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Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Person To Contact

Telephone Number:

Refer Reply To:
T:EP:RA:T3

Date
JUN - 7 2001

Attention:

Legend:

Company A =

Plan X =

Dear

This is in response to your ruling request dated October 28, 1998, submitted by your authorized representative regarding the treatment of ministers' housing allowances as "compensation" for purposes of determining the limits under section 415 of the Internal Revenue Code ("Code") on contributions to Plan X. Letters dated April 19, 1999, and August 3, 1999, supplemented the request.

Company A has been determined to be exempt from federal income tax as a religious organization described in section 501(c)(3) of the Code. Company A represents that it employs a substantial number of individuals who qualify as "ministers of the gospel" within the meaning of section 107 of the Code. The ministers are compensated with regular salary and a properly designated housing allowance. Company A reports this compensation on Form W-2, Wage and Tax Statement: the regular salary is reported in box 1 ("Wages, tips, other compensation"), and the housing allowance is reported in box 14 ("Other"). Company A does not verify the amount of each minister's annual housing allowance that is actually spent on housing and thus excludable from gross income under section 107 of the Code.

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Company A adopted Plan X in **** to provide retirement income to its employees, including the ministers. Plan X allows employees to make salary reduction contributions up to the limits on tax-excludable contributions under sections 403(b)(2), 415(c), and 402(g) of the Code. No other type of contribution is provided for under Plan X. No ruling is requested as to whether Plan X satisfies any of the relevant requirements under section 403(b).

Pending the receipt of guidance from the Internal Revenue Service, Company A has determined the limits on excludable section 403(b) contributions as if ministers' housing allowances were not part of compensation under section 415(c) of the Code or includible compensation under section 403(b)(3).

On the basis of the foregoing statement of facts, a ruling is hereby requested that, for purposes of determining the limits on contributions under section 415(c) of the Code, compensation paid to a minister in the form of a housing allowance may be treated as compensation pursuant to the alternative definitions of compensation under section 1.415-2(d)(11)(i) of the Income Tax Regulations, irrespective of the extent to which such allowances are excludable from the gross income of the recipients.

A tax-sheltered annuity (TSA) arrangement is treated as a defined contribution plan for purposes of contribution limits under section 415(c) of the Code. Section 415(c)(3) of the Code defines compensation for 415 purposes. Regulations implementing section 415(c)(3) are located at section 1.415-2. The general definition of "compensation" at section 1.415-2(d)(2) provides that "...[f]or purposes of applying the limitations of section 415, the term "compensation" includes all of the following:

> (i) The employee's wages, salaries, fees for professional services, and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the employer maintaining the plan to the extent that the amounts are includible in gross income (including, but not limited to, commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, bonuses, fringe benefits, and reimbursements or other expense allowances under a nonaccountable plan (as described in section 1.62-2(c))."

Subparagraphs (ii), (iii), (iv), (v) and (vi) provide for the inclusion in compensation of additional amounts (e.g., amounts under sections 104(a)(3) and 105(a) of the Code) but only if such amounts are includible in gross income.

Section 107 of the Code provides that, in the case of a minister of the gospel, gross income does not include (1) the rental value of a home furnished to the minister as part of his compensation, or (2) the rental allowance paid to the minister as part of his compensation, to the extent used by the minister to rent or provide a home. If a minister uses only part of the designated allowance to rent or provide a home, only the part so used would be excludable from income by virtue of section 107. For purposes of this ruling letter, the term "tax-free housing allowance" means the portion of a minister's housing allowance that is excluded from gross income under section 107.

Section 1.415-2(d)(3)(iv) of the regulations sets forth the general definition of compensation under section 415 of the Code. It states that the term "compensation" does not include amounts which receive "special tax benefits." The tax-free housing allowance paid to a minister is subject to a special tax benefit (i.e., exemption under section 107 of the Code) and thus is not includible as compensation pursuant to the general definition of compensation under section 415.

Two alternative definitions of compensation are provided at section 1.415-2(d)(11) of the regulations:

> (i) Information required to be reported under sections 6041, 6051 and 6052. Compensation is defined as wages within the meaning of section 3401(a) and all other payments of compensation to an employee by his employer (in the course of the employer's trade or business) for which the employer is required to furnish the employee a written statement under sections 6041(d), 6051(a)(3), and 6052. See sections 1.6041-1(a), 1.6041-2(a)(1), 1.6052-1, and 1.6052-2, and also see section 31.6051-1(a)(1)(i)(C) of this chapter. . . . Compensation under this paragraph (d)(11)(i) must be determined without regard to any rules under section 3401(a) that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in section 3401(a)(2)).
>
> (ii) Section 3401(a) wages. Compensation is defined as wages within the meaning of section 3401(a) (for purposes of income tax withholding at the source) but determined without regard to any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in section 3401(a)(2)).

