paid to the minister the following year, that housing amount is excluded from the taxable federal and state compensation that is reported in box 1 and 16 of the W2. The housing amount is instead reported in box 14 for informational purposes. The housing allowance is included in the computation of Social Security/Medicare taxes (SECA) at the self-employment tax rate unless the minister is retired.

How to establish the correct amount?

The IRS and related regulations do not state a specific percentage or dollar limitation as to how much of a minister’s compensation can be designated as housing allowance. For ministers that are bi-vocational it may be reasonable to designate 100 percent of their cash compensation as housing allowance. A minister’s cash housing allowance cannot exceed “reasonable compensation.”

IRS Publication 517 provides a definition of how much personage allowance can be excluded for ministers:

“If you own your home and you receive as part of your pay a housing or rental allowance, you may exclude from gross income the smallest of the following:

- + The amount actually used to provide a home
- + The amount officially designated as rental allowance, or

+ The fair rental value of the home, including furnishings, utilities, garage, etc.

You must include in gross income the amount of any rental allowance that is more than the smallest of your reasonable pay, the fair rental value of the home plus utilities, or the amount actually used to provide a home.”

We have formulated the attached worksheet to aid your ministerial staff in the process of estimating an appropriate housing allowance for the year. It should be stressed that this form is intended to assist in the estimation process; it is not a guarantee of what taxes will be owed. Each minister is responsible for tracking actual allowable, documented housing expenses during the year and reporting that amount to their tax preparer. Any amount of paid housing allowance that was not used on actual housing expenses has to be reclassified as taxable for federal and state income taxes on the minister’s tax return. Because of the complexity of ministerial taxes, we strongly recommend that ministers consult with tax preparers who specialize in church and clergy taxes.

Timing?

IRS guidelines stipulate that all housing allowances are approved by an appropriate governing body of the church **in advance** of paying it to the minister. Housing allowances cannot be approved or changed retroactively for housing expenses already incurred. We recommend that all housing allowances are approved no later than December 31, for the upcoming year. Approval should be recorded in the formal minutes of the governing body.

See the next page for a fillable worksheet for Annual Ministerial Housing Allowance.