

MANAGING CHURCH  
STAFF AND VOLUNTEERS?

GUIDELINES FOR MINISTRY WORK  
**FREE RESOURCE** ▶

Brotherhood Mutual

# CHURCH LawandTax.com

LEGAL & TAX HELP  
TO MANAGE MINISTRY

Updates | Archives | Legal Library | Weekly Lesson | Seminars | Resources | Store 

## Our Editorial Advisors



Richard R. Hammar  
J.D., LL.M., CPA



David  
Middlebrook



Vonna  
Laue



Ken Sande



Ann  
Buwalda

## FREE E-newsletters

## Can We Offer Our Pastor a No-Interest Loan?

*What leaders should know before entering such an arrangement.*

*By Richard R. Hammar*

**Q: Our church board has approved a \$10,000 no-interest loan to one of our pastors to assist him with the down payment on a new home. We have two questions about this transaction. Since the loan is for \$10,000, it is our understanding that the foregone interest would not represent taxable income to him. Is this correct? Second, if we decide to forgive the loan, we understand that the balance will be considered income and subject to federal and state income tax. At the time of forgiveness, does the entire balance become taxable or is it taxable incrementally throughout the remaining duration of the loan?:**

**A:** Let me make a few observations in response to your questions.

First, if the church makes a below-market interest loan of more than \$10,000 to an employee, it would have to report the "foregone interest" as taxable income to the employee.





Second, employers that make below-market interest loans of \$10,000 or less to an employee are not required to report the foregone interest as taxable income, but only to the extent that a principal purpose of the transaction was not the avoidance of tax. To the extent that the church fixed the amount of the loan as \$10,000 for the express purpose of avoiding the realization of taxable income, then the exemption may be lost.

Third, any agreement or understanding that would involve the church "forgiving" the employee's obligation would immediately result in the entire balance of the loan being realized as taxable income. It also might trigger the new and complex regulations that apply to nonqualified deferred compensation arrangements, since this arrangement might well be deemed nonqualified deferred compensation under the new and expansive definition contained in the regulations under section 409A of the tax code.

Fourth, many state nonprofit corporation laws prohibit corporate boards from making loans to any officer or director even if the loan includes a reasonable rate of interest. So, if your church is incorporated, be sure to check your state's nonprofit corporation law so that you are aware of any such restriction.

Fifth, any time that a church makes a below-market interest loan to an employee, the question of inurement arises. One of the requirements for tax-exempt status is that none of a church's income inures to the private benefit of any individual, other than as reasonable compensation for services rendered. To the extent that that taxable income associated with below-market interest loans is fully reported, this will eliminate this risk.

Sixth, any taxable fringe benefit that is provided by a tax-exempt employer to an officer or

- [Church Law & Tax Update](#) 
- [Church Finance Update](#) 
- [Church Management Update](#) 
- [Richard Hammar's Essential Reminders](#) 

Full Name

E-mail Address

Zip/Postal Code

**SUBMIT**

[More E-newsletters ...](#)

director (or a relative of one), and that is not reported as taxable income, exposes the recipient to substantial excise taxes (called "intermediate sanctions") of up to 225 percent of the amount of the unreported benefit. Board members who authorized the benefit are subject to an additional penalty of 20 percent of the amount of the benefit (up to a maximum penalty of \$20,000). As a result, it is important for church leaders to correctly report any taxable benefit associated with below-market interest loans.

*This article originally appeared in the November issue of [Church Finance Today](#), 2008.*

#### [Pastor, Church & Law 4th Edition 4 Volume Set](#)

**For more resources related to pastor employment, compensation, and law, purchase this [4 volume set](#) known as the most comprehensive and practical legal reference for churches and clergy. The complete set covers all your legal questions concerning the church, including: employment, liability, property laws, government regulations, first amendment issues, and more.**

Copyright © 2008 by Christianity Today International/Church Finance Today. All rights reserved.

[About Us](#)  
[Privacy Policy](#)  
[Help](#)  
[Contact Us](#)  
[Advertise with Us](#)

[Church Law & Tax Report](#)  
[Church Finance Today](#)  
[ChurchSafety.com](#)  
[YourChurchResources.com](#)

*Brought to you by:*



© 2011 Christianity Today International

Site redesigned, built and maintained in partnership with Global Pueblo Solutions, LLC