

HOUSING ALLOWANCE

Q & A's

HOUSING ALLOWANCE Q&As (FOR UNITED METHODIST CLERGY)

1. **What is the housing allowance?** When reporting gross income for federal income tax purposes, clergy can exclude a portion of their income designated by their church or salary paying unit as a "housing allowance" under Section 107 of the Internal Revenue Code (IRC). To be excludible, amounts designated as a housing allowance must be used to provide housing. In addition, there are limits on the amount that can be excluded. Note that a portion of the income of virtually all wage earners is used to pay for housing. What makes the housing allowance unique is that some of the income used to provide housing can be excluded from gross income for federal income tax purposes.

Also, clergy who live in a parsonage provided by the church do not have to report the fair rental value of the parsonage as income. (Note this "free" housing provided to clergy generally would be taxable compensation for lay employees.)

The housing allowance is sometimes called a "parsonage allowance" for clergy who are provided with a parsonage and a "rental allowance" for clergy who rent their home.

Example: A church pays its pastor an annual salary of \$35,000. In addition, she is provided the rent-free use of a furnished home owned by the church. The parsonage's annual fair rental value is \$10,000. The church and pastor do not have to report the \$10,000 fair rental value as income for federal income tax purposes.

2. **Is the housing allowance a deduction or exclusion from income?** The housing allowance is an exclusion from income, not a deduction. This means it is not reported as part of gross income for federal income tax purposes. (It is never deducted because it is not reported as income in the first place.)

Example: In the example above, the pastor reports \$35,000 as income (on IRS Form W-2, box 1). She takes no deduction for the \$10,000 fair rental value of the home that is provided to her because that \$10,000 is never reported as income for federal income tax purposes.

3. **What is the impact of the "Clergy Housing Allowance Clarification Act of 2002"?** The Clergy Housing Allowance Clarification Act of 2002 ("Act") prospectively codifies the fair rental value limitation on the amount of a designated housing allowance that can be excluded from gross income for federal income tax purposes. That law amended Section 107 of the IRC to now read:

Sec. 107. Rental value of parsonages

In the case of a minister of the gospel, gross income does not include –

(1) the rental value of a home furnished to him as part of his compensation; or

(2) the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home *and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities.*

(The new language added by the Act is shown in italics.)

This change is a statutory codification of the IRS's previous position on this issue and therefore, for most clergy, this is nothing new or different from the way the housing allowance has worked in the past. (The full text of the Clergy Housing Allowance Clarification Act of 2002 is included in the tax packet.)

The following question explains in more detail the three limitations on the housing allowance exclusion.

4. **Can clergy exclude from gross income for federal income tax purposes the entire cost of owning, renting, and/or furnishing a home?** It depends. The amount that can be excluded is the *lesser* of:

- (a) the amount designated as the housing allowance
- (b) the amount of actual housing expenses, or
- (c) the fair rental value of the property (furnished, plus utilities).

Example: A church pays its pastor annual compensation of \$45,000, of which \$10,000 is designated as a housing allowance. The pastor owns his own home and the fair rental value of his home is \$10,000 per year. The actual expenses of operating his home are \$10,000 per year. The church and pastor do not have to report the \$10,000 housing allowance as income for federal income tax purposes. (The church reports \$35,000 as salary on the pastor's Form W-2, box 1.)

Example: A church pays its pastor annual compensation of \$45,000, of which \$10,000 is designated as a housing allowance. The pastor owns her own home and the fair rental value of her home is \$10,000 per year. The actual expenses of operating her home are \$8,000 per year. The church and pastor do not have to report \$8,000 (out of the \$10,000 housing allowance) as income for federal income tax purposes. However, the "unused" \$2,000 of the housing allowance must be included in the pastor's gross income. This is because the pastor cannot exclude more than her actual housing expenses, regardless of the amount her church designates as a housing allowance or the fair rental value of the home.

Example: A church pays its pastor annual compensation of \$45,000, of which \$10,000 is designated as a housing allowance. The pastor owns his own home and the fair rental value of his home is \$12,000 per year. The actual expenses of operating his home are \$10,000 per year. The church and pastor do not have to report the \$10,000 housing allowance for federal income tax purposes. The pastor cannot claim a housing allowance exclusion for the entire fair rental value

of the home because his designated housing allowance and actual housing expenses are less than the fair rental value. He can only exclude from income the lesser of the fair rental value, designated housing allowance, or actual housing expenses, in this case, \$10,000.

