MINISTER HOUSING PROBLEMS

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The sharp increases in housing prices combined with the lower income ministers receive have created a housing crisis for many ministers. When a church hires a new minister, it wants to help the minister find suitable, affordable housing. Some churches are using methods to assist the new minister that may be jeopardizing the church's tax exempt status or exposing their minister to thousands of dollars in intermediate sanctions. This article will address the problems that arise from the two most common techniques used by churches: loans to ministers and shared ownership.

I will use the following example to illustrate the problems. Assume the new minister's home will cost $500,000, but the minister's income will only qualify for a $200,000 mortgage. The new minister has only $25,000 to pay down on a new home.

LOANS TO MINISTERS

To bridge the gap, the church proposes to loan the minister $275,000. In some instances, the church receives a second lien on the home. Since the minister cannot afford to make payments to the church on a compensation being paid by the church, the church's loan typically receives no payments until the minister sells the home.

Most states outlaw loans to officers and directors by nonprofit corporations. In some churches, ministers are considered officers or directors of the church. If the church makes a loan in violation of the state nonprofit corporation act, then those who approved the loan may be liable to repay the loan. Those who approve the loan have also breached their fiduciary duty to safeguard the church's assets. In some states, those who approve the loan may be held liable for punitive damages.

Even if the minister is not an officer or director of the church, a loan may still be prohibited by other state or federal laws. In many states, the church must use its assets exclusively in pursuing its exempt purposes. Providing a personal loan to an employee violates this requirement. In this instance, the church may lose in its tax exempt status under state law. This could mean that the church could be required to pay property taxes on all its property and/or income taxes.

Assuming your state allows loans to employees by nonprofit corporations, federal law may still restrict the church's ability to make the loan. Federal income tax laws require the church not to provide inurement or private benefits to any individual. This means that the church must conduct the lending process in a commercially reasonable manner. To act commercially reasonable, the church must secure a credit report on the minister. Assuming his or her credit score is high enough to justify a loan, the church must then make the loan using commercially reasonable terms. The church must require the same down payment as a commercial lender would require. It must charge interest at a rate at least equal to that which a commercial lender would require. It must also require

payments in the same dollar amount and timing that a commercial lender would require. If a commercial lender would not make the loan without collateral, the church must secure a lien on the home.

Assuming the church has lawfully complied with all the requirements in making a loan, it must service the loan in a commercially reasonable manner as well. If the minister is late making a payment, the church must charge and collect the late fee. If too many payments are missed, the church must accelerate the loan balance. If a commercial lender would do so, the church must foreclose on the home. A failure to follow commercially reasonable lending practices will constitute inurement or private benefit to the minister.

If the minister defaults on the repayment of the loan, the church faces a dilemma. If the church shows grace to its minister, it could lose its tax exempt status under both federal and state law. If the church complies with state and federal law, then it creates an adversarial relationship with its minister. For these reasons, I suggest that churches never loan money to their ministers to solve the housing problem.

SHARED OWNERSHIP

Until about 50 years ago, most ministers traveled for town to town and because most churches were not large enough to support a minister of full-time. If the church was large enough to support a minister full-time, it provided a parsonage (manse, rectory, etc.) to the minister. This parsonage solved the minister's housing problems. At same time, the minister did not have the opportunity to invest in a home. For many Americans, their home became their largest asset and assisted in funding retirement. Some ministers wanted this same opportunity. In 1954, Congress allowed ministers in the same tax break whether the minister was provided a parsonage or cash to purchase and occupy a home.

Some churches attempt to blend the parsonage with a cash housing allowance to address the minister’s housing costs. In my example above, the minister would purchase $200,000 of the house, while the church would purchase the remaining $300,000 of the house. Since the minister cannot secure a mortgage on 40% of the home, the minister tells the mortgage company that he or she will be making a $300,000 down payment. The minister then enters into a contract with the church providing that the church will own 60% of the home in exchange for $300,000. Under the contract, the church is responsible for 60% of the taxes, insurance, repairs and utilities. When the house is sold, the church receives 60% of the sales price, less than 60% of the closing costs. During the term of the contract, the minister is required to comply with all requirements of the mortgage, including the requirement that payments be made timely.

Under this arrangement, the minister must recognize 60% of the fair rental value as income for self-employment taxes. The minister may count the mortgage payment, utility payments and utilities (less any reimbursements from the church) towards the cash housing allowance that may be excluded from taxable income. The minister may deduct on his income tax return only 40% of the taxes paid.

The first problem with this arrangement relates to the mortgage company. It is virtually impossible to secure a mortgage on the property with shared ownership. If the shared ownership is not disclosed to the mortgage company with the application, the minister in the church have conspired together to file a false mortgage application. The filing of a false mortgage application is a criminal offense.

Assuming the mortgage company will approve the shared ownership, the mortgage company will typically require the church to guarantee repayment of the home mortgage. The signing of the guarantee by the church means that the church is acting as a lender, creating all the problems discussed above in the loan section.

In negotiating the shared ownership contract, the church is again facing a dilemma. If the church demonstrates grace to the minister, it is jeopardizing its tax exempt status. If the church complies with federal and state laws, it has created an adversarial relationship with the minister.

The contract must contain commercially reasonable terms for shared ownership arrangements. It must be followed using those same commercially reasonable terms. Those commercially reasonable terms also create operational problems. For example, if the house needs a new roof and the minister is unable to afford his portion of the costs, the church is facing a dilemma. If the roof is not replaced, the home might suffer serious damage. If the church replaces the roof, it is now placed in the position of being a lender to the minister. To protect the church's investment, the church must have final authority to authorize repairs and to advance funds to cure any defaults by the minister. The church must also have the authority to collect these funds from the minister by any lawful means, including foreclosure on the minister's portion of the home.

The most difficult term of the shared ownership contract to negotiate is the right to sell the home. If the minister leaves the church, he or she may not want to sell a home. Under these circumstances, the church is co-owner with an ex-employee. If the separation was not pleasant, this shared ownership arrangement can quickly become adversarial.

INTERMEDIATE SANCTIONS

From the minister's perspective, any mistakes by the church in making these arrangements can cause a minister huge financial liabilities. For example, if the church made the loan at a lower interest rate than was commercially available, the minister would owe an immediate sanction to the Internal Revenue Service. This sanction could cost the minister up to 300% times the difference in interest charged. On a 30 year mortgage, the sanction could easily exceed $100,000.

CONCLUSION

After working with dozens of churches, I do not believe there is a simple solution. In this area, creativity can easily create huge problems for both the church and the minister. I typically advise ministers to refuse such arrangements because the downside far exceeds any gains. I also typically advise churches to avoid such arrangements because the loss of tax exemption creates huge problems for the church.