

# The Pastor and His Salary Package



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In the mid-1960s as a young accountant, I began helping my pastor prepare his state and federal tax returns. I was surprised at his meager salary, lack of fringe benefits, and inability to provide financially for his future. His family lived in a church-owned parsonage totally controlled by the church; they couldn't even paint a wall without committee approval. It was a large farmhouse that was difficult to maintain and expensive to heat. I remember visiting that parsonage and finding his wife in tears over the frustration of living under those conditions. And I remember thinking, *This is not right*. Little did I know how that experience would begin to sow the seeds for the Stewardship Services Foundation, a ministry that would allow me to devote my energies to counseling pastors regarding finances, helping them prepare their personal income tax returns, and teaching church boards how to structure pastors' salary packages within the limits of IRS tax law. As a result, in 1977 the Stewardship Services Foundation ministry was born.

A church board needs to know about salary packages and their proper application in the budget process. The most important issue when it comes to this subject is the board's *attitude*—a proper understanding of the salary package issue and the desire to meet the needs of the pastor's family with a spirit of generosity.

## Salary packages

**When a church calls a pastor (whether he be senior, youth, music, or visitation), it is important to consider the following eight issues.**

1) A pastor requires a **cash salary** to meet his family's physical needs independent of his wife having to work. A good starting point would be to review their personal budget and build on it. A pastor who struggles to provide for his family will hesitate to teach Biblical stewardship from the pulpit. If he can't live it, he shouldn't teach it.

2) A pastor should have a **full-family medical plan** that provides adequate health insurance and protects his family and the church in the event of a catastrophic illness or accident. (This can be a tax-free fringe benefit.)

3) A pastor should have **disability insurance**. This is a cash replacement that provides income and protects his family and the church in case of a disabling illness or accident. (It can be a tax-free fringe benefit.)

4) Every pastor needs a **retirement plan**. Coupled with Social Security, it should provide an amount that would give the pastor approximately 80 percent of his take-home pay at retirement, assuming he has a debt-free home. If he has opted out of Social Security, which I do not advise, the plan must be more aggressive to meet his needs.

5 I recommend the plan begin as early as possible, with a minimum annual contribution of \$2,400, building to \$6,000 as soon as possible—and even more if he starts the plan after 40 years of age. A pastor should not be in IRAs or Roth IRAs. He should be in a 403(b) pension plan, with the deposits made by the church. This exempts the amount from self-employment tax and makes the distributions eligible for housing allowance upon his retirement, which would shelter the income from federal and state income taxes.

6 A pastor's family needs him to carry **life insurance**. Ideally this should be \$100,000 of term life insurance, paid by the church, with the wife as beneficiary. This coverage protects the church and provides for the pastor's family upon death. The church can pay the premiums on the policy, but only the premium on the first \$50,000 is a tax-free fringe benefit. The pastor should provide his own additional life insurance as needed, probably in the \$500,000 range.

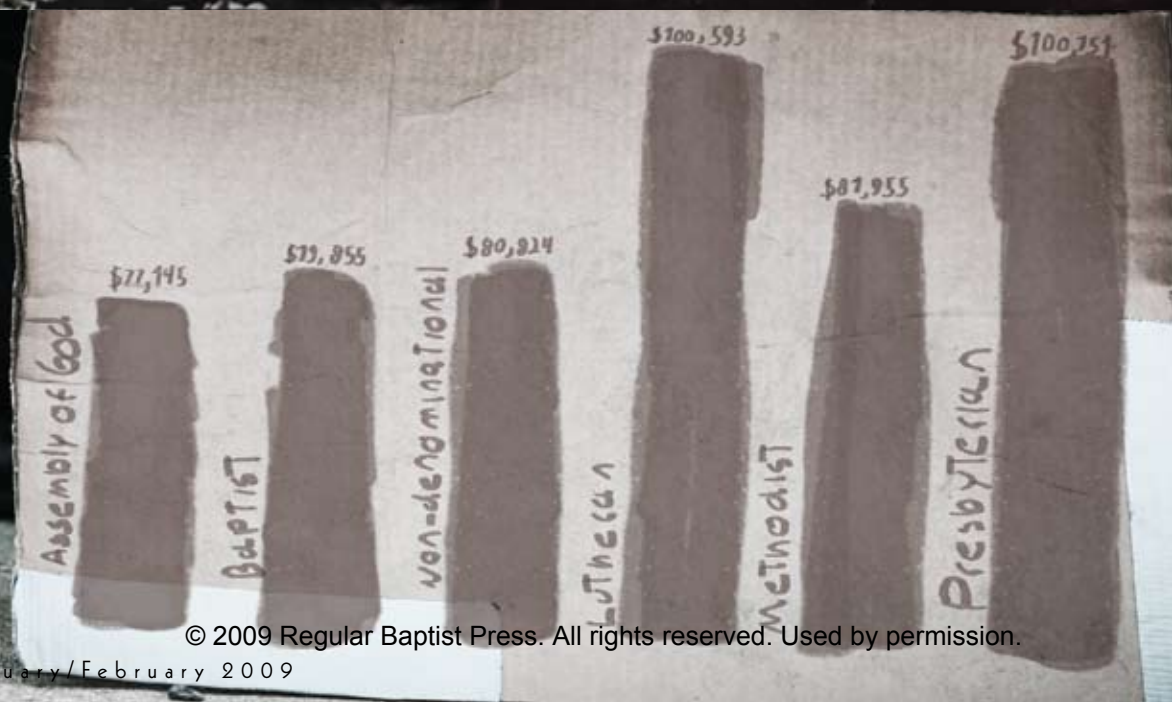
7 Every church should have a **professional expense reimbursement fund** for the pastoral staff. The IRS looks at a pastor as a businessman and recognizes that he incurs reimbursable professional expenses that allow him to perform his duties and should be paid by the church (automobile mileage, conferences, entertainment, supplies, anything pertaining to his responsibilities). In reality, these expenses are incurred for the benefit of the church, not the pastor.

