

ChurchLaw&Tax

LEAD YOUR MINISTRY WITH CONFIDENCE

The following article is located at: <https://www.churchlawandtax.com/web/2020/february/housing-allowances.html>

Housing Allowances

Exclusive Online, February, 2020

Understand how to properly set this significant pastoral benefit.

Richard R. Hammar [posted 3/03/2020]



The housing allowance is the most important tax benefit available to ministers. But many ministers do not take full advantage of it because they (or their tax adviser or church board) are not familiar with the rules.

The three most commonly use housing arrangements for ministers are (1) owning a home, (2) renting a home or apartment, and (3) living in a church-provided parsonage. The tax code provides a significant benefit to each housing arrangement. The rules are summarized below.

Housing allowance: minister owns the home

Ministers who own their home do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a housing allowance, to the extent that the allowance represents compensation for ministerial services, is used to pay housing expenses, and does not exceed the fair rental value of the home (furnished, plus utilities). Housing-related expenses include mortgage payments, utilities, repairs, furnishings, insurance, property taxes, additions, and maintenance.

Housing allowance: minister rents the home

Ministers who rent a home or apartment do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a housing allowance, to the extent that the allowance represents compensation for ministerial services and is used to pay rental expenses and does not exceed the fair rental value of the home (furnished, plus utilities).

Parsonages

Ministers who live in a church-owned parsonage that is provided rent-free as compensation for ministerial services do not include the annual fair rental value of the parsonage as income in computing their federal income taxes. The annual fair rental value is not deducted from the minister's income. Rather, it is not reported as additional income anywhere on Form 1040 (as it generally would be by most non-clergy workers).

In addition, ministers who live in a church-provided parsonage do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a parsonage allowance, to the extent that the allowance represents compensation for ministerial services and is used to pay parsonage-related expenses such as utilities, repairs, and furnishings.

How to set parsonage and housing allowances

Parsonage and housing allowances should be (1) adopted by the church board or congregation, (2) in writing, and (3) in advance of the calendar year. However, churches that fail to designate an allowance in advance of a calendar year should do so as soon as possible in the new year (though the allowance will only operate prospectively). In designating housing allowances, churches should keep in mind that the nontaxable portion of a housing allowance cannot exceed the fair rental value of a minister's home (furnished, plus utilities). Therefore, nothing will be accomplished by designating allowances significantly above this limit.

Using “safety nets”

Many churches do not limit housing allowances to a particular calendar year. For example, if a church intends to designate \$12,000 of its senior pastor's salary in 2021 as a housing allowance, its designation could state that the allowance is effective for calendar year 2021 *and all future years unless otherwise provided*. This clause may provide a “safety net,” protecting the pastor in the event that the board neglects to designate an allowance prior to the beginning of a future year.

A church also would be wise to have a “safety net” designation to cover midyear changes in personnel, delayed designations, and other unexpected contingencies. To illustrate,

such a designation could simply state that a specified percentage (e.g., 40 percent) of the compensation of all ministers on staff, regardless of when hired, is designated as a housing allowance for the current year and all future years unless otherwise specifically provided.

Such safety net designations should not be used as a substitute for annual housing allowance designations for each minister. They are simply a means of protecting ministers against inadvertent failures by the church board to designate a timely housing allowance.

Key details

Here is a recap of some important details, along with some helpful additional information ministers should know about the housing allowance:

- A housing allowance must be designated in advance. Retroactive designations of housing allowances are not effective.
- The housing allowance designated by the church is not necessarily nontaxable. It is nontaxable (for income taxes) only to the extent that it is used to pay for housing expenses, and, for ministers who own or rent their home, does not exceed the fair rental value of their home (furnished, plus utilities).
- A housing allowance can be amended during the year if a minister's housing expenses are more than expected. However, an amendment is only effective prospectively. Ministers should notify their church if their actual housing expenses are significantly more than the housing allowance designated by their church. But note that it serves no purpose to designate a housing allowance greater than the fair rental value of a minister's home (furnished, plus utilities).
- If the housing allowance designated by the church exceeds housing expenses or the fair rental value of a minister's home, the excess housing allowance should be reported on line 1 of Form 1040.
- The housing allowance exclusion is an exclusion for federal income taxes only. Ministers must add the housing allowance as income in reporting self-employment taxes on Schedule SE (unless they are exempt from self-employment taxes).
- The fair rental value of a church-owned home provided to a minister as compensation for ministerial services is not subject to federal income tax.

- Ministers should be sure that the designation of a housing or parsonage allowance for the next year is on the agenda of the church board for one of its final meetings during the current year. The designation should be an official action, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items—assuming in each case that the designation was duly adopted in advance by the church.
- Many churches base the housing allowance on their minister's estimate of actual housing expenses for the new year. The church provides the minister with a form on which anticipated housing expenses for the new year are reported. For ministers who own their homes, the form asks for projected expenses in the following categories: down payment; mortgage payments; property taxes; property insurance; utilities, furnishings, and appliances; repairs and improvements; maintenance; and miscellaneous. Many churches designate an allowance in excess of the anticipated expenses itemized by the minister. Basing the allowance solely on a minister's anticipated expenses penalizes the minister if actual housing expenses turn out to be higher than expected. In other words, the allowance should take into account unexpected housing costs or underestimated projections of expenses.
- Ministers who own their homes lose the largest component of their housing allowance exclusion when they pay off their home mortgage. Many ministers in this position have obtained home equity loans—or a conventional loan secured by a mortgage on their otherwise debt-free home—and have claimed their payments under these kinds of loans as a housing expense in computing their housing allowance exclusion. The Tax Court has ruled that this is permissible only if the loan was obtained for housing-related expenses.

Editor's note. In 2019 a federal appeals [court upheld](#) the ministers' housing allowance. [Additional attacks may occur](#), so church leaders should monitor developments on [ChurchLawAndTax.com](#).

Additional reading

For more on housing allowances, see the following:

- [Church & Clergy Tax Guide](#) (chapter 6)

- [*Church Compensation: From Strategic Plan to Compliance*](#) (chapter 11)
- [“Designating a Housing Allowance for 2020”](#)
- [“Sample Housing Allowance for Pastors”](#)
- [“Q&A: Can a Pastor Set Up a Housing Allowance on Two Payrolls?”](#)
- [“Q&A: What happens if a minister requests a housing allowance that exceeds his total salary?”](#)
- [“Q&A: Can an interim minister receive a housing allowance?”](#)
- [“Q&A: Is My Housing Allowance Considered “Earned” Income?”](#)
- [“What Retired Ministers Should Know About Housing Allowances”](#)
- [“Q&A: Can an Insurance Carrier Exclude a Disabled Pastor’s Housing Allowance from Benefit Calculations?”](#)

Go to the next article, [“Exemption from Self-Employment Taxes”](#) or return to [“15 Things Richard Hammar Wants Pastors to Know”](#) to choose an article of interest or that fits a particular need.

This content is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought. "From a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers and Associations."

Due to the nature of the U.S. legal system, laws and regulations constantly change. The editors encourage readers to carefully search the site for all content related to the topic of interest and consult qualified local counsel to verify the status of specific statutes, laws, regulations, and precedential court holdings.

CHRISTIANITY  TODAY