The I.R.C. Section 107 “Parsonage Allowance”

And Joseph made it a law over the land of Egypt unto this day, that Pharaoh should have the fifth part, except the land of the priests only, which became not Pharaoh's.

Genesis 47:26 KJV

The above Old Testament passage is evidence that religious exemptions from taxation are of ancient origin.

In 1970, the United States Supreme Court discussed the historical precedent of religious exemption from taxation in America:

*History is particularly compelling in the present case because of the undeviating acceptance given religious tax exemptions from our earliest days as a Nation.*

Rarely if ever has this Court considered the constitutionality of a practice for which the historical support is so overwhelming.

*The Establishment Clause, along with the other provisions of the Bill of Rights, was ratified by the States in 1791.*

Religious tax exemptions were not an issue

- in the petitions calling for the Bill of Rights,
- in the pertinent congressional debates,
  or
- in the debates preceding ratification by the States.

1 The absence of concern about the exemptions could not have resulted from failure to foresee the possibility of their existence, for they were widespread during colonial days.

2 Rather, it seems clear that the exemptions were not among the evils that the Framers and Ratifiers of the Establishment Clause sought to avoid.

Significantly, within a decade after ratification, at least four States passed statutes exempting the property of religious organizations from taxation. ³

[footnote 3] The support of religion with direct allocation of public revenue was a common colonial practice.

[footnote 4] Following passage of the Sixteenth Amendment, federal income tax acts have consistently exempted corporations and associations, organized and operated exclusively for religious purposes . . ., from payment of the tax. . . .

WALZ v. TAX COMMISSION OF CITY OF NEW YORK, 397 U.S. 664, 681 (1970)

Gross Income - I.R.C. § 61(a)

Internal Revenue Code (I.R.C.) § 61(a) broadly defines gross income as:

"all income from whatever source derived."

Therefore, absent a statutory exclusion, any:

- "in-kind" housing,
  or
- cash payment made in lieu thereof,

provided to ministers by a church would be subject to income taxation.

I.R.C. § 107 Exclusion

The taxability of the income of duly qualified church ministers is subject to certain exclusions, such as those found in I.R.C. § 107 - commonly known as the "Parsonage Allowance" - which provides as follows:

Sec. 107. Rental value of parsonages

In the case of a minister of the gospel, gross income does not include -

(1) the rental value of a home furnished to him as part of his compensation;

or

(2) the rental allowance paid to him as part of his compensation,

- to the extent used by him to rent or provide a home
  and
- to the extent such allowance does not exceed
• the fair rental value of the home, including furnishings and appurtenances such as a garage,
• plus the cost of utilities.

Notwithstanding the use in I.R.C. § 107 of the terms:

• “minister” - a generic reference to a clergy member in the Christian religion, and
• “gospel” - a term in the Christian religion referring to certain “good news” which is preached to its adherents,

and the male gender references therein, the application of I.R.C. § 107 is broadly extended by both the courts and the Internal Revenue Service to duly qualified officials of either gender, in a variety of different religions practiced in this country.

Revenue Act of 1921

The Parsonage Allowance was first codified in the United States Income Tax Code in Section 213(b)(11) of the Revenue Act of 1921, which granted an income exclusion for:

"[t]he rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation."


As originally enacted, the exclusion:

• applied only to in-kind housing provided to ministers of the gospel,
• but not to any cash allowances that such a minister may have received for other housing expenses.

The legislative rationale for the exclusion from gross income identified in the Revenue Act of 1921 was not identified, and has been described by the IRS in Driscoll v. Commissioner as being "obscure":

• The Senate Committee Report relating to the Revenue Act of 1921 failed to mention any such “Parsonage Allowance”,
• and
• the House Conference Report relating thereto indicated only that the House had accepted the Senate version of the bill with a "clerical change" amendment - not otherwise specified.
It has been suggested that such an **in-kind exclusion** was based upon:

"*the general respect held by Congress and the public for churches,*

as well as

"*Congress's tendency to benefit favored entities.*"

*Id.*

Unlike certain provisions found in the current Internal Revenue Code, there was no general exclusion for employer-provided housing in the **Revenue Act of 1921**.

