

# COMPENSATION GUIDELINES

## Sierra Pacific Synod Evangelical Lutheran Church in America

*Now to one who works, wages are not reckoned as a gift but as something due. [Romans 4:4]*

*The laborer deserves his wages. [1 Timothy 5:18]*

### INTRODUCTION

Pastors and associates in ministry are not always paid what they should be paid. While that may seem harsh, it is true for the vast majority of the congregations of the synod. In 2006, 51.9% of pastors under congregational call were below synod guidelines. Certainly, average compensation has gone up, but there are many pastors and associates in ministry who receive minimal pay for maximum work loads. Pastors and associates in ministry are professionals. They bring to the church their gifts, training and energy, and should be compensated according to their education, ability and responsibility, and in line with the incomes of professionals in comparable positions. They should be able to provide for their own economic needs and those of their families.

At the same time, a congregation deserves to be served by its professional leaders in a manner consistent with the spirit and letter of the call. Mission, programs and expectations must be clearly delineated if pastors and associates in ministry are to be held accountable for their service. A Congregation council is expected to review annually the mutual expectations of the congregation and its professional leaders, as well as compensation packages, to determine that realistic expectations are understood and adequate compensation is provided for the services performed.

It is helpful to remember that the process for determining compensation is a process which must be marked by openness, honesty and graciousness. Both professional leaders and congregational representatives, whether the congregation council, a staff support committee, or personnel committee, should articulate their needs clearly and develop a regular review process to report changes in those needs as program directions change or as the pastor's or associate's in ministry skills or needs change. These needs would be standards and details of the pastor's or AIM's performance on the one hand and a reasonable compensation level on the other.

Though no guidelines, however carefully crafted, can give congregations automatic, concise and simple answers to what are inherently complex issues, the following criteria may be helpful in compensation discussions:

- Years of service since ordination or certification.

- Prior service in other occupations which reflects the value of work experience and maturity.

- Performance and responsibility.

- Educational preparation and continuing education.

- Economic standards that prevail for professionals in the community in which the pastor or associate in ministry serves.

- Present cost of living.

While the specifics of these guidelines apply only to pastors and associates in ministry, the principles apply to other church workers. Secretaries, custodians, choir directors, organists, teachers and others also deserve fair compensation, and the responsibility of the congregation to these persons is no less than to the pastor or associate in ministry.

Adequate compensation may involve patience on the part of pastors and associates in ministry as a congregation works to set compensation at a level agreed to be fair, if current compensation is below that level. It will also involve a congregation's determined effort in stewardship and education to reach that level. Finally, adequate and fair compensation encourages good morale on the part of professional leaders and the congregation as they work together to do ministry and mission in the name and spirit of Jesus Christ.

## Salary and Housing Allowance

For 2010, a **MINIMUM** guideline for salary, **including housing-related allowances**, is shown below. This is intended to make it easier for congregations to understand the basic compensation of their pastor(s) and/or associate(s) in ministry. If your congregation provides a parsonage, the minimum guideline should be divided by 1.3 to account for the value of the parsonage.

If the congregation is already at or above the minimum salary guidelines, a cost of living increase of at least 2.9% should be considered (The CPI-W for Northern California was 2.9% in 2006), since the failure to provide a cost of living salary increase is, in effect, a salary cut. In addition, merit increases should be considered for all rostered leaders.

Congregations that are below the minimum guidelines should intentionally plan to reach guidelines within a set period of time. For example, if the congregation is 10% below guidelines, the congregation might make the commitment to increase the pastor's or AiM's salary by 6% - 8% per year for three years to reach the minimum guidelines three years hence.

Once the basic salary package has been set, the congregation council, upon consultation with the pastor, should set the amount of the basic salary that is to be designated as housing allowance for tax purposes. The form below is for congregation council use in designating the housing allowance. This procedure must be done annually, **prior** to the payment of the housing allowance. Most councils will make this designation at their December council meetings, but any time frame is appropriate as long as it is prior to the payment of the housing allowance.

Since the cost of housing varies so greatly throughout the synod, no attempt has been made to recommend the dollar amount of a pastor's housing allowance. In general, a housing allowance should be designated as high as possible, keeping in mind that the amount that can be excluded from taxable income cannot exceed the **lowest** of the following:

- 1) the allowance itself.
- 2) the amount actually used "to provide a home" or
- 3) the fair rental value of the furnished home, plus utilities.

Any amount spent by the pastor in excess of the allowance is not excludable; any allowance not used by the pastor becomes taxable income and must be reported as "other income" on Form 1040.

