

## Guidance for Called Workers who qualify as a Minister of the Gospel

It is our understanding that all pastors, and both male and female staff ministers, professors, and teachers of the WELS, who are *called and have received synod ministry certification* can be considered “Ministers of the Gospel” because of duties they perform in the exercise of ministry, according to guidance received from various sources by WELS.

### What changes with Minister of the Gospel status –

Dual tax status - Ministers of the Gospel have a dual tax status according to the Internal Revenue Code. They are considered self-employed for social security purposes and employees for other tax and fringe benefit purposes. A minister of the gospel, unless exempt, pays social security and Medicare taxes under the Self-Employment Contributions Act (SECA) of 15.3% and is not subject to FICA taxes or federal or state income tax withholding. A minister of the gospel needs to make estimated income tax payments quarterly or work with their calling body to voluntarily have federal and state income taxes withheld and remitted by the calling body. SECA should not be voluntarily withheld; however, a voluntary increase in federal taxes withheld is acceptable and may be used to cover estimated self-employment tax liability

Eligibility for Housing Allowance - Under IRC Section 107, Ministers of the Gospel may have a portion of their compensation that is earned in the exercise of ministry designated as a parsonage allowance, also referred to as a housing allowance. Only workers who are correctly classified as “Ministers of the Gospel” are eligible for the parsonage allowance benefit. If both spouses are entitled to a parsonage allowance, the combined parsonage allowances declared must not be more than the fair rental value or qualified housing expenses, whichever is lowest. Any excess amount declared must be added back to taxable income. Parsonage allowances cannot be declared retroactively.

Exemption from Self Employment taxes on 403b contributions – A minister of the gospel’s pre-tax contributions to a qualified 403b plan, like the WELS Shepherd Plan, are not subject to self-employment taxes. Contributions to a Roth are made with post-tax dollars and would not be exempt from self-employment taxes.

Helpful Resources include - IRS Publication 517 – “Social Security and Other information for members of the Clergy and Religious workers” (<https://www.irs.gov/pub/irs-pdf/p517.pdf>), portions of the WELS Tax Manual (found on the WELS cloud site) or the Guidestone Ministers Tax Guide (<https://www.guidestone.org/taxguide>).

### Steps to take as a Minister of the Gospel –

Communicate with your calling body to understand –

1. Effective date of Minister of the Gospel status accommodated by calling body – While the Synod has recommended an effective date of July 1, 2020, for recognizing the change to a female called worker’s status, some calling bodies may not be able to accommodate that date due to various circumstances. However, the change in tax status for female called workers must be recognized no later than January 1, 2021. If you elect to declare a parsonage allowance as a Minister of the Gospel, please contact your calling body’s administrator for specific guidance.
2. Resources provided by your calling body to guide you through this change in tax status – some calling bodies may have worksheets or other forms for you to reference and complete regarding the parsonage allowance.

3. SECA allowance eligibility – Synod compensation guidelines recommend that calling bodies offer SECA allowance, which is reimbursement for one half (7.65%) of self-employment taxes. Contact your calling body to see if they follow the synod guidelines and offer a SECA allowance.

Determine the appropriate amount of your parsonage allowance designation – The parsonage allowance designated by you, or you and your spouse (if both qualify for minister of the gospel status) cannot be greater than the following -

1. The actual amount used to provide a home during the year, which must be properly substantiated;
2. The amount officially designated as a housing allowance, approved by resolution in official minutes of the calling body; or
3. The fair rental value of the home, including furnishings, utilities, garage, etc.

If housing is provided to you by the calling body – The fair rental value of provided housing is taken into consideration for purposes of calculating self-employment tax. A parsonage allowance can only be designated to the extent the minister of the gospel is paying for utilities, furnishings, etc.

See **Appendix A** for examples of how to calculate a parsonage allowance.

See **Appendix B** for examples of the impact of the parsonage allowance on your taxable income.

Under Minister of the Gospel status, once you have determined the amount to have designated as your parsonage allowance, present the designated amount to your calling body. Prepare any necessary forms the calling body requires for their files.

The governing board of the calling body will need to approve the parsonage allowance. Typically, the board will pass a resolution to officially designate the parsonage allowance. The allowance is effective as of the first of the month in which the resolution was passed. The parsonage allowance cannot be applied retroactively. Similarly, a mid-year change to amend an existing parsonage allowance cannot be applied retroactively.

The approved parsonage allowance will need to be provided to the calling body's designated administrator to properly adjust W-2 wages. Once the change in tax status is effective, state and federal tax withholdings from your calling body will stop and Social Security and Medicare taxes will need to be submitted under SECA, unless you have entered into a voluntary withholding agreement. Please work with your tax professional to ensure you have determined the appropriate method to submit SECA as well as state and federal income taxes.

Some calling bodies may prefer to receive a new W-4 from you; however, it is not necessary for a minister of the gospel to complete a W-4 form unless they choose to enter into a voluntary withholding arrangement.

With any change in status or withholding election, it is recommended that the worker review the first pay stub after the effective date of the change to confirm the appropriate changes are reflected. In the case of a minister of the gospel status change, no FICA or income tax should be withheld, unless you have entered into a voluntary withholding arrangement for income tax.

As mentioned in Appendix A, it is very important that a minister of the gospel maintain adequate records to support the value of housing allowance designation.

Most often, parsonage allowances are officially designated by a calling body on an annual basis, towards the end of the calendar year, to go in effect at the beginning of the next calendar year. Make sure to communicate with your calling body to understand their annual process, or how mid-year changes to an existing parsonage allowance would be handled.

## APPENDIX A – How to Calculate your Housing Allowance

As a minister of the gospel who rents or owns a home, or lives in a church-provided parsonage, you do not pay income taxes on the amount of your compensation that the calling body 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). The following list will help you identify qualified expenses that can be included when determining your housing expenses.

Rental payments on a home	_____
Down payment on a home	_____
Mortgage payments on a loan to purchase or improve your home (principal and interest)	_____
Real Estate taxes	_____
Property insurance	_____
Utilities (electricity, gas, water, trash pickup, local phone service, etc.)	_____
Furnishings and appliances	_____
Structural repairs and remodeling	_____
Yard maintenance and improvements	_____
Maintenance items	_____
Homeowners association dues	_____
Total Estimated Expenses	_____

The entire parsonage allowance designated by the church is not necessarily nontaxable. The allowance is nontaxable only to the extent that it does not exceed actual housing expenses or the annual rental value of the home, furnished plus utilities. The qualified parsonage allowance is excluded from income taxes but is subject to self-employment taxes.

To determine fair rental value of a home, some appraisal experts recommend approximating the annual rental value as 1% of the home's fair market value multiplied by 12. The fair rental value can also be estimated by looking at houses of comparable size and quality in the same vicinity/neighborhood as your house. A local real estate agent may also be a good resource.

It is very important to properly substantiate housing expenses used to calculate the parsonage allowance. Proof of housing related expenses in the form of receipts or cancelled checks should be kept. Additionally, documentation supporting the fair rental value of the home should be kept. It is possible that the IRS will audit your tax return and they will look for these types of documents to support the parsonage allowance that you did not pay income taxes on.

## APPENDIX B – Examples of Parsonage Allowance impact

All examples include called female teachers or staff ministers who are synod ministry certified in their area of expertise.

Example #1 – Rebecca Smith, a single woman who is a teacher at a church-affiliated elementary school, lives in a church-owned parsonage. Her current salary is \$30,000 plus she receives a cash housing allowance of \$3,600 for utilities and repairs. The fair rental value of the parsonage is \$12,000 annually. Rebecca typically incurs utility and repair expenses of \$5,000 annually. Rebecca requested a resolution be passed by her calling body to declare a parsonage allowance for her in the amount of \$5,000. Rebecca is subject to self-employment taxes on her salary of \$30,000, cash housing allowance of \$3,600, plus the fair rental value of the parsonage of \$12,000, for a total of \$45,600. For income tax purposes, Rebecca is taxed on her salary of \$30,000, cash housing allowance of \$3,600, less the \$5,000 parsonage allowance declared by her calling body, for a total of \$28,600.

Example #2 – Rachel Jones, a married woman, is a director for her church-run Early Childhood Ministry. She and her husband rent an apartment. Her current salary is \$32,000 annually plus a cash housing allowance of \$15,000. Rachel contributes \$2,000 a year, on a pre-tax basis, to a 403b plan. Her housing expenses total \$18,000 annually, including rent, insurance, utilities and furnishings. Rachel has requested her calling body declare a parsonage allowance for her of \$18,000. Rachel is subject to self-employment taxes on her salary of \$32,000, cash housing allowance of \$15,000, less \$2,000 that she contributes to her 403b for a total of \$45,000. For income tax purposes, Rachel is taxed on her salary of \$32,000, cash housing allowance of \$15,000, less her pre-tax 403b contributions of \$2,000 and the declared parsonage allowance of \$18,000 for a total of \$27,000.

Example #3 – Sarah Johnson is married to Pastor Sam Johnson and is a Staff Minister of music for her church. Sarah and her husband own a home. Pastor Johnson has the church designate an annual parsonage allowance of \$24,000. Sarah's current salary is \$27,000, plus she receives a cash housing allowance of \$6,000. She contributes \$1,000 annually to a Roth IRA. Sarah's congregation provides a SECA allowance of \$2,500 to cover half of self-employment taxes. Sarah is not eligible to have her church designate a housing allowance for her since her husband has already declared the allowance for their household. Sarah would be subject to self-employment taxes on income of her \$27,000 salary, \$6,000 cash housing and \$2,500 SECA allowance for a total of \$35,500. She would be subject to income taxes on the same amount, \$35,500, because she has no parsonage allowance. The Roth contribution is not deducted from taxable compensation because it is made with post-tax dollars.

Example #4 – Sue Anderson teaches English and coaches girls varsity basketball at an Area Lutheran High School (ALHS). She is a single woman who owns her own home. Sue's current salary is \$35,000, plus she receives a cash housing allowance of \$12,000. The ALHS provides a SECA allowance in the amount of \$3,600. Sue requests her ALHS board to designate a housing allowance for her in the amount of \$20,000, which she has estimated will be her housing expenses for the year. The annual fair rental value of her home, furnished including utilities, is \$24,000 per year. Sue is subject to self-employment taxes on her salary of \$35,000, cash housing allowance of \$12,000, and SECA allowance of \$3,600 for a total of \$50,600. At the end of the year, Sue totals her housing expenses and realizes they are only \$15,000. For income tax purposes, Sue is subject to taxes on her salary of \$35,000, cash housing of \$12,000, SECA allowance of \$3,600 less the lower of the fair market rental of her home, her declared parsonage allowance, or her actual housing expenses, \$15,000, for a total of \$35,600.