



## **Tax Free Gift to the Pastor**

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I received an email the other day that talked about a church that wanted to bless their pastor with a gift. The church wanted to give their pastor a \$10,000 gift, but the church wanted to fix the gift so that the pastor would get gift, tax free. The church did not want the pastor to have to pay any taxes to the IRS or to his state government, on the money.

If an employer gives a "bonus" or "love gift" to an employee, it is simply additional salary. When a donor gives money to the church, receives a receipt for a deductible contribution to the church, and the church pays the bonus or gift to the employee, it is taxable compensation to employee.

Employers are permitted to exclude from gross income (as a *de minimis* fringe benefit) the value of a gift that is given by an employer if the value is insignificant (i.e., turkey, ham, etc.) (Revenue Ruling 59-58). This does not apply to gift certificates or similar items that can readily be converted to cash, regardless of the amount involved. The church can give some length of service awards that we will discuss later, that can be tax free, but it is for a very limited amount.

Church members are free to make personal gifts to ministers and it may or may not be tax free income. If the gift is organized by church leaders, it becomes taxable income.

### Examples: Gift as Income

The value of a boat, motor and boat-trailer received in payment for services as a minister was includable in gross income (*O.F. Potito, CA-5, 76-2 USTC P9494, 534 F2d 49. Cert. den., 429 US 1039*).

A women minister that had cash transfers from church members, deposited in her personal account, were taxable income in consideration for services rendered by her, rather than non-taxable gifts. The court ruled that special offerings made to a minister on her birthday, Mother's Day, church's anniversary and Christmas were taxable compensation for services rendered. Members of the local church transferred cash to their minister on four separate occasions. Gifts accumulated to more than \$40,000 annually. The offerings were not spontaneous and voluntary, but rather a highly structured program for transferring money to the minister on a regular basis (*C.E. Banks, 62 TCM 1611, Dec. 47,832(M), TC Memo. 1991-641*).

To the extent that a church pays any amount toward its minister's obligation for income tax or self-employment tax, the minister is in receipt of additional income which must be

included in the gross income and must be considered in determining income and self-employment tax liability (*Rev. Rul. 68-507, 1968-2 CB 485*).

Amounts received as clothing and food allowance in exchange for an individual's ministerial services constituted taxable income to the minister. The amounts could not be considered a rental allowance or meals furnished for the church's convenience (*D. Kalms, 64 TCM 153, Dec. 48,244(M), TC Memo. 192-394*).

***Example:*** *First Church's board votes to award a "Christmas bonus" in the amount of \$1,500 to Reverend A. The bonus is to be paid out of the church's general fund. Reverend A. has received taxable compensation.*

*First Church collects a Christmas offering for Reverend A. The congregation makes checks payable to the church. All the donors know that Reverend A is going to receive the gift, tax law general treats this as a gift to a specific individual so the **gifts would not be deductible.** The offering is presented to Reverend A in a single check by the church treasurer. Reverend A. **has received taxable compensation.***

*First Church collects a Christmas offering for multiple staff and employees. If the church leaders (not staff) determine the recipients and the allocation as to whom and the money is disbursed, all of the **donors would be given tax-deductible receipts** for their contributions. The offering presented to the staff and employees **has received taxable compensation.***

*First Church collects a Christmas offering for Reverend A. Donors are told to make their checks out to Reverend A. or give cash, and that the money would be given directly to Reverend A. and **no charitable contribution credit would be given.** The **offering would be considered taxable** (see *Swaringer v. Commissioner, T.C. Summary Opinion 2001-37 (2001); Pomeroy v. Commissioner, 2003-2 USTC 50,568 (D. Nev. 2003)*).*

**Eighth Circuit Court – Rule – Taxable Income:** A minister went to a church in 1963. In 1966, members of the congregation started making non-cash gifts to the minister. Then the gifts became cash gifts. By 1987, the gifts became a regular practice of the church and were made three times a year. Two weeks prior to the designated time for giving the gift the associate pastor would make an announcement to the congregation, then collect all the gifts in cash. They were given to the minister as an anonymous gift. Members of the church said the gifts were given out of “love, respect and admiration” for the minister.

The court ruled that these “gifts” were taxable income due to the following:

1. The gifts were taken in a regular and structured manner.

2. The gifts were made by the congregation as a whole, not by individual members.
3. The minister probably would have had to leave the church if not for the gifts.
4. The court ignored statements by the members and looked at the objective nature of the gifts (*Goodwin, (1995 CA-8) 76 AFTR2d, 95-5437*).

**BENEVOLENCE**: When an employer helps an employee or a member of an employee's family in need, it is considered **taxable compensation**. When a non-employee is helped, it is benevolence.

Expenditures of funds given "to or for the use of the church" must be used in the furtherance of the church's exempt purpose (IRC 170).

**INUREMENT**: The basic principle is that the money given to the church is to further the church's exempt purpose. The church should always spend money in that regard. If an employee of the church receives any economic benefit from the church, it is generally considered taxable income.

Churches are prohibited from engaging in activities that result in the church's income or assets going to "insiders" (i.e., church board members, officers, trustees, employees, ministers, etc.).

The prohibition against inurement is absolute, so any amount may be subject to excise tax or the loss of the organization's nonprofit status. (See Losing Your 501(c)(3) status)

### **RETIREMENT PLAN CONTRIBUTIONS**

When an employer pays the premium for a qualified retirement plan 403(b), **it is not taxable income** to an employee during his working years.

There are strict guidelines for each retirement plan. Prior to making any contribution, whether it be by the employee or the employer, make sure the plan is set up properly.

**EMPLOYEE ACHIEVEMENT AWARD**. If a person receives tangible personal property (other than cash, a gift certificate, or an equivalent item) as an award for length of service or safety achievement, the amount, generally can exclude its value from income. However, the amount to be excluded is limited to your employer's cost and cannot be more than \$1,600 (\$400 for awards that are not qualified plan awards) for all such awards the person receives during the year. The employer will tell the employee whether the award is a qualified plan award. The employer must make the award as part of a meaningful presentation, under conditions and circumstances that do not create a significant likelihood of it being disguised pay.

However, the exclusion does not apply to the following awards.

A length-of-service award if received for less than 5 years of service or if received another length-of-service award during the year or the previous 4 years.

**Example.**

Ben Green received three employee achievement awards during the year: a nonqualified plan award of a watch valued at \$250, and two qualified plan awards of a stereo valued at \$1,000 and a set of golf clubs valued at \$500. Assuming that the requirements for qualified plan awards are otherwise satisfied, each award by itself would be excluded from income. However, because the \$1,750 total value of the awards is more than \$1,600, Ben must include \$150 ( $\$1,750 - \$1,600$ ) in his income.

**Handling this wrong can cause the church to lose their 501(c)(3) status:**

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