Nos. 18-1277 and 18-1280

In the United States Court of Appeals for the Seventh Circuit

ANNIE L. GAYNOR, et al.,
Plaintiffs-Appellees,
v.

STEVEN T. MNUCHIN, Secretary of the United States Department of Treasury, et. al,
Defendants-Appellants,
and

EDWARD PEECHER, et. al,
Intervening Defendants-Appellants,

On Appeal from the United States District Court
for the Western District of Wisconsin,
No. 3:16-cv-00215, Judge Barbara B. Crabb Presiding

BRIEF OF EVANGELICAL COUNCIL FOR FINANCIAL ACCOUNTABILITY, UNION OF ORTHODOX JEWISH CONGREGATIONS OF AMERICA, NATIONAL ASSOCIATION OF EVANGELICALS, THE LUTHERAN CHURCH—MISSOURI SYNOD, COUNCIL OF CHURCHES OF THE CITY OF NEW YORK, QUEENS FEDERATION OF CHURCHES, AND CHRISTIAN LEGAL SOCIETY AS *AMICI CURIAE*
IN SUPPORT OF APPELLANTS AND URGING REVERSAL

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Appellate Court No: 18-1277, 18-1280

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Appellate Court No: 18-1277 and 18-1280

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EVANGELICAL COUNCIL FOR FINANCIAL ACCOUNTABILITY

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STATEMENT OF IDENTITY OF *AMICI CURIAE*, INTEREST IN THE CASE, AND SOURCE OF AUTHORITY TO FILE[1]

Amici joining this brief include religious bodies and denominations of the Jewish and Christian faiths, as well as nonprofit entities that assist religious organizations on matters such as financial accountability, religious liberty, and other issues. Through their work with clergy and congregations, *amici* have knowledge about the importance and operation of housing allowances for ministers—and a deep concern about the harms that would follow if the federal tax excludability of such allowances under 26 U.S.C. § 107(2) were invalidated. Over 64 years, the housing allowance has become deeply embedded in the American church-state tradition and in the compensation and retirement plans of ministers, their congregations, and their retirement fiduciaries. *Amici* file this brief to document that widespread use and detail the financial burdens that invalidation of § 107(2) would cause for many ministers—including retired ministers—and congregations. Addendum I to this brief details the interests of specific *amici*.

[1] Pursuant to FRAP 29(a)(4)(E), neither a party nor party's counsel authored this brief, in whole or in part, or contributed money that was intended to fund preparing or submitting the brief. No person (other than the *amici curiae*, their members, or their counsel) contributed money that was intended to fund preparing or submitting the brief. Pursuant to FRAP 29(a)(2), all parties have consented to the filing of this brief.

SUMMARY OF ARGUMENT

The exclusion from income tax for ministerial housing allowances extends back more than six decades; it is part and parcel of a policy extending back almost to the origin of the Internal Revenue Code. *Amici* agree with appellants that this longstanding provision fully coincides with the Establishment Clause and our nation's tradition of religious freedom. As appellants explain, 26 U.S.C. § 107(2) is among several provisions that allow employees to exclude employer-provided housing or housing benefits from income in various situations. And § 107(2)'s particular contours serve important constitutional values: equality among religious denominations and non-entanglement between church and state. Brief for Federal Appellants at 49-55; Brief of Intervening Defendants-Appellants at 37-49.

Amici file this brief for a distinct purpose: to detail the impact that invalidating § 107(2) would likely have on ministers and their congregations. In *Walz v. Tax Commission*, 397 U.S. 664, 676 (1970), the Supreme Court refused to invalidate tax exemptions that were "deeply embedded in the fabric of our national life"; it also took notice of the burdens that congregations would suffer were they subject to taxation. For these same reasons, this Court should reject the Establishment Clause attack on the longstanding exclusion from income for ministerial housing allowances.

To detail the impact of invalidating § 107(2), *amici* draw on standard nationwide surveys and perform basic calculations of ministers' tax liability, in hypothetical examples, with and without the exclusion. These figures lead to several significant conclusions:

A. Housing allowances excludable under § 107(2) are deeply embedded in our national life—that is, widely used in ministerial compensation structures. Figures in studies indicate that anywhere from 61 to 81 percent of congregations rely on housing allowances (as opposed to church-owned parsonages) to give their ministers housing benefits.

B. Invalidating § 107(2) would significantly disrupt the activities of ministers and congregations that have relied on the provision. The effects are evident in simple hypothetical examples involving a congregation of around the median-size budget, which is a modest $85,000. Solo ministers in that range receiving the median base salary—a modest $35,000— and a median housing allowance could see their federal tax liability nearly triple. To keep their ministers or preserve their financial stability, congregations would have to offset the added tax liability, including increased state income taxes. And the added compensation to accomplish that offset must significantly exceed the added taxes, since the new compensation is itself subject to federal and state income tax and federal self-employment tax. Calculating these effects in a simple hypothetical for a median-

sized congregation shows how disruptive the invalidation of § 107(2) would be for congregations that have little cushion to absorb the effects.

C. Invalidation of § 107(2) would disproportionately harm smaller congregations and those that must rely on a housing allowance as a means of structuring clergy compensation. The numerous congregations with small budgets have little flexibility to absorb the costs of increased compensation for their ministers. The effects on congregations with modest resources will be particularly severe in urban areas, where housing is particularly expensive.

D. Finally, invalidation would especially harm retired ministers and those nearing retirement. They have relied significantly on the ability to allocate retirement benefits to housing allowances. And retired ministers cannot cushion against the harm to their reliance, because they cannot receive higher salaries to compensate for their sudden added tax liability.

ARGUMENT

I. The Constitutional Validity of the Housing-Allowance Exclusion Is Supported by Its Long and Widespread Use, Its Reaffirmation by Congress in 2002, and the Reliance that Ministers and Congregations Have Placed on It.

