

LOCAL CHURCH TREASURER'S TAX GUIDE

Updated as of September 2009

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Introduction

This handbook has been prepared as a single-document resource for local church treasurers. Substantially all of the material has been obtained from the “Clergy Tax Packet” resource at the General Council on Finance and Administration’s web site at www.gcfa.org. We refer you to that web site for many other wonderful resources, not only in the financial/tax area, but also for issues related to trustees, legal, operations, etc.

As noted at the end of this handbook, the Internal Revenue Service also has excellent resources at their web site at www.irs.gov. And Richard R. Hammar’s annual publication of *Church & Clergy Tax Guide* is an excellent desktop resource.

We hope you find the information in this handbook helpful as you perform the important work of the local church treasurer.

HOUSING ALLOWANCE Q&As FOR UNITED METHODIST CLERGY

(Source = [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Tax_Information_for_Clergy/Housing_Allowance/HousingAllowanceQ&As.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Tax_Information_for_Clergy/Housing_Allowance/HousingAllowanceQ&As.pdf))

1. **What is the housing allowance?** When reporting gross income for federal income tax purposes, clergy can exclude a portion of their income designated by their church or salary paying unit as a "housing allowance" under Section 107 of the Internal Revenue Code (IRC). To be excludible, amounts designated as a housing allowance must be used to provide housing. In addition, there are limits on the amount that can be excluded. Note that a portion of the income of virtually all wage earners is used to pay for housing. What makes the housing allowance unique is that some of the income used to provide housing can be excluded from gross income for federal income tax purposes.

Also, clergy who live in a parsonage provided by the church do not have to report the fair rental value of the parsonage as income. (Note this "free" housing provided to clergy generally would be taxable compensation for lay employees.)

The housing allowance is sometimes called a "parsonage allowance" for clergy who are provided with a parsonage and a "rental allowance" for clergy who rent their home.

Example: A church pays its pastor an annual salary of \$35,000. In addition, she is provided the rent-free use of a furnished home owned by the church. The parsonage's annual fair rental value is \$10,000. The church and pastor do not have to report the \$10,000 fair rental value as income for federal income tax purposes.

2. **Is the housing allowance a deduction or exclusion from income?** The housing allowance is an exclusion from income, not a deduction. This means it is not reported as part of gross income for federal income tax purposes. (It is never deducted because it is not reported as income in the first place.)

Example: In the example above, the pastor reports \$35,000 as income (on IRS Form W-2, box 1). She takes no deduction for the \$10,000 fair rental value of the home that is provided to her because that \$10,000 is never reported as income for federal income tax purposes.

3. **What is the impact of the "Clergy Housing Allowance Clarification Act of 2002"?** The Clergy Housing Allowance Clarification Act of 2002 ("Act") prospectively codifies the fair rental value limitation on the amount of a designated housing allowance that can be excluded from gross income for federal income tax purposes. That law amended Section 107 of the IRC to now read:

Sec. 107. Rental value of parsonages

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 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.*

(The new language added by the Act is shown in italics.)

This change is a statutory codification of the IRS's previous position on this issue and therefore, for most clergy, this is nothing new or different from the way the housing allowance has worked in the past. (The full text of the Clergy Housing Allowance Clarification Act of 2002 is included in the tax packet.)

The following question explains in more detail the three limitations on the housing allowance exclusion.

4. **Can clergy exclude from gross income for federal income tax purposes the entire cost of owning, renting, and/or furnishing a home?** It depends. The amount that can be excluded is the *lesser* of:

- (a) the amount designated as the housing allowance
- (b) the amount of actual housing expenses, or
- (c) the fair rental value of the property (furnished, plus utilities).

Example: A church pays its pastor annual compensation of \$45,000, of which \$10,000 is designated as a housing allowance. The pastor owns his own home and the fair rental value of his home is \$10,000 per year. The actual expenses of operating his home are \$10,000 per year. The church and pastor do not have to report the \$10,000 housing allowance as income for federal income tax purposes. (The church reports \$35,000 as salary on the pastor's Form W-2, box 1.)

Example: A church pays its pastor annual compensation of \$45,000, of which \$10,000 is designated as a housing allowance. The pastor owns her own home and the fair rental value of her home is \$10,000 per year. The actual expenses of operating her home are \$8,000 per year. The church and pastor do not have to report \$8,000 (out of the \$10,000 housing allowance) as income for federal income tax purposes. However, the "unused" \$2,000 of the housing allowance must be included in the pastor's gross income. This is because the pastor cannot exclude more than her actual housing expenses, regardless of the amount her church designates as a housing allowance or the fair rental value of the home.

Example: A church pays its pastor annual compensation of \$45,000, of which \$10,000 is designated as a housing allowance. The pastor owns his own home and the fair rental value of his home is \$12,000 per year. The actual expenses of operating his home are \$10,000 per year. The church and pastor do not have to report the \$10,000 housing allowance for federal income tax purposes. The pastor cannot claim a housing allowance exclusion for the entire fair rental value of the home because his designated housing allowance and actual housing expenses are less than the fair rental value. He can only exclude from income the lesser of the

fair rental value, designated housing allowance, or actual housing expenses, in this case, \$10,000.

Example: A church pays its pastor annual compensation of \$45,000, of which \$11,000 is designated as a housing allowance. The pastor purchased her own home and the fair rental value of her home is \$10,000 per year. The actual expenses of operating her home in this first year of purchase are \$30,000 which includes a \$20,000 down payment. The pastor can exclude a total of \$10,000 from income for federal income tax purposes. She cannot claim a housing allowance exclusion for all her actual housing expenses because the exclusion cannot exceed the fair rental value of the home, in this case, \$10,000.

Example: A church pays its pastor annual compensation of \$45,000, of which \$8,000 is designated as a housing allowance. The pastor owns his own home and the fair rental value of his home is \$10,000 per year. The actual expenses of operating his home are \$10,000 per year. The church and pastor do not have to report the \$8,000 housing allowance as income for federal income tax purposes. The pastor cannot claim a housing allowance exclusion for the entire amount of his expenses or for the entire fair rental value of the home, because the exclusion cannot exceed the designated housing allowance, in this case, \$8,000.

5. **How do you determine the fair rental value of the parsonage or pastor's home?** In general, the fair rental value of the property is a question of facts and circumstances based on the local real estate market. If the pastor rents his home, the amount of the rent would be presumptive evidence of the fair rental value (assuming the rental agreement was an "arm's-length" transaction). Other methods of substantiating the fair rental value might include calculations and written documentation drawn from listings with local realtors of similar properties, verification of rent paid for comparable housing in the neighborhood, or a review of newspaper advertisements for rents of similar housing in the community. Perhaps the best substantiation would be a letter estimating the fair rental value of the property written by a realtor who is familiar with your property and other rental property in your community.
6. **What is the status of the litigation, *Warren v. Commissioner of Internal Revenue*, which challenged the fair rental value test and raised issues regarding the constitutionality of Section 107?** After passage of the Clergy Housing Allowance Clarification Act of 2002, the IRS agreed to dismiss its appeal of the case and the federal appeals court subsequently dismissed the case without ruling on any of the substantive issues raised.
7. **How should a pastor and church determine the amount of the housing allowance?** Past experience is the best test. If this is a "first time" situation, the Housing Allowance Estimate Worksheet, Attachment C to this document, could be helpful. In addition, this worksheet can assist clergy in planning for out-of-the-ordinary housing expenditures in the upcoming year.
8. **Does the housing allowance cost the church more money?** To the extent the church designates as a housing allowance a portion of the annual compensation it would otherwise pay to its pastor, designating the housing allowance results in no additional cost to the church. Regardless, it is important to remember it is the *Disciplinary* obligation of every

United Methodist church to provide housing for its pastor(s). This obligation can be fulfilled either by providing a parsonage or a housing allowance for the pastor(s).

9. **How is the housing allowance set up?** A pastor may not claim a housing allowance exclusion for federal income tax purposes unless his local church (or other salary paying unit) has first established or designated a housing allowance for him. The preferred way to do this is for the church council or charge conference to adopt a housing allowance resolution prior to each calendar year (or prior to the arrival of a new pastor) and record the resolution in the minutes of the meeting. However, to ensure that a housing allowance will always be in place for each calendar year, it is a good idea to have language in each resolution providing that the housing allowance will remain in effect in future years unless otherwise modified.

In determining the amount of the designated housing allowance, it can be very helpful if the pastor completes a form estimating his anticipated housing expenses for the coming year. (See Attachment C for a sample form.) This is important because, as seen in some of the examples above, any "mismatch" between actual housing expenses and the designated housing allowance could have tax consequences (specifically, either the pastor may not be able to exclude from his income as much as he otherwise could or he has to report additional income on his personal tax return).

In general, churches should avoid designating a set percentage of compensation as a housing allowance. The better approach is to estimate the anticipated expenses for the coming year and set the housing allowance accordingly. This approach minimizes the unfavorable tax consequences discussed above.

If the church provides the pastor with a parsonage, the church should annually (or prior to the arrival of a new pastor) adopt a resolution stating that it provides its pastor rent-free use of a church-owned parsonage and also designate the amount of the parsonage allowance (if any).

See Attachments A and B For a Sample Housing Allowance Resolution and Notification

10. **What types of housing related expenses can be included in the housing allowance?** Most reasonable household expenses can be included in the housing allowance, for example: down payment on a home, mortgage payments (including both interest and principal), home equity loan payments (assuming the loan proceeds are used for housing-related expenses), real estate taxes, property insurance, utilities, furnishings and appliances (including repairs), structural repairs, remodeling, yard maintenance and improvements, pest control, snow removal, maintenance items, and trash pickup. (Also see Attachment C.) Note that the cost of food and servants may not be included in the housing allowance. Also, housing-related expenses can only be included in the housing allowance for the year in which they are incurred. (See the following example.)

Example: In anticipation of needing to put a new roof on his house, a pastor requests, and the charge conference approves, an additional \$3,500 as part of the pastor's designated housing allowance for the upcoming year. The pastor, however, waits until it is too late for the work

to begin during that year. In that case, it is possible the pastor will not be able to exclude this additional \$3,500 from his income even though it was included as part of his housing allowance for the year. In short, the pastor can only exclude expenses in the same year they are incurred. The best the pastor can do in this situation is to ask the church to again designate an additional \$3,500 as part of his housing allowance for the following year and try to get the work done in that year.

11. **What type of housing expense records should clergy be keeping?** Clergy need to keep careful housing expense records to determine whether any part of the designated housing allowance is unexcludible and hence, must be reported as gross income. Records are also important for estimating a reasonable housing allowance for the next year. Original receipts, invoices, canceled checks, charge card records, etc. are all essential. Clergy may find it helpful to have one charge card dedicated solely to household expenses, to use the “shoe box” method of collecting all receipts in one handy place, and/or to have a dedicated bank account for this purpose. Clergy may also wish to create a contemporaneous log of expenses in the event some of the receipts or back up data are misplaced or difficult to interpret later.
12. **What happens if the pastor doesn't spend all of the designated housing allowance on housing expenses?** As noted above, the exclusion from gross income cannot exceed the lesser of the designated housing allowance, the actual housing expenses, or the fair rental value of the property. In particular, the exclusion from gross income can never exceed the actual housing expenses. Therefore, any "unused" portion of the designated housing allowance must be included in the pastor's gross income.

In general, any portion of the designated housing allowance that is not excludible because it is in excess of either the actual housing expenses or the fair rental value of the property, must be included in the pastor's gross income.

Example: A church pays its pastor annual compensation of \$40,000, of which \$12,000 is designated as a housing allowance. The pastor owns his own home and the fair rental value of his home is \$12,000 per year. The actual expenses of operating his home are \$10,000 per year. The church and the pastor do not have to report \$10,000 (out of the \$12,000 housing allowance) as income for federal income tax purposes. However, the \$2,000 "unused" portion of the housing allowance must be included in the pastor's gross income.

13. **If the designated housing allowance is greater than the amount that can be excluded under Section 107 of the IRC, how does the church (and pastor) report the difference as gross income for federal income tax purposes?** There are two methods for reporting this income:

(A) **The Church Determination Method:** Under this method, it is customary for the pastor, in mid-January, to provide the local church treasurer with documentation of all housing related expenses and the fair rental value of the property for the prior year. The treasurer uses this information to calculate the portion of the housing allowance that can be excluded by applying the three-part test discussed above. The church treasurer then reports the

unexcludible portion of the housing allowance on the pastor's Form W-2 (box 1) together with the pastor's other salary or compensation.

Example: A church pays its pastor annual compensation of \$45,000, of which \$12,000 is designated as a housing allowance. She owns her own home and the fair rental value of the home is \$12,000 per year. Under the church determination method, the pastor informs the church treasurer in mid-January that she had only \$11,500 in housing expenses in the prior year. The treasurer will then include the "excess" \$500 in the pastor's gross income for the prior year by reporting \$33,500 on the pastor's Form W-2 (box 1). The pastor does not separately report this \$500 on her Form 1040.

(B) Estimated Exclusion Method: Under this method, the local church treasurer reports on the pastor's Form W-2 (box 1) the total amount of compensation paid to the pastor during the year less the entire amount designated as a housing allowance. If the amount designated as a housing allowance is greater than the actual housing expenses or the fair rental value of the home, then it is the pastor's responsibility to report the difference as "other income" on the pastor's IRS Form 1040, line 21.

Example: A church pays its pastor annual compensation of \$45,000, of which \$12,000 is designated as a housing allowance. He owns his own home and the fair rental value of the home is \$12,000 per year. The pastor had only \$11,500 of housing-related expenses in the prior year. Under the estimated exclusion method, the church treasurer reports \$33,000 on the pastor's Form W-2, box 1 and the pastor reports the "excess" \$500 as income on his Form 1040.

Although both methods are appropriate, it is interesting to note that the second method is the one illustrated in IRS Publication 517. The second method has the advantage that it imposes less of an administrative burden on the local church treasurer, who is often a volunteer. However, if the second method is used by the church, it should probably incorporate in its housing allowance notification to the pastor a statement to the effect that the pastor (not the church) is responsible for properly computing and reporting any unexcludible portion of the housing allowance. (See Attachment B). Conversely, the advantage of the first method is that it helps insure that the pastor doesn't unknowingly forget to report taxable income. If the first method is chosen by the church, it should probably incorporate in its annual housing allowance resolution a statement that it is adopting this method.

Also note that the church may, but is not required to, report in box 14 of Form W-2 the amount of the designated housing allowance it did not include in the pastor's gross income. If the church does not fill in box 14 of Form W-2, it should independently inform the pastor of this amount. As discussed above, it is essential for the pastor to know this amount when computing his federal income taxes under the estimated exclusion method and also when computing his self-employment taxes (see below).

