

Are Voluntary Donations to Ministers Gifts or Taxable Income?

By Ted R. Batson, Jr., Partner

Churches should be aware of a recent Tax Court ruling on voluntary donations to ministers. In *Felton v. Commissioner*, TC Memo 2018-168, the Tax Court ruled that voluntary donations made to a minister in special contribution envelopes were taxable income, not nontaxable gifts.

Contribution Options

In the situation in question, a church in Minnesota used three types of contribution envelopes. White envelopes were for typical donations and included a line where congregants could designate contributions to the pastor. These were available at the door and ushers handed them out at all services. Church staff tracked the white envelope contributions and included those contributions, both regular contributions and pastoral contributions, in members' annual contribution statements as tax-deductible gifts. The church also reported the amount of pastoral contributions as income to the minister.

The church used gold envelopes for donations for special retreats and programs. The staff tracked these contributions and noted them on members' annual contribution statements as tax-deductible gifts.

In addition, the church introduced blue envelopes to use in lieu of "shake-hand" money, a practice in some congregations of congregants handing money to a minister at the door at the end of a service. The minister was uncomfortable with this practice, and wanted to implement a more systematized approach for congregants who didn't want to use the white envelopes for pastoral donations because they considered this money a gift and didn't want a tax deduction.

The blue envelopes were marked "pastoral gift." The minister told congregants they wouldn't receive a tax deduction for gifts made in blue envelopes. Blue envelope donations were not solicited and congregants had to

request the envelopes from ushers. The church did not track contributions made in blue envelopes.

During the years at issue in the case (2008 and 2009), the minister received:

- \$40,000 per year from pastoral contributions made in white envelopes, which he and his wife reported as income.
- More than \$200,000 per year in donations through blue envelopes. The minister and his wife did not report these contributions as income but claimed they were gifts excludable under Code Sec. 102(a).
- A parsonage allowance of \$78,000.

The executive board authorized a salary for the minister in 2008 and 2009, but he didn't take it.

The IRS said the blue envelope contributions were income, not gifts, and applied an accuracy-related penalty under Code Sec. 6662(a).

Deciding Factors

As the Tax Court noted in TC Memo 2018-168, the Supreme Court has ruled that "a gift in the statutory sense... proceeds from a 'detached and disinterested generosity'... 'out of affection, respect, admiration, charity or like impulses.'" The donor's intention is an important consideration. (*Commissioner v. Duberstein*)

The Tax Court found the fact that the minister did not request the personal donations, and that donors had to

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ask an usher for a blue envelope, tilted toward the contributions being a gift.

However, the court also identified these factors as tiling toward taxable income:

- Donations in exchange for services – The court found that objectively, blue envelope contributions were made in exchange for “intangible religious benefits” and to keep the minister at the church.
- Routinized, highly structured program – The court observed that the blue envelopes were marked “pastoral gift” and included instructions to make checks out to the minister. It noted the size and similar total of the donations in 2008 and 2009, which it said likely meant members were making regular payments. The court also wrote that these are “regular, sizable payments made by people that [the minister] provides a service for, and they are therefore hard to distinguish from compensation.”
- Ratio of salary to personal donations – The minister didn’t take a salary for almost 13 years while the church was young. The court noted that the amount of the blue envelope contributions was approximately twice the total of the minister’s deemed salary (the pastoral contributions made in white envelopes) and housing allowance for the years in question. That ratio, the court wrote, “gives the distinct impression that the transferors knew that, without the donations, they wouldn’t be able to keep” the minister.

The Ruling

The Court sided with the IRS, ruling that the blue envelope contributions were taxable income, not nontaxable gifts. It assessed a 20% accuracy-related penalty under Code Sec. 6662(a).

It’s unclear whether a less formal structure would have resulted in a different outcome, although this would not have addressed the exchange of the contributions for intangible religious benefits or the fact that the contributions were a functional substitute for a salary. Note, too, that the lack of an income tax deduction for the blue envelope contributions did not change the fact that they were deemed taxable to the minister.

If your church uses a similar system for voluntary donations to ministers, we encourage you to review the possible implications. If you have questions about this ruling or how it may affect your church, please contact us at info@capincrouse.com.

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