



10 ESSENTIALS OF

THE MINISTER'S HOUSING EXCLUSION

CHURCH

ESSENTIALS
SERIES

Introduction

Introduction

The minister's housing exclusion provides one of the most significant tax benefits for those who qualify as "ministers of the gospel" under the tax law. This exclusion from income tax is available to ministers who own their own homes and to those who live in church-provided housing.

These concepts apply to all "church" organizations that employ ministers, including ministries that may not be a traditional "steeple" church but meet the tax law qualifications to be recognized by the IRS as a church (examples include integral agencies of a church, conventions, or associations of churches). References to "church" or "churches" throughout this resource are intended to include all of these organizations employing ministers who may qualify for the minister's housing exclusion.

Why expend energy regarding salary and tax issues for ministers? Early in his ministry, the Apostle Paul wrote the churches in the region of Galatia and instructed them, saying that those that were taught God's Word should "share all good things with their instructor" (Galatians 6:6). We believe that includes their salary and sound tax advice.

Many ministers own a home, while others rent, and some reside in church-provided housing. Interestingly, we see all three situations in the New Testament. Some of God's workers appear to have owned homes (cf. Peter's home in Matthew 8:14-16), others rented lodging (cf. Paul's apartment in Rome in Acts 28:30-31), and some resided in housing provided for them (cf. Philemon's guest room in Philemon 1:22). As ministers find themselves in each of these living arrangements today, the aim of this resource is to equip churches to help each and every minister maximize the tax exclusion available to them as a matter of good stewardship.

Later, in writing his first letter to Timothy, the Apostle Paul added that those who "direct the affairs of the church" and labor in "preaching and teaching," are worthy of "double honor" (1 Timothy 5:17). This language can be understood as making every effort, or we might say in modern terms, "working double time," to supply the financial needs of "ministers of the gospel" so they are free to focus all their energy and attention on God's work. Churches honor their ministers when they assist them in taking advantage of this significant tax benefit.

On this biblical foundation, ECFA offers this helpful resource, *10 Essentials of the Minister's Housing Exclusion*.

1

Eligibility

Eligibility for the Housing Exclusion

The tax code provides a housing exclusion for federal income tax purposes for ordained, licensed, or commissioned ministers, with valid status, but only with respect to services the minister performs in the exercise of their ministry.¹ The meaning of the “exercise of their ministry” is a determining factor. Here is how the phrase is generally applied:

- **Church.** If the minister’s services are provided to a church, including an organization with convention or association of churches status, exercise of ministry includes the conduct of religious worship, ministration of sacerdotal functions, and control, conduct, and maintenance of the church.

When one thinks of a church, what comes to mind? Perhaps a congregation of people who meet together on Sunday morning and at other times during the week. Perhaps a church service is also shared virtually on the internet. The term “steeple” church is often applied to these organizations. However, an organization with convention or association of churches status is often distinctively different from a “steeple” church. The IRS has identified characteristics, together with other facts and circumstances, to determine whether an organization is considered a church for federal tax purposes. See [Churches](#).

- **Integral agency of a church.** If the minister’s services are provided to an integral agency (an organization under the authority of a religious body constituting a church or church denomination), exercise of ministry includes the conduct of religious worship, ministration of sacerdotal functions, and control, conduct, and maintenance of such organization. An example of an integral agency could be certain denominational-related colleges and other institutions. See Revenue Ruling 72-606 for integral agency criteria.
- **Other service.** If a minister is not engaged in service performed in the exercise of the ministry of a church, including an organization with convention or association of churches status, or an integral agency of a church or church denomination (or a church does not assign the services of a minister to certain other organizations), the definition of a qualifying minister becomes much narrower.

Tax law and regulations provide little guidance for ministers in this category. However, Tax Court cases and IRS rulings suggest that a minister that falls under this service definition will qualify for the special tax treatments of a minister only if the individual’s services for the

¹ Section 107 of the Internal Revenue Code; Treas. Reg. 1.107-1.

employer substantially involve conducting religious worship and/or performing sacerdotal functions. This might include conducting Bible studies, spiritual and pastoral counseling, conducting religious crusades, producing religious television and radio broadcasts, and publishing religious literature.

In one important case, *Mosley v. Commissioner*, T.C. Memo 1994-457 (1994), the Tax Court ruled that a minister fulfilled his ministry through his parachurch organization by producing mission tapes for local congregations. Testimony in this case indicated an ordained minister who “seeks to proclaim the gospel in any fashion to any person or groups of persons, or who provides church-related services to congregations” is functioning as a minister.

