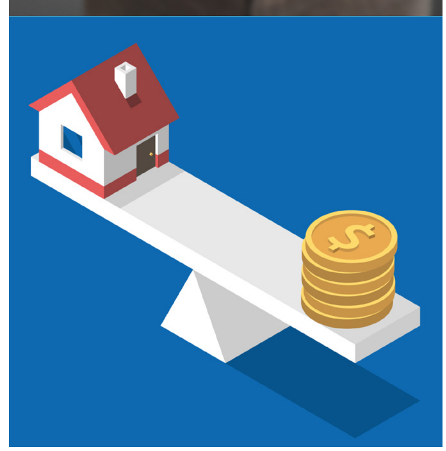
The Housing Allowance and Limits on Retirement Plan Contributions

This paper analyzes the question of whether there are potential problems associated with retirement plan (e.g., CRSP, PIP, or RPGA[1]) contributions when clergy have a large portion of their compensation excluded from taxable income as a housing allowance exclusion.

| November 17, 2023 | *Updated:* October 3, 2024 |

The short answer to the question is yes.[2] Contributions to those plans, whether they are employer or employee contributions, might be limited for such clergy due to the way the housing allowance exclusion impacts the Internal Revenue Code ("Code") Section 415 limit ("415 Limit") on annual contributions to a defined contribution ("DC") retirement plan, as discussed below. In particular, if a clergyperson has 100% of his or her compensation excluded from tax as a housing allowance, there cannot be *any* contributions made to those plans on behalf of that clergyperson. We begin with a summary of the 415 Limit.



415 Limit on Contributions to a Defined Contribution Plan

Code Section 415 of the Internal Revenue Code provides that the total amount of employer *and* employee contributions to DC plans (which include PIP and the DC component of CRSP) for a given year **cannot exceed the *lesser* of the following:**

a. **$66,000** (in 2023, or as indexed in later years), or
b. **100% of the employee's "415 Compensation"** (referring to the definition of compensation in Code Section 415).

(Note that this limit described above only applies to contributions to a DC plan. There is a separate Code Section 415 limit for *distributions* from a defined benefit plan, which is not relevant to this discussion.)

---

[1] CRSP: Clergy Retirement Security Program; PIP: Personal Investment Plan; RPGA: Retirement Plan for General Agencies (replaced by PIP effective January 1, 2025)

[2] Note that the answer here applies only to a housing allowance exclusion, and not the provision of an actual parsonage. Being provided with a parsonage would not give rise to the contribution limit issue that is discussed in this paper, as the value of the parsonage does not reduce the amount of a clergyperson's monetary compensation that is subject to taxation. This is explained further in footnote 4.

The Housing Allowance and Limits on Retirement Plan Contributions *(continued)*

As for ⓑ on page 1, **415 Compensation, in general, is the sum of the following**:

> ❶ **Taxable compensation**; and
>
> ❷ **Employee before-tax contributions** (elective deferrals) made to certain types of benefit plans [e.g., Code Section 401(k), 403(b) (which includes PIP and the DC component of CRSP), 125 (cafeteria plans), or 132(f)(4) plans][3].

And this is where the housing allowance comes into play. Because amounts excluded from taxable income as a housing allowance under Code Section 107 are not part of a clergyperson's taxable income, such amounts are excluded from ❶ above. In addition, employee-before tax contributions that make up ❷ above must be taken from a clergyperson's taxable compensation; in other words, a clergyperson must have some taxable compensation in excess of the housing allowance in order to make employee before-tax contributions to the benefit plan. Thus, if a clergyperson has a large amount of his or her compensation excluded from taxable income as a housing allowance, his or her Section 415 compensation that remains will be relatively small, leaving a small 415 Limit on employee and employer contributions.

