MEMO #1

Pensions and Benefits USA

Housing for Your Pastor: Parsonage or Housing Allowance?

"Should we continue to provide a parsonage and utilities or should we change to a cash housing allowance and let our pastor buy his own home?"

Across our denomination this difficult question is being asked, often out of genuine concern for the pastor's dilemma at retirement, when he has no real estate investment built up for a retirement home. The question becomes even more difficult to answer with the shift in the nation's economy and in each local economic situation. While there is *no absolute, authoritative answer,* the following list of advantages and disadvantages, which have become apparent to pastors and churches through actual experience, is offered to stimulate careful thinking and evaluation.

Remember! A parsonage may be nicer than a home the pastor could afford.

Remember! A parsonage may eliminate the need for temporary housing during a pastoral change.

Pro Parsonage and Con Housing Allowance:

1. In some situations, there really is little choice. The parsonage may be connected to or adjoining the church building with no alternative for selling or renting. Unless used for Sunday School rooms, it remains the pastor's home.
2. Churches owning a parsonage may strengthen their ability to attract the pastoral candidate of their choice who may not be able or willing to buy a home.
3. In some areas, there are no property taxes due on a church-owned parsonage, which may mean less expense is involved.
4. The church handles repairs and maintenance on the parsonage, thus freeing the minister from these time-consuming worries and expenses.
5. Often a parsonage is nicer than what a minister could afford to buy in the community.
6. Making a pastoral change is easier when moving from parsonage to parsonage, since securing temporary quarters is unnecessary for house hunting or waiting for occupancy.
7. When the parsonage is sold, the church loses a traditional and meaningful way of showing love and concern for the parsonage family.
8. Many ministers do not have sufficient funds for a down payment on a home.
9. The church which enters the loan business to "give" the pastor the down payment often bears the cost of low interest and little or no

Caution! Be sure to check the tax implications before making a loan to the pastor for housing.

payment on the principal. There may be tax implications as well. State nonprofit corporation laws must be followed carefully. Some states may even prohibit such loans.

10. The loan situation is hopefully trouble-free, but awkward situations have developed!

11. Many homes appropriate for the minister's needs are out of price range for his salary.

12. Very often the church cannot afford a housing allowance that fully covers all expenses including real estate taxes, fire and casualty insurance, upkeep, etc. It takes constant review and appropriate board action to keep pace with these increasing, inflationary costs.

13. Some pastors do not have the extra time, money, and expertise to handle such a real estate investment which includes the added responsibility to maintain and repair "his" home.

Remember! A home may not sell when necessary during a pastoral change.

14. In some locations, real estate can move very slowly, if at all! Adequate housing may not be available for purchase when needed. Likewise, a home may not sell when it comes time for a pastoral change.

15. If the minister is the one who purchases the parsonage, any difference between purchase price and appraised value may be considered taxable as ordinary income.

16. Appreciation of property is assumed, but depreciation can be a reality due to natural and man-made disasters or economic conditions. Home owners do not always sell at a profit. This potential is not a concern for the minister in a parsonage.

Pro Housing Allowance and Con Parsonage:

1. A housing allowance may solve the problem of having to build a new parsonage at today's costs, while at the same time help the pastor plan for his retirement.

2. With a housing allowance, some feel that compensation planning may be more flexible, easier to compare, and simpler to budget.

3. Home ownership suggests permanency and may encourage longer pastorates.

4. Since a home owner pays real estate taxes, he has more voice in community affairs.

5. A minister buying a home gets to choose the kind, style, and location.

6. The minister's family may decorate as they wish—even remodel without board action.

Remember! Home-owning ministers may benefit from special tax breaks.

7. Home ownership becomes an important investment for the future, assuming, of course, each property appreciates in value and appropriate equity is established. This growing "earned equity" is portable as the minister relocates, allowing him to take his full earnings to a new location.

See: MEMO #12, "Who Is a Minister for Tax Purposes?"

8. Home owning ministers get a double tax break. Within certain limits, the housing allowance used to provide and furnish a home is nontaxable income. In addition, mortgage interest and property taxes are deductible as itemized deductions. (See MEMO #12, "Who Is a Minister for Tax Purposes?" to see who qualifies for this double tax break.)

