

DISCIPLESHIP MINISTRIES
The United Methodist Church

What You *Really* Need to Know About

Clergy HOUSING ALLOWANCES

AUGUST 10, 2021 @ 6:30PM CDT

BRYAN MILLS, PRESENTER
GENERAL COUNSEL, GCFA

KEN SLOANE, HOST
DIRECTOR, STEWARDSHIP & GENEROSITY

UMC SUPPORT

1

POLL

Which statement best describes you?

1. Active clergy
2. Retired clergy
3. Laity, Finance Team
4. Laity, Staff-Parish Team
5. Laity, Other

UMC SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

2

THE HOUSING ALLOWANCE*

*(and other things)

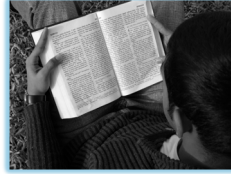
Bryan L. Mills
General Counsel, GCFA
August 2021

UMC SUPPORT

3

Four Special Clergy Tax Issues

- ❖ Self-employed status for Social Security purposes
- ❖ Can elect to “opt-out” of the Social Security system
- ❖ Exemption from income tax withholding
- ❖ Housing allowance



UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

4

Who are “Clergy” for Tax Purposes?

Ministers, with respect to services performed in the exercise of their ministry



UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

5

Who is a “Minister”?

- ❖ **Factors used in determining whether someone is a “minister” under the Tax Code:**
 - Is ordained, commissioned, or licensed (REQUIRED)
 - Administers sacraments
 - Conducts worship services
 - Performs services in the control, conduct, or maintenance of a religious organization
 - Is considered to be a spiritual leader by his/her religious body

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

6

What are “Services Performed in the Exercise of Ministry”?

❖ Such services include:

- Performance of sacraments
- Conduct of religious worship
- Administration and maintenance of religious organizations and their integral agencies
- Teaching and administrative duties at theological seminaries

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

7

Examples

- ❖ Ordained elder pastoring a local church?
- ❖ Ordained deacon serving as a worship director?
- ❖ Licensed local pastor serving at a local church?
- ❖ Certified lay speaker/servant/etc. serving at a local church?
- ❖ Retired elder serving as a paid treasurer of a local church?

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

8

A Quick Tangent

Roughly speaking... There are two types of people:

Employees
Self-Employed

and... There are two types of federal individual taxes:

Income Taxes
Social Security Taxes

and... The amount of these taxes is based on :

Taxable Income (for Income Tax purposes)
Taxable Earnings (for Social Security Tax purposes)



UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

9

Taxable Income vs. Taxable Earnings

- ❖ When computing their taxes, all taxpayers (whether clergy or lay) start out with "gross income" from all sources.
 - Then, depending on the taxpayer's status as an Ee or SE, different deductions are applied to gross income to arrive at the taxpayer's "Taxable Income" and "Taxable Earnings." It is these two amounts on which Income and Social Security taxes will be based.
- ❖ Specifically:

▪ Federal income taxes are based on : • <u>Employee Taxable Income</u> (if employee) • <u>Self Employed Taxable Income</u> (if self-employed)	▪ Social Security taxes are based on : • <u>FICA Taxable Earnings</u> (if an employee) • <u>SECA Taxable Earnings</u> (if self-employed)
---	--

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

10

Income Taxes

- ❖ How paid:
 - Employees have them withheld from their wages
 - Self employed persons make quarterly estimated payments
- ❖ How much:
 - A marginal rate (10%, 15%, 25%, etc.) is applied to everyone's "Taxable Income"

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

11

Taxable Income

- ❖ Taxable Income differs for Employees and Self Employed because different deductions are subtracted from gross income to compute this amount
- ❖ Business Expenses
 - ~~Employees can deduct some business expenses, provided they itemize their deductions and then, only to the extent these expenses exceed 2% of Adjusted Gross Income ("AGI") (Schedule A)~~
 - Self Employed can generally deduct a large portion of their business expenses, regardless of whether they itemize (Schedule C)
- ❖ Also, Self Employed receive an income tax deduction for one-half of their Social Security taxes

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

12

Social Security Taxes – Overview

❖ There are two components to the Social Security Tax:

- Old Age, Survivor, and Disability ("OASDI")
- Medicare Hospital Insurance ("Medicare")

❖ Social Security Taxes are paid through two "systems:"

- Employees are subject to the Federal Insurance Contributions Act ("FICA")
- Self Employed are subject to the Self-Employment Contributions Act ("SECA"). SECA taxes are commonly called "self-employment taxes."

