

Lawsuit Challenges Income Tax Preferences for Clergy

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In this article, the author argues that sections 107 and 265(a)(6)(B) are unconstitutional because they are narrow tax preferences for clergy that violate the First Amendment's establishment clause. Taxpayers have standing to challenge these sections. In *Freedom From Religion Foundation v. Geithner*, a district court correctly denied the government's motion to dismiss taxpayers' claims that section 107 is unconstitutional, but incorrectly granted the motion to dismiss claims that section 265(a)(6)(B) is unconstitutional.

A. Introduction

Only rarely do taxpayers challenge the constitutionality of the tax laws.¹ Rarer still are cases in which the constitutional challenge has substantial merit. One such case is *Freedom From Religion Foundation v. Geithner*, a lawsuit filed in October 2009 that challenges the constitutionality of sections 107 and 265(a)(6)(B).² Those sections provide tax benefits for "ministers of the gospel," a phrase generally understood as referring to clergy in all religions.³ The suit filed by the Freedom From Religion Foundation (FFRF) in the federal district court for the Eastern District of California asserts that sections 107 and 265(a)(6)(B) violate the establishment clause of the First Amendment to the Constitution.

Section 107(1) provides that a minister's gross income does not include the rental value of a home provided as compensation. Section 107(2) provides that a minister's gross income does not include a rental allowance paid as

¹One such case was *Murphy v. IRS*, 493 F.3d 170 (D.C. Cir. 2007), Doc 2007-15777, 2007 TNT 129-4. In *Murphy*, the taxpayer unsuccessfully argued that tax on a damage award for emotional distress was not an accession to wealth and therefore not gross income under section 61(a) and the 16th Amendment.

²See Complaint, *Freedom From Religion Foundation Inc. v. Geithner*, No. 2:09-cv-02894 (E.D. Cal. Oct. 16, 2009), Doc. 2009-23144, 2009 TNT 201-10.

³*Silverman v. Commissioner*, 57 T.C. 727 (1972), *aff'd*, 73-2 U.S.T.C. para. 9546 (8th Cir. 1973), held that a Jewish cantor is a "minister of the gospel," as did *Salkov v. Commissioner*, 46 T.C. 190 (1966). In *Salkov*, the Tax Court stated, "Although 'minister of the gospel' is phrased in Christian terms, we are satisfied that Congress did not intend to exclude those persons who are the equivalent of 'ministers' in other religions."

compensation, to the extent used to rent or provide a home. For compensation to be excludable under section 107(1) or 107(2), the minister must be "duly ordained, commissioned, or licensed" and must be performing services "in the exercise of his ministry." These two requirements are not found in the express language of section 107. They are in regulations and other guidance issued under section 107 and are based on the self-employment tax and employment tax rules applicable to clergy.⁴

Section 265(a)(6)(B) permits clergy to deduct mortgage interest and property taxes allocable to tax-exempt housing allowances paid under section 107(2). Section 265(a)(6)(B) is a narrow exception to section 265(a)(1), which generally prohibits the allowance of deductions allocable to tax-exempt income.

Employees may receive the use of employer-provided housing on a nontaxable basis, but only under the strict terms and conditions of section 119. Section 119 imposes requirements that have no counterparts under section 107. The housing must be provided "for the convenience of the employer" and "as a condition of employment." Further, the housing must be "on the business premises of the employer."

The plaintiffs in the lawsuit include FFRF and several of its members who live in California. In addition to challenging the constitutionality of sections 107 and 265(a)(6)(B), the suit challenges the constitutionality of the corresponding provisions of California's income tax law. The defendants include the Secretary of Treasury, the Commissioner of Internal Revenue, and the California official primarily responsible for administering California's income tax laws.

An important issue raised by FFRF's suit is the standing of the plaintiffs to file the lawsuit. In general, federal taxpayers do not have standing to challenge laws enacted by Congress. *Flast v. Cohen*, 392 U.S. 83 (1968), created an exception that allows federal taxpayers to challenge congressional spending programs enacted under Article I, section 8, of the Constitution as violations of the establishment clause. Commentators have stated that federal taxpayers may not have standing to challenge tax

⁴See sections 1402(a)(8), 1402(c)(4), 1402(e), 3121(b)(8)(A), and 3401(a)(9). For income tax purposes, clergy are often common-law employees of the church. Even so, these clergy are subject to self-employment taxes on their compensation for services as a minister, and the church is not liable for Social Security taxes on this compensation. Some clergy elect not to pay self-employment taxes by filing IRS Form 4361. See section 1402(e). When filing Form 4361, a minister must certify that he is opposed on the basis of religious principles to the acceptance of public insurance, which includes payments for death, disability, retirement, or medical care.

benefits for clergy. They note that *Flast* was narrowly interpreted in subsequent Supreme Court cases and that *Flast* involved challenges to government spending in support of religion, not tax credits, exemptions, exclusions, deductions, or other "tax expenditures."⁵ The tax expenditures attributable to section 107 are estimated at \$700 million for 2010; no estimates are available regarding section 265(a)(6)(B).⁶

In a May 21, 2010, order and opinion,⁷ the district court correctly concluded that federal taxpayers who are members of FFRF have standing under *Flast* to challenge sections 107 and 265(a)(6)(B), and the court properly denied the government's motion to dismiss for lack of subject-matter jurisdiction. The court also denied the government's motion to dismiss the section 107 claims for failure to state a claim on which relief can be granted, but it granted the government's motion to dismiss the section 265(a)(6)(B) claims on that basis. This article concludes that FFRF members have standing to challenge sections 107(1), 107(2), and 265(a)(6)(B) under the establishment clause and that these code sections are unconstitutional. The court should not have dismissed the section 265(a)(6)(B) claims.

B. Tax Laws Favoring Clergy

Congress has repeatedly acted to protect the financial interests of clergy. When the IRS and the Department of Justice took positions adverse to the interests of clergy in published guidance or litigation, Congress acted to protect those interests in 1921, 1954, and 1986. When the Ninth Circuit expressed its intention to address the constitutionality of section 107(2) in *Warren v. Commissioner* (discussed below), Congress enacted legislation in 2002 to moot the court case, thereby avoiding a ruling on the constitutional issue.

1. The 1921 legislation. The forerunner of section 107(1) was section 213(b)(11) of the Revenue Act of 1921. Section 213(b)(11) provided an income tax exclusion or exemption for "the rental value of a dwelling house and appurtenances thereof furnished to a minister of the

⁵See Burgess J.W. Raby and William L. Raby, "Some Thoughts on the Parsonage Exemption Imbroglio," *Tax Notes*, Sept. 9, 2002, p. 1497, Doc 2002-20304, or 2002 TNT 172-41, which states that the Supreme Court is likely to "take a limited view of who has standing to challenge a statute in a situation not on all fours with *Flast*." See also Eric Rakowski, "Are Federal Income Tax Preferences for Ministers' Housing Constitutional?" *Tax Notes*, Apr. 29, 2002, p. 775, Doc 2002-10328, or 2002 TNT 83-26, which states that *Flast* is a "powerful precedent" for challenging section 107, but notes that the Supreme Court may "limit its endorsement of *Flast* to cases involving direct expenditures pursuant to an Act of Congress, in effect limiting *Flast* to its facts rather than the broader language of the majority opinion."

⁶See Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2009-2013" (Jan. 11, 2010), Doc 2010-631, 2010 TNT 7-22, at 40 (entry in table captioned "Exclusion of housing allowances for ministers"). The JCT report does not list the tax expenditures attributable to section 265(a)(6).

⁷See *Freedom From Religion Foundation Inc. v. Geithner*, No. 2:09-cv-02894 (May 21, 2010), Doc 2010-11448, 2010 TNT 100-10, 2010 U.S. Dist. LEXIS 50413.

gospel as part of his compensation." A commentator has noted that "the legislative history of section 213(b)(11) is virtually nonexistent; there is no discussion of the parsonage exclusion in congressional committee hearings or reports."⁸

The 1921 statute nullified a remarkable ruling by the Bureau of Internal Revenue adverse to the financial interests of clergy. That ruling has not received the attention it deserves. Office Decision (O.D.) 862, 4 C.B. 85 (1921), held that when a clergyman is permitted to use a parsonage free of charge, the fair rental value of the parsonage is considered compensation for services and must be reported as income.

O.D. 862 is best understood in connection with other rulings establishing the Bureau's "convenience of the employer" doctrine. O.D. 265, 1 C.B. 71 (1919), held that board and lodging furnished to seamen in addition to their cash compensation is supplied "for the convenience of the employer" and the value thereof is not reportable as income. O.D. 915, 4 C.B. 85 (1921), held that hospital employees who are on call 24 hours a day — and who must therefore live and eat at the hospital — are not taxed on the value of the living quarters and meals the employer provides, which are furnished "for the convenience of the employer." O.D. 915 further held that other hospital employees who are not on call 24 hours a day are taxed on the value of meals and lodging furnished by the employer if they could obtain their meals and lodging outside the hospital and still perform their duties. Other rulings on the convenience of the employer doctrine include O.D. 814, 4 C.B. 84 (1921), and T.D. 2992, 2 C.B. 76 (1920).