- 14. What type of records should the church be keeping regarding the pastor's housing allowance?** The church (or other salary-paying unit) should maintain copies of the documents pertaining to the designation of the housing allowance, for example, the minutes

of the meeting during which the housing allowance resolution was adopted. It is advisable for the church to maintain a separate housing allowance file with copies of these minutes, the annual housing expense estimate that some pastors provide to their churches, and any other related documentation. If the church determination method (see above) is used, the church should keep copies of the pastor's housing expense information. If the estimated exclusion method (see above) is used, the church does not need to request or maintain the actual housing expense records because it is not responsible for determining or verifying whether the pastor is correctly reporting the housing allowance exclusion on his or her own individual tax return.

15. **Can the housing allowance resolution be adopted or amended mid-year?** Yes. The housing allowance resolution can be adopted or amended at any time. However, it can only be applied prospectively. That is why it is important for the housing allowance resolution to be adopted by the church council or annual charge conference prior to each new calendar year (or prior to the arrival of a new pastor) and for pastors to accurately estimate their housing expenses in advance.

Example: A local church waits until June 30 to establish its calendar year housing allowance of \$10,000. In that case, at most \$5,000 of the \$10,000 housing allowance can be excluded from the pastor's gross income in that calendar year.

Example: A pastor realizes in March that she has significantly underestimated her housing expenses for the year. There is still "room" under the fair rental value test to exclude her anticipated housing expenses but she is limited by the amount of her designated housing allowance. Therefore, at her request, the church council adopts a resolution, effective April 1, increasing the pastor's housing allowance from \$10,000 to \$12,400. However, the pastor may only exclude from gross income 3/4, or \$1,800, of the extra \$2,400 added to her housing allowance (that is, her maximum excludible housing allowance for the year is \$11,800). She cannot exclude 1/4, or \$600, of the extra amount because 1/4 of the year (January, February and March) has already passed before the amended housing allowance resolution was adopted by the church council.

16. **Is the housing allowance also excluded from earnings subject to social security taxes?** No. The housing allowance exclusion only applies for federal income tax purposes. Like most everyone else, clergy must pay both federal income taxes and social security taxes. Employees pay social security taxes through the Federal Insurance Contributions Act ("FICA") system and self-employed individuals pay social security taxes through the Self-Employment Contributions Act ("SECA") system. By law, clergy are considered self-employed for the purposes of paying social security taxes (more commonly referred to as self-employment taxes) and the housing allowance is subject to self-employment taxes. Also, the fair rental value of a parsonage provided to a pastor (including the cost of any utilities and furnishings provided) must be included as self-employment earnings subject to the self-employment tax. (See IRS Publication 517).

Example: A church pays its pastor an annual salary of \$35,000 and provides her with the use of a church-owned parsonage. The church pays for all expenses of maintaining the home.

The fair rental value of the parsonage (furnished, plus utilities) is \$10,000 per year. The pastor's gross income for federal income tax purposes is \$35,000, but for self-employment tax purposes her gross earnings are \$45,000 (\$35,000 salary + \$10,000 fair rental value of the parsonage).

Example: A church pays its pastor an annual salary of \$35,000 and provides him with the use of a church-owned parsonage. The church pays for all expenses of maintaining the home. The church serves an affluent community where the average price of a home is \$500,000. Hence, the fair rental value of the parsonage (furnished, plus utilities) is quite high, in this case, \$30,000 per year. While the pastor will not have to report the fair rental value of the parsonage as income for federal income tax purposes, he will have to include the \$30,000 fair rental value of the parsonage as gross earnings for self-employment (social security) tax purposes, inflating his reportable earnings to \$65,000.

This often seems unfair to pastors, who in this type of situation are required to come up with a sizeable amount of money to pay the self-employment tax. However, it is important to keep in mind that the pastor is still receiving a significant income tax "break," because he received a \$30,000 benefit (i.e., free housing) that is not reported as income for federal income tax purposes. But some churches do establish a (taxable) "social security allowance," increasing the cash compensation of the pastor to help defray the extra cost of the self-employment tax in this type of situation.

Example: A church pays its pastor annual compensation of \$45,000, of which \$10,000 is designated as a housing allowance. The pastor owns her own home and the fair rental value of her home is \$10,000 per year. The actual expenses of operating her home are \$10,000 per year. The church and the pastor report \$35,000 as income for federal income tax purposes (the \$10,000 housing allowance is not reported). However, the pastor must report the entire amount of her compensation, \$45,000, as gross earnings for self-employment (social security) tax purposes.

17. **How is the housing allowance reported for social security purposes?** It is reported by the pastor on Schedule SE of Form 1040, line 2, together with salary. It is important to note that when the local church completes the annual W-2 Form for clergy, Box 3 should be left blank (for clergy only). Box 3 on the W-2 Form is used only to report FICA wages, not SECA wages (clergy wages are considered SECA wages for purposes of social security). See above and the example W-2 for further information. IRS Publications 517 and 525 are also useful on these points.
18. **What is the Deason rule?** It is an interpretation of the Internal Revenue Code followed by the IRS based on a tax case going back to 1964 and reaffirmed by the U.S. Tax Court in a subsequent decision in 1988, and in a tax court decision in 1992 (see *Deason v. Commissioner*, 41 T.C. 465 (1964); *Dalan v. Commissioner*, T.C. Memo. 1988-106; and *McFarland v. Commissioner*, T.C. Memo. 1992-440). The rule applies only to clergy who are able to take a business expense deduction for unreimbursed business expenses, which is becoming more and more uncommon for United Methodist clergy. The rule provides that a clergy person who claims an exclusion from gross income for the housing allowance must

reduce their business expense deduction by the percentage of income that is excluded from income tax reporting for the housing allowance.

Example: A clergy person receives a salary of \$36,000, plus a housing allowance of \$18,000. He has unreimbursed business expenses of \$6,000, which, for purposes of this example, are assumed to be deductible. His total “ministry” income is \$54,000 (\$36,000 plus \$18,000 housing allowance). The exempt portion of his income (the \$18,000 housing allowance) is 33.33% of the total. Thus, he is only able to deduct 66.66% of the \$6,000 in deductible business expenses (\$4,000).

19. **Our church provides our pastor with a parsonage, fully furnished, all utilities paid. He requests a \$12,000 housing allowance each year. We do not think this is right. What can/should we do?** The church PPR/SPRC chair and/or the treasurer should sit down with the pastor to discuss what items and expenses are part of the \$12,000 housing allowance request. Attachment C, the Housing Cost Estimate Worksheet, may be helpful. The church should also be familiar with the fair rental value of a fully furnished (with all utilities paid) comparable house in the area. With this factual information as background, the church can then evaluate whether the \$12,000 request is truly a problem. If it is, then the church treasurer and chair of the staff pastor/parish relations committee should discuss with the pastor the church’s concerns, reviewing the estimated expenses the pastor will be making and the IRS rules regarding the fair rental value and other limitations on what can be excluded from gross income as a housing allowance. The pastor may have misunderstood the IRS rules or may have a logical explanation and reporting position for the housing allowance. If, after this meeting, the church is still concerned and the matter has not been resolved, then the chair of the SPRC and treasurer may want to involve the district superintendent in a follow-up meeting. Ultimately, it is up to the charge conference to approve the housing allowance resolution each year, and the church is certainly not required to approve a resolution in the amount requested by the pastor, if it believes in good conscience based on accurate factual information that the amount requested by the pastor is significantly too high.
20. **How does the housing allowance work for clergy couples?** Each clergy person can claim a housing allowance exclusion (assuming the appropriate steps have been taken with a housing allowance resolution), but the combined total amount of the exclusion may not exceed the fair rental value of their home or the actual expenses, whichever is less. In some circumstances, because of the nature of the United Methodist polity on itinerancy, each of the two clergy persons may live in separate homes and be provided with separate housing allowances (for example: appointments in two different locations, each with a parsonage, and with each salary paying unit requesting that the clergy person live in the parsonage). In these situations, the clergy couple should have a solid reporting position that the two housing allowances may be excluded from gross income for federal income tax purposes. The reporting position will be more tenable if the clergy couple has good documentation of the reasons for and professional necessity of maintaining two separate homes, and if the amounts claimed on their face for each home are reasonable.

21. **Can clergy take housing expenses on two homes at the same time?** No. The housing allowance exclusion is limited to one home at a time. (Except possibly for the clergy couple exception discussed above)

Example: If the clergy person is building or has acquired a retirement home or vacation home, and still lives in the parsonage as his or her main home, then none of the expenses of the second home are includable for housing allowance purposes.

22. **Can retired clergy receive their retirement benefits as a tax-free housing allowance?** Yes, subject to the three limitations set forth above. Each year the annual conference (or general agency or other United Methodist entity) needs to adopt a housing allowance resolution stating that all of the pension payments received by the clergy person from the General Board of Pension and Health Benefits qualify as a housing allowance for retired clergy. Retired clergy can receive up to 100% of their official United Methodist retirement benefits from the General Board of Pension & Health Benefits as a tax-free housing allowance (subject to the limitations set forth above).
23. **Can all church employees have a tax-free housing allowance?** No. Section 107 of the IRC allows only a “minister of the gospel” to have a housing allowance. Thus, only taxpayers who are serving as clergy under IRS rules for tax purposes are eligible for a housing allowance. For example, a church custodian or secretary cannot have a housing allowance. (Of course such staff as lay employees do get the benefit of having the church pay one half their social security) United Methodist elders in full connection appointed to serve at the local church are “ministers of the gospel” and are eligible for a housing allowance, as are appointed local pastors. Many deacons appointed to the local church also will be eligible for a housing allowance (see the separate Q&As on the clergy status of United Methodist deacons elsewhere in this tax packet).
24. **Does my housing allowance impact on the amount of contributions made to my 403(b) pension plan?** Yes, there could be an impact since the income designated as a housing allowance is **not** part of the “includible compensation” for certain contribution limitations established by IRS rules. Therefore, while the new tax law changes generally increase previous limitations, clergy still need to be mindful of 403(b) contribution rules when part of their salary is designated as housing allowance.

The General Council on Finance and Administration is not engaged in providing legal or accounting services. The service of a competent professional should be sought for legal and tax advice.

Attachment A

SAMPLE HOUSING ALLOWANCE RESOLUTION

(To be inserted in the minutes of the meeting)

The chairperson informed the meeting that under the tax law, a minister of the gospel is allowed to exclude from gross income: (1) the rental value of a home furnished to him or her as part of his or her compensation; or (2) a housing allowance paid to him or her as part of his or her compensation, to the extent used by him or her 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.

The (charge conference or church council) on the _____ day of _____, after discussing the amount to be paid to Rev. _____ as a housing allowance, on motion duly made and seconded, adopted the following resolution:

Rev. _____ shall receive salary of \$_____ for the year. Rev. _____ shall also receive a housing allowance of \$_____ for the year ____ and all future years unless otherwise provided.

(If the clergy person is to have rent-free use of a home, also state:

"Rev. _____ shall also have rent-free use of the home located at _____ for the year _____ and for every year thereafter so long as he/she is minister of the _____ United Methodist Church unless otherwise provided.")

The housing allowance (and/or rent-free use of a home) shall be so designated in the official church records.

Attachment B

SAMPLE HOUSING ALLOWANCE NOTIFICATION BY THE CHURCH

Date _____

Dear _____:

This is to notify you of the action taken establishing your housing allowance at a meeting held on _____ . A copy of the Resolution is attached.

Under Section 107 of the Internal Revenue Code, a minister of the gospel is allowed to exclude from gross income (1) the rental value of a home furnished to him or her as part of his or her compensation; or (2) a housing allowance paid to him or her as part of his or her compensation, to the extent used by him or her 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.

You should keep an accurate record of your expenditures to rent or provide a home in order to be able to substantiate any amounts excluded from gross income when filing your federal income tax return. In the event of an audit, clergy receiving a housing allowance will have the responsibility of substantiating the use of such funds. Also, remember that the housing allowance (including the fair rental value of a provided parsonage) must be included as part of your earnings for self-employment tax purposes.

Sincerely yours,

Title

Attachment

Attachment C

HOUSING ALLOWANCE ESTIMATE WORKSHEET

EXPENSE ITEM	ESTIMATE
• utilities (electricity, heat, water, trash pickup, and local telephone)	\$ _____
• furniture and appliances (purchases and repair)	_____
• building repairs and remodeling	_____
• property insurance	_____
• yard maintenance, landscaping and improvements	_____
• maintenance items (cleaning and maintenance supplies, electrical supplies)	_____
• miscellaneous	_____
FOR OWNERS	
• real estate taxes	_____
• mortgage payments/down payment	_____
• improvements	_____
FOR RENTERS	
• rent payments	_____
TOTAL	\$ _____

ACCOUNTABLE REIMBURSEMENT POLICIES Q&As

(Source = [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Business_Expenses_and_Reimbursement/Accountable_Reimbursement_Policies/AccountableReimbursementPoliciesQ_and_A.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Business_Expenses_and_Reimbursement/Accountable_Reimbursement_Policies/AccountableReimbursementPoliciesQ_and_A.pdf))

The following questions and answers are intended to assist local churches and organizations in establishing and maintaining accountable reimbursement policies for their clergy and staff. Also, at the end of this document, there are some examples of proper and improper expense reimbursements.

1. What is an accountable reimbursement policy and why should we have one?

For business and tax reasons, in most instances, it is in the best interests of the church and its staff to have in place an accountable reimbursement policy to pay for the business expenses that are necessary to do the ministry of the church. These policies are simply a method for claiming and reimbursing professional or business expenses rather than providing an expense allowance. It's as simple as this: A church sets up a budget for the pastor's professional and business expenses, such as travel, continuing education, subscriptions, etc. When the pastor incurs a professional or business expense, s/he submits a claim with backup substantiation. The church either pays the expense directly or reimburses the pastor.

2. Are accountable reimbursement policies only for clergy?

No. The church can set up the policy to cover the business expenses for all staff. When answers or examples refer to pastors, it is for illustration purposes and not meant to exclude other staff.

3. What are the advantages of an accountable reimbursement policy?

There are several advantages to using an accountable reimbursement policy. (a) Convenience: Staff reports the business expenses to the church and not to the IRS - this means that none of the expenses are reported on Forms W-2 and there is no need to worry about IRS forms or calculating deductions. (b) Data: It gives the church an accurate account of the "cost" of ministry and allows members to understand the financial support necessary for staff to do their work well. (c) No complex rules: the Deason rule does not apply (it otherwise requires clergy to reduce the deduction for business expenses proportionately if they have a tax exempt housing allowance). (d) Fewer limits: Certain limits on business meals are avoided. (e) Tax savings: It takes the place of Schedule C and may save on taxes.

4. What are the disadvantages of an accountable reimbursement policy?

There are two minor disadvantages: The clergyperson's work expenditures are subject to more review by church members and some privacy may be lost. Also, the funds in the accountable reimbursement budget belong to the church and may not be given outright to the pastor at year-end if there is money left unspent.

5. What needs to go in an accountable reimbursement policy?

It's as easy as this. All you need is a written policy, which can be as simple as a short paragraph in the form of a resolution or a detailed plan, depending on the church's own needs and structure. This tax packet includes easy to implement sample policies (short and long). Most churches will want to have a budget amount which will "cap" the allowed amount for each staff person. It can be helpful (but it is not required) for the pastor, SPR committee, and finance committee to develop the budget together, with an idea of the types of expenses that can be expected.

