

3 Financial Planning Topics *Exclusive* to Pastors



When you answered the call to ministry, you probably didn't realize everything that you were getting yourself into. One area that catches most pastors off guard is personal finances. Even if your parents taught you well, unless they were pastors themselves, you probably found that there were holes in your knowledge. That is because here in the U.S., pastors have a number of financial planning opportunities and challenges that are entirely

unique to the clergy. The major topics exclusive to pastors are the ministerial housing allowance, Social Security exemption, and dual-status taxation.

Financial planning issues for pastors:

- Ministerial housing allowance
- Social Security exemption
- Dual-status taxation

Ministerial Housing Allowance

Quite possibly the greatest financial advantage that you have as a pastor is your ability to exempt your housing expenses from federal income tax. U.S. tax law allows a church to provide a parsonage to its pastor rent-free without including the value in the pastor's taxable compensation. Since not all churches provide parsonages, pastors are also allowed to claim a cash or rental housing allowance that is also exempt from federal income taxation. The allowance covers any expenses necessary to "provide a home," so even if you live in a parsonage you can claim a cash housing allowance for things like linens and cleaning supplies.

There is a limit to the amount of housing allowance that you can claim.

Your housing exemption is limited to the lesser of:

- Your actual housing expenses
- 100% of your ministerial compensation
- The fair market rental value of your furnished home, including utilities
- The amount officially designated as a housing allowance in advance

As that last point stated, the housing allowance must be designated in advance. You cannot claim a housing allowance retroactively. Because of this, it is important to make accurate estimates of your coming expenses and even overestimate. If your designated housing allowance exceeds your actual expenses for the year, it is very simple to add the excess allowance back to your income when you file your taxes. As such, it is advisable to overestimate expenses rather than underestimate in order to take full advantage of the allowance. Also, if you have a large expense coming up, make sure to have your housing allowance officially increased before incurring the expense so that it is covered. The housing allowance can be requested or adjusted at any time and there is no limit to the number of changes that can be made.

You may even be eligible to claim a tax-free housing allowance in retirement. If you have a denominational pension or set some of your ministerial compensation aside in a retirement savings account like a 403(b), withdrawals in retirement could be designated as a housing allowance. The same limitations apply during retirement, including the requirement that the housing allowance is officially designated in advance by your employing church.

Which expenses qualify for the housing allowance?

- Mortgage principal, interest, down payment & closing costs
- Rent
- Real estate taxes
- Homeowners or renter's insurance
- Home maintenance, repairs, improvements
- Utilities, including internet, cable TV & landline
- Furniture & appliances
- Dishes, cookware, decorative items & linens
- Yard care services & tools
- Cleaning supplies

Which expenses are not allowed?

- Groceries
- Servants
- Personal items
- Personal gifts
- Personal toiletries
- Personal clothing
- Cell phone service

Social Security Exemption

Ordained, licensed, or commissioned ministers also have the opportunity to exempt themselves from the Social Security system for their ministerial income. You can opt out as a pastor if you can honestly say that you are “conscientiously opposed to, or because of my religious principles I am opposed to, the acceptance of public insurance.” You are not allowed to opt out of Social Security for purely economic reasons.

There is a limited window of time in which you can exempt yourself from the Social Security system. You have until the due date (including extensions) of the tax return for the second year in which you have at least \$400 of net earnings from self-employment, any of which came from ministerial services. For example, if you are ordained and start working as a pastor for pay in 2020, then you have until the due date of your 2021 tax return to opt out of Social Security.

How do you request a Social Security exemption?

1. File IRS Form 4361.
2. Inform your church that you filed.
3. Verify your grounds for filing with the IRS.
4. Receive your approved copy of Form 4361.

The Social Security program is designed as a safety net to provide Americans with retirement, disability, survivor, and medical benefits under Medicare. If you opt out of the program, then you need to provide all of those things for yourself through savings and insurance. However, even if you exempt yourself as a pastor, you may still be eligible for benefits under your spouse’s earnings record or if you worked enough years in a secular job where you paid into the system.

What benefits does Social Security provide?

- Retirement benefits
- Disability benefits
- Survivor benefits
- Medical benefits (Medicare)

Dual-Status Taxation

Pastors are subject to what is called dual-status taxation. That simply means that whether or not you are an employee of a church, you always have to pay your payroll (Social Security and Medicare) taxes as if you were self-employed. Usually, the employer pays half of the payroll tax and the employee pays the other half under the FICA system. Pastors, though, have to pay both halves, for a total of 15.3%, under the SECA system. Churches are not allowed to withhold payroll taxes for a pastor. If your church gives you money to help cover the cost of your payroll taxes, then that is considered additional taxable income to you.

Another unique twist on taxation for pastors is that churches are not required to withhold federal income taxes from a pastor's paycheck. This is a requirement in every other industry and for every other employee, just not pastors. Unlike with payroll taxes, though, churches are allowed to withhold taxes for their pastors. Many pastors take advantage of that and have their church withhold enough in income taxes to cover their payroll tax bill as well.

If your church doesn't withhold taxes from your paycheck or they don't withhold enough to cover your payroll taxes as well, then you are responsible for calculating and paying your taxes on a regular basis. The U.S. tax system is a pay-as-you-go system, so you are not allowed to wait until you file your return to pay. When you aren't subject to mandatory withholding, then you must make quarterly payments with Form 1040-ES.

You must make your quarterly estimated tax payments each year by:

- April 15
- June 15
- September 15
- January 15

If the due date falls on a weekend or holiday, it is pushed forward to the next business day.

When calculating your payroll tax, it is important to remember to add your parsonage and/or cash housing allowance back into your total income. The clergy housing allowance only exempts housing expenses from federal income tax, not payroll taxes. If you live in a parsonage, the fair market value if it were rented to a stranger is considered compensation and must be included in your calculations as income. As the pastor, it is your responsibility to determine the fair market value, not your church or the IRS.

As you can see, there are a number of unique financial opportunities available to you as a pastor. Nevertheless, these opportunities bring with them a host of additional complications. Yet, when you take the time to understand them and manage them well, it can be an incredible blessing. Our hope is that the information presented here will provide you with the knowledge to understand your responsibilities and wisely steward your finances. If you ever need assistance, whether it's a one-time consultation or an ongoing partnership, Guide Financial Planning is here for you.