8 A pastor should have a **housing/parsonage allowance**. I have advised churches for over 30 years to get out of the parsonage business. I think it's important to get a pastor into his own home as soon as possible for at least five reasons:

- Retirement: Owning a home at retirement is a key ingredient to retirement planning.
- Security: Owning their own home provides security for the pastor's family, particularly his wife.
- Privacy: The family can decorate how they want; it's *their* home.
- Longevity: The family feels more attached to the community because they have a stronger sense of belonging.
- Tax purposes: Income tax law provides for generous benefits to the pastor who is buying his own home. Federal and state income taxes are greatly reduced and sometimes eliminated due to the housing allowance and the double deduction for mortgage interest and real estate taxes.

9 Every pastor pays the **self-employment tax**. This issue is often misunderstood. A pastor is a dual status employee: he is an employee for income tax purposes but self-employed for Social Security and Medicare purposes (called self-employment tax). Instead of paying 7.65 percent for his Social Security and Medicare and his employer paying 7.65 percent as all other employees do, he must pay 15.3 percent (minus a small credit).

I recommend that the church include in his salary an amount that would cover the 7.65 percent that the church would normally pay if he weren't the pastor. Because he must pay taxes on the additional 7.65 percent, a proper increase would be 9.8 percent.



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## Average Compensation in a Baptist Church

Full-Time Senior Pastor	\$79,855
Full-Time Solo Pastor	54,456
Full-Time Administrative Pastor	80,469
Full-Time Associate Pastor	60,505
Part-Time Associate Pastor	14,397
Full-Time Christian Ed Pastor	61,509
Full-Time Youth Pastor	52,043
Part-Time Youth Pastor	10,660
Full-Time Children's Pastor	50,887
Full-Time Worship Pastor	66,588
Full-Time Church Secretary	29,381
Part-Time Church Secretary	12,059
Full-Time Church Custodian	36,094
Part-Time Church Custodian	7,108

**Q.** Is there any value in comparing your church staff compensation to national averages?

**A.** Yes, if your church needs to be challenged to increase staff pay! These figures can't address your local economy and unique situation, but they are a reminder that our pastors are worthy of honor. We expect a pastor to entertain frequently in a well-kept home, travel to appointments in a reliable vehicle, and dress appropriately in public—all of which require careful stewardship and appropriate pay.

*From the 2009 Compensation Handbook for Church Staff, based on a recent analysis of Baptist churches in the United States. The full report also shows how church salaries vary according to size of church income, church attendance, geographical region, education, and years employed.*

## The confusing "dual-status" when pastors pay taxes

According to IRS tax law, pastors employed by churches have a dual-status treatment in the Internal Revenue Code. This "dual-status" distinction can be confusing to congregations, who do not always understand why a pastor can be considered an employee (income tax reporting) and self-employed (Social Security reporting) at the same time.

**For income tax reporting**, pastors are to be treated as *employees* [see "common law rules" in Reg. 31.3401(c)-1]. The church is not *required* to withhold income tax for the dual-status pastor [see Sec. 3401(a) (9)]; this is optional.

**For Social Security and Medicare reporting**, pastors are considered *self-employed* [see Sec. 1402(a) (8)]. Churches *cannot* withhold FICA and Medicare taxes for their pastor. As a result, pastors receive a W-2 at the end of the tax year with boxes 3, 4, 5, and 6 left blank or with "none" entered in each space.

Pastors must carefully plan throughout the year, or they will be left with a significant payment at the end of the tax year. Pastors have two options for paying.

