

Severance Pay for Ministers & Church Employees

When a minister or other church employee is terminated, retires or voluntarily resigns under pressure, it is common for churches to provide some form of severance pay.

For those who are terminated or resign under pressure it is considered by most to be an appropriate thing for the church to do, especially since church employees do not receive unemployment insurance benefits in most states. Severance pay should never be presented or perceived as a “bribe”.

For someone retiring, the severance pay should never be presented or perceived for tax purposes as a “gift” or “benevolence” since it generally does not meet IRS criteria for either of these. It is an added payment for prior services rendered by the person. If significant payments are classified as “gifts” or “benevolence”, it could raise questions about the improper use of church assets and in extreme cases has the potential of affecting a church’s tax exempt status.

A church should have a policy regarding severance pay in the case of any form of involuntary termination. That policy should be adopted long before and completely independent of applying it to a specific employee. When churches deal with this issue when a person is involved, too many emotions enter into the dialogue. A pre-determined policy will help assure fairness and consistency for all church employees. That policy should state clearly who in the church is responsible for determining and/or recommending terms of the severance pay.

Determination of actual severance pay and its terms should include such factors as the employee’s length of employment, the level of compensation that goes with the position, reasons for termination, and financial resources of the church. Risk management considerations should also be considered in setting severance pay. These include issues like the potential of the employee retaliating or making disparaging comments about the church, disclosing confidential information, damaging church property, having access to passwords, and the return of items such as a computer or church owned cell phone. A church should make sure the termination clearly is not influenced by age, race, national origin, or disability since employees are protected under federal law from being terminated for any of these.

A frequent question regarding severance pay is how long it should continue. In situations involving involuntary termination, this is often a subject of intense debate. There are no absolute guidelines on this. They generally range from a low of about one week’s pay to an unusual high in one case of lifetime pay for the former pastor. Probably the most frequently suggested guideline for support staff is a week’s pay for each year of service at the church. For ministers the suggestions are usually a little longer, often by applying a minimum time such as three months or longer. These suggestions can provide a starting point for discussion, realizing that every situation is unique. Those recommending or making decisions on the time should always keep in mind that minister’s and church employee’s do not receive unemployment insurance benefits like many other people in the church would get through their jobs.

Severance pay and its terms should always be put in writing with the help of appropriate legal counsel. Some of the elements to be a part of the written agreement include correct identification of the parties, specific amounts to be paid, the time table for the payments, details on the pay being subject to the normal tax deductions, details regarding continued benefits such as retirement and insurance during the period when severance payments are to be made, and confirmation that all earned vacation time has been included. Normally, employer paid benefits will continue during the period of severance pay, except that vacation, sick and personal time will not continue to be earned. An attorney can help in including provisions regarding the employee’s continued compliance with the agreement, a waiver on potential claims against the church, confidentiality issues, and provisions to bar the former employee from seeking to coerce members of the church to leave.

An attorney may want to include a statement regarding continued insurance coverage due to COBRA laws. Continued insurance coverage for a period of time after employment termination may be desirable and appropriate in many situations, but it is not required. Churches are exempt from ERISA laws and therefore COBRA insurance continuation is not required. If the employee is in a GuideStone insurance plan, they can request “continued protection during unemployment” which will allow the individual to stay on GuideStone’s insurance for up to a year as long as they are seeking future qualified Southern Baptist employment. A church could, as part of the severance, agree to pay for that coverage for a specified period of time.

TAX REPORTING

The severance payments from a church should ordinarily be reported consistent with normal IRS reporting requirements for ministers and church employees. The continued salary would be reported as salary on the W-2 form.

For tax purposes, the payments should be handled as special wage payments, **NOT DEFERRED COMPENSATION**. While this may seem to be a minor difference, for tax purposes these terms are quite different and how the continued pay is treated is critical. *(In a few very rare cases, a church may be involved in a true Deferred Compensation Plan. There are many added tax complexities with these plans so competent guidance from a qualified tax professional should always be used when setting up those plans. If the severance pay is significantly high or continues over an extended period of time, they may be subject to these rules.)*

Another frequent question is whether Housing Allowance can be designated for ministers out of their severance pay. The IRS and no courts have addressed this question. It is reasonable to assume the housing can continue to be designated since the severance pay represents compensation based on prior services rendered as a minister.