How much time constitutes substantial involvement in conducting worship and/or administering the sacraments? This has not been defined. However, in two IRS letter rulings, the IRS determined that five percent of the minister’s working hours were insufficient to qualify for tax treatment as a minister.

For additional information, see the [***Minister’s Tax & Financial Guide***](#) by Michael Martin, published annually by ECFA.

2

Tax Treatment

The Minister's Housing Exclusion Relates to Federal Income Tax But Not Social Security Tax

The minister's housing exclusion is an exemption from federal income tax only—not social security tax.

Under the U.S. social security tax framework, all ministers are considered self-employed (even though they are considered employees for income tax purposes). Therefore, ministers must pay the full amount of social security tax (without the benefit of the amount being matched by the employing church) on all forms of compensation up to the annual social security wage base—unless the minister has met the strict qualifications and has formally opted out of social security).

Regardless of whether a minister lives in church-provided housing (see Essential 3) or receives a housing allowance for a home they provide (see Essential 4), these forms of compensation are subject to social security tax. Planning tip:

To avoid having a big tax bill on April 15—mostly due to social security—pay your tax bill each month by having additional federal income tax withheld. Optionally, use the 1040-ES, quarterly tax payment method.

Example 1: A minister lives in church-provided housing. The fair market value of living in the home plus utilities is \$20,000 per year. While the minister does not have to pay income tax on the \$20,000 value of living in the home, he is subject to 15.3% social security tax on the amount.

Example 2: A minister lives in a home she has purchased (i.e., not church-provided housing). The church properly designates from the minister's salary a housing allowance of \$25,000 for her housing expenses during the year. While the minister does not have to pay income tax on the \$25,000 housing allowance used to provide her home, she is subject to 15.3% social security tax on the amount.

If the church voluntarily pays the minister all or a portion of self-employment social security tax, the payment is reportable as compensation on Form W-2. The amount is fully taxable for income and social security tax purposes.

One key exception: The rental value of church-provided housing or a housing allowance provided after a minister retires is not subject to self-employment social security tax.

3

Church-Provided Housing

The Impact of the Housing Exclusion for Ministers Who Live in Church-Provided Housing

Some churches own a home (or otherwise provide a home) where the minister may live as part of his or her compensation package. The fair rental value of living in a church-provided home is eligible for the housing exclusion within certain limits.

Additionally, a housing allowance may be provided to a minister living in church-provided housing to cover out-of-pocket, housing-related expenses paid by the minister (for example, utilities, furnishings, etc.). It is a designation of cash salary (similar to a housing allowance for a minister who provides his or her own home).

Alternatively, it is appropriate for the minister's out-of-pocket expenses for the maintenance of a church-owned parsonage to be reimbursed by the church if a full accounting is made to the church. These reimbursements do not relate to a housing allowance.

If the church owns the housing provided to a minister, the church may wish to provide an equity allowance to help offset the equity not accumulated by the minister through home ownership. An equity allowance is taxable for both income and social security tax purposes unless directed to certain retirement programs, such as a 403(b) or 401(k) plan.

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Minister-Provided Housing

The Impact of the Housing Exclusion for Ministers Who Own or Rent a Home

Ministers generally provide their own homes rather than living in church-provided housing. In these cases, ministers may exclude, for income tax purposes (see [Essential 2](#)), a cash housing allowance that is the lowest of these factors:

- Reasonable compensation,
- Amount used from current ministerial income to provide the home (see Essential 6 for a worksheet of allowable housing expenses),
- Amount prospectively and officially designated by the church, or
- Fair rental value of the home including utilities and furnishings.

If a designated housing allowance exceeds any one of these four factors, the excess is reportable as additional income for income tax purposes.

The IRS does not place a percentage limitation on how much of a minister's compensation may be designated as a housing allowance by the employer. In a few instances, such as with bivocational ministers, 100% of cash compensation may be justified as a housing designation and exclusion.

It is often best for the church to over-designate a minister's housing allowance by a reasonable amount (e.g. 10% of anticipated costs), subject to the fair rental value limitation, to allow for unexpected housing expenses and increases in utility costs. However, the minister may only exclude the amounts actually paid within the year for housing-related expenses.

In addition to these limits, the housing exclusion may only apply to one residence at a time. Construction costs qualify as housing expenses. However, since the housing exclusion only applies to one home at a time, excluding construction costs expended while living in another home is problematic.

