LEGAL UPDATES

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Housing Allowance Appellate Decision Secures Millions in Tax Savings for Clergy

Service

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Key Points

The Seventh Circuit Court of Appeals found the tax-free housing allowance that ministers receive from the Internal Revenue Service (IRS) to be constitutional.

This is the second time the Seventh Circuit has reversed a district court ruling declaring the statute unconstitutional.

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

Tax-Free Clergy Housing Challenged

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. See our earlier analysis of that decision here. On March 15, 2019, the Seventh Circuit concluded that the housing allowance is constitutional, reversing the decision of the district court. A copy of the decision can be found here.

The 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. ("FFRF"), 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.

The Seventh Circuit Decision

The decision, authored by Circuit Judge Brennan on behalf of a three-judge panel, first dispensed of the standing issue, finding that both the individual defendants and FFRF had standing. The court then analyzed the constitutionality of Section 107(2) under both *Lemon v. Kurtzman*, 403 U.S. 602 (1971), and the "historical significance" test of *Town of Greece v. Galloway*, 572 U.S. 565, 576 (2014).

The so-called *Lemon* test has three prongs: (1) the statute must have a secular legislative purpose; (2) its principal or primary effect must be one that neither advances nor inhibits religion; and (3) the statute must not foster an excessive government entanglement with religion. 403 U.S. at 612-13. Citing legal scholars from Justice Antonin Scalia to Cass Sunstein, the court reached the opinion that the housing allowance has multiple secular purposes. The decision first notes an "overarching arrangement in the tax code to exempt employer-provided housing for employees with certain job-related housing requirements." The court dismissed FFRF's argument that the statute applied to "any minister, as opposed to any minister that uses his or her home for religious purposes." Even if the statute is overinclusive, reasoned the court, this alone does not render it unconstitutional. The decision also notes two other secular purposes: (1) avoidance of discrimination between clergy that reside in a parsonage and those that receive a housing allowance; and (2) avoiding excessive entanglement with religion. Specifically, the court noted that applying more general tax exemptions to ministers would force the IRS to conduct intrusive inquiries into how religious organizations use their facilities, which "would entangle church and state far more than under § 107(2)." As to the second prong, the court explained that the effect of the housing allowance "is not to advance religion on behalf of the government, but to allow churches to advance religion, which is their very purpose." Thus, the clergy housing allowance does not violate the Establishment Clause under the *Lemon* test.

The court performed a perfunctory examination of the housing allowance under the historical significance test, noting that "FFRF offers no evidence that provisions like § 107(2) were historically

viewed as an establishment of religion." Both Congress and states have enacted tax exemptions for religious organizations for over two centuries. For this reason, the clergy housing allowance does not violate the Establishment Clause under the historical significance test.

The decision concludes by reversing the district court with a flourish: "FFRF claims § 107(2) renders unto God that which is Caesar's. But this tax provision falls into the play between the joints of the Free Exercise Clause and the Establishment Clause: neither commanded by the former, nor proscribed by the latter."

What This Means to You

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 had an enormous impact on clergy and the churches they serve.

FFRF has not yet set forth its plans, but it is safe to assume that the group may appeal the decision to the Supreme Court of the United States. The Supreme Court has been willing to decide cases with religious themes in recent terms, although it is far from certain that the court will choose to hear this case because the decision of the Seventh Circuit maintains the status quo. Although this litigation has not resulted in any change to either the clergy housing allowance or exemptions related to parsonages, clergy and church administrators are encouraged to stay alert for a possible appeal.

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.