Example: A church pays its pastor annual compensation of \$45,000, of which \$11,000 is designated as a housing allowance. The pastor purchased her own home and the fair rental value of her home is \$10,000 per year. The actual expenses of operating her home in this first year of purchase are \$30,000 which includes a \$20,000 down payment. The pastor can exclude a total of \$10,000 from income for federal income tax purposes. She cannot claim a housing allowance exclusion for all her actual housing expenses because the exclusion cannot exceed the fair rental value of the home, in this case, \$10,000.

Example: A church pays its pastor annual compensation of \$45,000, of which \$8,000 is designated as a housing allowance. The pastor owns his own home and the fair rental value of his home is \$10,000 per year. The actual expenses of operating his home are \$10,000 per year. The church and pastor do not have to report the \$8,000 housing allowance as income for federal income tax purposes. The pastor cannot claim a housing allowance exclusion for the entire amount of his expenses or for the entire fair rental value of the home, because the exclusion cannot exceed the designated housing allowance, in this case, \$8,000.

5. **How do you determine the fair rental value of the parsonage or pastor's home?** In general, the fair rental value of the property is a question of facts and circumstances based on the local real estate market. If the pastor rents his home, the amount of the rent would be presumptive evidence of the fair rental value (assuming the rental agreement was an "arm's-length" transaction). Other methods of substantiating the fair rental value might include calculations and written documentation drawn from listings with local realtors of similar properties, verification of rent paid for comparable housing in the neighborhood, or a review of newspaper advertisements for rents of similar housing in the community. Perhaps the best substantiation would be a letter estimating the fair rental value of the property written by a realtor who is familiar with your property and other rental property in your community.
6. **What is the status of the litigation, *Warren v. Commissioner of Internal Revenue*, which challenged the fair rental value test and raised issues regarding the constitutionality of Section 107?** After passage of the Clergy Housing Allowance Clarification Act of 2002, the IRS agreed to dismiss its appeal of the case and the federal appeals court subsequently dismissed the case without ruling on any of the substantive issues raised.
7. **How should a pastor and church determine the amount of the housing allowance?** Past experience is the best test. If this is a "first time" situation, the Housing Allowance Estimate Worksheet, Attachment C to this document, could be helpful. In addition, this worksheet can assist clergy in planning for out-of-the-ordinary housing expenditures in the upcoming year.

8. **Does the housing allowance cost the church more money?** To the extent the church designates as a housing allowance a portion of the annual compensation it would otherwise pay to its pastor, designating the housing allowance results in no additional cost to the church. Regardless, it is important to remember it is the *Disciplinary* obligation of every United Methodist church to provide housing for its pastor(s). This obligation can be fulfilled either by providing a parsonage or a housing allowance for the pastor(s).

9. **How is the housing allowance set up?** A pastor may not claim a housing allowance exclusion for federal income tax purposes unless his local church (or other salary paying unit) has first established or designated a housing allowance for him. The preferred way to do this is for the church council or charge conference to adopt a housing allowance resolution prior to each calendar year (or prior to the arrival of a new pastor) and record the resolution in the minutes of the meeting. However, to ensure that a housing allowance will always be in place for each calendar year, it is a good idea to have language in each resolution providing that the housing allowance will remain in effect in future years unless otherwise modified.

In determining the amount of the designated housing allowance, it can be very helpful if the pastor completes a form estimating his anticipated housing expenses for the coming year. (See Attachment C for a sample form.) This is important because, as seen in some of the examples above, any "mismatch" between actual housing expenses and the designated housing allowance could have tax consequences (specifically, either the pastor may not be able to exclude from his income as much as he otherwise could or he has to report additional income on his personal tax return).

In general, churches should avoid designating a set percentage of compensation as a housing allowance. The better approach is to estimate the anticipated expenses for the coming year and set the housing allowance accordingly. This approach minimizes the unfavorable tax consequences discussed above.

If the church provides the pastor with a parsonage, the church should annually (or prior to the arrival of a new pastor) adopt a resolution stating that it provides its pastor rent-free use of a church-owned parsonage and also designate the amount of the parsonage allowance (if any).