6. When should the policy be set up?

The policy should be set up and funded when the church is doing the budget for the upcoming year. Once a written policy is in place, the church only needs to examine the budget funding for the accountable reimbursement policy each year.

7. How should the policy be funded?

Out of the church's budget, just like other expenses of running the church. The church needs to look at its budget and determine what amounts are necessary to pay for reasonable business expenses that fulfill the mission of the church, together with what it can reasonably afford. It is important for the church to realize that business expenses are properly church expenses and not something that the staff must cover from their own personal funds. It is important to review past expenditures (and future needs) carefully to arrive at an amount adequate to pay for the business expenses and at the same time within budget constraints.

8. Can the church "reduce" or "restructure" the pastor's salary to fund the accountable reimbursement policy?

The IRS has stated that it is currently reviewing some aspects of this issue. But until further notice from the IRS, churches should avoid these types of arrangements.

9. Can monies budgeted in the past for a travel allowance be used instead to fund an accountable policy?

Yes. For example, when the church is setting up its budget, it may reallocate the pastor's travel allowance (or other allowances other than a housing allowance) into an accountable reimbursement policy. By doing so, the church does not have to report the new travel reimbursement as part of W-2 income.

10. Can the church and the pastor negotiate compensation at the beginning of a new appointment that includes funding of an accountable reimbursement policy?

A pastor coming into a new appointment has the ability to create a salary/compensation/benefit package that includes an adequately funded accountable

reimbursement policy. The best approach is to budget for the policy out of church funds because these expenditures are for professional expenses which staff need to do their job.

11. What expenses/categories/items should be part of the policy?

Attached to the sample “long-form” policy included in this tax packet is a worksheet designed to help churches determine an acceptable budget for an accountable policy. The worksheet lists examples of appropriate business expenses that may be included (*e.g.*, business automobile expenses, parking, tolls, office supplies, business postage, office equipment, business-use computers, software, professional books/subscriptions, professional dues, religious materials, vestments, business gifts, continuing education, business entertainment, travel, etc.) There may be other business expenses that are appropriate to include, depending on the unique mission of your church. It is important to note that the categories on the worksheet are suggestions for budgeting, not rigid expense categories; the staff person, in consultation with the SPR chair and/or treasurer, or finance committee chair, may shift expenses during the year from one category to another. *Also see the examples at the end of these Q&As for suggestions about proper and improper reimbursements.*

12. Should the church reimburse the staff member or pay for their business expenses directly?

Either approach is acceptable. The staff person may submit a bill and ask that the church pay it. Alternately, s/he can substantiate the expense and ask that the church reimburse him/her. This tax packet includes a sample voucher form that can be used to submit requests for payment or reimbursement. Some churches provide certain members of their staff with business credit cards or long distance phone cards (restricted to business use) to make substantiation and bill payment easier. However, a credit card statement alone is not sufficient substantiation.

13. How should expenses be substantiated?

The IRS requires an adequate accounting by the employee and maintenance of good records by the employer. The IRS requires actual receipts for any expense over \$75.00. The church may use this figure or set a lower limit. (*e.g.*, GCFA requires receipts for all expenses over \$25.00.) The documentation should show (or be listed on the receipt itself): the purchase, amount, date, place, and the business nature of the expense. For example, if the pastor purchased a \$10.25 notebook, the substantiation would not require a receipt, but at the very least should state, “Purchased Notebook for \$10.25 on 1/5/01 for keeping accountable reimbursement records for church.” A meal expense might state, “\$5.90 lunch on 1/5/01, in Centerville while meeting with district superintendent.” Another example is \$150 expenditure for a continuing education seminar where the staff can submit the invoice for payment by the church to the vendor. Or, if the staff person paid personally, an acknowledgment of payment by way of a receipt for the seminar or the invoice with a front and back copy of a canceled check would be adequate to substantiate the reimbursement to the staff person.

14. When must substantiation/receipts be provided to the church?

The IRS requires that all substantiation of expenses occur within a reasonable time (within 60 days will be deemed reasonable) of the expense being paid or incurred. Using the above example of a notebook purchased on 1/5/01, the expense substantiation should be submitted no later than 3/4/01, to qualify as an accountable reimbursement. It is a good practice to turn in receipts at least every two weeks, to prevent forgetting about expenses or losing back-up receipts.

15. Can the church make advance payments? When must the staff substantiate the expenses?

Yes, it is appropriate to allow advances, if the church wishes to do so and has an adequate accounting system to track the substantiation for or reimbursement of advances. If an advance is given and exceeds the amount of business expense substantiated, the staff person must return the excess within a reasonable time (within 120 days will be deemed reasonable) of the date incurred or paid.

16. Who gets original receipts and documentation?

The church should be given the originals of receipts and written documentation and the staff person should keep a copy. It is unlikely that the staff person would ever need the copies unless s/he needed to substantiate expenses in excess of the amounts reimbursed.

17. Can the church give to the pastor at the end of the year any monies in the accountable policy not spent during the year?

No. The funds budgeted should not be shifted to a bonus or any other type of payment. This could jeopardize the entire accountable reimbursement policy. The monies can be used by the church for other types of expenses (*e.g.*, for mission, to reserves, or as a carry over to the accountable reimbursement budget line for next year).

18. Can the church increase the funding of the accountable reimbursement policy during the year?

Yes. If the church has additional funds or wants to shift budgeted funds from one account to another, it may do so. (No shifting is allowed from salary to an accountable policy).

19. Which church officer should be responsible for reviewing the propriety of the items submitted and which officer should be responsible for paying the expenses?

There is no single correct way to handle this responsibility. One method is to have the chair of the SPRC (in consultation with the committee) review and approve the submitted expenses and for the treasurer to handle payment. This avoids conflicts that may arise concerning the appropriateness of a given expense if all of the responsibility is on the

treasurer. Under any arrangement, it is important for someone, with credibility and respect to carefully review all of the submitted requests for reimbursement to ensure their appropriateness. Also, someone needs to be in charge of monitoring all expenses to ensure budget compliance, timely reporting, return of any advances and the like.

20. How should confidential items be handled in terms of substantiation and reporting?

When the pastor makes confidential visits to parishioners, s/he may want to write “private” or “confidential visit with church member” on a travel log. The pastor should at least be able to answer any questions or share information about these entries in confidence with the chair of the SPRC.

21. What does the IRS consider to be a properly reimbursable business expense and is it different for a church than a for-profit oriented business?

A business expense is one that is directly related to the purposes and goals of the organization and is reasonably necessary to fulfill those goals. The basic idea applies to all organizations, from the smallest widget manufacturer to the largest business corporations in the U.S., from the smallest rural church to the mega churches, even though the goals of a church are different from the goals of a business. It is necessary that expenses relate to the church’s unique mission and that they not be personal expenses of the pastor.

For example, it would not be proper for a minister to claim a travel reimbursement for the expense of visiting a sick relative who is not a member of the church and who lives 100 miles away, even if part of the purpose of the trip was to give spiritual comfort. The primary reason for the trip is to visit a relative. If a pastor went on a two-week vacation with his/her family and also preached at two churches during the trip, reimbursement for the travel vacation expenses would not be proper. Some of the expenses related to the preaching would be appropriate if the pastor’s church encouraged such preaching arrangements during vacations, the pastor obtained approval for this, and the pastor incurred additional expenses on the trip for going to those church locations. If the personal nature of the expense is the primary consideration, it is not a business expense. Also see the sample list of proper and improper reimbursement items at the end of these Q & As.

22. May a church tell a pastor not to spend funds even if the expense may be a proper business expense?

Yes. The question suggests a conflict between the pastor and the treasurer’s or the SPR committee’s view of necessary or authorized expenses as they relate to the mission of the church. The best way to resolve most conflicts is to try to understand them, discuss them, and come to some agreement.

For example, it is hoped that most churches would agree that annual conference related committee work and travel are part of each church and pastor’s commitment to the

connectional system (these would be legitimate business expenses). If a conflict over such conference expenses exists, the DS may be able to facilitate some meeting of minds (or pocketbooks). A difficult problem may arise when the church and the pastor view their mission differently. If the church does not approve of the clergy's involvement in an international mission project and finds it to be outside of the church's mission, the pastor should not submit travel or related expenses for such an activity. These issues should be explored ahead of time with the SPRC to avoid misunderstandings.

23. What happens if a new pastor is appointed in June and the previous pastor has already spent all of the funds in the accountable reimbursement policy account for that calendar year?

The best answer is that this type of situation should not arise in the first place, because the departing pastor, SPRC chair, and treasurer should make sure that it does not occur. These individuals all need to monitor the expenses and make sure that the accounts, absent unusual circumstances, are spent proportionally throughout the year. However, if this scenario should occur, it is possible to add to the accountable reimbursement policy for the new pastor, if funds are available elsewhere in the budget.

24. Who owns the equipment and other items purchased under the accountable reimbursement policies?

The church. If a church has paid for items through an accountable reimbursement policy, the equipment or other property belongs to the church, unless there is some other agreement. This issue of ownership usually does not come up until a pastor receives a new appointment and wishes to take equipment with him/her. It is not an issue in relation to travel, continuing education, professional dues, or entertainment expenses, which are not "tangible" things. Likewise, it would not often be a problem for office supplies, postage, periodicals or personal religious supplies, such as robes. These items are used up or are so personal that they have limited or no value to the church.

A computer is the most common item that raises this question. In this day and age it is important for the church to supply staff with a computer. However, if the pastor needs a computer, and the church has not budgeted for this purchase, the pastor may want to use accountable funds to make this purchase. While the pastor is at the church, the pastor uses the computer for business purposes.

What happens when the pastor, Rev. Dos, who purchased a computer with accountable reimbursement funds, leaves?

Rev. Dos decides she likes her computer and wants to take it to her new appointment. She approaches the chair of the SPRC and offers to personally purchase the computer for current fair market value (a purchase, at fair market value, would not be a taxable event). The SPRC decides to give the computer to Rev. Dos. The gift is a taxable event and the value of the gift for income tax purposes is the current fair market value.

25. Do accountable reimbursement policies include the housing allowance?

No. These are totally separate and need to be established and maintained separately. Accountable reimbursement policies are for business expenses, are available to all church staff, and can be used by any business or organization. Housing allowances relate only to clergy, as ministers of the gospel, and are authorized specifically by Internal Revenue Code § 107.

26. Do accountable policies include a cafeteria plan (flexible spending plan) for medical reimbursements?

No. However it is possible to set up cafeteria or flexible spending plans that may allow church staff to have medical reimbursements, dependent care reimbursements, and life insurance coverage, without income tax consequences. *All of the above arrangements need to be set up properly in a separate resolution or plan, with the assistance of a tax and benefits advisor, and must conform to the applicable Internal Revenue Code provisions.*

27. Are there any pension concerns when using an accountable reimbursement policy?

No. Amounts that are paid as accountable reimbursements are not part of “includible compensation” for certain pension contribution limitations established by IRS rules.

28. What are the implications of an accountable reimbursement policy for local church/conference reporting information?

GCFA’s Local Church Report to the Annual Conference and Local Church and Pastor Compensation and Expense Worksheet forms have been changed to show the distinction between **reimbursements** established for the pastor and **allowances** paid to the pastor. In the Report, line 66 is for reimbursements and line 67 is for allowances (other than the housing allowance that is put on line 65).

29. How should “ticketless” airline expenses be substantiated?

It is necessary that the documentation show the date, place, amount and business reason for the trip. The IRS has suggested that the itinerary from a travel agency and/or the airline receipt, along with an explanation of the reason for the travel, should be sufficient.

These Q & As are provided to give suggestions for establishing an accountable reimbursement policy. It is important to examine each situation closely to determine the correct result, because each church setting, ministry, budget and pastor are unique. The General Council on Finance and Administration is not engaged in providing legal or accounting services. The service of a competent professional should be sought for legal and tax advice.

Examples of Proper Reimbursement Items*

Reasonable travel and related expenses for attending meetings (e.g., annual conferences, United Methodist meetings, etc.)**

Church-approved trips to preach at another church

Trips to meet with the district superintendent, bishop or director of connectional ministries

Trips to visit members at hospitals, nursing homes, or parishioner's homes

Lunch meetings with officers of the church to discuss church business

Supplies for the church office (e.g., paper, pens, forms, notebooks, etc.)

Church-related continuing education

A computer required for church work

Vestments worn for worship

Church-related books and periodicals

Office furnishings and equipment (e.g., desk, chairs, telephone, etc.)

Spouse's travel expenses where the spouse accompanies the pastor **but only if the spouse was required by the church to be present for a business purpose** (e.g., the spouse is an elected delegate to the church meeting or group in charge of registration at the meeting and making a speech to the business meeting, etc.)

Business-related automobile operating expenses (if standard mileage rate was not used)

Long distance telephone calls to church when on vacation

Church-related telephone calls from the parsonage (most telephone expenses are covered under the housing allowance)

Many business related (non-personal) expenses allowable on Schedule C of the IRS tax return

**The items listed are, in most cases, proper. There may be some circumstances in which the church has specifically prohibited purchases. Each individual church must, in consultation with staff, make its own decision about what expenses are "professional and business" expenses and whether it will cover those items.*

***If the conference pays a pastor 15 cents per mile for attending a conference meeting, it is proper for the church to reimburse the difference between the church's rate and the 15 cents. For example, if the church reimburses staff travel at 31 cents per mile, in this case, the conference would pay 15 cents per mile and the church would pay 16 cents per mile for mileage.*

Examples of Improper Reimbursement Items***

Mileage to church from home for daily work (considered personal) - Mileage to home and back to church for lunch break

Meals with friends at which church matters are discussed

Spouse's travel under most circumstances (see example of proper reimbursement in limited circumstances above)

Vacations (including trip to Holy Land)

Books to plan vacation to Holy Land

Trips to visit sick relative

Trips to funeral home where that pastor is personally paid an honorarium for service (may be deducted on a Schedule C)

Tickets to attend the play "Joseph and His Amazing Technicolor Dream Coat"

Expenditures (*e.g.*, travel, books, phone calls) to research a book or article

Continuing education primarily for personal improvement

A computer used primarily by family

Everyday clothing, including business suits

Alcohol, even as an item on a receipt for a business meal

Medical expenses (may be part of a cafeteria or flexible spending accountable reimbursement policy)

Child care/dependent expenses (may be part of a cafeteria or flexible spending reimbursement plan)

Life or disability insurance premiums

Medical insurance premiums (may be part of a cafeteria or flexible spending plan)

Charitable contributions, tickets to charity functions

Expenditures related to a private business or generating income from a non-church source

Housing related expenses (e.g., utilities, furniture, upkeep (these are part of the housing allowance)) except to the extent they relate to an office

Subscriptions to a national news magazine for the pastor's personal use

****The items listed, in most cases, are improper. There may be some circumstances, particularly where the church has directed the staff person to make the expenditure for church mission, when these items may be proper. Each individual church must, in consultation with staff, make its own decision about what expenses are "professional and business" expenses and whether it will cover those items.*

SAMPLE ACCOUNTABLE REIMBURSEMENT POLICY

(Source = [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Business_Expenses_and_Reimbursement/Accountable_Reimbursement_Policies/AccountableReimbursementPolicy-LongForm.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Business_Expenses_and_Reimbursement/Accountable_Reimbursement_Policies/AccountableReimbursementPolicy-LongForm.pdf))

The _____ United Methodist Church ("Church") recognizes that certain expenses of ministry paid by the pastor/staff person are part of the ordinary and necessary costs of ministry in this Church/charge. Accordingly, we hereby establish an accountable reimbursement policy to defray them directly. The reimbursement account shall be an annual line item in the Church budget. It shall be in addition to the pastor's annual salary and housing. The reimbursement account for 20__ shall be \$_____. (*Amount may be determined by using the attached suggested worksheet.*)

The following requirements for the policy are binding upon the Church and upon, its pastor/staff person.

