

# Tax Shelter



Depending on whom you ask, the housing allowance for clergy is an essential tool for ministry or a case of the government paying for religion.

ROB HALL

**D**on Nelson, pastor of Beverly Evangelical Covenant Church in Chicago, knows firsthand how important the Internal Revenue Service's clergy housing allowance is to a pastor.

The first church that Nelson served was located in an economically depressed area, and the church could not afford to pay Nelson a large salary.

"The congregation provided us with a parsonage, and that made the difference," Nelson says. "If we had had to pay taxes on the value of the parsonage we would have had to move on after the third or fourth year, before my ministry there was complete." (Nelson ended up staying ten years.)

Since 1921, the IRS has allowed clergy to take a housing allowance, also

market value of Warren's home. The IRS then appealed to the Ninth Circuit Court. When the case reached a panel of the Ninth Circuit, Judge Stephen Reinhardt questioned the constitutionality of the exemption. Two of the three judges on the court decided to include the issue of whether the housing allowance is constitutional. They did this even though both parties objected to this issue being made part of the case.

If the housing allowance is ruled unconstitutional, clergy would face an estimated \$2.3 billion tax increase over the next five years. But the impact may be even more dramatic for pastors.

"Several Covenant pastors would lose their homes," says David Kersten,

sored legislation called the Clergy Housing Allowance Act of 2002 (the Act). The Act, which sped through the House of Representatives in one week, specifies that the housing allowance exemption cannot exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities. The Act was supported by the Church Alliance, an ecumenical coalition of thirty-two pension boards that includes the Covenant.

Both the House and Senate unanimously approved the Act and President Bush signed it into law on May 20, 2002.

Richard R. Hammar, an attorney and editor of *Church Law & Tax Report*, called the Ninth Circuit's decision to

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known as the parsonage allowance. It gives a pastor who lives in a parsonage an exemption for the fair market rental value of the parsonage. In 1954, the exemption was modified to allow pastors who do not live in a parsonage to designate part of their income as housing allowance. In both cases, the housing allowance is tax free.

The clergy housing allowance has come under attack recently as a result of a Ninth Circuit Court of Appeals case involving Rick Warren, pastor of Saddleback Church in Lake Forest, California, and the IRS. The IRS audited Warren's tax returns from 1993 to 1995, and disputed the amount he claimed for housing allowance. In 1995, for example, Warren claimed \$79,000 in housing allowance, or 80 percent of his salary. Warren was able to expend so much of his pastoral compensation on housing since he received substantial income from the sales of his books and tapes (more than \$220,000 in 1995).

The IRS claimed that Warren was only allowed a \$59,000 allowance in 1995, based on what they called the fair

executive minister of the Department of Ordered Ministry.

Most vulnerable will be those pastors who barely qualified for their mortgages under the current tax structure. It is likely that these pastors will not be able to both pay the increased taxes and their mortgage payments.

Retired pastors are also affected. Most retired pastors designate their entire pension as housing allowance. For them the increase in taxes that would result from the loss of the housing allowance would be devastating.

"Both retired pastors and missionaries in the Covenant rely on the tax benefit that comes with being able to designate most if not all of their pension as housing allowance," says Mary Miller, vice-president for administration and director of pensions for the Evangelical Covenant Church. "Many of the Covenant's older retirees need to use the housing allowance to stretch their pension dollar."

In an effort to protect the clergy housing allowance, U.S. Representative Jim Ramstad of Minnesota spon-

address the constitutionality of the housing allowance "extraordinary," since it is rare for courts to decide to litigate an issue not brought forward by the parties.

At issue is whether the housing allowance violates the Establishment Clause of the U.S. Constitution, (found in the First Amendment), which states that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof. . . ." In general, this clause has meant that states and the federal government may not set up a church, pass laws that aid one or all religions, or give preference to one religion.

Professor Erwin Chemerinsky of the University of Southern California argues that the housing allowance violates the Establishment Clause by serving to advance religion. Chemerinsky was asked by the Ninth Circuit to file a brief on the constitutionality of the

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housing allowance.

“Allowing ‘ministers of the Gospel’ to be paid in tax-free dollars and then [allowing them to] deduct their mortgage interest and property tax payments is hardly leaving religion alone,” wrote Chemerinsky. “It is giving religions, and only religions, a huge benefit being able to pay their clergy member employees much less than if the provision were eliminated and the government truly left religion alone and treated clergy by the same rules as all other taxpayers.”

