Tax Advantage: Clergy Housing Allowance Exclusion

PORTICO® Benefit Services
A Ministry of the ELCA

Clergy can use this exclusion to realize significant tax savings during their income-earning years. Section 107 of the Internal Revenue Code allows "ministers of the gospel" to exclude some or all of their ministerial income designated as housing allowance from their gross income.

Retired clergy can continue this tax advantage because the distributions stemming from contributions and earnings made to their ELCA Retirement Plan account while serving under call are also eligible for the clergy housing allowance exclusion.

Does this apply to me?
"Minister of the gospel" typically includes all clergy as well as those approved by a bishop to engage in word and sacrament ministry.

During Your Working Years

Before the tax year begins, you decide how much of your ministry income you want designated as eligible for the clergy housing allowance exclusion, usually based on an estimate of your eligible housing expenses for the coming year. Then, you ask your employer to designate in writing that this amount is housing allowance-eligible.

Before completing your federal income taxes*, you determine how much of your housing allowance-eligible income you can exclude from your taxable income. As the following example demonstrates, this involves identifying the **lowest** of three amounts.

Example: Pastor Mendez owns his own home and earns a $40,000 salary. Using past housing-related costs and upping them slightly to cover unexpected costs, he requests that his congregation designate 50% of his income, or $20,000, as housing-allowance eligible for the coming year.

At the close of the year, Pastor Mendez then identifies:

- The amount designated in advance by his employer as his eligible housing allowance ($20,000)**
- His actual eligible housing expenses for the year including down payment, mortgage principal and interest, utilities, property taxes, insurance, furnishings, maintenance, etc. ($15,000)
- The annual fair rental value of his home (whether owned or rented), including furnishings and utilities ($17,000)

He determines that he's able to exclude $15,000, or the **lowest** of the three amounts, from his gross income before completing his taxes. As a result, he reduces his $40,000 income to $25,000 for tax purposes.

* Most states with a state income tax also support the Clergy Housing Allowance Exclusion.

** If you take withdrawals from your retirement account and/or receive annuity payments while working, you may now have multiple sources of housing allowance-eligible income to factor into the calculation — the portion of your salary your employer designated as eligible, and the income you're receiving from your retirement account.

During Your Retirement

As a church plan administrator, Portico tracks the contributions and earnings coming into your ELCA Retirement Plan account during your years of service, and automatically designates 100% of the resulting distributions you receive in retirement eligible for the clergy housing allowance exclusion.* If you roll out your ELCA Retirement Plan savings to an IRA or retirement plan not connected to a church plan, your distributions from these plans are no longer housing-allowance eligible and you can't use them to reduce your taxable income.

Before completing your federal income taxes*, you determine how much of your housing allowance-eligible income you can exclude from your taxable income. As the following example demonstrates, this involves identifying the **lowest** of three amounts.

Example: Pastor Larson owns her home, it's mostly paid for, and she's partially annuitized her ELCA retirement savings. She receives $15,000 in annuity income and $15,000 in retirement withdrawals; all of these distributions are designated by Portico as housing allowance-eligible.

At the close of the year, Pastor Larson identifies:

- The amount designated by Portico as her housing allowance ($30,000)
- Her actual eligible housing expenses for the year, including housing payments, utilities, property taxes, insurance, furnishings, maintenance, etc. ($10,000)
- The annual fair rental value of her home (whether owned or rented), including furnishings and utilities ($24,000)

She determines that she's able to exclude $10,000, or the **lowest** of the three amounts, from her gross income. As a result, she reduces her $30,000 income to $20,000 for tax purposes. If Pastor Larson had rolled her retirement savings into a non-church affiliated institution, she would not be able to exclude any of her distributions via the housing allowance exclusion.

* If you were, at some point, enrolled in the ELCA Retirement Plan and not serving as a "minister of the gospel," Portico will not designate the income you made during that time as eligible for the housing allowance exclusion.

While Portico doesn't provide tax advice, we do provide:

- Help from financial planners who understand the clergy housing allowance exclusion
- Online access to the *Clergy Tax Return Preparation Guide* by Richard R. Hammer which covers this topic during your working years and in retirement

As a taxpayer, you're responsible for determining if you're eligible for the clergy housing allowance exclusion, and you'll need to keep records to substantiate the cost of everything you exclude from income as housing expenses.

For information about Portico resources, visit *myPortico.PorticoBenefits.org*. For IRS information, read IRS Publication 517. For specific tax questions, consult your own tax or legal adviser.