**Revenue Acts of 1928 and 1932; Internal Revenue Code of 1939**

A "**Parsonage Allowance**" identical to that appearing in Section 213(b)(11) of the **Revenue Act of 1921** was also identified in:

- Section 22(b)(8) of the **Revenue Act of 1928,**
- Section 22(b)(6) of the **Revenue Act of 1932,**
  and
- Section 22(b)(6) of the **Internal Revenue Code of 1939.**

*See Driscoll v. Commissioner, 135 T.C. No. 27, Page 8, Note 6; 135 T.C. 557, 563-564 (2010), Note 6, citing S. Rep. No. 275 at 14 (1921); H.R. Conf. Rep. No. 486 at 23 (1921).*

**Internal Revenue Code of 1954**

In 1954, Congress re-codified the “**Parsonage Allowance**” income exclusion as **I.R.C. § 107(1),** but:

- changed the phrase "*a dwelling house . . .*", to "*a home,*"
  and
- added the “**rental allowance**” provision currently found in **I.R.C. § 107(2),** which granted **ministers of the gospel** an income exclusion for the:

  "*rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home.*"
Congressional legislative reports relating to the Internal Revenue Code of 1954 identified that:

The word "home" as used in both paragraphs [sec. 107(1) and (2)] is not intended to change the law under section 22(b)(6) of the code [sic] of 1939 which used the term "dwelling house and appurtenances thereof."

Therefore, in changing the phrase "a dwelling house and appurtenances thereof" to "a home", Congress did not intend any change in the extent of the exclusion.

Congressional legislative reports relating to the Internal Revenue Code of 1954 also identified that Congress expanded the Parsonage Allowance in § 107(2) of the 1954 Code, in order to rectify:

"the discrimination in existing law by providing that the present exclusion is to apply to rental allowances paid to ministers to the extent used by them to rent or provide a home."

Certain religion organizations only provided in-kind housing to its officials, while others provided cash payments in lieu of in-kind housing.

Congressional legislative reports relating to the Internal Revenue Code of 1954 identified such "discrimination in existing law":

Under present law, the rental value of a home furnished a minister of the gospel as a part of his salary is not included in his gross income.

This is unfair to those ministers

- who are not furnished a parsonage,
- but who receive larger salaries (which are taxable) to compensate them for expenses they incur in supplying their own home.
In expanding the Parsonage Allowance in § 107(2) of the 1954 Code to exclude from income a rental allowance paid to a minister as part of his compensation, Congress emphasized that the term "home" would not extend to a situation where a minister:

- in addition to a home,
- rents, purchases, or owns a farm or other business property,

by adding the following phrase at the end of § 107(2):

"to the extent used by him to rent or provide a home."

The provision prohibits the Parsonage Allowance from extending to any portion of a rental allowance paid to a minister which is used for expenses relating to a farm, or other business property.

United States Treasury Income Tax Regulations

Income Tax Regulations § 1.107-1 Rental Value of Parsonages

In November of 1960, the Internal Revenue Service adopted Treasury Regulation § 1.107-1, which was amended in December of 1963, to provide:

- additional requirements,
- and
- certain guidance,

with respect to the Parsonage Allowance.

Treasury Regulation § 1.107-1(a) restates the general rule of IRC § 107, with a few clarifications, by providing in part as follows:

\[(a) \text{ In the case of a minister of the gospel, gross income does not include}
\]

\[(1) \text{ the rental value of a home, including utilities, furnished to him as a part of his compensation, or}
\]

\[(2) \text{ the rental allowance paid to him as part of his compensation to the extent such allowance is used by him to rent or otherwise provide a home.}
\]
In order to qualify for the exclusion, the home or rental allowance must be provided as remuneration for services which are ordinarily the duties of a minister of the gospel.

Treasury Regulation § 1.107-1(a) also:
- incorporates by reference,
- and
- makes applicable to the Parsonage Allowance determination,

the requirements identified in Treasury Regulation §1.1402(c)-5, by providing as follows:

In general, the rules provided in §1.1402(c)-5 will be applicable to such determination.

