



Welcome to the *2019 Tax Return Preparation Guide Ministers' Tax Guide for 2018 Returns*, written exclusively for pastors and other ministers by noted CPA and attorney Richard Hammar.

We are privileged as we begin this second century of service at GuideStone® to again provide this free guide.

We know that ministerial tax preparation can be complicated. While this book addresses the most commonly asked questions and most commonly used forms, you can find more extensive information on the IRS website, *IRS.gov*. For specific tax advice, you'll want to consult a tax professional who is familiar with the intricacies of ministerial taxes.

As we enter this new season advocating on behalf of pastors, ministers, churches, and ministries, this tax guide serves as a tangible reminder of our mission to honor the Lord by being a lifelong partner with our participants in enhancing their financial security. This resource is provided at no cost to our Southern Baptist and evangelical pastors and church workers. You can refer your colleagues to GuideStone.org/TaxGuide for copies of this booklet, in whole or in part, along with other helpful resources.

May the Lord richly bless you in the ministry you have received from Him!

Sincerely,

A handwritten signature in black ink, appearing to read "O.S. Hawkins". The signature is stylized with a large, looped initial "O" and a long horizontal stroke extending to the right.

O.S. Hawkins
President
GuideStone

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Special Supplement

CURRENT STATUS OF THE PARSONAGE AND HOUSING ALLOWANCE EXCLUSIONS

On November 22, 2013, U.S. District Court Judge Barbara Crabb of the District Court for the Western District of Wisconsin struck down the ministerial housing allowance as an unconstitutional preference for religion (*Freedom From Religion Foundation, Inc., v. Lew*, 983 F. Supp. 2d 1051 (W.D. Wis. 2013)). The ruling was in response to a lawsuit brought by the Freedom From Religion Foundation (FFRF) and two of its officers challenging the constitutionality of the housing allowance and the parsonage exclusion. The federal government, which defended the housing allowance since it is a federal statute, asked the court to dismiss the lawsuit on the ground that the plaintiffs lacked standing to pursue their claim in federal court.

“Standing” is a constitutional requirement of any plaintiff in a federal case and generally means that a plaintiff must have suffered some direct injury as a result of a challenged law. The Wisconsin court concluded that the plaintiffs had standing on the ground that they would have been denied a housing allowance exclusion had they claimed one on their tax return. The government appealed this ruling to a federal appeals court — the United States Court of Appeals for the Seventh Circuit in Chicago.

On November 13, 2014, the appeals court issued its ruling reversing the Wisconsin court’s decision (*Freedom From Religion Foundation, Inc., v. Lew*, 773 F.3d 815 (7th Cir. 2014)). It concluded that the plaintiffs lacked standing to pursue their challenge to the housing allowance. The plaintiffs had asserted that they had standing due to their “injury” of being denied a tax-free housing allowance should they claim one on their tax returns. But the appeals court refused to base standing on theoretical injury. It concluded: “Only a person that has been denied such a benefit can be deemed to have suffered cognizable injury. The plaintiffs here have never been denied the parsonage exemption because they have never requested it; therefore, they have suffered no injury.”

It suggested that this deficiency could be overcome if the FFRF’s officers filed tax returns claiming a housing allowance that was later rejected by the IRS in an audit: “The plaintiffs could have sought the exemption by excluding their housing allowances from their reported income on their tax returns and then petitioning the Tax Court if the IRS were to disallow the exclusion. Alternatively, they could have . . . paid income tax on their housing allowance, claimed refunds from the IRS, and then sued if the IRS rejected or failed to act upon their claims.”

The FFRF responded to the appeals court’s ruling by

designating a housing allowance for two of its officers. The officers reported their allowances as taxable income on their tax returns and thereafter filed amended tax returns seeking a refund of the income taxes paid on the amounts of their designated housing allowances. FFRF claims that in 2015 the IRS denied the refunds sought by its officers (one of whom had died and was represented by her executor).

Having endeavored to correct the standing problem, the FFRF renewed its legal challenge to the housing allowance in the U.S. District Court in Wisconsin, where the litigation began.

On October 6, 2017, Judge Crabb again ruled that the ministerial housing allowance is an unconstitutional preference for religion (*Gaylor v. Mnuchin*, (W.D. Wis. 2017)). Judge Crabb observed:

[The housing allowance] violates the establishment clause because it does not have a secular purpose or effect and because a reasonable observer would view the statute as an endorsement of religion.

The government promptly appealed this ruling to the United States Court of Appeals for the Seventh Circuit in Chicago. A ruling by the United States Court of Appeals for the Seventh Circuit ordinarily would apply only to ministers in that circuit, which includes the states of Illinois, Indiana, and Wisconsin. But Judge Crabb issued an injunction requiring the IRS to disallow the housing allowance on all tax returns filed by ministers. Judge Crabb delayed the effective date of the injunction for 180 days after a final ruling in the case. In effect, the ruling will become a national precedent if affirmed by the appellate court and U.S. Supreme Court, if applicable.

What should churches and clergy do now? Consider the following steps:

1. **Monitor developments.**
2. Many ministers will experience an immediate increase in income taxes. As a result, they should **be prepared to increase their quarterly estimated tax payments to reflect the increase in income taxes in order to avoid an underpayment penalty.** Note that there will be no effect on self-employment taxes (SECA), for which the housing allowance is not tax-exempt.
3. Many churches will want to increase ministers’ compensation to offset the adverse financial impact. Thousands of ministers have purchased a home and obtained a mortgage loan on the assumption that the housing allowance would continue to be available as it has for more than a half century. The sudden elimination of this tax benefit will immediately thrust many clergy into a dire financial

position with a mortgage loan based on a tax benefit that no longer is available. **Many church leaders will want to reduce the impact of such a predicament by increasing compensation. Such an increase could be phased out over a period of years to minimize the impact on the church.**

4. Ministers considering the purchase of a new home **should not base the amount and affordability of a home mortgage loan on the availability of a housing allowance exclusion** unless and until the courts conclusively uphold the constitutionality of the allowance.
5. **The fair rental value of church-provided parsonages remains a non-taxable benefit, for now.**