

Pastor is entitled to a subtraction for the portion of payments received under an IRC Section 403(b) plan that is not excluded from his federal adjusted gross income as a housing allowance.

September 18, 2014

Re: Request for Letter Ruling, TAXPAYER

Dear Xxxxx:

This is in response to your letter dated January 29, 2014 in which you request a legal tax ruling whether Illinois would recognize certain retirement income. The Department's regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding against the Department, but only as to the taxpayer issued the ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of Department policy that apply, interpret or prescribe the tax laws and are not binding against the Department. See 2 Ill. Adm. Code 100.1200(b) and (c). The nature of your letter and the information provided require that we respond with a General Information Letter.

Your letter states as follows:

RE: 20XX IL-1040
Letter ID: XXXXXXXXXXXXXXXXXXXX
Account #: XXXXXXXXXXX
TAXPAYER
ADDRESS
CITY, IL ZIP CODE

This is the 4th piece of correspondence attempting to resolve a question of retirement subtraction on the Illinois 1040 return. EMPLOYEE, of the Problems Resolution Division, fails to recognize retirement income.

The problem comes from the use of IRS Section 107 Housing Allowance for Clergy. A 1099-R from COMPANY, Pension/Retirement from COMPANY 1 (church affiliation) was received for \$\$\$, of which \$\$\$ was determined available for Section 107(2) Housing Allowance. The \$\$\$ was included on Line 16a Pensions & Annuities of the federal 1040. The required IRS presentation requires a schedule and inclusion on Line 21 of the Federal Return:

1099 amount	\$XX,XXX	Pension/Retirement
Housing allowance used	<u>(XX,XXX)</u>	IRS Subtraction
Excess over housing allowance	\$XX,XXX	Required to be placed on Line 21 of the federal 1040 (still pension/retirement)

The \$\$\$ was pension/retirement and, even though the housing allowance was carved away for federal purposes, the balance of \$\$\$ is still pension/retirement which is included as a subtraction on Line 5 of the Illinois return.

As interesting is that clergy housing allowance has been with us for over 30 years and only since Illinois electronic filing, has it become an issue with the Illinois Department of Revenue. Whether it is software or interpretation, it is now an issue.

Please review the enclosed documentation to support the original subtraction on Line 5 of the 2013 IL-1040. If direct conversation is necessary, we have included the IL-2848 again.

RESPONSE

The answer to your question can be found in Section 203(a)(2)(F) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.). Section 203(a)(2)(F) states as follows:

Section 203. Base income defined

(a) Individuals.

(1) In general. In the case of an individual, base income means an amount equal to the taxpayer's adjusted gross income for the taxable years as modified by paragraph (2).

(2) Modifications. The adjusted gross income referred to in paragraph (1) shall be modified ... by deducting from the total so obtained the sum of the following amounts:

(F) An amount equal to all amounts included in such total pursuant to the provisions of Sections 402(a), 402(c), 403(a), 403(b), 406(a), 407(a), and 408 of the Internal Revenue Code, or included in such total as distributions under the provisions of any retirement or disability plan for employees of any governmental agency or unit, or retirement payments to retired partners, which payments are excluded in computing net earnings from self employment by Section 1402 of the Internal Revenue Code and regulations adopted pursuant thereto;

Under federal law, retired ministers are eligible for housing allowance exclusion. "If you are a retired minister, you exclude from your gross income the rental value of a home (plus utilities) furnished to you by your church as a part of your pay for past services, or the part of your pension that was designated as a rental [housing] allowance," subject to the rules set in IRC Section 107 (IRS Pub. 517).

Churches and denominational pension plans that have established retirement income accounts (Section 403(b) plans, sometimes called tax-sheltered annuities) for their employees can designate some or all of a retired minister's account distributions as a housing allowance. Section 403(b) plans are the only type of retirement account that allow for this housing allowance designation. The housing allowance designation is lost if a minister rolls the funds from his/her 403(b) plan into another type of

retirement account (e.g. IRA, Roth IRA, non-403 (b) annuity) because any amount rolled over to an eligible retirement plan from a 403(b) plan, either as a direct rollover or a rollover made within the 60-day period, is treated as a distribution followed by a rollover contribution.

Distributions designated as housing allowance may not be prorated. They may only be used for housing expenses incurred in the same year as the distribution, subject to the requirements of IRC Section 107. Amounts not used for housing expenses in the distribution year are subject to the regular federal income tax rates.

In this manner, amounts exceeding that used by the retired minister would be added to the minister's adjusted gross income. As such, if the amounts distributed to TAXPAYER originate from a Section 403(b) plan, then the amount exceeding that used for housing would qualify for the subtraction modification found in IITA Section 203(a)(2)(F).

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you have any further questions, you may contact me at (217) 524-7580.

Sincerely,

Matthew Crain
Associate Counsel (Income Tax)