The housing-allowance exemption has roots going back to the inception of the modern federal income tax. Predating the tax code, the practice of providing housing for a minister—namely, a parsonage—crossed the Atlantic with the

American colonists. A10 (Decl. of James Hudnut-Beumler, ¶24).[2] Following the passage of the Sixteenth Amendment and creation of federal income tax in 1913, questions arose concerning ministers' housing. In response to the Department of Treasury's ruling that the fair rental value of parsonages was taxable income, Congress enacted § 213(b)(11) of the Revenue Act of 1921, Pub. Law No. 98, 42 Stat. 227, 239, to explicitly exempt parsonages. A20-21 (Hudnut-Beumler Decl., ¶¶72-77).

The exclusion for church-owned parsonages, however, "applied only to clergy of more established churches with fulltime clergy serving communities with enough accumulated capital to build or acquire a parsonage." App. A22 (Hudnut-Beumler Decl., ¶¶85-86). This limitation "made for a relatively high barrier of entry to newer and less affluent congregations seeking to provide for the temporal needs of their clergy so that the clergy could tend to the spiritual needs of the congregation." *Id.* In response, Congress enacted § 107(2) in 1954 to remove the "unfair[ness] to those ministers who are not furnished a parsonage, but who receive larger salaries (which are taxable) to compensate them for expenses they incur in supplying their own home." H. Rep. No. 83-1337, 1954 U.S. Code Cong. &

[2] Following the convention of appellants, we use "A" to refer to pages in the separate Appendix for the Appellants.

Admin. News 4017, 4040 (1954). This extension of the policy behind the parsonage exclusion has remained in place for 64 years.

Section 107(2) is not only longstanding; it has recently been reaffirmed overwhelmingly by Congress. The Clergy Housing Allowance Clarification Act of 2002, Pub. L. No. 107-181, made explicit the longstanding practice that exclusion of an allowance was limited to the "fair rental value" of the housing. But the act was also intended, as its chief sponsors made clear, to "protect the housing exclusion" by resolving a case in which an argument against its constitutionality had been raised *sua sponte* by a Ninth Circuit panel. See 148 Cong. Rec. H1300 (Apr. 16, 2002) (discussing *Warren v. Commissioner*, 282 F.3d 1119 (9th Cir. 2002)); *id.* (statement of Rep. Ramstad) (purpose was to "preserve the important housing allowance"). Both sponsors noted, among other things, that "[c]lergy members of every faith and denomination rely on the housing allowance" (*id.* at H1299 (Rep. Ramstad)) and that "[c]hurches, which already operate on the thinnest of margins, would be unable to offset th[e] tax increase" that would occur if the exclusion did not exist. *Id.* at H1300 (Rep. Pomeroy). The act passed by a 408-0 vote in the House and by unanimous consent in the Senate.

This long history and wide-ranging support are highly relevant to the constitutionality of § 107(2). The Supreme Court has made clear that "the Establishment Clause must be interpreted 'by reference to historical practices and

understandings.'" *Town of Greece v. Galloway*, 134 S. Ct. 1811, 1819 (2014) (quotation omitted) (upholding practice of non-coercive, non-disparaging legislative prayers). Most relevant to this case, *Walz v. Tax Commission*, 397 U.S. 664 (1970), rejected an Establishment Clause challenge to property-tax exemptions granted to religious organizations for properties used for religious worship. The Court found it "significant" that such exemptions had long historical acceptance and had become "deeply embedded in the fabric of our national life." *Id.* at 677, 676. Although long use does not give a "vested right in violation of the Constitution," the Court said, the long practice of "according the exemption to churches, openly and by affirmative state action, not covertly or by state inaction, is not something to be lightly cast aside." *Id.* at 678. Nor should the courts cast aside the policy of excluding ministerial housing from income, a policy that in some form has existed almost since the start of the Internal Revenue Code and that Congress has recently reaffirmed resoundingly.

Among other things, the long history of a practice can show that it does not create the sorts of harms the Establishment Clause was meant to prevent. In *Walz*, the Court held that longstanding exemptions for churches had not "given the remotest sign of leading to an established church or religion." 397 U.S. at 678. And in *Van Orden v. Perry*, 545 U.S. 677 (2005), which upheld a Ten Commandments display on the Texas state capitol grounds, Justice Breyer's

crucial concurring opinion focused on the monument's history. The fact that it had existed more than 40 years, he said, "suggest[ed] more strongly than can any set of formulaic tests that few individuals, whatever their system of beliefs, are likely to have understood the monument as amounting, in any significantly detrimental way, to a government effort to favor a particular religious sect, primarily to promote religion over nonreligion." *Id.* at 702 (Breyer, J., concurring). Likewise, instead of creating an established church, the housing allowance—in continuous use for 64 years—has allowed congregations of all faiths to structure their ministerial compensation packages to better provide for the diverse religious needs of their ministers and their congregations.

Section 107(2)'s constitutionality is bolstered by a recognition of the harms that ministers and congregations would suffer if they were subject to greater taxation. Justice Brennan, concurring in *Walz*, emphasized the "significant impact" that "the cessation of exemptions" would cause (397 U.S. at 692):

> Taxation … would bear unequally on different churches, having its most disruptive effect on those with the least ability to meet the annual levies assessed against them…. By diverting funds otherwise available for religious or public service purposes to the support of the Government, taxation would necessarily affect the extent of church support for the enterprises that they now promote. In many instances, the public service activities would bear the brunt of the reallocation[.]

Finally, § 107(2)'s history and widespread use strengthen reliance interests. Whether or not such interests are conclusive, the Supreme Court "counts the cost

of a rule's repudiation [for] those who have relied reasonably on the rule's continued application." *Planned Parenthood v. Casey*, 505 U.S. 833, 855 (1992). The Court emphasized that "[t]he Constitution serves human values"; for that reason, it said, it would consider "the certain cost of overruling" a longstanding rule "for people who have ordered their thinking and living around the case." *Id.* at 856. Analogously, the cost of overruling § 107(2) for diverse clergy and congregations nationwide, those that have "ordered their thinking and living" around the statute, cannot be dismissed. The next part, among other things, estimates that "certain cost."

