

# Participant distributions with housing allowance

How do Participants request a distribution with special Housing Allowance tax treatment?



Written by Envoy Financial  
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## Introduction

The Minister's Housing Allowance is one of the greatest tax benefits available to ordained, licensed, or commissioned ministers and comes from Section 107 of the Internal Revenue Code. When an ordained, licensed, or commissioned minister receives a portion of their compensation as housing allowance, that portion is excluded from gross income and therefore not subject to federal income tax. This can represent substantial tax savings for the minister. Further, when an ordained, licensed, or commissioned person retires, a portion of their 403(b)(9) retirement plan distribution can be received as housing allowance, providing additional tax savings in retirement.

Envoy has extensive experience with housing allowance for ministers and is committed to protecting this important benefit. We have developed tools to make it easy for ministers to maintain their housing allowance, even if they change employers. Using specially earmarked rollover accounts that protect the 403(b)(9) money source and other tools, Envoy works with ministers to preserve the housing allowance benefit during active ministry years and in retirement.

## Housing Allowance: What Is It?

The housing allowance provision allows a minister who is ordained, licensed, or commissioned to receive a portion of their compensation that is excluded from gross income and not subject to federal income tax. The provision recognizes that a minister often uses their home as part of their regular duties.

The minister receiving the housing allowance must determine their eligibility, understand the limits and follow the rules. Ministers must keep records to substantiate the amount they include when calculating housing expenses. Eligible expenses include mortgage payments (principal and interest); rent payments; real estate taxes; property insurance; utilities (gas, electricity, water,

sewer, garbage pickup, local telephone service); appliances and furniture (purchase or rental cost and repairs); remodeling expenses; homeowners' dues; and pest control. The housing allowance may not exceed the lesser of 100% of compensation or actual housing expenses.

A housing allowance must be board-approved and designated in writing by the organization before the beginning of the calendar year. It cannot be designated retroactively, meaning it must be established before the minister earns the income on which the organization designates the housing allowance.

The following topics provide information and clarity on housing allowance within the 403(b)(9) Retirement Plan context.

### **Housing Allowance During Active Years is a Positive Benefit**

A housing allowance - sometimes called a parsonage allowance or rental allowance - is excludable from gross income for federal and state income tax purposes, but not for self-employment tax purposes. (When a portion of compensation is received as housing allowance, federal and state taxes are directly reduced.) SECA taxes are not directly reduced.

The housing allowance is an exclusion from income permitted by Section 107 of the Internal Revenue Code. It is not a deduction. In other words, a housing allowance is money that is not reported as income. A housing allowance is never deducted because it is never reported as income in the first place. However, the minister is required to include any excess housing allowance as income on their Form 1040.

Whether the minister owns or rents a home, it is essential that his or her employing organization designate a housing allowance. Housing allowances must be:

1. Adopted by the organization board or leadership
2. Recorded in written form (such as minutes)
3. Designated in advance of the calendar year

However, organizations that fail to designate an allowance in advance of a calendar year should do so as soon as possible in the New Year. The allowance will operate prospectively.

### **The Impact of a Housing Allowance on Retirement Plan Distributions**

Under certain denominational plans and those established specifically to protect the value of the housing allowance, 403(b)(9) retirement plan distributions may be taken as part of the ongoing housing allowance.

This means that the taxable amount of any 403(b)(9) retirement distribution is reduced dollar-for-dollar by the amount of the minister's designated housing allowance. For example, if the annual distribution is \$7,000 and the housing allowance is \$3,000, the amount of the taxable income associated with the total distribution for federal and state tax purposes will be \$4,000.

## **How Envoy Protects the 403(b)(9) Money Source When Ministers Change Employers**

When an employee leaves an organization, it is common practice for their retirement account to be transferred out of the retirement plan. The account is usually rolled to another retirement plan or to an IRA. When 403(b)(9) accounts are rolled to a 401(k) or IRA, eligibility for the housing allowance provision is lost. When a minister changes employers to a non-ministerial entity, Envoy can easily transfer the 403(b)(9) account to a specially earmarked IRA that protects the money source as from a 403(b)(9). If the minister later joins another organization where he/she is eligible for housing allowance, the IRA account can be rolled into the new plan, retaining full housing allowance eligibility.

## **Full and Clear 1099-R Reporting Makes Individual Tax Reporting Easy**

Envoy has arranged for this special tax consideration to be reported on the 1099-R that is issued for the distribution.

1. The Gross (total) Distribution is reported in Box 1.
2. The Taxable Amount of the Distribution (Gross distribution minus Housing Allowance amount) is reported in Box 2a.

Protecting the value of the retiree's housing allowance is a priority to us. Envoy is one of the few organizations that make it possible for the retiree to ensure the tax-favored distribution from their 403(b)(9) plan is protected. Please note that this tax benefit will be lost if the monies are not segregated and are transferred to any other retirement vehicle.

## **Roth 403(b) Contribution Is a Good Choice for Many**

In 2006, the Roth 403(b) option became another way for people to save for retirement by contributing dollars after-tax, and experiencing tax-free growth and distribution at retirement. (All normal Roth requirements apply.)

A Roth 403(b) contribution option, when added to a traditional 403(b)(9) plan, has benefits for many. The combination of regular personal tax exemptions coupled with either itemized deductions or standard deduction and a housing allowance often results in a very low tax situation, perhaps even zero. Providing a tax-advantaged investment alternative where the earnings grow tax-free and the distribution is the same, has great appeal for many. As noted above, the Roth 403(b) contributions also reduce the SECA tax payment required.