❖ How they are paid:

- Employees have FICA taxes withheld from their wages
- Self Employed make quarterly estimated SECA tax payments

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

13

FICA and SECA Taxable Earnings

❖ FICA and SECA Taxable Earnings differ because different deductions are subtracted from gross income to compute these two amounts

❖ Business Expenses

- Employees cannot deduct business expenses in computing their FICA Taxable Earnings
 - Aside – Contributions to an employer sponsored Sec. 125 "cafeteria plan" are one of the few deductions available to Employees in computing FICA taxable earnings
- Self Employed can generally deduct a large portion of their business expenses in computing their SECA Taxable Earnings

❖ Also, Self Employed have a 7.65% "deduction" applied to their gross income in computing their SECA Taxable Earnings

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

14

Social Security Taxes – How Much?

❖ Employees and their employers each pay:

- OASDI Tax equal to 6.2% of "FICA Taxable Earnings"
 - Note: FICA Taxable Earnings in excess of \$142,800 (for 2021) are not subject to the OASDI portion of the tax

Plus

- Medicare Tax equal to 1.45% of "FICA Taxable Earnings"

❖ Self Employed pay:

- OASDI Tax equal to 12.4% of "SECA Taxable Earnings"
 - Note: SECA Taxable Earnings in excess of \$142,800 (for 2021) are not subject to the OASDI portion of the tax.

Plus

- Medicare Tax equal to 2.9% of "SECA Taxable Earnings"

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

15

So, Are Clergy Employees or Self-Employed?

❖ **Answer:** It depends.

❖ **For Income Tax purposes, United Methodist Church ministers are treated as employees.**

- Who says so? The IRS (and some courts).
 - Weber v. Commissioner, 60 F. 3d 1104 (4th Cir. 1995)
 - By the way, who did the Weber court say was the employer?
- **Small Exception:** income ministers receive from individuals for weddings, funerals, baptisms, etc. is counted as Self Employed income.
- Answer could be different for clergy of other denominations

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

16

Rule #1 – Self-Employed Status for Social Security

❖ **For Social Security Tax purposes, “ministers” are treated as self-employed**

- This is hardwired into the Tax Code

❖ **This means they are not subject to FICA**

- Churches must not withhold the FICA employee share from a minister's paycheck and should not pay the FICA employer share

❖ **Instead, ministers pay SECA taxes**

- Must make quarterly estimated payments, unless doing voluntary withholding

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

17

Rule #2 – Opting Out of Social Security

❖ **Under certain restrictive conditions, ministers can make an irrevocable election to “opt-out” of the Social Security system if they have a religious-based opposition to the acceptance of public insurance benefits**

- Clergy who make this election don't pay Social Security taxes but, in return, they don't receive Social Security benefits (e.g., retirement, survivor, disability, and Medicare benefits)
- Obviously, this is a critically important decision with substantial consequences
- United Methodist clergy do not commonly make this election

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

18

Rule #3 – Exempt from Income Tax Withholding

- ❖ Even though ministers are treated as employees for income tax purposes
- ❖ Clergy can enter into a **voluntary withholding agreement with the local church to withhold income taxes from their salary.**
 - Simply complete a W-4 like other employees
 - The church does not have to agree to do the withholding
 - The agreement can be terminated at any time by either party
 - This can be a good way for clergy to avoid making quarterly estimated payments for income taxes
 - Additional amounts can be withheld to cover SECA obligations

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

19

POLL

Which statement best describes your church?

1. The pastor lives in our church owned parsonage.
2. The pastor lives in a house she/he owns or rents.
3. The church owns a parsonage, but the pastor lives somewhere else, but not a home she/he owns (such as the parsonage of another church).
4. None of the above

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

20

RULE #4

21

The Housing Allowance

- ❖ The "Housing Allowance" is in Section 107 of the Tax Code
- ❖ In short, Sec. 107 allows ministers to exclude from their gross income:
 - The fair rental value of a home provided to them as part of their compensation, and/or
 - A parsonage/housing allowance used to "provide a home"
- ❖ It is an exclusion, not a deduction
 - Amounts excluded under Sec. 107 are not reported anywhere on Form 1040 and do not need to be reported on Form W-2
- ❖ While excluded in calculating taxable income, these amounts are included when determining taxable earnings for social security purposes

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

22

Options

- ❖ In-kind provision of a parsonage
 - Fair rental value (furnished, plus utilities) is excluded from the pastor's taxable income
- ❖ Cash allowance
 - Can come in two forms:
 - Parsonage allowance = cash allowance provided to cover legitimate expenses related to living in the parsonage
 - Housing allowance = cash allowance provided to cover legitimate expenses related to living in the pastor's purchased or rented home
 - Is excludible from the pastor's taxable income, but the amount is limited, and certain requirements must be met

REMEMBER: the above amounts are included when determining social security tax liability

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

23

Requirements for Excluding an Allowance

- ❖ The salary paying unit (e.g., local church) must formally designate an amount for the parsonage/housing allowance in advance
- ❖ The amount excludible from income is the lesser of three things:
 - Amount of the designation
 - Amount of "qualified expenses" actually incurred
 - Fair rental value of the parsonage/home (furnished, plus utilities)

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

24

Qualified Expenses

❖ **Qualified expenses are those that relate to "providing a home"**

❖ **Examples of qualified expenses:**

- rent, mortgage payments, down payments, property taxes
- insurance for the home
- improvements and repairs
- utilities
- furnishings and appliances
- household maintenance items (cleaning supplies, light bulbs)
- yard maintenance

❖ **Examples of non-qualified expenses:**

groceries, clothes, music, toiletries, servants

NOTE: The test is not whether these expenses are business related or personal. The test is whether they are necessary to "rent or provide a home."
(Local/long distance phone service? Cell phone service? Cable or satellite TV? Internet service? Netflix subscription?)

