

Clergy Care

Pastors who want to steward their resources well will want to make the most of their church compensation package. When it comes to the housing allowance, a benefit afforded by the Internal Revenue Service (IRS), pastors also must understand their responsibility to make plans in advance to comply with the tax code.

MMBB Financial Services (), a financial services ministry, comes alongside pastors to assist with compensation, including retirement benefits. Active since 1911, this nonprofit organization serves more than 17,000 members as a member of American Baptist Churches, USA as well as a wide range of church groups, including all of the major African American denominations. MMBB's members have entrusted more than \$2.5 billion to the care of the organization.

Charisma recently spoke with Rev. Dr. Perry Hopper, who is in his 34th year at MMBB. Dr. Hopper is associate executive director and director of denominational relations responsible for coordinating special programs that support MMBB's mission. He also serves as an associate national secretary of the American Baptist Churches USA.

Hopper is well qualified for this financial services work. His pastoral experience includes serving churches in Boston, New York City, New Jersey and Philadelphia. Beyond his traditional ministry role, he is highly qualified on the financial side as well. His education includes a B.A. in political science (with a minor in business administration) from the University of Washington and an MBA from Penn State. Perry also holds a master of divinity degree from Harvard University Divinity School and a doctorate of ministry as a Samuel DeWitt Proctor Fellow at the United Theological Seminary of Dayton, Ohio.

He brings all this education and expertise to aid clergy in

the roles to which they have been appointed. One of the areas he knows well is the clergy housing allowance, which MMBB says is the most important tax benefit available to ministers who own or rent their homes.

How the Allowance Works

MMBB understands how important it is to maximize the value of the housing allowance for the benefit of the clergy. Many ministers either fail to claim the allowance or simply do not claim enough.

Pastors can take one of the three common types of clergy housing allowance, depending on their living situation. Those who live in a church-provided parsonage do not pay federal income taxes on the amount of their compensation that their church designates in advance as a parsonage allowance.

If the pastor rents a home or apartment, the pastor does not pay federal income taxes on the amount of compensation the church designates in advance as a housing allowance. The same applies if a minister owns their home.

The clergy housing allowance includes housing-related expenses such as mortgage and rental payments, utilities, repairs, furnishings, insurance, property taxes, additions and maintenance. The housing allowance is also subject to limits, according to the Internal Revenue Service (IRS) code.

“The limits for the housing allowance are really based on what you claim and what is designated by the church and then what is actually spent,” Hopper says. “So, for example, the IRS applies a three-part test to determine how much of the income you can actually claim. First, how much did your church or employer designate as your housing allowance? Second, what is the fair rental value of your home furnished, plus utilities? That requires some assessment of how much that home is worth, maybe even an appraisal. And the third is what is actually spent. When you total up all your expenses for the year, how

much did you actually spend? Under the IRS code the limit is the lowest amount of those three that you're eligible to claim as the housing amount for the year."

So, the bottom line is clergy are limited to the lesser of the three:

What did the church designate?

What did the pastor actually spend for the year?

What is the fair market value of the home?

The housing allowance is considered compensation for ministerial services, and the church must designate the value of the clergy housing allowance in advance. It's important to know that a minister cannot exclude more than the church designates. Any amount a minister spends on housing that exceeds what the church designates must be reported as taxable income. If audited by the IRS, it is the responsibility of the minister to document actual housing expenses and keep all receipts.

Pastors must pay close attention to structuring their compensation package to take advantage of every tax benefit available.

Hopper points out, "If you structure certain elements of a clergy person's compensation in ways that are tax-advantaged and paid on their behalf instead of directly to them, it becomes favorable strategy."

Some parts of compensation should be paid directly to the clergy, but other parts should be paid on their behalf. MMBB recommends structuring compensation so that cash and the Social Security allowance (also known as a Social Security/Medicare tax offset) are paid directly to the clergy, and the rest paid on their behalf, so it doesn't become taxable income to the pastor. Ministers should also take note

that they must pay Social Security/Medicare taxes on the dollar amount designated as clergy housing allowance.

During budget season, churches must consider the clergy housing allowance as part of their spending plan for the year.

“As we’re in this budget season, and as pastors consider where they’re headed in 2021, this would be the time to begin making those kinds of estimates,” Dr. Hopper explains. “And I say ‘estimate’ because it’s not always an exact science, but you estimate to the best of your ability how much of your income will be declared as housing. And so, you set it up in consultation with the church, you declare how much it is, or is going to be, and then you put that on file with the employer or with the church.”

Dr. Hopper explains how his own allowance works as an example.

“At MMBB, I have already been asked to declare how much of my income is going to be designated as housing allowance for 2021,” he says. “And then that goes through the board’s Personnel Committee, similar to a church trustee board, you put that on file, and they basically vote to approve it. This way, the church is in partnership with you, if you will, on exactly how much of your income is going to be declared as housing, and that is filed with the church as a matter of record.”