Duties of a Minister

Treasury Regulation § 1.107-1(a) provides some guidance with respect to the qualifications of a "minister of the gospel" under IRC § 107, by providing in part as follows:

Examples of specific services the performance of which will be considered duties of a minister for purposes of section 107 include
- the performance of sacerdotal functions,
- the conduct of religious worship,
- the administration and maintenance of religious organizations and their integral agencies,
  and
- the performance of teaching and administrative duties at theological seminaries.

Home - Defined

Treasury Regulation § 1.107-1(b) provides a definition of a "home" under IRC § 107, by providing in part as follows:

(b) For purposes of section 107, the term "home" means
- a dwelling place (including furnishings)
  and
- the appurtenances thereto, such as a garage.
Rental Allowance - Prior Approval

Treasury Regulation § 1.107-1(b) provides a definition of a “rental allowance” under IRC § 107, by providing in part as follows:

*The term “rental allowance” means an amount paid to a minister to*

- rent
  - or
- otherwise provide a home . . .

*if such amount*

- *is designated as rental allowance*
- *pursuant to official action taken in advance of such payment by the employing church or other qualified organization . . . .

Evidentiary Requirement

Treasury Regulation § 1.107-1(b) identifies the requirements with respect to the “designation of an amount as rental allowance” under IRC § 107, by providing in part as follows:

*The designation of an amount as rental allowance may be evidenced*

- *in an employment contract,*
- *in minutes of or in a resolution by a church or other qualified organization* or
- *in its budget,* or
- *in any other appropriate instrument evidencing such official action.*

*The designation referred to in this paragraph is a sufficient designation if it permits a payment or a part thereof to be identified*

- *as a payment of rental allowance*
- *as distinguished from salary or other remuneration.*
Amount Includable in Gross Income

Treasury Regulation § 1.107-1(c) subjects to taxation under IRC § 107 any *rental allowance* to the extent that it is not used to either rent, or purchase, a home, by providing in part as follows:

\[(c)\] A rental allowance must be included in the minister's gross income in the taxable year in which it is received, to the extent that such allowance is not used by him during such taxable year to rent or otherwise provide a home.

Circumstances under which a rental allowance will be deemed to have been used to rent or provide a home will include cases in which the allowance is expended

\[(1)\] for rent of a home,

\[(2)\] for purchase of a home,

and

\[(3)\] for expenses directly related to providing a home.

Expenses for food and servants are not considered for this purpose to be directly related to providing a home.

Farms and Business Property Not Qualified

Treasury Regulation § 1.107-1(c) denies the *Parsonage Allowance* with respect to that part of a *rental allowance* used for expenses relating to a farm or other business property, by providing in part as follows:

Where the minister rents, purchases, or owns a farm or other business property in addition to a home, the portion of the rental allowance expended in connection with the farm or business property shall not be excluded from his gross income.

Income Tax Regulations § 1.1402(c)-5 Ministers

In December of 1963, the Internal Revenue Service adopted Treasury Regulation § 1.1402(c)-5, which was amended in October of 1968, in order to:

\* specify certain requirements with respect to self-employment taxes for ministers, and

\* provide certain guidance with respect to the *Parsonage Allowance*. 
Ministers of the Gospel

Treasury Regulation § 1.1402(c)-5(a)(2) identified that a minister of the gospel is engaged in a trade or business with respect to services performed in the exercise of his or her ministry, by providing in part as follows:

For any taxable year ending after 1967, a duly

- ordained,
- commissioned,

or

- licensed

minister of a church . . . is engaged in carrying on a trade or business with respect to service performed by him in the exercise of his ministry . . . unless an exemption under section 1402(e)

(see §§1.1402(e)-1A through 1.1402(e)-4A)

is effective with respect to such individual for the taxable year during which the service is performed.

The Internal Revenue Service appears to be using a bifurcated qualification test:

- ordained,
  and

- commissioned, or licensed,

in determining whether a taxpayer qualifies for the Parsonage Allowance as a minister of the gospel.

Of the three qualifications, ordination is often given the greatest weight by the IRS - since ordination usually involves the highest level of qualification and recognition of a religious leader by a church or other religious organization.

Nevertheless:

- taxpayers may qualify for the Parsonage Allowance based upon their status as a commissioned, or licensed religious official,
- but may be subject to greater scrutiny by the IRS than taxpayers that are “ordained”.

