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Clergy Tax Exemption Problematic Despite 7th Circ. Ruling

By **Amy Lee Rosen**

Law360 (March 19, 2019, 8:04 PM EDT) -- Even though the Seventh Circuit recently found an uncapped parsonage housing tax exemption to be constitutional, flaws and inconsistencies remain in the statute, such as uncertainty over who qualifies for the benefit.

In an eagerly awaited decision, the court said Friday that Internal Revenue Code Section 107(2), which excludes from taxable income housing allowances paid to a "minister of the gospel," is neutral toward religion and does not violate the establishment clause or the free exercise clause of the U.S. Constitution.

This result does not change the status quo, since clergy members still can exclude housing allowances paid to them; however, a significant ambiguity remains in the definition of "minister of the gospel," according to Samuel D. Brunson, a professor at Loyola University Chicago School of Law.

Annie Laurie Gaylor, left, president of the Freedom From Religion Foundation, protested outside a Houston stadium in August 2011. Gaylor took part in a suit against the federal parsonage housing tax exemption. (AP)

"To qualify for this [housing tax exemption], you have to be 'a minister of the gospel,'" he said. "But they decline to talk about who qualifies as a minister of gospel, which turns out to be a really hard and invasive question for purposes of [Section] 107."

In 1966, the Internal Revenue Service found a Jewish cantor did not qualify for Section 107 because he did not perform a function that only a rabbi can do, which was to decide questions of Jewish law. Faced with a case of first impression, the U.S. Tax Court in Salkov v. Commissioner defined "minister" as "one who is authorized to administer the sacraments, preach and conduct services of worship" while "gospel" meant "glad tidings or a message, teaching, doctrine or course of action having certain efficacy or validity."

"Although 'minister of the gospel' is phrased in Christian terms, we are satisfied that Congress did not intend to exclude those persons who are the equivalent of 'ministers' in other religions," the Tax Court said. "Nomenclature alone is not determinative."

The term “Gospel” with a capital “G” is clearly Christian, but limiting the deduction to that section of religion would clearly not work, and this case shows the parsonage housing tax exemption also likely can be used by a rabbi or imam, Brunson said.

The IRS later followed Salkov when it issued Rev. Rul. 78-301 in 1978, which said that a “Jewish cantor who is not ordained but has a bona fide commission and is employed by a congregation on a full-time basis to perform substantially all the religious worship, sacerdotal, training and educational functions of the Jewish denomination's religious tenets and practices is a minister of the Gospel within the meaning of Section 107.”

Although the standard seems to evaluate whether a person is officially commissioned as a minister, other factors are whether one does "ministerial things" and if those actions are such things done through one's place of worship, Brunson said.

The parsonage tax exemption is abused in plenty of places and can even occur at some religious schools where they may say some or all faculty members can qualify, he added.

“But I don’t think Congress will act to define ‘minister of the gospel,’” Brunson said. “The problem is that Congress is hesitant to define what qualifies as religious practice, so Congress tends to be happy to leave that to courts and the IRS. The courts have a test which isn’t clear and isn’t necessarily workable, but it gives a fair amount of autonomy to religions to designate ministers of gospel.”

Several tax professors, including Brunson, signed an amicus brief to the Seventh Circuit arguing the clergy housing tax exemption should be quashed because it entangles church and state and subsidizes religion, they said. The case was brought in 2016 by Annie Laurie Gaylor and Dan Barker, founders of the 501(c)(3) Freedom From Religion Foundation, who claimed that the housing credit set aside specifically for clergy members, for which they didn’t qualify, was unconstitutional.

Ellen Aprill, who is a professor at Loyola Law School, Los Angeles, and who was listed in the amicus brief, said Gaylor failed to resolve another issue in Section 107(2), which is that the provision allows clergy members to use the tax exemption for their own housing while being able to take advantage of other housing-related tax deductions. However, a similar statute that applies to religious and nonreligious entities, Section 119 of the Internal Revenue Code, does not grant tax benefits to the individual or allow the individual to own the housing, which means that a taxpayer cannot take housing-related tax deductions via Section 119.

