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## AN EXAMINATION OF RELIGIOUS TAX EXEMPTION POLICY UNDER SECTION 501(c)(3) INTERNAL REVENUE CODE

PAUL H.K. HAGEMAN\*†

### INTRODUCTION

In these worrisome times of inflation, taxes and shrinking municipal tax bases, a growing concern arises as to the wisdom of letting millions of dollars worth of property owned by religious organizations stand tax-exempt. Many people wonder why they should absorb more of the tax burden each year when churches and other religious institutions could just as easily carry the burden. Be assured, however, that the Internal Revenue Service, Congress and the courts have a substantial basis for exempting religious organizations from the income tax and other taxes.

This paper will deal with the policy of exempting religious organizations from tax on income, especially under section 501(c)(3) of the Internal Revenue Code of 1954. The history of this policy, its growth and modification and its application past, present and future will be explored. The application of this section will be discussed in three areas: education; property; and, all other activities. Hopefully, this paper will provide some insight into the tax exemption status of religious organizations and provide some answers and questions concerning the future of this policy.

#### I. THE GENESIS AND EARLY INTERPRETATION OF SECTION 501(c)(3)

##### A. *The Source of the Taxing Power*

The Constitution of the United States grants to the legislative branch of the government the power to tax in Article I. The power to raise revenue is found in several sections of the Constitution. Before 1913, they represented the solitary power of Congress to raise revenue and these sections were restrictive. Article 1 section 2 and section 8 require a direct tax to be levied on an apportionment basis among the population and among the states. These provisions gave Congress

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little power to adjust the burden of the tax and the growth of such revenue.

A more important provision is found in Article I section 8 of the Constitution where taxation is specifically enumerated as a power of Congress: "The Congress shall have power: To lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defence and general welfare of the United States . . ." <sup>1</sup> Through this provision Congress can tax personal and corporate income directly. However, the apportionment provisions still control such a tax. The country was provided with a continuing source of revenue, however, which served it adequately for well over one hundred years.

At the turn of the century the country was growing well beyond its sources of revenue. As a result, Congress passed in 1909 and the States ratified in 1913 the Sixteenth Amendment. It reads as follows: "The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration". <sup>2</sup> With the passage of this amendment our modern income tax was born. No longer does the government have to apportion taxes on income. The Sixteenth Amendment brought the revenue powers of the United States into the Twentieth Century. Now the government could greater control who paid more of the tax burden. Before this time only emergency measures such as one during the Civil War eliminated the need for apportionment of a tax on income. <sup>3</sup> With the passage of the Sixteenth Amendment no state constitution may interfere with the direct collection of taxes on income by the federal government.

The Sixteenth Amendment also made it possible for Congress to constitutionally for the first time exempt religious organizations from the income tax. The United States Supreme Court acknowledged this fact in *Brushaber v. Union Pacific Railroad Company* where it confirmed the constitutionality of the Sixteenth Amendment and thereby Congress' power to tax income and exempt organizations from the income tax. <sup>4</sup>

Congress had previously exempted religious organizations under

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1. P. DORF, THE CONSTITUTION OF THE UNITED STATES WITH A CLAUSE-BY-CLAUSE ANALYSIS 105-6 (1976).

2. *Id.* at 166.

3. *Id.*

4. *Brushaber v. Union Pacific Railroad Co.*, 240 U.S. 1, 21 (1916).

section 22 of the Revenue Act of 1894, but this act was subsequently declared unconstitutional.<sup>5</sup> It was not until the Revenue Act of 1913, section II(G)(a) that religious organizations were exempted from the income tax constitutionally.

Traditionally, churches and other religious organizations have been excused from paying taxes because the State has felt a need to encourage charitable works. Religious groups were not singled out, but were included with all other charitable organizations. The English Statute of Charitable Uses of 1601 is the basis for the modern day exemption. Even then there was concern about "clerical" wealth, but it was regarded as unimportant because of the need to encourage philanthropy. The removal of the obstacle of taxation promoted good works and this policy was established and has been with our society ever since. The tax exemption on property was just the beginning; it later encompassed income, inheritance tax, sales tax and state and local taxes depending on the jurisdiction.<sup>6</sup>

Since the ratification of the Sixteenth Amendment, Congress has consistently provided for the exemption from the income tax of religious organizations in every major Revenue Act that has passed. Congress has assumed that good works will be fostered by the exemption and stated the following in its report on the Revenue Act of 1938 through the Ways and Means Committee:

The exemption from taxation of money or property devoted to charitable or other purposes is based upon the theory that the government is compensated for the loss of revenue by its relief from the financial burdens which would otherwise have to be made by appropriations from public funds, and by benefits resulting from the promotion of the general welfare.<sup>7</sup>

This seems to indicate a willingness by Congress to preserve tradition. It also indicates the wisdom of such a policy, because it has not been deleted from any subsequent Revenue Act since it was first constitutionally established in 1913.

The Revenue Act of 1934 was the first such act to add the phrase

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5. P. WEBER & D. GILBERT, *PRIVATE CHURCHES AND PUBLIC MONEY: CHURCH-GOVERNMENT FISCAL RELATIONS* (1981).

6. *Id.* at 29-31.