Thus, in order to be included in compensation under one of the alternative definitions under section 1.415-2(d)(11) of the regulations, the housing allowance must be either (1) wages within the meaning of section 3401(a) of the Code, without regard to any rules under section 3401(a) that limit the remuneration included in wages based on the nature or location of the employment or the services provided or, (2) a payment of compensation for which the employer is required to furnish the employee a written statement under sections 6041(d), 6051(a)(3) or 6052.

First, we must determine whether the tax-free housing allowance is wages within the meaning of section 3401(a) of the Code (for purposes of income tax withholding at the source). As required by section 1.415-2(d)(11) of the regulations, that determination is made without regard to any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in section 3401(a)(2)).

Income tax withholding is imposed on remuneration paid by an employer only to the extent that an employee recognizes income.[1] Accordingly, excludable compensation is not

[1] Requiring income tax withholding on amounts not includible in income could result in over-withholding and, in certain cases, would require the filing of a Form 1040, U.S. Individual Income Tax Return, in order to obtain a refund when filing is not otherwise required.

considered wages under section 3401(a). See, for example, Rev. Rul. 56-632, 1956-2 C.B. 101. This is consistent with the legislative history of sections 3401-3404, which indicates that a purpose of income tax withholding is to enable individuals to pay income tax in the year in which the income is earned. H.R. Conf. Rep. No. 510, 78th Cong., 1st Sess. at 1 (1943); H.R. Rep. No. 401 78th Cong., 1st Sess. at 1 (1943); and S. Rep. No. 221 78th Cong., 1st Sess. at 1 (1943).

Thus, amounts excluded from income (including a tax-free housing allowance) are not considered wages under section 3401(a) of the Code and are not subject to income tax withholding.

Section 3401(a) of the Code defines wages, in part, as all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include remuneration paid for services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order.

You argue that the housing allowance, even if excluded from income under section 107 of the Code, constitutes compensation under section 1.415-2(d)(11) (i) or (ii) because if section 3401(a)(9) were disregarded, the housing allowance would be wages under section 3401(a). However, as a general matter, excludable compensation is not wages under section 3401(a), so the tax-free housing allowance is excepted from the general definition under section 3401(a). It is not excluded from wages on account of section 3401(a)(9), a rule that limits the remuneration included in wages based on the nature or location of the employment or the services performed. Section 3401(a)(9) operates to exclude from wages taxable compensation paid to a minister whereas tax-free compensation is excluded under the general definition of wages. Thus, even if section 3401(a)(9) is disregarded as required under the alternative definitions in section 1.415-2(d)(11)(i) or (ii), a tax-free housing allowance still is not wages under section 3401(a) and thus is not included in the alternative definitions of compensation.

Next, we must determine if the minister's housing allowance is a payment of compensation for which the employer is required to furnish the employee a written statement under sections 6041(d), 6051(a)(3) or 6052 of the Code.

Sections 6051 and 6041 of the Code both impose a duty on employers to file information reports of compensation paid to workers.[2]

Section 6051(a) of the Code imposes a requirement on employers to furnish to each employee with respect of the remuneration paid by such person to such employee during the calendar year a written statement showing: (1) the total amount of wages as defined in section 3401(a); (2) the total amount deducted and withheld as tax under section 3402 (i.e., income tax withholding); (3) the total amount of wages as defined in section 3121(a); and 4) the total amount deducted and withheld as tax under section 3101 (i.e., taxes under the

[2] Section 6052 of the Code is also mentioned in section 1.415-2(d)(11)(i) of the regulations but deals with wages in the form of group-term life insurance and does not apply to the compensation considered here.

Federal Insurance Contributions Act (FICA)). Section 6051(a) also requires reporting of other items not relevant to this discussion.

Because section 6051 of the Code lists the specific categories to which its reporting requirement applies, compensation that does not fall into any of the specific categories is not required to be reported under section 6051.

As previously indicated, amounts excluded from income (including a tax-free housing allowance) are not considered wages under section 3401(a) of the Code and are not subject to income tax withholding. Thus, a tax-free housing allowance is not required to be reported under section 6051 because the tax-free housing allowance is not considered wages under section 3401(a) and no amounts would be deducted and withheld as tax under section 3402 on this amount.