1. A pastor can pay his self-employment tax by the church's withholding it as additional federal income tax; or
2. A pastor can pay his self-employment tax by quarterly payments using form 1040-ES.

**A bit of history:** Prior to 1994, pastors were considered self-employed for income tax reporting. Then a court ruling declared that a pastor is an employee and therefore the employer (church) must report earnings on Form W-2. Churches have generally incorporated this change, but the distinction is sometimes lost on accountants who do not have experience with the unique tax status of pastors. Even after the court ruling, pastors continued their self-employed status for Social Security and Medicare taxes, adding to the confusion.

# Examples of the budget process

For a representative pastor who is 40 years of age, is married, and has two teenage children.

## Example 1:

**Pastor living in parsonage.** A pastor receives a cash salary of \$42,000 per year and lives in a church-owned parsonage with a monthly Fair Market Rental Value (FMRV) of \$950; the annual FMRV is \$11,400. The church pays the utilities (which they should) of \$3,200 per year.

His annual self-employment tax (Social Security) will amount to \$7,997 ( $\$42,000 + \$11,400 + \$3,200 = \$56,600 \times 92.35 \text{ percent} = \$52,270 \times 15.3 \text{ percent} = \$7,997$ ) of which the church agrees to pay \$5,547 (9.8 percent of \$56,600).

### Pastor living in parsonage

Cash Salary (42,000 + 5,547)	\$47,547
Fringe Benefits: Medical Plan \$700/mo.	8,400
Disability Insurance	800
Retirement Plan	2,400
Life Insurance	400
<b>Total</b>	<b>\$59,547</b>

## Example 2:

**Pastor living in own home.** A pastor receives a cash salary of \$42,000 per year and lives in his own home. The church adds an additional amount of \$18,200 to his cash salary to cover his mortgage payment (\$11,400), utilities (\$3,200), real estate taxes (\$2,100), insurance (\$500), and maintenance (\$1,000). The church would pay the utilities, insurance, and maintenance of \$4,700 if the pastor was in a church owned parsonage, so this portion is not new money. His annual self-employment tax will amount to \$8,506 ( $\$60,200 \times 92.35 \text{ percent} = \$55,595 \times 15.3 \text{ percent} = \$8,506$ ) of which the church agrees to pay \$5,900 (9.8 percent of \$60,200).

### Pastor living in own home

Cash Salary (42,000 + 18,200 + 5,900)	\$66,100
Fringe Benefit: Medical Plan 700/mo.	8,400
Disability Insurance	800
Retirement Plan	2,400
Life Insurance	400
<b>Total</b>	<b>\$78,100</b>

**Church ministry expenses for both examples:** The pastor drives his car an average of 11,000 miles a year for the church, which is reimbursed by the church at the current IRS rate (\$.585 per mile from July to December 2008) for a total of \$6,435. In addition, he spends approximately \$1,000 for conferences he and his wife attend, \$400 for ministry related books and periodicals, \$500 for meals he provides for counselees and church related guests in his home, and \$300 for miscellaneous expenses. A total of \$8,635 is added to the church budget for church ministry expenses on a line item totally separate from the pastor's financial package category. The professional expense amount of \$8,635 would appear in a line item in the church budget separate from the salary package category. The pastor would be reimbursed from this line item as he accounts to the treasurer with all details including mileage logs and receipts. A church credit card may be used for many of these expenses.

A pastor pays the self-employment tax on the total of his wages *including* his housing allowance (if buying or renting). In the event that he lives in a church-owned parsonage, he pays his self-employment tax on the total of his wages *including* the parsonage value and church-paid utilities.

Paying the additional self-employment tax can be a hardship for the pastor. Congregation members often forget about the impact of this 15.3 percent deduction, and as a result have an inflated impression of the pastor's compensation package. Comparing a pastor's salary to your own leads to confusion.

I realize that these numbers may be currently out of reach for some churches. However, stewardship principles require each of us to be responsible with the resources and family God has entrusted to our care.

A good procedure is to assign two respected church leaders to review the needs of the staff annually and to make

recommendations to the church for consideration. Perhaps the pastor could be treated to an informal lunch where his financial needs can be sensitively discussed. It is appropriate for church leaders to ask the pastor if he is keeping current with his financial obligations, and to ask if his needs are being met.

When it comes to our pastors, we should take 1 Corinthians 9:14 and 1 Timothy 5:17 seriously. Addressing all of these issues at one time may be difficult. But by prayer, planning, and proper stewardship, a church can address every single one. **B**

*Jim Rickard is a certified public accountant and the director of the Stewardship Services Foundation, which advises churches and pastors about financial issues. His foundation prepares tax returns for more than 2,000 pastors nationwide, including hundreds of our pastors in GARBC churches.*

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