It is inappropriate for a church to directly reimburse expenses related to minister-owned housing because the expenses are not the responsibility of the church. Instead, these expenses are eligible for inclusion under a cash housing allowance paid by the church.

5

Action by the Church

Housing Allowances Require Action by the church

Ministers are eligible to exclude up to the fair rental value of church-provided housing (see [Essential 3](#)) for income tax purposes without any official action by the church.

However, a cash housing allowance (see [Essential 4](#)) is only excludable under the following rules:

- The allowance must be officially designated by the church. The designation should be stated in writing, preferably by resolution of the board (or a committee of the board) in an employment contract. If the only reference to the housing allowance is in the church budget, the budget should be formally approved by the board.
- Tax law does not specifically say that an oral designation of the housing allowance is unacceptable. Still, the use of a written designation is highly recommended. The lack of a written designation significantly weakens the defense for the housing exclusion upon audit.
- The housing allowance must be designated prospectively (in advance) by the church. Cash housing allowance payments made prior to a designation of the housing allowance are fully taxable for income tax purposes. Carefully word the resolution so that it will remain in effect until a subsequent resolution is adopted.
- Only actual expenses can be excluded from income. The source of funds used to pay for a minister's housing expenses must be compensation earned by the minister in the exercise of ministry in the current year.
- Only an annual (not month-by-month or paycheck-by-paycheck) comparison by a minister of housing expenses to the housing allowance is required.

Example: A church designates a housing allowance in December, effective for the following year, of \$30,000 for a minister. The comparison of the \$30,000 allowance with actual housing expenses is only required at the end of the year by the minister.

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Creation of the Housing Designation

Important Steps in Establishing a Housing Designation

Churches should follow these important steps in properly establishing a housing allowance designation for their ministers:

1. Verify the qualified tax status of the minister (see [*Essential 1*](#)).
2. Determine the extent to which the payment of housing expenses will be the responsibility of the minister—these expenses will vary based on whether the housing is provided by the church or the minister.
3. Request that the minister provide an estimate of housing-related expenses (see sample worksheet on page 18) expected in the coming year for which the minister will be responsible.
4. Adopt a written designation based on the minister's estimates (see sample form on page 19). This designation may be included in the minutes of the board, an employment contract, annual budget, or another appropriate document.

It is immaterial whether the payment of a properly designated cash housing allowance is a separate payment or is part of a payment that also includes other compensation.

Example: It is acceptable to include the amount designated as a housing allowance in the same paycheck with other compensation.

Some churches mistakenly believe that providing a housing allowance to their minister will increase the church budget. This is not true. If a portion of the minister's compensation is designated as a housing allowance, it costs the church nothing. The minister's income is simply divided between housing allowance and compensation.

Housing Exclusion Worksheet

Minister Living in Home Minister Owns or Is Buying

Minister's name: _____

For the period _____, 20__ to _____, 20__

Date designation approved _____, 20__

Allowable Housing Expenses *(expenses paid by minister from current income)*

	<u>Estimated Expenses</u>	<u>Actual</u>
Down payment on purchase of housing	\$ _____	\$ _____
Housing loan principal and interest payments	_____	_____
Real estate commission, escrow fees	_____	_____
Real property taxes	_____	_____
Personal property taxes on contents	_____	_____
Homeowner's insurance	_____	_____
Personal property insurance on contents	_____	_____
Umbrella liability insurance	_____	_____
Structural maintenance and repair	_____	_____
Landscaping, gardening, and pest control	_____	_____
Furnishings <i>(purchase, repair, replacement)</i>	_____	_____
Decoration and redecoration	_____	_____
Utilities <i>(gas, electricity, water, phone)</i> and trash collection	_____	_____
Homeowner's association dues/condominium fees	_____	_____
Subtotal	_____	
10% allowance for unexpected expenses	_____	
TOTAL	\$ <u>_____</u>	\$ <u>_____</u> (A)
Properly designated housing allowance		\$ <u>_____</u> (B)
Fair rental value of home, including furnishings, plus utilities		\$ <u>_____</u> (C)

The amount excludable from income for federal income tax purposes is the lowest of A, B, or C (or reasonable compensation).

Sample Housing Allowance Declaration Applicable to Minister-Provided Housing

Name: _____ Minister's Name

The following resolution was duly adopted by the board of _____ Name of Church.