Although not stated so directly, O.D. 862 implicitly determined that parsonages are not provided to clergy "for the convenience of the employer." That conclusion makes perfect sense. A minister can perform his duties effectively without living in a parsonage. His situation is unlike that of the hospital employees in O.D. 915 who are on call 24 hours a day or the seamen in O.D. 265 who live and work on a ship.

The Revenue Act of 1921 provision that nullified O.D. 862 was a narrow rule for clergy only; no comparable benefit was given to others who did not qualify under the Bureau's convenience of the employer doctrine. The 1921 provision was codified, without change, as section 22(b)(6) of the Internal Revenue Code of 1939, the immediate predecessor to section 107(1).

2. Section 107(2). Given the wording of the 1921 provision, the government correctly argued in several cases that only housing provided in kind is excludable from a clergyman's income; a cash housing allowance is taxable. The government lost some of the cases in which the question was presented.⁹ Eventually Congress resolved the issue of clergy housing allowances by enacting section 107(2) as part of the Internal Revenue Code of 1954.

⁸See Roger Taft, "Tax Benefits for the Clergy: The Unconstitutionality of Section 107," 62 Geo. L.J. 1261, 1267 (1974).

⁹See, e.g., *Williamson v. Commissioner*, 224 F.2d 377 (8th Cir. 1955), rev'd 22 T.C. 566 (1954).

For a second time, Congress nullified the position of the executive branch on a tax issue relating to clergy.

3. Section 119. Section 119 was also enacted as part of the 1954 code. It provides that an employee may exclude from gross income the value of employer-provided housing if three requirements are met. The housing must be provided to the employee "for the convenience of the employer" and must be on the employer's "business premises." Also, the employee must be required to accept the housing "as a condition of employment."

There are fundamental differences between sections 107 and 119. The exclusion under section 107 applies to all clergy regardless of whether they are considered employees¹⁰ or independent contractors; section 119, by contrast, is applicable only to employees. Section 107(2) permits clergy to receive housing allowances on a non-taxable basis while housing allowances for nonclergy taxpayers are not excludable under section 119.¹¹ Also, clergy obtain the use of tax-free housing under section 107(1) without having to meet the three requirements of section 119.

Reg. section 1.119-1(b) provides that the "condition of employment" requirement means that the employee must be required to accept the lodging to enable him to properly perform the duties of his employment. Lodging is furnished to enable the employee to properly perform the duties of his employment when, for example, it is furnished because the employee is required to be available for duty at all times or because the employee could not perform the services required of him unless he is furnished such lodging.

Only rarely would a clergyman be able to exclude the value of a parsonage under section 119, even if the parsonage is located on the business premises of the church. In almost all cases, neither the convenience of the employer requirement nor the condition of employment requirement would be satisfied. Clergy can almost always perform their duties effectively without living in a home on the church's business premises. Because most clergy have access to an automobile or public transportation, there is usually no business need for them to live on or near church property.¹² Also, as a practical matter, clergy are not available for duty at all times. Although a minister must occasionally respond to an emergency or crisis, those events probably arise no more often than for

other professionals, such as doctors or lawyers. Also, when a minister faces a crisis, for example, a church member's sudden illness or death, this would not typically require the minister's presence in the church building itself. In general, his presence would be needed at some other location, such as a hospital or the church member's home. In view of those considerations, there is usually no business need for the minister to live on church property, and the requirements of section 119 would almost never be met.

There are very unusual circumstances in which section 119 might apply to clergy. Assume that church members live together for religious reasons on church-owned property, as in the case of David Koresh and his followers. Section 119 might apply in that situation if the minister is an employee of the church. There is a considerable body of case law under section 119, and it would not be difficult for the IRS to determine whether section 119 is applicable to a clergyman.

4. The 1986 legislation. Rev. Rul. 83-3, 1983-1 C.B. 72, held in part that clergy cannot deduct mortgage interest and property taxes paid with a section 107(2) housing allowance. The rationale is that the interest and property taxes are allocable to tax-exempt income under section 265(a)(1). Congress responded in 1986 by overruling the position of the executive branch, just as it had done in enacting the 1921 and 1954 legislation. Congress enacted section 265(a)(6), which nullified Rev. Rul. 83-3 insofar as that ruling concerned clergy; the ruling remains in effect insofar as other taxpayers are concerned.¹³

The narrow scope of section 265(a)(6) is explained in *Induni v. Commissioner*, 990 F.2d 53 (2d Cir. 1993), Doc 93-4653, 93 TNT 83-10. In *Induni* the court disallowed deductions for mortgage interest and property taxes allocable to a tax-exempt living quarters allowance received by a civilian federal employee stationed in Canada. The court said that section 265(a)(6) benefits only clergy and members of the military. The taxpayer, a federal employee, was not within either of the groups favored by Congress, and his deductions were disallowed by section 265(a)(1).

Under section 265(a)(6)(B) and Rev. Rul. 87-32, 1987-1 C.B. 131, clergy are allowed to deduct mortgage interest and property taxes allocable to a section 107(2) allowance. For example, if a minister receives a section 107(2) allowance of \$75,000 and \$45,000 of the allowance is used to pay deductible mortgage interest and property taxes, the minister excludes \$75,000 and deducts \$45,000. The minister obtains a double benefit with respect to the \$45,000. This amount is both excluded and deducted.

5. The 2002 legislation. In 2002 Congress enacted legislation to address a statutory issue that was pending in litigation. In *Warren v. Commissioner*, 114 T.C. 343 (2000), Doc 2000-13875, 2000 TNT 96-8, the Tax Court rejected the government's argument that the Rev. Richard Warren¹⁴

¹⁰The courts have on occasion determined whether a minister is an employee or an independent contractor. One such case was *Weber v. Commissioner*, 103 T.C. 378 (1994), Doc 94-8014, 94 TNT 168-11, aff'd, 60 F.3d 1104 (4th Cir. 1995), Doc 95-7651, 95 TNT 171-9 (ordained Methodist minister was an employee).

¹¹The Supreme Court stated in *Kowalski v. Commissioner*, 434 U.S. 77 (1977), that section 119 does not cover cash payments of any kind. While the case dealt with the excludability of an employer's payments for meals, the Tax Court held in *Goldstein v. Commissioner*, 73 T.C. 164 (1979), that the exclusion under section 119 does not apply to cash payments for lodging.

¹²Although an Orthodox Jewish rabbi must live near the synagogue to be able to walk to the synagogue on the Sabbath and other holy days, there would not usually be any work-related need for him to live on the synagogue's business premises.

¹³Rev. Rul. 83-3 was based on the analysis in GCM 38948 (1983).

¹⁴Warren is the author of the best-selling book, *The Purpose Driven Life*. He delivered the invocation at President Obama's inauguration ceremony.

was liable for a tax on a section 107(2) housing allowance to the extent the allowance exceeded the fair rental value of his home. On appeal by the government to the Ninth Circuit, the court appointed Prof. Erwin Chemerinsky to assist it in addressing the constitutionality of section 107(2), an issue the parties had not raised. Clergy then began a lobbying campaign to prevent the Ninth Circuit from ruling on the constitutional question. The campaign succeeded. Congress enacted the Clergy Housing Allowance Clarification Act of 2002 (P.L. 107-181). The 2002 legislation was designed to moot the court case, thereby preventing the Ninth Circuit from addressing the constitutional issue. The legislation resolved the statutory question in Warren's case in his favor. For later years not at issue, the legislation adopted the IRS's position that a section 107(2) housing allowance is taxable to the extent it exceeds the fair rental value of the residence.

The 2002 legislation mooted Warren's court case as intended. The Ninth Circuit dismissed the government's appeal and denied Chemerinsky's motion to intervene as a party in *Warren v. Commissioner*, 302 F.3d 1012 (9th Cir. 2002), Doc 2002-19753, 2002 TNT 166-5. In denying his motion to intervene, the Ninth Circuit said that Chemerinsky had a "generalized interest as a taxpayer" under *Flast* to raise the constitutional question: "Because Prof. Chemerinsky may raise this issue through a separate lawsuit, our denial of intervention will not impair his ability to protect his interest as a taxpayer." Chemerinsky did not file a lawsuit to challenge section 107(2), but his amicus brief in *Warren* persuasively argues that section 107(2) is unconstitutional.¹⁵

To summarize, Congress has on three occasions enacted legislation that nullified the executive branch's position on clergy taxation. Also, in 2002 Congress enacted legislation to moot a pending case, based on a reasonable belief that the court would hold that section 107(2) is unconstitutional.

C. Major Establishment Clause Cases

To understand the constitutional issues at stake in FFRF's lawsuit, it is necessary to review several establishment clause cases.

Lemon v. Kurtzman, 403 U.S. 602 (1971), states that a statute must satisfy three requirements to comply with the establishment clause. It must have a secular legislative purpose, its principal or primary effect must be one that neither advances nor inhibits religion, and it must not foster an excessive government entanglement with religion.

