

Presbytery of Los Ranchos  
REQUEST TO CHANGE MINISTER'S TERMS OF CALL  
*Instructions and Definitions* (2011 Compensation)  
(with information for reporting income to Board Of  
Pensions and Internal Revenue Service)

**Change In terms of call**

The Form of Government requires that Presbytery approve changes in a pastor's compensation because it is part of the terms of call.

"The call extended to a pastor or associate pastor shall be approved by the presbytery and **cannot be changed except by consent of the presbytery**, at the request of the pastor or associate pastor or at the request of...the congregation ... The terms of call shall always provide for compensation that meets or exceeds any minimum requirements of the presbytery in effect when the call is made and shall thereafter be adjusted annually as required to conform to such requirement." FOG, G-14.0510 & G-14.0534.

"An active member engaged in a validated ministry in other service of this church ... shall request and obtain the approval of the presbytery of membership. Changes in the terms of the call or dissolution of the relationship shall be reported to the presbytery. FOG, G-11.0410

"Before entering upon [service beyond the jurisdiction of the church] the minister shall request permission of the presbytery ... if the presbytery grants the permission requested, such permission shall be subject to review and renewal annually". -FOG, G-11.0411

The form attached is to be used by the session (upon action by the congregation) or employing organization and minister to request approval of a change in the terms of a call. Terms of call include all compensation received by ministers, as well as vacation time, reimbursed professional expenses, and professional development leave.

The information in this paper will hopefully be useful to clergy, church treasurers, Session members, and Clerks. Please see that a copy goes to each of these persons.

**A Minister's Compensation**

Note first that the amount of money a minister receives (compensation) is different from the cost to the church for having a minister. The cost to the church includes such things as dues for the Presbyterian Church (U.S.A.) Health and Pension Plan and expenses incurred by the pastor for the benefit of the church.

Only the categories considered EFFECTIVE SALARY for Board of Pensions purposes are considered "compensation". Other expenses are either reimbursements or allowances which benefit the church--or optional benefits which may or may not be considered

income for IRS purposes. For example, reimbursing the minister for miles driven to the hospital or calling on members is a way of showing that this is a cost **to the church**, not to the minister. A social-security offset helps balance the fact the pastor must pay social-security **as if** they were self-employed. "Administrative Costs" should NOT be included in the compensation section of the church budget.

**BACKGROUND**

**Pension Dues, SECA, and Income Taxes**

In addition to the concern that ministers' spiritual and temporal welfare are properly maintained, the presbytery wants to assist congregations in insuring that ministers pay only those taxes required under complex federal and state tax laws; that churches fulfill their legal obligations to report compensation correctly; and that churches correctly calculate dues for the Presbyterian Church (U.S.A.) Health and Pension Plan.

Elders or other church members who have some expertise in investments and tax laws will want to help their pastor minimize tax obligations and maximize the investment opportunities available.

The following comments are intended to raise concerns and point out areas of the tax law that are relevant or have changed recently; **they are not intended to be tax advice**, though we have tried to be as accurate as possible. Please consult your own (or a reputable) tax adviser if you have questions about current tax codes. Call the Board of Pensions at 800-773-7752 (or check their website, [www.pensions.org](http://www.pensions.org)) if you have questions about the current definition for calculating effective salary for Board purposes.

**Social Security Taxes**

A minister is considered "self-employed" for social security tax purposes and therefore must pay all of her/his own SS taxes. While an employer pays half of an employee's FICA tax, a minister must pay the entire 15.3% of SECA tax (unless exempted under very narrowly construed IRS guidelines). You may provide a social security offset up to 7.65% to help with the extra SECA costs--but remember that such an offset is treated as cash income when preparing a W-2 and when calculating taxable income and self-employment tax (**but not included in effective salary for Board of Pensions unless it exceeds**

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7.65%)

### **Withholding**

The minister may ask the church to withhold money from cash salary to cover taxes, and the church may do the withholding, but it is only a voluntary arrangement. Ministers are specifically exempt from withholding requirements. A church's only liability is to pay the withheld money to the state or federal government or to the minister.

A minister or other employee of the church may request other amounts be withheld: for repaying a loan, paying into a savings fund, purchasing certain insurance policies, etc. All employees of churches, including ministers, are eligible to receive beneficial tax treatment for a tax-deferred annuity/savings plan under sections 403(b) (and/or 401(k)) of the tax code.

