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M E M O R A N D U M

TO: Principals and Administrators

FROM: Mordechai Biser, Esq., Associate General Counsel

CC: Mrs. Deborah Zachai, Director of Education Affairs
Mr. Dovid Tanenbaum, Education Affairs Associate

RE: Parsonage Payments

We receive frequent requests from menahalim, rebbeim, rabbonim, accountants for yeshivos and shuls, and others to answer questions about parsonage allowances, which enable rabbonim and rebbeim to legally receive part of their salary in a way that is not subject to federal income tax. We have therefore prepared the attached memorandum to answer the most frequently asked questions.

You do not need a law or accounting degree to understand the parts of this memo (the part above the footnotes) that apply to you. The footnotes, however, are for the tax lawyers and accountants (and the legally curious) who may want to know the legal basis for our suggestions and conclusions.

This memo should not constitute legal or accounting advice. Indeed, we encourage you to consult with your own accountant or tax attorney. However, it has been prepared with the input of leading attorneys and accountants in the field, and we encourage you to share it with your tax advisor.

We hope that we have clarified and explained what is an often-misunderstood area of tax law. Most importantly, we hope that this memo will enable our community's rebbeim and rabbonim to make use of this tax break to the fullest extent allowable by law.

Agudath Israel of America
January 2010

PARSONAGE PAYMENTS--TAX BREAK FOR REBBEIM AND RABBONIM*

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General Introduction

Pursuant to Section 107 of the Internal Revenue Code¹, under certain circumstances a member of the clergy does not have to pay federal income tax on the part of his income that he spends on housing. This means that a rabbi or rebbe can reduce his income tax bill by having part of his salary designated as a rental allowance (often called “parsonage payments”). Even if a rebbe owns his own home, he can still receive parsonage payments to cover his housing costs.

The requirements for parsonage payments are as follows:

* Agudath Israel of America acknowledges and thanks attorney Kevin Babitz for researching and writing the first draft of this memorandum. We also thank attorneys Jacob I. Friedman and Amanda H. Nussbaum of Proskauer Rose, LLP, Yehuda Kupfer, Esq., staff attorney at Agudath Israel, and Chaim Aaron Levin, CPA, for reviewing this updated memo and offering their comments.

¹ For more details, see Treasury Regulations Sec. 1.107-1.

- **The parsonage allowance must be provided as payment for services that are ordinarily the “duties of a minister”.**² One need not be the rabbi of a shul to take advantage of this provision. "Duties of a minister" includes “the ministrations of sacerdotal functions and the conduct of religious worship, and the control, conduct, and maintenance of religious organizations.”³ The IRS has ruled that rebbeim teaching in yeshivos and day schools are eligible to receive parsonage allowances.⁴
- **The employer, as a general rule, should be a religious organization.**⁵ However, if the rabbi or rebbe is performing religious worship or similar services, even if his employer is not a religious organization he is still entitled to receive parsonage payments.⁶ Thus, a rabbi who works for a nursing home in a non-rabbinic capacity will not qualify for parsonage payments,⁷ but if he gives shiurim, runs the shul, and counsels patients on religious matters, he is eligible for parsonage.
- **There needs to be an official action taken by the employer organization (the shul or the yeshiva) that designates the payment as a “rental allowance” under Section 107 of the Internal Revenue Code.** This designation can be made in an employment contract, in the minutes of a meeting of the Board of Directors of the employer, in an employer resolution, in a budget, or in any other appropriate document. The designation should specify how much of the rabbi’s or rebbe’s salary is to be a parsonage allowance. (See Appendix B for a suggested text of this designation.)
- **The parsonage allowance cannot be greater than the amount that the rabbi actually spends for housing costs, or the fair market rental value of the housing, whichever is less.**⁸ Therefore, a shul or yeshiva cannot designate a rabbi’s entire salary as a parsonage allowance, unless he actually spends his entire salary for housing. (See Appendix A for sample application form for rabbi or

² Note that retired clergy can receive part of their pension benefits as parsonage payments.

³ Treasury Regulations Sec. 1.1402(c)-5(b)(2).