*See Attachments A and B
For a Sample Housing Allowance Resolution
and Notification*

10. **What types of housing related expenses can be included in the housing allowance?** Most reasonable household expenses can be included in the housing allowance, for example: down payment on a home, mortgage payments (including both interest and principal), home equity loan payments (assuming the loan proceeds are used for housing-related expenses), real estate taxes, property insurance, utilities, furnishings and appliances (including repairs), structural repairs, remodeling, yard maintenance and improvements, pest control,

snow removal, maintenance items, and trash pickup. (Also see Attachment C.) Note that the cost of food and servants may not be included in the housing allowance. Also, housing-related expenses can only be included in the housing allowance for the year in which they are incurred. (See the following example.)

Example: In anticipation of needing to put a new roof on his house, a pastor requests, and the charge conference approves, an additional \$3,500 as part of the pastor's designated housing allowance for the upcoming year. The pastor, however, waits until it is too late for the work to begin during that year. In that case, it is possible the pastor will not be able to exclude this additional \$3,500 from his income even though it was included as part of his housing allowance for the year. In short, the pastor can only exclude expenses in the same year they are incurred. The best the pastor can do in this situation is to ask the church to again designate an additional \$3,500 as part of his housing allowance for the following year and try to get the work done in that year.

11. **What type of housing expense records should clergy be keeping?** Clergy need to keep careful housing expense records to determine whether any part of the designated housing allowance is unexcludible and hence, must be reported as gross income. Records are also important for estimating a reasonable housing allowance for the next year. Original receipts, invoices, canceled checks, charge card records, etc. are all essential. Clergy may find it helpful to have one charge card dedicated solely to household expenses, to use the "shoe box" method of collecting all receipts in one handy place, and/or to have a dedicated bank account for this purpose. Clergy may also wish to create a contemporaneous log of expenses in the event some of the receipts or back up data are misplaced or difficult to interpret later.
12. **What happens if the pastor doesn't spend all of the designated housing allowance on housing expenses?** As noted above, the exclusion from gross income cannot exceed the lesser of the designated housing allowance, the actual housing expenses, or the fair rental value of the property. In particular, the exclusion from gross income can never exceed the actual housing expenses. Therefore, any "unused" portion of the designated housing allowance must be included in the pastor's gross income.

In general, any portion of the designated housing allowance that is not excludible because it is in excess of either the actual housing expenses or the fair rental value of the property, must included in the pastor's gross income.

Example: A church pays its pastor annual compensation of \$40,000, of which \$12,000 is designated as a housing allowance. The pastor owns his own home and the fair rental value of his home is \$12,000 per year. The actual expenses of operating his home are \$10,000 per year. The church and the pastor do not have to report \$10,000 (out of the \$12,000 housing allowance) as income for federal income tax purposes. However, the \$2,000 "unused" portion of the housing allowance must be included in the pastor's gross income.

13. **If the designated housing allowance is greater than the amount that can be excluded under Section 107 of the IRC, how does the church (and pastor) report the difference as gross income for federal income tax purposes?**

There are two methods for reporting this income:

(A) The Church Determination Method: Under this method, it is customary for the pastor, in mid-January, to provide the local church treasurer with documentation of all housing related expenses and the fair rental value of the property for the prior year. The treasurer uses this information to calculate the portion of the housing allowance that can be excluded by applying the three-part test discussed above. The church treasurer then reports the unexcludible portion of the housing allowance on the pastor's Form W-2 (box 1) together with the pastor's other salary or compensation.

Example: A church pays its pastor annual compensation of \$45,000, of which \$12,000 is designated as a housing allowance. She owns her own home and the fair rental value of the home is \$12,000 per year. Under the church determination method, the pastor informs the church treasurer in mid-January that she had only \$11,500 in housing expenses in the prior year. The treasurer will then include the "excess" \$500 in the pastor's gross income for the prior year by reporting \$33,500 on the pastor's Form W-2 (box 1). The pastor does not separately report this \$500 on her Form 1040.