Under certain circumstances, pastors can make changes in their housing allowance.

“It can be changed for things like a major expense that require you to change your housing allowance, such as a roof replacement, or if you’re going to add on a room to the house for various reasons,” Hopper says. “If there’s some major change that requires you to change your housing allowance, that is fine. If you change in the middle of the year, in July, for example, that can only be for expenses going from July forward. You cannot change retroactively. Pastors and

other church workers often get confused as to whether they can change and include retroactive expenses—you cannot. Changes can only be for those expenses that are paid forward.”

Hopper also adds one helpful caveat.

“If you move from one ministry to another, or you go to another church during the middle of the year, of course, you are able to change your housing allowance from that point on.”

Why Negotiation Is Important

With the ever-present COVID-19 pandemic in 2020, churches and their leadership have had many challenges, including a drop in giving in many congregations. This brings attention to the whole issue of sustaining local churches and employing pastoral staff.

“We have to look at the entire scope of compensation in the pandemic and how churches are doing financially,” Hopper says. “For example, if we look at negotiating compensation, there are going to be some headwinds due to the difficult health and economic environment in general. Many churches have been shuttered for many months now. Some are experiencing reduced tithes and offerings. I’m very concerned that the longer this pandemic goes on, the more Americans are unemployed, and these are the same people who are in your pews contributing to the ministry and its budget, every week, every month. As well, the financial markets have been volatile. Even for churches that are blessed with things like endowments, those kinds of assets may not be yielding returns that are required to sustain the ministry.”

Along with those headwinds, the question about keeping pace with appropriate compensation arises.

“We’re sensitive to that at MMBB, even though we’re recommending in 2021, that there be a 2% increase based on several factors,” Hopper comments. “One, the consumer price

index is 1.5%, so if there is no increase, of course, the person is losing ground. The index has been relatively flat, but it's 1.5%, nevertheless. We're recommending that compensation at least keep pace with inflation, so people are staying even if not getting ahead."

When pastors renegotiate compensation with their employing church or move to a new ministry, they must understand what's at stake if they don't grasp the full compensation picture. This is where MMBB comes in to assist, especially if the pastor doesn't have financial training.

"Not enough is done upstream, if you will, around financial literacy, which leads to financial wellness," Hopper says. "That's one of the objectives of MMBB conducting financial wellness seminars at the denominational convention level with a number of our partners and engaging in initiatives supported by grants from Lilly Endowment Inc. MMBB has partnered with the Lilly Endowment on financial wellness and financial literacy."

"We're also working with seminary partners to educate seminarians about what they are going to encounter once they leave seminary and they explore a call to a church or to a ministry," Hopper says. "One of the blind spots is that once you're ordained, your relationship with the government changes, hence the dual status of being employed and self-employed."

MMBB seeks to minimize this confusion.

"I think the confusion comes as to, am I allowed to get a housing allowance or even, what is it?" Hopper notes. "I think there's a lack of understanding as to what compensation includes, a lack of full transparency around how you establish a housing allowance, and how is it implemented? For those who really get it, most of them do it well. But there are plenty of clergy out there for which the importance of doing courses

and webinars on financial literacy is especially beneficial because a lot of them don't have all the information."

Negotiation with churches on the subject of compensation is important. Many clergy are putting in more and more hours, especially during the pandemic. Workload should be one of the factors that comes into play when settling on clergy compensation.

"For example, how does your ministry and that of the church impact the lives of the people you serve?" Hopper advises pastors. "My sense is that pastors are working harder than they've ever worked, even though they're doing it remotely for the most part, but they're being called upon to be creative and to be engaged in ways that many of them are not necessarily used to. And with the home office, it's kind of hard to separate home from work. We find ourselves doing emails well into the night, not to mention the stress calls that come as a natural part of the ministry, so we need to look at compensation and what others in similarly situated professions are making. And then, of course, what's the capacity of the church? There's a lot that goes into the question of housing and compensation, even during the pandemic."

Although there have been some court challenges through the years, including one from the atheist group Freedom From Religion Foundation in 2019, none have succeeded in removing the clergy housing allowance from the IRS code.

"For now, we do enjoy the housing allowance and it remains intact," Hopper says. "And as a church benefits plan, we also have the ability for those in retirement and receiving their annuity to claim up to 100% of their pension annuity as housing allowance if it can be justified, and that is a major win as well. Clergy not only have a housing allowance on the front end, but on the back end, as you collect your annuity, you can also claim that as a housing allowance to the extent

it's used for housing on the principal residence in retirement. This is based on an IRS private-letter ruling that church pension plans enjoy. And that's very important."

MMBB understands what it calls "the unique blessings and challenges of the ministry." After more than a century, MMBB still aims to help ministers and missionaries be good stewards of the financial gifts of God.

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