**2010\***  
**Minimum Salary Guidelines**  
 Sierra Pacific Synod

<b>YEAR OF SERVICE</b>		<b>YEAR OF SERVICE</b>	
1	<b>49,600</b>	21	<b>68,200</b>
2	<b>51,100</b>	22	<b>69,100</b>
3	<b>52,200</b>	23	<b>69,900</b>
4	<b>53,000</b>	24	<b>71,000</b>
5	<b>53,700</b>	25	<b>72,300</b>
6	<b>54,500</b>	26	<b>73,400</b>
7	<b>55,100</b>	27	<b>74,700</b>
8	<b>56,000</b>	28	<b>75,600</b>
9	<b>56,900</b>	29	<b>76,700</b>
10	<b>57,600</b>	30	<b>77,600</b>
11	<b>58,600</b>	31	<b>78,900</b>
12	<b>59,500</b>	32	<b>80,300</b>
13	<b>60,400</b>	33	<b>81,300</b>
14	<b>61,400</b>	34	<b>82,600</b>
15	<b>62,300</b>	35	<b>83,600</b>
16	<b>63,000</b>	36	<b>85,200</b>
17	<b>64,300</b>	37	<b>86,400</b>
18	<b>65,000</b>	38	<b>87,600</b>
19	<b>66,300</b>	39	<b>89,100</b>
20	<b>67,200</b>	40	<b>90,200</b>

**NOTES:**

- 1) Minimum Salary = Cash Salary plus Housing Allowance or Parsonage Value.
- 2) If a Social Security Allowance is provided, it is IN ADDITION to the above guidelines.
- 3) If a parsonage is provided, the above guidelines should be divided by 1.3 to determine the minimum cash salary.

**HOUSING ALLOWANCE RESOLUTION**

(Insert in Congregation Council Minutes)

In order to permit (Name of Pastor) to benefit from the provisions of Section 107 of the Internal Revenue Code, the council specifies that the total compensation paid to her/him during the fiscal year ended (Subsequent Year) includes a housing allowance. (Name of Pastor) estimates that s/he will spend \$\_\_\_\_\_ during the year for housing expenses. Since such approval by the council would permit her/him to deduct that amount from her/his taxable income and has no further effect upon our congregation or budget, it was

RESOLVED,

That the total compensation of \$ (Amount) paid to (Name of Pastor) include a housing allowance of \$\_\_\_\_\_.

\_\_\_\_\_  
 Signature Title Date

(The above resolution should be included in the minutes of the congregation council prior to January 1 of each year. A copy should be made, signed and titled by the president or secretary of the congregation, and given to the pastor(s) for his/her records.)

*\*Note: This is a 2% increase over 2009 based on discussion and vote of the Leadership Discipling Team*

## Equity Allowance

It is suggested that an equity allowance be provided if a pastor or associate in ministry lives in a congregation owned home. The equity allowance provides the financial resources for a professional leader to purchase housing, whether during his/her active ministry or upon retirement, when a parsonage will no longer be available. When the pastor lives in a parsonage, it is the congregation that is enjoying any equity buildup in that home, not the pastor or AiM. When the person leaves the parsonage, there is no equity with which to finance new housing. Thus, congregations with parsonages are encouraged to provide an equity allowance plan to share with the pastor or associate in ministry that buildup in the value of the parsonage. A suggested equity allowance might be:

- An amount equal to 3% of the pastor's or AIM's defined compensation. (Base salary plus 30%).
- A split of the increased value of the parsonage from year to year. Since it is wise for a congregation to have an annual property appraisal for insurance purposes, this increase in value is easily determined.

In paying the equity allowance to the pastor or AIM, it is helpful for the congregation to pay directly to a tax deferred plan which delays the income tax due until the funds are actually withdrawn for use. If the congregation wishes to setup an equity allowance plan, a resolution to be adopted by the congregation if the investment vehicle is other than the ELCA Optional Pension Plan is shown below.

### HOUSING EQUITY ALLOWANCE AGREEMENT

*(This form is for use when contributions to a housing equity allowance are not made by the congregation to the member's ELCA optional pension plan. When payments are made to the ELCA optional pension plan, the congregation uses the forms presented by the fund custodians.)*

At a properly called meeting of the congregation of \_\_\_\_\_ Lutheran Church held

on \_\_\_\_\_ and with a quorum present, it was moved, seconded and voted to establish a housing equity allowance for the Rev. \_\_\_\_\_ with (1) an initial contribution of \$ \_\_\_\_\_ for the year 20\_\_\_\_, and (2) with subsequent contributions to be determined each year thereafter by vote of the congregation.

