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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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The Honorable Christopher J. Dodd
30 Lewis Street
Suite 101
Hartford, Ct 06103

Attention:

Dear Senator Dodd:

I am responding to your inquiry, dated March 24, 2009, on behalf of your constituent, . is concerned regarding his use of tax-sheltered annuity savings and church pension funds to make a down payment on a new home. You specifically request information as to whether your constituent has any appropriate recourse in the matter.

Parsonage Allowances

Section 107 of the Internal Revenue Code (Code) allows a "minister of the gospel" to exclude from income the rental value of a home the church furnishes as part of his or her compensation or the rental allowance it pays under the same circumstances to the extent the minister uses the allowance to rent or provide a home to the extent such allowance does not exceed the fair rental value of the home. The home or rental allowance the religious organization provides must be as payment for services that ordinarily are the duties of a minister of the gospel [section 1.107-1(a) of the Income Tax Regulations]. The duties that ministers ordinarily perform are sacerdotal functions, conducting of religious worship and the control, and conduct and maintenance of religious organizations (including religious boards, societies and other integral agencies of such organizations), under the authority of a religious body [section 1.1402(c)-5(b)(2) of the Income Tax Regulations]. The designation of an amount as rental allowance may be evidenced in an employment contract, in minutes of or in a resolution by a church or other qualified organization or in its budget, or in any other appropriate

instrument evidencing such official action [section 1.107-1(b) of the Income Tax Regulations]. The amount designated as rental allowance is not excludable from gross income to the extent that such amount received during the taxable year is either greater than the amount used to rent or provide a home during the taxable year or the fair rental value of the home (including furnishings and appurtenances) plus the cost of utilities for the taxable year.

Annuities and Pensions

The governing body of a religious denomination may set up a retirement fund which designates a portion of a retired minister's pension as a parsonage allowance. See Rev. Rul. 63-156, 1963-2 C.B. 79. The Service stated in Rev. Rul. 75-22, 1975-1 C.B. 49, that a national governing body of a religious denomination having complete control over a retirement fund could designate a portion of a retired minister's pension as a rental allowance. This rental allowance was excludable from the retired minister's gross income to the extent allowed by section 107 of the Code because the trustees of the general pension plan were deemed to be acting on behalf of the local churches in which the retired clergy performed services as ministers of the gospel.

The Warren Case

Your constituent mentions Warren v. Commissioner, 114 T.C. No. 343 (2000), appeal dismissed 302 F.3d 1012 (9th Cir. 2002). Mr. Warren was a minister at a congregation in California. In the three years in question, the home's fair rental value was \$58,061, \$58,004 and \$59,479. The church trustees allocated \$42,496, \$85,000 and \$80,000, respectively, as the taxpayer's parsonage allowance. The allocated amounts were 80% to 100% of the compensation the church paid the taxpayer for his ministerial services. The taxpayer spent \$77,663, \$76,309 and \$84,278 to provide a home for themselves by paying for mortgage, utilities, furnishings, landscaping, repairs, maintenance, real property taxes and homeowner's insurance. The taxpayer excluded the designated amounts from income as rental allowances under section 107.

The litigation involved the difference between how much the taxpayers spent on housing and the home's fair rental value during the years at issue. The IRS disallowed the rental allowance exclusion for amounts they spent in excess of the fair rental value. However, the Tax Court held that the Warrens could exclude the full designated amount. The court carefully evaluated the wording and history of section 107, concluding that it did not limit the exclusion to fair rental value. The IRS appealed to the Ninth Circuit but the appeal was ultimately withdrawn and the Ninth Circuit never issued an opinion with respect to the issue considered in the Tax Court.

Subsequently, Congress responded by passing the Clergy Housing Allowance Clarification Act of 2002, Pub.L. No. 107-181, 116 Stat. 583, to amend section 107. The Act adopts the IRS's interpretation of the statute and provides that the rental allowance is limited to the fair rental value of a minister's housing. The Act specifies that this limitation is effective for tax years beginning after 2001.

I hope this information is helpful to your constituent in understanding why his rental allowance was not excluded from his gross income. In addition, information which may be helpful to him in resolving his tax issue is available at irs.gov, including how to file an offer in compromise, setting up installment payment agreements, and seeking help from a taxpayer advocate. We have also included a copy of Publication 594, *The IRS Collection Process*.

If you need further information, please contact me or _____ of my office at _____.

Sincerely,

By: _____
Janine Cook
Chief, Employment Tax, Branch 1
Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)

Enclosure