

NO. 00-71217

**IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

RICHARD D. and ELIZABETH WARREN,

Petitioners-Appellees

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant

**ON APPEAL FROM THE DECISION
OF THE UNITED STATES TAX COURT**

**MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF
SUPPORTING THE DECISION OF THE UNITED STATES TAX COURT**

COME NOW, National Association of Church Business Administration, Presbytery of New Covenant of the Presbyterian Church (USA) and Eagle Mountain International Church (collectively referred to as the “Amicus Curiae” herein), and hereby pray that this court will grant leave to file the Amicus Curiae Brief that is attached hereto. They would further show the court as follows:

1. The Amicus Curiae pray that this court affirm the decision of the United

States Tax Court. They represent thousands of churches and their clergy across America. Virtually every clergy person is paid a housing allowance from his or her church. The issue of housing allowance is at the core of this case. This court's decision will affect how each compensates at least some of its clergy. Further, clergy are compensated very modestly compared to other learned professionals with comparable education and experience. If the church's clergy are required to pay more federal income taxes, then the churches must divert more of its resources from its charitable and religious activities toward its clergy's compensation. As a result, the Amicus Curiae are vitally interested in the outcome of this proceeding. The filing of this Brief was authorized by the governing body of each Amicus Curiae.

2. Since the dissent in the United States Tax Court and the Commissioner's opening brief raise the issues of public policy related to churches and their clergy, the Amicus Curiae felt compelled to respond. Rev. Warren, as an individual minister, is not qualified to address the public policy issues raised by the Tax Court's dissent and addressed in the Commissioner's brief. The Amicus Curiae are uniquely qualified to answer these public policy issues because they represent the thousands of clergy that will be required to comply this court's decision. This Brief represents their concerns and addresses the public policy issues that others have raised.

WHEREFORE PREMISES CONSIDERED, National Association of Church Business Administration, Presbytery of New Covenant of the Presbyterian Church

(USA) and Eagle Mountain International Church pray that this court grant leave to file the attached brief and for such other and further relief to which they are justly entitled.

Respectfully submitted,

FRANK SOMMERVILLE

HAMMAR & SOMMERVILLE

1400 Summit Tower

Eleven Greenway Plaza

Houston, TX 77046

(713) 961-9045

(713) 961-5341

Attorneys for the Amicus Curiae,
National Association of Church Business
Administration, Presbytery of New Covenant
of the Presbyterian Church (USA) and Eagle
Mountain International Church

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the attached motion and brief was forwarded by first class mail, postage prepaid, on the _____ day of January 2001, to all parties as required by FRAP 25(b).

Gilbert S. Rothenberg
Andrea R. Tebbets
Attorneys
Department of Justice
Tax Division
P.O. Box 502
Washington, DC 20044

Arthur A. Oshiro
Saavedra & Zufelt
One World Trade Center, Suite 2160
Long Beach, CA 90831-2160

Respectfully submitted,

FRANK SOMMERVILLE

HAMMAR & SOMMERVILLE
1400 Summit Tower
Eleven Greenway Plaza
Houston, TX 77046
(713) 961-9045
(713) 961-5341

Attorneys for the Amicus Curiae

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**FRANK SOMMERVILLE
HAMMAR & SOMMERVILLE
1400 Summit Tower
Eleven Greenway Plaza
Houston, Texas 77046
(713) 961-9045
(713) 961-5341 (fax)**

*Attorneys for National Association of Church Business Administration, et al
in support of the affirming of the
decision of the United States Tax Court*

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IDENTITY OF AMICUS CURIAE

This Brief is filed on behalf of the following organizations:

National Association of Church Business Administration
100 North Central Expressway, Suite 914
Richardson, TX 75080-5326

This is the largest national professional organization representing the interests of church business administrators. This nonprofit corporation's members come from over one thousand churches and are charged with the business administration of each church. The members represent virtually every major faith in America, including without limitation, United Methodist Church, Presbyterian Church (USA), The Episcopal Church in America, the Assemblies of God, Southern Baptist Churches,

The Disciples of Christ Church, certain Orders and dioceses of the Roman Catholic Church, Churches of Christ, The Congregational Church in America, the Brethren Church, the Evangelical Covenant Church, the Wesleyan Church, the American Baptist Churches, and others. The outcome of this proceeding will affect how each will perform his or her duties. Virtually every church will be affected by this court's decision. Affirming the Tax Court decision will greatly simplify their business administration.

Presbytery of New Covenant of the Presbyterian Church (USA)
1110 Lovett Blvd.
Houston, TX 77006

This a local unit of the Presbyterian Church (USA). It is an association of Presbyterian churches in the Houston area. The member churches will be affected by this court's decision because many of its churches provide cash housing allowances to their ministers. Due to the housing market in Houston, it will cost the churches more to attract ministers if the Tax Court's decision is not affirmed.

Eagle Mountain International Church
14355 Morris-Dido Road
Newark, Texas 76071

This a large, local independent church in the Dallas-Fort Worth area. It teaches that debt is to be avoided as evil. Its ministers are encouraged to pay cash for everything, including their personal residence. The ministers trained and ordained by this church will be impacted by this decision.

RULE 26.1 STATEMENT

None of the Amicus Curiae are publicly traded, nor do they own 10% or more of any publicly traded company.

SUMMARY OF ARGUMENT

The Commissioner in Rev. Rul. 71-280, 1971-2 C.B. 92 encourages clergy to incur debt to purchase their personal homes. This interpretation of Section 107(2) causes harm to some faiths because they believe that debt is evil.

Affirming the Tax Court decision should not result in any loss of federal tax revenue and/or abuse. The clergy compensation surveys show that clergy are among the lowest compensated professions. The Commissioner argues about “abuse” when surveys shows that abuse is virtually impossible given the financial constraints of the faith world. Besides, the Commissioner has plenty of weapons to curb abuse by churches and their clergy.

By claiming a large housing allowance exclusion in one year, the clergy must forgo larger housing allowance exclusions in the future, resulting in higher tax revenues over the years she occupies the home.

Besides the multi-year tax incentive to avoid a large upfront payment for a house, the clergy have another strong incentive to avoid abuse: church pension benefits. The clergy’s retirement benefit is based on his/her taxable income. By claiming a large housing allowance exclusion, the clergy’s future retirement benefits will be reduced.

ARGUMENT

The Amicus Curiae hereby support and adopt the arguments made by Appellant Warren in total though they are not repeated herein. On the other hand, the Commissioner's Brief is constructed using false assumptions about the church world and represents an unnecessary intrusion into the faith practices of certain churches. As discussed below, the Amicus Curiae believe that this court should affirm the decision of the United States Tax Court in *Warren*.

THE COMMISSIONER'S INTERPRETATION OF SECTION 107 VIOLATES FAITH BASED PRINCIPLES

The Commissioner's position in this case ignores the realities of the marketplace. Through Rev. Rul. 71-280, 1971-2 C.B. 92, clergy are encouraged by the Commissioner to incur debt for virtually every major expenditure related to the ownership and maintenance of a home. For example, if the clergy replaces the roof on his home, it is likely the total housing costs for the year will exceed the fair rental value of the home for that year. To avoid that adverse result, the clergy will finance the roof replacement to spread the payments over several years, allowing the full amount spent to be kept below the fair rental cap imposed by the Commissioner. Clergy routinely incur debt to buy furniture, repair homes, make home additions and remodel homes. They are forced into this contrived debt by the Commissioner's policies that are adverse to the principles espoused by several major religions in the

world as well as causing the clergy adverse economic consequences.

The Commissioner's opinion expressed in Rev. Rul. 71-280, 1971-2 C.B. 92, encourages clergy to incur debt – debt that violates their principles of faith. Treas. Reg. Section 1.107-1(c) states that the purchase of a home is deemed to have been spent providing a home as required by Section 107(2). The regulation, originally published in 1960, does not contain the limit that the Commissioner now advocates. As adopted after public comment, the regulation allowed clergy to apply his housing allowance to purchase a home and exclude the cash amount paid towards price from income tax. This regulation was affirmed by the Tax Court and complies with the faith based principles.

Eleven years later, the Commissioner published Rev. Rul. 71-280, 1971-2 C.B. 92, limiting the amount of the cash housing allowance to the fair rental value of the residence. Unlike the regulations that require public comment, the revenue ruling process operates without public input. If the Commissioner had sought input from churches, he would have learned that many faiths have proscriptions against debt.

The Christian faith relies on the Holy Bible to determine faith issues. The Holy Bible states:

“Let no debt remain outstanding, except the continuing debt to love one another, for he who loves his fellowman has fulfilled the law.” Romans 13:8 (New International Version).

“He who puts up security for another will surely suffer, but whoever refuses to strike hands in pledge is safe.” Proverbs 11:15 (New International Version).

“Do not be a man who strikes hands in pledge or puts up security for debts.” Proverbs 22:26 (New International Version).

Based on these and other Scriptures, many Christian faiths teach their adherents to avoid debt. Yet the revenue ruling calls for the clergy to incur debt to spread the cost of a home over many years. In Rev. Rul. 83-3, 1983-1 C.B. 72, the Commissioner further encouraged clergy to incur debt by allowing the clergy both the exclusion under Section 107 and the mortgage interest deduction under Section 163. This double benefit is a major tax benefit to clergy. Yet the Bible teaches otherwise. By providing these incentives, the clergy actually will pay less federal income taxes over a period of time than under the *Warren* Tax Court decision but in doing so will violate their faith based principles.

Judaism also has rules that discourage debt, especially debt that includes collateral. The Torah states:

“If you lend money to one of my people among you who is needy, do not be like a moneylender; charge him no interest. If you take your neighbor’s cloak as a pledge, return it to him by sunset, because his cloak is the only covering he has for his body. What else will he sleep in? When he cries out to me, I will hear, for I am compassionate.” Shemos (Exodus) 22:25-27 (New International Version).

“When you make a loan of any kind to your neighbor, do not go into his

house to get what he is offering as a pledge. Stay outside and let the man to whom you are making the loan bring the pledge out to you. If the man is poor, do not go to sleep with his pledge in your possession. Return his cloak to him by sunset so that he may sleep in it. Then he will thank you, and it will be regarded as a righteous act in the sight of the LORD your God.” Devarim (Deuteronomy) 24:10-13 (New International Version).

Muslims have similar teachings. From the Koran (Qur’an):

“Those who live off the interest on loans will never stand up, except in the way those whom Satan knocks down with a fit rise up again. That is because they say: ‘Trading is just like taking interest.’ Yet God has permitted trading and forbidden taking interest. Anyone who receives such an instruction from his Lord and stops doing so, may keep whatever [capital] is a thing of the past, while his case rests with God; yet those who do so over and over again will become inmates of the Fire, to remain there forever. God wipes out usury and nourishes acts of charity; God does not love every vicious disbeliever.” Chapter 2: The Cow, Verse XXXVIII (Dr. T.B. Irving’s translation).

In essence, the Commissioner’s restrictions under Rev. Rul. 71-280, 1971-2 C.B. 92, violate principles found in the world’s major religions. The common sense approach that the Commissioner used in the regulations should prevail because it is neutral to religious faiths. Those faiths that allow for debt are free to use debt to pay for a residence; those faiths that prohibit debts are also allowed to pay for housing in accordance with their faith principles.

In contrast with the Commissioner’s interpretation stands the Tax Court’s decision that rightfully accommodates the faith principles of the world’s major religions. The Tax Court used the plain reading of the statute and the legislative

history to reach its conclusions. While not repeating the arguments found in that decision, it defies logic that the Congress would enact a law that violates principles governing the world's major religions. The Commissioner's hostility to religion should not be sustained.

NO ROOM FOR ABUSE

The Commissioner claims that *Warren* will lead to abuse of the tax system by clergy. This conclusion is speculative and is not borne out by the facts.

The National Association of Church Business Administration ("NACBA") publishes an annual compensation report for its members. The NACBA surveys its members and compiles the data into a report. A copy of relevant pages from the 1999-2000 report is attached and incorporated as Exhibit 1.¹ Of 1,716 respondents, the average senior minister's total compensation was \$77,242.00. The total compensation includes salary, housing allowance, retirement contributions, insurance and social security offset.

Another prominent compensation survey is published by the Church Law & Tax Report and is attached and incorporated as Exhibit 2.² Of the 1225 responses

¹ The Amicus Curiae will provide a complimentary copy of the entire report to the court and to any other party to this appeal upon request.

² Richard Hammar is a partner in Church Law and Tax Report and a partner in the law firm representing the Amicus Curiae. Again, the

given in the 2001 report, 1198 had full time senior pastors. The median total compensation for senior pastors was \$66,096.00, with 95% of senior ministers earning less than \$118,284.00. Table 4-3. This number also includes all nontaxable compensation, such as insurance, retirement contributions and housing allowance. *Id.* From this group, 85% received a cash housing allowance under Section 107(2), while the church furnished 20% with a parsonage under Section 107(1). *Id. at 41.* Due to the overlapping percentages, apparently some ministers received housing allowances under both Sections 107(1) and 107(2) as compensation.

The modest total compensation for clergy demonstrates that the clergy could not pay cash for a home, even if they wanted to do so. The Commissioner apparently believes that the potential for abuse is sufficient to harm the thousands of clergy that have very modest amounts of income.

