

From Warren To New Law

The IRS's theory is that the housing allowance exclusion under Internal Revenue Code Sec. 107(2) was adopted in the 1950s to level the playing field for ministers who served a church that did not have a parsonage. Code Sec. 107(1), which has been in the Code since the 1920s, provides that the value of living in a parsonage is not taxable income to the minister who receives the benefit of the free housing. Since the value of a year of living in housing that the minister does not own is equivalent to the fair rental value of the parsonage, the IRS limited the housing allowance under 107(2) to fair rental value. The idea was to make the tax exclusion for a minister's owned home equivalent to the value of the parsonage, so that Code Sec. 107(1) and 107(2) would be equivalent or nearly so.

Rev. Warren claimed more than the fair rental value of his home as a housing allowance in the three years (1993-95) at issue in his case. In some years the allowance declared by his church limited his exclusion and in some years his actual expenses limited his exclusion. The IRS disallowed his exclusion to the extent it exceeded the fair rental value of his home as determined by the IRS. Rev. Warren challenged the IRS in Tax Court and won by a vote of 14-3 among the 17 Tax Court judges. The Tax Court ruled that the IRS's third limit (the fair rental value) was not supported by the Internal Revenue Code. This is the result that many clergypersons believe is the proper interpretation of the Code.

Unfortunately, the IRS did not agree. So they appealed to the Court of Appeals for the 9th Circuit (covering the states West of the Rockies, including California, where Rev. Warren lives). In the 9th Circuit the case took a turn for the worse. Two of the three judges hearing the appeal asked the parties to brief the question of whether the housing allowance under Code Sec. 107(2) is unconstitutional under the First Amendment's requirement that Congress shall make no law respecting the establishment of religion. Thankfully, both the IRS and Rev. Warren told the 9th Circuit that the issue in the case did not involve the U.S. Constitution. At that point we all thought that the unconstitutionality issue would fade away. Sadly, the Court did not give up. They appointed a law professor from the University of Southern California to brief the unconstitutionality issue so that they could consider it as part of the Warren decision.

At this point the Church Alliance decided to become more actively involved in the case. The Church Alliance is an information exchange and lobbying group representing the pension boards of most major denominations. The Church Alliance believed that the judges of the 9th Circuit who heard the Warren case would have voted 2-1 in favor of unconstitutionality, based on their actions, their opinions in decisions in the case, and their records. Therefore, the

Church Alliance undertook two responses. First, the Alliance commissioned a counter-brief that argued in favor of the constitutionality of Code Sec. 107(2).

Second, the Alliance decided to try to promote a settlement between the IRS and Rev. Warren so that the case could be withdrawn from the 9th Circuit before the Court could issue a ruling that 107(2) is unconstitutional. They communicated with the IRS and were advised that, although the IRS was sympathetic on the constitutionality issue, they did not want the Tax Court decision striking down the fair rental value limitation to be allowed to stand. The Alliance decided it could not leave it to the 9th Circuit to uphold the IRS for the reasons described above, so they decided to go to Congress. The Alliance supported legislation embodied in H.R. 4156 that would reinstate the IRS's fair market value limitation. That legislation passed the House and Senate and was signed into law by President Bush.

The Church Alliance understands that supporting this legislation limits the housing allowance exclusion (prospectively only) that clergy have been allowed to take after the Warren Tax Court case. With the passage of this legislation, the IRS will be free to withdraw the Warren case from the 9th Circuit before the 9th Circuit rules on the constitutionality of Code Sec. 109(2). On the theory that 3/4 of a loaf is better than none, the Church Alliance is giving up a little to preserve the housing allowance from a probable "unconstitutional" decision that could eliminate it completely. If the 9th Circuit or the U.S. Supreme Court were to rule Code Sec. 107(2) unconstitutional (and there are those who think that such a holding would immediately or eventually extend also to 107(1)), it would be too late for a legislative "fix." The only legislative solution to a court determination of unconstitutionality is to amend the U.S. Constitution, which is extraordinarily difficult to do.

The Church Alliance also understands that the maneuver to withdraw the Warren case from the 9th Circuit before a decision will not necessarily stop another case from arising that also challenges the constitutionality of the housing allowance exclusion.