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

25

What if it All Cannot be Excluded?

❖ **What happens, if using the "lesser of" rules discussed above, a minister is unable to exclude the entire amount of a designated housing allowance?**

❖ **Answer:** The excess must be included as income on Form 1040, Line 1

❖ **Moral:** Churches and their clergy should work together to estimate an appropriate amount for the designated housing allowance

- Set too low = not maximizing the exclusion
- Set too high = additional income to report

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

26

Don't Forget!

❖ **Designations must be made in advance**

❖ **A best practice is for the church to set the housing allowance for the upcoming year before January 1**

❖ **Mid-year designations can happen, but they only apply prospectively**

Example: On December 31, the church sets the pastor's annual housing allowance for the upcoming year at \$12,000. Then, on June 30 of that year, the church increases the annual amount to \$24,000. The maximum the pastor can exclude from taxable income is \$18,000 (\$6,000 for the first six months + \$12,000 for the last six months).

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

27

Also Don't Forget!

❖ ...about the fair rental value limitation

Example: Pastor annually incurs around \$15,000 in qualified expenses associated with owning her home, which is less than its \$17,500 annual fair rental value. For 2021, Pastor's church set her housing allowance at \$15,000, all of which she will be able to exclude from income. Late in 2021, Pastor's adult son, and his spouse and two young children, moves in on what she expects (fears?) will be an indefinite basis. Pastor quickly realizes more space will be needed in order to keep her family from tearing itself apart, so she arranges for an addition to built. Work will begin in early 2022 and will cost \$30,000. She plans to fully pay for the addition before the year ends, so she asks her church to set her designation to \$45,000 for 2022.

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

28

Housing Allowance and Pensions

❖ **Contributions:** Amounts excluded from income as a housing allowance can impact the maximum amount that can be contributed to clergy pension accounts. (Contact the General Board of Pension and Health Benefits for more details.)

❖ **Distributions:** Pension payments are also eligible for the housing allowance exclusion. (The same "least of 3 amounts" rule also applies in this case.)



UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

29

Is it Constitutional?

❖ The Freedom From Religion Foundation has filed several suits challenging the constitutionality of Section 107

- Most recent case filed in 2016 in Wisconsin
- District Court declared Section 107(2) unconstitutional
- 7th Circuit overturned the decision – the first time an appellate court had ruled on the merits
- FFRF announced on June 14, 2019, that it would not appeal the 7th Circuit's ruling

UMC
SUPPORT

DISCIPLESHIP MINISTRIES
The United Methodist Church

30

Resources

- ❖ Church and Clergy Tax Guide from Richard Hammar
- ❖ Zondervan's Minister's Tax and Financial Guide from Dan Busby
- ❖ IRS Publication 517 (Social Security and Other Information for Members of the Clergy and Religious Workers)



31

Questions?
Thank You!



32



Providing solutions, sustaining ministries



QUESTIONS?

Contact the Legal Services Department:

1 Music Circle North
Nashville, TN 37203

615.329.3393

legal@gcfa.org

www.umcsupport.org

33

STAY CONNECTED!
ksloane@umcdiscipleship.org

"UMC Stewardship"
On Facebook

UMCdiscipleship.org/stewardship

You Are Invited:
**STEWARDSHIP
DISCUSSION FORUMS**
2ND THURSDAY EACH MONTH AT 10:00AM CT

**UMC
SUPPORT**

DISCIPLESHIP MINISTRIES
The United Methodist Church

34

CREATING A
Narrative Budget
THE STORY BEHIND THE NUMBERS

Tuesday, Sep. 21, 2021, 6:30pm CDT
"Cultivating the Craft of Asking" (w/ Bonnie Marden, Myte Ministries)

Tuesday, November 16, 2021, 6:30pm CST
"Inviting Generosity Beyond the Sunday Offering"

UMCdiscipleship.org/stewardship

EQUIPPING WORLD-CHANGING DISCIPLES UMCdiscipleship.org

©2021 Discipleship Ministries
The United Methodist Church

DISCIPLESHIP MINISTRIES
The United Methodist Church

35

**PLEASE
COMPLETE
THE SURVEY!**

**UMC
SUPPORT**

DISCIPLESHIP MINISTRIES
The United Methodist Church

36