Whereas, section 107 of the Internal Revenue Code permits a minister of the gospel to exclude from gross income (in computing federal income taxes) a church-designated allowance paid to the minister as part of their compensation to the extent used by the minister for actual expenses in owning or renting a home;

Whereas, the above minister is compensated by _____ Name of Church
exclusively for services as a minister of the gospel; and

Whereas _____ Name of Church
does not provide housing for the above
pastor; therefore,

Resolved, the portion of the minister's total income that is designated to be a housing allowance pursuant to section 107 of the Internal Revenue Code will be:

\$ _____ per _____ year _____ month (circle one)
All housing will be divided by 26 and paid on each pay period.

This designation of the above amount as a housing allowance shall apply to the calendar year _____
and all future years unless otherwise provided.

Minister's signature

Church representative signature

Sample Housing Allowance Declaration Applicable to Church-Provided Housing

Name: _____ Minister's Name

The following resolution was duly adopted by the Board of _____ Name of Church.

Whereas, the Internal Revenue Code permits a minister of the gospel to exclude from gross income "the rental value of a home furnished as part of compensation" or a church-designated allowance paid as a part of compensation to the extent that actual expenses are paid from the allowance to maintain a parsonage owned or rented by the church;

Whereas, the above minister is compensated by _____ Name of Church
exclusively for services as a minister of the gospel; and

Whereas _____ Name of Church provides the minister with the rent-free use of housing owned by (rented by) the church as a portion of the compensation for services rendered to the church in the exercise of ministry;

Resolved, the portion of the minister's total income that is designated to be a housing allowance pursuant to section 107 of the Internal Revenue Code will be:

\$ _____ per _____ year _____ month (circle one)
All housing will be divided by 26 and paid on each pay period.

This designation of the above amount as a housing allowance shall apply to the calendar year _____ and all future years unless otherwise provided.

Minister's signature

Church representative signature

7

Modifications to the Housing Designation

Churches Should Take These Steps to Modify a Housing Designation

To modify a housing designation during the year, the following steps should be taken:

1. The minister should keep records of allowable housing expenses paid, including receipts (scanned, copies, or original documents) for those expenses.
2. The minister should identify any significant change in housing expenses and estimate the amount by which the total actual expenses may exceed the amount designated as the housing allowance.
3. When housing expenses are running higher than anticipated or are expected to do so, the minister can ask the church to prospectively increase the housing allowance designation. The church can officially and prospectively amend the minister's housing allowance as appropriate to reflect the anticipated change in housing expenses.

Caution: When a church makes a mid-year increase in the ministerial housing designation, the increase only applies to expenses incurred subsequent to the designation change.

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Reporting the Housing Allowance Designation to Ministers

Reporting the Housing Allowance to Ministers

A designated housing allowance for a minister-employee may be reflected on Form W-2 in Box 14 with the notation, "Housing Allowance." Though not required, this reporting method is suggested by [*IRS Publication 517*](#).

Alternatively, a church can report the designated housing allowance to a minister by providing a statement separate from Form W-2. This may be in a memo or letter. The statement need not be attached to income tax returns.

Using either reporting option, the calculation of the taxable income for federal income tax purposes is, for example:

Gross compensation	XXXX
Less designation housing allowance	YYYY
Taxable income for federal income tax purposes	<u>ZZZZ</u>

For ministers who are independent contractors, the housing exclusion is not reportable on Form 1099-NEC. The amount can be communicated to the minister by memo or in another form.

There is no requirement for the minister to account to the church for actual housing expenses.

9

Special Circumstances

Housing Allowances for Retired Ministers, Evangelists, and Teachers/Administrators

Retired Ministers

Pension payments, retirement allowances, or disability payments paid to a retired minister from an established plan are generally taxable as pension income. However, churches and denominations may designate a housing allowance for retired ministers to compensate them for past services to the church.

Withdrawals from a denominational- or church-sponsored 403(b) or 401(k) plan qualify for designation as a housing allowance. Withdrawals from a 403(b) or 401(k) plan not sponsored by a church are not eligible for designation as a housing allowance.

Retired ministers may also exclude the fair rental value of a home furnished by a church or a rental allowance paid by a church as compensation for past services. However, a surviving spouse of a retired minister cannot exclude a housing allowance from income. If a minister's surviving spouse receives a rental allowance, it is includable in gross income.