Accordingly, the Church hereby establishes an accountable reimbursement policy, pursuant to IRS regulations and upon the following terms and conditions:

1. The pastor/staff person shall be reimbursed from the reimbursement account for his/her ordinary, necessary, and reasonable business expenses incurred in the conduct of the ministry for, and on behalf of, the Church. The following expenses are budgeted in this accountable reimbursement policy, as suggested for the work needs of the pastor/staff person.
2. The committee on SPR/PPR chairperson, Church payroll person, or treasurer, (as designated by the Church) must be given an adequate accounting within 60 days after the expense is paid or incurred. The adequate accounting shall include, but not be limited to, a statement of expense, account-book diary or other similar record showing the amount, date, place, business purpose, and business relationship involved. Such documentation shall include receipts for all items of \$75 or more (*a church may set a lower amount*). Appropriate documents, cash receipts, canceled checks, credit card sales slips, and contemporaneous records (for those non-receipt expenses less than \$75), must be attached to each expense report. A log of total miles per day and enumeration of their general purpose shall suffice to substantiate automobile mileage, but under no circumstances will commuting mileage between the pastor's home and Church office be reimbursed. Copies of the documentary evidence and expense report shall be retained by both the pastor/staff person and the Church.

The committee on SPR chairperson (or treasurer) shall be responsible for approving the expense. The committee on SPR chairperson (or treasurer) shall exercise his/her discretion regarding the adequacy of the substantiation and the appropriateness of any reimbursement. Questions arising in these areas will be resolved by the SPR chairperson (or treasurer), subject to the review and approval of the committee on SPR/committee on finance.

3. It is the intention of this policy that reimbursements will be paid after the expense has been incurred by the pastor/staff person. However, should circumstances require payment of an advance for any particular anticipated expense, the pastor/staff person must account for the expense as described above and return any excess reimbursement within 120 days after the expense is paid or incurred. Any excess advance must be returned to the Church before any additional advances are provided to the pastor/staff person.

4. Budgeted amounts not spent must not be paid as a salary bonus or other personal compensation. If such payments are made, the entire amount of the accountable reimbursement policy account will be taxable income to the pastor/staff person. The Church will be required by law to report that amount as part of the pastor's/staff person's compensation. Disposition of any unspent balances remains at the discretion of the committee on finance/the council/charge conference in building the budget for the next Church year.

5. It is understood by the various parties that all elements of this resolution must be carefully followed to prevent the Church from being required by regulation to include all reimbursements as income on the pastor's/staff person's Form W-2. The primary responsibility in this regard is on the pastor/staff person to report and adequately account for his or her expenses to the committee on SPR chairperson, church payroll person, and/or treasurer.

Adopted on _____, 20____, by the Church Council [Charge Conference] of the _____ United Methodist Church.

Chair, Church Council

SPR/PPR Chairperson/Church Treasurer

Pastor/Staff Person

Secretary

This is a sample of an accountable reimbursement policy. The specifics of each policy should be reviewed by each church and minister considering their specific concerns. If legal or tax advice is required, the services of a competent professional advisor should be sought.

WORKSHEET FOR SETTING A BUDGET FOR AN ACCOUNTABLE REIMBURSEMENT POLICY

The following are suggested items for inclusion in this accountable reimbursement policy. It is only the total listed in Item K which is to be put in the policy itself. This worksheet is for budgeting purposes only and it is permissible for the reimbursed individual to shift items from one area to another.

A. Automobile (standard federal mileage rate), parking and tolls	\$ _____
B. Office supplies and postage	\$ _____
C. Office equipment, computer and software	\$ _____
D. Books, subscriptions and periodicals such as professional journals	\$ _____
E. Professional dues	\$ _____
F. Religious materials, vestments and business gifts	\$ _____
G. Continuing education and seminars (as approved by the committee on SPR and/or the committee on finance)	\$ _____
H. Entertainment required for Church business	\$ _____
I. Travel fares, lodging and meals while on business for the Church	\$ _____
J. Other	\$ _____
K. Total*	\$ _____

**The total listed in Item K must be the same as the total reimbursement amount set forth in the first paragraph of the policy. Church council action is required for an increase to Item "K" (Total). To allow for the pastor/staff person's spending discretion, only Item "K" is necessary to be reported as a line item in the charge conference approved budget and in the policy document. Circumstances dictate that the above expenses will vary from church to church and from time to time.*

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Sample Expense Voucher Form

(Source = [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Business_Expenses_and_Reimbursement/Accountable_Reimbursement_Policies/Sample_Expense_Voucher.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Business_Expenses_and_Reimbursement/Accountable_Reimbursement_Policies/Sample_Expense_Voucher.pdf))

Set forth below is a sample voucher form that can be used to record information relating to business purchases for the church. The form can be used to request payment or reimbursement for church-related items bought by a member of the church, such as paper plates for the church kitchen, cleaning supplies, or a new electrical switch for the parsonage. The form can also be used by a staff person to request payment or reimbursement of expenses pursuant to an accountable reimbursement plan.

Direct Payment Example: The choir director may be requesting direct payment of some continuing education expense that is part of his/her accountable reimbursement plan. The director would complete the form, attach the invoice or bill, preferably the original, obtain the necessary authorization (i.e., signature of person authorized to approve the expense), and submit the completed form to the treasurer for payment. The choir director should keep a copy.

Reimbursement Example: The pastor purchases and pays for a new robe. He/she would complete the form, asking that reimbursement be made to him/her for purchase of vestments and would attach the original or a copy of the receipt. The necessary authorization signature is obtained and the completed form is submitted to the treasurer for payment. The treasurer would remit the amount to the pastor. The pastor should keep a copy.

In each case, it will simplify the treasurer's job if the person submitting the voucher notes the account number or budget line item number.

“CHURCH NAME” Expense Voucher	
Date: _____	Amount: \$ _____
Pay To: Name _____	_____
Address _____	_____
Description of Expense: _____	_____
Business Purpose of Expense: _____	_____
Receipt/Bill: <input type="checkbox"/> Attached <input type="checkbox"/> No	
Account Number or Budget Line Item Number: _____	
Person Requesting Payment: _____	
Approved By: _____	
Special Instructions: _____	

LOCAL TRANSPORTATION EXPENSES Q&A

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Business_Expenses_and_Reimbursement/Local_Transportation_Expenses/LocalTransportationExpensesQ_and_As.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Business_Expenses_and_Reimbursement/Local_Transportation_Expenses/LocalTransportationExpensesQ_and_As.pdf))

The following questions and answers provide information on church local transportation expenses for clergy and staff. The Q&As assume a local church situation where the staff person's principal place of business is at the church (**not at home**) and the staff person is given a reimbursement rather than deducting the expenses on his/her tax return. At the end of these Q&As, there is a separate discussion dealing with transportation expenses for pastors serving multiple-point charges.

In general, the rules for reimbursable local transportation expenses can be complex and unusual fact situations cannot be dealt with here. (See IRS Publication 463 - Travel, Entertainment, Gift, and Car Expenses, for additional information) As always, you should consult with your own tax advisor when making tax related decisions.

1. What are the general rules for distinguishing between commuter mileage/personal mileage, which is not reimbursable, and business mileage for local transportation, which may be reimbursed to a church staff person?

Business related travel, including local transportation expenses incurred as part of the staff person's work, are reimbursable expenses. Commuter expenses/personal travel between the staff person's home and a regular work location or personal trips are not reimbursable. Commuter expenses occur when a staff person goes from home to the church, which is the regular work location. However, if the staff person goes from the church or home to a special meeting away from the church or on a parishioner call, this is properly a business expense.

Examples of non-reimbursable trips starting at home or at church: Trips to the church, a temporary office within a metropolitan area, for a personal errand, or to an evening meeting at the church.

Examples of reimbursable trips starting at home: A clergyperson who as part of his/her job visits a parishioner at home or at the hospital, a trip to a business meeting away from the church, a meeting with the district superintendent, performing a funeral service, and the like.

2. Is a trip taken for an emergency evening meeting at the church by a staff member a reimbursable business expense or commuter expense? What about a trip home to pick up a draft of my sermon that I was working on at home last night?

All trips that relate to your personal commute from your home to the church are not reimbursable. This includes travel to your regular church work site, home from work, back to the church (where you regularly work) at night, and all personal trips (home or elsewhere).

3. Is travel to a church approved continuing education event reimbursable?

Yes.

4. By the way, what specific expenses are reimbursable?

You can be reimbursed for the actual expenses of operating a vehicle or the standard mileage rate (published annually by the IRS), plus business related tolls and parking. If you receive more than the standard mileage rate, the excess is treated as income; if you receive less, the difference can be treated as a deduction.

5. What kind of records should I be keeping for my transportation expenses?

You should keep a travel log showing the date, place, mileage, and business purpose of all trips.

6. Are there special rules for staff with part-time appointments who have another job?

Yes. If you work at two workplaces in one day, whether or not for the same employer, you can be reimbursed (if the same employer) or deduct the expense of getting from one job to the other.

7. Do these rules change if my office is in my home and this is my principal place of work?

Yes. Be aware that the IRS is very strict about the tests used to determine if your home is indeed your principal place of business. If you are provided a place to work in the church and choose not to use it, the IRS probably will not allow you to treat your home as your principal place of business. If you meet the IRS tests, then you will have business rather than commuter expenses when you travel to other locations for the church.

8. How are “transportation expenses” (discussed here) different from “travel expenses”?

Basically, the IRS defines “travel expenses” as those relating to overnight travel away from home. The rules pertaining to travel expenses are also discussed in IRS Publication 463.

TRANSPORTATION EXPENSES FOR PASTORS SERVING MULTIPLE POINT CHARGES

Listed below are examples of local travel situations that might arise for a pastor serving a multiple point charge.

Example 1

Pastor Smith serves Church A and Church B. Four days a week he spends the morning at Church A and the afternoon at Church B. One day a week he visits parishioners in hospitals, nursing homes, and the homebound. He lives one block away from Church A and often walks to Church A rather than drive. He then walks home for lunch. After lunch, he drives to Church B.

Is the drive from his home to Church B a reimbursable business expense?

No. This is a commute from home to a regular business location (not temporary) and as such it is non-reimbursable commuter mileage.

Example 2

Same as Example 1, except that Pastor Smith walks back to his driveway, does **not** go into the house, gets in the car and drives to Church B.

Is the drive from his home to Church B a reimbursable business expense?

Probably. The IRS allows travel between two work locations as a business expense. Because his car is parked only one block away, this may be treated the same as if he had driven directly from one business location, Church A, to another business location, Church B.

Is the drive from Church B to his home at day's end considered a reimbursable business expense?

No. It is commuter mileage.

Example 3

Pastor Smith starts the day by driving to Church B. At 5:00 PM, he leaves Church B and goes home.

Is the drive from his home to Church B a reimbursable business expense?

Is the drive from Church B to his home a reimbursable business expense?

No. Both are non-reimbursable commuter mileage.

Example 4

Pastor Smith starts the day by driving to Church B. He leaves Church B and goes to park his car in his house's driveway. Then, without going into his home, he walks over to Church A for a meeting.

Is the drive from his home to Church B a reimbursable business expense?

No. It is commuter mileage.

Is the drive from Church B to his driveway (but not going into his home) a reimbursable business expense?

Probably, because he went directly (directly being considered within one block of his home and not going into his home) from one business location to another.

Example 5

On Sunday mornings, Pastor Smith walks to Church A. After the worship service, he walks back to his driveway, (but does not go into his home) gets in his car and drives to Church B to hold worship.

Is the drive to Church B considered a business expense?

Probably. As in Example 2 above, he is essentially going from one business location to another. Because his car is parked only one block away in his driveway, and he does not go into his house, this could be viewed as direct travel between two work locations.

The General Council on Finance and Administration is not engaged in providing legal or accounting services. The service of a competent professional should be sought for legal and tax advice.

MOVING EXPENSES MEMORANDUM

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Business_Expenses_and_Reimbursement/Moving_Expenses/Memorandum-MovingExpenses.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Business_Expenses_and_Reimbursement/Moving_Expenses/Memorandum-MovingExpenses.pdf))

To: Annual Conference Treasurers
Interested Parties

From: GCFA Legal Department

Re: Income Tax Treatment of Moving Expenses for
United Methodist Clergy at The Local Church

Date: September 2001

REQUIRED CONDITIONS FOR EXCLUDING EXPENSES

Local churches, annual conferences and other entities that pay directly or reimburse¹ “qualified” moving expenses to clergy may treat these payments **as exclusions from the income** of the recipient. In these cases only, the payer will **not** be required to report taxable income. In all other cases of payments for or reimbursements of moving expenses, such payments will be considered taxable income under Section 82 of the Internal Revenue Code, which requires that moving expense reimbursements be included in gross income for reporting purposes.

WHAT ITEMS ARE “QUALIFIED”

“Qualified” or deductible moving expenses include only (1) the reasonable expenses of moving household goods and personal effects from a former residence to a new residence, provided that the new place of work is at least 50 miles farther from the former residence than the previous job site, (2) the cost of storage and insurance for household goods and personal effects within any consecutive 30-day period after the day things are moved from the former residence and before delivery to the new residence, and (3) the reasonable expenses of travel (including lodging) from a former residence to a new place of residence. Expenses of only one trip (per person) may be deducted but all members of the household need not travel together. The costs of meals, premove house hunting expenses, temporary living expenses, are **never** qualified expenses and as such are considered taxable income if reimbursed.

¹ Reimbursements must be pursuant to an accountable reimbursement policy. To be an accountable policy or plan, expenses allowed must be the type for which deduction is allowed, had the taxpayer paid the expense personally. Such expenses must be documented and accounted for within a reasonable time. Prepayment of excess reimbursement must be returned within 120 days of the date incurred or paid.

