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CLERGY HOUSING ALLOWANCE

A case previously before the Ninth Circuit Court of Appeals, *Warren v. Commissioner,* had the potential to spell changes for the pastors' housing allowance. The case involved Rick Warren of Saddleback Valley Community Church in California. The IRS argued that Warren claimed too much housing allowance for a particular year. Warren argued that he only claimed what the church authorized and what he actually spent on his house.

The housing allowance allows clergy to exclude from reporting as gross income the amount of housing allowance designated by the church to the minister for ministerial services if the minister owns or rents a home not provided by the church. To a non-minister, the allowance would be treated as income and would have to be reported as income. The allowance is an exclusion from gross income, not a deduction, which means the amount of the allowance is not reported anywhere as income on the minister's W-2 or 1099 Form. Section 107 of the Internal Revenue Code states that "[i]n the case of a minister of the gospel, gross income does not include—(1) the rental value of a home furnished to him as part of his compensation; or (2) the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home."

The Internal Revenue Code excludes from a minister's gross income the actual expenses incurred by a minister in owning or renting a home, up to but not exceeding the amount of the church-designated allowance. I.R.C. § 107. The maximum amount of allowance permitted for a minister who rents a home is the annual fair rental value of the house lived in by the minister, furnished, plus the cost of utilities. A minister who owns a home can exclude actual expenses, including mortgage payments, insurance, real-estate taxes, furnishings, repairs to house or furnishings, utilities and others to the extent such expenses do not exceed either the church-designated allowance or the fair rental value of the home, furnished, plus the cost of utilities.

The Internal Revenue Code excludes from a minister's gross income the actual expenses incurred by a minister in owning or renting a home, up to but not exceeding the amount of the church-designated allowance.

If a minister's actual expenses of owning or renting a home are equal to or exceed the allowance, then no reporting is necessary. A minister whose actual expenses exceed the church-designated allowance can only exclude the allowance. If, however, the church-designated allowance exceeds the actual expenses of owning or maintaining a home, then the excess must be reported as "other income" on the minister's Form 1040.

For example, Rev. M owns a home. The church designates $10,000 of Rev. M's $35,000 salary as a housing allowance. Rev. M has expenses of $7,000 for mortgage payments, $1,500 for property taxes, $2,000 for utilities, $1,000 for property insurance and $1,000 for furnishings. The fair rental value of the home is $9,000 (including utilities). The actual expenses were $12,500, but Rev. M cannot exclude more than the church-designated allowance ($10,000) or the fair rental value of the home plus utilities ($9,000). Therefore, Rev. M can only exclude $10,000 from income taxes.

The housing allowance must be spent to be excludable. Spending can be anything to provide a home. This includes, but is not limited to, yard care (including lawn mower, gasoline, etc.), snow removal, utilities (not long-distance telephone calls), curtains, bed linens, pots and pans—anything necessary to provide a home except for food and maid service. Ministers must keep written receipts or other adequate documentation substantiating all their housing costs.

The housing allowance was in jeopardy, however, when a case from the United States Tax Court was appealed to the Ninth Circuit Court of Appeals. Rick Warren is a minister of the gospel within the meaning of Section 107 of the Internal Revenue Code. In 1980, he founded the Saddleback Valley Community Church in his home. The church grew and eventually used several different facilities to house the congregation. By 1991, the congregation had grown to more than 18,000 members and continued to grow. For all tax years in question, except one, the church's trustees approved compensation and designated the full amount as a housing allowance. In 1993, Warren received compensation of $77,663 and excluded the full amount as a housing allowance. In 1994, Warren received compensation of $86,175 and excluded $76,309 as a housing allowance. In 1995, Warren received compensation of $99,653 and excluded $79,999 as a housing allowance. The IRS disputed the amounts Warren had taken as a housing allowance. The amounts in dispute were the differences between the rental values of Warren's home and the amounts he excluded from his tax return. Warren appealed the IRS determination to the Tax Court.

Previously, in 1971, the IRS had issued a revenue ruling that limited the nontaxable portion of a church-designated housing allowance for ministers who own their homes to the annual "fair rental value" of the home, furnished with utilities. In the Warren case, the Tax Court held that Warren could exclude from gross income all amounts actually spent on providing his family with a home. The court rejected the annual "fair rental value" test that limited nontaxable housing allowances for ministers who own their own homes to the annual rental value of their home. *Warren v. Commissioner,* 114 T.C. 343 (2000).

An appeal of the Tax Court's decision was taken to the Ninth Circuit Court of Appeals. Before a decision was rendered, two of the three judges on the panel ordered briefs on the issue of the housing allowance's constitutionality, even though neither party raised the constitutional issue. The court also asked a law professor, Erwin

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Chemerinsky, to submit a brief on whether the pastors' housing allowance exemption is an unconstitutional establishment of religion. *Warren v. Commissioner,* 282 F.3d 1119 (9th Cir. 2002).

In response, Congress passed the Clergy Housing Allowance Clarification Act, 26 U.S.C.A. § 107, (H.R. 4156) to remedy a potentially adverse ruling in the *Warren* case. The act makes clear that in the case of a minister of the gospel, gross income does not include the rental allowance paid to the minister as part of compensation, to the extent used by the minister to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities.

The act reads as follows:

SECTION. 1. SHORT TITLE.

This Act may be cited as the "Clergy Housing Allowance Clarification Act of 2002".

SECTION 2. CLARIFICATION OF PARSONAGE ALLOWANCE EXCLUSION.

(a) In general.—Section 107 of the Internal Revenue Code of 1986 is amended by inserting before the period at the end of paragraph (2) "and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities."

(b) Effective Date.—

(1) In general.—The amendment made by this section shall apply to taxable years beginning after December 31, 2001.

(2) Returns positions.—The amendments made by this section also apply to any taxable year beginning before January 1, 2002, for which the taxpayer—

(A) on a return filed before April 17, 2002, limited the exclusion under section 107 of the Internal Revenue Code of 1986 as provided in such amendment, or

(B) filed a return after April 16, 2002.

(3) Other years before 2002.—Except as provided in paragraph (2), notwithstanding any prior regulation, revenue ruling, or other guidance issued by the Internal Revenue Service, no person shall be subject to the limitations added to section 107 of such Code by this Act for any taxable year beginning before January 1, 2002.

After the act was passed, the parties to the lawsuit filed a joint stipulation to dismiss the case before the Ninth Circuit, saying the IRS was precluded under the new law from continuing the case. Chemerinsky, the law professor, filed a motion opposing the dismissal and provided notice that he intended to intervene in the matter. His supplemental brief had asserted that section 107(2) is unconstitutional because it gives clergy a benefit not afforded to others. The Ninth Circuit, however, found that Chemerinsky could not intervene because he failed to demonstrate a significant protectable interest in the matter. The court said that he could raise the issue in a separate lawsuit and ordered the appeal dismissed. *Warren v. Commissioner,* 302 F.3d 1012 (9th Cir. 2002). As a result, pastors once again can exclude actual housing expenses to the extent the expenses do not exceed either the church-designated housing allowance or the fair rental value of the home. ■

COPYRIGHT CONSIDERATIONS FOR CHURCHES

Churches violate copyright laws every day, some intentionally and some unintentionally. Churches and church personnel should be familiar with copyright laws because fines for violation are substantial. Litigation against churches for copyright infringement has not been frequent. However, in those cases in which churches have been sued for copyright infringement, damages have been substantial.

Article I, Section 8 of the United States Constitution gives Congress the authority to promote the arts by giving authors the exclusive rights, for a limited time, to their respective writings. Authors have incentive to produce artistic works if they have the rights to their works. A copyright is a severable property right that can be sold, leased, divided and inherited. "The right of an author in his intellectual product resembles any other personal property right. It may be sold outright in its entirety, or a limited interest may be assigned. The various rights that compose a copyright may be split up and sold to different entities. Sales may be absolute or conditional, and they may be with or without qualifications and restrictions. The only limitations on these extensive rights are those encompassed in the copyright laws or other laws of the United States, e.g., antitrust laws." *F.E.L. Publications, Ltd. v. Catholic Bishop of Chicago,* 1982 WL 19198 (7th Cir. 1982).

The copyright laws are codified in Title 17 of the United States Code. Copyright law, since 1978, has been exclusively federal. Prior to 1978, unpublished works were protected under state law. The Copyright Act of 1976 makes both unpublished and published works subject to protection under federal law. On March 1, 1989, the United States became a party to the Berne Convention, an international copyright convention established a century ago and endorsed by more than 80 nations. Participation by the United States in this convention generally will increase international protection available to American authors.

Churches and church personnel should be familiar with the copyright laws because the fines for violation are substantial.

Work Made for Hire

Although the person who creates a work generally is its author and initial owner of the copyright in the work, Section 201(b) of the Copyright Act provides that "[i]n the case of a work made for hire, the employer or other person for whom the work was prepared is considered the author . . . and, unless the parties have expressly agreed otherwise in a written instrument signed by them, owns all of the rights comprised in the copyright." Employees should be aware that copyright law defines "work made for hire" as "a work prepared by an employee within the scope of his or her employment." The person creating the work must be considered an employee, as opposed to self-employed. This is usually determined by the same factors used to determine a person's status for federal income-tax reporting purposes. The person must also have created the work within the scope of employment.

Falling within the "work made for hire" category is a consideration, for example, if a minister of music composes a piece of music at the church, during working hours and using church equipment. The minister may believe the minister owns the copyright in the work created, but the church may actually own the copyright. The parties can avoid such an outcome because Section 201(a) allows an employer and employee to agree that copyright ownership in works created by the employee within the scope of employment belong to the

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employee and not the employer. The agreement, however, must be in writing.

The case of *Wihtol v. Crow,* 309 F.2d 777 (8th Cir. 1962), illustrates how important it is to determine whether a work is a "work made for hire." In Wihtol, the choir director and organist at a Methodist church rearranged a piece of music into a choral arrangement. The director duplicated a copy for each member of his choir. He then wrote the original composer of the music, Wihtol, advising him of the new arrangement and asking if he would be interested in buying it. Wihtol informed him he was guilty of copyright infringement and sued. The choir director was found guilty of copyright infringement. The church was also found liable for copyright infringement, since an employer is legally responsible for the actions of employees committed within the scope of their employment.

Copies

In *F.E.L. Publications, Ltd. v. Catholic Bishop of Chicago,* 1982 WL 19198 (7th Cir.), a music publisher sued the bishop of Chicago for copyright infringement. F.E.L. Publications, Ltd. [F.E.L.] is a music publisher that began publishing and marketing hymnals to Chicago's Catholic parishes. The Roman Catholic Church had not developed a national hymnal, and most individual parishes in Chicago used a custom-made hymnal. F.E.L. licensed the right to copy its songs on a two cents per-song/per-copy basis for use in the custom-made hymnals. At the time, copyright infringement was widespread in the parishes. As a result, F.E.L. instituted its Annual Copyright License. The license permitted the parishes to copy one or more of F.E.L.'s songs, more than 1,400 at the time, in unlimited quantities for a one-year period. The license fee was $100 and required that copies must be destroyed upon termination of the license unless renewed. Renewal of the license required a $100 payment per year.

F.E.L. became convinced that the license had failed to discourage illegal copying. It filed suit against the bishop, alleging copyright infringement. F.E.L. alleged that the bishop, through his agents, copied and published F.E.L. songs without permission from F.E.L. and produced hymnals containing F.E.L. songs. As a result of an agreement between the parties, thousands of song sheets and homemade hymnals were collected from the parishes and impounded by the court. In all, more than 1.5 million unauthorized copies of F.E.L. songs were collected from the bishop. The district court granted the bishop summary judgment, but the Seventh Circuit Court of Appeals reversed on appeal.

The bishop argued that the license issued by F.E.L. licensed performances rather than copies and publishing. The court disagreed. The court noted that a copyright holder has the right to perform a work publicly for profit. 17 U.S.C. § 1. A copyright holder cannot prevent a not-for-profit performance of the work nor can the copyright holder exact a fee for such a performance. 17 U.S.C. § 1(e). The singing of a hymn at a religious service is a not-for-profit performance, and F.E.L. could not prevent congregations from performing any of its copyrighted works at a service. F.E.L. could, however, prevent churches from copying or publishing its copyrighted works, even if the churches only intended to use the copies or publications at not-for-profit religious services. Further, the court noted that the right to perform music at not-for-profit religious services meant that the musical work has to be performed from memory or legal copies. Neither the religious element nor the nonprofit element of a performance would protect any illegal copying.

Another case involved one church copying a book owned by another church. *Worldwide Church of God v. Philadelphia Church of God, Inc.,* 227 F.3d 1110 (9th Cir. 2000), *cert. denied,* 532 U.S. 958 (2001). Worldwide Church of God [WCG] is a nonprofit religious organization whose founder, Herbert Armstrong, wrote a book entitled *Mystery of the Ages.* He copyrighted it in the name of WCG and published it in serial form in *The Plain Truth,* WCG's magazine. WCG also distributed copies of the book to its employees and to viewers of its telecasts. Two years after Armstrong's death in 1986, WCG decided to discontinue distribution of the book for several reasons. WCG's positions on divorce, remarriage and divine healing had changed, and WCG thought that Armstrong conveyed racist views in the book. WCG disposed of excess inventory copies of the book and stopped distribution but retained archival and research copies.

Neither the religious element nor the nonprofit element of a performance would protect any illegal copying.

In 1989, two former WCG ministers founded a new religious organization, Philadelphia Church of God [PCG]. The new organization claimed to strictly follow the teachings of Herbert Armstrong and asserted that the book was central to its religious practice and required reading for all members hoping to be baptized into PCG. Initially, PCG relied on existing copies of the book, but later began copying it for its own use. PCG never requested permission from WCG to print the book and copied it verbatim. PCG distributed thousands of copies of the book in both English and foreign-language versions and used it in advertisements. It received substantial contributions from people who received the book. WCG demanded that PCG stop infringing on its copyright and cease distribution of its book. PCG ignored the request, and WCG sued it for copyright violations.

PCG disputed WCG's ownership of the book copyright and contended that Armstrong, not WCG, had the right to control the book's creation. The court disagreed, noting that Armstrong, who owned the book's copyright, bequeathed his entire estate to WCG. His will left all his personal and real property to WCG. Armstrong's will was admitted to probate and was not challenged. Because ownership of a copyright may be bequeathed by will, 17 U.S.C. § 201(d), WCG is the copyright owner. The court also disregarded PCG's claim that Armstrong granted a nonexclusive, implied license for the book to be disseminated by those who value its religious message. Although an implied license may be granted orally or implied from conduct, PCG failed to show that Armstrong created the book for dissemination by third parties or that he intended to license PCG to reprint the entire book and use it for its own church.

PCG also argued that its use of the book was a statutorily protected "fair use" of the work. Fair use involves consideration of four factors. The first factor calls for consideration of "the purposes and character of the use, including whether such use is of a commercial nature or is for nonprofit education purposes." 17 U.S.C. § 107(1). The court found that PCG's copying of WCG's book in its entirety superseded the object of the original book, to serve religious practice and education. PCG also attracted new members to its church, thus ensuring its growth, through distribution of the book. It profited from copying the book by gaining a benefit through distributing the book without accounting to the copyright holder.

When an alleged infringer copies material to use for the same intrinsic purpose that the copyright owner intended it to be used is strong indicia of no fair use.

The second factor, "the nature of the copyrighted work," turns on whether the work is informational or creative. 17 U.S.C. § 107(2). The court found that the creativity, imagination and originality in the book, as opposed to factual or informational material, were too great to qualify as a fair use.

The third factor considers

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"the amount and substantiality of the portion used in relation to the copyrighted work as a whole." 17 U.S.C. § 107(3). PCG argued that its copying of the entire work was reasonable because its use of the book was religious in nature. The court found, however, that when an alleged infringer copies material to use for the same intrinsic purpose that the copyright owner intended it to be used is strong indicia of no fair use. Here, PGA used the book as a central element of its members' religious observance. The court asserted that a reasonable person would expect PCG to pay WCG for the right to copy and distribute the book created by WCG with its resources.

The fourth factor considers "the effect of the use upon the potential market for or value of the copyrighted work." 17 U.S.C. § 107(4). "Potential market" does not require that a copyright holder charge a fee for the work. WCG planned an annotated version of the book and pointed out that those who respond to PCG's ads are the same people who would be interested in WCG's planned annotated version. With an annotated book, WCG hoped to reach a wider audience. WCG argued that PCG's distribution of its unauthorized version of the book harmed WCG's goodwill by diverting potential members and contributions from WCG. PCG argued that WCG's lack of a concrete plan to publish a new version showed that the book had no economic value to WCG that PCG's dissemination of the work would adversely affect. The court disagreed, because an author is entitled to protect the copyright for as long as the author is the copyright holder. The copyright holder can make a change or annotation to the work at a later time.

PCG contended that finding it in violation of the copyright laws would be a violation of the Religious Freedom Restoration Act [RFRA]. 42 U.S.C. §§ 2000bb-2000bb-4. RFRA provides that government will not substantially burden a person's exercise of religion, even if the burden results from a rule of general applicability. The government must justify any regulation imposing a substantial burden on the free exercise of religion by showing that the regulation satisfies strict scrutiny. PCG contended that requiring it to stop copying the book would substantially burden a central tenet of its religious doctrine: distribution of the book to current and potential adherents of its church.

The court found that PCG failed to show that subjecting it to the copyright laws substantially burdened its exercise of religion. The burden must be substantial and interfere with a tenet or belief central to religious doctrine. "Having to ask for permission, and presumably to pay for the right to use an owner's copyrighted work, may be an inconvenience, and perhaps costly, but it cannot be assumed to be a matter of law a substantial burden on the exercise of religion." *Worldwide Church of God,* 227 F.3d 1110, 1121.

Videocassettes

The rental or purchase of a home videocassette does not carry with it the right to perform the copyrighted work publicly. (17 U.S.C. § 202). Section 101 defines publicly performing a work as "to perform . . . it at a place open to the public or at any place where a substantial number of persons outside of a normal circle of a family and its social acquaintances is gathered." 17 U.S.C. § 101. This definition makes clear that performances in semipublic places such as clubs, lodges, factories, summer camps and schools are public performances subject to copyright control. H.R. Rep. No. 1476, 94th Cong., 2nd Sess. 64, *reprinted in* 1976 U.S. Code Cong. & Admin. News 5659, 5677–78. To perform the work publicly, a license must be secured.

There are two exceptions when having a license is not required. The first is that home videocassettes may be shown, without a license, in the home to "a normal circle of a family and its social acquaintances." Such showings are not public. 17 U.S.C. § 101. Secondly, home videocassettes may also be shown, without a license, in certain "face-to-face teaching activities" 17 U.S.C. § 110(1). No license is needed in these situations because the law makes a very specific and limited exemption for such showings. No other exemptions are available.

Section 110(1), which allows teachers and students to perform copyrighted works in face-to-face instruction, does not require a license. However, the exemption would apply only if: (1) the showing takes place in a classroom or similar place devoted to instruction, (2) attendance is limited to the instructors and pupils, (3) the purpose of the showing is instruction and (4) the performance or display of a work is part of the teaching activities of a nonprofit educational institution. The exemption would definitely apply to Christian and parochial schools, but it is unclear whether church Sunday school classes are subject to the exemption.

All other showings of home videocassettes are illegal unless they have been authorized by a license. A license is permission secured from the producer or distributor of a videocassette for another to publicly perform the videocassette. Churches or organizations that wish to engage in nonhome showings of home videocassettes must secure licenses to do so, regardless of whether an admission or other fee is charged. 17 U.S.C. § 501. This requirement applies to both profit-making and nonprofit organizations.

The rental or purchase of a home videocassette does not carry with it the right to perform the copyrighted work publicly.

A videocassette may be sold with "audiovisual rights." Audiovisual rights are restricted rights that allow video showings in a nonprofit setting if there is no admission charge. Videocassettes labeled "For Home Use Only" do not have audiovisual rights. Many church distributors grant audiovisual rights with the purchase of a film or videocassette. Churches should determine whether their distributor(s) offers such rights with a film or videocassette purchase.

Broadcasts

Another area churches need to be especially careful about copyright infringement is in the context of church broadcasts. Church broadcasts are exempt from copyright infringement if (1) the work is performed during a religious service at a church or other place of religious assembly and (2) no copyrighted materials are performed or (3) the broadcasting station has obtained a license to broadcast the copyrighted works.

There is an exception to the exclusive right of the owner to publicly perform the work. Section 110(3) provides that "performance of a nondramatic literary or musical work or of a dramatico-musical work of a religious nature, or display of a work, in the course of services at a place of worship or other religious assembly" is not a copyright infringement. This includes performances and displays of a musical or dramatic work of a religious nature. The performance or display must be in the course of religious services, and it must occur at a place of worship or other assembly.

The Section 110(3) Religious Services exemption, however, does not cover public broadcasting over radio or television, because the broadcast constitutes a separate performance. Because the transmission of the broadcast over television or radio is not at a church or other place of religious assembly, broadcasters must have a license to perform the copyrighted works in order not to violate copyright laws. An example would be a church that tapes its Sunday service but broadcasts it later in the week. The broadcast would be a separate performance that would not fall under the religious services exemption.

Copyright issues arise in several areas of the church. Church employees and volunteers should make every effort to comply with the copyright laws. Purchasing a license is one way that churches can avoid violating the copyright laws. Those churches with licenses should ensure that they are complying with the stated terms of agreement. Churches without licenses should determine whether they should acquire one. ■

INTERNAL REVENUE SERVICE NEWS

Revocation of Exemption from Self-Employment Tax

Clergy who are exempt from self-employment tax because their faiths oppose accepting any form of public insurance have until April 15 to revoke the exemption, according to IRS Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers. The relevant section reads:

Revocation of exemption from self-employment tax.

If you are a minister, a member of a religious order not under a vow of poverty or a Christian Science practitioner, and are exempt from self-employment tax because you have an approved Form 4361, you have until April 15, 2002, to revoke that exemption. This deadline is extended beyond April 15, 2002, if you get an extension to file your 2001 return.

To revoke the exemption, you must file Form 2031.

The revocation will be effective for either 2000 or 2001 and all later years. You will be covered under the social security system, and your earnings will be subject to self-employment tax during those years. Once you revoke the exemption, you can never again elect exemption from self-employment tax. ■

Charitable Contributions

The Internal Revenue Service has issued IRS Publication 1771, Charitable Contributions—Substantiation and Disclosure Requirements. In the publication, the IRS confirms for the first time that a nonprofit organization may acknowledge a contribution via E-mail.

For gifts of $250 or more, a nonprofit organization must send the donor a written receipt. There are two general rules that organizations need to be aware of to meet substantiation and disclosure requirements for federal income tax return reporting purposes:

1. A donor is responsible for obtaining a written acknowledgment from a charity for any single contribution of $250 or more before the donor can claim a charitable contribution on a federal income tax return.

2. A charitable organization is required to provide a written disclosure to a donor who receives goods or services in exchange for a single payment in excess of $75.

Previously, the IRS did not specify whether an acknowledgment from a receiving organization could be electronic. The IRS now says that an organization can provide either a paper copy or an electronic copy—such as an E-mail message addressed to the donor—of the acknowledgment to the donor. "There are no IRS forms for the acknowledgment. Letters, postcards or computer-generated forms . . . are acceptable." ■

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