(B) Estimated Exclusion Method: Under this method, the local church treasurer reports on the pastor's Form W-2 (box 1) the total amount of compensation paid to the pastor during the year less the entire amount designated as a housing allowance. If the amount designated as a housing allowance is greater than the actual housing expenses or the fair rental value of the home, then it is the pastor's responsibility to report the difference as "other income" on the pastor's IRS Form 1040, line 21.

Example: A church pays its pastor annual compensation of \$45,000, of which \$12,000 is designated as a housing allowance. He owns his own home and the fair rental value of the home is \$12,000 per year. The pastor had only \$11,500 of housing-related expenses in the prior year. Under the estimated exclusion method, the church treasurer reports \$33,000 on the pastor's Form W-2, box 1 and the pastor reports the "excess" \$500 as income on his Form 1040.

Although both methods are appropriate, it is interesting to note that the second method is the one illustrated in IRS Publication 517. The second method has the advantage that it imposes less of an administrative burden on the local church treasurer, who is often a volunteer. However, if the second method is used by the church, it should probably incorporate in its housing allowance notification to the pastor a statement to the effect that the pastor (not the church) is responsible for properly computing and reporting any unexcludible portion of the housing allowance. (See Attachment B). Conversely, the advantage of the first method is that it helps insure that the pastor doesn't unknowingly forget to report taxable income. If the first method is chosen by the church, it should probably incorporate in its annual housing allowance resolution a statement that it is adopting this method.

Also note that the church may, but is not required to, report in box 14 of Form W-2 the amount of the designated housing allowance it did not include in the pastor's gross income. If the church does not fill in box 14 of Form W-2, it should independently inform the pastor of this amount. As discussed above, it is essential for the pastor to know this amount when computing his federal income taxes under the estimated exclusion method and also when computing his self-employment taxes (see below).

14. **What type of records should the church be keeping regarding the pastor's housing allowance?** The church (or other salary-paying unit) should maintain copies of the documents pertaining to the designation of the housing allowance, for example, the minutes of the meeting during which the housing allowance resolution was adopted. It is advisable for the church to maintain a separate housing allowance file with copies of these minutes, the annual housing expense estimate that some pastors provide to their churches, and any other related documentation. If the church determination method (see above) is used, the church should keep copies of the pastor's housing expense information. If the estimated exclusion method (see above) is used, the church does not need to request or maintain the actual housing expense records because it is not responsible for determining or verifying whether the pastor is correctly reporting the housing allowance exclusion on his or her own individual tax return.
15. **Can the housing allowance resolution be adopted or amended mid-year?** Yes. The housing allowance resolution can be adopted or amended at any time. However, it can only be applied prospectively. That is why it is important for the housing allowance resolution to be adopted by the church council or annual charge conference prior to each new calendar year (or prior to the arrival of a new pastor) and for pastors to accurately estimate their housing expenses in advance.

Example: A local church waits until June 30 to establish its calendar year housing allowance of \$10,000. In that case, at most \$5,000 of the \$10,000 housing allowance can be excluded from the pastor's gross income in that calendar year.

Example: A pastor realizes in March that she has significantly underestimated her housing expenses for the year. There is still "room" under the fair rental value test to exclude her anticipated housing expenses but she is limited by the amount of her designated housing allowance. Therefore, at her request, the church council adopts a resolution, effective April 1, increasing the pastor's housing allowance from \$10,000 to \$12,400. However, the pastor may only exclude from gross income 3/4, or \$1,800, of the extra \$2,400 added to her housing allowance (that is, her maximum excludible housing allowance for the year is \$11,800). She cannot exclude 1/4, or \$600, of the extra amount because 1/4 of the year (January, February and March) has already passed before the amended housing allowance resolution was adopted by the church council.

16. **Is the housing allowance also excluded from earnings subject to social security taxes?** No. The housing allowance exclusion only applies for federal income tax purposes. Like most everyone else, clergy must pay both federal income taxes and social security taxes. Employees pay social security taxes through the Federal Insurance Contributions Act ("FICA") system and self-employed individuals pay social security taxes through the Self-Employment Contributions Act ("SECA") system. By law, clergy are considered self-employed for the purposes of paying social security taxes (more commonly referred to as self-employment taxes) and the housing allowance is subject to self-employment taxes. Also, the fair rental value of a parsonage provided to a pastor (including the cost of any utilities and furnishings provided) must be included as self-employment earnings subject to the self-employment tax. (See IRS Publication 517).