SUMMARY OF REQUIREMENTS

In addition to those items stated above, the required conditions for the moving expense adjustment are:

1. The move must be made to a new principal place of work.
2. The new job site must be at least 50 miles farther from the former home than the previous job site.
3. The moving expenses incurred must be within a "reasonable time" of the start of a new job, generally construed to be no more than one year later (but sometimes expandable if circumstances indicate a longer period would be reasonable).
4. The work at the new location must continue for a certain period. The general rule is that the individual must work full time for at least 39 weeks during the first 12 months after the move to the new location. There may be circumstances under which this time period test is suspended such as death, disability or involuntary transfer from employment at a new location. Additionally, if the individual is married and files a joint return, either spouse may satisfy this time test, but the couple cannot combine their weeks of work.
5. Qualified clergy moving expenses paid **directly** to the moving company by a salary paying unit (or employer), will not be reported. Qualified moving expense reimbursements paid directly to an employee pursuant to an accountable plan are not reported as income, but are reported as an informational item in Box 12 of Form W-2 and are identified under Code "P." Other moving expense payments or reimbursements (non-qualified expenses) are reported as income in Box 1.
6. Assuming the allowable moving expenses are reimbursed by the employer pursuant to an accountable reimbursement arrangement, the employer reimburses **only** those expenses that are qualified and that are properly substantiated.

WHAT IF THE ANNUAL CONFERENCE PAYS EXPENSES FOR CLERGY AT THE LOCAL CHURCH?

Annual conferences vary on how moving expenses for clergy at the local church are handled when clergy change appointments. In some conferences, the new local church pays for

the moving expenses. In others, the conference pays for the moving expenses. While the above IRS rules hold true in either situation, the method of reporting expenses needs to be considered.

IRS staffers have suggested that the proper form to report qualified, non-taxable moving expenses is on the Form W-2, not on a 1099. That suggestion works well when the local church is paying for the moving expenses, since the local church is also issuing the W-2. The IRS' suggestion for using a W-2 is not practical when the annual conference is paying the qualified moving expenses for clergy serving in local churches, since the annual conference is not the salary paying unit and otherwise would not be issuing a W-2 for these individuals. Each annual conference treasurer in this situation will have to make a decision as to one of the following options for reporting qualified moving expenses paid on behalf of clergy serving in local churches: 1) ask the local church to add the expense to the clergy person's W-2; 2) give the local church the moving expense money and ask them to pay for the moving expenses and then add the expense to the W-2; 3) report the expense on a 1099 anyway; or 4) some other creative alternative that is developed in consultation with outside tax counsel.

EXAMPLES OF QUALIFIED AND NOT QUALIFIED MOVING EXPENSES

These examples illustrate the IRS rules:

1. Rev. Winken lived in a parsonage next door to the church and moves 49 miles from his old parsonage home to a new parsonage next door to the new church. Since the move was not 50 miles, expenses incurred do not qualify as moving expenses and any payment or reimbursement is reported as income. **(not qualified)**

2. Rev. Blinken has accepted a job at a new church and plans to move into a new parsonage. Her former parsonage is 4 miles from her former church. Her former parsonage is 51 miles from her new church. The rules are that the taxpayer's new place of work must be at least 50 miles farther from the taxpayer's former residence than the former place of work. Therefore, Rev. Blinken's new church would have to be at least 54 miles farther from the old parsonage in order for the moving expense to be qualified. Rev. Blinken's moving expenses must be reported as income. **(not qualified)**

3. Rev. Nodd moves to a new parsonage that is 285 miles farther than the distance between his old home and his previous job, for the purpose of taking a new appointment. The church pays not only for the costs of the move and travel but also for a pizza party for the volunteer movers and the Nodd family and additional meal expenses for the family during the trip. The reimbursed meal expenses are reported as income. All other travel related moving expenses incurred, however, were reimbursed directly to the moving company (not to the pastor) and are not reported as income. **(qualified, except for meal expenses)**

4. Rev. Won moves 100 miles and the distance qualifies. The new local church pays for Rev. Won's rental of a moving van and gas mileage for driving the van and the two family cars (their mileage expense is \$.14 a mile). Rev. Won and volunteers do the actual move. If Rev. Won submits receipts pursuant to an accountable policy, then the local church only reports the amount paid in Box 12 of his W-2 as a qualified moving expense reimbursement. If Rev. Won fails to submit receipts, however, then the payment is put in Box 1 and is considered a nonqualified moving expense reimbursement subject to income tax (as all "non-taxable" reimbursements must be pursuant on accountable plan with receipts). Note that Rev. Won could file IRS Form 3903 to calculate and deduct qualified expenses reimbursed under a non-accountable policy. **(qualified, if receipts given)**

5. Rev. Knight moves 66 miles farther than the distance between his previous parsonage and his old job, to take a new appointment. Prior to his move he incurs costs for several house hunting trips. The distance qualifies and the moving expenses – except for the house hunting trips - are qualified reimbursable expenses with receipts. If, however, the local church paid for the several house hunting trips, then those expenses would be put on the pastor's W-2 in Box 1 as income. **(qualified, except for house hunting costs)**

6. Rev. Sale has retired from the annual conference and moves from her last appointment to her retirement home 200 miles away. Her moving expenses are paid by the conference but since she is not moving to a new job, all the expenses are reported as income. **(not qualified)**

Please note that these examples apply only to clergy moves. Different rules apply for lay staff moves.

MISCELLANEOUS

Remember that the Internal Revenue Service requires Form 8822, Change Of Address, to be filed whenever a taxpayer changes address. (This requirement applies to **all** moves.)

IRS Publication 521 "Moving Expenses" contains valuable additional information on moving issues. Form 8822, Form 3903 and Publication 521 can be obtained by calling 1-800-829-3676 or by logging on at www.irs.gov.

This memorandum explores the income tax aspects of moving expenses. Other aspects of clergy moves are not addressed here. The General Council on Finance and Administration is not engaged in providing legal, tax or accounting advice or services. Please consult a competent local attorney for legal advice or a tax professional for tax advice.

MEMORANDUM

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Business_Expenses_and_Reimbursement/Spousal_Travel_Expenses/Memorandum-SpousalTravelExpenses.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Business_Expenses_and_Reimbursement/Spousal_Travel_Expenses/Memorandum-SpousalTravelExpenses.pdf))

To: Annual Conference Treasurers
Interested Parties

From: GCFA Legal Department

Re: Income Tax Treatment of Spousal Travel Expenses

Date: September 2001

In most instances, spousal travel expenses are not considered deductible business expenses. An employer's reimbursement of spousal travel expenses would generally be considered compensation and, therefore, taxable income to the employee.

However, in some **very** limited instances, spousal travel expenses could be considered a business expense, a working condition fringe benefit, or possibly even a charitable contribution.

Business Expense: Section 274(m)(3) of the Internal Revenue Code provides that an employer can pay for spousal travel as a business expense so long as the traveling spouse: (1) would otherwise have been able to deduct the expenses, (2) must have traveled for a bona fide business purpose and (3) is an employee of the reimbursing employer. The employer's payment of the business expense, of course, would not be taxable income to the employee. However, unfortunately for tax purposes, in most cases the traveling spouse is not an employee of the church, and therefore such payment may be taxable income.

Example: A church pastor and his spouse travel to a church convention in another city. The convention offers the pastor significant business-related activities, such as participation in meetings, workshops, lectures and exhibits. The spouse also works for the church as its Christian education director. She is attending the convention in order to present a workshop for other leaders in Christian education. Both the pastor and his spouse's expenses are business expenses that can be reimbursed by the church with no reportable income.

Example: Same facts as above except that rather than presenting a workshop, the spouse plans to attend several scheduled spouse meetings, as well as take in the sights of the city. Without a bona fide work-related purpose for having the spouse travel to the convention, the reimbursement of the spouse's expenses would be considered taxable compensation rather than payment of a business expense. As compensation, the amount must be reported in Box 1 of the W-2. For lay staff, the church would pay withholding and FICA.

Working Condition Fringe Benefit: Treasury Regulation 1.132-5(t) which clarifies IRC Section 274(m)(3). This regulation provides that even if reimbursement of spousal travel does not qualify as a business expense, it may qualify as a nontaxable working condition fringe benefit. A working condition fringe benefit is an expense paid by an employer which an employee could have written off had the employee paid the expense directly. Examples of these benefits are job training, educational assistance programs, meals that are provided for the convenience of the employer and employer-provided vehicles used for business.

Under the regulations, reimbursement of spousal travel expenses qualifies as a nontaxable working condition fringe benefit only if all of the following conditions are met: (1) the employer has not treated the reimbursement as compensation; (2) the spouse's presence is for a legitimate business purpose; and (3) the employee substantiates the expenses under an accountable reimbursement arrangement.

To determine whether the spouse's presence is for a legitimate business purpose, consider whether that individual's travel would be reimbursed even if he or she were not a spouse. Consider whether the spouse is participating in meetings, workshops, lectures, exhibits or other activities that have business value to the church and which would regularly be at the church's expense, regardless of the marital relationship.

Example: A church employee attends an out-of-town church convention with her spouse. The spouse is not an employee of the church, but was selected by the church as an official delegate to the convention. The spouse attends business meetings with the employee and votes on issues raised. The couple's travel expenses are substantiated pursuant to an accountable reimbursement plan and are fully reimbursed by the church. The church does not treat the reimbursement as compensation, the spouse's travel is for a legitimate business purpose, and the expenses are properly substantiated pursuant to an accountable plan. Therefore, the spousal travel reimbursement is not taxable income, but rather it is a nontaxable working condition fringe benefit.

Example: Same facts as above except that the church advances the employee \$500 for the couple's travel expenses. No substantiation of expenses is required by the church. Because of the failure to require substantiation, the full amount of the advance should be recorded as income on the employee's W-2. However, the employee can deduct her travel expenses as an itemized deduction on Schedule A. The travel expenses incurred for her spouse are not deductible on Schedule A, but may qualify as a charitable contribution as discussed below.

Charitable Contribution: If the spouse's travel expenses are not reimbursed or deductible as a business expense or working condition fringe benefit, they still may be considered a deductible charitable contribution. Treasury Regulation 1.170A-1(g) provides that expenses incurred in providing services to a charitable organization may constitute a deductible contribution. The value of the services cannot be deducted, but the unreimbursed expenses incurred while

contributing the labor generally can. So, if the spouse is contributing labor and incurred reasonable out-of-pocket transportation, meal and lodging expenses in order to do so, those expenses can be deducted from taxable income. In order to make use of the charitable contribution as a deduction, of course, the taxpayer must file Schedule A for itemized deductions.

Example: A church employee and his spouse travel to annual conference. The employee attends the meeting. The spouse is an architect and volunteers with the planning of several new homes for a church-organized project in the city where the meeting is being held. Her reasonable, unreimbursed travel, lodging and meal expenses (but not the contribution of her time and expertise) probably can be deducted from her income as a charitable contribution.

Compensation: In **most** instances, an employer's payment for spousal travel expenses are considered to be compensation and, therefore, taxable income to the employee. The taxable income is the additional cost incurred due to the spouse's travel.

Example: A church employee travels to another city to attend a religious meeting. His spouse comes along but is not an employee of the church and has no official duties of her own at the meeting. The church reimburses the couple's substantiated travel expenses. Their expenses were \$200 for lodging (a hotel room for one person would have cost only \$150), \$85 for a rental car (the spouse did not use the rental car alone), \$500 for two airline tickets and \$110 for meals (the spouse's portion was \$45). The portion of those expenses attributable to having the spouse on the trip was only \$50 for lodging, \$250 for the airline tickets and \$45 for meals. Therefore, the employee will have \$345 in taxable income for the employer's reimbursement of the spouse's portion of the travel expenses.

This memorandum explores the income tax aspects of spousal travel expenses. Other aspects of spousal travel are not addressed here. The General Council on Finance and Administration is not engaged in providing legal, tax or accounting advice or services. Please consult a competent local attorney for legal advice or a tax professional for tax advice.

**A MATTER OF GOOD STEWARDSHIP:
TIPS FOR RESPONSIBLE HANDLING
OF A PASTOR'S DISCRETIONARY FUND**

By the GCFA Legal Department

September 2001

(Source: <http://www.gcfa.org/PDFs/PastorsDiscretionaryFund.pdf>)

United Methodist churches commonly have a fund called the pastor's discretionary fund, which is intended to give the pastor complete discretion and authority to provide confidential financial support to persons in need. In some local churches, the pastor is given free reign, with no guidelines or instructions on how the church intended for the pastor to handle these monies. In other local churches, the pastor is given some guidance, but it may be very general or unclear, given orally or understood culturally. In addition, in some churches pastors understand that they can use these funds to pay for program or other expenses that are not totally covered by the budget. All of these churches and their pastors no doubt are unaware of the potential income tax consequences to these arrangements.

Regardless of the level of trust between the congregation and its pastor (or between the pastor and the finance committee, treasurer and financial secretary) written policies for the responsible handling of the pastor's discretionary fund are beneficial for everyone and should minimize negative income tax consequences. If the pastor has complete discretion, without clear guidelines or financial policies, there is a risk that the entire fund could be construed as income to the pastor, simply because the pastor ultimately has the discretion to pay the funds to himself.

Tips

Set forth below are some tips for local churches on the responsible handling of a pastor's discretionary fund.

- Establish a written policy that: 1) sets forth the exclusive purpose(s) of the fund with specificity and clarity (Is it to be used only for providing assistance to the needy? May the pastor use it for any other purposes and, if so, for what specific purposes, consistent with the program and budget of the church); 2) requires the pastor to document and record distributions from the fund (and authorizes the church to request additional documentation) showing the types of assistance provided during any given year (for example: \$100 was given to a needy family to purchase groceries; \$500 was given to a needy family to pay for hospital emergency room treatment for a seriously ill child; \$150 was given to a needy elderly woman to provide her with transportation to and from a kidney dialysis center for a year; bus tickets and a new pair of shoes and slacks were purchased for a homeless person who had a job interview); 3) encourages the pastor to use the monies for goods and services rather than cash assistance (examples: taxi fare, bus ticket, a bag of groceries, a pair of shoes, a doctor bill), which helps to protect the pastor, the church and the persons receiving assistance from

accusations of irregularity or private inurement; 4) requires the pastor to request the funds from the treasurer on some type of request voucher form, as an internal control mechanism over access to the fund (note: this can be done and still maintain confidentiality for the specific needy persons who will be beneficiaries); 5) requires the fund to be audited with the other church funds; 6) states that the fund may not ever be used by the pastor for himself or his family, and 7) limits the dollar amount that may be expended at any one time without advance written permission from the church council or finance committee.