The conditions of this agreement are as follows:

1. The annual contribution shall be placed in an interest-bearing account in the name of the congregation.
2. The fund shall not be available for use by the congregation or by the pastor except for the purchase of a house by the pastor or the pastor's spouse.
3. The fund shall be paid in full to the pastor or survivors in the event of the pastor's disability, retirement or death.
4. Upon resignation as pastor from this congregation and acceptance of a call to another congregation or organization, the fund balance shall be transferred to the new employer or paid to the pastor, as the pastor may direct.
5. The funds shall be payable to the pastor's estate if there is no surviving spouse.

\_\_\_\_\_  
Signature of an officer of the congregation Date

\_\_\_\_\_  
Signature of the pastor Date

## Social Security Allowance

As self-employed persons, pastors will pay 15.30% of their salary and housing allowance for social security benefits. Many congregations provide an allowance for all or part of this expense. This allowance, if provided, is part of the taxable income for the pastor.

Since congregations are required to pay 7.65% of a lay employee's salary for social security benefits, it would be fair to pay this amount as a Social Security allowance for the pastor.

## ELCA PENSION /OTHER BENEFITS PLAN

The congregation should provide for the pastor's/AIM's participation in the Pension and Other Benefits Plan of the Evangelical Lutheran Church in America. This plan includes coverage for Retirement Pension Benefits, Medical and Dental Benefits, Disability Benefits, and Death Benefits for the pastor or associate in ministry. Coverage for dependents (spouses and children) is now optional only to the extent that it is provided by the employer of the spouse. In other words, if coverage is not provided for dependents by another employer, the congregation is **expected** to provide coverage as part of the pastor's/AIMs benefits package.

The [Board of Pensions](#) provides a memorandum to members and congregational treasurers each year (usually in August or September) which outlines the percentage of defined compensation which will be required for each category of benefits for the following year. The rates for 2010 can be found [here](#). The Board of Pensions also has [calculators](#) available to assist in determining contribution amounts, defined compensation, and total compensation.

### VACATIONS

Four weeks annually (including four Sundays) is the minimum. Congregations may wish to provide an additional 2 Sundays per year in order to allow pastors and AIMs to take a "3 day weekend".

### CONTINUING EDUCATION

In addition to vacation time, congregations should make available two weeks of continuing education time. Congregations should budget at least \$1000 per year to provide part of the cost for tuition, travel, and books. The pastor or associate in ministry is expected to contribute at least \$200 annually for continuing education.

A minimum of 25 contact hours per year of continuing education is required of every pastor and associate in ministry of the ELCA. It is expected that every rostered leader will have a completed CONTINUING EDUCATION COVENANT. If you need assistance in developing a COVENANT, contact Synod Office or the Leadership Discipling Team. During the pastor's/AIM's absence for continuing education, the congregation continues to pay salary and allowances, and is responsible for pulpit supply and the other regular expenses for ministerial services.

### SABBATICAL LEAVES

From time to time, a pastor or associate in ministry may desire an extended period of time for study, personal growth, and reflection without the responsibilities of regular parish service -- a sabbatical leave. The following are suggested to assist professional leaders and congregations in the consideration of sabbaticals:

- Pastors or associates in ministry and congregations contemplating sabbatical leaves should consult with the Bishop or an Assistant to the Bishop early in the process.
- Sabbatical leaves are intended for in-depth study or personal growth related to the regular call of the pastor or associate in ministry, and should include time for personal and familial reflection.
- Sabbatical leaves will normally be for a period of not less than three months and not more than twelve months.
- Pastors and associates in ministry who have a minimum of seven years of active service, and who have served their current call or appointment for five or more years may present proposals for sabbatical leaves.
- A proposal should include:
  - a. A rationale for the sabbatical, including personal goals and potential value for the congregation.
  - b. A detailed outline of the intended courses of study and use of time.
  - c. An outline of financial implications of the sabbatical.
  - d. An indication of the use of vacation time during the sabbatical. At least one half of the period

