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Parsonage Exclusion Found by Seventh Circuit to Be Constitutional

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On March 15, 2019, the U.S. Court of Appeals for the Seventh Circuit held in Gaylor v. Mnuchin that the tax exemption for "ministers of the gospel" (defined below) under Section 107(2) of the Internal Revenue Code (the "Code") does not violate the Establishment Clause[1] of the First Amendment and, therefore, is constitutional, overruling the district court decision.[2]

In *Gaylor*, the Freedom From Religion Foundation (the "FFRF")[3] sued the Treasury Department after the Internal Revenue Service (the "IRS") denied the refund claims of FFRF's co-presidents who sought to exclude the portion of their salaries paid in the form of a housing allowance. The central issue in the case on appeal was whether the district court was correct in holding that the exclusion for housing allowances under Section 107(2) is a law "respecting an establishment of religion."

Overview of Section 107

Section 107, commonly referred to as the "parsonage exclusion," excludes from gross income housing furnished to a "minister of the gospel" (or, "minister") as part of his or her compensation. For the purposes of this Code section, a "minister of the gospel" is "a duly ordained, commissioned, or licensed minister of a church or a member of a religious order"[4] and applies to religious leaders of any denomination.[5] The housing may be provided in kind under Section 107(1), in which case the rental value of the home including utilities are excluded,[6] or in the form of an allowance under Section 107(2), in which case the allowance is excluded to the extent it is considered "reasonable compensation" for the minister's services[7] and is actually used in the taxable year in which it is received to pay for rent, the purchase of a home or expenses directly related to providing a home.[8] A cap on the exclusion under Section 107(2) equal to the fair rental value of a home, including furnishings, appurtenances and utilities, was added by Congress in response to constitutional concerns over the holding in *Warren v. Commissioner*, where the Tax Court determined that the language of the statute did not impose any such restriction.[9]

Consistent with exemptions under the "convenience-of-the-employer" doctrine for secular employees

whose jobs have housing requirements, Congress enacted Section 107 to provide a housing exemption for ministers whose homes are often used as part of, or located in a certain area for, their ministry. While Section 107(1) was generally accepted by the FFRF to put ministers on equal footing as other employees who may exclude certain employer provided in kind housing under Section 119(a)(2),[10] the FFRF argued that the exemption under Section 107(2) for housing allowances is "different" and "better" than those for secular employees under the Code. Section 107(2) differs primarily from Section 119(a)(2) in that it excludes housing allowances as well as in kind housing and it does not require ministers to use their homes as a part of their ministry or to live in certain proximity to their "work" (i.e., their congregation).

Exclusion under Section 107(2) Found Constitutional

The court found that Section 107(2) does not violate the Establishment Clause as it has a secular legislative purpose, its principal effect is neither to endorse nor to inhibit religion and it does not cause excessive government entanglement.[11] The court additionally analyzed whether Section 107(2) is consistent with the "historical practices and understandings" of the Establishment Clause, following the mandate of *Town of Greece v. Galloway*.[12]

Although the primary housing exclusion provided under Section 119(a)(2) only excludes in kind housing, the court noted that there are "myriad" provisions in the Code that provide in cash and in kind housing exemptions for various categories of employees[13] and that limiting the parsonage exclusion to in kind housing tended to discriminate against ministers of smaller or poorer denominations.[14] Furthermore, Section 107(2) was found to avoid "excessive entanglement" with religion that would result if the IRS needed to inquire into the use of a minister's home and what activities constitute "worship." Although the IRS nonetheless must determine who qualifies as a "minister of the gospel" under Section 107,[15] the court reasoned that it involves less entanglement than the alternative of applying the requirements of Section 119(a)(2), which would force the IRS to determine what the "business" of a church is and how far the "premises" of the church extend.

Notably in determining whether Section 107(2) has the primary effect of advancing or inhibiting religion, the court declined to apply Justice Brennan's plurality opinion in *Texas Monthly* that a tax exemption for religious publications violated the Establishment Clause because "[e]very tax exemption constitutes a subsidy that affects nonqualifying taxpayers,"[16] concluding that the Brennan plurality opinion was not binding under the *Marks* test.[17] As the *Texas Monthly* plurality was not binding, the court felt bound by *Walz* and *Amos* to conclude that tax exemptions do not constitute sponsorship of a religion.[18]

Turning to the historical significance test of *Town of Greece*, the court also found that Section 107(2) is constitutional because of the tradition throughout American history to provide tax exemptions for religion, particularly for church-owned properties. In other words, a tax exemption for parsonage is not what has been historically understood as constituting an "establishment of religion" and therefore is not a violation of the Establishment Clause.[19] The court dismissed both the district court's finding that Section 107(2) is distinguishable from historical tax exemptions for religion since it is an income and not a property tax exemption, and the position of FFRF that a historical analysis of the Establishment Clause is only applicable when determining the constitutionality of legislative prayer.