Example: A church pays its pastor an annual salary of \$35,000 and provides her with the use of a church-owned parsonage. The church pays for all expenses of maintaining the home. The fair rental value of the parsonage (furnished, plus utilities) is \$10,000 per year. The pastor's gross income for federal income tax purposes is \$35,000, but for self-employment tax purposes her gross earnings are \$45,000 (\$35,000 salary + \$10,000 fair rental value of the parsonage).

Example: A church pays its pastor an annual salary of \$35,000 and provides him with the use of a church-owned parsonage. The church pays for all expenses of maintaining the home. The church serves an affluent community where the average price of a home is \$500,000. Hence, the fair rental value of the parsonage (furnished, plus utilities) is quite high, in this case, \$30,000 per year. While the pastor will not have to report the fair rental value of the parsonage as income for federal income tax purposes, he will have to include the \$30,000 fair rental value of the parsonage as gross earnings for self-employment (social security) tax purposes, inflating his reportable earnings to \$65,000.

This often seems unfair to pastors, who in this type of situation are required to come up with a sizeable amount of money to pay the self-employment tax. However, it is important to keep in mind that the pastor is still receiving a significant income tax "break," because he received a \$30,000 benefit (i.e., free housing) that is not reported as income for federal income tax purposes. But some churches do establish a (taxable) "social security allowance," increasing the cash compensation of the pastor to help defray the extra cost of the self-employment tax in this type of situation.

Example: A church pays its pastor annual compensation of \$45,000, of which \$10,000 is designated as a housing allowance. The pastor owns her own home and the fair rental value of her home is \$10,000 per year. The actual expenses of operating her home are \$10,000 per year. The church and the pastor report \$35,000 as income for federal income tax purposes (the \$10,000 housing allowance is not reported). However, the pastor must report the entire amount of her compensation, \$45,000, as gross earnings for self-employment (social security) tax purposes.

17. **How is the housing allowance reported for social security purposes?** It is reported by the pastor on Schedule SE of Form 1040, line 2, together with salary. It is important to note that when the local church completes the annual W-2 Form for clergy, Box 3 should be left blank (for clergy only). Box 3 on the W-2 Form is used only to report FICA wages, not SECA wages (clergy wages are considered SECA wages for purposes of social security). See above and the example W-2 for further information. IRS Publications 517 and 525 are also useful on these points.
18. **What is the Deason rule?** It is an interpretation of the Internal Revenue Code followed by the IRS based on a tax case going back to 1964 and reaffirmed by the U.S. Tax Court in a subsequent decision in 1988, and in a tax court decision in 1992 (see Deason v. Commissioner, 41 T.C. 465 (1964); Dalan v. Commissioner, T.C. Memo. 1988-106; and McFarland v. Commissioner, T.C. Memo. 1992-440). The rule applies only to clergy who are able to take a business expense deduction for unreimbursed business expenses, which is becoming more and more uncommon for United Methodist clergy. The rule provides that a clergy person who claims an exclusion from gross income for the housing allowance must reduce their business expense deduction by the percentage of income that is excluded from income tax reporting for the housing allowance.
- Example:* A clergy person receives a salary of \$36,000, plus a housing allowance of \$18,000. He has unreimbursed business expenses of \$6,000, which, for purposes of this example, are assumed to be deductible. His total "ministry" income is \$54,000 (\$36,000 plus \$18,000 housing allowance). The exempt portion of his income (the \$18,000 housing allowance) is 33.33% of the total. Thus, he is only able to deduct 66.66% of the \$6,000 in deductible business expenses (\$4,000).
19. **Our church provides our pastor with a parsonage, fully furnished, all utilities paid. He requests a \$12,000 housing allowance each year. We do not think this is right. What can/should we do?** The church PPR/SPRC chair and/or the treasurer should sit down with the pastor to discuss what items and expenses are part of the \$12,000 housing allowance request. Attachment C, the Housing Cost Estimate Worksheet, may be helpful. The church should also be familiar with the fair rental value of a fully furnished (with all utilities paid) comparable house in the area. With this factual information as background, the church can then evaluate whether the \$12,000 request is truly a problem. If it is, then the church treasurer and chair of the staff pastor/parish relations committee should discuss with the pastor the church's concerns, reviewing the estimated expenses the pastor will be making and the IRS rules regarding the fair rental value and other limitations on what can be excluded from gross income as a housing allowance. The pastor may have misunderstood the IRS rules or may have a logical explanation and reporting position for the housing allowance. If, after this meeting, the church is still concerned and the matter has not been resolved, then the chair of the SPRC and treasurer may want to involve the district superintendent in a follow-up meeting. Ultimately, it is up to the charge conference to approve the housing allowance resolution each year, and the church is certainly not required to approve a resolution in the amount requested