Section 119 allows for meals or lodging furnished for the convenience of the employer to be excluded from the income of the employee, Aprill said. For example, a museum director will have fundraising events and meet with potential donors, which means the person will have to do sufficient work at her or his home, but that property has to be owned by the entity, not the person, in order for the director to qualify under Section 119, she said.

“That means the entity has to have the money to own or rent it and the executive does not build up equity because it is not his or her own home,” Aprill said. “Whereas under the [parsonage] housing allowance exception, the member of the clergy can own the housing, put the money toward the mortgage, can take the mortgage interest deduction and benefit from the increase in equity.”

Brunson told Law360 that Section 107(2) was not created with the mortgage interest deduction in mind, but this is one of those odd gaps in two different regimes that can apply at the same time.

Ministers should also be allowed to take state and local tax deductions on top of the mortgage interest deduction because Section 265(a)(6) expressly allows the state and local deduction even with the parsonage allowance, he added.

But just because Section 107(2) has now been held constitutional by the Seventh Circuit does not mean it is sound tax policy, said Edward Zelinsky, who is a professor at Yeshiva University's Benjamin N. Cardozo School of Law and was not a listed author on the amicus brief.

"My position is that basically once you say it's constitutional, it doesn't mean its sound as a matter of tax policy," he said. "My next step is that in general, I don't think cash exclusions make sense, especially an uncapped cash exclusion makes sense."

Zelinsky pointed out that Section 107(2) provides a tax exemption to a cash housing allowance that has no set monetary cap, whereas Section 119 has no cap because the benefit is not dollars toward housing, but rather the value of free housing or meals that an employer provides to the employee, which makes it harder to administer.

Section 107(2) is a cash equivalent that can be easily taxed and is administrable, so it would make sense to put a cap on the deduction the same way that Section 132 of the Internal Revenue Code caps pretax amounts to pay for certain transit expenses and how Section 129 allows an employee to deduct up to $5,000 for dependent care assistance.

"Why is it my kids can only exclude $5,000 of dependent care assistance but a clergyman like Rick Warren can exclude tens of thousands of dollars," Zelinsky said. "As much as I admire Rick Warren, I don't see the logic of an uncapped exclusion."

Richard D. Warren is the founder and senior pastor of Saddleback Church, and Zelinsky's reference to him involved a 2002 Ninth Circuit case, Warren v. Commissioner. In Warren, the Ninth Circuit reviewed a 2000 U.S. Tax Court decision that permitted Warren and his wife to exclude up to $80,000, which exceeded the fair market rental value of the home.

The Ninth Circuit asked Erwin Chemerinsky, who was then a professor at the University of Southern California Law School, to serve as amicus curiae, but Congress amended Section 107(2) to limit the parsonage allowance to the "fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities." Warren and the IRS agreed to dismiss the case but Chemerinsky filed a motion to intervene, challenging the newly amended Section 107(2). That motion was denied.

Chemerinsky, who is now the dean and a professor at University of California, Berkeley School of Law, said he believes the Gaylor decision helps religious institutions because they can still pay their members less, since they can receive the benefit of the parsonage exemption.

"I believed then and believe now that the parsonage exemption — benefiting ministers of the gospel — violates the establishment clause," he told Law360. "I am thus disappointed in the court's ruling."

Alexander Reid, partner at Morgan Lewis & Bockius LLP, defended the ruling in Gaylor, saying it reaffirmed a critical legal distinction between a tax exemption and a tax subsidy. Congress is capable of revisiting Section 107(2), just as it recently narrowed Section 119 to raise revenue in the Tax Cuts and Jobs Act, but it is unclear how much revenue would be raised by changing the parsonage tax exemption, he said.

“It’s unclear how much revenue there is to be raised, however, so the juice may not be worth the squeeze," Reid told Law360. “Could the statute be improved? Perhaps, but Congress might be well advised to look elsewhere for revenue, and leave the parsonage alone."

--Editing by Tim Ruel and John Oudens.