II. Basic Data Show that the Housing-Allowance Exclusion Is Deeply Embedded in National Life and Invalidating It Would Significantly Disrupt Ministers and Congregations.

In this part, *amici* draw on basic, widely available studies to show the impact that invalidating § 107(2) would have on clergy and congregations. This Court can take notice that the housing-allowance exemption is "deeply embedded in … our national life"—widely used by congregations nationwide—and that invalidating it would have significantly "disruptive" effects on ministers and congregations that have reasonably relied on it. *Walz*, 397 U.S. at 676; *id.* at 692 (Brennan, J., concurring).

We draw the figures and calculations from several standard sources, including well-recognized national surveys:

- National Congregations Study (NCS): This randomized study provides information regarding 3,815 congregations in the United States, collected over three waves: 1998, 2006-2007, and 2012. Mark Chaves & Allison Eagle, *Religious Congregations in 21st Century America: National Congregations Study*, 1 (2015), http://www.soc.duke.edu/natcong/Docs/NCSIII_report_final.pdf (hereinafter "NCS").
- Pulpit and Pew: This study employed telephone interviews, supplemented by focus groups, with senior and solo pastors of Christian denominations and a sample of non-Christian religious leaders from April to October 2001. Pulpit & Pew National Survey of Pastoral Leaders (2001), http://www.thearda.com/Archive/Files/Descriptions/CLERGY01.asp (hereinafter "Pulpit & Pew").
- United States Congregational Life Survey (USCLS): This randomized study used self-administered surveys from church attendees, congregation profiles, and religious leaders from 2008-2009. We use the survey of church leaders. U.S. Congregational Life Survey, Wave 2, 2008/2009, Random Sample Leader Survey (2008-2009),

http://www.thearda.com/Archive/Files/Descriptions/CLS08LS.asp (hereinafter "USCLS").

- Finally, we use figures from Richard R. Hammar, *2018 Compensation Handbook for Church Staff* (Christianity Today International 2018). The *Compensation Handbook*, which seeks to provide congregations with information regarding compensation practices, is a non-randomized study with data provided by subscribers of *Church Law & Tax Report*, *Church Finance Today*, and other publications. *Id.* at 2. From February to May 2017, the study received data for 7,000 staff positions for publication by *Church Law & Tax Report*. *Id.* The *Compensation Handbook* offers the most detailed compilation of figures concerning the prevalence and size of ministers' housing allowances.

We cite figures in two categories. First, aggregate figures—for example, the percentage of ministers who receive housing allowances—confirm that the allowance excludable under § 107(2) is widely used, that is, "deeply embedded in the fabric of our national life" (*Walz*, 397 U.S. at 676). Second, specific simple examples show the amount by which invalidation of § 107(2) would increase the tax liability of a minister receiving a given base salary and housing allowance—and in turn, the additional compensation the congregation would have to pay to offset the minister's increased taxes. These examples confirm that if § 107(2) were

invalidated, ministers and congregations that have relied on it in good faith would suffer substantial "disruptive effect[s]"—especially small congregations and retired ministers, who have "the least ability" to absorb the resulting costs. *Walz*, 397 U.S. at 692 (Brennan, J., concurring).

A. Housing Allowances Excludable under § 107(2) Are Deeply Embedded in National Life—Widely Used in Ministerial Compensation Structures.

A large percentage of congregations use the housing allowance exemption in structuring their ministers' compensation packages. The *Compensation Handbook*, *supra*, reports that 81 percent of full-time senior pastors receive a housing allowance, as do 75 percent of associate pastors and 67 percent of full-time solo pastors. *Compensation Handbook* at 16 tbl. 3-1. Pulpit & Pew reports that 63.5 percent of respondent ministers receive a housing allowance. Pulpit & Pew, Codebook, http://www.thearda.com/Archive/Files/Codebooks/CLERGY01_CB.asp, at no. 237. And USCLS reports that 61.7 percent receive a housing allowance. USCLS, Codebook, http://www.thearda.com/Archive/Files/Codebooks/CLS08LS_CB.asp, at no. 89. Whether the number is closer to 61 percent or 81 percent, the major surveys indicate that a large majority of congregations have "ordered their thinking" around housing allowances (*Casey*, 505 U.S. at 856) in structuring compensation for their ministers.

Given these percentages, invalidation of § 107(2) would affect an enormous number of religious congregations, of all faiths. According to a recent study, the U.S. has approximately 384,000 congregations. Simon G. Brauer, *How Many Congregations Are There?: Updating a Survey-Based Estimate*, 56 J. Sci. Stud. Religion 438, 444 (2017) (using the NCS to calculate the number of congregations nationally). If the percentage of congregations using a housing allowance ranges from 61.7 percent to 81 percent, the corresponding number of congregations using such an allowance ranges from 236,928 to 311,040.[3] These 200,000-300,000 congregations nationwide will be required to revisit and restructure their ministerial compensation packages as a result of invalidation. As discussed below, these congregations will each be required to make up the difference between their minister's former base salary and housing allowance with an increased base salary

[3] The total amount of new tax burdens would also be very large. The Treasury estimates that ministers would be assessed $970 million in 2018 taxes if the parsonage and housing-allowance exclusions—§ 107 as a whole—were not in place. U.S. Department of the Treasury, Office of Tax Analysis, Tax Expenditures 23 (Oct. 16, 2017), https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2019.pdf. (Although the Treasury refers to the reduction in revenue attributable to § 107 as a "tax expenditure," the Supreme Court has emphasized that "[t]he 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." *Walz*, 397 U.S. at 675.) If the 107(2) exclusion accounts for somewhere between 61.7 percent and 81 percent of the $970 million, then the additional 2018 tax burden on ministers from invalidation of that exclusion would range between $598.5 million and $785.7 million.

that encompasses housing expenses and increased tax liabilities. In turn, the new ministerial salary structures will place significant strain on already modest church budgets.

