

AACS LEGAL REPORT

HOUSING ALLOWANCES:

"ARE TEACHERS AND STAFF EMPLOYED BY A CHURCH SCHOOL ELIGIBLE TO RECEIVE A HOUSING ALLOWANCE?"

I. INTRODUCTION

Individuals who pastor churches often receive a portion of their compensation in the form of a "housing allowance." A housing allowance is an attractive part of a pastor's compensation package because it is not considered as income, and for that reason, is exempt from federal income tax. By way of example, a pastor who receives \$25,000 in salary and an additional \$25,000 as a housing allowance is taxed only on the \$25,000 in salary that he receives. As a result, pastors who are paid a "housing allowance" receive thousands of dollars in tax savings each year.

But, are pastors the only individuals who can take advantage of a "housing allowance"? What about other church employees? And more specifically, what about teachers and staff members who are employed by a church-sponsored school? Can they take advantage of the tax savings offered in the form of a "housing allowance"?

We will look at this issue in more detail below. At the outset, however, you should know that a threshold requirement for receiving a housing allowance is that the individual must be "duly ordained, commissioned, or licensed" as a minister of the gospel. In an attempt to comply with this requirement, some schools take the position that all of their teachers and administrative staff can be "commissioned" as ministers of the gospel, and therefore, can receive a housing allowance as part of their compensation package.

Recently, however, the IRS issued a private letter ruling in which it concluded that teachers and administrative staff employed by a particular church school were not eligible for a housing allowance - even if the school had attempted to “commission” the employees as ministers of the gospel. In connection with its ruling, the IRS concluded that the teachers and employees at the school in question were not performing the other functions of a minister of the gospel, and for that reason, were not eligible to receive the tax benefit of a housing allowance.

In this Legal Report, we will discuss this private letter ruling and the various factors that the IRS considered in making its determination.

II. DISCUSSION

The school that was the subject of this private letter ruling was operated by a church, and taught preschool through eighth grade. All of the teachers were certified by the state, and the school was accredited by the state department of education. The teachers and staff were not required to attend a Bible college, a seminary, or other theological program, and although the teachers and staff were required to attend a church, they were not required to attend the church that sponsored the school.

The school board adopted a resolution giving a housing allowance to the teachers and administrative staff. Accordingly, when a teacher or staff person was hired, the administrator of the school “commissioned” the new hire as a minister of the gospel by “calling” him or her to be a teacher or staff person at the school.

After engaging in this practice for a period of time, the school asked the IRS to issue a private letter ruling confirming that the teachers and administrative staff were eligible for the housing allowance. The IRS concluded, however, that the teachers and administrative

staff of this school were not “ministers” for tax purposes, and therefore, were not eligible for the tax-free benefit of a housing allowance.

Because this was a private letter ruling and not a ruling from the United States Tax Court, the ruling applies only to this particular school. Nevertheless, the ruling does reflect the current position of the IRS with respect to this issue.

A. What factors did the IRS consider in reaching its decision?

In connection with its ruling, the IRS applied a "balancing test" to determine whether the teachers and administrative staff of this church school should be considered as ministers of the gospel for tax purposes. In particular, the IRS looked at the particular **duties** being performed by these employees.

1. The IRS concluded that, to be eligible for a "housing allowance," an individual must perform certain ministerial duties.

The IRS stated that the teachers and staff personnel should be involved in *ministerial duties* in order to take advantage of the "housing allowance" benefit. In looking at these duties, the IRS asked the following questions:

- does the individual conduct worship services;
- does the individual administer the sacraments;
- does the individual perform services in the control, conduct or maintenance of a religious organization under the authority of a church or religious denomination;
- is the individual considered to be a spiritual leader by his or her religious body.

The IRS concluded that the teachers and administrative personnel of this particular church school were not performing these duties. Accordingly, the IRS concluded that these employees could not be considered as ministers of the gospel for tax purposes.

In utilizing the "balancing test," the IRS did not state *how many* of these duties must be performed before an individual could qualify for a housing allowance. Instead, the IRS simply stated that the "failure to meet one or more of these factors must be weighed . . . in each case."

2. The IRS also concluded that the teachers and administrative staff were not entitled to a housing allowance because they had not been properly ordained, commissioned, or licensed as ministers of the gospel.

As noted above, an individual must be duly ordained, commissioned, or licensed as a minister before he is eligible to receive the tax advantage available through a housing allowance. In addition to finding that the teachers were not performing the duties of a minister, the IRS also concluded that the teachers and staff had not been *properly* ordained, commissioned, or licensed by the school.

In rejecting the school's commissioning process, the IRS stated that the term "commission" means "the act of committing to the charge of another or an entrusting." The IRS found that these teachers and staff members had not been "commissioned" because, in part, no congregation or other body of believers had been committed to their charge. The IRS also concluded - incorrectly - that spreading the gospel, either by sermon or teaching, had not been entrusted to their care. Instead, the IRS found that "the duties and responsibilities of the teachers and administrative staff reflect[ed] the typical duties and responsibilities found in secular schools."

This portion of the IRS private letter ruling is particularly troublesome - and unnecessary. In particular, the IRS could have upheld the commissioning process of the school, and still found that the teachers were not entitled to a housing allowance because their duties were not equivalent to the duties performed by a minister. Nevertheless, the IRS went one step further, and found that the commissioning process itself did not meet the standards established under the tax code.

B. What impact will this private letter ruling have on AACCS schools?

The private letter ruling discussed in this Legal Report is binding only on the employees of the school that requested the ruling. For that reason, it is not binding on AACCS schools.

In considering this ruling, one question that should be asked is whether the factual situation involving a typical AACCS school is so different that it would change the position of the IRS on this issue. For example, would it have made a difference if the teachers and staff were required to attend a Bible college, seminary, or other theological training program? Or, if the teachers and staff were required to be members of the church that sponsored the school? Or, if specific religious instruction was included in each subject offered by the school?

These are difficult questions to answer. Nevertheless, the private letter ruling seems to focus on whether the teachers were actually *performing those duties* that are typically associated with a pastor, such as:

- conducting worship services;
- administering the Lord's supper and performing baptisms;
- sitting on church governing boards and moderating church sessions; and

- performing marriage and funeral services.

Since the teachers and administrative personnel at this school were not performing these particular duties, the IRS concluded that they were not ministers of the gospel for purposes of qualifying for a housing allowance.

One final issue to consider is this. Even though all of your teachers and staff may not qualify for a housing allowance, certain individuals may be entitled to this benefit. The first condition that must be met is that the individual must be duly ordained, commissioned, or licensed as a minister of the gospel. In addition to meeting that requirement, the individual must perform some ministerial duties at the school. By way of example, an ordained, commissioned, or licensed individual may qualify for a housing allowance if he is providing religious instruction or performing worship services at the school.

III. CONCLUSION

In a recent private letter ruling, the IRS took the position that teachers and administrative personnel at a church-sponsored school were not eligible for the tax advantages of a housing allowance. While this private letter ruling is not binding on AACCS schools, it does offer insight into the reasoning applied by the IRS to this issue. Those schools that engage in this practice may want to obtain a copy of this private letter ruling. The citation is *IRS Letter Ruling 200318002 (2003)*.

If you have any questions or comments concerning the issues raised in this Legal Report, please feel free to contact Steve Cummings at the new AACCS Legal Hotline number in Athens, Georgia - (706) 548-5000.

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