- Educate new pastors, finance secretaries, treasurers, finance committee chairs and church council chairs on the existence and purpose of the fund and the internal controls and policy that have been established to protect the church and all persons from accusations of irregularity or private inurement;
- Give the pastor authority to distribute the fund only for the specified purpose and consistently enforce the limits on this authority;
- Educate all new pastors about the policy, and ensure that they understand the church's protocols (for example, make sure the pastor knows that the funds can never be used personally or for any family member, for any purpose, including but not limited to college tuition for the pastor's children or other family members; health care expenses for the pastor and his family; emergency cash for the pastor or family members; etc.)
- Educate all new pastors, treasurers and financial secretaries about these matters, and ensure that they understand the potential income tax implications if the church's policy is not followed carefully
- Ensure that the pastor does not keep a stash of emergency cash in his/her desk for quick disbursement, because security and internal controls for cash in a desk drawer are inadequate;
- Account for all expenditures on church financial statements and reports, including the Local Church Statistical Table II
- Retain administrative control over the fund to ensure that all distributions further the church's mission and ministry, and are in keeping with its tax exempt status.

Examples of Inappropriate Use of Pastor's Discretionary Fund

- 1) **Appropriate:** Pastor Dave's church has a written discretionary fund policy with careful internal controls. The annual budget for the fund is \$2,500, and Pastor Dave is allowed to spend no more than \$300 at any one time. The written policy specifies that the discretionary fund may be used only to provide care for the needy. During the year, Pastor Dave submits appropriate

documentation for the following expenditures under this fund: 1/5/01 - \$100 for grocery coupons for needy family in church community; 2/14/01 - \$200 to Meadows Community Center, Inc. for winter boots for children of needy families; 2/20/01 - \$100 paid directly to utility company for heat bill for needy family; 4/10/01 - \$172 for groceries for homeless family in church community; 4/3/01 - \$100 for 5 bus passes for men at homeless shelter; 8/1/01 - \$300 for Wesley House for school supplies for needy children; 8/20/01 - additional \$300 for Wesley House for school supplies for needy children (approval of church council obtained for additional expenditure); 10/15/01 - \$275 for groceries for food pantry for Thanksgiving baskets for needy families; 11/2/01 - \$200 for winter coats for children at Meadows Community Center; 11/30/01 - \$50 for cab fare coupons for elderly woman in need of transportation for kidney dialysis until regular volunteer driver's car is repaired.

- 2) **Appropriate expense but troublesome procedures:** Pastor Cathy is given a \$5,000 discretionary fund each year. The church does not have a written policy about how the funds are to be used. The funds are kept in a separate checking account, for which Pastor Cathy is the sole authorized signer on the account. Pastor Cathy always uses the funds for the same purposes each year: to purchase school supplies and winter coats for needy children in the area; to provide homeless persons with a Thanksgiving and Christmas dinner at a local restaurant; to purchase food and bus passes for the church's most needy families. While the use of the funds in this example is fine, the scenario is troublesome because of: a) the lack of internal controls (two signers on the account; documentation of the expenses for the church treasurer or financial secretary; b) the absence of a written policy stating that Pastor Cathy may not use the funds for anything other than assistance to needy persons and families; and c) the absence of any protocols to prohibit Pastor Cathy from using the funds for any personal purposes may make the entire \$5,000 taxable income to her.
- 3) **Might be inappropriate:** Pastor Nancy used the discretionary fund to buy a bag of groceries for all new members of the church. While it is certainly appropriate for the church to give a small gift of hospitality to all new members of the church, the pastor's discretionary fund should not be used for this purpose unless the written church policy specifically states that this is one of the authorized purposes for the discretionary fund. It would be more appropriate for the hospitality gifts for new members to come from the budget of the evangelism committee. It would be especially inappropriate to use the discretionary fund for hospitality gifts to all new members if the church's policy intends for the discretionary fund to be used for needy families, unless **all** new members of the church qualified as needy.

- 4) **Unwise under most circumstances:** Pastor Tom distributed \$1,000 out of the discretionary fund to pay for Christmas gifts to his staff. It is appropriate for a church to authorize its pastor to use church funds to take staff out for a Christmas lunch, at the church's expense, and it is appropriate for the church to buy small gifts of appreciation to staff for special occasions. It is best for these expenses to come from a specific line item in the budget where other staff support expenses are borne; also it might be more appropriate for these types of expenses to come from the budget of the pastor parish relations committee, where there may be greater accountability and control over the expenditure.
- 5) **Probably inappropriate:** Pastor Janet used \$2,000 of the discretionary fund to pay for new appliances in the kitchen of the parsonage. While new appliances might have been needed and would be an expense appropriate for the local church to make, if it chose to do so, this scenario is troublesome because: a) the church should make the decision about what to upgrade in the parsonage, if the church is going to pay for that expense; b) the expenses of upgrading the parsonage should come from the budget for church property, or out of the pastor's housing allowance, depending on the circumstances and the arrangements between the church and the pastor regarding parsonage expenses; c) the discretionary fund should not be used for anything that appears to be for the benefit of the pastor or her family.
- 6) **Always inappropriate:** Pastor Robert borrowed \$5,000 from the discretionary fund to pay for his son's college tuition expense.
- 7) **Always inappropriate:** Pastor William distributed \$5,000 out of the discretionary fund to assist his daughter with the down payment for the purchase of a first home. His daughter otherwise would not have been able to purchase the home.
- 8) **Always inappropriate:** Pastor Sue's church has a written discretionary fund policy with careful internal controls. The annual budget for the fund is \$5,000, and Pastor Sue is allowed to spend no more than \$500 at any one time. The written policy specifies that the discretionary fund may be used for any of the following purposes: 1) providing care for the needy; 2) for special church projects that come up during the year without other budget dollars for support, provided that the pastor seeks approval of the church council before spending the money for any such project. The youth group approaches Pastor Sue to ask for help with a mission project that the church council will not agree to fund. Pastor Sue agrees to provide \$400 for the project. While the project might qualify for support under the discretionary fund policy (purpose #2), Pastor Sue should have gone to the church council for approval before agreeing to support the project.

In summary, regardless of how a church decides to fund a pastor's discretionary account (through the annual budget, special offerings, etc.), a written policy on usage with specificity and clarity, together with sound internal controls, are important protections for the pastor, the church, and those who are recipients of the funds. Confidentiality for recipients can be maintained even with these sound internal controls. Protecting the church's assets is a matter of good stewardship of the gifts that have been entrusted to the church to do God's work in the community and world.

LOCAL CHURCH TAX REPORTING REQUIREMENTS

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Tax_Information_for_Local_Churches/Tax_Reporting_and_Filing_Requirements/Local_Church_Tax_Reporting_Requirements.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Tax_Information_for_Local_Churches/Tax_Reporting_and_Filing_Requirements/Local_Church_Tax_Reporting_Requirements.pdf))

1. PAYROLL TAXES FOR CHURCHES

A. Withhold taxes on staff employees, file forms and comply with deposit requirements

1. Federal Social Security (NO CLERGY WITHHOLDING)
2. Federal Income Tax (NO **REQUIRED** CLERGY WITHHOLDING)
At the request of the clergy, the employer may withhold income tax for that clergy, pursuant to a Form W-4 and state equivalent of federal Form W-4. (Keep W-4 forms on file).
3. State income tax withholding (requirements vary from state to state)

There is no mandatory federal income tax withholding for clergy; income tax withholding can be done at clergy request, but Social Security is never to be withheld for clergy.

B. Quarterly Filing Requirements (April 30, July 31, October 31 and January 31 for the first, second, third and fourth quarters)

1. Form 941 – Federal
2. State equivalent form (may vary from state to state)

See separate memo on Form 941 Filing Requirements - clergy compensation is shown on 941 but no information on Social Security and Medicare wages and withholding.

C. Annual Filing Requirements

1. January 31: Form W-2 must be given to employees.
2. February 28: Form W-3 must be filed with the Social Security Administration.

(Note: W-2 and W-3 filings can be made electronically in some cases. See the Social Security Administration website at www.ssa.gov for more details.)

3. State filing requirements vary from state to state.

2. FILING REQUIREMENTS FOR PAYMENTS TO SELF-EMPLOYED INDIVIDUALS (Such as independent contractors supplying repair or other services to the church)

- A. January 31: Form 1099-MISC must be given to individuals (who receive compensation of \$600 or more).
- B. February 28: Form 1099-MISC must be filed with the IRS
- C. February 28: File Form 1096 with the IRS together with the 1099-MISC forms.

FORM 941 FILING REQUIREMENTS

(Source: http://www.gcfa.org/PDFs/Form_941_Filing_Requirements.pdf)

Internal Revenue Service Form 941 is the Employer's Quarterly Federal Tax Return. The first report for the year must be filed by April 30 (for the pay period ending March 31). Subsequent filing dates are July 31, October 31 and January 31. Form 941 reports the number of employees, the amount of Social Security and Medicare wages and taxes, as well as the income taxes, which are withheld in each quarterly period. You have already been filing the Form 941 if you currently have an employee(s).

It is the position of the Internal Revenue Service that a church which has only a minister (and no other staff) need not file a Form 941 (see letter from the IRS to GCFA in this tax packet). However, if the minister should file a Form W-4, electing to have voluntary income tax withholding, Form 941 is required. Any amounts withheld are reported as income tax on Line 3.

General Instructions for Filing Form 941

(Note: complete instructions on filing Form 941 are available at the IRS website, www.irs.gov.)

Make checks payable to "United States Treasury".

File only one form per quarter, even if your church has multiple locations or divisions

Make dollar entries without the dollar sign and comma — 1000.00; show negative amounts in parentheses (1000.00).

Line 1 is for the number of employees.

Line 2 is for the total amount of quarterly wages, tips and other compensation paid to all employees that are subject to federal income tax. The total compensation should **not** include salary reduction pension contributions, any housing or utility allowance, or accountable reimbursement policy payments. Health insurance premiums paid by the church are also excluded. Taxable fringe benefits and travel or other allowances are includable as income.

For Lines 6 and 7, there is no information reported for clergy, as the church must not do any Social Security or Medicare withholding on behalf of clergy. Because of specific code provisions, clergy are always considered self-employed for Social Security taxes. If there is no other staff withholding, these boxes should be left blank.

The box in Line 8 should not be checked (unless none of the payments are subject to Social Security taxes).

Reconcile your year-to-date wage and tax information with the Form 941 that you just filed. This should be done every quarter.

Show employee earnings only up to the Social Security taxable wage base.

Questions have arisen about whether the IRS will be concerned that Social Security and Medicare taxes withheld on Lines 6 and 7 (which **must not** include any withholding for clergy) are inconsistent with the compensation paid (which **does** include clergy salary). IRS officials have stated that IRS computers should not identify these disparities. However, should such an inquiry arise, you should inform the IRS that clergy are considered self employed for Social Security taxes for services performed in the exercise of ministry under Internal Revenue Code § 3121(b)(8)(A).

TIPS FOR RECONCILIATION

Here are some tips to make the year-end process run of 941s and W-2s as error-free and smooth as possible:

Review all wage and tax categories. Then, prior to processing your W-2s and 941s, verify that all general ledger liability accounts balance.

WHAT TO LOOK FOR

Remember any mid-year changes made in salary reduction pension contributions, housing allowances, accountable reimbursement plans or employer/employee tax withholding accounts. Be prepared to make correcting journal entries for out of balance situations caused by mid-year or year-end adjustments.

Complete your fourth-quarter 941 first, then prior to distributing the W-2s, balance the 941 totals against the W-2s.

WHAT TO BALANCE — SOCIAL SECURITY AND MEDICAL TIPS AND WAGES (FOR LAY EMPLOYEES) AND FEDERAL INCOME TAX WITHHELD

If there are any inconsistencies, you can correct them promptly.

Do a preliminary run of the W-2s on plain paper and verify the totals against your annual reconciliation worksheet.

The General Council on Finance and Administration is not engaged in providing legal or accounting services. The service of a competent professional should be sought for legal and tax advice.

INFORMATION FOR COMPLETING FORM W-2 FOR CLERGY

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Tax_Information_for_Local_Churches/Tax_Reporting_and_Filing_Requirements/Form_W-2/Information_for_Completing_Form_W-2_for_Clergy.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Tax_Information_for_Local_Churches/Tax_Reporting_and_Filing_Requirements/Form_W-2/Information_for_Completing_Form_W-2_for_Clergy.pdf))

The purpose of this document is to give some general information on completing Form W-2 for clergy. More specific instructions on completing Form W-2 are available at the IRS website (www.irs.gov).

Box A, Control Number does not have to be completed.

Box B is the Employer Identification Number. Each local church (or charge) should have its own Employer Identification Number (EIN). Employer Identification Numbers can be obtained by filing IRS Form SS-4.

Box C, D, E & F are self-explanatory.

Box 1 contains certain items of compensation paid by the church. Set forth below are two lists, one for items that are reported in box 1 and the other for items that are not reported in box 1.

ITEMS WHICH NEED TO BE REPORTED IN BOX 1

1. Salary, wages and bonuses
2. Most gifts which are paid through a church account
3. Allowances (other than the housing allowance) must be reported as well as reimbursements which are made under a non-Accountable Reimbursement Policy.
4. If a per diem arrangement is used, payments in excess of IRS rates
5. If the standard mileage rate is used, any amounts in excess of those rates (If the IRS rate was \$.55 per mile and a pastor were paid \$.60 per mile, the difference, \$.05 per mile, would have to be reported here.)
6. Taxable fringe benefits, the most common are:
 - a. the cost of employer-provided group term life insurance that exceeds \$50,000 (Note: This applies to the \$50,000 CPP death benefit together with any PPP death benefit or policy purchased by either the church or provided through an annual conference group plan. Conference treasurers or pension officers will need to supply information from conference plans. (If the total insurance coverage does not exceed \$50,000, the cost of such coverage is not reported.)
 - b. The value of the personal use of a church-provided automobile;
7. A social security allowance (or any portion of the minister's self-employment taxes paid by the church)

8. Reimbursements of non-qualified moving expenses (typically, a move less than 50 miles)

ITEMS NOT REPORTED IN BOX 1

1. Salary reduction contributions to the Board of Pensions and Health Benefits 403(b) Plan or other qualified plans

2. Properly designated (in advance) housing and utility allowance

3. Qualified health and medical plan premium payments

4. Reimbursement of business expenses under an Accountable Reimbursement Policy

5. Payments under a qualified salary reduction plan — for medical reimbursement accounts or dependent care assistance

6. Excludable Fringe Benefits:

a. Term life insurance (up to \$50,000 of life insurance coverage or CPP or BPP death benefit)

b. Qualified tuition payments

c. Qualified moving expenses

Box 2, the local church is not required to do any federal income tax withholding for clergy. However, some clergy may wish to request voluntary withholding by filing a Form W-4 with the church. Through voluntary income tax withholding, clergy may avoid the need to pay quarterly estimated taxes.

Box 3, 4, 5 & 6 are left blank for clergy. Clergy are defined as self-employed for Social Security or SECA purposes (under the Internal Revenue Code Section 3121 (b)(8)(A)). The church should not report Social Security/Medicare wages and must not do any Social Security/Medicare tax withholding. Any Social Security tax withholding done erroneously by the church (which comes from church funds) is additional reportable income to the pastor. If the church wishes to assist the pastor in paying all or a portion of his Social Security taxes, it should add an additional amount to the wages paid to the pastor.

