

LEGAL UPDATES

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Clergy Housing Allowance Declared Unconstitutional...Again

KEY POINTS

The tax-free housing allowance that ministers receive from the IRS has been ruled unconstitutional by a U.S. District Court judge.

It is estimated 90 percent of clergy claim the housing allowance.

The judge's order is likely to be appealed.

Previous appeals of similar rulings have been vacated on procedural grounds.

Judge Rules That Tax Break Violates First Amendment

On October 6, 2017, a U.S. District Court judge in Wisconsin issued an order declaring that the tax-free housing allowance for ministers violates the U.S. Constitution. The order will likely be appealed; however, a significant change to the federal statute that contains the housing allowance would have an enormous impact on clergy and the churches they serve.

The October 6, 2017, order by Judge Barbara Crabb of the U.S. District Court for the Western District of Wisconsin declared that 26 U.S.C. § 107(2), which excludes from the gross income of a “minister of the gospel” a “rental allowance paid to him as part of his compensation,” violates the establishment clause of the First Amendment to the U.S. Constitution.

Under Section 107 of the Internal Revenue Code, a minister’s housing allowance can be excluded from gross income for income tax purposes but not for self-employment tax purposes. Although the provision uses the term “minister of the gospel,” the IRS has interpreted this term to encompass

religious leaders outside of the Christian context. Housing allowances for clergy were codified in federal law in 1921, and Section 107(2) was enacted in 1954. In 2002, the Clergy Housing Allowance Clarification Act further revised the statute to specify that the exclusion could not exceed the fair rental value of the minister's home.

The Freedom From Religion Foundation Inc., along with some of its officers, brought the lawsuit to challenge Section 107(2) on the ground that it discriminates against secular employees and violates both the establishment clause of the First Amendment and the equal protection component of the Fifth Amendment. The plaintiffs also challenged Section 107(1), which excludes from a minister's gross income "the rental value of a home furnished to him as part of his compensation," but the court dismissed this challenge for lack of standing.

This is not the first time that Judge Crabb has held Section 107(2) unconstitutional. Years ago, Judge Crabb concluded that the provision "violates the establishment clause because it provides a benefit to religious persons and no one else, even though doing so is not necessary to alleviate a special burden on religious exercise." The Court of Appeals for the Seventh Circuit vacated the judgment on the ground that the plaintiffs did not have standing to sue. The Freedom From Religion Foundation refiled the case after rectifying the issue of standing.

The Judge's Reasoning

Judge Crabb sums up her position as follows: "Although defendants try to characterize Section 107(2) as an effort by Congress to treat ministers fairly and avoid religious entanglement, the plain language of the statute, its legislative history and its operation in practice all demonstrate a preference for ministers over secular employees... A desire to alleviate financial hardship on taxpayers is a legitimate purpose, but it is not a secular purpose when Congress eliminates the burden for a group made up of solely religious employees but maintains it for nearly everyone else."

The defendants raised four distinct arguments as potential secular purposes for the clergy housing exclusion:

Providing for the "unique housing needs" of ministers;

Eliminating discrimination among religions;

Reducing entanglement between church and state; and

Alleviating financial hardship on ministers.

Judge Crabb considered and rejected each of these arguments. She also analyzed the history of religious tax exemptions, concluding that "Section 107(2) is not entitled to any special presumptions on account of history, particularly because the statute has evaded judicial scrutiny for a variety of

procedural reasons for decades.” Ultimately, Judge Crabb concluded that “Congress could have enacted a number of alternative exemptions without running afoul of the First Amendment” and suggests many such options.

Although the order states that Section 107(2) is unconstitutional, Judge Crabb noted her reluctance to make a definitive determination regarding the appropriate remedy. She ordered the parties to file supplemental briefs regarding additional appropriate remedies and whether relief should be stayed pending a potential appeal.

What This Means to You

It is safe to assume that the decision will be considered by the Seventh Circuit, as it was in 2013, and that Judge Crabb will stay enforcement of her ruling pending the appeal. What is less clear is whether the Seventh Circuit will consider the substance of Judge Crabb’s decision or again vacate the judgment on procedural grounds.

According to reports, nearly 90 percent of ministers claim the housing allowance under Section 107, creating a tax exclusion worth \$700 million annually. A significant change to Section 107(2) would have an enormous impact on clergy and the churches they serve.

Clergy and church administrators would be wise to be alert to further developments, both with the pending litigation and, if Judge Crabb’s ruling is upheld, on the legislative front. It should also be noted that this ruling does not apply to clergy who receive a parsonage, as Judge Crabb rejected the challenge to Section 107(1) for lack of standing.

Contact Us

For more information about the ruling and how it may affect your organization, please contact Jordan T. Ault or Bruce G. Arnold of Husch Blackwell’s Nonprofit Organizations & Religious Institutions team.