Section 3121(a) defines the term "wages", for FICA purposes, as all remuneration for employment, with certain limited exceptions.

For purposes of FICA, section 3121(b) of the Code defines "employment" generally to mean any service of whatever nature performed by an employee for any person employing him, except for those services specifically excluded.

Section 3121(b)(8) of the Code excludes from the definition of employment services performed by a duly ordained, commissioned, or licensed minister of the church in the exercise of his ministry. Thus, even if a minister is a common law employee, the liability for social security taxes is not imposed under FICA because the minister's services are not included in the definition of "employment" for FICA purposes.[3] Thus, there are no FICA wages to report and no amounts would be deducted and withheld as tax under section 3101. Accordingly, a tax-free housing allowance is not required to be reported under section 6051.

Section 6041(a) of the Code provides, with exceptions not applicable here, that any person engaged in a trade or business must file an information return with respect to certain payments made in the course of that trade or business to another person aggregating $600 or more in the calendar year. This filing requirement applies to payments (whether made in cash or property) of salaries, wages, commissions, fees, other forms of compensation for services, and other fixed or determinable gains, profit, or income.

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[3] Ministerial services are covered by social security provisions under the Self -Employment Contributions Act (SECA). Under section 1402(a) of the Code the term "self-employment income" means the net earnings from self-employment derived by an individual from "any trade or business" carried on by such individual, less the deductions allowed. Under section 1402(c), the performance of services by a duly ordained, commissioned, or licensed minister in the exercise of his ministry (whether the minister is an employee or is self-employed) is included in the term "trade or business" unless the minister has qualified for the exemption from SECA because of conscientious objections to the social security system. Thus, if the minister has not qualified for exemption from SECA, remuneration for services as a duly ordained, commissioned, or licensed minister is includible in computing net earnings from self-employment and the liability for SECA taxes arises. Under section 1402(a)(8), a tax-free housing allowance is included in determining net earnings from self-employment for purposes of SECA.

Section 6041(d) of the Code requires persons who are required to make returns under section 6041(a) to furnish to the recipient of the payment a written statement showing the name, address, and identification number of the person making the return and the aggregate amount paid to the recipient that is required to be shown on the return.

Section 1.6041-1(c) of the regulations defines "fixed or determinable income." Income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained.

Section 6041 of the Code requires the reporting of all "compensations ... or other fixed or determinable gains, profits, and income" The word "income" as used in section 6041 is not defined by statute or regulation; however, its appearance in the phrase "fixed or determinable gains, profits, and income" indicates that what is referred to is "gross income," Thus, the payments of compensation (and other amounts) required to be reported under section 6041 are those includible in gross income.

Under section 1.6041-2 of the regulations, wages, as defined in section 3401 of the Code, paid to an employee are required to be reported on Form W-2. All other payments of compensation, including the cash value of payments made in any medium other than cash, to an employee by his employer in the course of the trade or business of the employer must also be reported on Form W-2 if the total of such payments and the amount of the employee's wages (as defined in section 3401), if any, required to be reported on Form W-2 aggregates $600 or more in a calendar year.

The instructions to Form W-2 provide that the employer may want to give an employee additional information and, in particular, information on a minister's housing allowance by entering this item in box 14. As indicated by the instructions for this form, the housing allowance is not an amount required to be shown on the Form W-2.

Because "income" under section 6041 of the Code is interpreted to mean only income includible in gross income under section 61, a tax-free housing allowance is not required to be reported under section 6041 notwithstanding that it is a salary, compensation, or remuneration. The portion of a housing allowance that is not excluded because it is not used for the housing is "income" under section 6041. However, it is not "fixed or determinable" under section 6041, and thus is not required to be reported, because Company A has no basis to determine how much of the housing allowance was or was not used for housing.

In conclusion, a tax-free housing allowance is not required to be reported under section 6041(d) or section 6051(a)(3) of the Code, so the reporting requirements do not provide a basis for its inclusion under the alternative definition of compensation in section 1.415-2(d)(11)(i) of the regulations.

Accordingly, we conclude that, for purposes of determining the limits on contributions under section 415(c) of the Code, amounts paid to a minister as a tax-free housing allowance may not be treated as compensation pursuant to the general or alternative definitions of compensation under section 1.415-2(d) of the regulations.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

A copy of this ruling has been sent to your authorized representative, in accordance with a power of attorney on file in this office.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans, Technical Group 3
Tax Exempt and Government Entities Division

Enclosures:
Notice of Intention to Disclose
Deleted Copy of Ruling
Copies of Letter to Authorized Representatives

CC: