Parsonage Rule Update:
U.S. Tax Court Rules Parsonage Extends to Non-Commercial Use of a Second Home

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On December 14, 2010, the United States Tax Court ruled in a divided decision, *Driscoll v. Commissioner* (135 T.C. No. 27), that a "minister" for tax purposes correctly excluded from gross income the pre-designated housing allowance he received as part of his compensation and which he actually used for the non-commercial use of **two personal residences**. The petitioner in the case, Philip Driscoll, was a minister who owned more than one home, a primary residence and a summer home. Neither of the houses was used for rental or any commercial purposes at any point during the years at issue. In each of the years, the ministry, a 501(c)(3) tax-exempt organization, pre-designated part of his compensation as a parsonage housing allowance to be used for the acquisition and maintenance of each of the homes. The petitioner excluded those amounts from his gross income that were pre-designated and actually used for housing expenses for each of his two homes. The IRS determined that the petitioner owed additional taxes, the amount excluded from gross income that was used for the second home. The petitioner sought review by the Tax Court. The Tax Court held that under §107 of the Internal Revenue Code, the term "a home" is not to be interpreted as being limited to one home.

The court emphasized that the term 'home' does not extend to situations where "a minister, in additional to a home, rents, purchases, or owns a farm or other business property." Thus, it is clear that the exclusion under §107 applies only for the minister's personal use of the second home – the second home may not be rented or leased to a tenant or used for any commercial or business purposes.

What is unclear from the case is how the law would treat the personal use of a third home, fourth home etc. The court merely decided the facts before it, which was a case involving two homes. It would seem that the reasoning should extend to more than two homes. Indeed, as the dissent notes, "[t]he majority decides today that, if a property is a dwelling house, then it is a 'home' for which an allowance is excludable, no matter the number of 'homes' a minister may claim." However, the court stopped short and left that determination for another day.

Moreover, it is also unclear how the "fair rental value" limitation would apply in a situation where the minister excluded housing expenses for two homes. Among other limitations, parsonage is limited to the fair rental value of a home that is fully furnished, plus the actual cost of utilities. Until now, it was clear that this limitation is for the fair rental value of one home. The court did not address whether fair rental value is for one home or two homes (presumably because fair rental value was not an issue in the facts of the case) and so the extent of the current limitation seems unclear in the situation where the minister excludes housing expenses for two homes.

It should be noted that the rule is not limited to situations where the minister *owns* a second home – if he *rents* a second home, that should qualify as well. The designation made by the minister's employer must be done in advance of both (i) earning the income, as well as (ii) spending on the housing related expenses. Since the parsonage amounts must be pre-designated, this case may not be used to exclude additional amounts for the 2010 tax year. For the 2011 tax year, those wishing to exclude the housing expenses for their second homes must be sure to pre-designate additional amounts of their compensation to cover those expenses to be used for the second home. If a designation has already been made for the 2011 tax year, it may be amended to increase the housing allowance, so long as those amounts have not yet been earned or expended on housing expenses.

Most importantly, while this case is a matter of first impression setting a new precedent in the law, given that the court was divided in its decision (meaning, not all of the judges agreed with the decision), there

remains a strong likelihood that the IRS will appeal the decision and that the law may change at some point in the future. Thus, you are urged to consult your own tax advisor before implementing any changes based on this court decision.

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