



How to structure compensation packages for ministerial staff

More than 1 million ordained ministers work throughout the United States. Properly structuring their compensation plans — with an eye toward tax efficiency and legal compliance — is a complex endeavor. Unfortunately, well-meaning, but untrained lay leaders and staff frequently handle this task.

Key elements of an appropriately formulated compensation plan are:

- Awareness of the dual tax status of the minister
- Compliance with the reasonable pay rules (salary, housing allowance and benefits)
- Attention to properly structured benefits for tax-efficiency
- Recognition of benefits “beyond the basics” — their purpose and importance.

Most ministers are employees for federal income tax purposes, but are self-employed for Social Security (SECA) purposes in the exercise of their ministry. Few ministers, such as traveling evangelists or interim pastors are self-employed for federal income tax purposes. This means that most ministers should receive a Form W-2 not a 1099. Awareness of these rules sets the foundation on which the church begins to build its compensation plan for the pastor.

All churches and nonprofit organizations are subject to the reasonable compensation rules for its employees, including the

pastor. Pay and benefits satisfy these rules if the total amount is reasonable and necessary to carry out the work. In other words, if the economic value of the compensation plan does not exceed the value of services performed, then pay is reasonable. Compensation in excess of this standard may result in penalties or jeopardize the tax-exempt status of the organization.

Salary and housing

The criteria for this first component of the compensation plan — salary and housing allowance — takes into account the education, skills, responsibilities and experience of the minister matched with the needs of the church and its surrounding community. Look to what similar churches in comparable areas (rural, suburban, inner-city) provide.

The portion of salary designated as housing allowance requires thought as well. While this portion of pay is exempt from federal income taxes to the extent it complies with applicable rules, it is subject to SECA. Further, when housing allowance consumes a large portion of salary, it may have an adverse impact on certain benefits. For example, consider contributions to the retirement plan.

A church is permitted to base its retirement plan contributions on salary plus the portion designated as housing allowance. However, whether the contribu-

tion is valid under tax law generally depends on salary exclusive of housing allowance. As the portion of salary designated as housing allowance designation increases, so does the likelihood that contributions may exceed allowable limits.

Properly structured benefits

Churches need to set benefits, separate and apart from salary and housing allowance. Just as many laypersons in the church have jobs where cash salary is separate from benefits, a church needs to establish a stand-alone benefits regime. The major reason for this approach is three-fold: stewardship, tax-efficiency and compliance with applicable law.

Stewardship: When a church separates benefits from salary/housing allowance, it is a better use of its resources. Properly structured benefits preclude unintended taxes. Generally, when the church and minister enter into the negotiation of how salary is allocated, the portion allocated to benefits is taxable to the minister. In effect, the church unintentionally diverts a portion of its resources to taxes and the minister’s cash flow is diminished.

Tax-efficiency: Consider medical insurance premiums under the negotiated approach. Because there is a choice between cash and the benefit, the medical insurance premium is a taxable benefit. If the benefit is non-nego-

tiable, then it is a tax-free benefit. Thus, the minister's cash flow is not reduced unintentionally.

Compliance with applicable law:

No matter how the church labels a benefit, its taxability is determined by the tax code.

Here is a list of basic benefits to include in the church's benefits package:

- Medical and dental insurance
- Retirement plan
- Life and disability insurance

Beyond the basics

Having covered compensation and benefits basics, there are other elements of pay that are important to include in the total plan for the minister.

Social Security supplement:

Because the minister is self-employed by Social Security (SECA) in the exercise of his ministry, he is responsible for paying the full 15.3 percent. Consider adding to his pay the 7.65 percent the church pays for its non-ministerial employees.

Accountable reimbursement accounts: Use of these accounts fit into the categories of good stewardship and tax-efficiency. Rather than provide the minister with an allowance for his car, books, education, etc., it is far more effective to handle these benefits through accountable reimbursements.

Fringe benefits: A 125 or cafeteria plan can benefit all staff members. This type of plan allows the minister to pay for non-covered items, such as co-pays or deductibles, on a pre-tax basis. The tax savings yields more cash flow.


Reward effective leadership: Scores of literature proclaim, and studies validate, that appreciation has a positive impact. Recognitions of appreciation may range from simple notes of "thanks" to significant gifts of recognition. When the reward tends toward the significant, once again, good stewardship and tax-efficiency is important. Apart from a spontaneous gift, most rewards are

taxable to the minister. It is prudent to structure the reward in a manner that complies with legal limitations and maximizes the resources of the church.

Dollars and cents cannot define the full value of the minister and his ministry team. It takes planning and some expertise to structure a compensation

plan that is compliant, tax-efficient and applies church resources wisely.

Sherre Stephens is a certified employee benefits specialist and director of executive services for GuideStone Financial Resources, Dallas, TX.
[www.GuideStone.org]



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