Box 7, 8 & 9 are not applicable.

Box 10 would include any dependent care benefits that are paid.

Box 11 does not apply for most clergy. Amounts contributed to plans administered by the GBPHB or other 403(b) plans should not be included in this box. However, if a pastor is a participant in some other (non-qualified) plan, amounts may need to be reported here.

Box 12 is to be used to show codes and amounts of benefits or contributions for clergy. (See the IRS Form W-2 instructions for a complete list of codes.) The following codes are the most relevant for clergy:

1. **Code C** — If the pastor is provided more than \$50,000 in CPP and BPP death benefits or group term life insurance, you need to show the premiums attributed to benefits *in excess* of \$50,000. If CPP and BPP together provide more than \$50,000 in death benefits, the General Board of Pension and Health Benefits will supply this information on request to your conference treasurer who, in turn, should make this available to the local church. If the pastor has served more than one church during the year, typically this information is only included in the W-2 of the last church served.
2. **Code E** — 403(b) employee salary reduction contributions
3. **Code P** — Qualified moving expense reimbursements paid directly to the employee.

Box 13 is checked if the pastor is a participant in the church retirement plan(s)

Box 14 may be used for additional reporting. You may include information on a housing allowance or utility allowance here. If the church does not put that information here, the church should independently tell the pastor these amounts.

Box 16—20 state and local tax information — states and municipalities vary on what items are deducted from gross wages.

General Council on Finance and Administration is not engaged in providing legal or accounting services. If legal or tax advice is required, the service of a competent professional should be sought.

Example of Form W-2 for Clergy

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Tax_Information_for_Local_Churches/Tax_Reporting_and_Filing_Requirements/Form_W-2/ExampleofFormW-2forClergy.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Tax_Information_for_Local_Churches/Tax_Reporting_and_Filing_Requirements/Form_W-2/ExampleofFormW-2forClergy.pdf))

This is an example of how to fill out a Form W-2 for Rev. Sue Service. Rev. Service has a salary of \$25,000 from the local church. Rev. Service is provided a parsonage and the church pays a \$1,500 housing (parsonage/utility) allowance to her pursuant to an estimate of such expenses and a properly adopted resolution (this is in addition to her \$25,000 salary). The parsonage allowance is not included as income in Box 1 on Form W-2 but it may be reported in box 14. If the church does not report the amount in box 14, it should report it independently to the pastor because this amount must be included in self-employment (Social Security) earnings (along with the fair rental value of the parsonage).

Rev. Service receives a non-accountable travel allowance of \$3,000. This entire sum is included as income and must be added to her \$25,000 salary, giving a total of \$28,000 in income from the church.

There is also an accountable reimbursement policy for other professional business expenses in the amount of \$2,500. None of this amount is reported on the Form W-2. (Note: travel/vehicle expenses can be handled by an accountable reimbursement policy as well but that would be in lieu of a travel allowance).

The local church makes a Ministerial Pension Plan (MPP) contribution of \$2,750. This is not reported as income. There is a 403(b) pension contribution of \$500 by the church, out of the pastor's salary, to the pastor's personal account and that amount is treated as an after-tax contribution which does not reduce income. Additionally, the pastor made a voluntary 403(b) salary reduction (pre-tax) contribution of \$900. This voluntary contribution reduces her reportable income from \$28,000 to \$27,100. (Note in box 13, the Retirement Plan box should be checked.)

Rev. Service has not requested any voluntary federal income tax withholding by the church but rather has assumed the obligation of making quarterly estimated payments.

The church pays (*out of the church's own budget, and not as a salary reduction*) a medical insurance premium under the conference plan in the amount of \$3,000, which is not reportable income.

Box 1 of Form W-2 reports wages and tips of \$27,100, consisting of the salary and the travel allowance (less the pension salary reduction contribution). (If the minister wishes to take deductions for the travel expenses, those deductions must be taken on Schedule A as opposed to Schedule C.) None of the accountable reimbursement amount is included in Box 1 and these expenses are not reported on the minister's tax return.

Reportable Income Items

Cash salary (which includes the personal pension contribution of \$500)	\$25,000.00
Travel allowance	3,000.00
Value (if any) of life insurance provided in excess of \$50,000 under CPP	—

Reductions of Income (before tax)

Salary reduction for pension plan	900.00
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Non Reportable Funds

Accountable reimbursement policy for business expenses	2,500.00
Parsonage allowance (for utilities for the parsonage)	1,500.00
Medical insurance premium	3,000.00
Ministerial Pension Plan (MPP)	2,750.00

Box 2 is not completed, as Rev. Service did not choose to have any voluntary income tax withholding, but rather paid estimated taxes directly. If the church withheld income taxes pursuant to a filed Form W-4, such amounts would be reported here.

Box 3-6 should *not* have any entries (leave blank, do *not* insert “0”s).

Box 12 should show the code and amount reflecting the voluntary salary reduction contribution, in this case, E \$900. (If Rev. Service received the benefit of life insurance in excess of \$50,000, the amount of the premium would be included in box 1 and shown here together with the code letter C.)

Box 13 should show an X in the box for Retirement Plan.

Box 14 may include the housing allowance of \$1,500

Box 16-20 should be completed according to your own state's requirements.

The General Council on Finance and Administration is not engaged in providing legal or accounting services. The service of a competent professional should be sought for legal and tax advice. In addition, GCFA is not recommending any particular salary, housing allowance, or travel allowance. The examples here are merely illustrative.

FORM W-3 REPORTING REQUIREMENTS

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Tax_Information_for_Local_Churches/Tax_Reporting_and_Filing_Requirements/Form_W-3/FormW-3ReportingRequirements.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Tax_Information_for_Local_Churches/Tax_Reporting_and_Filing_Requirements/Form_W-3/FormW-3ReportingRequirements.pdf))

The Form W-3 - Transmittal of Wage and Tax Statements must be filed annually by employers together with Copy A of the Forms W-2. Basically, the information contained in the Forms W-2 and Forms 941 (filed quarterly) are the basis for the information to be supplied on Form W-3. The Form W-3 must be filed with the Social Security Administration by February 28.

The employer should make sure the Form W-3 wage and withholding information agrees with the total amounts from the Forms W-2 and that the Form W-3 is reconciled with the quarterly Form 941 returns.

Note: According to the IRS instructions for Form W-3, in Box b – Kind of Payer, a church or church organization should check the “941” box even if it is not required to file Form 941 or Form 944 (for example, because the church staff consists of only the pastor).

For more complete information, refer to the Form W-3 instructions available at the IRS website (www.irs.gov).

UNRELATED BUSINESS INCOME TAX (UBIT)

The provisions relating to UBIT are set forth in sections 511 to 514 of the Internal Revenue Code. Churches are subject to UBIT for income from activity that:

1. Constitutes a trade or business. This generally includes any activity carried on to produce income or profit.
2. Is regularly carried on by the church. This refers to the frequency and continuity with which the activities are conducted and the manner in which they are pursued. Activities that are intermittent and infrequent are generally not considered to be regularly carried on by the church.
3. Is not substantially related to the performance of the church's exempt purpose. Activities that contribute importantly to the accomplishment of the church's exempt purpose are excluded from UBIT. This determination generally needs to be made based on the facts and circumstances of each individual case.

Exceptions

Even if an activity would otherwise be considered unrelated, there are exceptions that exclude from UBIT:

- Activities in which substantially all the work is performed by unpaid volunteers.
- Activities carried on by a church primarily for the conveniences of its members.
- Selling merchandise, substantially all of which has been contributed to the church.

Income Excluded from UBIT

Dividends, interest, annuities, royalties, capital gains, and rents are generally not subject to UBIT, subject to the following two limitations.

1. If a church has a mortgage on its property, the above income will be subject to UBIT on proportionate basis of the debt to the value of the property. However, if substantially all (85% or more) of the church property is used for its exempt purposes, then this income is not subject to UBIT even if a church has a mortgage on its property. There are also neighborhood land rules and demolition rules that may also allow income to be excluded from UBIT on debt-financed property.
2. The above income cannot be excluded from UBIT if it is generated from organizations that are controlled by the church.

Returns

If a church is subject to UBIT, it must file a Form 990-T with IRS by May 15 (assuming the church's tax year ended the previous December 31). A church will not lose its tax-exempt status by engaging in unrelated business activities.



General Council on Finance and Administration GROUP RULING REQUEST FORM

DATE: _____

MY ORGANIZATION IS A: GROUP 1 * GROUP 2
(Church, Agency, Conference, etc.) (Other - see below)

(Please print or type)
CHURCH / ORGANIZATION NAME: _____

PASTOR / DIRECTOR'S NAME: _____

ADDRESS: _____

PHONE NUMBER: _____ FAX NUMBER: _____

E-MAIL ADDRESS: _____

EMPLOYER IDENTIFICATION NUMBER (EIN): _____
(9 digit number- REQUIRED, CANNOT BE PROCESSED WITHOUT THIS NUMBER)

CHARTER / INCORPORATION DATE: _____

REQUESTED BY: _____

PHONE NUMBER: _____

E-MAIL ADDRESS: _____

COMMENTS: _____

*Generally, the "Group 2" designation applies to an organization that is a subsidiary of or otherwise related to a "Group 1" organization. Common examples of Group 2 organizations are: Wesley Foundations, church preschools/child-care centers, community centers, annual conference retreat centers/camps, church foundations, community ministries (e.g., missions, shelters, food distribution centers).

If your organization falls under the Group 2 category, you must attach a copy of the organization's governing documents for review (i.e., Articles of Incorporation, By-Laws, etc.). If your Group 2 organization does not have these documents, please note that in the "Comments" section of this Request Form and we will contact you for more information.

Fax your completed request to GCFA's Legal Department – 866-246-2516 or
E-mail to legal@gcfa.org

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Tax_Information_for_Local_Churches/Tax_Exempt_Status_of_Churches/Group_Ruling_Request_Form.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Tax_Information_for_Local_Churches/Tax_Exempt_Status_of_Churches/Group_Ruling_Request_Form.pdf))

GROUP RULINGS AND CHARITABLE CONTRIBUTIONS

(Source: <http://www.gcfa.org/PDFs/GroupRulingsandCharitableContributions.pdf>)

IRS Publication 4573 (Group Exemptions) (<http://www.irs.gov/pub/irs-tege/p4573.pdf>) provides information on group tax exemption rulings such as the one covering United Methodist local churches, annual conferences, general agencies, and certain other United Methodist affiliated organizations.

In 1974, GCFA, acting on behalf of The United Methodist Church, applied for and received a group tax exemption ruling from the IRS. In the language of the IRS, GCFA is referred to as the “central organization” of the group ruling and the other covered entities are referred to as “subordinate organizations”. (For information purposes, the IRS Group Exemption Number for The United Methodist Church Group Tax Exemption Ruling is: 2573.)

The 1974 group ruling from the IRS is still valid today and by its terms, it provides that all subordinate organizations covered by the group ruling are exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.

However, from time to time, potential donors have raised questions about verifying the tax-exempt status of our organizations covered under our group ruling. Their interest, of course, is to insure that their contributions to our organizations will be tax deductible. Publication 4573 provides helpful guidance to donors in this regard.

Specifically, Publication 4573 states that to establish the deductibility of their contributions to a subordinate organization, donors may rely on:

- (1) the central organization’s (in this case, GCFA’s) listing in IRS Publication 78 (which is online at www.irs.gov); together with
- (2) the central organization’s (in this case, GCFA’s) verification that the subordinate organization is included in the group ruling.

If you have potential donors who have expressed concerns about the deductibility of their contributions, please feel free to direct them to Publication 4573 or to GCFA’s Legal Department.

Department of the Treasury



Internal Revenue Service

Washington, DC 20224

Date:

OCT 16 1974

In reply refer to:

T:MS:EO:R:1-2

Council on Finance and Administration of the United Methodist Church, a/k/a the United Methodist Church and Its Affiliated Organizations
1200 Davis Street
Evanston, Illinois 60201

Attention: R. Bryan Brawner

Dear Applicant:

This refers to the information submitted for use in determining your status and the status of your affiliated religious organizations, on the list you submitted, as being exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code.

For the purposes of this group ruling, your affiliated religious organizations include The General Conference, Judicial Council; General Agencies, Commissions, Committees, their divisions and departments thereof, and, other related organizations; Jurisdictional Conferences and Affiliated Agencies, Commissions, and other organizations; Annual Conferences and divisions and departments thereof; Annual Conference Agencies, Commissions, Committees, and affiliated organization; Local Churches and Local Church Agencies, Commissions, Committees, and other affiliated organizations.

Based on the information supplied, we rule that you and your affiliated religious organizations, on the list you submitted, are exempt from Federal income tax under section 501(c)(3) of the Code.

We have further determined that you and the affiliated religious organizations you operate, supervise, or control, and which are covered by your notification to us, are not private foundations within the meaning of section 509(a) of the Code, because you and your affiliated religious organizations are organizations described in sections 170(b)(1)(A)(i) and 509(a)(1) of the Code.

Council on Finance and Administration of the
United Methodist Church, a/k/a the United
Methodist Church and Its Affiliated Organiza-
tions

Organizations that are not private foundations are not subject to the excise taxes under Chapter 42 of the Code. However, they are not automatically exempt from other Federal excise taxes.

You and your affiliated religious organizations are not required to file the Return for Organizations Exempt From Income Tax, Form 990, as you come within the exception contained in section 6033(a)(2)(A)(i) of the Code.

You and your affiliated religious organizations are not required to file Federal income tax returns unless you are subject to the tax on unrelated business income under section 511 of the Code. If you or your affiliated religious organizations are subject to this tax, you must file an income tax return on Form 990-T. In this letter we are not determining whether any of your present or proposed activities, or those of your affiliated religious organizations, is unrelated trade or business as defined in section 513 of the Code.

You and your affiliated religious organizations are not liable for social security (FICA) taxes unless you file a waiver of exemption certificate as provided in the Federal Insurance Contributions Act. You and your affiliated religious organizations are not liable for the taxes imposed under the Federal Unemployment Tax Act (FUTA).

Donors may deduct contributions to you and to your affiliated religious organizations as provided by section 170 of the Code. Bequests, legacies, devises, transfers, or gifts to or for your use, or to or for the use of your affiliated religious organizations, are deductible for Federal estate and gift tax purposes under section 2055, 2106, and 2522 of the Code.

If you change your purposes, character, or method of operation, please let your key District Director know so he may consider the effect on your exempt status. Also, please keep him informed of any changes in your name or address.

Council on Finance and Administration of the
United Methodist Church, a/k/a the United
Methodist Church and Its Affiliated Organiza-
tions

You should advise each of your affiliated religious organizations of the provisions of this ruling, including the requirements for filing Federal tax returns.