But clergy are not the only individuals who benefit from the tax shelter of housing allowances. Military personnel, Foreign Service employees, and Peace Corps volunteers are able to exempt their basic housing allowances from taxable income. Also, employees who have housing provided for them

ily assess the value of a parsonage without any objective standard.”

Even as costs escalated and the IRS offered to settle if Warren would drop the case, Warren wrote that he felt he needed to stay in the fight as a matter of principle. “My father and Kay’s [his wife] father were pastors of small churches, and we both spent time living in a parsonage growing up. Our parents could not have served these small churches without the help of a parsonage allowance.”

Warren’s point is well taken. Warren’s relatively large pastoral salary and healthy outside income tend to detract from what is at stake for most pastors and churches. The average Protestant church in the United States has less than 150 members. In 2001, according to the pastoral compensation report issued by the Covenant Church (which

stantial housing allowance. I could not pastor here without it.”

Chemerinsky argues this is precisely why the Establishment Clause is being violated. “The more someone says that getting rid of this will affect them,” Chemerinsky told the *LA Times*, “the more proof there is that the government is subsidizing them.”

The Beckett Fund disagrees. In their brief, they quote the Supreme Court in saying, “for the men who wrote the Religion Clauses of the First Amendment the ‘establishment’ of a religion connoted sponsorship, financial support, and active involvement of the sovereign in religious activity. . . . Tax exemptions and general subsidies, however, are qualitatively different. Though both provide economic assistance, they do so in fundamentally different ways. A subsidy involves the direct transfer

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at the convenience of the employer—such as the live-in staff at colleges and universities—do not pay income taxes on the value of their housing. The theory is that these employees are required as part of their job responsibilities to be available at all times.

Support for the constitutionality of the housing allowance is based on the convenience of the employer doctrine.

The Beckett Fund for Religious Liberty, a bipartisan, ecumenical, public-interest law firm that protects the free expression of all religious traditions filed an *amicus curiae* (literally “friend of the court”) brief in support of the constitutionality of the housing allowance. In the brief, the Beckett Fund argued that the exemption was constitutional, saying that “ministers fall within the general class of employees who are expected as part of their job duties to make the home paid for by their employer available to serve the needs of their employer.”

In a lengthy letter sent to pastors, Warren indicated that he felt called “to challenge the vagueness of the revenue ruling that allowed agents to arbitrar-

ily assess the value of a parsonage without any objective standard.”

included data from twenty-four denominations), the median salary for a minister was \$42,700.

“The loss of the housing allowance exemption would have a broad impact in the Covenant. Every pastor would feel a significant pinch,” says Kersten.

IRS Publication 517, “Social Security and Other Information for Members of the Clergy and Religious Workers,” provides a sample tax return for a pastor. When the sample is adjusted to remove the housing allowance, the tax liability increases from \$1,961 to \$3,064. The amount of refund decreases from \$1,038 to \$65. If the housing allowance is eliminated, churches will need to increase compensation to their pastors just to keep them at the same after-tax income level. For many churches, that would be difficult.

“Eliminating the clergy housing allowance would be a severe blow,” says Nelson. “Churches would have to cut back on ministry expenses to increase salary packages. Service would become financially burdensome for pastors. The church I serve now does not own a parsonage. Instead, they give us a sub-

stantial housing allowance. I could not pastor here without it.”

of public monies to the subsidized enterprise and uses resources exacted from taxpayers as a whole. An exemption, on the other hand, involves no such transfer.”

The Justice Department, on behalf of the IRS, and lawyers for Warren agreed to drop the case and asked the Ninth Circuit Court to dismiss it. But at the time the *Companion* went to press, the Ninth Circuit had not dismissed the case, and could still rule on the case if they decide the legal issue is important enough. The situation is further complicated by the fact that Chemerinsky has filed a motion on behalf of himself as a taxpayer, challenging the constitutionality of the housing allowance.

“I would like to see the court reach the constitutional question,” Chemerinsky told *The Wall Street Journal*. A decision on his motion is pending.

Kersten predicts that the housing allowance will be ruled constitutional. “I think in the end the housing allowance exemption will be protected,” he says.

A lot of churches—and pastors—are hoping he is right. □