Note that in this discussion we have been careful to refer to the amount of the housing allowance that is actually excluded from taxable income, as opposed to the amount that was initially designated as a housing allowance. For the purposes of how the housing allowance impacts the 415 Limit, the only amount that matters is the amount of the housing allowance that is actually excluded from tax. If a clergyperson's excludible amount is less than the designation because either his or her actual housing-related expenses or the fair rental value of his or her housing is less than the designated amount, then only the smallest of the these three amounts (designation, actual expenses or fair rental value) will be excluded from income tax and, therefore, affect the 415 Limit.

Also, because in this discussion we are only interested in the impact of relatively large housing allowances on plan contributions, in what follows **we make the following assumption**, which will typically be the case in this context:

> *We assume that the amounts excluded from gross income as a housing allowance are sufficiently large so that the clergyperson's 415 Compensation [i.e., the sum of* ❶ *and* ❷ *above] is less than $66,000 (in 2023) [i.e.,* ⓐ *page 1]. Hence, the 415 Limit on the total amount of employer and employee contributions for the year is the clergyperson's 415 Compensation [i.e.,* ⓑ *page 1].*

We can illustrate **415 Compensation and the 415 Limit** graphically as follows[4]:

Housing Allowance Excluded from Tax	**Elective Deferrals** (including *employee* contributions to PIP and the DC component of CRSP)	**Taxable Compensation Remaining After Any Elective Deferrals**
Total Compensation		
	415 Compensation (which according to our assumption above, is the 415 Limit on employee plus employer contributions)	
		Maximum Amount of 415 Compensation Available for *Employer* Contributions to PIP and the DC component of CRSP

The higher the percentage of total compensation excluded from tax as a housing allowance, the smaller the clergyperson's 415 Compensation; hence, there is less "room" under the 415 Limit for employee elective deferrals and employer contributions. In the case where 100% of compensation is excluded from tax as a housing allowance, *no contributions* (whether employee or

[3] Note that an employer's contributions towards the cost of health coverage are not included and does not factor into the 415 Limit calculation.

[4] If an actual parsonage were provided instead of a housing allowance, the box on the top left (Housing Allowance Excluded from Tax) would instead represent the value of the parsonage, which is exempt from income taxation. The total compensation bar underneath it would remain the same, but the portion of compensation underneath that box would equal 25% of the actual compensation paid to the clergyperson (as PIP and CRSP increase a clergyperson's plan compensation by 25% to account for the deemed value of the parsonage provided). Whether a housing allowance or an actual parsonage is provided, the clergyperson receives an employer contribution on the value (or deemed value) of the housing allowance or actual parsonage. Either way, that value is exempt from income taxation. What remains is 415 Compensation that must be equal to or greater than the total employer and employee contributions to the plans (to avoid a 415 Limit violation).

employer contributions) would be permitted to the DC plan. In the case where not all of a participant's compensation is excluded from tax as a housing allowance, but the remaining taxable amount is then contributed as a before-tax employee contribution to employee benefit plans, then no *employer* contributions would be permitted to the DC plan (as there would be no Taxable Compensation Remaining After Any Elective Deferrals to support such employer contributions).

In the usual case, we are not interested in maximizing the amounts of employer contributions, because those are already pre-determined by terms of the plan and the amounts of employee contributions. (For example, for the DC component of CRSP, the employer contribution is 2% of compensation plus a matching contribution for amounts contributed to PIP of up to 1% of compensation.) Thus, we are usually interested in knowing the maximum amount of a housing allowance that can be excluded from tax given the amounts of elective deferrals and employer contributions. This is equivalent to setting the Taxable Compensation amount in the above chart equal to the amount of employer contributions, adding the amount of elective deferrals, and then computing how much of total compensation is left to accommodate an excludible housing allowance.

In terms of a **formula**, let:

X = Total Compensation for the given year;

Y = Before-tax contributions (elective deferrals) to be made to the benefit plans listed in ⓑ page 1 (e.g., cafeteria plans, PIP, etc.); and

Z = Employer contributions to be made on behalf of the employee.

Then, as can be seen from the chart above:

Maximum amount that can be excluded as a housing allowance = X – Y – Z.