Each year, within 45 days after the close of your annual accounting period, please send the following to the Director, Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19155, Attention: EOR Branch:

1. A statement describing any changes during the year in the purposes, character, or method of operation of your affiliated religious organizations.
2. Lists of the names, mailing addresses, including Postal Zip Codes and employer identification numbers, of your affiliated religious organizations that during the year:
 - a. changed names or addresses;
 - b. were deleted from your roster; or
 - c. were added to the roster.
3. For affiliated religious organizations to be added attach:
 - a. a statement that the information upon which your present group exemption letter is based applies;
 - b. a statement that each has given you written authorization to add its name to the roster;
 - c. a list of those to which the Service previously issued exemption rulings or determination letters; and
 - d. a statement that none of the affiliated religious organization are private foundations as defined in section 509(a) of the Code.

Council on Finance and Administration of the
United Methodist Church, a/k/a the United
Methodist Church and Its Affiliated Organiza-
tions

4. If applicable, a statement that your group exemption roster did not change during the year.

This ruling supersedes our ruling letter of November 20, 1945. In addition, this ruling letter supersedes our group exemption letters to your affiliated Annual Conferences and Conferences and to the individual determination or ruling letters issued to your affiliated churches and other affiliated religious organization.


Please be sure to enter your employer identification number on all your tax returns and in your correspondence with the Internal Revenue Service.

This ruling is not applicable to your affiliated foreign religious organizations.

The key District Director, Internal Revenue Service, Chicago, Illinois, which is your key district for exempt organization matters, will be furnished a copy of this letter. Please keep this ruling in your permanent records.

Thank you for your cooperation.

Sincerely yours,


Milton Cerny
Chief, Rulings Section I
Exempt Organizations Branch

OTHER TAXES

Sales Taxes

Exemptions by churches from sales taxes vary from state to state. Some states exempt sales made by churches, whereas other states exempt sales made to or by churches. If applicable, sales tax exemptions typically require completion of an application. Check the rules of your state to determine whether or not your church can be exempt from sales taxes.

Property Taxes

All states exempt churches from property taxes on buildings that are used as places of worship. There is a great deal of variety, however, on whether or not other forms of church-owned property are exempt from property taxes. Property tax exemptions typically require completion of an application, often from the county in which the property is located rather than the state. Check the rules of the county and state where your church is located.

Unemployment Taxes

Services performed as an employee of a church ordinarily are exempt from state unemployment taxes.

Good Samaritan/Benevolence Fund Policy

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Tax_Information_for_Local_Churches/Charitable_Contributions/Benevolence_Fund_Policy.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Tax_Information_for_Local_Churches/Charitable_Contributions/Benevolence_Fund_Policy.pdf))

*Take care of him, and when I come back, I will repay you whatever more you spend. . . .
Jesus said, "Go and do likewise." Luke 10:35-37*

Many churches seek to provide funds to help needy persons. If funds are raised on a case-by-case basis, it is likely that any donations made will not be tax deductible. The better way to handle the desire to help those in need is for the church to adopt a Good Samaritan/Benevolence Fund policy, such as the sample policy below. A Good Samaritan/Benevolence committee should be set up or, in the alternative, the function of selecting needy donees can be assigned to another existing committee of the church. It is important that all of the decisions be made totally independently of donor's suggestions and on the basis of need and other objective criteria. (See also IRS Publication 526 - Charitable Contributions)

Sample Benevolence Fund Policy

_____ United Methodist Church, in keeping with its Biblical and charitable goals, has established a Good Samaritan/Benevolence Fund ("Fund") to assist persons in our community in financial need. Donors may suggest beneficiaries of the Fund. However, such suggestions shall be deemed advisory rather than mandatory in nature. The administration of the Fund, including all disbursements, is subject to the exclusive control and discretion of the Church. All gifts to the fund are gifts to the Church and while the committee may consider suggested designations, in no event is it bound to follow them. Checks should be made payable to the Church, with a notation that the funds are to be placed in the Church's Good Samaritan/Benevolence Fund.

Employee or Independent Contractor?

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Tax_Information_for_Local_Churches/Employee_or_Independent_Contractor/Employee_or_Independent_Contractor.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Tax_Information_for_Local_Churches/Employee_or_Independent_Contractor/Employee_or_Independent_Contractor.pdf))

Introduction

An important question arises when a church hires, retains or selects a new person to perform a particular job for the church - is the person an employee or independent contractor? Serious tax and other financial consequences may result if a person is misclassified. Most persons retained to do the day-to-day work of any organization, including a church, are considered employees. The Internal Revenue Service and courts have determined that United Methodist clergy at the local church are to be classified as employees for income tax purposes and are not self employed.¹ This analysis will not revisit the issue of clergy self-employment but is limited to looking at hiring or contracting with lay persons for work. The IRS may view independent contractor arrangements with suspicion and scrutiny, because of previous abuses and an underlying viewpoint that persons who are working for an organization should be considered employees for income tax purposes. Therefore it is crucial to carefully review the hiring and contracting classification process.

20 Factor IRS Test

The IRS uses a 20-factor test to determine whether a person is an employee. In connection with this test, the IRS has stated the following:

. . . 20 factors have been identified that indicate whether sufficient control is present to establish an employer-employee relationship. The degree of importance of each factor varies depending upon the occupation and the context in which the services are performed. It does not matter that the employer allows the employee freedom of action, so long as the employer has the right to control both the method and the result of the services . . . (Business Reporting, I.R.S. Publication 937).

¹ Weber v. Commissioner, 60 F.3d 1104 (4th Cir. 1995). However, Church polity is clear that clergy are not employees, *Book of Discipline* ¶ 141.

The 20 common law factors are:

- 1) **Instructions.** An employee must comply with instructions about when, where, and how to work. Even if no instructions are actually given, the control factor is present if the employer has the right to give instructions. Independent contractors direct themselves as to when, where and how to do their work.
- 2) **Training.** An employee is trained to perform services in a particular manner. Independent contractors ordinarily use their own methods and receive no training from the purchasers of their services.
- 3) **Integration.** An employee's services are integrated into the business operations because the services are important to the success or continuation of the business. This shows that the employee is subject to direction and control.
- 4) **Services rendered personally.** An employee renders services personally. This shows that the employer is interested in the methods as well as the results. Independent contractors are generally free to hire assistants or to sub-contract their work, since they are directing their own operations and making their own decisions about how to get the job done.
- 5) **Hiring, supervising and paying assistants.** An employee works for an employer who hires, supervises, and pays assistants under a contract that requires him or her to provide materials and labor and to be responsible only for the result.
- 6) **Continuing relationship.** An employee has a continuing relationship with an employer. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals. An independent contractor ordinarily is hired to do a particular job and then moves on to do work elsewhere for another organization.
- 7) **Set hours of work.** An employee has set hours of work established by an employer. An independent contractor is the master of his or her own time.
- 8) **Full-time work.** An employee normally works full-time for an employer. An independent contractor can work when and for whom he or she chooses.
- 9) **Work done on employer's premises.** An employee works on the premises of an employer, or works on a route or at a location designated by an employer. An independent contractor ordinarily sets his/her own place of work.
- 10) **Order or sequence set.** An individual who must perform services in the order or sequence set by an employer looks like an employee, subject to direction and control.
- 11) **Oral or written reports.** A person who regularly submits reports to a supervisor looks like an employee, who must account to the employer for his or her actions.

12) **Payments.** An employee is paid by the hour, week, or month. An independent contractor is paid by the job or on a straight commission.

13) **Expenses.** An employee's business expenses are customarily paid by an employer. This shows that the employee is subject to regulation and control. An independent contractor ordinarily pays for his/her own business expenses.

14) **Tools and materials.** An employee is furnished significant tools, materials, and other equipment by an employer (examples in a church: computer, books, music, uniforms).

15) **Investment.** An independent contractor has a significant investment in the facilities he or she uses in performing services for someone else.

16) **Profit or loss.** An independent contractor can make a financial profit or suffer a financial loss, whereas an employee ordinarily does not suffer any financial losses associated with his/her work.

17) **Works for more than one person or firm.** An independent contractor offers and ordinarily gives his or her services to two or more unrelated persons or firms at the same time (example: an outside snow removal or lawn service used by a church would do the same work for a number of clients and would be considered an independent contractor; a facilities maintenance person who does full time work for the church that includes snow removal and lawn service and does not have a snow removal/lawn service business for other clients probably would be considered an employee, absent other unique circumstances).

18) **Offers services to general public.** An independent contractor makes his or her services available to the general public.

19) **Right to Fire.** An employer can fire an employee. An independent contractor typically cannot be terminated so long as he or she produces a result that meets the specifications of the contract for the services.

20) **Right to quit.** An employee can quit his or her job at any time without incurring liability. An independent contractor usually agrees to complete a specific job and is responsible for its satisfactory completion, or is legally obligated to make good for failure to complete it.

The IRS has attempted to streamline these questions and considerations. For example, see IRS Publication 15-A, "Employer Supplemental Tax Guide." In this Publication the IRS sets forth the employee versus independent contractor analysis by grouping concerns and questions into three categories, Behavioral Control, Financial Control, and Type of Relationship. The Publication also notes that an individual may request a specific determination from the IRS by filing Form SS-8.

Examples in a Church Setting

- A church organist/music director who holds the position of Minister of Music, who works 35 hours a week and who works under the direction of the church, **probably is an employee.**
- An organist who works for six area churches when their regular organist is sick or on vacation (and offers his/her services to other churches) **probably is an independent contractor.**
- A maintenance person who works 20 hours a week for the church on evenings, weekends (and after weddings and funerals) and who has a regular day job elsewhere but does not have a facilities maintenance business **probably would be viewed by the IRS as an employee of the church,** absent other facts.
- A maintenance person who works for ABC Maintenance Company and is sent to different job locations, including the church, depending on the work schedule set by ABC, would be an employee of ABC Maintenance Company. ABC Maintenance Company **would be an independent contractor** in its relationship with the church.
- A painter who walks in off the street and offers to spend the next four weeks painting the church for a flat fee **is probably an independent contractor.** S/he will do the assigned painting tasks and then go on to paint other churches, businesses or homes.

Problems With Improper Classification

Typically churches will attempt to classify a worker as an independent contractor to avoid the paperwork and expense of a new employee. Churches are well aware of the many reporting, withholding and payment obligations that exist if an individual is classified as a lay employee. To name a few, the church must complete an I-9 form for immigration purposes; begin social security and income tax withholding; report the hiring of the employee on state or federal informational forms; issue a W-2; possibly enroll the person in state unemployment compensation programs (many states exempt churches); enroll the employee in worker's compensation; possibly enroll the person in insurance, medical or pension plans; and create an employee personnel folder. If a church considers a person as a self-employed independent contractor, generally none of the above need be done. However, if the church is held to have *improperly* classified that person as an independent contractor, then the church will be responsible for back taxes, withholding, interest, possibly tax penalties, back insurance premiums, etc.² That is why it is so crucial that a church make the right decision when deciding how to classify a new person.

² In a well-publicized recent case, Microsoft was sued by "permanent temporary" workers that Microsoft treated as independent contractors. Some of these individuals worked at Microsoft for over a year. The court found in that case the differences between employees and these "independent contractors" were not clear and that the temporary workers were entitled to benefits. (*Vizcaino v. Microsoft*, 97 F. 3d 1187, 1996).

What A Church Can Do To Protect Itself

There are different steps that a church can take to protect itself.

Complete Review and Written Opinion. Each church organization needs to do its own analysis, in close consultation with legal and/or tax counsel, for any “job” that is in a gray area if the church wants to classify the person as an independent contractor. The church needs to explain the complete fact scenario, provide a job description, and review the above 20 factors with its outside consultant. Where there might be disagreement with classification as an independent contractor, it is advisable to have the outside attorney or qualified tax professional put their opinion in writing to demonstrate the church’s good faith effort to comply with the law.

Uniform Application. Make sure that you treat people the same way, by consistently applying the rules. Make sure independent contractors receive 1099s (for payments exceeding \$600.00).

Written Contracts. It is also very useful to have a written agreement with the hired individual stating that he or she understands and agrees that the work being performed is done as an independent contractor. While such an agreement will not in and of itself convince the IRS of independent contractor status, it can help clarify what work is being done, how and where it is to be done, the time frame for completion and the person’s understanding and agreement that s/he is self employed. This will also confirm that the church is not doing any tax withholding for the person, not paying any insurance or pension benefits, not responsible for unemployment compensation or worker’s compensation, etc. Any contract should be reviewed by legal counsel to comply with your specific needs.

Remember the Job is Being Performed by an “Independent” Contractor.

Try not to manage or control how the contractor performs the job. The more day-to-day oversight that is exerted, the more it will look like supervising an “employee.”

The General Council on Finance and Administration is not engaged in providing legal or accounting services. The service of a competent professional should be sought for legal and tax advice.

IRS Publications and Materials

(Source: [http://www.gcf.org/PDFs/TaxPacket2006\(Current\)/Additional_Resources/IRSPublicationsandMaterials.pdf](http://www.gcf.org/PDFs/TaxPacket2006(Current)/Additional_Resources/IRSPublicationsandMaterials.pdf))

The following IRS Publications may be helpful:¹

Publication 15 – Circular E, Employer’s Tax Guide

Publication 15-A – Employer’s Supplemental Tax Guide

Publication 463 – Travel, Entertainment, Gift, and Car Expenses

Publication 517 – Social Security and Other Information for Members of the Clergy and Religious Workers

Publication 521 – Moving Expenses

Publication 525 – Taxable and Nontaxable Income

Publication 526 – Charitable Contributions

Publication 533 – Self-Employment Tax

Publication 535 – Business Expenses

Publication 557 – Tax-Exempt Status for Your Organization

Publication 1771 – Charitable Contributions (Substantiation and Disclosure Requirements)

Publication 1828 – Tax Guide for Churches and Religious Organizations

Publication 3833 – Disaster Relief (Providing assistance through charitable organizations)

¹ See the document in this handbook on "Obtaining IRS Forms and Publications".

OBTAINING IRS FORMS & PUBLICATIONS

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Additional_Resources/ObtainingIRSForms&Publications.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Additional_Resources/ObtainingIRSForms&Publications.pdf))

Pick-up or Order by Telephone

IRS forms and publications can be obtained from your local IRS office or by contacting the IRS at **1-800-829-3676 (1-800-TAXFORM)** and asking that your order be mailed to you. (Many public libraries and post offices also have some forms available.)

Internet

IRS forms and publications are available for downloading on the IRS website: www.irs.gov . (On the IRS website, use either the search function or click on “Forms and Publications”.)

Fax

The most frequently requested tax forms are available from the IRS by fax. Dial the IRS fax number (**703-368-9694**) from your fax machine and follow the voice prompts.

Other Resources

(Source: [http://www.gcfa.org/PDFs/TaxPacket2006\(Current\)/Additional_Resources/OtherResources.pdf](http://www.gcfa.org/PDFs/TaxPacket2006(Current)/Additional_Resources/OtherResources.pdf))

Richard R. Hammar, *Church & Clergy Tax Guide*, (Published annually by Christian Ministry Resources)

B.J. Worth, *Worth's Income Tax Guide for Ministers*, (Published annually by Evangel Publishing House)