*Special Note:* A recent seminary graduate with a family, earning \$30,000 (plus housing valued at \$20,000) may not realize that she\he likely will have year-end social security tax obligations in excess of \$7,500 **PLUS** income tax (plus paying the deductible and cost-sharing portions of the major medical plan, and loans). A withholding program by the church may help a pastor properly budget for these expenses.

Deferred and withheld monies are part of the minister's compensation and must be reported as part of the terms of call--either as part of salary, or on another appropriate line on the form--and included in computation of pension dues. Deferred income, if properly arranged, is not required to be reported to the IRS; be sure to report such income in the correct Tax Form box. [Contributions to the new Roth IRA's are treated as income.]

If a church withholds Federal or State taxes on a voluntary basis for a minister who files income tax as an employee, the church must report the withheld monies on Forms W-2 and the appropriate state form, and may be subject to penalties if the money is not remitted to the appropriate agent by the deadlines specified. (i.e. the IRS maintains it can assess penalties to a church for failure to report **all** of a minister's compensation on a Form W-2).

### **Employees versus self-employed**

The IRS maintains that all ministers are "common law employees", even though they must pay their social security tax as "self-employed individuals". **RECENT TAX COURT RULINGS REQUIRE THAT ALMOST ALL CLERGY NOW FILE INCOME TAX AS "EMPLOYEES"**. (see *Church Law & Tax Report* March/April 2006)

### **Form W-2**

All parish clergy (and most specialized clergy) should be filing as an employee and the church or employing organization must report income on a W-2. Note that ministers are not subject to FICA tax (they must pay the higher SECA tax) so **do not put anything in box 3** ("social security wages") except perhaps the word "minister". The church must report in box 1 ("wages") all payments to the minister (or on behalf of the minister) with the following exceptions:

# 1 Housing allowance designated in advance (see January Omnibus motion) by the Session is an exclusion from Income Tax and may be indicated in the appropriate box (14) as "*housing*". The minister must demonstrate that the amount was actually spent on housing and does not exceed "fair rental value"; **clergy in Validated Ministries should note that housing allowance is not automatic; you must meet IRS standards to qualify;**

# 2 any social security offset (described later) should be added to cash salary in box 1. Pension dues and (some) medical or life insurance premiums are **not** included on W-2;

# 3 **do not** include deferred compensation; retirement savings plans, annuities, etc. in income; they should be **reported in box 12 "E"**.

# 4 **do** include all "**allowances**" (other than housing) paid directly to the minister. *\*Legitimate business expenses are better set up as a "vouchered, reimbursable expense accounts" (with the expressed understanding that "unspent" funds in such accounts revert to the church, not the pastor)--and if appropriately detailed documents and written records are presented in a timely fashion, the reimbursements need not be included on the W 2*

# 5 **do** include on the W-2 the value to the minister of any low or no interest loan (*imputed income*), and the difference between the fair market value and selling price of any property sold to the minister below value. There are ways to set up such loans so as to minimize the "*imputed income*" consequences, but it requires professional advice to do so. [A "shared equity plan" is such a way.]

# 6 **do** include the annualized cost of any church-owned car used by the minister unless certain conditions are met (see "Church owned car", below).

#7 **do** include gifts and bonuses paid by the church.

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**Check Box 13 “-Retirement Plan”**; this was new in 2001 and all minister are in Board of Pensions’ Retirement Plan.

### **Form 1099-Misc**

The church should **NOT** use 1099 for a pastor **except upon advice of a tax attorney**, and then only for individuals who qualify as Self-Employed using the IRS criteria.

### **EFFECTIVE SALARY**

The minister's *EFFECTIVE SALARY* is a figure that can be used to compare a minister's compensation with that of other professionals. It is the (minimum) basis for calculating pension dues, and (along with any Social Security offset) is the basis for calculating self-employment tax (income tax for ministers is based on *effective salary* minus housing and other allowable deductions). Note that *effective salary* is the discretionary compensation the minister receives for her/his own use. (Most other expenses are for the benefit of the congregation.) The Board of Pensions has published a booklet containing a series of "clarifications" of what constitutes *effective salary*. It is available online at [www.pensions.org](http://www.pensions.org).

### **Annual Cash Salary**

The annual cash salary is the portion of the minister's salary exclusive of housing allowance, "deferred income", and any other allowances.

### **Social Security Offset** [Other]

A "social security offset", is an amount paid to the minister to help offset the fact that the minister must pay the full self-employment tax. If provided, it should only be up to the amount the church would pay if the minister were a lay employee. [Note that this offset must, nevertheless, be added to the compensation reported to the IRS (e.g. in box 1 and 12 of Form W-2)]. **The offset is not included in calculating pension dues (“effective salary”) unless it exceeds 7.65% .** {*Note the one year modification of SS payments in 2011*}

### **Deferred Income**

Deferred income means, primarily, monies spent to purchase tax deferred annuities or for retirement savings plans. They are paid via a salary reduction agreement, where the minister's salary is reduced by the amount of the deferred income. Such a salary reduction agreement may take place without receiving prior permission of presbytery if it is at the request of both parties and the total effective salary remains the same. If the arrangement continues, it

should be included in subsequent reports to the presbytery.

**A tax-deferred annuity/retirement savings under section 403(b)/401(k) has considerable tax and retirement advantages for the minister.**

**Housing** For IRS purposes, as well as for the Board of Pensions, "housing" includes house or apartment, furnishings, utilities, and maintenance expenses. The IRS compares a minister's housing with the cost of a similar rented unit, furnished, with all maintenance and utilities paid. Recent congressional legislation limits “Fair Market Value”, usually to 40% of Cash Salary even if a higher figure can be justified. [Exception: year in which a home is purchased.]. Be aware that beginning in 2005, the IRS is aggressively interpreting the law in favor of requiring “Fair Market Value” of manses.

When a minister who lives in a manse calculates self-employment tax (schedule SE), the portion of "housing" attributable to a provided manse must not be **less** than "fair rental value", of a similar house or apartment. It can be deduced that the **same** number should be used in both places!

### **Utilities & furnishings allowance** (manse)

Ministers living in a manse may have a portion of their salary designated as a "housing allowance" to pay for utilities, furnishings, and maintenance. The only things definitely **not** allowed under this category are maid services and food. If the minister is to receive favorable tax treatment for this category, the total of all expenses for housing, including the rental value of the manse, utilities, and furnishings, must not exceed the "fair rental value" of similarly furnished housing in the area. The amounts reported to the IRS (on schedule SE), the Board of Pensions, and the presbytery, should not be **less** than the "fair rental value". The amounts must also be designated **in advance** by the congregation for this tax treatment. (See Omnibus Motion for January Session meeting) The minister must be prepared to present documents to the IRS showing that the allowance was actually spent on allowable housing.

### **Value of manse**

Both the pension plan and the IRS want to know the “compensation” value of the manse (house) in which the minister is living, if it is owned by the church. The IRS wants to know the 'fair rental value' of the house, a number which should reflect the actual rental value of other housing in the area. The Board of Pensions asks that the "value of the manse” for its purposes be **at least** 30% of the sum of cash salary and utilities/housing, plus any

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deferred compensation and social security offset above 7.65%--or the fair rental value

The presbytery asks that "value of manse" be calculated according to the Board of Pensions' definition.

### Housing allowance or budget (no manse)

Ministers not provided a manse may have a portion of their compensation designated as an "allowance to provide a home". This allowance may be used for mortgage payments or apartment rental, real estate taxes, insurance, utilities, furnishings, improvements, maintenance and supplies. The designation must take place by the congregation in **advance** of the money being spent. [We recommend at the January Annual Meeting--or incorporated into By-Laws as a per cent of compensation.]

**It is advisable to designate more money than the minister expects to spend;** excess is simply treated as other income for income tax purposes. Since it is the minister's responsibility to prove to the IRS that the money was spent on housing, and that it does not exceed the "fair rental value", the congregation can safely designate a very large part of the minister's salary as housing,--though an amount above 50% will certainly draw IRS attention.

Ministers and churches may, by mutual agreement, change the amount designated "housing allowance" without receiving prior permission from the presbytery if the total *effective salary* remains unchanged. However, if done after February, the IRS may not accept the change.

**Ministers in non-parish validated ministries should be aware that he IRS has strict standards for permitting "housing allowance". Because of problems in this area, we recommend all clergy in validated ministries consult with a tax professional before claiming a housing allowance.**

### Travel reimbursement

Travel reimbursement is a vouchered, reimbursable expense indicating what the church pays for the pastor to travel on church business. The IRS recognizes \$.55 per mile (2011 rate--adjusted annually by IRS) as a conservative value of travel by car.

If the minister is reimbursed upon timely presentation of a detailed report, by trip, showing date, number of miles traveled, and purpose of trip--and as long as the amount reimbursed does not exceed the IRS allowed mileage rate--the church need not report this

reimbursement to the IRS. Other expenses, e.g. parking fees or tolls, may be reimbursed without reporting to IRS if accompanied by a receipt and statement of date and purpose of trip.

[If travel expenses are paid directly to the minister as an allowance (which is NOT recommended), it must be reported to the IRS by the church on a W-2.]

### If Car Is provided

If a car is provided by the church, please enter the "value" of such an arrangement under "Travel reimbursement budget". Include the cost to the church of insurance, annualized cost of the car (or annual depreciation), interest on any loan used to purchase the car, and other costs such as tires and maintenance. An "annualized" amount will be fine, assuming a four or five year life for the car. ("Annualized" means adding up the total expected cost to the church for the four or five years, subtract the resale value at the end of that time, then divide by four or five to come up with an annualized cost for a car.)

The value of the car need not be reported to the IRS **if** all of the criteria enumerated below are met, but it should be reported to the presbytery as part of the terms of call.

The church **must** report to the IRS the value of the car (e.g. its annualized cost of lease or purchase of car, insurance, maintenance, etc.) unless **all of the** following criteria are met:

- (1) the vehicle is owned or leased by the church and provided to a minister (or other church employee) for church business;
- (2) when not being used for church business, the vehicle is kept on the church's premises;
- (3) no employee using the vehicle lives on the church's premises;
- (4) under a written policy statement adopted by the church board, no employee of the church can use the vehicle for personal purposes, except for "*de minimis*" (minimal) personal use (such as a stop for lunch between two business trips);
- (5) the church reasonably believes that, except for "*de minimis*" use, no church employee uses the vehicle for any personal purpose; and
- (6) the church must be able to supply sufficient evidence to prove to the IRS that the preceding conditions have been met. Reg. 1.274-6T(a)(2). [Commuting is almost always considered personal use; the value of the car must be reported on W-2 if used for travel from the minister's home to the church. Consult your tax advisor for exceptions.]

### Professional development budget

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Presbytery requires that all clergy receive at least \$1,000 per year for professional development. If not spent in the year allocated, these funds may escrow/roll over for up to three years (meaning \$3,000 would be available for professional development). The church is to accrue the money ("accounts payable") until the minister uses it for professional development. It is not salary, so unspent portions are not collectable upon termination of the relationship .

We encourage ministers to be accountable to sessions/employers for the kinds of professional development experiences they have. Thus we request that ministers ask their session in advance for approval of professional development experiences. The church should ask for and receive receipts for travel, tuition, housing, books, etc. (along with a report on the professional development experience itself). Any amount paid to the Pastor but not documented this way should be reported to the IRS as additional INCOME.

### Vacation

The presbytery minimum standard for a minister's vacation is thirty (30) calendar days including days off.

Periods in **excess** of 30 days (such as **"six weeks"**) are acceptable.

### Medical/dental supplement

In response to the crisis in funding medical care, the Board of Pensions has instituted a number of programs to contain expenses. In addition to not counting co-pays toward deductibles, the plan has a deductible on the member and on the member's family; and a 20% of URC\* co-payment provision up to 4% total "out-of-pocket" expenses. Once this "stop loss" point is reached, the Pension Plan pays 100% of approved medical bills. Pharmacy expenses are independent of other medical expenses and do not count toward the deductible limit..

*\*80% of Usual, Reasonable, & Customary.* Essentially, the Board has gone to an "In Network" and "Out of Network" system, paying 80% of negotiated fees for "In Network" and only 50% for "Out of Network" fees. A minister may, in any calendar year, be liable for medical bills (not counting eye and dental) up to 4% of effective salary. (Pharmacy has a separate deductible, limit, and co-pay) The church may provide an offset for these deductibles—see below. **If the church pays premiums for the Board of Pension Dental Supplement, that amount should be included on "Medical/Dental Supplement" line.**

If the church purchases a supplemental medical insurance policy for the pastor, be careful that you are getting value for your money.

If the church does not offer a medical-dental supplement that meets the deductible, cost-sharing, and optional provisions of the Pension Plan, it is possible to establish one of several types of acceptable plans: **Flexible Savings (105's and 125's),**

**Health Reimbursement, Archer Medical Savings, Health Savings.** Please consult a professional on the advantages and disadvantages of each type plan—and the requirements.

Any above plan must be a "use it or lose it" arrangement; if all monies are not used in a given year, they revert to the church, not the pastor, otherwise the **TOTAL AMOUNT OF THE FUND** must be treated as **INCOME**.

### "Book, conference, other professional expense allowance or budget"

This item is for other professional expenses or allowances. Once again, there are tax advantages to the minister if this money is disbursed in response to **received vouchers** by the minister. If given as an "allowance", it must be reported to the IRS, and a deduction can be taken only on Schedule A, and subject to a 2% limitation.

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### **Tax tip #1 re: expenses**

One way a minister can reduce taxes on monies expended for professional expenses, (and the church can avoid a requirement that they be reported to the IRS), is to set up a *Pastor's Discretionary Fund*. The pastor could have honoraria for weddings and funerals made out to the church for deposit into this fund, along with monies from the session or deacons. Even though it is "discretionary", the session should expect a report from the minister in broad categories such as "Books and supplies", "Assistance", etc. and the Pastor should not personally (as opposed to professionally) benefit from the funds. One warning: this is a "red flag" for the IRS and you probably need professional advice to be sure it is set up and operated in strict accordance with IRS regulations.

### **TAX TIP #2 RE: EXPENSES**

If a minister makes purchases for supplies or equipment which exceed the church budget for professional expense, but nevertheless wishes to make an additional purchase and have it tax deductible, the minister and session may agree to reduce the minister's salary for this purpose. The arrangement basically moves monies from the "salary" line to the "other professional expense" line by mutual consent.

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One complication: the equipment or supplies so purchased are really being purchased by the church; if the minister wishes to take the property when she/he leaves that particular church, the session must first transfer the property to the minister, perhaps as a gift.

The presbytery should, strictly speaking, approve such arrangements in advance, (to insure salaries do not fall below minimum standards); but in actual practice, the presbytery won't question arrangements approved by mutual consent which are to the (tax) advantage of the minister.

**Terms of call change form**

This document is meant as a general guide to pastoral compensation and help in filling out appropriate reports for pastoral salaries and/or changes to call. Please fill in the form 7, found on the Presbytery website, [www.losranchos.org](http://www.losranchos.org), on the Resource page under "Treasurer/session" resource documents, for reporting changes in the minister's terms of call and/or salary and return it to the presbytery office (PO Box 910, Anaheim, Ca., 92815-0910) **as soon as the change is approved by the congregation**--or January 30, 2011, whichever is earlier. Thank you! If you have any further questions about compensation or the forms needed to be completed, please contact Elvira in the Presbytery office, 714-956-3691, X125. There are also documents required by the Board of Pensions to be filled out if the clergy has a change in call and/or salary for 2011. These documents are on the Presbytery website under Resources, under "Personnel/session" under "changes in salary" and "changes in service".

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**LOVE GIFTS:**

Special gifts to pastors, especially parting gifts, have very nuanced tax implications. Please contact the Presbytery Treasurer to discuss how to set up such a gift so as to minimize tax and Board of Pensions implications and insure the pastor gets maximum allowable benefit.

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The format for this paper was established by Merrill Cook. It is edited annually by Dr. Keith Geckeler to comply with tax and Presbytery policy changes. Resource materials used include:

*Publication 517. Social Security for Members of the Clergy and Religious Workers* from the Internal

Revenue Service;

***Church Law & Tax Report*** edited by Richard R. Hammar, from Christian Ministry Resources, P.O. Box 1098, Matthews NC 28106, phone **704** 846-2507; (also see "*Church Treasurer's Alert*" and "*CHURCH AND CLERGY TAX GUIDE*".

Articles by Manfred Holck, Jr. in *Church Management, The Clergy Journal*, P.O. Box 162527, Austin, TX 78716.

*Member Change Form and The Terms Of The Benefits Plan Of The Presbyterian Church (U.S.A.)* published by the Board of Pensions, 2000 Market St. Philadelphia, PA 19103-7752, phone 800 346-7161.

Every effort has been made to insure that the above information is accurate and timely. However, the Editor is not licensed to provide professional legal or tax advice. The reader is thus advised that **the reader is responsible for checking with her/his own tax advisor and/or lawyer to determine whether specific information is accurate and whether it applies to her/his situation.**

If you find errors or misstatements in this paper, please contact the presbytery office immediately at 714-956-3691. **"If legal or tax advice or other expert assistance is required, the services of a competent professional should be sought."**