***Reed v. Commissioner, 82 T. C. 208 (1984)***

Ministers can exclude from gross income only the amount of a housing allowance actually used for out-of-pocket housing expenses, not the full fair rental value of their homes.

**Summary**

The case involved multiple ministers who received housing allowances from Lubbock Christian College, equating to the fair rental value of their homes but exceeding their actual housing costs. The court held that under Section 107(2) of the Internal Revenue Code, these ministers could only exclude the amount of the allowance used for actual housing expenses. The decision clarified that the exclusion under this section is limited to expenditures made in the same year the allowance is received, not the full fair rental value, thus resolving a key issue in tax treatment for ministers' housing allowances.

**Facts**

The petitioners, ministers at Lubbock Christian College and also part of the Church of Christ, received housing allowances as part of their compensation. These allowances were designated by the college to equal the fair rental value of the ministers' homes. However, the allowances exceeded the ministers' actual out-of-pocket expenses for housing. The petitioners sought to exclude the entire fair rental value from their gross income under Section 107(2) of the Internal Revenue Code.

**Procedural History**

The petitioners challenged the Commissioner's determination of tax deficiencies. The cases were consolidated for trial, briefs, and opinion in the U. S. Tax Court. The court's decision was that the petitioners could exclude only the amount of the housing allowance used for actual housing expenses.

**Issue(s)**

1. Whether ministers can exclude the fair rental value of their homes from gross income under Section 107(2) when the designated housing allowance exceeds their actual out-of-pocket housing expenses.

**Holding**

1. No, because Section 107(2) limits the exclusion to the amount of the allowance actually used by the minister to rent or provide a home.

**Court's Reasoning**

The court interpreted Section 107(2) to require a direct correlation between the

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amount received as a housing allowance and the amount used for housing expenses in the same tax year. The statute specifies that the exclusion applies “to the extent used by him to rent or provide a home,” indicating a use requirement. The court rejected the petitioners’ argument that excluding only out-of-pocket expenses discriminated against ministers without parsonages, noting that Congress deliberately chose different language for Section 107(2) compared to Section 107(1) (which deals with parsonages). The court emphasized that the legislative intent was clear in requiring actual expenditure for the exclusion to apply, and upheld the regulation’s requirement that the use of the allowance must be in the same year it is received.

**Practical Implications**

This decision sets a clear precedent that ministers can only exclude the portion of a housing allowance that directly corresponds to their actual housing costs. This impacts how ministers and their employers calculate taxable income, requiring accurate tracking of housing expenses. It also affects tax planning for religious organizations, as they must ensure housing allowances do not exceed actual costs to avoid unnecessary tax liabilities. Subsequent cases and IRS rulings have followed this interpretation, reinforcing the need for ministers to substantiate their housing expenditures when claiming exclusions under Section 107(2). This case also highlights the distinction between the treatment of housing allowances under Section 107(2) and the provision of parsonages under Section 107(1).

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