- e. normally granted as annual vacation leave shall be so designated in sabbatical leaves of 3-6 months. In proposals for sabbaticals of 7-12 months the entire annual vacation leave should be included in the sabbatical.
- Realizing that the congregation will be without the services of its regularly called pastor or appointed associate in ministry during the sabbatical, the pastor or associate in ministry should seek the counsel and consent of the Bishop before finalizing the agreement.
- Proposals for sabbatical leaves should be presented to the congregation council not less than six months prior to the beginning of the leave.
- Careful consideration should be given to all aspects of the proposal and implications for the congregation and the pastor or associate in ministry.
- Normally, the financial considerations for the sabbatical should be negotiated by the pastor or associate in ministry and the congregation. It is suggested, however, that salary/housing and the ELCA Pension and Other Benefits Plan be maintained at the current level, with the pastor or associate in ministry assuming responsibility for all other expenses.
- When a sabbatical leave is granted, the pastor or associate in ministry should normally agree to serve the congregation for a minimum of two years following the completion of the leave.
- Within six weeks of the completion of the sabbatical leave, the pastor or associate in ministry should present to the congregation and the Bishop a detailed reflection on the experiences of the leave.

#### **DISABILITY LEAVE**

During the first two months of a disability, the congregation provides full compensation. Beginning with the third month, a member of the ELCA Pension and Other Benefits Plan is entitled to receive a monthly benefit equal to 66 % of the member's defined compensation, minus any social security benefits to which the member may be entitled, and minus any other governmental disability program benefits payable to the member based on the disability. In general, the monthly benefits continue until the member recovers from the disability. However, if the member has not recovered by his or her 65th birthday, the monthly benefits will stop and pension benefits will begin.

During the first 2 months of disability, the congregation is responsible for continuing to pay the monthly contribution to the Medical and Dental Benefits Plan and the Survivor Benefits Plan. If coverage has been continued during the first 2 months, then thereafter the Disability Benefits Plan will pay the cost of continued coverage under the Medical and Dental Benefits and Survivor Benefits Plans.

#### **ELCA PENSION AND OTHER BENEFITS PLAN**

The congregation should provide for the pastor's/AIM's participation in the Pension and Other Benefits Plan of the Evangelical Lutheran Church in America. This plan includes coverage for Retirement Pension Benefits, Medical and Dental Benefits, Disability Benefits, and Death Benefits for the pastor or associate in ministry. Coverage for dependents (spouses and children) is now optional only to the extent that it is provided by the employer of the spouse. In other words, if coverage is not provided for dependents by another employer, the congregation is **expected** to provide coverage as part of the pastor's/AIMs benefits package.

The Board of Pensions provides a memorandum to members and congregational treasurers each year (usually in August or September) which outlines the percentage of defined compensation which will be required for each category of benefits for the following year. The rates for 2008 can be found at <https://www.elcabop.org/> The Board of Pensions also has calculators available to assist in determining contribution amounts, defined compensation, and total compensation.

#### **OTHER LEAVES**

Several congregations have asked for guidelines for sick leave and maternity/paternity leave. While it is the responsibility of the congregation to develop its own policies in this area, the following are the standards for the Synod and may be helpful in formulating congregational policies.

Sick Leave -- All employees (Pastors, Associates in Ministry, and lay employees) earn one (1) day of paid sick leave for each calendar month. Employees may carry over sick leave up to a maximum of twenty-four (24) days.

Family (Maternity/Paternity) Leaves -- pastors, associates in ministry and employees who request leave for pregnancy-related reasons should be granted leave up to six weeks with full salary, housing and benefits. When this leave is exhausted, an unpaid leave of absence may be granted.

# Reimbursements

## BOOKS AND JOURNALS

Most congregations provide the pastor or associate in ministry with a yearly allowance from which reimbursement is made for books and journals. Some congregations broaden this allowance to "professional expenses." In either case, \$250 per year is the recommended minimum.

## AUTOMOBILE EXPENSES

A Pastor or Associate in Ministry should be reimbursed for the **full** expense of driving his/her car on church business. Too often, the reimbursement received is insufficient to cover the full costs of driving a personal automobile. That part of these unreimbursed costs become an added financial burden for pastors and AIMs and may mean increased income taxes for the pastor.

Since the cost of operating a car on church business is a business expense and a car is required by the congregation for the performance of the ministry of the church, the congregation should be responsible for the full cost. It is important to understand that the cost of operating an automobile **is not compensation**; it is merely reimbursement for the expenses of doing the ministry of the church. The automobile reimbursement is an administrative expense of the congregation.