In *Walz v. Tax Commission of New York City*, 397 U.S. 664 (1970), the Supreme Court upheld the constitutionality of a property tax exemption for church property. There are five major aspects to the Court's rationale. First, the real estate tax exemptions were broadly available to "all houses of religious worship within a broad class of property owned by nonprofit, quasi-public corporations

¹⁵For Chemerinsky's amicus brief in *Warren*, see Doc 2002-13072, 2002 TNT 117-39. See also Erwin Chemerinsky, "The Parsonage Exemption Violates the Establishment Clause and Should Be Declared Unconstitutional," 24 *Whittier L. Rev.* 707 (2002).

which include hospitals, libraries, playgrounds, scientific, professional, historical, and patriotic groups."¹⁶

Second, governments have sometimes shown "hostility toward religion," and grants of exemption reflect "the latent dangers inherent in the imposition of property taxes; exemption constitutes a reasonable and balanced attempt to guard against those dangers."¹⁷ Churches "should not be inhibited in their activities by property taxation or the hazard of loss of those properties for nonpayment of taxes."¹⁸ Property tax exemptions do not establish religion, but instead spare churches "from the burden of property taxation levied on private profit institutions."¹⁹

Third, the Court was concerned with the potential for government entanglement with religion:

Either course, taxation of churches or exemption, occasions some degree of involvement with religion. Elimination of exemption would tend to expand the involvement of government by giving rise to tax valuation of church property, tax liens, tax foreclosures, and the direct confrontations and conflicts that follow in the train of those legal processes.

Granting tax exemptions to churches necessarily operates to afford an indirect economic benefit and also gives rise to some, but yet a lesser, involvement than taxing them. In analyzing either alternative, the questions are whether the involvement is excessive and whether it is a continuing one calling for official and continuing surveillance leading to an impermissible degree of entanglement.²⁰

Fourth, the Court stated, "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."²¹ Fifth, the Court emphasized historical considerations, noting "the unbroken practice of according the exemption to churches, openly and by affirmative state action."²²

In *Committee for Public Education v. Nyquist*, 413 U.S. 756 (1973), the Court struck down state income tax deductions for parents whose children attend private religious schools. The rationale was that "special tax benefits . . . cannot be squared with the principle of neutrality established by the decisions of this Court. To the contrary, insofar as such benefits render assistance to parents who send their children to sectarian schools, their purpose and inevitable effect are to aid and advance those religious institutions."²³ The Court distinguished *Walz* in several respects. First, granting the tax benefits in *Nyquist* "would tend to increase, rather than limit, the

¹⁶*Walz*, 397 U.S. at 673.

¹⁷*Id.*

¹⁸*Id.* at 672.

¹⁹*Id.* at 673.

²⁰*Id.* at 674.

²¹*Id.* at 675.

²²*Id.* at 678.

²³*Nyquist*, 413 U.S. at 793.

involvement between Church and State.”²⁴ Second, “the exemption challenged in *Walz* was not restricted to a class composed exclusively or even predominantly of religious institutions. Instead, the exemption covered all property devoted to religious, educational, or charitable purposes.”²⁵

A statute is a permissible “accommodation of religion” and does not violate the establishment clause if it exempts individuals or entities from the burden of laws that interfere with the practice of religion. Examples of the accommodation principle include statutes exempting individuals from combat if they oppose war for religious reasons and statutes that permit the sacramental use of peyote or other banned substances. The leading case on the accommodation principle is *Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v. Amos*, 483 U.S. 327 (1983).

Amos involved a suit by a church employee whose employment was terminated for religious reasons. The employee sued the church based on religious discrimination in employment, which is banned by the Civil Rights Act of 1964. At issue was the constitutionality of an exemption in the Act for churches and other religious employers. Originally the exemption covered only the religious activities of religious employers; churches were thus prohibited from discriminating in their nonreligious operations. As a result of a 1972 amendment to the Act, the exemption was broadened to apply to the nonreligious operations of religious employers. It appears that the plaintiff’s employment was with respect to a nonreligious operation. He was an engineer who worked at a church gymnasium open to the public.

The Court held in *Amos* that the broadened exemption under the 1972 amendment did not violate the establishment clause. It stated, “Under the *Lemon* analysis, it is a permissible legislative purpose to alleviate significant governmental interference with the ability of religious organizations to define and carry out their religious missions.”²⁶ The Court’s rationale was that:

it is a significant burden on a religious organization to require it, on pain of substantial liability, to predict which of its activities a secular court will consider religious. The line is hardly a bright one, and an organization might understandably be concerned that a judge would not understand its religious tenets and sense of mission. Fear of potential liability might affect the way an organization carried out what it understood to be its religious mission.²⁷

In *Texas Monthly Inc. v. Bullock*, 489 U.S. 1 (1989), the Supreme Court held that a Texas sales tax exemption limited to religious literature violated the establishment clause. The difference between Justice Brennan’s plurality opinion and Justice Blackmun’s concurring opinion was that Justice Blackmun’s opinion was narrower. He stated, “We need not decide today the extent to which the

Free Exercise Clause requires a tax exemption for the sale of religious literature by a religious organization; in other words, defining the ultimate scope of *Follett* and *Murdock* may be left for another day.”²⁸ Justice Brennan, however, limited the significance of *Follett* and *Murdock* by rejecting “some unnecessarily sweeping statements” in those cases, in which individuals went from house to house preaching the gospel and selling religious literature.²⁹ Flat license taxes or occupation taxes were at issue in those cases, and the taxes were held to violate First Amendment rights to preach.

D. Section 107(1) Is Unconstitutional

1. Section 107(1) provides clergy with special tax benefits. On its face, the 1921 statute’s purpose is religious and there is no evidence in the legislative history of any secular purpose. In particular, there is no evidence that Congress enacted the 1921 statute to avoid the difficulties involved in determining whether parsonages are provided for the convenience of the employer or in determining the fair rental value of a parsonage. The primary effect of the 1921 statute is to confer a substantial economic benefit on clergy by eliminating the possibility they would be taxed under O.D. 862. The 1921 legislation was enacted to nullify O.D. 862. Congress was concerned only with clergy; no tax relief was provided to other taxpayers who were required to determine the value of housing provided to them by their employers under the rules of the Bureau of Internal Revenue.

Sections 107(1) and 119 were enacted as part of the 1954 code. The religious purpose of section 107(1) is evident when that section is compared with section 119. Taxpayers, except clergy, must satisfy the strict requirements of section 119 to receive the use of housing on a nontaxable basis. The primary effect of section 107(1) is to advance religion, because section 107(1) provides clergy with a tax exclusion that would not be available under section 119. As discussed above, clergy would almost never be able to exclude the rental value of a parsonage under section 119.

Under *Nyquist* and *Texas Monthly*, narrowly targeted tax benefits that promote religion are unconstitutional. Sections 107(1) and 107(2) are unconstitutional because taxpayers are entitled to the section 107 exclusions only by meeting specified religious criteria. While some taxpayers other than clergy may be entitled to an exclusion or deduction for housing or housing costs under other code sections — for example, sections 119, 134, 280A, 911, and 912 — this fact does not mean that section 107 may be constitutional. Those sections were enacted at different times for different purposes and are unrelated to section 107. There is no unifying rationale or “overarching secular purpose” underlying section 107 and those other sections.³⁰

It might be argued that *Texas Monthly* merely prohibits a “statutory preference for the dissemination of religious

²⁴*Id.*

²⁵*Id.* at 794.

²⁶*Amos*, 483 U.S. at 335.

²⁷*Id.* at 336.

²⁸*Texas Monthly*, 489 U.S. at 28 (Blackmun, J., concurring).

²⁹*Id.* at 21 (plurality opinion).

³⁰*Id.* at 14, n.4.

ideas,”³¹ while sections 107(1) and 107(2) are statutory preferences for clergy housing. But that is a distinction without a difference. Clergy disseminate religious ideas, and a statutory preference for clergy is a statutory preference for the dissemination of religious ideas. Whether a tax exemption is directed at the sale of religious literature or clergy housing is immaterial because the tax exemption advances religion in either case. Justice Scalia did not view the holding in *Texas Monthly* as narrowly limited to tax exemptions for religious literature. His dissent in that case correctly recognized that the constitutionality of section 107 was placed in peril by the Court’s decision. Also, even if *Texas Monthly* could be narrowly viewed as an opinion that concerns sales tax exemptions for religious publications and nothing else, sections 107(1) and 107(2) would nonetheless be unconstitutional under the rationale of *Nyquist*.

When an individual performs the services of a minister of the gospel, he does not, on that basis alone, become entitled to tax benefits under section 107. Under *Kirk v. Commissioner*, 425 F.2d 492 (D.C. Cir. 1970), the individual must also be a “duly ordained, commissioned, or licensed minister of the gospel.” Sections 107(1) and 107(2) thus discriminate among individuals based on their status as clergy or lay people.

The taxpayer in *Kirk* was performing the services of a minister of the gospel but was denied favorable tax treatment because he was not a minister of the gospel. The opposite situation also arises. A minister of the gospel who teaches math or coaches basketball at some church-affiliated colleges — those considered an “integral agency of a church” — will qualify for section 107’s tax benefits even though his services are entirely secular.³²

Congress can provide tax benefits for those who perform services deemed beneficial to the community, but the benefits of section 107 are not provided to all who perform “good works.” Rather, they are narrowly available to clergy only and are provided to clergy without regard to whether they perform good works. Teaching math and coaching basketball at a Christian college that is an integral agency of a church would not ordinarily be viewed as good works or as an activity “in the exercise of ministry.” Congress has unconstitutionally granted tax benefits based on the taxpayer’s status as a minister and has impermissibly discriminated against lay people who perform activities that constitute ministry, such as the plaintiff in *Kirk*. This type of discrimination is no more lawful than denying tax benefits to atheists. The Supreme Court has analogized classifications based on religion to those based on race,³³ and race-based discrimination

generally violates the equal protection clause of the 14th Amendment and the due process clause of the 5th Amendment.³⁴

2. Section 107(1) is not a permissible accommodation of religion. Sections 107(1) and 107(2) do not “alleviate significant governmental interference” with the ability of clergy “to define and carry out their religious missions.”³⁵ The Supreme Court has said that “to the extent that imposition of a generally applicable tax merely decreases the amount of money [the taxpayer] has to spend on its religious activities, any such burden is not constitutionally significant.”³⁶ The federal income tax does not impose a constitutionally significant burden on clergy, and sections 107(1) and 107(2) cannot be upheld under the principle of accommodation of religion. If these sections were upheld on this basis, by the same logic clergy could be exempted from all federal taxes and return filing requirements.

3. Section 107(1) cannot be upheld under *Walz*.

a. Section 107 is a subsidy, lacks breadth, and doesn’t relieve a burden. Section 107 cannot be upheld under *Walz* because section 107 lacks the breadth of the tax exemptions in *Walz*. Also, federal income taxes on clergy are not burdensome in the same way that the imposition of property taxes on churches would be a burden. One such burden is “the hazard of loss of [the place of worship] for nonpayment of taxes.”³⁷ Loss of the place of worship would have a drastic effect on the congregation. The impact on the congregation would not be as severe if the IRS took enforcement action against the minister for nonpayment of income taxes. Another burden associated with property taxes is that they are usually computed without regard to the taxpayer’s ability to pay. By contrast, federal income taxes take the taxpayer’s ability to pay into account.

The Court emphasized in *Walz* the “unbroken practice” since colonial days of granting property tax exemptions to churches. The exemptions are “deeply embedded in the fabric of our national life.”³⁸ Section 107 lacks this historical pedigree and universal acceptance. The income tax exclusion for parsonages was first enacted in 1921, several years after enactment of the original income tax statute, the Revenue Act of 1913. Also, while property tax exemptions for churches have been universally accepted, O.D. 862 held that clergy are liable for tax on the value of their parsonages. Further, the constitutionality of section

on race . . . so too we strictly scrutinize governmental classifications based on religion. . . . Absent the most unusual circumstances, one’s religion ought not affect one’s legal rights or duties or benefits.”³⁹

³¹*Id.* at 28 (Blackmun, J., concurring).

³²“The Service has consistently ruled that ordained ministers who teach at schools that are integrally related to churches are performing services within the exercise of their ministry, no matter what they teach.” Joel S. Newman, “On Section 107’s Worst Feature: the Teacher-Preacher,” *Tax Notes*, Dec. 20, 1993, p. 1505, 93 TNT 260-20.

³³*See, e.g., Board of Educ. v. Grumet*, 512 U.S. 687, 714-715 (1994) (O’Connor, J., concurring in part). (“Just as we subject to the most exacting scrutiny laws that make classifications based

³⁴*Brown v. Board of Education*, 347 U.S. 483 (1954); *Bolling v. Sharpe*, 347 U.S. 497 (1954). See also *Moritz v. Commissioner*, 469 F.2d 466 (10th Cir. 1972) (statute allowing deduction for dependent care expenses violated due process because it discriminated against unmarried men).

³⁵*Amos*, 483 U.S. at 335.

³⁶*Jimmy Swaggart Ministries v. Board of Equalization*, 493 U.S. 378, 391 (1990) (citing *Hernandez v. Commissioner*, 490 U.S. 680, 699 (1989)).

³⁷*Walz*, 397 U.S. at 672.

³⁸*Id.* at 676.

(Footnote continued in next column.)

107 was challenged long ago in *Kirk* (the court refused to consider the taxpayer's argument). Section 107 has been far more controversial than real estate tax exemptions for churches.

The Court said in *Walz* that a property tax exemption for church property is not a form of state sponsorship. Given the differences between income taxes and property taxes, the Court's statement has no bearing on whether section 107 represents a subsidy or sponsorship. Income taxes are imposed on income "from whatever source derived."³⁹ Because the tax base under section 61 is as broad as possible and clergy compensation is taxable income under any conceivable income tax statute, section 107 represents an obvious exception to the breadth of the income tax base. That is why the tax benefits attributable to section 107 are a "tax expenditure"⁴⁰ and why section 107 represents a government subsidy. By contrast, the base on which property taxes are imposed is probably limited — as a political and economic matter — to property owned by individuals and business entities. As one commentator has observed, "Nonprofit organizations, to the extent they are not producing wealth, simply do not inhabit the base on which taxation is properly levied."⁴¹ Property tax exemptions for nonprofit entities thus reflect the *definition* of the tax base, rather than a specific *exception* to the tax base. For this reason, it may be argued that property tax exemptions for churches do not represent a government subsidy.

Also, Supreme Court cases decided after *Walz* refer to income tax exemptions and deductions as subsidies the burden of which is borne by taxpayers generally.⁴² Fur-

³⁹Section 61.

⁴⁰As noted above, the tax expenditures attributable to section 107 have been estimated at \$700 million for 2010 alone; *see* JCT, *supra* note 6.

⁴¹See Evelyn Brody, *Property-Tax Exemption for Charities: Mapping the Battlefield* 176 (2002). *See also* Edward A. Zelinsky, "Are Tax 'Benefits' for Religious Institutions Constitutionally Dependent on Benefits for Secular Entities?" 42 B.C. L. Rev. 805, 810 (2001):

An alternative understanding of deductions, exclusions, and exemptions is that they define the base of the relevant tax, rather than subsidize. . . . From this perspective, Professor Bittker contends, it is plausible to characterize the base of the New York real property tax as "personal residences and business property." Hence, there is no "exemption" or "subsidy" for religious or charitable properties since excluding these properties from taxation "is simply a natural outgrowth of the unavoidable process of defining the appropriate tax base."

⁴²See *Regan v. Taxation With Representation*, 461 U.S. 540 (1983); *Bob Jones University v. United States*, 461 U.S. 574 (1983). In *Regan*, the Supreme Court said, "Both tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system." In *Bob Jones University*, the Court said, "When the Government grants exemptions or allows deductions all taxpayers are affected; the very fact of the exemption or deduction for the donor means that other taxpayers can be said to be indirect and vicarious 'donors.'" In *Texas Monthly*, Justice Brennan's plurality opinion notes that "every tax exemption constitutes a subsidy that affects nonqualifying taxpayers." *Texas Monthly*, 489 U.S. at 14 (citing *Regan* and *Bob Jones University*).

ther, in *Rosenberger v. Rector and Visitors of the University of Virginia*, 515 U.S. 819, 859 (1995), Justice Thomas stated that tax exemptions and direct monetary subsidies are indistinguishable and footnote 5 in his opinion specifically refers to section 107 as an illustration of this equivalence.

b. Section 107(1) creates excessive entanglement. The Court noted in *Walz* that taxation of religious properties would lead to greater entanglement of church and state, while property tax exemption minimizes entanglement. The section 107(1) exemption does not similarly avoid or minimize government entanglement, except to the extent that it avoids disputes between clergy and the IRS over the fair rental value of parsonages provided to clergy. In other respects, the section 107(1) exemption increases entanglement given the difficult and subjective religious determinations the IRS must make when auditing clergy tax returns. These determinations are much more difficult and subjective than the determination of whether land is used for religious worship and thus exempt from property taxes.

If housing provided to clergy were governed by section 119 rather than section 107, the questions presented would be relatively easy for the IRS to resolve. Entanglement would be minimal because the issues presented would be secular rather than religious, and objective criteria would be used to make the necessary determinations of whether the parsonage is provided to clergy for the convenience of the employer and as a condition of employment on the business premises of the employer. As previously discussed, clergy would almost never satisfy all of these requirements, and some clergy would be ineligible for the section 119 exclusion because they are not employees. The IRS has been strict in its interpretation of section 119.⁴³ Given the extensive case law under section 119 and the rigor with which the IRS applies section 119 to other taxpayers, the IRS would encounter little or no difficulty in applying the requirements of section 119 to clergy.

By contrast, in administering section 107 the IRS uses vague criteria to make difficult and subjective religious determinations, four of which are discussed below. The need to make those determinations creates excessive entanglement between government and religion. This entanglement is especially problematic given "the prospect of inconsistent treatment."⁴⁴

The first religious issue is whether an individual is a minister of the gospel. For example, is a Jewish cantor a "minister of the gospel" for purposes of section 107? The question arose in two court cases.⁴⁵ The government argued that a rabbi — but not a cantor — is the equivalent of a Christian minister of the gospel. The

⁴³The action on decision in *Erdelt* illustrates the IRS's strict approach to section 119. In AOD 1992-001, 92 TNT 14-49, the IRS said that it will not follow the decision in *Erdelt v. United States*, 909 F.2d 510 (8th Cir. 1990), *aff'g per curiam* 715 F. Supp. 278 (D. N.D. 1989), regarding the excludability under section 119 of lodging furnished to a school superintendent.

⁴⁴*Texas Monthly*, 489 U.S. at 20.

⁴⁵See cases cited *supra* note 3.

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major distinction between rabbis and cantors is that rabbis — but not cantors — have the authority to interpret Jewish law and to sit on rabbinic courts that adjudicate disputes according to Jewish law.⁴⁶ That distinction is more important in Orthodox Judaism than in Reform Judaism because the latter emphasizes ethical principles and minimizes the importance of strict adherence to Jewish law. After losing the cases, the government changed its position and ruled in Rev. Rul. 78-301, 1978-2 C.B. 103, that cantors are ministers of the gospel for section 107 purposes. The ruling says that cantors perform "substantially all" of the religious functions of rabbis. That statement seems incorrect or misleading, because cantors cannot interpret Jewish law and the interpretation of Jewish law is very important in Orthodox Judaism. In issuing Rev. Rul. 78-301, the government minimized the importance of interpreting Jewish law, which is consistent with the Reform Jewish view that strict adherence to Jewish law is optional. Previously, the government's position was consistent with Orthodox Judaism. The government must inevitably take sides in the religious debate between these two branches of Judaism. The government is thus entangled in a religious dispute.

The question of cantors has been resolved. But issues of this type continue to arise. A similar question is whether an ordained deacon is a minister of the gospel. A ruling on this topic was the subject of an article.⁴⁷ *Knight v. Commissioner*, 92 T.C. 199 (1989), also addressed who qualifies as a minister of the gospel. The case holds that a minister of the gospel must be ordained, commissioned, or licensed, and that four other relevant factors must be weighed in the context of all the relevant facts and circumstances. The four factors are (1) whether the individual conducts religious worship, (2) whether he is considered a spiritual leader, (3) whether he participates in church government, and (4) whether he has the authority to perform sacerdotal functions such as baptism, the Lord's Supper, and solemnization of a marriage. While Rev. Rul. 78-301 would apparently require that the individual satisfy "substantially all" of these four criteria, no rigid rule was established in *Knight*. The taxpayer in that case was held to be a minister of the gospel even

⁴⁶In *Silverman v. Commissioner*, 73-2 U.S.T.C. para. 9546 (8th Cir. 1973), the court said that "the interpretation of Jewish law (the Law of the Talmud) is the only function reserved solely to the rabbi." Jewish law (halacha) covers a vast territory. It is not limited to purely religious questions, for example, the requirements for conversion to Judaism and the activities that are forbidden on the Sabbath. Jewish law also deals with questions of property law, business law, and divorce law. A beis din (or beth din) is a panel usually composed of three rabbis who adjudicate disputes according to Jewish law. Those disputes would include which party is the true owner of a valuable Torah scroll, whether a Jewish congregation acted properly in terminating the employment of a rabbi, and whether a restaurant is in compliance with religious rules regarding food preparation and handling.

⁴⁷See Lloyd H. Mayer, "Letter Ruling Alert: Rendering Unto Caesar," *The Exempt Organization Tax Review*, May 1999, p. 331 (discussing LTR 199910055 (Dec. 10, 1998), Doc 1999-9645, or 1999 TNT 49-20).

though he met only the first two criteria. The Tax Court did not say that meeting two of the criteria would always be sufficient. *Knight* gives the IRS a great deal of discretion in determining whether an individual is a minister of the gospel, and it is likely the IRS uses that discretion to make inconsistent administrative determinations. This is particularly so given the specific legal contexts in which the minister of the gospel question arises. When examining tax returns involving sections 107 and 265(a)(6)(B), the IRS will argue that the individual is not a minister of the gospel, but in cases involving exemption from self-employment tax under section 1402(e), it is to the IRS's advantage to make the opposite argument.⁴⁸

A second religious issue creating excessive entanglement is whether the activities of a minister are "in the exercise of his ministry." In LTR 9231053, 92 TNT 157-53, the IRS held that an ordained minister who worked for an independent section 501(c)(3) organization did not qualify for tax benefits under section 107 because his main activity was to provide spiritual counseling to drug addicts and alcoholics; this counseling was neither a "sacerdotal function" nor otherwise in the exercise of his ministry. The ruling appears incorrect; there is an example in the regulations stating that a university chaplain who counsels students is performing services within the exercise of his ministry.⁴⁹ The ruling is also at odds with a subsequent Tax Court decision giving a broad interpretation to "sacerdotal function." *Mosley v. Commissioner*, T.C. Memo. 1994-457, Doc 94-8445, 94 TNT 182-6, held that the production and distribution of evangelistic videos was a sacerdotal function given the emphasis in the Baptist religion on evangelism.

More fundamentally, LTR 9231053 illustrates the subjectivity of government determinations on religious matters and the lack of objective standards. The ruling rests on a narrow understanding of the concepts of "ministry" and "sacerdotal function." Why is counseling drug addicts and alcoholics not an act of ministry when Jesus frequently gave practical and spiritual advice to those in need? No one would deny that Jesus was acting in the exercise of his ministry when he counseled the woman caught in adultery to "sin no more" and when he advised

⁴⁸Clergy must generally pay self-employment taxes on their ministerial income. See *supra* note 4. Under section 1402(e), however, clergy may opt out of self-employment taxes if specified requirements are met. The taxpayer must file an application with the IRS (Form 4361) by the due date of the tax return for the second year in which the taxpayer has net earnings from self-employment of \$400 or more, any part of which is from ministerial services. Thus, the IRS typically argues that in some prior year or years the taxpayer was earning income from ministerial services and the application was filed too late. The taxpayer argues to the contrary that in the prior year or years he was not earning any income from ministerial services because he was not a minister.

⁴⁹Example: 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 conducting 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. See reg. section 1.1402(c)-5(b)(2)(iii).

the rich ruler to "sell all that thou hast, and distribute unto the poor, and . . . follow me."⁵⁰ Excessive entanglement is created by the IRS's need to determine whether activities are sacerdotal functions or otherwise in the exercise of ministry. Given the differing approaches to this question typified by LTR 9231053 and *Mosley*, inconsistent determinations are to be expected.

A third religious issue that the IRS must often resolve is whether a Christian college is an integral agency of a church or church denomination. The criteria for resolving this question are probably not being applied in a consistent fashion. This issue is important for the following reason: If a college qualifies as an integral agency of a church or church denomination, any ordained, commissioned, or licensed minister working as a college teacher, administrator, or athletic coach will qualify for tax benefits under section 107. The tax benefits are available regardless of the secular nature of the work performed by the minister. Math teachers and basketball coaches at these favored colleges receive tax benefits simply because they happen to be ministers.⁵¹ The tax benefits are not available if the college has an affiliation with a church or denomination but is not technically an integral agency of the church or denomination. The integral agency question can be resolved only through an intrusive inquiry into the tenets and practices of a particular church, its form of government, and the manner in which the church exercises control or influence over the operations of the college.

The "integral agency" issue is illustrated by *Flowers v. United States*, 1981 WL 1928 (N.D. Tex.), 49 A.F.T.R.2d 82-438, 82-1 U.S.T.C. para 9114. The court held that Texas Christian University is not an integral agency of the Christian Church (Disciples of Christ) despite their close relationship and the "moral persuasion" the Church exercises over TCU. The rationale was that the Church "cannot legally force directly or indirectly TCU to take any action." This conclusion seems correct, but the reasoning conflicts with Rev. Rul. 70-549, 1970-2 C.B. 16. In Rev. Rul. 70-549 a college was held to be an integral agency of a church even though the church could not force the college to take any action. The church lacked a central governing body and a church hierarchy; this was no doubt based on the religious principle that each local congregation and church-related entity is directly accountable to God and should have complete independence and autonomy. The church did not appoint the directors of the college, but the church was nonetheless held to exercise "indirect control" over the college because each college director was required to be a member

⁵⁰As to the woman caught in adultery, see John 8:11. ("Neither do I condemn thee: go, and sin no more.") As to the rich ruler, see Luke 18:22.

⁵¹See Newman, *supra* note 32. It is often difficult to determine whether the criteria for "integral agency of a church" are satisfied. The IRS uses the criteria listed in Rev. Rul. 72-606, 1972-2 C.B. 78, and also relies on Rev. Rul. 70-549, 1970-2 C.B. 16. Typical rulings in this area include LTR 9608027 (Nov. 21, 1995), Doc 96-5491, 96 TNT 39-49; LTR 200002040 (Oct. 18, 1999), Doc 2000-1760, 2000 TNT 11-24; and LTR 200925001 (Feb. 24, 2009), Doc 2009-13951, 2009 TNT 117-28.

in good standing of a local congregation. The pastor and elders of the local congregation may have exerted moral influence over the director, but could not require him to vote in a certain way on issues he faced as a director. Many private letter rulings cite Rev. Rul. 70-549 but none cite *Flowers*. While the government successfully litigated *Flowers*, it appears that the IRS has chosen to ignore the case.

A fourth contentious issue creating excessive entanglement is whether an evangelistic organization is a church. This can determine whether the officers of the organization can claim the benefits of section 107. The question arose in *Whittington v. Commissioner*, T.C. Memo. 2000-296, Doc 2000-24536, 2000 TNT 185-5. No definition of the term "church" is provided in the code or regulations, but it appears that an organization is not a church if its sole or primary activity is an evangelistic outreach to the general public; churches are focused primarily on worship and other activities for their members, not the general public. In *Whittington*, the organization spread the gospel through television and radio broadcasts, written publications, and crusades, but the Tax Court emphasized other facts more characteristic of churches. The organization "had loyal followers, some who attended worship services held regularly in Greenville, and others who attended crusades held regularly in various cities. Many of [the organization's] members were not associated with any other religious organization or denomination."⁵² The dividing line between a church and a purely evangelistic organization is unclear, and inconsistent determinations will no doubt be made on this issue.

4. Section 107(1) avoids need for valuation but is still unconstitutional. While it is true that section 107(1) avoids the need to determine the fair rental value of the clergyman's residence, that fact alone is not a sufficient basis on which to conclude that section 107(1) is constitutional. One commentator has argued that section 107(1) is constitutional because it avoids the need for property valuations, thereby decreasing entanglement.⁵³ That reasoning is incorrect. The avoidance of entanglement was only one aspect of *Walz*. Property tax exemption for churches was not upheld solely on the basis that the exemption avoided entanglement.

Also, if Congress were truly concerned with the difficulties involved in valuing parsonages and the resulting entanglement between church and state, that concern would be consistently manifested. Section 107(2), however, requires a valuation in that a housing allowance is taxable to the extent the allowance exceeds the fair rental value of the parsonage. Further, clergy provided with the use of a parsonage must determine its rental value for purposes of self-employment taxes. Under section 1402(a)(8), the net earnings from self-employment are computed "without regard to section 107," and clergy

⁵²*Whittington*, T.C. Memo. 2000-296 at 10.

⁵³See Thomas E. O'Neill, "A Constitutional Challenge to Section 107 of the Internal Revenue Code," 57 *Notre Dame Lawyer* 853 (1982) (concluding that section 107(1) is constitutional because it avoids entanglement, but section 107(2) is unconstitutional).

must therefore determine the value of the parsonage.⁵⁴ Section 107(1) cannot be considered constitutional on the basis that it avoids the need for a valuation. Congress has determined that valuing a parsonage is not especially difficult; valuations are required for self-employment tax purposes and for purposes of section 107(2).

In summary, section 107(1) is unconstitutional because its tax benefits are for clergy only and its primary purpose and primary effect are religious. Section 107(1) allows clergy to receive the use of housing on a tax-exempt basis without meeting the requirements of section 119. Also, section 107(1) discriminates against lay people who perform ministerial services. Given its narrow scope, section 107(1) is similar to the tax deduction in *Nyquist* and the sales tax exemption in *Texas Monthly*, rather than the property tax exemption in *Walz*. Further, the section 107(1) exclusion does not lift a regulatory burden on the practice of religion; the rationale of *Amos* does not apply. Moreover, section 107(1) entangles government and religion. Excessive entanglement is created by the need for IRS officials to resolve difficult religious questions to administer section 107(1), for example, whether a cantor is a minister of the gospel. While section 107(1) eliminates the need for taxpayers to determine the fair rental value of a parsonage for income tax purposes, section 107(1) cannot be upheld for that reason.

E. Section 107(2) Is Unconstitutional

Section 107(2) allows clergy to receive nontaxable housing allowances. No comparable benefit is available under section 119 for taxpayers other than clergy. Section 107(2) is a narrow tax preference for clergy only. Section 107(2) lacks a secular purpose, and its primary effect is to promote religion. It is similar to the tax deduction in *Nyquist* and the sales tax exemption in *Texas Monthly*. It cannot be justified as an accommodation of religion under *Amos* and does not pass muster under *Walz*.

If section 107(2) had not been enacted, clergy would have been taxed on their housing allowances; that taxation would not create any difficult issue for the IRS. However, excessive entanglement is created by the IRS's need to make difficult and subjective religious determinations when auditing clergy tax returns, for example, whether an individual is a minister of the gospel, whether the individual is performing services in the exercise of his ministry, or whether a college is an integral agency of a church.

Also, section 107(2) creates entanglement in a way that section 107(1) does not. Under section 107(2), a housing allowance is taxable to the extent it exceeds the fair rental value of the property; a valuation is thus required by section 107(2). The need for a valuation increases the level of entanglement. The opposite situation was presented in *Walz*, in which the tax exemption avoided the need for a valuation.

The legislative history of section 107(2) indicates that Congress wanted to remove the distinction made by section 22(b)(6) of the 1939 code between clergy who were provided a home as part of their compensation and

clergy who received a housing allowance.⁵⁵ Thus it is sometimes argued that section 107(2) was enacted for the secular purpose of equalizing the tax treatment of clergy.

This argument may seem plausible but should still be rejected. The main problem with the argument is that section 107(2) creates a new and greater inequity: Only clergy are allowed to receive nontaxable housing allowances. Further, the argument assumes that section 107(1) is constitutional. If section 107(1) is unconstitutional, section 107(2) cannot be justified as a means of achieving tax equity for clergy who receive housing allowances.

Also, the argument is flawed because section 107(2) does not actually equalize the tax treatment of all clergy: Section 107(2) provides better tax benefits than those provided by section 107(1). Under section 107(2), the minister may use the housing allowance to purchase a residence that can appreciate in value, as noted by one commentator.⁵⁶ The potential for appreciation is a benefit unique to section 107(2). Clergy provided with the use of a residence under section 107(1) do not enjoy any comparable benefit. Also, clergy provided with a section 107(2) housing allowance are allowed to deduct mortgage interest and property taxes paid with the allowance. Those deductions reduce taxable income. Clergy who exclude the fair rental value of a parsonage under section 107(1) do not obtain the benefit of deductions for mortgage interest and property taxes.

F. Section 265(a)(6)(B) Is Unconstitutional

Section 265(a)(6)(B) is unconstitutional because its primary purpose and primary effect are to advance religion. It was enacted to nullify Rev. Rul. 83-3's treatment of clergy. Only clergy and military personnel are allowed deductions for expenses allocable to tax-exempt income. Taxpayers generally — such as the taxpayer in *Induni* — cannot deduct mortgage interest or other expenses allocable to tax-exempt income. Given its narrow scope, section 265(a)(6)(B) is similar to the income tax deduction in *Nyquist* and the sales tax exemption in *Texas Monthly*, and it cannot be upheld under the rationale of *Amos* or *Walz*. Also, the administration of section 265(a)(6)(B) creates excessive entanglement.⁵⁷

It is true that military taxpayers receive a parallel benefit under section 265(a)(6)(A), but this fact is insufficient to make section 265(a)(6)(B) constitutional. A broad class of taxpayers is not given the tax benefits conferred on clergy and the military by section 265(a)(6). In *Walz*, the real estate tax exemption for church property was upheld primarily because tax exemptions were granted to a broad class of organizations.

⁵⁴S. Rep. No. 83-1622 at 16 (1954).

⁵⁵O'Neill, *supra* note 53, at 864.

⁵⁷As with section 107, the religious determinations required in the administration of section 265(a)(6)(B) create excessive entanglement. The district court incorrectly stated that "plaintiffs' Complaint does not appear to allege, nor does the court discern, that section 265(a)(6) fosters an excessive government entanglement with religion." In fact, paragraph 35 of the complaint alleges that section 265(a)(6) fosters excessive entanglement. See *supra* note 2.

⁵⁴See, e.g., *Flowers v. Commissioner*, T.C. Memo. 1991-542.

In FFRF's lawsuit, the district court incorrectly granted the motion to dismiss with respect to section 265(a)(6)(B) based on the conclusion that the primary purpose (and primary effect) of that section is to encourage clergy to purchase a home. It is a secular purpose to encourage home ownership, but it is not a secular purpose to provide clergy with better tax incentives for the purchase of a home than are given to other taxpayers. Only clergy and the military have the benefit of a double tax incentive: The amounts they receive as a tax-exempt housing allowance are deductible to the extent used to pay mortgage interest and property taxes, as the following example illustrates.

Example: A minister receives compensation of \$75,000, all of which is excludable under section 107(2). He is married, and his spouse earns \$45,000. They file a joint income tax return. The minister spends \$45,000 of the \$75,000 housing allowance for mortgage interest and real property taxes deductible under sections 163 and 164. Those deductions are available because of section 265(a)(6)(B). The minister uses the other \$30,000 for payment of mortgage principal, utilities, and other non-deductible housing expenses. None of the minister's \$75,000 compensation is taxable, and the \$45,000 in deductions offsets the spouse's \$45,000 income. On the joint return, there is zero taxable income. Although \$75,000 was spent on housing, taxation is avoided on \$120,000 (\$75,000 plus \$45,000). The minister obtains both an exclusion and a deduction for the \$45,000.

When the church pays its minister a section 107(2) allowance of \$75,000, the church is poorer by \$75,000, but the minister is enriched not only by the \$75,000, but also by the economic value of the deductions for mortgage interest and property taxes. A transfer from the church to the minister should not increase the combined wealth of the two parties — it would be a wash if the income tax laws did not exist. The increase in combined wealth arises from the valuable deductions for mortgage interest and property taxes. The government is providing a subsidy, as is acknowledged even by a commentator who argues that section 107 is not a subsidy.⁵⁸

G. FFRF's Members Have Standing to Sue

In *Flast*, the Supreme Court created an exception to the general rule that taxpayers do not have standing to challenge congressional legislation.⁵⁹ *Flast* held that for a taxpayer to have standing, there must be a nexus between the plaintiff's status as a taxpayer and the legislation being challenged. There are two aspects to the nexus requirement. First, the legislation being challenged must be an exercise of congressional power to tax and spend under Article I, section 8. Second, the lawsuit must allege that the legislation violates a specific limitation on congressional power. In *Flast*, the establishment clause was held to be a specific limitation on the power to tax and spend for the following reason:

⁵⁸See Dean T. Barham, "The Parsonage Exclusion Under The Endorsement Test: Last Gasp Or Second Wind?" 13 *Va. Tax Rev.* 397, 421 (1993).

⁵⁹The general rule against taxpayer standing was first stated in *Frothingham v. Mellon*, 262 U.S. 447 (1923).

Our history vividly illustrates that one of the specific evils feared by those who drafted the Establishment Clause and fought for its adoption was that the taxing and spending power would be used to favor one religion over another or to support religion in general. James Madison, who is generally recognized as the leading architect of the religion clauses of the First Amendment, observed in his famous Memorial and Remonstrance Against Religious Assessments that "the same authority which can force a citizen to contribute three pence only of his property for the support of any one establishment may force him to conform to any other establishment in all cases whatsoever."⁶⁰

Flast involved a challenge to congressional spending in support of religious institutions. The facts of *Flast* are thus different from the facts involved in FFRF's lawsuit. The lawsuit nonetheless satisfies the *Flast* nexus requirement because sections 107(1), 107(2), and 265(a)(6)(B) were enacted under Article I, section 8, and these code sections involve the use of the taxing power "to support religion in general." There is a logical nexus between a plaintiff's status as a taxpayer and the tax provisions at issue in FFRF's suit.

For purposes of the nexus requirement, there is no good reason to treat "tax expenditures" that subsidize religion differently than ordinary congressional spending in support of religion. The benefits to religion are the same regardless of the type of subsidy. As noted above, the Supreme Court has characterized tax exemptions and deductions as subsidies, the burden of which is borne by taxpayers.⁶¹

Congressional spending decisions are in public view and are debated and scrutinized, while tax subsidies such as sections 107 and 265(a)(6)(B) are permanent features of the IRC and generally fly under the radar. This is the main difference between tax subsidies and ordinary congressional spending, but this difference has no constitutional importance. As a policy matter, it would make no sense to conclude that ordinary congressional spending in support of religion is subject to judicial review under *Flast*, but permanent tax subsidies for religion — which receive far less attention from Congress and the public — should be exempt from judicial review.

Flast is an exception to the general rule that taxpayers do not have standing to challenge illegal or unconstitutional expenditures of government funds. The explanation for the general rule is that a taxpayer has only a minute, remote, and indirect interest in Treasury and suffers no direct injury or measurable economic harm (for example, an increased tax burden) when government funds are spent in an illegal or unconstitutional manner. Also, when a taxpayer complains about unconstitutional government expenditures, he is usually seeking "to employ a federal court as a forum in which to air his

⁶⁰*Flast*, 392 U.S. at 103.

⁶¹See *supra* note 42 and accompanying text.

generalized grievances about the conduct of government.⁶² Those generalized grievances should be directed to the executive and legislative branches of government, not the judiciary.

The general rule against taxpayer standing applies to state taxpayers as well as federal taxpayers. In *Doremus v. Board of Educ. of Hawthorne*, 342 U.S. 429 (1952), the Supreme Court likened state taxpayers to federal taxpayers and held that a state taxpayer's lawsuit amounts to an Article III case or controversy only when it is a "good-faith pocketbook action," in which the taxpayer alleges injury to a "direct and particular financial interest." When a lawsuit does not involve an establishment clause challenge, the "rationale for rejecting federal taxpayer standing applies with undiminished force to state taxpayers."⁶³ Also, just as *Flast* created an exception to the general rule against federal taxpayer standing for lawsuits based on the establishment clause, so too have federal courts recognized a similar establishment clause exception to the general rule against state taxpayer standing.⁶⁴

The establishment clause exception to the general prohibition against federal and state taxpayer standing is rooted in the unique nature of the establishment clause as a specific limitation on legislative power to tax or spend. Taxpayers are viewed as experiencing an injury sufficient to confer standing when the taxing or spending power is used "to favor one religion over another or to support religion in general." Under *Flast*, a plaintiff has standing even if he does not experience any measurable economic harm or direct injury as a result of the exercise of the power to tax or spend. In *Flast* the Supreme Court quoted James Madison's statement about the evil of forcing a citizen "to contribute three pence" for the support of a religious establishment. Although three pence is a trivial amount, a cognizable injury still exists whenever taxpayers are compelled to support religion financially; taxpayers therefore have standing.

When James Madison wrote about the evil of forcing taxpayers to contribute three pence for a religious establishment, he was referring to a proposed Virginia tax earmarked for a religious purpose. In our era, no such special tax is used to support religion. Instead, religion is unconstitutionally supported through expenditures paid from general tax revenues and by "tax expenditures" that benefit religion, such as sections 107 and 265(a)(6)(B).

⁶²*Flast*, 392 U.S. at 106.

⁶³*DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 345 (2006), Doc 2006-9420, 2006 TNT 94-18.

⁶⁴See, e.g., *Colo. Taxpayers Union, Inc. v. Romer*, 963 F.2d 1394 (10th Cir. 1992). The court stated:

After considering the cases relating to both federal and state taxpayer standing, we conclude that where an Establishment Clause violation is not asserted, a state taxpayer must allege that appropriated funds were spent for an allegedly unlawful purpose and that the illegal appropriations and expenditures are tied to a direct and palpable injury threatened or suffered. Only by meeting these requirements will a state taxpayer satisfy the "good-faith pocketbook" requirement of *Doremus*. *Id.* at 1401. [Emphasis added.]

These are the modern equivalents of the special tax that James Madison had in mind.

Sections 107 and 265(a)(6)(B) have a significant effect in the aggregate even though the impact on any one taxpayer is trivial in amount ("three pence"). The tax expenditures attributable to section 107 are estimated at \$700 million for 2010. American taxpayers are forced to participate in a tax system that subsidizes clergy, and they pay higher taxes or receive diminished government services as a result of the tax subsidies provided by sections 107 and 265(a)(6)(B). This is the evil that James Madison wrote about and that the Supreme Court was concerned with in *Flast*. The tax subsidies for clergy may be compared to the subsidies in *Texas Monthly*. Justice Brennan said the Texas sales tax exemption "burdens nonbeneficiaries by increasing their tax bills by whatever amount is needed to offset the benefit bestowed on subscribers to religious publications."⁶⁵

In *Warren*, the Ninth Circuit said, without analysis, that Chemerinsky would have standing under *Flast* if he sued to challenge section 107(2). This is the only known case directly stating that a federal taxpayer has standing to challenge federal income tax benefits for religion, although the Second Circuit also addressed this issue in *Abortion Rights Mobilization Inc. v. Baker*, 885 F.2d 1020 (2d Cir. 1989). In that case, the plaintiffs alleged that the IRS and Treasury were ignoring the Catholic Church's violations of the bans against lobbying and political activity in section 501(c)(3). The plaintiffs were thus challenging the government's failure to enforce the requirements of section 501(c)(3). The court stated that the plaintiffs "do not challenge Congress' exercise of its taxing and spending power as embodied in section 501(c)(3) of the Code; they do not contend that the Code favors the Church."⁶⁶ The clear implication of this language is that the plaintiffs would have had standing as taxpayers if they had challenged section 501(c)(3) itself or if they had alleged that in properly administering the code, the IRS granted tax benefits to the church. The case actually involved the opposite allegation — that the IRS was improperly administering the code. Because the IRS was allegedly acting contrary to the will of Congress, the court concluded that the plaintiffs did not have standing; there was "no nexus between plaintiffs' allegations and Congress' exercise of its taxing and spending power."⁶⁷

Federal courts, including the Supreme Court, have often exercised jurisdiction to rule on state taxpayers' challenges to special preferences for religion in state tax laws. In the *Byrne* case, the Third Circuit stated that the plaintiffs had standing under *Flast*, even though the parties had not raised the issue of standing. The Supreme Court summarily affirmed.⁶⁸

Federal courts are obligated to determine whether standing is present even if the parties do not raise the issue. In the absence of standing, there is no case or

⁶⁵*Texas Monthly*, 489 U.S. at 18, n.8.

⁶⁶885 F.2d at 1028.

⁶⁷*Id.*

⁶⁸See *Byrne v. Public Funds for Public Schools of New Jersey*, 590 F.2d 514, 516 n.3 (3d Cir. 1979), aff'd, 442 U.S. 907 (1979).

controversy as required by Article III of the Constitution. The Article III requirements for standing must be met whether the lawsuit challenges state tax laws or federal tax laws. Cases such as *Byrne* in which federal courts ruled on the merits of taxpayer challenges to state tax benefits for religion are relevant precedents in determining whether federal taxpayers have standing to challenge sections 107 and 265(a)(6)(B). There is no valid reason for federal courts to be more receptive to establishment clause challenges to state tax laws (as in *Byrne*) than challenges to federal tax laws. In fact, the opposite may be true because a federal court may be accused of violating principles of federalism and comity if it permits an establishment clause challenge to a state tax law to be heard on the merits.⁶⁹

In *Winn v. Arizona Christian School Tuition Organization*, 562 F.3d 1002 (9th Cir. 2009), *Doc 2009-9059, 2009 STT 76-1, cert. granted May 24, 2010*, the Ninth Circuit held that Arizona taxpayers have standing to bring an establishment clause challenge to Arizona income tax credits for contributions to school tuition organizations.⁷⁰ The Ninth Circuit relied on the fact that "the Supreme Court has repeatedly decided Establishment Clause challenges brought by state taxpayers against state tax credit, tax deduction and tax exemption policies, without ever suggesting that such taxpayers lacked Article III standing."⁷¹ The Ninth Circuit acknowledged that the exercise of jurisdiction by a court is not legal precedent for the existence of jurisdiction. Nevertheless, as it noted, the Supreme Court has consistently exercised jurisdiction in cases involving taxpayer challenges to state tax benefits for religion,⁷² and this practice is legally significant, as the

⁶⁹In *Taub v. Commonwealth of Kentucky*, 842 F.2d 912 (6th Cir. 1988), the court stated:

As recent Supreme Court decisions have made clear, the restrictions on federal taxpayer standing prevent unwarranted intrusions by the courts into matters entrusted to the legislative and executive branches of the federal government. This separation of powers concern has a counterpoint which should be considered when a state taxpayer seeks to have a federal court enjoin the appropriation and spending activities of a state government. Considerations of federalism should signal the same caution in these circumstances as concern for preservation of the proper separation of powers in an "all federal" action.

⁷⁰The Ninth Circuit, reversing the district court, denied the motion to dismiss for failure to state a claim on which relief can be granted. On May 24, 2010, the Supreme Court granted certiorari (Sup. Ct. Dkt. No. 09-987). The petition for certiorari raises the issue of standing in addition to the substantive establishment clause question.

⁷¹562 F.3d at 1010.

⁷²The cases cited by the Ninth Circuit include *Mueller v. Allen*, 463 U.S. 388 (1983) (state income tax deduction for expenses at religious schools); *Nyquist*, 413 U.S. 756 (1973) (hybrid state tax deduction-tax credit program for tuition paid to private schools); *Hunt v. McNair*, 413 U.S. 734 (1973) (state tax exemption for state-issued revenue bonds that went in part to religious schools); and *Walz*, 397 U.S. 664 (1970) (state property tax exemption for religious nonprofit organizations).

Supreme Court concluded in *Hibbs v. Winn*, 542 U.S. 88 (2004), *Doc 2004-12400, 2004 TNT 115-11*.⁷³

Similarly, the Sixth Circuit held in *Johnson v. Econ. Dev. Corp. of County of Oakland*, 241 F.3d 501 (6th Cir. 2001), that a Michigan taxpayer had standing to challenge the issuance of tax-exempt revenue bonds to finance the construction of buildings at Catholic schools. The Sixth Circuit concluded that the loss of tax revenues attributable to a religious tax exemption is an injury sufficient to confer standing on the plaintiff:

Contrary to Defendant's argument, the Supreme Court [in *Doremus v. Board of Education*, 342 U.S. 429 (1952)] did not distinguish between an expenditure and loss of revenue in determining whether there was a "good-faith pocketbook injury." Under *Doremus*, state taxpayer standing simply requires that there is a "requisite financial interest that is, or is threatened to be, injured by the unconstitutional conduct." 342 U.S. at 435. Moreover, the Supreme Court has decided several cases involving Establishment Clause challenges to tax exemptions as they relate to religious entities. See e.g., *Walz v. Tax Comm'n*, 397 U.S. 664 (1970) (property tax exemption for churches); *Hunt v. McNair*, 413 U.S. 734 (1973) (tax exemption for state issued revenue bonds, some of which went to religiously affiliated schools); *Mueller v. Allen*, 463 U.S. 388 (1983) (state income tax deduction for school expenses where some of taxpayers' children attended religious schools). Defendant argues that these cases have no precedential value because the Court did not specifically address whether the plaintiffs had standing in those cases. . . . Defendant's point is well-taken. Notwithstanding, in a case where the Supreme Court specifically addressed state taxpayer standing to challenge violations of the Establishment Clause, the Court cited with approval many of the cases it had previously decided on the merits without specifically addressing the standing issue, including *Hunt*, a case involving a program similar to the one at issue here. See *School Dist. v. Ball*, 473 U.S. 373, 380 n.5 (1985), overruled on other grounds by *Agostini v. Felton*, 521 U.S. 203 (1997).⁷⁴

In *Byrne*, *Winn*, and *Johnson*, federal appeals courts held that state taxpayers have standing to challenge a state tax credit, exemption, or deduction benefiting religion. These appellate decisions are based on the establishment clause exception to the prohibition against taxpayer standing. The establishment clause exception

⁷³In *Hibbs v. Winn*, the Supreme Court held that the Tax Injunction Act (TIA), 28 U.S.C. section 1341, did not bar a lawsuit brought by Arizona taxpayers to enjoin the operation of an Arizona tax statute that grants state income credits for contributions to nonprofit school tuition organizations. *Hibbs* relied on the fact that many courts, including the Supreme Court, had "reached the merits of third-party constitutional challenges to tax benefits without mentioning the TIA." 542 U.S. at 110.

⁷⁴241 F.3d at 507, 508.

also applies to FFRF's lawsuit. To rule on the constitutionality of sections 107 and 265(a)(6)(B) does not involve any extension of the principle established in *Flast*. *Flast* requires a logical nexus between the plaintiff's status as a taxpayer and the legislation being challenged. There is a logical nexus between a plaintiff's status as a federal taxpayer and provisions of the Internal Revenue Code that subsidize clergy. No distinction should be drawn between "tax expenditures" such as section 107 and ordinary congressional spending for purposes of the nexus requirement.

H. Conclusions

Sections 107(1), 107(2), and 265(a)(6)(B) are unconstitutional. They are narrow statutory preferences for religion that violate the establishment clause. The members of FFRF have standing as federal taxpayers to challenge those code sections.

Reform or Redesign? The Future Of the Personal Income Tax

By Allison L. Evans and Ralph B. Tower

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In this article, Evans and Tower evaluate the merits of the design of the personal income tax system based on the volatility of the federal tax base and the coordination of federal-state relationships. To enhance revenue stability and harmonization, they propose a streamlined framework that eliminates the current multistep calculation in favor of a simpler "income minus deductions" approach.

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A. Introduction

The economic events of the past three years have served as a powerful reminder of the consequences of failed predictions. Governments, businesses, and the general population must all respond to the resulting challenge. However, the present design of our tax system makes a coordinated effort virtually impossible. Stabilizing this design gives all parties the foundation necessary to evaluate and react to unforeseen economic events in a timely manner.

Governments depend on multiple tax systems to fund operations, each with a unique purpose and design ideal. Policymakers can achieve an optimal tax structure only if they focus first on design fundamentals, rather than on modification and amendment of existing law. A central consideration when creating a reliable tax design is the ability to project its revenue flow.

As legislators evaluate the efficiency and effectiveness of their tax regimes, they must concentrate their attention on primary revenue sources. In most jurisdictions, the personal income tax (PIT) system plays a critical role. Yet nearly a century of additions, modifications, and revisions has left a complex system that responds poorly to unexpected change. The multilayer, interrelated character of the PIT reduces the predictability of the resulting revenue stream. Compliance and collection costs increase for all concerned, and informed decision-making becomes close to impossible. The answer lies in a simpler system, one with more robust predictive power.

Through the lens of system stability, we examine the PIT designs currently used in the United States. This process enables us to identify critical features that improve system predictability and efficiency. A simpler design that shifts the tax base from a multistep taxable income (TI) model to a single-step "income minus deductions" (I-D) approach reduces volatility and offers a more