Page 10 of IRS Publication 15-A; Employer’s Supplemental Tax Guide (January 31, 2012), provides the following definition of “Ministers”:
Ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination.

They are given the authority to conduct religious worship, perform sacerdotal functions, and administer ordinances and sacraments according to the prescribed tenets and practices of that religious organization.

In the same manner, Page 3 of IRS Publication 517 - Social Security and Other Information for Members of the Clergy and Religious Workers (February 24, 2012), provides the following definition of "Ministers":

Ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination.

They are given the authority to conduct religious worship, perform sacerdotal functions, and administer ordinances and sacraments according to the prescribed tenets and practices of that religious organization.

If a church or denomination ordains some ministers and licenses or commissions others, anyone licensed or commissioned must be able to perform substantially all the religious functions of an ordained minister to be treated as a minister for social security purposes.

Page 4 of IRS Publication 517 - Social Security and Other Information for Members of the Clergy and Religious Workers (February 24, 2012), provides the following definition of "Ministerial Services":

Ministerial service, in general, is the service you perform in the exercise of your ministry. . . . Most services you perform as a minister . . . are ministerial services.

These services include: performing sacerdotal functions, conducting religious worship, and controlling, conducting, and maintaining religious organizations . . . that are under the authority of the religious body that is a church or denomination.

Page 8 of IRS Publication 517 - Social Security and Other Information for Members of the Clergy and Religious Workers (February 24, 2012) provides additional requirements in order to enjoy the benefits of the Parsonage Allowance:

Ordained, commissioned, or licensed ministers of the gospel may be able to exclude from income tax the rental allowance or fair rental value of a Parsonage as provided to them as pay for their services.

Services include ministerial services, . . .
Examples: Ministry Service

Treasury Regulation § 1.1402(c)-5(b)(2) identifies certain examples of services which constitute the *exercise of a ministry*, by providing in part as follows:

(2) Except as provided in paragraph (c)(3) of this section, service performed by a minister in the *exercise of his ministry* includes

- the *ministration of sacerdotal functions*
  and

- the *conduct of religious worship*.
  and

- the *control, conduct, and maintenance of religious organizations* (including the religious boards, societies, and other integral agencies of such organizations),

  under the authority of a religious body constituting a church or church denomination.

Factors

Treasury Regulation § 1.1402(c)-5(b)(2) identifies certain factors which should be taken into consideration in any determination with respect to the *exercise of a ministry*, by providing in part as follows:

*The following rules are applicable in determining whether services performed by a minister are performed in the exercise of his ministry:*

(i) Whether service performed by a minister constitutes

- the *conduct of religious worship*

  or

- the *ministration of sacerdotal functions*

  depends on the tenets and practices of the particular religious body constituting his church or church denomination.

(ii) Service performed by a minister in the *control, conduct, and maintenance* of a religious organization relates to directing, managing, or promoting the activities of such organization.

*Any religious organization is deemed to be under the authority of a religious body constituting a church or church denomination if*
The I.R.C. Section 107 "Parsonage Allowance"
Gary C. Dahle, Attorney at Law - Copyright 2013, all Rights Reserved

- it is organized and dedicated to carrying out the tenets and principles of a faith
- in accordance with either the requirements or sanctions governing the creation of institutions of the faith.

The term "religious organization" has the same meaning and application as is given to the term for income tax purposes.

Treasury Regulation § 1.1402(c)-5(b) provides a number of examples of the exercise of a ministry by a duly ordained minister, primarily for the purpose of identifying which of such services will be subject to the self-employment tax.

However, such examples apparently may also be used with respect to determining a taxpayer’s eligibility for the Parsonage Allowance.

**Religious Worship and Sacerdotal Function**

Treasury Regulation § 1.1402(c)-5(b)(2) identifies certain examples of services which constitute the exercise of a ministry, by providing in part as follows:

(iii) If a minister is performing service in

- the conduct of religious worship
  
  or

- the ministration of sacerdotal functions,

such service is in the exercise of his ministry whether or not it is performed for a religious organization.

The application of this rule may be illustrated by the following example:

M, a duly ordained minister, is engaged to perform service as chaplain at N University.