Evangelists

Traveling evangelists may treat a portion of an honorarium received as an excludable housing allowance to the extent that the paying church designates all or a portion of the honorarium as a housing allowance in advance of the payment. Honoraria payments of \$600 or more in a calendar year to an evangelist require the church to issue Form 1099-NEC. The \$600 reporting threshold is after excluding any properly designated housing allowances and net of expense reimbursements based on adequate substantiation.

Teachers/Administrators

Ministers employed as teachers or administrators by a church-sponsored school, college, or university, for purposes of the housing exclusion, perform ministerial services. However, if the minister performs services as a teacher or administrator on the faculty of a non-church college, he or she cannot exclude from income a housing allowance related to the value of a home that is provided.

10

Accounting Considerations

Accounting for the Housing Exclusion

Determining fair rental value

Determining the fair rental value of church-provided housing for self-employment social security tax purposes is solely the responsibility of the minister. The fair value should be based on comparable rental values of similar residences in the immediate community, comparably furnished.

One of the best methods to establish the fair rental value of housing is to request that a local realtor estimate the value in writing. The minister should retain the estimate in a tax file and annually adjust the value for inflation and other local real estate valuation factors.

Determining actual expenses

The actual amount expended for housing and furnishings is limited to amounts expended in the current calendar year. Amounts expended in a prior year cannot be carried forward to a following year through depreciation or because the prior year's expenses exceeded that year's designation. Housing expenses in prior years that are not used to justify a housing exclusion simply have no value in future years.

Home equity loans and second mortgages

Ministers who own their homes and itemize their deductions are eligible to deduct mortgage interest and property taxes on Schedule A even though these items are also excluded from taxable income as part of the housing allowance. This is sometimes referred to as a "double deduction."

Without a home mortgage, a minister has no mortgage principal and interest amounts to exclude under a housing allowance. Therefore, there would be no "double deduction" of the mortgage interest as an itemized deduction and as a housing expense for purposes of the housing allowance exclusions.

Loan payments on home equity loans and second mortgages qualify as housing expenses only in certain instances. The use of the loan proceeds as housing expenses vs. non-housing expenses determines whether the loan payments may be excluded for income tax purposes.

Now What?

Action Steps
to Excellence

Now What? Action Steps to Excellence

Action Steps for Churches

- Help your minister(s) focus time, resources, and energy on ministry by assisting them in maximizing the provision in the tax code for the minister's housing exclusion whether they own, rent, or live in church-provided housing.
- Establish who is eligible for the housing exclusion based on ministerial duties, not based on job titles.
- Differentiate between church-provided housing and a housing allowance for minister-provided housing.
- Determine the extent to which payment of housing expenses will be the responsibility of the minister – these expenses will vary based on church vs. minister provided housing.
- Request that the minister provides an estimate of housing related expenses (sample worksheet [Page 18](#)).
- Adopt a housing designation, approved by the board and put in writing in the employment contract (not just the church budget). The designation can be a portion of the minister's existing salary, and should represent reasonable compensation and fair market value.
- Modify the designation if needed, based on documentation of significant changes in expenses, as provided by the minister.
- Consider any special circumstances such as retired ministers, traveling evangelists and church-sponsored school/university teachers and administrators.
- Provide proper reporting of housing designations to ministers on W-2's or separate memos.

Action Steps for Ministers

- Verify with the church your eligibility for the housing exclusion based on ministerial duties, not on job title.
- Understand that the housing exclusion is an exemption from federal income tax only – not social security tax. To avoid a big tax bill on April 15 due to social security, pay your tax bill monthly by having additional federal income tax withheld.

- Differentiate between church-provided housing and a housing allowance for housing you own or rent. If you are in church-provided housing, you may exclude the fair rental value of the home, as well as any housing allowance you may receive for out-of-pocket housing related expenses.
- For any housing allowance (whether for a home you own or rent, or for out-of-pocket housing related expenses) provide the church with an estimate of expenses for the coming year (sample worksheet Page 18). This estimate will be used to determine a reasonable and fair housing designation.
- Ensure that the designated housing allowance is approved by the board and is provided in writing in your employment contract (not just in the church budget).
- Once the housing designation is established, keep records of allowable expenses paid, including receipts for those expenses, so that you can provide documentation should a modification to the designation be necessary.
- Refer to the rules for special circumstances if you are a retired minister, traveling evangelist, or a teacher/administrator in a church-sponsored school or university.
- Follow the calculation below for federal income tax purposes:

Gross compensation	XXXX
Less designation housing allowance	YYYY
Taxable income for federal income tax purposes	<u>ZZZZ</u>

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