B. Invalidating § 107(2) Would Significantly Disrupt the Activities of Ministers and Congregations that Have Relied on the Provision.

A few hypothetical examples indicate the adverse financial effects that will befall ministers and congregations nationwide if § 107(2) were invalidated. For that end, we employ a variety of national studies. We begin with data reflecting the median church attendance and budget. The NCS reports that in 2012, the median church had a weekly attendance of 70 and an annual budget of $85,000. NCS at 39, 40. As these figures show, a large number of American congregations have very modest resources—from rural parishes to urban storefront churches to small communities of immigrant-oriented religions.

To match the median figure of 70 attendees with figures on clergy compensation, we use the *Compensation Handbook*, *supra*, which breaks down compensation based on church attendance; its roughly corresponding category is for congregations with 100 or fewer attendees. The median base salary in that category is $35,000 for a full-time solo minister and $30,000 for a full-time senior minister. *Compensation Handbook* at 42, 28. These median base salaries are comparable and are confirmed by a different survey: the USCLS, which finds that

the mean salary for a minister is $39,392. USCLS, at no. 84. All these figures dramatize how many ministers receive very modest salaries.

Using these figures, we perform tax calculations in simple scenarios, for individual filers and for married couples filing jointly. Under the new tax law, the standard deduction for married filing jointly is $24,000 and for filing single is $12,000. 26 U.S.C. § 63(c)(7)(A). We use the Internal Revenue Code tax brackets for 2018 to calculate the tax liability. 26 U.S.C. § 1(j)(2)(A) (married filing jointly); *id.* § 1(j)(2)(C) (single filers). We begin with adjusted gross income—first with the housing allowance excluded from income, second with it included—and then subtract the standard deduction to arrive at taxable income. Inputting taxable income into the relevant tax bracket yields the tax liabilities when the housing allowance is excluded and included in income—and the increase in federal tax liability from including the allowance in income. But the increase in the federal income figure also likely increases state income taxes, which are commonly tied to the federal number. To offset the combined additional federal and state taxes on its minister(s), a congregation will have to pay an even larger amount of additional compensation, since any such compensation is itself taxable. Calculating these figures in a simple example demonstrates the significant added burdens on ministers and on their congregations.

1. Example 1: Full-Time Solo Pastors

As a prime example, consider a full-time solo pastor in a roughly median-sized congregation (under 100 attendees). In that category, the median base salary is $35,000, and the median designated housing allowance is $18,000. *Compensation Handbook* at 42.

With respect to the federal taxes, assume that this median minister is filing as an individual. If the $18,000 housing allowance is excluded from income, the minister has $35,000 in adjusted gross income and (after the $12,000 standard deduction) taxable income of $23,000. This produces a federal tax liability of $2,570. But if the housing allowance were included in adjusted gross income, because § 107(2) had been invalidated, the adjusted gross income would be $53,000 and the taxable income $41,000. The tax liability would nearly double, to $4,960. The increase in federal tax liability from including the housing allowance in income is $2,390.

A married minister filing jointly in this situation would face a near tripling of federal tax liability. Such a minister who excludes the housing allowance has $35,000 in adjusted gross income and (after the $24,000 standard deduction) $11,000 in taxable income. The federal tax liability is $1,100. But with the housing allowance included, adjusted gross income rises to $53,000 and taxable income to $29,000. The tax liability rises to $3,099, a 182 percent increase.

We show these federal-tax figures in table form:

Facts:		
Base Salary:	$35,000	
Official Housing Designation:	$18,000	
Housing Allowance Excluded	**Single filer**	**MFJ**
Adjusted Gross Income	$35,000	$35,000
Standard Deduction	$12,000	$24,000
Taxable Income	$23,000	$11,000
Tax	$2,570	$1,100
Housing Allowance Included	**Single filer**	**MFJ**
Adjusted Gross Income	$53,000	$53,000
Standard Deduction	$12,000	$24,000
Taxable Income	$41,000	$29,000
Tax	$4,960	$3,099
$ Increase in Tax	$2,390	$1,999
% Increase in Tax	93%	182%

Congregations will be required to offset these decreases in their ministers' take-home pay or risk losing their ministers' services. But the numbers above will be just the start of burdens on the congregation, for several reasons:

1) ***State Income Taxes.*** Ministers would also likely face increased state income-tax liability that their congregations would have to offset. Almost three-quarters of states (36 in total) use federal definitions of adjusted gross income, gross income, or taxable income as starting points for state taxable income. Nicole Kaeding, *Does Your State's Individual*

Income Tax Code Conform with the Federal Tax Code? (Dec. 13, 2017), https://taxfoundation.org/state-individual-income-tax-code-conform-federal-tax-code/. Although state income-tax structures and rates vary widely, we offer the example of Wisconsin, where plaintiffs filed this lawsuit, and which ties its taxable income initially to federal adjusted gross income. See Form 1 Instructions, Wisconsin Income Tax 2017, at 12, https://www.revenue.wi.gov/TaxForms2017through2019/2017-Form1-Inst.pdf. For the single-filer minister in our example, the $18,000 housing allowance now treated as taxable income would be taxed at a marginal rate of 6.27 percent, which in itself would produce an increased state tax liability of $1,129.[4] In fact, however, the increase would be greater, because in Wisconsin the standard deduction decreases as income rises. See Form 1 Instructions, *supra*, at 55 (2017 Standard Deduction Table). The actual increase in state tax liability would be $1,266, as explained in the footnote.[5] Adding $1,266 to the increased

[4] State of Wisconsin, Department of Revenue, Tax Rates, https://www.revenue.wi.gov/Pages/FAQS/pcs-taxrates.aspx (6.27 percent marginal rate for taxable income over $22,470 but not over $247,350). We use rates for 2017 taxes, the latest officially published; 2018 rates are reported as being the same. Morgan Scarboro, *State Individual Income Tax Rates and Brackets for 2018*, Fiscal Fact No. 576, at 9 (March 2018), https://files.taxfoundation.org/20180315173118/Tax-Foundation-FF576-1.pdf.