by the pastor, if it believes in good conscience based on accurate factual information that the amount requested by the pastor is significantly too high.

20. **How does the housing allowance work for clergy couples?** Each clergy person can claim a housing allowance exclusion (assuming the appropriate steps have been taken with a housing allowance resolution), but the combined total amount of the exclusion may not exceed the fair rental value of their home or the actual expenses, whichever is less. In some circumstances, because of the nature of the United Methodist polity on itinerancy, each of the two clergy persons may live in separate homes and be provided with separate housing allowances (for example: appointments in two different locations, each with a parsonage, and with each salary paying unit requesting that the clergy person live in the parsonage). In these situations, the clergy couple should have a solid reporting position that the two housing allowances may be excluded from gross income for federal income tax purposes. The reporting position will be more tenable if the clergy couple has good documentation of the reasons for and professional necessity of maintaining two separate homes, and if the amounts claimed on their face for each home are reasonable.
21. **Can clergy take housing expenses on two homes at the same time?** No. The housing allowance exclusion is limited to one home at a time. (Except possibly for the clergy couple exception discussed above)
- Example:* If the clergy person is building or has acquired a retirement home or vacation home, and still lives in the parsonage as his or her main home, then none of the expenses of the second home are includable for housing allowance purposes.
22. **Can retired clergy receive their retirement benefits as a tax-free housing allowance?** Yes, subject to the three limitations set forth above. Each year the annual conference (or general agency or other United Methodist entity) needs to adopt a housing allowance resolution stating that all of the pension payments received by the clergy person from the General Board of Pension and Health Benefits qualify as a housing allowance for retired clergy. Retired clergy can receive up to 100% of their official United Methodist retirement benefits from the General Board of Pension & Health Benefits as a tax-free housing allowance (subject to the limitations set forth above).
23. **Can all church employees have a tax-free housing allowance?** No. Section 107 of the IRC allows only a "minister of the gospel" to have a housing allowance. Thus, only taxpayers who are serving as clergy under IRS rules for tax purposes are eligible for a housing allowance. For example, a church custodian or secretary cannot have a housing allowance. (Of course such staff as lay employees do get the benefit of having the church pay one half their social security) United Methodist elders in full connection appointed to serve at the local church are "ministers of the gospel" and are eligible for a housing allowance, as are appointed local pastors. Many deacons appointed to the local church also will be eligible for a housing allowance (see the separate Q&As on the clergy status of United Methodist deacons elsewhere in this tax packet).

24. Does my housing allowance impact on the amount of contributions made to my 403(b) pension plan?

Yes, there could be an impact since the income designated as a housing allowance is **not** part of the "includible compensation" for certain contribution limitations established by IRS rules. Therefore, while the new tax law changes generally increase previous limitations, clergy still need to be mindful of 403(b) contribution rules when part of their salary is designated as housing allowance.

The General Council on Finance and Administration is not engaged in providing legal or accounting services. The service of a competent professional should be sought for legal and tax advice.

Attachment A

(SAMPLE) HOUSING ALLOWANCE RESOLUTION

(To be inserted in the minutes of the meeting)

The chairperson informed the meeting that under the tax law, a minister of the gospel is allowed to exclude from gross income: (1) the rental value of a home furnished to him or her as part of his or her compensation; or (2) a housing allowance paid to him or her as part of his or her compensation, to the extent used by him or her to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities.

The (charge conference or church council) on the ____ day of _____, after discussing the amount to be paid to Rev. _____ as a housing allowance, on motion duly made and seconded, adopted the following resolution:

Rev. _____ shall receive salary of \$ _____ for the year. Rev. _____ shall also receive a housing allowance of \$ _____ for the year _____ and all future years unless otherwise provided.