⁴ Private Letter Ruling 9126048 (April 02, 1991). What if a rebbe teaches secular subjects for a yeshiva? A member of the clergy who is assigned to perform even secular duties by his church may still be entitled to parsonage payments for his work. See Treasury Regulations Sec. 1.1402(c)-5(b)(2)(v). Whether a yeshiva by itself may “assign” a rebbe to teach secular studies and thus enable him to qualify for parsonage payments remains an open question. One could argue that, under the terms of these Treasury Department regulations, a rebbe who teaches secular studies for a yeshiva is performing services pursuant to an assignment by his “church” and thus still qualifies for the parsonage exclusion. However, there is a case in which parsonage payments to a professor of religion at a church-affiliated college were disallowed on the grounds that the college was not an “integral agency” of the church and because the professor was not performing “sacerdotal functions.” *Flowers v. United States of America*, 1981 WL 1928 (November 25, 1981). Therefore, we recommend that this issue be dealt with on a case-by-case basis in consultation with a tax attorney.

⁵ Revenue Ruling 68-68 (January, 1, 1968)

⁶ Treasury Regulations Sec. 1.1402(c)-5(b)(2)(iii).

⁷ Unless the nursing home is an ‘integral agency’ of a shul.

⁸ IRC Sec. 107(2).

rebbe to submit to employer, to enable the employer make the appropriate parsonage designation.)⁹

Specific Questions and Issues

1. How does the yeshiva or shul make the "official designation"? Is it sufficient to type "parsonage allowance" on the employee's paystub?

A parsonage rental allowance must be designated as such pursuant to "official action" by the employer taken in advance of such payment.¹⁰ This designation must mention the particular individual who will be receiving the payments, and it must be in writing, either in an employment contract, in minutes of or in a resolution by the Board of Directors of the employer's organization, or in any other appropriate document demonstrating such official action. Making the designation on a paystub alone is thus not likely to qualify as an official action taken in advance of the payment of the housing allowance. Without official designation, the parsonage allowance is not valid, and cannot legally be excluded from gross income.¹¹ The designation can state that it will remain in effect for the duration of the rabbi's or rebbe's employment, but since housing costs change often, we recommend that the designation be reissued each year. Attached as Appendix B is a suggested form of minutes for a Board of Directors meeting to make the parsonage designation, and as Appendix C is a suggested form of letter to give to the rabbi or rebbe after the designation has been approved. Even though the designation comes from the employer, the burden of providing proof of the designation to the tax authorities will almost always fall on the employee. As a practical matter the employee should therefore solicit a copy of the official designation from the employer at the beginning of the school year, or at the signing of his contract. The employee should also make certain that the designation is properly dated and is consistent with the information he provided to his employer.

Dependent on its governance structure an employer may find it more practical to have an authorized officer approve the application form (Appendix A). In that situation Appendices B and C need not be used. The employee should retain a copy of the signed approval. Attached as Appendix D is a worksheet which the employee can utilize in preparing the estimated housing expenses.

2. What is the maximum amount that can be taken as a parsonage allowance?

A parsonage allowance can be for the full amount (but not more than) the rabbi's or rebbe's actual housing expenses, as long as this does not exceed the fair market rental

⁹ It is not the employer's responsibility to investigate whether the employee has accurately estimated his housing expenses for purposes of making parsonage payments.

¹⁰ Treasury Regulations Sec. 1.107-1(b).

¹¹ This provision appears to be strictly enforced. In *Mosley v. Comm'r*, T.C. Memo. 1994-457(1994), a minister had taken a housing allowance for several tax years, but did not have any evidence of an official action for the earlier years. Even though the taxpayer was able to produce evidence of official action for the later years, no exclusion was permitted for the earlier years because of this lack of evidence of official action.

value of the housing.¹² See question 3 as to what can be included in calculating housing expenses.

