

# No Taxation With Religious Invocation: Seventh Circuit's Decision to Impact Ministerial Employees

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In *Gaylor v. Mnuchin*, the Seventh Circuit Court of Appeals recently held that a tax code exemption for religious housing of ministers does not violate the Establishment Clause of the First Amendment of the U.S. Constitution. The decision has a direct impact on religious employers and their ministerial employees as well as a potential impact on secular employers that provide housing allowances for their employees.

The Freedom From Religion Foundation (FFRF) and several of its employees sued the secretary of the U.S. Department of the Treasury, the acting commissioner of the Internal Revenue Service (IRS), and the United States, challenging the constitutionality of 26 U.S.C. §107(2) of the Internal Revenue Code. This provision excludes the rental allowance paid to ministers as part of their compensation from their taxable income, to the extent it is used to rent or provide a home.

The U.S. District Court for the Western District of Wisconsin granted summary judgment in favor of FFRF and its employees, holding that §107(2) violated the Establishment Clause, which states that "Congress shall make no law respecting an establishment of religion." The U.S. Department of the Treasury and several intervening religious organizations appealed the district court's decision.

On appeal, the Seventh Circuit first determined that the FFRF's employees had standing and the FFRF had organizational standing. It then analyzed whether §107(2) violates the Establishment Clause under two tests developed by the Supreme Court of the United States: the three-factor test from *Lemon v. Kurtzman*, and the "historical significance" test from *Town of Greece v. Galloway*. The Seventh Circuit held that the statute satisfies both tests.

## ***Lemon* Test**

Under *Lemon*, to pass muster under the First Amendment:

1. a law must have a secular legislative purpose;
2. its principal or primary effect must be one that neither advances nor inhibits religion; and
3. the law must not cause excessive government entanglement with religion.

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## I. Secular Legislative Purpose

For the first *Lemon* factor, the appellants in *Mnuchin* argued that the statute has three secular legislative purposes:

### 1. *Eliminating discrimination against ministers*

According to the appellants, the exemption eliminated discrimination against ministers by affording them the same benefit as non-religious employees receiving a similar tax exemption. When Congress first imposed a federal income tax in the early 1900s, Congress and the Treasury Department excluded housing provided to employees if given: (1) by an employer to an employee, (2) in kind, (3) on the employer's business premises, (4) for the convenience of the employer, and (5) as a condition of employment. This convenience-of-the-employer exemption, however, was not made available to ministers. After the Treasury Department announced that ministers would be taxed on the rental value of their living quarters, Congress enacted a statute to exclude church-provided living quarters from the taxable income of ministers. Thus, the exemption was made available to ministers to give them the same benefits that secular employees received under the doctrine.

According to the court, §107(2) bypasses the proof requirements of the convenience-of-the-employer doctrine, obviating the need for ministers and the IRS to engage in the doctrine's fact-intensive analysis. Despite the FFRF's and its employees' claim that §107(2) puts ministers in a better position than secular employees, the court noted that the Internal Revenue Code has relaxed the proof requirements of the convenience-of-the-employer doctrine for other employees, including certain teachers and university employees, members of the military, and government employees living abroad.

### 2. *Eliminating discrimination between ministers*

The second secular purpose offered by the Treasury Department was elimination of discrimination between ministers. As originally enacted, the tax exemption applied only to ministers given in-kind housing, which had the effect of discriminating against ministers of smaller or poorer denominations. Thus, §107(2) eliminated this discrimination by excluding from ministers' taxable income the rental allowance paid to them.

### 3. *Avoiding excessive entanglement with religion*

The third question under the *Lemon* test is whether the statute creates "excessive government entanglement with religion." As discussed above under the first *Lemon* prong, even though §107(2) entails some interaction between church and state, the Seventh Circuit agreed with the government that application of §107(2) prevents the more intrusive inquiry necessary under the convenience-of-the-employer doctrine.

## Historical Significance Test

The historical significance test mandates that an analysis under the Establishment Clause reference historical practices and understandings and acknowledge any "practice that was accepted by the

Framers and has withstood the critical scrutiny of time and political change.” The court noted that there is a tradition of religious tax exemptions dating back to the 1800s, especially for church-owned properties, which continues today with more than 2,500 federal and state religious tax exemptions. The Seventh Circuit, therefore, held that the statute passed the historical significance test.

## Key Takeaways

This ruling is a win for religious organizations, many of which intervened and argued that it would be difficult for them to survive without the exemption. Many religious employers, including churches, church-affiliated organizations, and parochial schools, provide housing allowances to ministerial employees as a substantial part of their incomes. Without the tax advantages that these housing allowances offer, many religious organizations would be hard-pressed to keep their staff members and/or to generate additional funds to compensate their employees.

The *Gay/lor* decision also has some potential spillover effect on secular organizations that provide similar housing allowances to their employees. As noted by the Seventh Circuit, the housing allowance for ministerial employees was intended to put them on equal footing with similarly situated secular employees. Removal of the allowance for ministerial employees could lead to legislative efforts to level the playing field and result in increased scrutiny of these exemptions in general.

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