[5] At $35,000 in income (that is, with the housing allowance excluded), Wisconsin's standard deduction for a single filer is $7,945; but at $53,000 (with the housing

federal tax liability of $2,390 (*supra* p. 16) produces total increased taxes of $3,656.

2) ***Taxes on Additional Compensation.*** The additional compensation that congregations pay to offset this tax burden, and place the minister at pay equity, is itself taxable income. Therefore, the additional compensation must exceed the added taxes in order to offset the total additional taxes. For the single-filer minister we have discussed, the added compensation to offset the combined federal and Wisconsin tax liability—$3,656—would be subject to a marginal federal tax rate of 22 percent. See 26 U.S.C. § 1(j)(2)(C) (22 percent marginal rate on income over $38,700). The new compensation would also be subject to Wisconsin's marginal tax rate of 6.27 percent (see *supra* p. 18). Finally, it would be subject to Self Employed Contributions Act (SECA) taxes at a 7.65 percent rate.[6]

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allowance included), the deduction drops to $5,785. Form 1 Instructions, *supra*, at 55. At both income levels, the personal exemption for a single filer is $700. See Wisconsin Income Tax Form 1 (2017), line 17a, at 2, https://www.revenue.wi.gov/TaxForms2017through2019/2017-Form1.pdf. Subtracting both the standard deduction and the personal exemption from income yields the Wisconsin taxable income. Excluding the housing allowance from income, the Wisconsin taxable income is $26,355, producing a $1,349 tax liability. Form 1 Instructions, *supra*, at 49 (2017 Tax Table for Form 1 Filers). Including the housing allowance in income, the taxable income rises to $46,515 and tax liability to $2,615. *Id.* at 50. Thus, as noted in text, the increase from including the housing allowance in income is $1,266 ($2,615 minus $1,349).

[6] Ministers are treated as self-employed rather than "employed" for Social Security purposes, 26 U.S.C. § 3121(b)(8)(A), and are thus subject to self-employment tax;

The combined tax rate from these three taxes on the additional compensation is 35.92 percent. Accordingly, to place its minister at pay equity after the $3,656 in new tax liability, a congregation would actually have to pay additional compensation of $5,705.37 ($3,656 divided by 0.6408, the tax divisor for taxes of 35.92 percent).

3) Finally, the added taxes on a married minister filing jointly, and thus the added compensation necessary to offset those taxes, may well be higher than in the estimate for that status here (*supra* p. 16). The jointly-filing couple is likely to have two salaries; depending on the size of the spouse's income, some or all of the minister's additional compensation could be taxed at even higher marginal rates. See 26 U.S.C. § 107(j)(2)(A) (graduated brackets for married taxpayers filing jointly).

These burdens will take a toll on congregations' already modest budgets. Recall that half of the congregations in the nation have a budget of under $85,000.

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moreover, for purposes of that tax, they cannot exclude § 107 allowances from their "net earnings." 26 U.S.C. § 1402(a)(8). The SECA rate is 15.3 percent, but a self-employed taxpayer "can deduct the employer-equivalent portion of" the self-employment tax in figuring adjusted gross income. IRS, Self-Employment Tax (Social Security and Medicare Taxes), https://www.irs.gov/businesses/small-businesses-self-employed/self-employment-tax-social-security-and-medicare-taxes. An employer's rate is 7.65 percent, see Social Security Administration, Social Security & Medicare Tax Rates, https://www.ssa.gov/oact/progdata/taxRates.html—producing likewise a 7.65 percent SECA rate for the taxpayer.

See *supra* p. 14 (citing NCS at 40). In our example of a minister filing single, facing $3,656 in new tax liability, the added compensation of $5,705 that a congregation must shoulder to achieve pay equity would amount to 6.7 percent of this already tight median budget.

These figures are significant even though they may not appear large to well-paid professionals. A doubling or tripling of federal tax liability (see *supra* p. 16) affects any taxpayer significantly. And it must be remembered that seemingly modest sums can have great impact on persons with modest incomes, like the median minister ($35,000 salary, $53,000 including housing allowance). According to the Federal Reserve, fully 44 percent of American households could not pay for an emergency expense of $400 without facing financial "disruption"—that is, without having to "borrow or sell something to do so." Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2016*, 26-27 (May 2017), https://www.federalreserve.gov/publications/files/2016-report-economic-well-being-us-households-201705.pdf; see also Neal Gabler, *The Secret Shame of Middle-Class Americans*, The Atlantic, May 2016, https://www.theatlantic.com/magazine/archive/2016/05/my-secret-shame/476415/. A $3,656 tax increase for the median minister (filing singly) is *more than nine*

times the amount that nearly half of American households would have trouble paying without disruption.

Likewise, in gauging the effect of increased ministerial compensation on congregational budgets, one must remember that half of those budgets are below $85,000 yearly. To increase its spending, such a congregation must raise more from its donors—that is, from its congregants, who in many cases have very modest resources themselves. (Congregants with low incomes are less likely to receive charitable-contributions deductions to make their donations easier, because they are more likely to claim the standard deduction than to itemize deductions.)

In short, increasing salary in order to make the minister whole following the invalidation of § 107(2) is likely to place a strain on many financially strapped congregations.

All these strains are dramatized by the declarations of clergy intervenors in this case. Father Patrick W. Malone, OSB pastors a small Anglican congregation of 65 weekly attendees and $50,000 annual budget—both just below the national medians—and receives a housing allowance near the yearly median of $18,000. A85, A82 (Malone Decl. ¶¶11-12, 3). Taxing his housing allowance "would severely harm the Church, … because of its small size and the modest income of its members." A86 (Malone Decl. ¶15). Taxing the allowance would "cause a major increase" in his tax liability—perhaps an increase similar to that in our

example, given the similar-size allowance—which would force him "to reevaluate" his call to the church. *Id.* And the church could not "compensate for [that] additional tax," because "it is already on a shoestring budget." *Id.* (Malone Decl. ¶¶15-16). Likewise, the urban congregation pastored by intervenor Chris Butler is sufficiently strapped that it cannot afford to pay him a full-time salary, and "[a]ny additional expenses would be a significant financial burden on [the church] and could threaten [its] mission to continue our vital community ministries." A111-12 (Butler Decl. ¶¶15, 17).

