

## **CLERGY DISCRETIONARY FUNDS**

General Council on Finance and Administration of The United Methodist Church  
Legal Services Department

It is common for a local church to establish a fund which is intended to give its pastor complete discretion and authority to provide confidential financial support to persons in need. Similarly, it is common for an annual conference to establish a fund which is intended to give its bishop the authority to pay for program expenses which would otherwise be unfunded. These are two examples of what we will generically refer to in this document as a “clergy discretionary fund.” The details of these clergy discretionary funds can vary. In some cases, no guidelines or instructions as to acceptable use of the funds is provided, effectively giving the clergyperson free reign as to how they are spent. In other instances, the clergyperson is given some guidance, but it may be very general or unclear and may be given orally or understood culturally.

These funds can lead clergy – both local church pastors and bishops – to unknowingly run afoul of relevant Internal Revenue Service regulations and can result in unintended tax consequences to clergy and to donors. GCFA’s Legal Services Department is providing the below guidance in order to help annual conferences, local churches, and clergy avoid the pitfalls present with clergy discretionary funds. All the issues covered below should be clearly expressed in a written policy adopted by the annual conference or local church.

### **Ownership of the Fund**

A clergy discretionary fund should be an account of the annual conference or local church. If it is maintained via a separate bank account, that account should be in the name of the annual conference or local church (e.g., “First UMC Clergy Discretionary Fund” or “XYZ Conference Discretionary Fund”). Contributions to the fund would therefore be given to the local church or annual conference, rather than to the clergyperson. This will permit the gifts to be recorded as charitable contributions by the donor (a gift to a person is not tax-deductible). Because the clergy discretionary fund is an asset of the local church or annual conference, it should be included in that entity’s annual audit.

### **Clearly Defined Purpose**

Generally, clergy discretionary funds at a local church are for helping the poor and needy. At the annual conference, a clergy discretionary funds is more typically to be used to support missions, programs, or activities which are underfunded or even lack funding altogether. In both instances, the fund’s purpose must be clearly communicated to the clergyperson at the outset. Additionally, if donors will be permitted to contribute directly to the clergy discretionary fund, all solicitations or other communications regarding the fund should include a clear statement of the fund’s purpose(s).

### **Prohibitions on Personal Use and Conflicts of Interest**

The clergyperson administering the clergy discretionary fund is essentially acting as a trustee of the funds held in it, which are owned by the local church or annual conference and often funded by the contributions of numerous donors. As such, the clergyperson is obligated to use the clergy discretionary fund only for its stated purposes, and not for personal gain or benefit. Thus, it should be clearly established and enforced that a clergy discretionary fund may not be used to benefit, directly or indirectly, the clergyperson or the clergyperson's family. Similarly, a clergy discretionary fund should not be used on projects which might present an actual or potential conflict of interest or an appearance of impropriety.

Examples: cash payments to the clergyperson or a family member; paying the tuition/medical/etc. bill of the clergyperson's child; reimbursing non-business related travel expenses of the clergyperson's spouse<sup>1</sup>; paying one month's rent for a cousin of a clergyperson, even if the cousin is poor or needy; providing funds to support the activity of another nonprofit entity lead by a family member of the clergyperson.

### **Documentation/Recordkeeping**

The clergyperson should be required to document and record distributions from the fund showing the types of assistance provided during any given year.

Examples: \$100 was given to a needy family to purchase groceries; \$500 was given to a needy family to pay for hospital emergency room treatment for a seriously ill child; \$150 was given to a needy elderly woman to provide her with transportation to and from a kidney dialysis center for a year; bus tickets and a new pair of shoes and slacks were purchased for a homeless person who had a job interview; \$1,000 was given to help start a faith based after school program for inner city children.

When necessary, the annual conference or local church should have the authority to request additional documentation of expenditures. The clergyperson should request payments from the fund through some type of formal mechanism in order to ensure internal control over access to the fund (this can be done and still maintain confidentiality for the specific needy persons who will be beneficiaries).

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<sup>1</sup> See GCFA's [Tax Packet page](#) for more information on this topic.

### **Dollar Amount Limitations**

There should be a limit on the dollar amount that may be expended at any one time without advanced and written permission being received from the church council or finance committee (or other similar body, in the case of an annual conference).

### **Purchase of Goods and Services vs. Cash Payments**

The clergyperson should be encouraged to use the clergy discretionary fund to, when possible, purchase goods and services (e.g., taxi fare, bus ticket, a bag of groceries, a pair of shoes, a doctor bill) rather than provide direct cash assistance. This practice would help to shield the clergyperson, the local church or annual conference, and those individuals or programs receiving assistance against accusations of irregularity or private inurement.

### **Separation from Accountable Reimbursements**

A clergy discretionary fund is sometimes used to cover expenditures which would be eligible for reimbursement via an accountable reimbursement plan (e.g., continuing education, business-related travel, vestments).<sup>2</sup> This practice should be avoided, for at least two reasons. First, keeping these arrangements separate minimizes the chance of any unintended tax consequences to the clergyperson. Second, such payments would be inconsistent with the stated purpose(s) of the clergy discretionary fund.

### **Education**

New clergypersons, finance secretaries and/or treasurers, and the chairs of relevant committees should be educated on the existence and purpose of a clergy discretionary fund and its established internal controls and policies. This education should cover the potential income tax consequences which could result from failure to adhere to those internal controls and policies.

