

Minister's Housing Allowance On Trial

By Phill Martin

Dallas (NACBA) – Ministers who claim a portion of their income as “housing allowance” may lose this tax benefit based on the outcome of an IRS appeal of a lower tax court decision. A federal appeals court recently issued an order requesting briefs on whether the cash housing allowance is unconstitutional. Congress established the original housing allowance in 1921 and it has remained unchallenged until now. A *Los Angeles Times* article recently estimated the tax benefit to ministers may exceed \$400 million annually. These dollars could be diverted from church ministries and benevolences to supplement ministers' salaries if the allowance is eliminated. Those ministers whose churches provide their housing (sometimes called a parsonage, rectory, manse or ashram), do not appear to be affected by this court decision.

This case began when the IRS examined tax returns filed by Rev. Richard Warren, pastor of Saddleback Church in Lake Forest, California. The IRS agent asked Rev. Warren to verify the fair rental value of his residence. His representatives asked the agent for assistance in computing this value. More than 450 days passed without a response from the agent. As Rev. Warren later found out, though the agent sought help from the national IRS office, the agent discovered that no rules existed regarding this valuation. In the more than 30 years since the IRS issued its ruling limiting the housing allowance exclusion to the “fair rental value,” ministers have been forced to comply with a ruling without any guidance on how to comply.

Left to his own devices, this agent reported to Rev. Warren's representatives that he had a valuation from a certain realtor working with a local real estate company. Rev. Warren later discovered that the agent created a fictitious realtor name and falsely claimed the realtor was associated with a local real estate company. In summary, the agent created a fair rental valuation without any basis for that valuation. Without any additional IRS guidance, agents are free to make the fair rental determination in any arbitrary or capricious manner that suits them. Rev. Warren calls such behavior abusive.

Rev. Warren feared that other ministers were being subjected to similar abuse so he challenged the IRS agent's arbitrary and capricious ruling in the United States Tax Court. Fourteen of the seventeen tax court judges agreed with Rev. Warren and ruled that the IRS ruling was without any basis.

The IRS then appealed that tax court decision. The case took an unexpected turn when the a federal appeals court ordered Professor Erwin Chemerinsky of University of Southern California Law School and the parties to address the constitutional question. This order has sent Jewish, Christian and other religious faiths scurrying to respond to the order of the court, fearing a ruling that would render the allowance unconstitutional. Looking for a method to avoid an unfavorable court ruling, the Church Alliance—a coalition of 32 Protestant, Catholic and Jewish benefits programs—decided to seek a legislative solution. They asked Rep. Jim Ramstad of Minnesota to introduce H.R. 4156. The bill seeks to reinstate the vague and arbitrary standards that the tax court overruled. The bill's backers believe it will require the Department of Justice and the IRS to dismiss their appeal to the federal appeals court, depriving the court of the opportunity to address the constitutionality issue. However, the bill also re-empowers the IRS and endorses minister abuse by the IRS, similar to the abuse that was served on Rev. Warren.

Whereas this legislative solution is a bold attempt to solve the current crisis, not all see it as a “sure thing” or a “lasting solution.” Frank Sommerville, one of the attorneys who participated in

oral arguments before the federal appeals court, believes it “may not result in the dismissal of the appeal and may not eliminate the constitutionality question.” Since the bill must clear the House and the Senate and be signed by President Bush before the federal appeals court rules, the Church Alliance group is trying to push the bill through Congress at lightning speed. The bill in its present form does not address the concerns that caused Rev. Warren to challenge the ruling in the first place. It simply reinstates the old abusive IRS ruling without adding any rules, guidance or safe harbors. The bill grants the IRS the legal authority to be arbitrary and capricious in their determinations. Additionally, it does not do anything to address the constitutional issues that have been raised. Sommerville observes, “The bill may reserve the constitutional dispute for another day, but the constitutional issue will not go away simply because Congress passes this bill.” With the constitutional issue remaining unresolved, ministers may lack the freedom to defend their rights in the courts. Every challenge to an IRS position may become a constitutional case with its attendant time and money requirements. Most ministers lack both the time and money to mount a constitutional case. This potential threat gives the IRS a tremendous advantage in future minister exams, virtually assuring that ministers will be required to let the IRS win.

The legislative option may be the only way to avoid an adverse court ruling, but faith communities continue searching for a way out of the current situation. They look for a solution that not only eliminates the old arbitrary IRS ways, but also assures a favorable court decision on constitutionality. A perfect solution would address the IRS concerns about potential minister abuses and, at the same time, address Rev. Warren’s concerns about the IRS abuses of ministers. So far no solution has been found.

The National Association of Church Business Administration was among the organizations that hired Sommerville’s law firm to file an amici brief in support of the tax court decision. The association has followed the case with great concern. Its members, representing some 40 plus faith groups, are the men and women who serve on the front line as they manage budgets of local congregations who benefit from the cash housing allowance. They will be among the first to experience the cash crunch if the cash housing allowance is declared unconstitutional. Executive Director Simeon May said, “While we are not opposed to some type of legislative action, we are concerned that it will not result in a final solution. Even if Congress acts in a timely manner there is no guarantee the constitutionality question will not be addressed by this or some other court. We are actively seeking to address this constitutional concern and believe it is definable.”

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