These effects would be especially severe for many congregations in large urban areas. Because housing costs in such cities significantly exceed those in other settings, median housing allowances are higher as well: for example, $22,000 for a solo minister in an urban congregation versus $14,400 for her rural counterpart, and $30,000 for a senior minister in an urban congregation versus $18,000 for her rural counterpart. *Compensation Handbook* at 43 (solo ministers); *id.* at 29 (senior ministers). Yet many urban congregations also have very modest resources, as is dramatized by intervenors' declarations. Father Gregory Joyce, priest of an Orthodox parish in Chicago, receives a $2,917/month allowance to cover his housing costs. A96 (Joyce Decl. ¶¶27). But for the first 17 years of his 20-year ministry his salary was meager enough that he had to take on secular employment to support his family, which made it "difficult … to fulfill [his

priestly] duties"; and taxing his allowance "would reduce [his] take-home pay by as much as one-third." A96, A94 (Joyce Decl. ¶¶28, 23); see also A110-12 (Butler Decl.). Moreover, the high costs of urban housing render purchasing a parsonage—in particular, making a down payment on it—difficult if not impossible for congregations of modest means. See, e.g., A78 (Peecher Decl. ¶15), A85 (Malone Decl. ¶12).

2. Example 2: Full-Time Senior Pastors

Having presented simple calculations for one median example, solo ministers, we briefly present some of the same calculations for another category, full-time senior pastors.[7] The effects of invalidating § 107(2) remain significant in this category.

For congregations with less than 100 attendees, a full-time senior pastor receives a median base salary of $30,000 and a housing allowance of $20,000. *Compensation Handbook* at 28. For a married minister filing jointly and excluding the housing allowance from income, the federal adjusted gross income would be $30,000, the total taxable income $6,000, and the federal tax liability $600. However, if invalidation of § 107(2) were to require including the housing allowance, then adjusted gross income would be $50,000 and total taxable income

[7] To avoid burdening the text unnecessarily, we present the table for these calculations in Addendum II to this brief.

would be $26,000. This yields a federal tax liability of $2,739, an increase of $2,139: 357 percent. If filing single, the minister excluding the housing allowance from income would have adjusted gross income of $30,000, taxable income of $18,000, and federal tax liability of $1,970. If the housing allowance were included in income, the adjusted gross income would be $50,000, the taxable income $38,000, and the federal tax liability $4,300: an increase of $2,330 or 118 percent.

As with the figures in our first example, the minister would also face greater state tax liability stemming (in most states) from one of the federal income figures. And as in the first example, offsetting the cost to the minister would require the congregation to pay more than the added tax liability in salary, since that salary is also subject to federal and state income taxes and federal self-employment tax. Again, the effects on a congregation of a median-sized budget ($85,000) could easily approach 7 percent of the already-tight budget.[8]

* * * * *

The possible examples for these calculations are endless, but even a small number indicates the reality. If § 107(2) is invalidated, ministers at median levels

[8] The median figures that we have used from the *Compensation Handbook* are confirmed by similar figures in the USCLS, which reports that the mean clergy salary is $39,392 and the mean housing allowance is $18,497. USCLS at nos. 84, 90.

of congregation size—who already receive modest compensation and have relied on the housing allowance—could face double or nearly triple the federal tax burden. And the very large number of congregations nationwide with modest resources could face nearly 7 percent increases in their already-strapped budgets in order to offset these costs and preserve their ministers' financial stability. These costs cannot be dismissed.

C. Invalidation of § 107(2) Would Disproportionately Harm Smaller Congregations and Those that Must Rely on a Housing Allowance as a Means of Structuring Clergy Compensation.

In *Walz*, Justice Brennan remarked that any ruling invalidating tax exemptions "would bear unequally on different churches, having its most disruptive effect on those with the least ability to meet the annual levies assessed against them." 397 U.S. at 692 (Brennan, J., concurring). Likewise, Congress was concerned to reduce unequal effects in 1954 when it added the exclusion for housing allowances to the exclusion for parsonage value. Excluding only parsonages, Congress indicated, was "unfair to those ministers who are not furnished a parsonage, but who receive larger salaries (which are taxable) to compensate them for expenses they incur in supplying their own home." H.R. Rep. No. 83-1337, *supra*, 1954 U.S. Code Cong. & Admin. News at 4040. Adding § 107(2) "removed th[is] discrimination in existing law." *Id.*

As already discussed, smaller churches have less flexibility to meet the increased tax liabilities that invalidation of § 107(2) would mean for their ministers. A leading practitioner and expert on clergy compensation and tax issues states:

> If you're a pastor from a large church with a large budget, the church will be able to more readily absorb an increase in the pastor's salary resulting from the loss of the housing allowance. But pastors in most small- and medium-sized churches are going to have to make some lifestyle choices.

Chris Lutes, *Facing a Future Without the Clergy Housing Allowance*, Church Finance Today, February 2018, https://www.churchlawandtax.com/cft/2018/february/facing-future-without-clergy-housing-allowance.html (interviewing Richard R. Hammar).

Likewise, invalidating the housing-allowance exclusion, leaving only the exclusion for church-owned parsonages, would discriminate against certain denominations—especially against "small, new" denominations, a form of inequality with which the Establishment Clause is particularly concerned. *Larson v. Valente*, 456 U.S. 228, 245 (1982). Invalidation would disfavor congregations that do not own a parsonage or cannot afford the down payment—primarily congregations that are less established or wealthy, and especially when those congregations are in high-cost urban areas. See *supra* pp. 22-24. Invalidation would also discriminate against ministers serving several congregations and not

living in the housing of any one, which would likewise disfavor smaller or less established religious bodies.

