P&B | Memo #1
Pensions and Benefits USA, Church of the Nazarene

# 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 asked, often out of genuine concern for the pastor's dilemma at retirement, when he or she has no savings built up for a retirement home. The question becomes even more difficult with shifts in the nation's economy and in each local 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.

### 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 be unable or unwilling to buy a home.
3. In some areas, no property taxes are due on church-owned parsonages, which may mean less expense.
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 a better accommodation 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.
9. The church that enters the loan business to "give" a pastor the down payment often bears the cost of low interest, and little or no payment on the principal. There may be tax implications as well. State nonprofit corporation laws must be followed carefully. Some states may even

**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.

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

prohibit such loans.

10. The loan situation is hopefully trouble-free, but awkward situations could develop.
11. Very often the church cannot afford a housing allowance that fully covers all expenses: real estate taxes, fire and casualty insurance, upkeep, etc. It takes constant review and appropriate board action to keep pace with these inflationary costs.
12. In some locations real estate can move slowly, if at all. Adequate housing may not be available for purchase when needed. Likewise, a home may not sell when it's time for a pastoral change.
13. If the minister purchases the parsonage, any difference between purchase price and appraised value may be considered as taxable income.
14. Appreciation of property is assumed, but depreciation can be a reality due to natural and man-made disasters or economic conditions. Homes do not always sell at a profit. This is not a concern for the minister in a parsonage.

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

## 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 helping the pastor plan for retirement.
2. With a housing allowance, compensation planning may be more flexible, easier to compare, and simpler to budget.
3. Home ownership suggests permanency and may encourage longer pastorates.
4. A homeowner pays real estate taxes thus having 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—even remodel—as they wish, without board action.
7. Home ownership becomes an important investment for the future, assuming each property appreciates in value and appropriate equity is established. This growing "earned equity" is portable as the minister relocates, allowing full proceeds to be taken to a new location.
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 may be 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 a 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. (See IRS Publication 523 for details).
10. In the event of disability, death, or retirement, home ownership with adequate insurance generally means an immediate move is unnecessary.

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

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**See:**
**Memo #12:** *Who Is a Minister for Tax Purposes?*

## Tax Implications

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

a) Extra care should be taken when a parsonage is to be given or sold to a minister 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 by the IRS, 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

**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.

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

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

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

**Remember!**
Tax liability is not incurred on 403(b) funds until the money is withdrawn, and Nazarene ministers may receive the funds as tax-free "housing allowance."

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.

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.

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 legal or tax counsel.

The church board that does not allow its minister to purchase his/her own home, but does provide an adequate parsonage and an allowance for parsonage furniture, etc., is still without an answer for their concern about 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 an adequate retirement without selling the parsonage?"

This question can be answered much more easily. A local church may provide a retirement housing reserve by contributing to their pastor's Nazarene 403(b) Retirement Savings Plan account.

## 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.

*See next page for an illustration on how the retirement housing reserve can work.*

The following chart illustrates 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 provided using current rates.

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

| PARTICIPANT'S AGE | MONTHLY DEPOSIT UNTIL AGE 66 | *TOTAL CASH AT 7 PERCENT INTEREST AT AGE 66 | *MONTHLY INCOME FROM TOTAL CASH WITH ANNUITY OPTION AT AGE 66 |
|---|---|---|---|
| 30 | $ 100 | $ 194,365 | $ 1,465 |
| 40 | $ 100 | $ 88,102 | $ 664 |
| 50 | $ 100 | $ 35,227 | $ 265 |

*Illustrations only (not guarantees or estimates) if dividends and interest remain unchanged. Annuity option of "life with 60 percent to survivor" with an annuity purchase rate of $132.71/$1 of monthly income at age 66 (i.e., $132.71 buys you a monthly annuity payment of $1). Annuity purchase rate is subject to change.



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