## **Payment of SECA Taxes on Voluntary or Employee 403(b)(9) Contributions**

The SECA tax owed by those with this status is reduced by the amount contributed to either a traditional or Roth 403(b)(9) plan. Again, this is only true for those with this status. Envoy is

committed to protecting and ensuring that your tax and retirement plan benefits are truly there for you during your active service years and beyond.

## Special Housing Allowance Tax Treatment for You: How It Works:

Complete the following steps to obtain a distribution that includes housing allowance tax treatment:

Download the [Distribution Authorization Form - Special Housing Allowance Tax Treatment](#). Complete all sections of the form, as described below, and return to your former employer.

### **Section 2: Participant Information:**

Complete all the fields in this section. Please print clearly.

### **Section 3: Payment Information:**

**a. Frequency:** Indicate how often you want to receive the distribution:

Recurring Payment (Monthly, Quarterly, Annually)  
One-Time Payment

**b. Amount:** Enter the specific dollar amount for either the Recurring or One-Time Payment, before taxes, if any, are withheld.

**c. Timing:** Select whether you want payments made on the 10th or 25th of the month.

**d. First Payment Due:** For recurring payments, enter the date payments should begin. The day selected should be consistent with the Frequency and Timing already selected.

**e. Annual Housing Allowance:** Designate the annualized dollar amount of the distribution that is eligible for treatment as Housing Allowance. For recurring payments, Envoy will prorate the annualized amount based on the number of payments to be received during the calendar year.

**f. Payment Method:** Indicate how you want to receive your payment:

**Check:** This option is available for one-time payments only.

**Electronic Deposits:** This option is available for both one-time and recurring payments. *Complete Section 4: Bank Information* when choosing this option.

**g. Federal Tax Withholding on Taxable Portion:** For the portion of the gross distribution that will not be treated as Housing Allowance, indicate the percentage amount of the Federal income taxes to be withheld. If the entire distribution is Housing Allowance, the taxable amount will be zero.

**Section 4: Bank Information:** For electronic deposit (ACH), provide the required banking information: Bank Name, Routing Number (ABA), Account Number and Account Type (Checking or Savings).

**Section 5: Spouse's Authorization:** If you are married, the Distribution Authorization Form - Housing Allowance Tax Treatment must be signed by your spouse.

**Section 6: Participant's Authorization:** The Distribution Authorization Form - Special Housing Allowance Tax Treatment must be signed by you.

**Section 7: Employer's Authorization:** Forward the Distribution Authorization Form - Special Housing Allowance Tax Treatment to your former employer or governing organization for signature. The distribution can not be processed without a former employer signature.

**Forward the Form to Envoy:** Two documents need to be returned to Envoy. Have your employer or governing organization return the fully executed Distribution Authorization Form - Special Housing Allowance Tax Treatment and a copy of your Housing Allowance Authorization Letter to Envoy at [PlanSponsor@EnvoyFinancial.com](mailto:PlanSponsor@EnvoyFinancial.com).

**Payment:** Once Envoy receives the fully executed Distribution Authorization Form - Special Housing Allowance Tax Treatment and a copy of your Housing Allowance Authorization Letter from your employer or governing organization in good order, your distribution will arrive in accordance with your elections. One-time payments will be processed in approximately two weeks.

## Special Tax Treatment of Distributions Received As Housing Allowance: Frequently Asked Questions:

**What criteria must be met for me to take a distribution with special housing allowance tax treatment?**

You must be at least age 59½ and receive a Housing Allowance Authorization letter from your church or governing organization.

**How does Envoy know the approved amount of my distribution and housing allowance?**

You must provide the Housing Allowance Authorization letter from your organization, on letterhead, signed by an authorized individual, indicating the amount of Housing Allowance approved for the year.

(This letter can indicate that this amount is to continue from year to year unless the organization changes the amount.)

**Can I request one distribution and have a portion of that distribution be treated as housing allowance and another portion a regular distribution?**

Yes. You will receive one check or one electronic payment (ACH) for the total amount of the distribution less any elected tax withholding.

**Will I get a 1099 at tax time?**

You will get a 1099-R that shows the gross amount of your distribution in Box 1 and the Taxable Amount of the distribution in Box 2a.

**Will any money be withheld from my distribution?**

You may designate the percentage to be withheld from any taxable portion of your distribution, but you will be responsible for any estimated tax and any penalties incurred as a result of that decision.

**Can Envoy help me with my taxes?**

No, you must consult your tax advisor for personalized tax advice.

**What if my approved housing allowance amount changes?**

You are responsible for submitting a new Distribution Authorization Form - Special Housing Allowance Tax Treatment to Envoy. If you do not submit a new Distribution Authorization Form - Special Housing Allowance Tax Treatment to Envoy, your original Housing Allowance amount as elected on the form will continue from one tax year to the next for recurring payments.

**For how long will my recurring payment continue?**

Your payments will continue until you stop the payment or until your account balance is depleted.

**What if I want to stop my recurring payment?**

You are responsible for stopping your recurring payment. Contact Envoy at 888.879.1376, option 1 or via [email](#).

**Are sample Housing Allowance Letters for my governing board approval provided?**

Yes. Your governing board will need a detailed breakdown of your Housing Allowance before it is approved.

Forms: [Notification of Housing Allowance](#) (*Word document*) (This document validates the housing allowance.)

Worksheets: [Housing Allowance Worksheet - Parsonage](#) (*Word document*), [Housing Allowance Worksheet - Home](#) (*Word document*).