### **Examples of Appropriate and Inappropriate Uses of a Clergy Discretionary Fund**

- 1) **Appropriate:** Pastor Dave's church has a written discretionary fund policy with careful internal controls. The annual budget for the fund is \$2,500, and Pastor Dave is allowed to spend no more than \$300 at any one time. The written policy specifies that the discretionary fund may be used only to provide care for the needy. During the year, Pastor Dave submits appropriate documentation for the following expenditures under this fund: 1/5/01 - \$100 for grocery coupons for needy family in church community; 2/14/01 - \$200 to Meadows Community

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<sup>2</sup> See GCFA's [Tax Packet page](#) for more information on this topic.

Center, Inc. for winter boots for children of needy families; 2/20/01 - \$100 paid directly to utility company for heat bill for needy family; 4/10/01 - \$172 for groceries for homeless family in church community; 4/3/01 - \$100 for 5 bus passes for men at homeless shelter; 8/1/01 - \$300 for Wesley House for school supplies for needy children; 8/20/01 - additional \$300 for Wesley House for school supplies for needy children (approval of church council obtained for additional expenditure); 10/15/01 - \$275 for groceries for food pantry for Thanksgiving baskets for needy families; 11/2/01 - \$200 for winter coats for children at Meadows Community Center; 11/30/01 - \$50 for cab fare coupons for elderly woman in need of transportation for kidney dialysis until regular volunteer driver's car is repaired.

- 2) **Appropriate:** XYZ Annual Conference has established a discretionary fund for its resident bishop that permits the funding of United Methodist missions and programs within the bounds of the conference. The conference's policy is to allow up to \$5,000 to be spent in a calendar year, with a stated preference that no more than \$1,000 be given to any one mission or program. After receiving the permission of the relevant conference committee, the resident bishop directs the full \$5,000 to cover the fundraising shortfall of a district-operated children's home which is in need of extensive building repairs.
- 3) **Appropriate expense but troublesome procedures:** Pastor Cathy is given a \$5,000 discretionary fund each year. The church does not have a written policy about how the funds are to be used. The funds are kept in a separate checking account, for which Pastor Cathy is the sole authorized signer on the account. Pastor Cathy always uses the funds for the same purposes each year: to purchase school supplies and winter coats for needy children in the area; to provide homeless persons with a Thanksgiving and Christmas dinner at a local restaurant; to purchase food and bus passes for the church's neediest families. While the use of the funds in this example is fine, the scenario is troublesome because of: a) the lack of internal controls (two signers on the account; documentation of the expenses for the church treasurer or financial secretary; b) the absence of a written policy stating that Pastor Cathy may not use the funds for anything other than assistance to needy persons and families; and c) the absence of any protocols to prohibit Pastor Cathy from using the funds for any personal purposes may make the entire \$5,000 taxable income to her.
- 4) **Might be inappropriate:** Pastor Nancy used the discretionary fund to buy a bag of groceries for all new members of the church. While it is certainly appropriate for the church to give a small gift of hospitality to all new members

of the church, the discretionary fund should not be used for this purpose unless the written church policy specifically states that this is one of the authorized purposes for the discretionary fund. It would be more appropriate for the hospitality gifts for new members to come from the budget of the evangelism committee. It would be especially inappropriate to use the discretionary fund for hospitality gifts to all new members if the church's policy intends for the discretionary fund to be used for needy families, unless **all** new members of the church qualified as needy.

- 5) **Unwise under most circumstances:** Pastor Tom distributed \$1,000 out of the discretionary fund to pay for Christmas gifts to his staff. It is appropriate for a church to authorize its pastor to use church funds to take staff out for a Christmas lunch, at the church's expense, and it is appropriate for the church to buy small gifts of appreciation to staff for special occasions. It is best for these expenses to come from a specific line item in the budget where other staff support expenses are borne; also it might be more appropriate for these types of expenses to come from the budget of the pastor parish relations committee, where there may be greater accountability and control over the expenditure.
- 6) **Probably inappropriate:** Bishop Smith used \$2,000 of the discretionary fund to pay for new appliances in the kitchen of the episcopal residence. While new appliances might have been needed and would be an expense appropriate for the annual conference to make, if it chose to do so, this scenario is troublesome because: a) the conference should make the decision about what to upgrade in the episcopal residence, if the conference is going to pay for that expense; b) the expenses of upgrading the episcopal residence should come from the budget for the episcopal residence; and c) the discretionary fund should not be used for anything that appears to be for the benefit of the bishop or the bishop's family.
- 7) **Always inappropriate:** Pastor Robert borrowed \$5,000 from the discretionary fund to pay for his son's college tuition expense.
- 8) **Always inappropriate:** Pastor William distributed \$5,000 out of the discretionary fund to assist his daughter with the down payment for the purchase of a first home. His daughter otherwise would not have been able to purchase the home.
- 9) **Always inappropriate:** Bishop Jackson has been asked to speak at the grand opening of new facility of a local church she once served as its head pastor. Her husband, who is a retired accountant and an avid golfer, will be travelling with

her because of the excellent golf courses in the area. While the church is in her episcopal area, Bishop Jackson's busy schedule has created the need to fly to the grand opening. Bishop Jackson uses \$750 of the discretionary fund provided by the annual conference to pay for her husband's plane ticket.

- 10) **Always inappropriate:** Pastor Sue's church has a written discretionary fund policy with careful internal controls. The annual budget for the fund is \$5,000, and Pastor Sue is allowed to spend no more than \$500 at any one time. The written policy specifies that the discretionary fund may be used for any of the following purposes: 1) providing care for the needy; 2) for special church projects that come up during the year without other budget dollars for support, provided that the pastor seeks approval of the church council before spending the money for any such project. The youth group approaches Pastor Sue to ask for help with a mission project that the church council will not agree to fund. Pastor Sue agrees to provide \$400 for the project. While the project might qualify for support under the discretionary fund policy (purpose #2), Pastor Sue should have gone to the church council for approval before agreeing to support the project.

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