We illustrate this formula in the following example:

Example

Suppose Rev. Wesley, a participant in CRSP, receives $60,000 in total compensation in 2023. Also suppose that Rev. Wesley makes before-tax contributions of 3% ($1,800) of his total compensation to a Code Section 125 cafeteria plan and 5% ($3,000) of his total compensation to PIP. Then under the DC component of CRSP, his annual conference will make a 2% ($1,200) non-matching contribution and a 1% ($600) matching contribution on his behalf.

According to the formula above, we have:

X	=	$60,000
Y = $1,800 + $3,000	=	$4,800
Z = $1,200 + $600	=	$1,800; therefore,
The maximum amount that can be excluded as a housing allowance	=	**X – Y – Z = $53,400**

As an aside, note that in this example, if Rev. Wesley does indeed have an excludible housing allowance of $53,400, then from the chart above, his

415 Compensation = $60,000 - $53,400 = $6,600

This amount is less than $66,000 (i.e., ⓐ page 1), which is what we assumed. Hence, Rev. Wesley's 415 Compensation equals his 415 Limit for employee and employer contributions to the plan.

(continued)

The Housing Allowance and Limits on Retirement Plan Contributions *(continued)*

The formula discussed on the preceding page can also be illustrated in chart form. The chart below shows the maximum housing allowance (as a percentage of total compensation) at various levels of employer and employee contributions (as a percentage of total compensation). As you can see, the more the employee chooses to contribute in before-tax contributions to PIP (and/or a Code Section 125 plan), the lower the maximum housing allowance percentage.

Employee Before-Tax Contributions to Cafeteria, DC plans, etc.	**Employer Contribution**	**Maximum Housing Allowance**
0%	2%	**98%**
5%	3%	**92%**
10%	3%	**87%**
15%	3%	**82%**
25%	3%	**72%**

A Special Rule for Church Plans

In our discussion, we have focused on the general rules regarding 415 Limits for DC plans. However, there is a special rule regarding 415 Limits for DC ***church plans*** (including all UMC DC retirement plans) that provides for a minimum annual 415 Limit of $10,000. Under this special rule, if a participant's 415 Limit is less than $10,000 in a given year, then his or her 415 Limit will be deemed to be increased to $10,000, provided that the cumulative lifetime total of all such deemed increases does not exceed $40,000. So, for example, if a participant's 415 Limit is only $4,000 in a given year, due to a relatively large housing allowance, this special rule can be used to increase the participant's 415 Limit for that year to $10,000 (with the deemed increase of $6,000 counting towards the $40,000 lifetime limit). Thus, in close cases, where the excludible housing allowance was a bit too high, resulting in not enough taxable compensation to cover all contributions to UMC benefit plans, this special minimum 415 Limit rule could be used to avoid an annual 415 Limit violation. Note that this would only be the case for situations in which the clergyperson's annual 415 Limit is below $10,000 and the clergyperson hasn't already exceeded the special rule's $40,000 cumulative lifetime amount.

Does Wespath Monitor the 415 Limit for Participants?

Wespath will monitor the 415 Limit (including the special minimum limit rule for church plans) in some situations, but it is not something that is monitored systematically in all cases. Wespath completes the analysis only when a DC plan participant exceeds the Code Section 402(g) limit ($22,500 in 2023) for employee contributions to the plan, or upon a participant's request. Also, Wespath provides plan participants information on the 415 Limit annually in the *Wespath Update* newsletter, so that participants can monitor the limits on their own. However, if a participant would like to request that the Wespath complete a 415 Limit analysis, the participant can contact Wespath and request a "403(b) Planner." Wespath will then provide the form with the additional information needed to complete the analysis. The form is also available on Wespath's extranet or this link: **wespath.org/assets/1/7/3001.pdf**.

Wespath
BENEFITS | INVESTMENTS

1901 Chestnut Ave.
Glenview, IL 60025-1604
wespath.org