3. What can be included in calculating housing expenses?

For purposes of a parsonage allowance, housing costs may include:

- ✓ rent,
- ✓ mortgage payments,
- ✓ down payments and other costs of buying a home,
- ✓ real estate taxes,
- ✓ homeowner's or renter's insurance,
- ✓ the actual cost of home improvements,
- ✓ maintenance expenses,
- ✓ repair costs, including appliance repairs,
- ✓ utilities (electricity, gas, water, sewer charges, garbage and snow removal charges, non-business phone line),
- ✓ furniture costs,
- ✓ appliances (including vacuum cleaner, garage door opener, lawn mower),
- ✓ household goods (dishes, cookware, linens, lawn care tools and supplies, cleaning supplies, light bulbs and fixtures, etc..) and
- ✓ home decorations (carpets, curtains, paint, wallpaper, pictures, mirrors, etc.).¹³

Please note that while all of the above may legally be included when calculating one's housing costs, a rabbi or rebbe should estimate his housing expenses as accurately as possible. If the expenses are over-estimated, the rabbi or rebbe may have additional taxable income. On the other hand, if the housing expenses are under-estimated it could result in the rabbi or rebbe paying additional income taxes.

4. Does a rebbe need smicha in order to receive a parsonage allowance?

We recommend strongly that all rebbeim in yeshivos who are receiving parsonage allowances have some form of formal certification of ordination from the yeshiva where they learned. While one doesn't need Yoreh Yoreh to claim the parsonage exclusion,

¹² Even if the fair rental value of the home is greater than the actual housing expenses, only the actual expenses can be excluded from gross income. *Reed v. Comm'r*, 82 T.C. 208, 214 (1984). If the clergyman's actual housing expenses exceed the fair rental value of his home, he may only exclude from income the fair market rental value of his home. IRC Sec. 107(2), as amended by the "Clergy Housing Allowance Clarification Act of 2002", effectively overturning *Warren v. Comm'r*, 114 T.C. 343 (2000). Note that if a rebbe overestimated his housing expenses for a given year (e.g., he planned to make some home improvements and then decided not to), and already received parsonage payments based on his estimates, the difference between what he actually spent on housing and the amount of his parsonage payments must be reported as taxable income.

¹³ See Treasury Regulations Sec. 1.107-1(c). There is generally a liberal view as to the scope of "furnishings," as the IRS is reluctant to "dictate the quality of a minister's quarters." GCM 34454 (March 15, 1971). The IRS has even ruled that seemingly "extraordinary or extravagant" expenses (such as fancy antique furniture) may be excluded from income. GCM 37820 (January 15, 1979).

possessing a “Rav u'Manhig” or some other sort of certificate or letter would definitely be advisable.¹⁴

5. Can women receive a parsonage allowance?

There is no clear precedent whether an Orthodox Jewish female teacher who has a bona fide certification (i.e., a certificate from a seminary or other Jewish program as described below) to teach Limudei Kodesh, and who is employed by a Jewish school for that purpose, is eligible to receive a parsonage allowance. We therefore cannot state with certainty that such payments would not be challenged by the IRS, which could affect the tax liability of the teacher and the school’s withholding obligation. However, according to the legal experts with whom we have consulted, it should be reasonable for a school to pay a parsonage allowance to a female Limudei Kodesh teacher who is performing clearly religious functions (e.g., davening with students, teaching Limudei Kodesh, and providing religious counseling) and is appropriately commissioned or licensed. They advise that such commission or license should be in the form of a certificate from a seminary or other qualified Jewish program designed to prepare Limudei Kodesh teachers (and not from a board of education or other secular organization or school) and should certify that the recipient is authorized to perform those religious functions.

6. Is a parsonage payment totally tax-free income?

No. Parsonage payments are not included in one’s federal gross income and therefore are not subject to federal income tax.¹⁵ However, a recipient of parsonage payments is

¹⁴ The Internal Revenue Code does not define the phrase “minister of the gospel,” nor does the statute’s legislative history. The regulations list three sorts of duties that are considered to be those of a minister: (1) the performance of sacerdotal functions, (2) the conduct of religious worship, and (3) the performance of services in “control, conduct, and maintenance of religious organizations.” Treasury Regulations Sec. 1.1402(c)-5(b)(2). However, case law has established that other important factors are whether the taxpayer was duly “ordained, commissioned or licensed”, and whether the particular church or denomination recognized the taxpayer as a minister or religious leader. *Knight v. Comm’r*, 92 T.C. 199 (1989); *Wingo v. Comm’r*, 89 T.C. 922 (1987).

Based in part on their lack of rabbinical ordination, the IRS initially disallowed the exclusion for cantors. The Tax Court overruled the IRS position and has permitted cantors to claim the exclusion on the grounds that their duties and services are considered to be sufficiently ministerial (the IRS acquiesced and modified its earlier ruling). Yet it is important to note that in the Tax Court cases, the cantors had formal certificates from the appropriate organization indicating their qualifications to serve as cantors. *Salkov v. Comm’r*, 46 T.C. 190 (1966); *Silverman v. Comm’r*, 57 T.C. 727 (1972). Furthermore, in a subsequent case, a shamash for a shul who gave bar mitzvah lessons and served as a witness at weddings was not permitted to claim the exclusion. *Haimowitz v. Comm’r*, T.C. Memo 1997-40 (1997). The Tax Court held that even though these duties were related to the Jewish religion, they were nevertheless more organizational than religious in nature, as they did not require performance from one who held ministerial authority. These factors, combined with the fact that the shamash was not ordained as a rabbi or certified as a cantor, led the Tax Court to conclude that he was not a “minister of the gospel” under section 107 and the accompanying regulations. Accordingly, we recommend that a rebbe who is taking the parsonage exclusion should have some form of formal ordination.

¹⁵ In general, states and localities tend to simply base their income taxes on the adjusted gross income on one’s federal tax return, so that parsonage payments would also not be reportable for state or local tax purposes either. However, some states require taxpayers to add back certain exclusions or deductions taken

subject to the rules governing self-employment tax (SECA) on the full amount of his salary (including his parsonage allowance). When filing his tax return, he must, therefore, include the full amount of his salary on the form for self-employment income (Schedule SE), and pay tax accordingly.¹⁶ He is required to pay self-employment tax on the entire salary he receives for his duties as a member of the clergy, unless SECA taxes were already withheld from his pay, at his request.¹⁷ See question 8 below.

7. Does the employer need to report parsonage payments on the employee's W-2 form?

No. Parsonage payments are not included in federal gross income and therefore should not be reported as taxable income on the year-end W-2 form. However, as noted above in the answer to question 6, the rabbi or rebbe who receives parsonage payments is required to pay self-employment tax on the full amount of his parsonage allowance. Therefore, the employer may indicate the total amount of the parsonage payments in box 14 of the rabbi or rebbe's W-2 form so that he will know how much he received in parsonage payments that year.¹⁸

8. May the shul or yeshiva withhold FICA taxes from the amount designated as parsonage allowance? Does the shul or yeshiva still withhold FICA taxes from the non-parsonage part of the rabbi or rebbe's salary?

Salary payments to a member of the clergy for services that are the duties of a clergyman are exempt from FICA withholding, when paid from a religious organization with exempt status under Section 501(c)(3) of the Internal Revenue Code.¹⁹ The shul or yeshiva thus should not withhold any FICA taxes from the rabbi or rebbe's salary.^{19a} The rabbi or rebbe is required to report his entire salary (including parsonage allowance) for his duties as a member of the clergy as income for self-employment tax purposes (SECA).²⁰ This is

on one's federal return. We are not aware of any state or locality that denies the parsonage exclusion, but this needs to be checked with one's local accountant.

¹⁶ IRC §1402(a)(8), Treasury Regulations Sec. 1.1402(a)-11(a), *Flowers v. Comm'r*, T.C. Memo. 1991-542(1991).

¹⁷ For more information, including details on how those receiving parsonage should fill out Form SE, see IRS Publication 517, "Social Security and Other Information for Members of the Clergy and Religious Workers". Note that even if a shul provides the rabbi with a free home, he is still required to pay self-employment tax on the rental value of that residence. *McFarland v. Comm'r*, T.C. Memo. 1992-440 (1992).

¹⁸ Although the rebbe's employer may choose to state the amount of the parsonage allowance in box 14 of the rebbe's W-2 form, this does not mean it needs to be reported to the IRS.

¹⁹ IRC Sec. 3121(b)(8)(A); Treasury Regulations Sec. 31.3121(b)(8)-1(b).

^{19a} A shul or yeshiva that has been paying the employer portion of FICA taxes on the non-parsonage payment and now decides to discontinue paying those taxes, should add an additional amount to the rabbi or rebbe's payments so that the rabbi or rebbe is not hurt by the change. This will ensure that the shul or yeshiva has acted consistently with the understanding about the amount the rabbi or rebbe will receive as net salary. If a shul or yeshiva does pay FICA taxes on the rabbi or rebbe's salary, the amount paid is considered additional taxable income to the rabbi or rebbe.

²⁰ IRC §1402(a)(8), Treasury Regulations Sec. 1.1402(a)-11(a), *Flowers v. Comm'r*, T.C. Memo. 1991-542 (1991).

reportable on Schedule SE of his tax return. He can request that the employer withhold SECA taxes from his salary.

9. Are members of the clergy required to receive a parsonage allowance? If not, is there ever an advantage to not receiving parsonage?

It is not mandatory that a member of the clergy receive any of his salary as a parsonage allowance. In some instances, it can actually be advantageous for a rabbi or rebbe to forego receiving parsonage. Each rabbi or rebbe should consult with a tax professional to determine whether or not he should receive parsonage payments.²¹

Parsonage Issues For Homeowners

10. Can a rabbi who owns his own home still receive a parsonage allowance?

Yes. The amount of his parsonage allowance may include his mortgage payments, real estate taxes, and other housing expenses (see question 3). It can also include the amount of his down payment and other purchase costs, but only during the tax year that he actually made such expenditures. The total amount of the parsonage allowance for any year may not exceed the annual fair market rental value of the home plus the cost of utilities.

11. Can a rabbi who owns his own home and receives a parsonage allowance still deduct mortgage interest payments and real estate taxes from his gross income?

Yes. Even though a parsonage allowance (which can include the cost of real estate taxes and mortgage interest payments) is excluded from gross income, a clergyman is nonetheless permitted to also deduct real estate taxes and qualified home mortgage interest from his total gross income.²² A rebbe or rabbi who owns his own home thus gets, in effect, a double tax break.

12. What happens when a rabbi has completed paying his mortgage, or paid for his home in full and has no mortgage?

In such cases, the amount of his excludable parsonage allowance will only be his actual remaining housing costs.²³ Therefore, before prepaying a mortgage, a rabbi should consult with an accountant or tax attorney about the consequences.²⁴

²¹ For example, the current tax rules provide for earned income credits and additional child tax credits, both of which are refundable even if the employee had no income tax withheld. These credits are based on the employee's taxable income. Therefore, in some instances, a rabbi or rebbe will lower the amount of his tax refund if he receives a parsonage allowance.

²² IRC §265(a)(6); Rev. Rul. 87-32 (April 27, 1987).

²³ Swaggart v. Comm'r, T.C. Memo 1984-409 (1984).

²⁴ The IRS has explicitly ruled that, if a clergyman pays for his home in full in cash, or has already paid off his mortgage, he may not spread the purchase price over a number of years and claim the parsonage exclusion for each of those years. Similarly, he may not use the parsonage allowance to pay off a home equity line of credit, or use the allowance to pay off a loan secured by the paid-off home (unless the

13. When a rabbi buys a home, can he exclude as parsonage the down payment and other purchase-related costs?

Yes, provided that this exclusion is taken during the tax year that the down payment and costs were actually expended, and provided that the total amount of the parsonage allowance that year does not exceed the fair market rental value of the home plus the cost of utilities.

refinancing was used for capital improvements on the home). Private Letter Ruling 9115051 (January 16, 1991).

APPENDIX A: SUGGESTED PARSONAGE ALLOWANCE APPLICATION FORM

Name of Employer: _____

Name of Applicant: _____

Ordination or Certification Received from*: _____

Home Address: _____

My estimated housing expenses (plus utilities) for the [calendar year 20__] or [the school year __ 20__ - 20__] are as follows: \$_____ **

The above is an estimate of my anticipated housing expenses. Should my housing expenses change significantly during the course of the year, I will promptly notify my employer and submit a new parsonage allowance request form.

Signature of Applicant _____

Printed Name of Applicant _____

Date _____

Approved _____ by: _____
[Name and title of authorized officer]
Date _____

*copy on file with the Employer

** Amount may not exceed fair rental value (for the calendar year) of the home, including furnishings and appurtenances, such as a garage, plus the cost of utilities.

APPENDIX B: SUGGESTED OFFICIAL DESIGNATION OF PARSONAGE ALLOWANCE

(A copy of this designation should be presented to the rabbi upon completion)

At a meeting of the Board of Directors of _____ (the "Organization"), duly convened with proper notice, the Chairman of the Board advised that under Section 107 of the Internal Revenue Code, a qualified member of the clergy is not subject to federal income tax on the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home. Since Rabbi _____ is duly ordained and engaged by the Organization to perform religious services as defined by the Internal Revenue Code and accompanying regulations, he is eligible to receive a designated housing allowance. After reviewing Rabbi _____'s application for such housing allowance, which lists his estimated housing expenses, the following motion was moved, seconded, and unanimously adopted:

Resolved, that \$ _____ is hereby designated as Rabbi _____'s annual parsonage allowance. Be it further resolved, that as long as Rabbi _____ continues as an employee of the Organization in good standing, that the above amount of designated housing allowance shall apply to all future years unless and until modified. Rabbi _____, in his parsonage allowance application, has pledged to inform the Board of Directors of any significant changes in his monthly housing costs.

In witness whereof, I, the undersigned, Secretary of the Organization, hereby certify that the above resolution was duly adopted at a meeting of the Board of Directors duly convened on _____(date).

Signature of Secretary

**APPENDIX C: SUGGESTED LETTER TO RABBI DESIGNATING
PARSONAGE ALLOWANCE**

Dear Rabbi _____,

Pursuant to your application for a housing allowance under Internal Revenue Code Sec. 107, the Board of Directors recently met and approved an annual housing allowance in the amount of \$_____. Attached is the Board's official designation of your housing allowance.

This housing allowance is not reportable as taxable income on your federal tax return. However, you are required by the Internal Revenue Code to report it as self-employment income, and to pay self-employment tax accordingly. (Indeed, as a member of the clergy, you are required to pay self-employment tax -- reportable on schedule SE of your tax return -- on your entire salary, both your housing allowance and the rest of your salary. If you do not pay self-employment tax, you run the risk of substantial penalties if audited. Furthermore, you (or your family members) will not be able to receive the Social Security benefits to which you would otherwise have been entitled, since those benefits are based on what you paid in self-employment taxes.)

Should your housing costs change significantly during the course of your employment, please obtain a new parsonage allowance application from the office and submit it promptly.

Sincerely,

(Enclose a copy of Appendix B, the official designation of parsonage allowance)

APPENDIX D: HOUSING EXPENSES WORKSHEET

Calendar Year 20____

Rent _____

Mortgage Payments (principal and interest) _____

Down Payments and other costs of buying house _____

Real Estate Taxes _____

Homeowner's or renter's insurance _____

Actual Cost of home improvements (new roof, room addition, pool, garage) _____

Maintenance and expenses _____

Repair costs, including appliance repairs _____

Utilities

- Electricity _____
- Gas _____
- Water _____
- Sewer charges _____
- Garbage and snow removal _____
- Non-business phone line (base charge only) _____

Furniture Costs _____

Appliances (including vacuum cleaner, garage door opener, lawn mower) _____

Household goods (dishes, cookware, linen, tools and supplies, cleaning supplies, light bulbs and fixtures) _____

Home decorations (carpets, curtains, paint, wallpaper, pictures, mirrors, etc.) _____

Lawn care _____

Notes

- The aggregate parsonage allowance may not exceed the fair market value of the home including furnishings (and garage) plus utilities. Excess amounts should be reported as income on your tax return.
- Only one home may be counted.
- All parsonage payments from all employers must be aggregated.
- Evidence of expenses should be kept in your files.
- Keep a copy of the formal approval of the parsonage amount. The approval must be made in advance of the receipt of the parsonage payment.

- Real estate taxes and interest on the mortgage may also be deducted on your Schedule A of Form 1040.
- Do not count maid service, labor, groceries, personal toiletries, clothing, toys, etc.