Future of Section 107(2)

The ruling by the Seventh Circuit in *Gaylor v. Mnuchin* does not necessarily settle the constitutionality of Section 107(2). Whether the FFRF will appeal the case or whether the Supreme Court will review it

is uncertain.

[1] The Establishment Clause of the First Amendment states that “Congress shall make no law respecting an establishment of religion,” U.S. Const. amend. I, and has been held to not only forbid Congress from establishing a state religion but also to limit the government’s ability to “favor one faith over another” or to show “adherence to religion generally,” *McCreary County v. ACLU*, 545 U.S. 844 (2005), and thus to generally obligate “governmental neutrality between religion and religion, and between religion and nonreligion,” *Epperson v. Arkansas*, 393 U.S. 97, 104 (1968).

[2] *Gaylor v. Mnuchin*, 278 F. Supp. 3d 1081 (W.D. Wis. 2017).

[3] The FFRF is a non-profit educational organization under Section 501(c)(3) of the Code that promotes “the constitutional principle of separation of state and church” and “educate[s] the public on matters relating to nontheism.” *What is the Foundation’s Purpose*?, Freedom From Religion Foundation, https://ffrf.org/faq/item/14999-what-is-the-foundations-purpose (last visited March 28, 2019).

[4] Treas. Reg. Section 1.1402(c)-5(a)(1).

[5] *See, e.g., Salkov v. Comm’r*, 46 T.C. 190 (1996) (holding that a Jewish cantor was a “minister of the gospel”).

[6] Treas. Reg. Section 1.107-1(a).

[7] *See* Rev. Rul. 78-448 (rental allowance cannot exceed reasonable compensation for services where the minister performs only occasional and insubstantial services for a church).

[8] *See* Treas. Reg. Section 1.107-1(c).

[9] *See* Pub. L. No. 107-181, § 2(a), 116 Stat. 583 (2002); *Warren v. Commissioner*, 114 T.C. 343 (2000), *appeal dismissed*, 302 F3d 1012 (9th Cir. 2002). In *Warren*, the IRS challenged the position of Richard Warren, a minister of the gospel within the meaning of Section 107, that the exclusion under Section 107(2) was not limited to the fair rental value of a home. Concerns that the Tax Court’s broad interpretation of Section 107(2) in its holding for Warren violated the Establishment Clause prompted Congress to add the fair rental value cap in 2002. This legislative change made the government’s appeal of the case moot, and the appeal was dismissed by the Ninth Circuit accordingly.

[10] Section 119(a)(2) exempts in kind lodging that an employee must accept as a condition of employment and that is furnished on the business premises of, and is for the convenience of, the employer. Treas. Reg. Section 1.119-1(b).

[11] The aforementioned conclusions are based off of the “Lemon” test, first articulated in *Lemon v. Kurtzman*, 403 U.S. 602 (1971). Lower courts have generally applied the Lemon test, amongst other tests, when analyzing an Establishment Clause question, although there are some doubts about its

continuing vitality.

[12] 572 U.S. 565, 576 (2014).

[13] *See, e.g.*, Section 162 (housing provided to an employee away on business for less than a year); Section 134 (housing provided to current or former members of the military); Section 912 (housing provided to government employees living abroad).

[14] *See, e.g., Larson v. Valente*, 456 U.S. 228, 244 (1982).

[15] Even so, the IRS has specifically said it will not issue rulings or determination letters regarding whether an individual is a "minister of the gospel" for Federal tax purposes. *See* Rev. Proc. 2019-3.

[16] *Texas Monthly, Inc. v. Bullock*, 489 U.S. 1, 14 (1989) (Brennan J., plurality opinion).

[17] The *Marks* test references *Marks v. United States*, which held that when "a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of five Justices, the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds." 430 U.S. 188, 193 (1977).

[18] *See Walz v. Tax Comm. Of City of N.Y.*, 397 U.S. 664, 675 (1970) ("The grant of a tax exemption is not sponsorship since the government does not transfer part of its revenue to churches but simply abstains from demanding that the church support the state."); *Corp. of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v. Amos*, 483 U.S. 327, 337 (1987) ("We do not see how any advancement of religion achieved by the [exempt religious organization] can be fairly attributed to the Government, as opposed to the Church.").

[19] This "historical significance" test developed under *Town of Greece v. Galloway*, 572 U.S. 565 (2014) and requires that the Establishment Clause be interpreted "by reference to historical practices and understandings."

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