Assuming that a church and its clergy chose to “abuse” the tax system by paying an outrageous housing allowance, the Commissioner has plenty of weapons to shut down such abuse besides Section 107. First, the clergy’s total amount of compensation must be reasonable to prevent inurement. Section 501(c)(3), the Internal Revenue Code section that includes churches, prohibits all forms of

Amicus Curiae will provide a complimentary copy of the entire report to the court and to any other party to this appeal upon request.

inurement and private benefit. If the church pays the clergy \$1.00 more than a reasonable amount of compensation, then the Commissioner may revoke the church's tax exemption. *Western Catholic Church v. Commissioner*, 73 T.C. 196, 209 (1979), *affd. in an unpublished opinion* 631 F.2d 736 (7th Cir. 1980); *People of God Community v. Commissioner*, 75 T.C. 127 (1980); *John Marshall Law School v. United States*, 81-2 U.S.T.C. para. 9514 (Ct. Cl. Trial Div., June 24, 1981), *affd.* 228 Ct. Cl. 902 (1981); *Birmingham Business College, Inc. v. Commissioner*, 276 F.2d 476 (5th Cir. 1960).

If the Commissioner needs another tool to curb abuse, then it may impose an excise tax (commonly referred to as "intermediate sanctions") on the clergy person. 26 U.S.C. Section 4958. The initial tax is 25% of the amount of the clergy's compensation that exceeds a reasonable amount. 26 U.S.C. 4958(a)(1). If the clergy person fails to repay the excess compensation within the tax year the initial tax, then a second excise tax of 200% is imposed on the clergy person. 26 U.S.C. Section 4958(b). This tax was enacted to punish the nonprofit employee for excessive compensation while not punishing the nonprofit organization. The intermediate sanction provides a very strong incentive to the clergy to avoid abusive amounts of compensation, including housing allowances.

FEDERAL TAXES WILL BE HIGHER UNDER WARREN

The Commissioner implies that the federal fisc will be harmed by the *Warren* decision. Appellant's Brief at page 36. Nothing could be farther from reality.

Assume that a clergy opted to pay \$100,000 (representing the clergy's entire compensation) cash for a home in YR1. That year would result in no income taxes for the clergy. If the clergy resided in the home for twenty years, then the clergy's housing allowance exclusion would be limited to utilities, taxes and maintenance for the remaining nineteen years.³ Her total housing allowance exclusion and cash expenses for the acquisition of the home equal the \$100,000.00 purchase price.

On the other hand, assume that a clergy opted to finance her \$100,000.00 home with a 95% mortgage for twenty years at 7% interest. Her monthly principal and interest payment is \$736.43, or \$8,837.16 per year. Assuming these payments do not exceed fair rental value, she will be entitled to exclude from taxable income \$176,743.20 as a housing allowance over the twenty years. Besides, she will be entitled an interest deduction in the amount of \$81,743.20. Basically, she will exclude from federal income taxation a total amount of \$286,486.40 (\$176,743.20+\$81,743.20). Over the twenty years, the government will lose the income tax revenues on \$186,486.40 of income. It is indeed rare for the

³ These expenses remain the same under both examples.

Commissioner to call “abusive” transactions that result in higher taxes.

PENSIONS PROVIDE DISINCENTIVE

Clergy are typically participants in church pension plans. The clergy’s housing allowance is not part of the clergy’s compensation base that is used for computing pension contributions. Treas. Reg. Section 1.415-2(d)(2); Private Letter Ruling 8416003 (December 19, 1983)(explaining the application of the regulation to Section 107). By reducing their taxable compensation with increased housing allowance, the clergy will have a smaller pension contribution, resulting in a smaller pension. As discussed *supra*, the *Warren* decision will result in increased pension contributions. Assuming, *arguendo*, the Commissioner is correct that the *Warren* decision will result in decreased taxes, then the clergy have a disincentive to claim inflated housing allowances. The increased housing allowance exclusion will result in decreased pension contributions from their churches. The decreased pension contribution will result in a reduced pension to the clergy at retirement.

CONCLUSION

The Amicus Curiae believe that this court’s opinion will have a major impact on them and their members. The Tax Court clearly understood the issues when it issued its decision. We believe that it was well reasoned. Besides all the reasons listed in the Tax Court opinion, this court should respect beliefs of some of the major

religions of the world. This court should find that the Commissioner's position is abusive and outside the boundaries of the statute.

Warren is not about abuse. The Commissioner's contrived arguments about abuse are designed to distract this court away from the substance of the case. Even if public policy is to be considered, as explained above, it still favors affirming the Tax Court decision because it construes the statute in favor of the federal fisc. The Amicus Curiae pray that this court affirm the *Warren* Tax Court decision.

Respectfully submitted,

FRANK SOMMERVILLE

HAMMAR & SOMMERVILLE

1400 Summit Tower
Eleven Greenway Plaza
Houston, TX 77046
(713) 961-9045
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**FRANK SOMMERVILLE
HAMMAR & SOMMERVILLE
1400 Summit Tower
Eleven Greenway Plaza
Houston, Texas 77046
(713) 961-9045
(713) 961-5341 (fax)**

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