

Judge Rules IRS Can Tax Gifts Made Directly to Pastors¹

In October of 2018 a Federal Tax Court judge ruled that “love gifts” provided to pastors are taxable income. The written opinion cited both legal authorities and Bible verses.

Pastor Felton was pastor of Holy Christian Church in St. Paul, Minnesota during the years at issue – 2008 and 2009. In each of those two years, Pastor Felton received from members of his congregation more than \$200,000 that he considered nontaxable gifts for income tax purposes. Congregants used special “blue envelopes” to indicate that their gifts were to go directly to the pastor and were not to be considered tax deductible contributions. Congregants were also permitted to direct contributions to Pastor Felton by using “white envelopes” and marking them to indicate a portion of their gift as “Pastoral.” Gifts made using the white envelopes were considered by the church to be tax-deductible contributions, and Pastor Felton treated the amounts he received via the white-envelope contributions as taxable income. The facts of the case indicate that the church did not pay Pastor Felton a salary. It did, however, relay the blue-envelope “gifts” to him, along with the white-envelope contributions and a clergy housing allowance of about \$80,000 per year.

Pastor Felton prepared and filed his own tax returns for years 2008 and 2009...but only after the IRS contacted him. His position on the matter was that gifts are not taxable income and the amounts he received via the blue envelopes were gifts. The IRS’s position was that the blue envelope amounts given to Pastor Felton were given by congregants because of his service as a pastor and were, thus, taxable income to him.

In addressing the core issue, the judge cited numerous Bible references and provided a very thorough analysis of applicable law, relevant cases, and other authority (including reference to a case in which a minister was criminally prosecuted for failing to recognize love gifts as taxable income).

The judge noted that the law in the area of gifts for ministers was not abundantly clear. However, in the end, he agreed with the IRS’s position that all the monies directed to Pastor Felton by the church members were given because of the services Pastor Felton provided to the church and the congregation. Thus the monies were not gifts, but “fees for service.” As such, they represented wages which are subject to the income tax regulations. Unfortunately for Pastor Felton, the judge also agreed with the IRS’s position that a 20% penalty was warranted for “substantial understatement” of income.

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This material is presented with the understanding that the author is providing basic information only and assumes no liability whatsoever in connection with its use. Tax laws are constantly changing, are subject to differing interpretations, and the facts and circumstances in any particular situation may not be the same as those presented here. Therefore, we urge you to do additional research and make sure that you are fully informed and knowledgeable before using the information contained herein.

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¹ https://taxprof.typepad.com/taxprof_blog/2018/10/lesson-from-the-tax-court-when-payments-to-a-pastor-are-not-gifts.html
<https://www.churchlawandtax.com/web/2018/november/sorting-out-gifts-from-compensation-for-pastors-income-tax-.html>
<https://www.nonprofitcpa.com/wp-content/uploads/2018/10/Felton-Case-1.pdf>