SAVING GRACE

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A GUIDE TO FINANCIAL WELL-BEING

CLERGY WORKBOOK

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CLERGY SECTION 1

Setting Up Your Finances with Your Congregation

> **CLERGY VIDEOS**
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> Videos for the clergy sessions are available at AmplifyMedia.com (search Saving Grace) and are included on the *Saving Grace* DVD.

Now that we've begun talking about an approach to financial freedom that liberates us to trust and serve God, let's explore what that means for you as a minister. In these special clergy-focused sections, we're going to talk about some of the unique features of clergy finances and the role that you play in helping others live into financial health and well-being. We're also going to confront some of the thought-processes and barriers that keep us from being the financial leaders we can be. In addition to these sections of the clergy workbook, you will also find free videos featuring Phil and Janet Jamieson on Amplify Media. To view the videos, visit AmplifyMedia.com and search Saving Grace (these videos are also included on the *Saving Grace* DVD). These videos provide helpful recaps of the material in these sessions and can be a great way to begin small group sessions discussing this material.

Nothing quite prepares you for the many decisions you need to make as a clergyperson entering ministry. Because of the way clergy are treated in the U.S. tax code, clergy have a bewildering array of terms that often seem to overlap in meaning and that have varying impacts on your short- and long-term future. In The United Methodist Church, pastors must make important decisions about their finances in conversation with the local church they serve, with some items requiring action by a charge conference.

In this chapter we will give you some of the definitions and tools you need to approach these decisions with more confidence. The terrain for clergy finances shifts frequently, so it will be important for you to monitor tax laws and changes in your denomination's pension and benefit plans. Many clergy will rely on the assistance of a tax professional and financial advisor to help them navigate this changing landscape. The good news is that there are a number of features in the tax code that can benefit clergy.

Even if you have been in your current position for a while, this chapter will be of interest to you. Each year, United Methodist clergy are asked to work with their church to create a clergy compensation form for the coming year. You can begin planning now for the next time you have that conversation with your Staff/Pastor-Parish Relations Committee or the equivalent body in your church.

Debt

Part of the backdrop of any discussion of personal finances is debt. In other parts of this workbook, there are sections and exercises to help you address types of debt that affect many people, not just clergy. Consumer debt, home mortgages, and the realities of everyday life create liabilities that need to be accounted for in any personal budget. Looking at your compensation in light of those obligations is important.

There is one form of debt, however, that creates a particular pressure for many clergy as they enter their early years of ministerial service—educational debt. Many denominations, including The United Methodist Church, require a seminary-level master's degree for clergy seeking ordination. Added to the cost of an undergraduate degree, the tuition and fees related to preparation for ministry can prompt many students to take on a significant debt load to complete their education. A 2015 *Christian Century* article noted that the average debt for theological students at graduation is close to $40,000. That level of debt is sobering when you consider that it is almost at the level of the annual median wage for clergy.

If you are still a student, it pays to take stock of your resources for funding your education that might keep you from taking out an excessive amount of student loans. Spend some time with the staff in your school's financial aid office to explore the range of aid packages and scholarships that may be available to you. Consider work-study programs that could reduce your tuition payments.

Talk with your denomination's staff about scholarships and grants available through their offices. In The United Methodist Church, these are administered by the General Board of Higher Education and Ministry. Some annual conferences in The UMC also offer service loans that can be repaid through years of ministerial service in the conference.

Don't be bashful about approaching your local church as well. Churches usually find that their own sense of vocation is renewed when they support new candidates for ministry. Let them partner with you to help fund your education. You may discover that it builds a holy and meaningful relationship for both of you.

If you have already graduated, the information found in other parts of this book will be helpful to you in addressing the remaining balance on your loan. As with consumer debt, educational debt can cripple your sense of financial freedom if you let it linger. Early in your career, you will have competing demands for your limited resources and you will want to look at the retirement of your educational debt in light of those demands, but develop a plan to erase your debt as quickly as possible. Talk with a financial advisor about possibilities for loan consolidation and income-based repayment plans, if necessary, but make sure you are not limited in paying them off early.

Income: Determining Clergy Status

The first step in thinking about clergy compensation is determining if you are clergy. That may sound like a simple question, but the Internal Revenue Service (IRS) has two qualifications to be considered clergy that may differ from the standards of your denomination. Filing taxes as a clergyperson carries with it a number of uncommon tax provisions.

One requirement is that an individual must qualify as a "minister of the gospel," a definition about which the IRS generally allows some latitude. Most denominations and churches have a defined process for ordaining, commissioning, and licensing ministers. In The United Methodist Church, elders and deacons are ordained, provisional elders and deacons are commissioned, and local pastors are licensed for ministry. While these different statuses refer to varying roles within the denomination, for IRS purposes they are all considered to carry a "clergy" status.

However, in addition to this qualification, the IRS also requires that the individual be performing services that constitute ministerial duties. The person must perform some or all of these functions:

- administering sacerdotal functions (e.g., marriage and funeral services, baptisms, and Communion);
- considered to be a religious leader by a church or denomination;
- conducting religious worship;
- exercising management responsibility in the conduct of your church or denomination.

For most local church pastors, these are regular functions of your office. However, if you are in an extension ministry that does not involve these duties, or your role in the local church does not involve leadership of worship or managing the church, you will need to examine your tax status more closely and discuss it with your employer. Persons involved in the administration of a religious denomination or a church-related institution are generally considered to meet the qualifications, but there are IRS criteria to determine if an institution meets the threshold of being an integral part of the church with meaningful church control.

Salary

If you have determined that you can be considered "clergy" for tax purposes, you have unique tax circumstances related to the concept of "employment." At the federal level, there are two types of taxes that clergy pay when they file with IRS each year—income tax and social security tax. States also impose a variety of taxes, but we will only be dealing with federal taxes here. Be sure you understand the tax requirements of your state and the impact they may have on you as a clergyperson.

Income Tax—Most clergy are considered employees

On the income tax side, most ministers are considered to be employees of the church they serve. Pastors will generally receive a W-2 form every year from their church or charge. United Methodist elders, deacons, and licensed local pastors under appointment to a local church should receive a W-2 from that church even though their membership is with the annual conference and they are appointed by the bishop. Pastors should receive a W-2 even though, as we shall see, they are considered self-employed for Social Security.

Some clergy may also wonder why they are considered employed if their accountability structure allows them considerable freedom to determine what to do day-to-day. The IRS standard is that a minister is considered an employee if there is significant behavioral and financial control by the employer and the relationship between the church and the minister is in an ongoing, on-site relationship with the church that could be terminated.

Social Security Tax—Ministers are self-employed

With regard to Social Security taxes, which the clergyperson must also file each year, ministers in active service are treated as self-employed. The consequence of this determination is that ministers have to calculate Social Security tax on Schedule SE and report and pay the tax with Form 1040, the normal form for filing your income taxes. Ministers will pay the Social Security tax, along with their income taxes, through the year. They may do this by filing estimated taxes quarterly or by having the amount withheld by the church. If you do not pay quarterly by the IRS deadlines, you will be subject to penalties. Also, if you fail to correctly estimate your taxes, you may also have to pay penalties.

There are significant implications to this status. For instance, if a minister were not self-employed, the church would be obligated to deduct Social Security tax from the pastor's salary under the Federal Insurance Contributions Act (FICA). Self-employed individuals pay Social Security tax under the Self-Employment Contributions Act (SECA). Therefore, a church should not withhold FICA from a minister's paycheck.

It is possible for a minister to be exempt from SECA tax, but the consequences are stark. A minister must have a conscientious objection to receiving public insurance in order to claim an exemption. This also means that the minister would not be entitled to receive any Social Security benefits, which is a key part of many people's retirement planning.

Elements of Pastoral Compensation

As you meet with the body in your church that develops the clergy compensation package (in The United Methodist Church this is usually the Staff/Pastor-Parish Relations Committee), you will need to think about your salary in light of the tax significance discussed above. Two items in particular have tax implications that will be affected by how you and your congregation deal with them—accountable reimbursement (which is not actually compensation but church expenses paid by the clergyperson) and the housing allowance. Both of these are dealt with in the sections below.

Clergy Housing

As a clergyperson, your housing can provide you with a significant tax benefit. Whether the church provides you with housing (in the form of a parsonage) or you own or rent your own house, as a qualified minister you can receive a housing allowance that is excluded from income tax liability. You should plan with your church to properly designate this amount and to set an appropriate amount for the allowance.

Many people have the misperception that, by setting a housing allowance, the church is increasing the church's budget and payment to their clergyperson. This is not the case. The housing allowance is a portion of the pastor's compensation that is designated ahead of time as a housing allowance. For instance, a pastor with a total compensation of $60,000 per year might designate $20,000 of that amount as a housing allowance. The church would still be paying $60,000, but the amount of the pastor's taxable income could be $40,000 depending on their qualifying expenses related to housing.

It is important to note in all cases that this exclusion of a portion of income for housing-related expenses is only for income tax purposes. Clergy must still include the amount for their self-employment Social Security tax.

If a pastor lives in church-owned housing, the allowance for housing-related expenses is often called a parsonage allowance. Pastors may exclude expenses such as utilities, landscaping, furnishings, and property and casualty insurance (renter's insurance) as part of this allowance. It is important to carefully estimate these expenses when determining the amount of the allowance, and to track the expenses through the year. If the actual expenses amount to less than the parsonage allowance, the unused balance becomes taxable income. Also, expenses beyond the amount of the allowance will also be taxable.

The situation for pastors who own or rent their home is similar. However, in addition to the types of expenses listed above, other expenses are applicable to the exclusion, such as mortgage payments, real property taxes, and homeowner's association dues.

Whether the housing allowance is for a home provided by the church or for housing the minister provides, the amount that can be excluded from taxable income is dependent on other figures. The housing exclusion claimed by a minister cannot exceed any of these three amounts (in other words, the exclusion must be the smallest of the three):

- the actual amount spent from the minister's income on allowable expenses related to the home;
- the amount designated by the church for a housing allowance;
- the fair rental value of the home, including utilities and furnishings.

The first two factors are easily determined. The third requires some investigation by the pastor. Fair rental value is based on the rental value of similar residences in your area that are furnished in a comparable manner. You can determine that value based on your own determination, but you may want to enlist a local realtor to help.

In order to be properly designated, the housing or parsonage allowance must be approved by the church prior to the period in which the expenses will be incurred. In The United Methodist Church, the annual charge conference is usually the body that adopts the allowance for the subsequent year, identifying in writing the amount of the allowance and recording the action in its minutes. You should keep a copy of this written action of the church in your tax records.

You should make sure that the amount of this allowance accords with your estimated actual expenses, although some planners recommend that this should be the highest of the three factors, with any unused funds being brought back into tax calculations for income as unused housing. Remember that if an unanticipated expense occurs that would take you over the set allowance, the allowance cannot be changed. This is particularly important to communicate with your church at the time of a pastoral transition, since your expenses may differ from those of your predecessor.

It's also important to recognize that, while the fair rental value of a parsonage that is provided to a minister is not taxable for income tax purposes, it is for Social Security tax.

Accountable Reimbursement for Church Expenses

Another important area to discuss with your church is the method for reimbursing expenses related to your ministry. It is almost always more advantageous for a minister to have an accountable reimbursement plan with the church to cover these expenses. The IRS has certain requirements for such plans, and most annual conferences assist churches in adopting one at each annual charge conference.

You incur many expenses on behalf of the church in the course of ministry. Auto-related expenses are a major category for most pastors, but there are also expenses related to continuing education, professional subscriptions, vestments, and meals with parishioners. The standard for determining if an expense is reimbursable is that it must be both ordinary and necessary for the church. If the expense is one that is common and generally accepted in your field, it probably qualifies as ordinary. If it aids you in the pursuit of your work on behalf of the church, it should qualify as necessary. Personal expenses are not reimbursable. If you receive such a reimbursement it should be reported on your W-2 since it is taxable income.

The accountable part of a plan involves records you keep and submit to the church within a reasonable time frame for reimbursement. Those records should note the purpose of the expense and a mileage record and/or receipts to substantiate the expense. This type of documentation should be submitted regularly throughout the year. In general, every expense should be submitted within sixty days of the date it was incurred.

The pastor may find it is useful to submit expenses on two forms. A cash expense form, on which the date and business purpose of each expense can be recorded, should be accompanied by the receipts related to those expenses. The second form is a mileage log, on which you can document dates, destinations, and business purposes of trips.

If you are driving your own vehicle in the course of your work conducting church business, you may use one of two methods to determine expenses that are reimbursable. The standard mileage rate method uses a rate per mile determined by the government to estimate the average cost of operating an automobile. In 2020, that rate is 57.5 cents per mile. Many ministers prefer the simplicity of this method, and, with current mileage rates and costs, using the mileage rate is more advantageous. An accountable reimbursement plan with the church can set the reimbursement of mileage at this rate.

The alternative is an actual expense method in which the minister determines the portion of fuel and maintenance costs related to business-related travel. This method may result in tax benefits if your operating costs exceed those allowed by the standard mileage rate method. It does, however, depend on more stringent record keeping that involves tracking depreciation of a vehicle.

Whatever method you choose, it is helpful to have a good estimate of your reimbursable expenses as you prepare your compensation for the coming year. As the pastor, you will often have great say in setting the amount of an accountable reimbursable plan. If properly documented and administered, these funds will not be taxable income and will not be reported to the IRS.

However, if you do not incur expenses up to the amount set in the agreement, you cannot receive the excess funds as income, at least not without paying taxes on it. If the balance is given to you as a bonus, all the payments made for expenses during the whole year become taxable.

Some churches may offer expense allowances that are nonaccountable. These also are less advantageous to the minister because the allowances must be reported as taxable income.

Other Benefits

A number of other benefits may be part of your compensation package as a clergyperson. You should be aware of the benefits and take advantage of them to the extent that you can. One major benefit is employer-sponsored health insurance. If your employer pays your group health insurance policy premiums, this is a tax-free benefit. Health insurance costs can constitute a major part of expenses for most people, and if you are paying the premiums on your own individual health plan in the marketplace, you will likely not see a tax benefit. However, many conference group health plans have a Section 125 provision that allows any portion of the premium paid by the clergyperson to be a pre-tax deduction.

Another major benefit offered to clergy is a pension plan. Pension programs, like the plan administered for United Methodist clergy by Wespath, offer a range of services that can be helpful to you throughout your lifetime. We'll cover some of the retirement planning options in the next clergy chapter, but you should note that your payments into a tax-deferred account can offer you significant benefits over the long term. Your church's contribution to the denominational pension plan are also part of the package provided to you.

Check with your church or denominational staff about other employer-offered benefits such as life insurance and disability insurance for yourself and your family members. If your church provides group life insurance coverage, the first $50,000 of coverage can be tax-free to you.

These insurance options can be critically important in providing for your family in the case of an unexpected illness or accident. Younger clergy (and much of the U.S. population) sometimes neglect this part of their overall financial well-being, and the situations that arise can be tragic and long-lasting. On the other hand, having adequate coverage can make a huge difference in providing a sense of security and well-being.

Moving Expenses

One common benefit provided to clergy is the payment of moving expenses for an incoming pastor. In an itinerant system, such as The United Methodist Church has, moving is a frequent experience for ministers as they are appointed to new ministry settings. The costs associated with moving have usually been paid by the church.

Until 2018, those moving expenses were not reportable to the IRS as income. A change in the tax laws in 2017, however, resulted in the suspension of the provisions in the code that allowed for this tax benefit through the end of 2025. The result of this is that money paid to move clergy by their church must now be reported as income on the minister's Form W-2.

Since moving expenses can easily run to thousands of dollars, clergy who are moving should prepare for the tax implications of their move in their planning. It is not clear whether the suspension will be lifted after December 31, 2025, or what will replace it if it is lifted.

Discussion Questions

- How would you characterize the tax requirements and implications related to clergy salary and benefits?
- What aspects of clergy finances discussed in this section stood out as especially important or helpful to know? Why?
- What have your previous experiences of these requirements and implications been like? How do these past experiences shape your current approach to personal finances?
- Beyond the practical aspects, how do clergypersons' personal finances affect their relationship with God? their relationship with their congregation? What, if anything, is unique about a clergyperson's experience?
- On a scale of one to ten, how would you rate your current understanding and management of how to set up your personal finances with your congregation? Why?

- What obstacles or challenges do you encounter as you work with your congregation to set up your finances each year?
- How could you help your congregation understand the importance of providing insurance as a way of preparing for unknown future events? What biblical passages help us think about the risks of the future? What would your family need if you were to die or not be able to work for several months if disabled?
- What, if anything, will you begin to do differently as a clergyperson as a result of this program?