



Housing Allowance . . . **Exclusion for Ministers**

An individual who qualifies as a minister of the gospel under §107 may receive a housing allowance as part of his or her compensation. This housing allowance is sometimes referred to as a parsonage allowance or a rental allowance. The housing allowance is excluded from gross income in the year received, to the extent it is used to provide a home or pay utilities for a home that is provided. If the individual is simply commissioned or is not an ordained minister, he or she will not qualify for the exclusion.

While not subject to income tax, the housing allowance is subject to self-employment tax, unless the minister has filed for and received exemption under Reg. §1.1402(e)-2A or is a member of a particular religious sect who has taken a vow of poverty.

To qualify as an excludable housing allowance, the amount must be officially designated in advance of payment. This amount must be specified in the minister's employment contract, the church minutes, the church budget, or any other officially-written document, indicating an official action had been taken. The housing allowance cannot exceed the reasonable compensation for the minister's services, but can be 100% of the minister's compensation, especially if the minister is part-time, has a very small congregation, or has another source of income [Warren vs. Commissioner]. It also must be paid every year. Unless the designation is set as a permanent amount, the church must repeat this process and establish this allowance each and every year for all qualified ministers.

The amount of housing allowance excludable from taxable income is the lesser of the following:

- The amount actually used to provide a home;
- The amount officially designated (in advance of payment) as a rental or housing allowance; or
- The fair rental value of the home, including furnishings, utilities, garage, etc., based on area location.

Keeping in mind that the lesser of the above-mentioned guidelines applies; a housing allowance can include anything spent to provide a home for the minister and his or her family. While the Code and Regulations do not specify the types of expenditures of "providing a home," a list is provided in the case of Richard D. Warren, et ux. vs. Commissioner, [114 T.C. 343]. It provides some insight into what the tax court considers appropriate expenses:

- Rent or principal payments, purchasing costs for the home, including any down payment.
- Real estate taxes and mortgage interest for the minister's principal residence.
- Insurance on home and furnishings.
- Improvements, repairs, and upkeep of the house and contents.
- Furniture and appliances that stay with the home, and interest on the purchase of such items.
- Decorating items, painting, and wallpapering that stay with the home.
- Utilities, including heat, lights, water, cable TV, trash pick-up, sewer, satellite dish, personal phone, etc.
- Cleaning supplies, carpet cleaning, tools for landscaping or garden.
- Hose, brooms, light bulbs, expenses for mower, etc.
- Homeowners' association dues or condominium fees.
- Carpeting, throw rugs, linoleum, flooring, ceiling tile, and ceiling fans.

Allowable items are personal in nature for the minister, not business expenses, and are determined on the cash basis.

Even though the minister uses his or her mortgage interest and real estate taxes in the housing allowance exclusion, he or she can still include them as itemized deductions on Schedule A [§265(a)(6) and Rev. Rul. 87-32].

However, mortgage interest on a home equity loan, where the proceeds were used for unallowed expenses, cannot be used for the housing allowance exclusion [Roland E. Rasmussen, T.C. Memo 1994-311].

Example: Pastor Mike has an agreement with his church that designates \$16,000 for a housing allowance. The annual fair rental value of his housing was \$13,200. The rental value of his furniture was \$1,200. His other annual expenses were as follows:

- Cable - \$540
- Utilities - \$900
- Telephone - \$960
- Mortgage - \$12,000
- Repairs - \$250
- Insurance - \$750
- Furnishings - \$350
- Real estate taxes - \$1,700
- Wallpaper - \$125
- Ceiling fan - \$250
- Landscaping - \$80
- Cleaning supplies - \$75

His allowable exclusion for a housing allowance is the lesser of the amount designated (\$16,000), the fair rental value of the housing and furniture, plus utilities (\$13,200 + \$1,200 + \$540 + \$900 + \$960 = \$16,800), or the amount actually spent (\$17,980). After entering the above-listed expenses, the housing allowance exclusion is limited to the amount designated (\$16,000).

DO NOT INCLUDE: Labor hired for maintenance or maid service, groceries, personal toiletries, paper products, personal clothing, toys, computer games, VCR or DVD movies, cellular phones used outside the home, or home equity loans not used for housing-related expenses.

§§107 and 1402

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