9. A homeowner can sell his principal residence and may not be required to pay any tax on up to *$500,000* of profit. The exclusion can be used as frequently as every two years. To be eligible, the homeowner must have owned and occupied the home as a primary residence for at least two of the five years before the sale. (IRS has specific regulations controlling how this may be done.)

10. In the event of disability, death, or retirement, home ownership with adequate insurance generally means an immediate move is unnecessary.

Tax Implications

In addition to the above considerations, the local church board should insist that the tax implications be explored thoroughly before any decision is made. The following examples represent possible concerns:

> **Caution!** Explore the impact of selling a parsonage to your pastor below fair market value, both to the pastor's tax liability and to the church's tax exempt status.

a) Extra care should be taken when a parsonage is to be given to a minister or sold to him at a value below the fair market value. The church may contend this is a "gift" and is not compensation. However, it is likely this would be challenged forcing the minister to pay taxes on the value of the "gift" or take the issue to a tax court.

b) Where the church does make such a considerable "gift" to their minister without reporting it as compensation, the church may be jeopardizing or calling into question its tax-exempt status. In order to have such status, the assets of the corporation cannot accrue to the personal benefit of an individual other than as reportable compensation. Tax-exempt organizations also must be careful that they are not paying "unreasonable" compensation to employees.

> **Caution!** Explore the tax implications of selling or renting a parsonage.

c) Another concern involves the sale or rental of the parsonage. The church can be subject to taxation when it receives "unrelated business income." This possible interpretation of the tax laws should not go unexplored before a final decision is made.

Another Alternative

The above lists are not intended to be exhaustive. Hopefully, they will stimulate thinking in this complex area. Many statements are similar but have opposite impact when phrased from a different perspective.

> **Caution!** Any decision should be jointly agreed upon by the church board, district board, district superintendent, pastor, and tax advisors before selling the parsonage.

Churches with strong financial resources may have no difficulty if they decide to sell their parsonage and provide a cash housing allowance. However, such a decision should be preceded by careful evaluation and in consultation with the church board, district board of church properties, district superintendent, pastor, and tax advisor.

The church board which does not allow its minister to purchase his own home, but does provide an adequate parsonage and an allowance for parsonage furniture, etc., is still without an answer for their concern for the pastor's future retirement need. But, there is another alternative if the original question is rephrased, "How can we provide the pastor with an adequate salary now and also an adequate retirement nest egg without selling the parsonage?"

> **Idea!** Provide your pastor with a Retirement Housing Reserve by contributing into the Nazarene 403(b) Retirement Savings Plan.

This question can be answered much more easily. A local church may provide a RETIREMENT HOUSING RESERVE for their pastor by contributing into the Nazarene 403(b) Retirement Savings Plan.

Retirement Housing Reserve

- The church can contribute and tax-shelter this compensation.
- Interest or gain can be realized on contributions without incurring an immediate tax liability. No tax liability is incurred until funds are withdrawn by the participant.
- Withdrawals at retirement often are at a reduced tax rate or as a minister's tax-free "housing allowance."
- Numerous withdrawal options allow for maximum flexibility in retirement planning.

> **Remember!** Tax liability is not incurred on TSA funds until the money is withdrawn, and Nazarene ministers may receive the funds as tax free "housing allowance."

The following chart will *illustrate* how the RETIREMENT HOUSING

RESERVE can work, assuming a modest cash salary of only $10,000 per year and assuming an interest rate of 7 percent (annual effective interest). Upon request, specific illustrations can be given using current rates.

*Nazarene 403(b) Retirement Savings Plan Illustrations**

PARTICIPANT'S AGE	MONTHLY DEPOSIT UNTIL AGE 65	*TOTAL CASH AT 7 PERCENT INTEREST AT AGE 65	*MONTHLY INCOME FROM TOTAL CASH WITH ANNUITY OPTION AT AGE 65
30	$ 100	$ 171,142	$ 1,083
40	$ 100	$ 78,304	$ 495
50	$ 100	$ 31,110	$ 197

*Illustrations only (not guarantees or estimates) if dividends and interest remain unchanged. Annuity option of "life with 60% to survivor" with an annuity purchase rate of $158.05/$1 of monthly income at age 65. Annuity purchase rate is subject to change.

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