D. Invalidation Would Especially Harm Retired Ministers and Those Nearing Retirement.

The consequences of invalidating the housing-allowance exclusion, detailed above, are serious enough for active ministers and their congregations. But the harm would be even more serious for retired ministers. They have relied significantly on the exclusion in structuring their retirement benefits, and unlike their active counterparts, they cannot receive higher salaries to compensate for their sudden added tax liability. Likewise, ministers approaching retirement may be unable to contribute enough to their retirement plans to cover the shortfall in their remaining years of active ministry.

Under longstanding IRS rulings, "[t]he portion of a retired minister's pension designated as a rental allowance by the national governing body of a religious denomination having complete control over the retirement fund may be excludable under section 107." Rev. Rul. 75-22 (IRS RRU), 1975-1 C.B. 49, 1975 WL 34680. These benefits are excludable, the IRS has said, because "[t]he trustees of the fund are ... deemed to be acting on behalf of the local churches in matters affecting the unified pension system in compensating retired clergy for [their] past services."

Id.[9] The IRS's current audit guidelines concerning ministers confirm that "[t]rustees of a minister's retirement plan may designate a portion of each pension distribution as a parsonage [or housing] allowance excludable under Code section 107." IRS, Minister Audit Technique Guide (April 1, 2009), 2009 WL 2491366, at *9.

Indeed, the § 107 exclusions are likely even more central to retirement benefits than to active-clergy compensation. For one thing, because retirement benefits generally fall short of active-service salaries,[10] housing values constitute a larger percentage of overall retirement benefits than of overall active-service compensation. Moreover, while active clergy cannot exclude § 107 allowances from their earnings in computing self-employment taxes (*supra* p. 20 n.5), retired clergy may exclude retirement benefits designated under § 107. See 26 U.S.C. § 1402(a)(8) (excluding from "net earnings from self-employment the rental value of

[9] Retired ministers are not the only retirees whose benefits for past services can be excluded from gross income. Military benefits "received by any member or former member of the uniformed services of the United States or any dependent of such member" are also excluded. 26 U.S.C. § 134(a), (b)(1)(A).

[10] In the context of a Contracts Clause challenge to a state's impairment of a pension-plan agreement, one court has observed that "[t]he diminution of pension benefits is more likely than not an even *more* substantial impairment than a diminution of annual salary because the individual receiving pension benefits is typically already living on a reduced income as compared to her pre-retirement earnings." *Andrews v. Anne Arundel County, Md.*, 931 F. Supp. 1255, 1265 (D. Md. 1996) (emphasis in original).

any parsonage or any parsonage allowance (whether or not excludable under section 107) provided after the individual retires").

For these reasons, ministers and their retirement fiduciaries have placed significant, good-faith reliance on the § 107(2) exclusion. "In many instances, retired ministers are able to exclude some or all of their pension income by having the pension plan designate a portion of their income as a housing allowance." Richard R. Hammar, *2018 Church & Clergy Tax Guide* 531 (Christianity Today International 2018). In fact, the exclusion "is one of the main advantages of denominational pension plans." *Id.* at 530. As noted above, retired ministers cannot cushion against the harm to their reliance, because they cannot receive higher salaries to compensate for their sudden added tax liability. Nor can ministers approaching retirement make up for the shortfall by contributing more to their retirement plans in a few short years.

CONCLUSION

Over 64 years, the housing allowance has become deeply embedded in the American church-state tradition and in the compensation and retirement plans of ministers, their congregations, and their retirement fiduciaries. This practice and this widespread good-faith reliance are important to the consideration of this case. As figures show, many ministers are not highly compensated; moreover, the hours

are often long and the work can be emotionally taxing. The profession often requires sacrifice of personal and financial security. If § 107(2) were invalidated, ministers in many cases—including retired ministers—will suffer a significantly reduced standard of living. In other cases, congregations, to preserve their ministers from such loss, will have to devote more of their already tight budgets to compensating personnel, and less to teaching children, serving the poor, or counseling those in distress. Smaller congregations will feel that burden disproportionately—a concern that properly motivated Congress in adopting, and reaffirming, the §107(2) exclusion.

The judgment of the district court should be reversed.

Respectfully submitted.

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CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS, AND TYPE-STYLE REQUIREMENTS

1. This brief complies with the length limitation of Circuit Rule 32(c) because it contains 6,730 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

2. This brief complies with the requirements of Fed. R. App. P. 32(a) and Circuit Rule 32(b) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2016 in 14-point Times New Roman font.

s/ Kimberlee Wood Colby
Kimberlee Wood Colby

Dated: April 26, 2018

CERTIFICATE OF SERVICE

I certify that on April 26, 2018, the foregoing brief and attached appendices were served on counsel for all parties by means of the Court's ECF system.

s/ Kimberlee Wood Colby
Kimberlee Wood Colby

Dated: April 26, 2018

ADDENDUM I

STATEMENTS OF INTEREST OF *AMICI CURIAE*

The **Evangelical Council for Financial Accountability** ("ECFA") provides accreditation to leading Christ-centered churches, associations of churches and parachurch organizations that faithfully demonstrate compliance with established standards for financial accountability, stewardship, and governance. For thirty-nine years, one of ECFA's core principles has been the preservation of religious freedom through its standards of excellence and integrity, which help alleviate the need for burdensome government oversight of religious organizations. More than 2,250 Christ-centered churches, ministries, denominations, educational institutions, and other tax-exempt 501(c)(3) organizations are currently accredited by ECFA.

Recognizing ECFA's history and expertise in matters involving religious liberty and government regulation, Senator Charles Grassley called upon ECFA to provide input on significant accountability and tax policy issues, including the ministerial housing allowance exclusion. ECFA, in turn, formed a national Commission of eighty religious and nonprofit leaders from virtually every major faith group in America, along with legal experts experienced in constitutional law and church and nonprofit tax issues.

The Commission's careful consideration and recommendations on the ministerial housing allowance exclusion allow ECFA to offer unique expertise on

this issue in hopes that it will be of some assistance to the Court in its deliberations. Enhancing Accountability For The Religious and Broader Nonprofit Sector, Commission on Accountability and Policy for Religious Organizations, December 2012, 21-27. Accessible at www.ReligiousPolicyCommission.org.

ECFA values the religious liberty principles embodied by the ministerial housing allowance exclusion, which accommodates the special relationship between churches and their ministers, allows for diversity among religions and across denominational lines, and maintains the respectful "hands-off" approach that characterizes a healthy church-state relationship. ECFA is also concerned with the longstanding reliance that religious congregations and their ministers have placed on the ministerial housing allowance exclusion, the loss of which would have troubling consequences for active and retired ministers and their congregations.

Union of Orthodox Jewish Congregations of America ("Orthodox Union") is the nation's largest Orthodox Jewish synagogue organization, representing nearly a thousand congregations across the United States. The Orthodox Union, through its OU Advocacy Center, has participated in many cases before the federal courts that, like this one, raise issues of critical importance to the Orthodox Jewish community, including *Trinity Lutheran Church v. Comer*, 137 S. Ct. 2012 (2017); *Burwell v. Hobby Lobby Stores*, 134 S. Ct. 2751 (2014); *Locke v. Davey*, 540 U.S. 712 (2004); and *Zelman v. Simmons-Harris*, 536 U.S. 639 (2002).

The Orthodox Union thus has a strong interest in this Court's reversal of the decision below. The Orthodox Union is the umbrella association that represents more than 1,000 synagogues as well as other institutions that employ rabbis across the United States. These congregations – and their clergy – rely upon the Internal Revenue Code's housing allowance to be able to hire and compensate the clergy, and this reliance has been acted upon for decades. The invalidation of the housing allowance will have a devastating economic impact upon the Jewish community. It is essential for the American Jewish community's continued vibrancy that the housing allowance be preserved.

The **National Association of Evangelicals** ("NAE") is the largest network of evangelical churches, denominations, colleges, and independent ministries in the United States. It serves 40 member denominations, as well as numerous evangelical associations, missions, nonprofits, colleges, seminaries, and independent churches. NAE serves as the collective voice of evangelical churches, their religious ministries, and separately organized evangelical ministries. It believes that religious freedom is God-given and thereby unalienable, that it is a right prior to the state that is recognized in and protected by the First Amendment and other federal laws, and that the proper ordering of church-state relations places a restraint on governmental authority that ensures the autonomy of religious organizations. NAE believes that

civil government has a high duty to protect the religious freedom of peoples of all faiths.

The Lutheran Church—Missouri Synod ("the Synod") has about 6,000 member congregations and close to 22,000 ordained and commissioned ministers, including nearly 6,500 of whom are retired.

In addition to its member congregations, the Synod has two seminaries, nine universities, the largest Protestant parochial school system in America, numerous related entities, and hundreds of recognized service organizations engaged in charitable work throughout the country. All of these entities call and employ ministers for fostering the mission and ministry of the church. The clergy housing allowance is, and has been for decades, an important benefit for the Synod, its congregations and its ministers in planning and exercising good stewardship for the benefit of their ministries.

The Synod promotes and fully supports the preservation of all First Amendment protections and supports the constitutionality of the clergy housing allowance.

The **Council of Churches of the City of New York** ("Council"), organized in 1895, is the oldest continuing council of churches in the United States. It is an ecumenical coalition of the major representative religious organizations representing Protestant, Anglican, and Orthodox Christian denominations having ministry in the

City of New York. It is governed by a Board of Directors comprised of the bishop or equivalent officer of each local diocese, association, synod, presbytery, conference, or district of its member denominations and of the president and executive officer of the local councils of churches serving in each of the boroughs of the City of New York.

The **Queens Federation of Churches** was organized in 1931 and is an ecumenical association of Christian churches located in the Borough of Queens, City of New York. It is governed by a Board of Directors composed of an equal number of clergy and lay members elected by the delegates of member congregations at an annual assembly meeting. Over 390 local churches representing every major Christian denomination and many independent congregations participate in the Federation's ministry. The Federation and its member congregations are vitally concerned for the protection of the principle and practice of religious liberty, including the detrimental impact that would be felt by its member congregations and their ministers if the ministerial housing allowance were held unconstitutional.

Christian Legal Society ("CLS") is an association of Christian attorneys, law students, and law professors, founded in 1963 and dedicated to the defense of religious freedom. For four decades, CLS has sought to protect all citizens' free exercise and free speech rights, both in this Court and Congress. CLS was instrumental in passage of landmark federal legislation to protect persons of all

faiths, including: 1) the Equal Access Act of 1984, 98 Stat. 1302, 20 U.S.C. § 4071 *et seq.*, which protects the right of all students, including religious groups to meet for "religious, political, philosophical or other" speech on public secondary school campuses; 2) the Religious Freedom Restoration Act of 1993, 107 Stat. 1488, 42 U.S.C. § 2000bb *et seq.*, which protects the religious freedom of persons of all faiths; and 3) the Religious Land Use and Institutionalized Persons Act of 2000, 114 Stat. 803, 42 U.S.C. § 2000cc *et seq.*, which protects religious freedom for congregations and institutionalized persons of all faiths.

ADDENDUM II

Calculation of Federal Tax Liability for Full-Time Senior Pastor with Base Salary of $30,000 and Housing Allowance of $20,000

Facts:

Base Salary:	$30,000
Official Housing Designation:	$20,000

Housing Allowance Excluded	**MFJ**	**Single**
Adjusted Gross Income	$30,000	$30,000
Standard Deduction	$24,000	$12,000
Taxable Income	$6,000	$18,000
Tax	$600	$1,970

Housing Allowance Included	**MFJ**	**Single**
Adjusted Gross Income	$50,000	$50,000
Standard Deduction	$24,000	$12,000
Taxable Income	$26,000	$38,000
Tax	$2,739	$4,300
$ Increase in Tax	$2,139	$2,330
% Increase in Tax	357%	118%