The most effective way for a congregation to provide for the full cost of travel, is for the congregation to lease or purchase an automobile for the pastor's use. The congregation then provides for the upkeep of the auto, including gas, repairs and maintenance, and the pastor or AIM uses the auto exclusively for congregational business. However, that arrangement may not be possible for many congregations. Alternately, the congregation provides a reimbursement for the cost of using a pastor's or AIM's personal automobile. Your pastor or Associate in Ministry should keep a detailed records of all costs associated with a personal car used for church business (including insurance and depreciation). The congregation can then reimburse these costs based on the mileage driven in the course of the ministry. The IRS allowed business mileage reimbursement rate, beginning January 1, 2008, is \$0.505 per mile.

## REIMBURSEMENTS and TAXABLE INCOME

Anytime reimbursements are made to a pastor or associate in ministry in a flat rate basis (e.g. \$200 per month or \$300 per month, etc.) it is considered taxable income under IRS regulations. Therefore, it behooves congregations, for the sake of reducing the professional leader's taxable income, to setup an "accountable reimbursement plan". The implementation of an accountable reimbursement plan by a congregation is one of the most important components of a compensation package. The benefits of such a plan are:

Pastors and associates in ministry report their business expenses to the congregation rather than to the IRS. Pastors who report their income taxes as employees (or who report as self-employed and are reclassified as employees by the IRS in an audit) avoid the limitations on the deductibility of employee business expenses. These include (1) the elimination of any deduction if the person cannot itemize deductions on Schedule A (85% of all taxpayers cannot), and (2) the deductibility of business expenses on Schedule A as an itemized expense only to the extent that these expenses exceed 2% of the adjusted gross income.

The *Deason* allocation rule is avoided. Under this rule, pastors must reduce their business expense deduction by the percentage of their total compensation that consists of a tax-exempt housing allowance. The "80% limitation" that applies to the deductibility of business meals and entertainment expenses is avoided.

Pastors who report their income as self-employed avoid the shock of being reclassified as an employee by the IRS in an audit. Many clergy who report their income as self-employed have been so reclassified by the IRS. The effect of this is to move their business expenses from Schedule C (where they are fully deductible) to Schedule A where the above limitations apply.

An accountable reimbursement plan is one that, (1) reimburses only those business expenses that a pastor or other employee periodically substantiates as to the date, amount and business nature of each expense, and (2) requires that and "excess reimbursements" (e.g. advances) to be returned to the church. The IRS guidelines specify that a person's "accounting" or substantiation of his or her expenses, and the return of any excess reimbursements must occur within a "reasonable time."

The reasonable time requirement may be satisfied in two ways. First, under the "fixed date method", business expenses will be deemed substantiated within a reasonable amount of time if done so *within 60 days* after the expenses are paid or incurred, and excess reimbursements will be deemed to have been

returned within a reasonable time if done *sowithin 120 days* after the expenses are paid or incurred. Under the alternate "periodic statement method", a congregation gives the pastor or employee a periodic statement (not less than quarterly) setting forth the amount by which the congregation's reimbursements exceed the amount of business expenses substantiated by the pastor or employee, and requesting the pastor or employee to either substantiate the difference or return the excess to the congregation with 120 days of the statement. Expenses that are substantiated or returned within the 120 period satisfy the reasonable time requirement.

How does a congregation implement an accountable reimbursement plan? By having the congregation council adopt an appropriate resolution containing the requirements summarized above. This resolution, when adopted, remains in effect until the Congregation Council votes to rescind it.

If such an accountable reimbursement plan is adopted, congregations may wish to combine book, auto and other allowances into one "professional expenses" line item on their budgets for clarity and simplicity. All substantiated business expenses could then be charged against one account.

#### **YEAR END REPORTING TO THE INTERNAL REVENUE SERVICE**

If the congregation has adopted an accountable reimbursement plan and/or a qualified equity allowance plan, then the only amount reported as income to the Internal Revenue Service is the pastor's or AiM's salary and social security allowance (if applicable).

If, however, the congregation reimburses expenses on a flat rate basis (e.g. \$200 or \$300 per month automobile allowance) then these amounts must be **included** as income on W-2s or 1099s.

Housing allowances, utilities allowances, furnishings allowances and continuing education are **always excluded** from the income reported.

### **ACCOUNTABLE REIMBURSEMENT POLICY**

The following resolution was duly adopted by the congregation council of \_\_\_\_\_ Lutheran Church at a regularly called meeting held on \_\_\_\_\_, a quorum being present:

Whereas income tax regulations 1.162-17 and 1.274-5(e) provide that an employee "need not report on his tax return" expenses paid or incurred by him or her solely for the benefit of his/her employer for which he/she is required to account and does account to the employer and which are charged directly or indirectly to the employer; and

Whereas income tax regulation 1.274-5(e) further provides that "an adequate accounting means the submission to the employer of a ... statement of expense or similar record maintained by the employee in which the information as to each element of expenditure (amount, time and place, business purpose, and business relationship) is recorded at or near the time of the expenditure, together with supporting documentary evidence, in a manner which conforms to the 'adequate records' requirements" set forth in the regulation; and

Whereas \_\_\_\_\_ Lutheran Church desires to establish a reimbursement policy pursuant to regulations 1.162-17 and 1.274-5(e); therefore be it

Resolved, that \_\_\_\_\_ Lutheran Church hereby adopts a reimbursement policy pursuant to income tax regulations 1.162-17 and 1.274-5(e), upon the following terms and conditions:

1. Any pastor called, or any person now or hereafter employed by \_\_\_\_\_ Lutheran Church shall be reimbursed for any ordinary and necessary business and professional expense incurred on behalf of the church, if the following conditions are satisfied: (1) the expenses are reasonable in amount; (2) the person incurring the expense documents the amount, time and place, business purpose, and business relationship of each such expense with the same kinds of documentary evidence as would be required to support a deduction of the expense on the person's federal income tax return; and (3) the person documents such expenses by providing the church treasurer with an accounting of such expenses no less frequently than monthly. In no event will an expense be reimbursed if substantiated more than 60 days after the expense is paid or incurred by a pastor, associate in ministry or employee.

2. The church shall not include in a pastor's or employee's W-2 form the amount of any business or professional expense properly substantiated and reimbursed according to the preceding paragraph, and these persons should not report the amount of and such reimbursement on his or her Form 1040.

3. Any church reimbursement that exceeds the amount of business or professional expenses properly accounted for pursuant to this reimbursement policy must be returned to the church within 120 days after

the associated expenses are paid or incurred and shall not be retained by the pastor, associate in ministry or employee.

4. If, for any reason, the church's reimbursements are less than the amount of business and professional expenses properly substantiated by a pastor or other employee, the church will report no part of the reimbursements on the person's W-2, and the pastor or employee may deduct the unreimbursed expenses as allowed by law.

5. Under no circumstances will the church reimburse a pastor or other employee for business or professional expenses incurred on behalf of the church that are not properly substantiated according to this policy. Church and staff understand that this requirement is necessary to prevent our reimbursement plan from being classified as a "nonaccountable" plan.

6. All receipts and other documentary evidence used by a pastor or other employee to substantiate the business nature and amount of business expenses incurred on behalf of the church shall be retained by the church. The pastor or employee may, at his or her election, make copies of such evidence.

## Employee or Self-Employed?

The Lutheran church's understanding of call is that the congregation and pastor or associate in ministry enter into a "continuing mutual relationship and commitment." This is a special relationship in which the pastor or AIM is called by God through the congregation. Therefore, the pastor or AIM is **not** a hiring, but rather a partner in the ongoing ministry of the congregation.

At the same time, it is necessary to determine the employment status of a pastor or associate in ministry as it relates to the laws of the country, and in particular, the tax laws and regulations. Whether or not a pastor or nonordained staff member is an employee or self-employed is an important question. Unfortunately, it also can be a complex and at times confusing question. This section will address this question on the basis of the most recent legal precedent.

The focus of this section will be on the correct reporting status of pastors and nonordained staff members for federal income tax reporting purposes. The correct reporting status of these individuals for social security purposes is also addressed in this section, but this issue occupies much less attention. The reason is simple--*pastors always are treated as self-employed for purposes of social security with respect to services they perform in the exercise of their ministry*. The difficulty in determining the correct reporting status of pastors therefore is associated with income tax reporting, and not social security. Similarly, for nonordained staff members, their reporting status for federal income tax purposes generally determines their reporting status for social security. In summary, the focus of this section will be on the correct reporting status of pastors and nonordained staff members for income tax purposes.

In Summary:

**Reporting income taxes as an employee.** Most clergy should report their federal income taxes as employees, because they will be considered employees under the test currently used by the IRS. Most clergy will be "better off" reporting as employees, since (1) the value of various fringe benefits will be excludable, including the cost of employer-paid health insurance premiums on the life of the pastor, (2) the risk of an IRS audit is substantially lower, and (3) reporting as an employee avoids the additional taxes and penalties that often apply to self-employed clergy who are audited by the IRS and reclassified as employees.

**Pastors have a "dual tax status."** While most pastors are employees for federal income tax reporting purposes, they all are self-employed for social security purposes (with respect to services they perform in the exercise of their ministry). This means that pastors are not subject to "FICA" taxes, even though they report their income taxes as employees and receive a W-2 from their church. Rather, they pay the "self-employment tax."

**Nonordained church workers.** The IRS and the courts will apply the same tests used in determining the correct reporting status of pastors to determine the reporting status of nonordained church workers for income tax reporting purposes.

**Tests for determining employee status.** There are at least 3 recognized tests for determining whether a pastor or lay worker is an employee or self-employed for federal income tax reporting purposes. These include: (1) the "common law employee" test set forth in the income tax regulations; (2) the 20-factor test announced by the IRS in 1987; and (3) the 7-factor test announced by the United States Tax Court in 1994 in 2 cases addressing the correct reporting status of pastors.

The question of whether a pastor should report his or her federal income taxes as an employee or as a self-employed person is one that has generated a good deal of controversy. It is a significant question for many reasons, including the following:

**(1) Reporting compensation.** Employees report their compensation directly on Form 1040 (line 7--wages), and deduct unreimbursed (and "nonaccountable" reimbursed) business expenses on Schedule A only if they itemize deductions and only to the extent that such expenses exceed 2% of adjusted gross income (only 50% of business meals and entertainment expenses are counted). Self-employed persons report compensation and business expenses on Schedule C. Business expenses are in effect deductible whether or not the pastor itemizes deductions, and are not subject to the 2% floor.

**(2) Adjusted gross income.** Adjusted gross income ordinarily will be higher if a pastor reports as an employee, since unreimbursed (and "nonaccountable" reimbursed) business expenses are deductions from adjusted gross income. Self-employed persons deduct business expenses in computing adjusted gross income. Adjusted gross income is a figure that is important for many reasons. For example, the percentage limitations applicable to charitable contributions and medical expense deductions are tied to adjusted gross income.

**(3) W-2 or 1099?** Pastors working for a church or church agency should receive a Form W-2 each year if they are employees, and a Form 1099-MISC if they are self-employed (and receive at least \$600 in compensation).

**(4) Tax-deferred annuities.** Favorable "tax-deferred annuities" (also known as "403(b) annuities") offered by nonprofit organizations (including churches) may only be available to employees.

**(5) Tax treatment of various fringe benefits.** Certain fringe benefits provided by a church on behalf of a pastor are excludable from the pastor's income only if he or she is an employee. Examples include medical insurance premiums paid by a church on behalf of its pastor; group term life insurance (up to \$50,000) provided by a church on behalf of a pastor; amounts payable to employees on account of sickness, accident, or disability pursuant to an employer-financed plan; employer-sponsored "cafeteria plans" which permit employees to choose between receiving cash payments or a variety of fringe benefits.

**(6) Audit risk.** Self-employed persons face a much higher risk of having their tax returns audited. IRS data reveals that the "voluntary reporting percentage" (i.e., persons who voluntarily report the correct amount of income) is 99.5% for employees covered by mandatory income tax withholding, but is only 13% for persons not covered by mandatory withholding and for whom no 1099 or W-2 forms are filed. As a result, the IRS scrutinizes the tax returns of self-employed persons (who are not subject to tax withholding) much more closely than those of employees. It is also relevant to note that the IRS has been concerned for a number of years with the problem of persons reporting their income taxes as self-employed when in fact they are more properly characterized as employees. The IRS and General Accounting Office conducted a joint study to determine whether 1099-MISC forms (annual information returns issued to self-employed workers) may reveal workers more properly classified as employees. The study revealed a "universe" of self-employed persons who received all of their business income (reported on Schedule C of Form 1040) from a single employer. The IRS is in the process of determining whether such a relationship is an indication of a misclassification of employees as self-employed. This is a significant issue for clergy, many of whom continue to report their federal income taxes as self-employed. In many cases, all of the Schedule C earnings of such clergy are attributable to their employing church, and are reported on a single 1099-MISC form. The IRS study concluded that the receipt of a single 1099-MISC form reporting self-employment income from a single source indicates that a worker is improperly reporting his or her federal income taxes as self-employed. As a result, self-employed clergy may wish to re-evaluate their status for federal income tax reporting purposes. *Internal Revenue Manual update MT 5(10)00-2.*

**(7) Consequences of being reclassified as an employee.** Clergy who report as self-employed face a significant risk of additional taxes and penalties if they are audited by the IRS and reclassified as employees. This is because many clergy who report as self-employed deduct their unreimbursed (and "nonaccountable" reimbursed) business expenses as a deduction on Schedule C. If they are reclassified by the IRS as employees, their business expense deduction will be allowable only as an itemized deduction on Schedule A, and then only to the extent that the expenses exceed 2% of adjusted gross income. Clergy who are not able to itemize end up with no deduction for their business expenses. This can result in a substantial increase in taxable income.

The primary disadvantage of employee status is that most business expenses are deductible only as itemized deductions on Schedule A (i.e., the pastor must be able to itemize deductions in order to deduct them), and they are deductible only to the extent that they exceed 2% of adjusted gross income. This

"disadvantage" can be overcome simply by having your employing church adopt an accountable reimbursement policy under which the church reimburses you for those business expenses that you periodically substantiate

### **Selecting the correct status--3 tests**

For many years, most pastors reported their income taxes as self-employed persons. This was consistent with the treatment of all pastors as self-employed for social security purposes (with respect to services performed in the exercise of ministry). However, it is important for clergy to realize that they have a "dual" tax status--they are considered self-employed for social security purposes (they pay the self-employment tax rather than FICA taxes), but they may be employees or self-employed for federal income tax purposes depending upon a variety of circumstances outlined below.

Beginning in 1978, the IRS began making statements that were interpreted by some to require pastors to report their income taxes as employees. For example, in Revenue Ruling 80-110, the IRS held that a pastor who is "an employee of a church" may not deduct unreimbursed business expenses on Schedule C but rather must use Schedule A. See also Revenue Ruling 79-78. In Publication 517 ("Social Security for Members of the Clergy and Religious Workers"), the IRS lists a comprehensive example demonstrating how a pastor who is "an employee of the church" should report his income and business deductions. These pronouncements led some tax advisors to conclude that the IRS now views all pastors serving local churches as employees rather than as self-employed. Reliance has also been placed on section 3401(a)(9) of the Internal Revenue Code which states that pastors who are employees of a church are exempt from tax withholding.

The IRS and the courts generally apply either or both of three tests in deciding whether a particular worker is an employee or self-employed for income tax reporting purposes -- (1) the so-called common law employee test, (2) the "20 criteria test" adopted by the IRS in 1987, or (3) the "7 factor test" announced by the United States Tax Court in 1994. Since the 20 criteria and 7 factor tests are amplifications of the common law employee test, for clarity only the common law test is explained in the paragraphs that follow.

### **The "common law employee" test**

The best approach to this issue is to treat pastors as employees only if they satisfy the common law employee test adopted by the Treasury Department:

Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee. Generally, physicians, lawyers, dentists, veterinarians, contractors, subcontractors, public stenographers, auctioneers, and others who follow an independent trade, business, or profession, in which they offer their services to the public, are not employees. *Treas. Reg. 31.3401(c)-1(b)-(c)*. See also Publication 517.

## Interim Ministry

Interim pastors in the Sierra Pacific Synod are generally rostered in three categories: Pastors under call by the synod to interim ministry, pastors on leave from call, or retired pastors. When a pastor is appointed as interim pastor, the Bishop will discuss with the Congregational Council the appropriate compensation for the interim pastor. However, the following guidelines may be helpful for planning purposes.

### **Pastor under call to Interim Ministry or Pastor On Leave from Call**

The current compensation guidelines apply to these pastors just as a regularly called pastor, according to the year of service. Thus if a pastor has served the church for 20 years, salary and housing allowance would be \$67,200. This compensation would then be adjusted according to the amount of time the Interim Pastor is expected to work, e.g. full time, half time, etc.

In addition to basic compensation, the congregation provides pension, medical/dental coverage, and other benefits through the Board of Pensions of the ELCA, again, just as a regularly called pastor. An auto allowance also is provided.

### **Retired Pastor**

For retired pastors, the median compensation guideline is used. For 2009, the median years of service within the synod was 15.0 years, therefore the compensation guideline is \$62,300, adjusted for the expected work schedule.

Since retired pastors are already receiving retirement benefits, it is not necessary for congregations to pay into the ELCA pension plan. However, congregations should provide reimbursement for the medical/dental premiums which the retired pastor is required to pay and an automobile reimbursement.

## Sunday Pulpit Supply

When a congregation engages the services of a pastor for pulpit supply, such as vacation or illness of a regularly called pastor, the following schedule may be used to determine appropriate compensation:

One Service	\$175
One Service and Adult Class	\$200
Two Services	\$200
Two Services and Adult Class	\$225
Each additional responsibility	\$50

In addition, the congregation provides a travel reimbursement in the amount of \$0.505 per mile and full payment for other expenses incurred in connection with the service of the supply pastor.