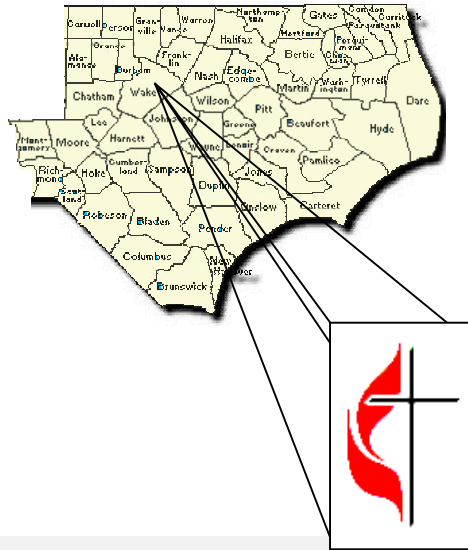


2003 COMPENSATION ISSUES

Affecting Taxes and Plan Compensation for Ministerial Pension Plan (MPP) and Comprehensive Protection Plan (CPP)

A guide for clergy and local church treasurers in the North Carolina Annual Conference, Southeastern Jurisdiction, of The United Methodist Church

Treasurer Tips



Sharon E. Strother, CPA
Conference Treasurer /
Business Administrator /
Pension Officer
sestrother@nccumc.org
(919)832-9560 or (800) 849-4433

Clergy Pension Plan Compensation and Taxes Overview

1. Clergy must receive a W-2 and wages must be reported to the IRS. Under United Methodist polity, clergy are self employed.
2. Clergy must pay self-employment tax and any payments made by the local church for this tax are additional taxable income for clergy.
3. Pension Plan Compensation is based on your cash salary, cash allowances, and housing exclusions or parsonage allowance.
4. Travel is recommended to be paid under an accountable reimbursement plan which is then not included in plan compensation.
5. All value received in the form of a parsonage, utilities, or housing exclusion are taxable for self-employment tax but are *excluded* from income tax wages.
6. Utilities may be paid by the local church directly to the utility company or the pastor. The Staff Parish Committee should recommend a method to the charge conference. Amounts paid to the pastor increase the pension plan compensation.

ARE CLERGY EMPLOYEES? Should their wages be reported ?

“It is recognized that for certain limited purposes such as taxation, benefits, and insurance, governments and other entities may classify clergy as employees.” *Book of Discipline* ¶ 141 The IRS and courts determined that United Methodist clergy at the local church are to be classified as employees for income tax purposes. (*Weber v. Comm.*, 60 F.3d 1104 (4th Cir. 1995)). The employer is generally considered the salary paying unit. However, for the self-employment tax (i.e., Social Security or SECA), all clergy are defined by statute as self-employed. (IRC Sec. 1402©, 3121(b)(8))

For these reasons, all local churches should report income tax wages for clergy on form W-2 each year. NO social security wages are reported. Local churches should not fund any portion of the self-employment tax liability. Any church payments toward the pastor's self-employment tax liability are taxable compensation for both income tax and self-employment tax.

TRAVEL REIMBURSEMENTS

We recommend an accountable reimbursement plan to fund travel and other business expenses.

- Actual travel reimbursement is not included in plan compensation.
- Cash travel allowances paid without documentation to the church must be included in plan compensation.

This topic is too broad to address here in more detail. Please see our website for examples of documentation and policies required.

HOW SHOULD UTILITIES BE PAID?

- The 2002 North Carolina Annual Conference adopted policies to be consistent with other Annual Conferences in treating cash utilities allowances as plan compensation.

- Cash utilities allowances paid to the pastor are included in plan compensation. The result is a slightly higher pension contribution.
- Church payments directly to utility companies for parsonage utilities are not included in plan compensation. This procedure creates pension contributions consistent with prior years.
- The staff parish committee and pastor should discuss and jointly recommend a method to fund utilities to charge conference for approval.
- All utilities (regardless of who pays them) must be included in the fair rental value of the parsonage or cash housing allowance and is subject to self-employment tax.

HOUSING ALLOWANCES AND EXCLUSIONS (IRC Sec. 107)

Clergy can exclude the value received to provide a home from income for income tax purposes within the limits imposed under section 107 of the Internal Revenue Code. Currently a minister of the gospel may exclude the lesser of:

- Fair rental value of the home or parsonage including utilities
- Actual housing expenses, including utilities
- Amount designated as the housing allowance exclusion

HOW DO WE CREATE THE HOUSING EXCLUSION

Clergy living in a parsonage are already using the housing exclusion. The fair rental value of a fully furnished home, including utilities must be reported as self-employment earnings but is not subject to income tax.

Additional amounts can be excluded with the adoption of a housing allowance resolution as long as the total excluded amount does not exceed limitations under IRC Sec. 107 above.

Clergy receiving cash housing allowances in lieu of a parsonage may also adopt a housing allowance resolution and exclude the cost of their home subject to the limitations.

A pastor living in their own home and not receiving a cash housing allowance may use the

housing allowance exclusion to designate a portion of compensation which would otherwise be treated as salary and reclassify that amount to be for housing.

The housing allowance may only be used for the primary residence. If a pastor lives in a parsonage and also has a personal home, only one of the homes qualifies for exclusion.

Part-time pastors living in their own home are eligible to use the housing allowance exclusion provided that they are ordained, commissioned or licensed as a minister.

A resolution should be adopted by charge conference. Examples are available on our website. The resolution should state:

- Beginning date and period of the resolution (may only be prospective)
- Total compensation amount
- Housing allowance portion, including utilities, included in the compensation
- Address of any parsonage provided rent-free to the pastor.

The amount excluded should be estimated as closely as possible to actual expenses. Some excludable costs include but are not limited to:

- Furniture and appliances
- Building and grounds maintenance
- Cleaning and other supplies
- Property insurance and taxes
- Rent or mortgage or down payments

Food, servants, and personal items do not qualify for the exclusion. Ultimately, it is up to the charge conference to approve the housing allowance resolution each year, and requests should be based on factual information.

INSURANCE PERSONAL PORTION

The pastor's personal portion of health insurance premiums are taxable compensation and should be included in plan compensation.

WHAT ELSE SHOULD I KNOW?

General Council on Finance and Administration produces reference materials which discuss these and other tax related issues in much greater detail. We encourage all pastors and local church treasurers to use this reference package from our web site and help control our postage costs. If it is not feasible for you to do so, please contact our office.

<http://www.nccumc.org/treasurer>

The staff of the N C Annual Conference are not engaged to provide legal or tax advice and recommend that all individuals and churches consult their professional advi