M devotes his entire time to performing his duties as chaplain which include

- the conduct of religious worship,

- offering spiritual counsel to the university students,

  and

- teaching a class in religion.

M is performing service in the exercise of his ministry.
Services for Internal Agencies

(iv) If a minister is performing service for an organization which is operated as an integral agency of a religious organization under the authority of a religious body constituting a church or church denomination, all service performed by the minister

- in the conduct of religious worship,
- in the ministration of sacerdotal functions,
- or
- in the control, conduct, and maintenance of such organization (see subparagraph (2)(ii) of this paragraph)

is in the exercise of his ministry.

The application of this rule may be illustrated by the following example:

M, a duly ordained minister, is engaged by the N Religious Board to serve as director of one of its departments.

He performs no other service.

The N Religious Board is an integral agency of O, a religious organization operating under the authority of a religious body constituting a church denomination.

M is performing service in the exercise of his ministry.

Delegated Assignment to a Secular Body

(v) If a minister, pursuant to an assignment or designation by a religious body constituting his church, performs service for an organization which is neither

- a religious organization
- nor operated as an integral agency of a religious organization,

all service performed by him, even though such service may not involve the conduct of religious worship or the ministration of sacerdotal functions, is in the exercise of his ministry.

The application of this rule may be illustrated by the following example:

M, a duly ordained minister, is assigned by X, the religious body constituting his church, to perform advisory service to Y Company in connection with the publication of a book dealing with the history of M's church denomination.

Y is neither a religious organization nor operated as an integral agency of a religious organization.
M performs no other service for X or Y.

M is performing service in the exercise of his ministry.

Service by a Minister not in the exercise of his ministry.

Treasury Regulation § 1.1402(c)-5(c) identifies certain examples of services which do not constitute the exercise of a ministry, by providing in part as follows:

(2) If a minister
• is performing service for an organization which is neither a religious organization nor operated as an integral agency of a religious organization and
• the service is not performed pursuant to an assignment or designation by his ecclesiastical superiors,

then only the service performed by him in the conduct of religious worship or the ministration of sacerdotal functions is in the exercise of his ministry. . . .

The application of the rule in this subparagraph may be illustrated by the following example:

M, a duly ordained minister, is engaged by N University to teach history and mathematics.

He performs no other service for N although from time to time he performs marriages and conducts funerals for relatives and friends.

N University is neither a religious organization nor operated as an integral agency of a religious organization.

M is not performing the service for N pursuant to an assignment or designation by his ecclesiastical superiors.

The service performed by M for N University is not in the exercise of his ministry.

However, service performed by M in performing marriages and conducting funerals is in the exercise of his ministry.

Revenue Ruling 1961-213

In 1961, the IRS issued Revenue Ruling 61-213, which held that a taxpayer who performed the duties of a cantor at a Jewish Community Center was not entitled to a Parsonage Allowance because he was not an "ordained minister" in the Jewish faith.
The I.R.C. Section 107 "Parsonage Allowance"
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Revenue Ruling 1965-124; Revenue Ruling 1966-90

In 1965, the IRS issued Revenue Ruling 65-124, and in 1966, Revenue Ruling, 66-90, both of which held that a taxpayer who was licensed or commissioned as a minister by a church or church denomination that ordained some of its ministers, must be invested with the status and authority of an ordained minister fully qualified to exercise all the ecclesiastical duties of that church denomination in order to be entitled to a Parsonage Allowance.

1978: Revenue Ruling 78-301

In 1978, the IRS reversed and modified such prior Revenue Rulings by issuing Revenue Ruling 78-301, which held that a taxpayer who performed the duties of a cantor at a Jewish synagogue was entitled to the benefits of a Parsonage Allowance, even though he was not an "ordained minister" in the Jewish faith.

Revenue Ruling 78-301 also expanded the eligibility of religious officials who are not "ordained" to obtain the benefits of a Parsonage Allowance by treating them in the same manner as ordained ministers of the gospel when such commissioned or licensed ministers performed substantially all of the religious functions within the scope of the tenets and practices of their religious denominations.

The 2002 Amendments to I.R.C. § 107

In 2002, Congress made the following addition to final sentence of I.R.C. § 107(2):

"and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities".

Such amendment was to be:

• effective on May 20, 2002,
  and
• applicable with respect to taxable years beginning after December 31, 2001.

Thereafter I.R.C. § 107(2) read in full as follows,

In the case of a minister of the gospel, gross income does not include -

(2) the rental allowance paid to him as part of his compensation,

• to the extent used by him to rent or provide a home
  and
to the extent such allowance does not exceed

- the fair rental value of the home, including furnishings and appurtenances such as a garage,

- plus the cost of utilities.

The impetus for such a change arose from a U.S. Tax Court decision issued on May 16, 2000, in favor of the evangelist Richard Warren - author of a number of Christian books - including the "Purpose Driven Life".


During the years 1993, 1994, 1995, Richard Warren had:

- been employed as a minister of the gospel by a church in California, and
- claimed a Parsonage Allowance in the amount of $77,663, $76,309, and $79,999 during such years.


During the years in question, the IRS had:

- claimed that the rental value of Richard Warren’s home was $58,061, $58,004, and $59,479, respectively, and
- sought to limit Warren’s exclusion from gross income pursuant to the Parsonage Allowance to the rental value of the home.

Id.

Warren did not contest the IRS’s determinations of the rental values of the home during such years, perhaps because at the time, there was no statutory requirement that the exclusion from gross income pursuant to the Parsonage Allowance be limited to the rental value of the home.

The IRS argued that permitting a Parsonage Allowance exclusion in excess of the rental value of the home would be:

- contrary to the “rental” language in the statute, and also
- contrary to Congressional intent relating to the statute when it was adopted in 1954.
However, the Tax Court disagreed with the IRS’s position, and allowed the full Parsonage Allowance to Warren.

In response to the Tax Court’s decision, the IRS obtained from Congress an amendment to I.R.C. § 107(2) which essentially adopted the position taken by the IRS in the Warren Tax Court case, effective for taxable years beginning after December 31, 2001.

However, as identified by the Tax Court in the Warren decision, the adoption of the above provision burdens the taxpayer with an additional evidentiary requirement:

If we adopt respondent’s [the IRS] position, ministers eligible for an exclusion under section 107(2) will face a compliance burden not imposed on ministers eligible under section 107(1).

Under respondent’s [the IRS] position, ministers who receive a rental allowance could be required to obtain an estimate of the rental value of their home every year in order to know how much to exclude under section 107(2).

This burden is not imposed on ministers for whom homes are provided, the rental value of which is excludable under section 107(1), because they may simply exclude the value of the home without any need to estimate the rental value.

. . . the burden of obtaining valuation estimates could become onerous where rental value is in dispute.

We decline to endorse this disparate treatment here by imposing potentially burdensome valuation obligations where neither the statute nor the legislative history so requires.

It can be expected that the IRS will attempt to enforce the rental value limitation requirement whenever it determines that a taxpayer is seeking to obtain a disproportionately large Parsonage Allowance, although satisfying such rental value limitation will always be a requirement for taxpayers seeking to obtain the benefit of a Parsonage Allowance with respect to a rental allowance.
It can also be expected that many taxpayers will not be prepared to meet this evidentiary burden - which may require a professional appraisal every year - even if they are aware of the rental value limitation requirement.

One Home or Two?

In a decision issued on December 14, 2010, the U.S. Tax Court was called upon - apparently for the first time as “an issue of first impression” - to decide whether a minister of the gospel was entitled to the Parsonage Allowance with respect to two separate homes simultaneously.

Philip A. Driscoll v. Commissioner of Internal Revenue, 135 T.C. No. 27

During each of the years from 1996, through 1999, taxpayers Philip and Lynne Driscoll claimed a Parsonage Allowance with respect to two separate homes (located in Tennessee), simultaneously:

- one of which was their principal residence,
  and
- one of which was described as a “Lake Home”.

Driscoll v. Commissioner, 135 T.C. No. 27 (2010), Page 3.

During such years the shares of the Parsonage Allowance allocated to the Lake Home were $25,842.53, $70,707.50, $116,309.11, and $195,778.52 respectively.

Driscoll v. Commissioner, 135 T.C. No. 27 (2010), Page 5.

The IRS:

- disallowed those shares of the Parsonage Allowance which had been allocated by the taxpayers to the Lake Home,
  and
- assessed tax deficiencies against the taxpayers in the amount of $64,905, $83,512, $107,562, and $149,880, during such years.

Driscoll v. Commissioner, 135 T.C. No. 27 (2010), Page 2.

In addition, the IRS sought to impose civil fraud penalties on the taxpayers pursuant to Internal Revenue Code section 6663(a) - representing 75% of the portion of the underpayment attributable to fraud - in the amount of $48,678.75, $62,634, $80,671.59, and $112,410.00 with respect to such years by reason of the taxpayers claiming the Parsonage Allowance for the Lake Home.
The combined total of the civil fraud penalties sought by the IRS in this case was in excess of $300,000.

Based upon the tax dollars at issue in the dispute, it was clear that:

- the taxpayers had been progressively aggressive in seeking to obtain the benefits of the Parsonage Allowance with respect to two homes,
  and
- the Commissioner of Internal Revenue had been equally resolved to punish such behavior, and to deter others from making similar claims.

The IRS may also have been looking for a test case it could win in the U.S. Tax Court in order to establish a national precedent for the limitation of the Parsonage Allowance to a single home.

In order to do so, the IRS needed a taxpayer sufficiently motivated by the threat of a significant tax liability in order to provide an incentive for the taxpayer to incur the expense of an appeal to the US Tax Court.

After reviewing the various arguments provided by the parties, the U.S. Tax Court found in favor of the taxpayers, holding that nothing in:

- I.R.C. § 107,
- the regulations thereunder,
  or
- its legislative history,

precluded the taxpayers from receiving the benefits of the Parsonage Allowance with respect to more than one home simultaneously.

Driscoll v. Commissioner, 135 T.C. No. 27 (2010), Page 14, 17.

However, the Tax Court decision was not unanimous - in fact 6 of the 13 Tax Court judges dissented.

Driscoll v. Commissioner, 135 T.C. No. 27 (2010), Page 28;
Commissioner of Internal Revenue v. Philip A. Driscoll, 669 F3d 1309 (11th Cir. 2012)

Of the seven Tax Court justices in the majority:

- one concurred in the result only, but not in the opinion of the majority,
  and
one concurred with the result only because it was based upon certain limited facts.


Even then, the majority decision was based upon certain stipulations which had been entered into between the IRS and the taxpayers.

Driscoll v. Commissioner, 135 T.C. No. 27 (2010), Page 2, 18.

Therefore, the decision of the Tax Court majority in favor of the taxpayer was made on limited grounds - which might not be available to another taxpayer in the same situation.

The IRS appealed the case to the 11th Circuit Court of Appeals - which has jurisdiction over federal cases originating in the states of Alabama, Florida and Georgia - since the taxpayers then resided in the State of Georgia.


In 2012, the 11th Circuit Court of Appeals:

- reversed the decision of the Tax Court,

and

- upheld the denial by the IRS of all exclusions relating to the Parsonage Allowance with respect to the Lake Home.

Commissioner of Internal Revenue v. Philip A. Driscoll, 669 F3d 1309 (11th Cir. 2012)

Therefore, at least within the jurisdiction of the 11th Circuit Court of Appeals, taxpayers may only be allowed to receive the benefit of the Parsonage Allowance with respect to one home.

Based upon the issues raised in these cases, one could expect the IRS to request that Congress amend I.R.C. § 107 to specifically limit the availability of the Parsonage Allowance to only one home per taxpayer.

Until then, taxpayers attempting to claim the benefit of the Parsonage Allowance with respect to more than one home can perhaps expect:

- intense audit scrutiny,

and

- strenuous opposition,

from the Internal Revenue Service.
Church

Perhaps surprisingly, the term "church" is not defined in IRC §107, and:

• while the regulations thereunder make reference to a church, and to a church denomination,
• they do not provide definitions thereof.

Nevertheless, the recognition by the IRS of a "church" as the employer of a "minister of the gospel" appears to be a prerequisite for the Parsonage Allowance income tax exclusion, by reason of Treasury Regulation §1.1402(c)-5(b)(2), which provides in part as follows:

(2) Except as provided in paragraph (c)(3) of this section, service performed by a minister in the exercise of his ministry includes

• the ministration of sacerdotal functions
  and
• the conduct of religious worship,
  and
• the control, conduct, and maintenance of religious organizations (including the religious boards, societies, and other integral agencies of such organizations).
  under the authority of a religious body constituting a church or church denomination.

In 2000, the U.S. Tax Court provided renewed guidance with respect to the requirements for classification as a church, by citing a decision it had issued in 1987, which provided in part as follows:

To classify a religious organization as a church under the Internal Revenue Code, we should look to

• its religious purposes
  and,
• particularly, the means by which its religious purposes are accomplished. * * *

At a minimum, a church includes

• a body of believers or communicants
• that assembles regularly in order to worship.
When bringing people together for worship is only an incidental part of the activities of a religious organization, those limited activities are insufficient to label the entire organization a church.


The Tax Court’s statement in Whittington was made in response to a claim by the IRS that a duly ordained minister who engaged in preaching activities, performed weddings, and officiated at funerals while working for a religious organization that was not a “traditional” church, was not entitled to a Parsonage Allowance.


The taxpayer’s ministry organization engaged in crusades, produced television shows, and solicited direct mail contributions monthly pursuant to a 500,000 name mailing list.


Based upon such activities, the Tax Court held that the taxpayer’s ministry had the “requisite body of believers” in order to constitute a church.

Whittington, T.C. Memo 2000-296, pages 6-7

**Taxability of the Parsonage Allowance**

While the Parsonage Allowance:

- is excludable from gross income for income tax purposes,
- it is not excludable for self-employment tax purposes.

The combined Social Security portion and the Medicare tax portion of the self-employment tax now equals:

- 15.3% for married taxpayers filing jointly with earned income of less than $250,000, and
- 16.2% for married taxpayers filing jointly with earned income in excess of $250,000.

Income tax rates currently range from 10% to 39.6%, depending on the amount of taxable income.

Therefore, at the lower income levels, the Parsonage Allowance provides a significantly lesser benefit than at the upper income levels.
However, in the absence of the Parsonage Allowance, all eligible taxpayers would bear a higher income tax burden.

**Parsonage Allowance - Cash Payments**

A minister of the gospel can exclude from gross income the lesser of:

- the amount of the "rental allowance" actually used to provide or rent a home - within the tax year received;
- the fair market rental value of the home (including furnishings, utilities, garage, etc.);
- the amount officially designated (in advance of payment) as a rental or housing allowance,
  or
- an amount which represents reasonable pay for his or her services.

**Housing In-Kind**

If instead of receiving a housing rental allowance, a minister is provided with housing in-kind as pay for his or her services as a minister:

- the minister may exclude the value of the housing from income,
- but must include the fair market rental value of the housing in net earnings from self-employment for self-employment tax purposes.

**Reporting the Parsonage Allowance Not Excluded For Income Tax Purposes**

The amount of the Parsonage Allowance that cannot be excluded should be entered with the minister’s other wages on line 7 of Form 1040.

**Self-employment Taxes**

For Social Security and Medicare tax purposes, a duly ordained, licensed or commissioned minister is self-employed.

Therefore,

- the minister’s salary provided by his or her church identified on IRS Form W-2,
- the minister’s net profit from other ministry activities identified on Schedule C or C-EZ, and
- the full amount of the minister’s Parsonage Allowance,
less any deductible expenses - are subject to self-employment tax - and reported on Form 1040, Schedule SE, Self-Employment Tax.

Exemption From Self-employment Tax

A minister who is conscientiously opposed to public insurance for religious reasons can request an exemption from self-employment tax.

However, the minister may not be able to request such an exemption solely for economic reasons.

To request the exemption, the minister would file with the IRS Form 4361, Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners.

However, IRS Form 4361 must be filed by the due date of the minister’s income tax return (including extensions) for the second tax year in which the minister has net earnings from self-employment of at least $400.00, if any part of the minister’s net earnings from each of the two years came from the performance of ministerial services.

The two years do not have to be consecutive tax years.

Such a filing deadline can be easily missed.

For more information, refer to Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers.

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