

Church Financial Hot Topic

Living in a Parsonage

Some Churches provide their Minister with a place to live owned by the Church: Church-provided homes are often referred to as a parsonage. If a church provides its minister a parsonage for his housing needs, then the minister must pay the Social Security Self-Employment tax on fair rental value of parsonage. On the other hand, the minister would not have to pay income taxes on the fair rental value of the parsonage.

Is the staff member a Minister? In determining if a person is a “minister” for federal tax purposes, the following five factors need to be considered, the person must: (1) be ordained, commissioned, or licensed; (2) administer sacraments; (3) conduct religious worship; (4) have management responsibilities in the local church or a parent denomination; and be (5) considered to be a religious leader by the church or parent denomination. In general, the IRS and the courts require that a minister be ordained, commissioned, or licensed, and then they apply a "balancing test" with respect to the other four factors.

The Minister’s gross income does not include the fair rental value of the parsonage: The fair rental value of the parsonage may be excluded from federal and state income tax.

Ministers are eligible for a housing allowance: Ministers who live in a parsonage are still eligible for a housing allowance. The church must approve the housing allowance before the minister incurs the actual housing expenses. The church can allocate part or all (up to 100%) of the minister’s compensation to housing allowance.

Ministers living in a parsonage should report the housing allowance and the fair rental value of the parsonage for their Social Security self-employment taxes: The annual rental value of the parsonage and the church approved housing allowance is excludable for federal and state income tax reporting. However, the FRV of the parsonage and housing allowance is subject to the Social Security self-employment tax of 15.3% unless the minister has opted out of Social Security under the federal guidelines or has retired.

Example of a Minister reporting his housing allowance and FRV of the parsonage – Pastor S lives in the church-provided parsonage. The church and Pastor S determine the fair rental value of the parsonage is \$500 per month. The church also allocates \$300 per month as a housing allowance for additional housing expenses incurred by the pastor. The church must approve this allocation of the parsonage’s fair rental value and the housing allowance according to the church’s own policies and procedures. When Pastor S prepares his income taxes, he will need to report his housing allowance and the FRV of the parsonage as \$9,600 [Fair Market Value (\$6000) + Allowance (\$3600)] and pay the 15.3% self-employment tax on this amount plus his salary from the church. However, he will only pay income taxes on his regular salary. If the church pays for parsonage’s utilities directly, then the minister’s housing allowance should be increased to cover these additional benefits.

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