(If the clergy person is to have rent-free use of a home, also state:

"Rev. _____ shall also have rent-free use of the home located at _____ for the year _____ and for every year thereafter so long as he/she is minister of the _____ United Methodist Church unless otherwise provided.")

The housing allowance (and/or rent-free use of a home) shall be so designated in the official church records.

Attachment B

**(SAMPLE)
HOUSING ALLOWANCE NOTIFICATION BY THE CHURCH**

Date _____

Dear _____:

This is to notify you of the action taken establishing your housing allowance at a meeting held on _____. A copy of the Resolution is attached.

Under Section 107 of the Internal Revenue Code, a minister of the gospel is allowed to exclude from gross income (1) the rental value of a home furnished to him or her as part of his or her compensation; or (2) a housing allowance paid to him or her as part of his or her compensation, to the extent used by him or her to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities.

You should keep an accurate record of your expenditures to rent or provide a home in order to be able to substantiate any amounts excluded from gross income when filing your federal income tax return. In the event of an audit, clergy receiving a housing allowance will have the responsibility of substantiating the use of such funds. Also, remember that the housing allowance (including the fair rental value of a provided parsonage) must be included as part of your earnings for self-employment tax purposes.

Sincerely yours,

Title

Attachment

Attachment C

HOUSING ALLOWANCE ESTIMATE WORKSHEET

<u>EXPENSE ITEM</u>	<u>ESTIMATE</u>
• utilities (electricity, heat, water, trash pickup, and local telephone)	\$ _____
• furniture and appliances (purchases and repair)	_____
• building repairs and remodeling	_____
• property insurance	_____
• yard maintenance, landscaping and improvements	_____
• maintenance items (cleaning and maintenance supplies, electrical supplies)	_____
• miscellaneous	_____
FOR OWNERS	
• real estate taxes	_____
• mortgage payments/down payment	_____
• improvements	_____
•	
FOR RENTERS	
• rent payments	_____
TOTAL	\$ _____

Clergy Housing Allowance Clarification Act of 2002

(This is the text of the Clergy Housing Allowance Clarification Act of 2002 ("Act") which amended the housing allowance exclusion in Section 107 of the Internal Revenue Code.)

H.R. 4156

One Hundred Seventh Congress of the United States of America

AT THE SECOND SESSION

Begun and held at the City of Washington on Wednesday, the twenty-third day of January, two thousand and two

An Act

To amend the Internal Revenue Code of 1986 to clarify that the parsonage allowance exclusion is limited to the fair rental value of the property.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Clergy Housing Allowance Clarification Act of 2002".

SEC. 2. CLARIFICATION OF PARSONAGE ALLOWANCE EXCLUSION.

(a) IN GENERAL - Section 107 of the Internal Revenue Code of 1986 is amended by inserting before the period at the end of paragraph (2) "and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities".

(b) EFFECTIVE DATE -

(1) IN GENERAL - The amendment made by this section shall apply to taxable years beginning after December 31, 2001.

(2) RETURNS POSITIONS - The amendment made by this section also shall apply to any taxable year beginning before January 1, 2002, for which the taxpayer -

(A) on a return filed before April 17, 2002, limited the exclusion under section 107 of the Internal Revenue Code of 1986 as provided in such amendment, or

(B) filed a return after April 16, 2002.

(3) OTHER YEARS BEFORE 2002 - Except as provided in paragraph (2), notwithstanding any prior regulation, revenue ruling, or other guidance issued by the Internal Revenue Service, no person shall be subject to the limitations added to section 107 of such Code by this Act for any taxable year beginning before January 1, 2002.

Text of Section 107 Before and After the Act

Text of §107 of the Internal Revenue Code prior to the Act:

Sec. 107. Rental value of parsonages

In the case of a minister of the gospel, gross income does not include –

(1) the rental value of a home furnished to him as part of his compensation;
or

(2) the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home.

Text of §107 of the Internal Revenue Code as amended by the Act:

Sec. 107. Rental value of parsonages

In the case of a minister of the gospel, gross income does not include –

(1) the rental value of a home furnished to him as part of his compensation;
or

(2) the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities.