

Ministers' Housing Allowance Developments

Legal Status of Minister's Housing Allowance

Why it happened

What we can do about it

Tax Planning

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Minister's Housing Allowance Issues for 2014

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Introduction

- I attended school to be a preacher...
- I've done this before...
 - Never a Webinar!
 - Never on PowerPoint!
 - At my age technology kind of freaks me...
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Who are we?

- Steve Richardson & Company was founded in 1976...
- I have 38 years of experience as a CPA...
- Working with churches started out as a professional hobby and it kind 'a took off...
 - We do church audits and reviews...
 - Compensation planning...
 - Compensation planning is a big deal after the "Intermediate Sanction Regs" came out...
 - Tax consulting and tax preparation for ministers and church staff...

In 38 years I've seen everything (both good and bad)

- I have had some wild cases
 - Two revocations (very rare and I won both)
 - Death of a child on a youth retreat
 - Child molesting in a church daycare
 - Many more... Some (trust me on this) you cannot imagine!
- One of the most unusual cases was a man (a lawyer) who sued the church for a refund of his tithes based on false promises...
 - The law...
 - The unexpected solution...
- Each case has significant tax and financial implications

For the past 38 years I've seen every major trend in the church from the point of view of a CPA/Professional...

- I've see some bad things; but, I've also seen some good things too...
- The Church, right now, I believe is on the front edge of a miracle of restoration...
 - We had to hit rock bottom to be prepared for this new movement
 - We have hit rock bottom:
 - The 20-to-40 demographic has abandoned the church in record numbers... Why?
 - We no longer have the respect of our society...
 - We are no longer relevant to our culture...
 - I think we know why; it takes no genius to see our errors; Hindsight is 20-20. Better people than me can document our failures...

**Let's not lose sight of this:
the future role of the church in our society is very bright!**

- Nothing that happens in the 7th US Circuit Court will change that...
- **Stay focused!**

This is the trend that I see:

- The Generous Movement...
- Suggested Reading: **Generosity** by Gordon MacDonald...
- Our church's experience in this movement has been ... wow!
- Do not let this case cause you to lose focus!

The Case: we all know what happened!

On November 22, 2013, federal Judge Barbara Crabb from the Western District Court of Wisconsin (a President Carter appointee) struck down the ministerial housing allowance as an unconstitutional preference for religion. The ruling was in response to a lawsuit brought by the "Freedom From Religion Foundation" (FFRF) challenging the constitutionality of the housing allowance and the parsonage exclusion.

What is The “Freedom From Religion Foundation”?

- They are not Christian
- They are in fact opposed to religion in public or private life.

What is The “Freedom From Religion Foundation”?

• This is what they say about themselves:

The history of Western civilization shows us that most social and moral progress has been brought about by persons free from religion. In modern times the first to speak out for prison reform, for humane treatment of the mentally ill, for abolition of capital punishment, for women's right to vote, for death with dignity for the terminally ill, and for the right to choose contraception, sterilization and abortion have been freethinkers, just as they were the first to call for an end to slavery. The Foundation works as an umbrella for those who are free from religion and are committed to the cherished principle of separation of state and church.

What is Their Purpose?

- The “Freedom From Religion Foundation” has only one goal and they are very open about what that goal is:

That is to destroy the influence of Religion in our Society

- We can properly classify them as “the opposition”.

Why did they attack the “ministerial housing allowance?”

- Obvious: they want to hurt us so they are attacking the pocketbook!

Pain!!!

- As always: in politics, religion or crime - Follow the Money...
- We all know that the lifeblood of modern ministry is money.
- This will hit ministry where it hurts.

First: What is a “ministerial housing allowance?”

- The ministerial housing allowance
 - Is authorized by Section 107(2) [the (2) designates the 2nd paragraph of Section 107] of the Internal Revenue Code. This Code Section exempts the Clergy from paying taxes on income properly designated as a housing allowance.

Code Section 107 comes in two parts;

- The first part, Code Section 107(1) provides a similar benefit to a parsonage allowance for a church owned home.
- This section was left **for now** largely untouched by this ruling.

“For now” are two big words!

- If Section 107(2) falls, Section 107(1) will not be far behind.
- “For Now” doesn't help us – at all!
- Tax planning schemes based on Section 107(1) are ill-advised and, if 107(2) falls 107(1) will fall without a fight.

How much money is involved?

- As a direct result, the clergy saves Billions-of-Dollars each year in taxes! (I've seen estimates of \$700 Million but those estimates are way low.)
- I will explain why these estimates are low later.

Why is this case important!

- Many people are saying that this case will effect 50,000 or so members of the clergy (ministers, priests, rabbis, imams and others); that's also low.
- But, these same people are saying that, on average, these members of the clergy are facing a loss of take-home pay of 8 to 10%; that's not correct either.
- They are also saying that this will increase federal tax revenues by \$700-million; that's not correct. The number is much larger.
- The way these numbers are being calculated are based on IRS data; the IRS is notoriously bad at creating these data points.

Why these numbers are low

- **Example**
- An actual case study:
 - Taxpayer Minister has exempted himself from Social Security
 - He pays zero estimated taxes
 - He is married to a stay at home mom (home schooling her children)
 - They have two children
 - He earns:
 - Salary of \$25,000
 - Housing of \$20,000
 - Total Compensation = \$45,000!

Is this Minister typical?

- Unfortunately-Yes!
- Revolution by George Barna
 - The backbone of the Christian movement is...

The Tax Calculation

• He gets a 2012 refund of	\$4,733	
• Income taxes are		\$0
• Self-employment taxes are		\$0
• Earned income credit is		\$2,733
• Additional child tax credit is		<u>\$2,000</u>
• A total refund of:		<u>\$4,733</u>

If this case stands up:

• He gets a 2012 refund of	\$181	
• Income taxes are		\$0
• Self-employment taxes are		\$0
• Earned income credit is		\$0
• Additional child tax credit is		<u>\$181</u>
• A total refund of:		<u>\$181</u>

That tax increase is a lot more than 10% 2,515%

Steve's Maxim:

Bad Law always hits poor people hardest.

- I find that this maxim is true no matter the political rhetoric or the intent of the law; when we have bad law those least able to defend themselves (the poor) are the ones hardest hit.

Unanticipated

- If this case goes through the process and is ultimately affirmed, the church will have a significant humanitarian crisis in the clergy...

History of the Housing Allowance The Big Picture

- The housing allowance law was passed by Congress in 1954. (Prior to 1954...)
- History...
- Under this new law, subject to certain statutory guidelines, ministers are able to declare a portion of their ministry income as a housing allowance that is not subject to federal income tax.

The purpose of this law

- The purpose of this law was to give members of the Clergy an economic (tax) benefit.
 - Why? Why would congress feel the need to give members of the Clergy a tax benefit?
 - A compelling public need and a legitimate secular purpose ...
 - Congress felt that they had a compelling **secular purpose** and public policy need to subsidize members of the Clergy
 - Poverty
 - Health Care
 - Elder Care
 - Disaster Relief

Politics

- But – there was an unavoidable element of politics
 - LBJ and political payback!
- The public, in 1954, was in full agreement with Congress; they believed (in 1954) that the clergy was an essential part of the community and, because of near poverty level wages, any financial help from the IRS would be most welcome.
 - Things have changed...
 - What happened?

What happened?

- Coincidentally, shortly after the housing allowance was approved by Congress, the church began to lose public confidence. That decline continues to this day.
- We have lost the respect of our society...
- Why?

Lyndon Baines Johnson

- **LBJ, President Johnson, plays a significant role in the decline of the modern church...**

Why?

- We did what LBJ said we shouldn't do...
- We were largely on the wrong side in the Civil Rights movement...
- Liberal v. Conservative infighting in the Church...
- We lost our social charitable vision...
- We abandoned the poor...
- We put LBJ in a position to undermine the church through the political process... The Great Society

The loss of moral authority and social leadership...

- We have lost and are continuing to lose credibility with our society...
- This loss has legal, tax and financial implications...

Tax Theory

- Modern tax theory is not all that modern; it goes far back into history...
 - Before Epic of Gilgamesh was written modern tax theory was a fact of life
- Modern tax theory was ancient long before it migrated into English Common Law...
 - English Common Law is the foundation of the American legal system.
- Tax law is Statutory Law, not common law; but –
 - the environment in which it was written and the principles that drive it are inescapably rooted in English Common Law

Modern tax theory

- Modern tax theory says that 100% of the wealth of a nation belongs to the State (or, in ancient time, the King)...
- When citizens are allowed to keep a portion of their wealth that is called a:

Tax Expenditure

- When you are allowed to keep a portion of the money you earn, modern tax theory says that the State has made a "Tax Expenditure" by allowing a portion of the wealth that belongs to the state to accrue to your use.

A Christian viewpoint on modern tax theory

- We as Christians are, of course, comfortable with this theory; after all, we are 100% sure that the King does in fact own everything
- And –**
- We are responsible to the King of Kings for how we use his wealth!
 - And the state, of course, is ordained by God...

Striking similarities

- There are remarkable similarities between the Christian view point on wealth and modern tax theory. The state allows certain tax expenditures to be made for different reasons:
- Lessens the burdens of government
 - The State has a vested interest in the welfare of its people.
 - The State recognizes that seeing to the welfare of its people is too daunting a task for the State alone, therefore people and organizations who do lessen the burdens of government are allowed "Tax Subsidies" by the State

Some obvious burdens of government that cannot be entirely managed by the state alone are:

- Poverty
- Health Care
- Elder Care
- Disaster Relief
- Prison reform and rehabilitation

We come full circle...

- Our society and our nation no longer sees us as a viable ally in addressing these burdens of government.
- So, we have had and will continue to have attacks aimed at the church...

The Case

- The “Freedom From Religion Foundation” won this case; they got everything they wanted. From their point of view, this was a total victory!
- This was “the perfect storm”; Judge Barbara Crabb does not have a church-friendly track record when ruling on issues related to religion. They got the Judge that they wanted to win this case.
- Crabb also ruled in 2010 that the National Day of Prayer was unconstitutional; that ruling was overturned the following year.
- Getting the right judge may end up working against them in the long-run.

The Ruling

- The court ordered the IRS and the Department of the Treasury to refrain from enforcing Section 107(2) **but** the ruling "shall take effect at the conclusion of any appeals . . . or the expiration of the deadline for filing an appeal, whichever is later."
- Those appeals will initially go to the Seventh Circuit Court of Appeals in Chicago.
- This will not be a quick process.

There is some (limited) cause for hope

- Seventh Circuit Court of Appeals in Chicago, which covers the states of Wisconsin, Illinois and Indiana, is far more church friendly when they have ruled on matters related to religion.
- This court has overruled Judge Crabb's anti-religious decisions.
- Judge Crabb, in 2010, ruled that the National Day of Prayer was unconstitutional; that ruling was overturned by this court.
- This is also the court that barred the enforcement of the Obama administration's contraceptive mandate. That ruling will very likely be taken up by the U.S. Supreme Court next spring.
- It is possible that the 7th Circuit will overrule Judge Crabb; it will not surprise me if they do.

The US Supreme Court

- Win or lose – in my opinion, this case or one much like it, will eventually get to the Supreme Court.

If the ruling is appealed and affirmed by the Seventh Circuit Court of Appeals, it will only apply to ministers in that circuit (Illinois, Indiana, and Wisconsin).

We could have a situation where tax law in Illinois, Indiana, and Wisconsin is different from tax law in the rest of the country. This is not unprecedented (actually it has happened numerous times in the past) but, if it does happen, the Supreme Court will most definitely get involved.

No matter what happens, this case or one much like it will eventually be appealed to the Supreme Court.

BUT: This could take years!

In the mean-time

- As a result, the church should continue to apply the law and designate housing allowances for their ministerial staff.

[Advice: (1) Do a good job of documenting full compliance with the law. (2) Do not push the envelope. (3) Each subsequent year consult with a qualified tax professional on this issue until it is resolved.]

- How to do a good job?

How do you do a good job in tax compliance...

- Follow the law:
 - Approve the housing allowance in advance
 - I suggest that the housing allowance be approved in a resolution as a part of the budget process in the most recent preceding year.
 - Make a formal resolution each year...
 - The mermaid rule of tax law...

The heart of Judge Crabb's ruling

- The court (Barbara Crabb from the Western District Court of Wisconsin) determined that the housing allowance under section 107(2) is an **unconstitutional preference for religion** since the same benefit is not provided to other taxpayers.

The legal precedent

- The court relied on a 1989 decision by the United States Supreme Court in which the Court ruled that a Texas statute exempting from the state sales tax periodicals and books "published or distributed by a religious faith" was an unconstitutional preference for religion. The Supreme Court concluded that tax exemptions that include religious organizations "must have an overarching **secular purpose** that equally benefits similarly situated nonreligious organizations."

This purpose must be one that lessens the burdens of government.

The legal precedent (#2)

- 1989 decision by the United States Supreme Court is a good ruling; it is consistent with a long history of cases where preferential treatment for religion is based on compelling "**secular purposes**".
- The concept of "**secular purposes**" is built into tax law.

The legal precedent (#3)

- The Supreme Court must abide by its own ruling. In the 1989 case, the Court ruled that tax exemptions that include religious organizations "must have an overarching **secular purpose** that equally benefits similarly situated nonreligious organizations." Judge Crabb could find no secular purpose to justify special treatment for a housing allowance that benefited only the clergy.

What are those purposes?

- Poverty
- Health Care
- Elder Care
- Disaster Relief
- Etc.

The legal precedent (#4)

- Judge Crabb also concluded that other provisions of the tax code that recognize housing allowances, and it referred specifically to state department employees and the military, "is not enough to point to a small number of secular groups that could receive a similar exemption for a different reason."
- The implications: housing allowances for state department employees and the military do serve a well understood "**secular purpose**".

What is a “secular purpose”?

- This is the heart of Judge’s Crabb’s ruling.
- We need to understand this concept because we will keep hearing it

In 1998 I wrote a book, **The Eagle’s Claw: Christians and the IRS**. It was a good book; did well in the market place. Now it seems almost prophetic. In that book I discussed the concept of “secular purpose” as codified in the Internal Revenue Code as actions that – *Lessening the burdens of government*.

The Eagle’s Claw: Christians and the IRS

- **Book quotations:**
- “The idea that an organization or individual should be blessed by government because it “lessens the burdens of government” is as old as ancient English common law. This concept is also a fundamental part of American law.”
- “The IRS’s own regulations, Section 1.501(c)(3)-1(d)(2), tells us what kind of activities tax favored organization should be active in providing to society: “relief of the poor and distressed or of the underprivileged; ... advancement of education; ... and *Lessening the burdens of government*””
- Code Section 501 is at the heart of how the IRS and the Courts look at tax subsidies that are related to the church and religious communities.

I want to make a point here

- Another book quote, “These regulations read like they came directly out of Matthew 25; when the IRS tells us to take care of people in need, they are asking us to obey the Word of God.”
- Book quote, “There is a direct and undeniable link between a failure to follow God’s demands on the Church and high taxes. To me, such a link is irrefutable.”

The Link

- When the government must step in and do our job, the job assigned by God to the church, it costs money. To pay for these social services requires taxes.
- Naturally the government looks to our tax subsidies to collect those taxes.

The Impact

- The financial impact of this ruling, if upheld, will be significant.
 - Ministers who purchased homes relying on the housing allowance
 - Earned Income Credit Calculations
- This will cause serious hardships! This ruling, if upheld, will be far more than a mere financial inconvenience

Unconstitutional

- If this ruling stands, the Constitutional challenge means that Congress is very limited in what they can do to mitigate the dire financial impact of the ruling. Congress can't change the law to make it Constitutional. When we lose in the Courts, we lose with no recourse.
- We cannot look to Congress to undo this case!

Prediction (I may be wrong in the short run)

- It is my personal belief that this case will be upheld on appeal to the 7th Circuit.
- I believe it will be difficult for the 7th Circuit to ignore a substantial body of law that has developed in the courts that say Judge Crabb is legally on solid ground
- From there it will move on to the US Supreme Court and, it will be upheld there. I do not believe that the Supreme Court will overrule its own cases that support Judge Crabb.
- In short, I believe that we will lose this case; I believe that the Minister's housing allowance will be ruled unconstitutional.

I may be wrong on the details of my predictions

- We may win in the 7th Circuit.
- The 7th Circuit is a conservative court
- They have overruled Judge Crabb before on religious matters.
- In the long run we will ultimately lose. These people who oppose the church will keep coming and coming until they win...

What does it mean?

- I've run a few test cases. If you are a prosperous minister with a total financial package of \$70,000 half in housing allowance, your taxes will increase by \$10,000 per year. Ministers who make less than this prosperous minister will be hit harder!
- Much Harder!

Can Congress Help?

- Congress cannot take something that is unconstitutional and make it constitutional; if this ruling is upheld we lose the ministerial housing allowance permanently!

Can Congress Mitigate the impact?

- Yes they can, if they will.

Discussions about this case are far from over

Other Resources

- Richard R. Hammar, CPA, LLM and half-a-dozen other initials too...
- His publication: "Church Law and Tax Report" is essential reading for churches

Court cases often have unintended consequences

- On Friday, the 13th of December 2013, a federal judge has struck down parts of Utah's anti-polygamy law as unconstitutional. Judge Clark Waddoups of United States District Court in Utah ruled late Friday that part of the state's law prohibiting polygamy violates the First Amendment guarantee of free exercise of religion, as well as constitutional due process.
- Judge Waddoups, is a conservative, appointed by President George W. Bush
- His opinion and reflects upon the nation's changing attitude toward government regulation of personal affairs and unpopular groups.

Q&A

- The 1st question is from a client via email.
- **Senior Pastor of a Large Church:**
- Q: I am concerned about the future for our ministers on staff and want to do something to try to help them before this housing allowance issue become the law of the land.
 - **Excellent! Good decision making; but it must be on a voluntary basis....**
- My questions are:

Q&A

- My questions are:
- #1. Would it be legal to take money that the church was going to put into their retirement fund (both their deduction, the matching amount from the church, and the amount that the church contributes) and put it directly on to their mortgage payment?
- **Yes it would be legal to do this; it needs to be supported by a resolution from the committee overseeing staff compensation and designated as an additional housing allowance. Making this a part of the housing allowance is, of course, a technical tax issue; they will need a CPA to guide them. This much additional housing allowance may run into the “Fair Rental Value” limitation.**

Q&A

- My questions are:
- #2. If that is legal, would it be a smart thing to do?
 - **Yes; it is a smart thing to do if your staff will follow through as you intend. The mortgage rate being paid by your staff exceeds any likely return that they will get from the market place. People, especially people with young families, will often sabotage their own financial future to manage a short term cash flow issue.**

Q&A

- My questions are:
- #3. Here is what I am thinking. I know that the money would be taxable (as income) rather than tax-deferred as part of the retirement program but it seems to me that knowing that your mortgage was getting paid down faster would be a great retirement plan in itself. Of course, we would need to insure that the pastors were still making their monthly mortgage payment and that this was not replacing that (that would be terrible.)
 - 1st, if the housing allowance is designated properly, it may not be taxable. Diversion of the additional mortgage payment is a valid concern; as pointed out above young families may willfully sabotage this arrangement; but, there is an easy fix to help these younger staff make the right decisions. Make these additional mortgage payment distributions twice a year on June 1 and December 1. Additional unscheduled payments in no way changes the normal monthly scheduled payments. By the terms of their mortgage, they must maintain their regularly scheduled mortgage payments....
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Q&A

- My questions are:
- #4. My idea is that if we offered all ordained ministers the opportunity to divert their retirement contributions (in our church that is a minimum of 3% from the church and then there is a matching opportunity up to 4%. If the minister will put in 4% the church will put in 4%. So, that brings it to a maximum of 11% a year. If we had a plan where for a set number of years (maybe three years) we would put their retirement contribution directly to pay down their mortgage (understanding that they will have to pay tax on that amount), would that be a good thing or not?
 - **Excellent Plan! It is a clear win for your staff with no downside for the church; I like it.**

Q&A

- One additional thing:
- Never. Trust. A. Banker. To state this as a positive, always get your annual mortgage statements and study them to see that the additional, unscheduled, mortgage payments are shown as reductions in principal! I state this from experience.