7. P. TREUSCH & N. SUGARMAN, *TAX-EXEMPT CHARITABLE ORGANIZATIONS* 3 (1979).

“. . . and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation.” This was probably due to congressional fears about the abuse of such an exemption. The Congress probably wanted to make sure the charities receiving the exemption remained charitable. Thus, no one member could influence legislation or profit from the income to a charitable organization.<sup>8</sup> This phrase will be explored in detail later on.

No substantial changes were approved by Congress until 1954 when our present Internal Revenue Code was adopted. Then the exemption for religious organizations was placed in section 501(c)(3) instead of its former home, Section 101(6). The pertinent part of section 501(c)(3) reads as follows:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, . . . purposes . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h)) and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.<sup>9</sup>

Under the Tax Reform Act of 1969 churches were forced to give up part of their privilege as their unrelated business income became taxable.<sup>10</sup> The tax on unrelated business income had applied to other tax-exempt organizations before, but was only applied to churches after the Act of 1969.

The Tax Reform Act of 1969 also disqualified churches from a new requirement that newly formed organizations apply for recognition of tax-exempt status.<sup>11</sup> This being the case, churches, their integrated auxiliaries and conventions or associations of churches will be presumed tax exempt until further changes in the law.

The most recent modification of exempt status for religious organizations came with passage of the Tax Reform Act of 1976. This Act set up standards for the use of charitable contributions in influenc-

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8. Revenue Act of 1934, 48 Stat. 700 (1934).

9. I.R.C. sec. 501(c)(3).

10. Ellis, *Tax on Unrelated Business Income of Churches*, 7 TAX ADVISER 270 (1976).

11. Tax Reform Act of 1969, Pub. L. No. 91-172 sec. 101(a), 83 Stat. 495 (1969).

ing legislation. The purpose of the provision is to create an appropriate measure of legislative activity which may be done by an exempt organization before its exempt status will be lost.<sup>12</sup> Apparently many organizations were not technically within the bounds of section 501(c)(3) I.R.C. and this legislation ensured that they would be.

The Treasury position during the hearings on the House bill favored the legislation:

H.R. 13500 is a product of a number of attempts to reach a compromise among representatives of conflicting interests. It has been designed to provide certainty and predictability to the administration of the lobbying provisions of sec. 501(c)(3). It provides clear quantitative measures of permissible lobbying activities. It defines with some precision which activities constitute lobbying and which do not. Finally, it enlarges the scope of activities in which charitable organizations may engage without adverse tax consequences.<sup>13</sup>

In essence, the bill sought to define what "no substantial part" as referred to legislative activity means in section 501(c)(3).

Charities such as the American Jewish Committee sent letters to the Committee on Ways and Means in support of the legislation, because it clarified the vagueness of section 501(c)(3).<sup>14</sup> As a result of a statement by the National Council of the Churches of Christ in the United States of America, several compromises were made in H.R. 13500. Churches, their integrated auxiliaries and conventions or associations of churches were disqualified under the bill. This means they are protected by the current language of the section. Furthermore, the decision in *Christian Echoes National Ministry v. United States* was not affected by Congress. So, churches may lose their tax exemption for substantial lobbying, but they still may qualify for tax-exempt status under section 501(c)(4).<sup>15</sup>

The National Council of Churches did suggest the Committee drop the restriction on "influencing" legislation altogether, because of the church's need to contribute to the solutions to the problems of society. However, this point was not approved by the Committee after taking it into consideration.<sup>16</sup>

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12. *Influencing Legislation by Public Charities: Hearings on H.R. 13500 Before House Comm. on Ways and Means, 94th Cong., 2d Sess. 77 (1976).*

13. *Id.* at 11.

14. *Id.* at 71.

15. *Id.* at 78.

16. *Id.* at 78.

Ultimately, the bill was approved by the Committee<sup>17</sup> and passed by the House.<sup>18</sup> The Senate in turn struck all portions of the bill but the enacting clause and amended it to deal with food stamp purchases by welfare recipients instead. The Senate believed the substance of H.R. 13500 had already been enacted under H.R. 10612 as part of the Tax Reform Act of 1976.<sup>19</sup>

The Act was considered and amended by both houses and eventually passed on September 16, 1976. It was signed by President Ford on October 4, 1976.<sup>20</sup> In its final form, churches were disqualified from the new provisions relating to influencing legislation by charitable organizations.<sup>21</sup> This does not mean that religious organizations cannot lose their exempt status, however. They should be careful not to spend too much money on lobbying efforts or they will find themselves in the same position Christian Echoes National Ministry did.<sup>22</sup> Since the Tax Reform Act of 1976, there have been no substantial reforms in the revenue laws pertaining to tax-exempt religious organizations passed by Congress.

#### B. *Qualification for Tax-exempt status Under Section 501(c)(3)*

To qualify as a "religion" or a "church" under the new Code for purposes of tax exemption, the organization must explain in some manner the meaning of life for its followers.<sup>23</sup> Congress and the Supreme Court have never defined "religion" or "church", but it is generally accepted that there is some belief in another existence beyond the present one which is fostered by a particular group in a particular manner.

The word "church" usually refers to a building set aside for worship and not the institution itself.<sup>24</sup> Hopkins lays out the factors used by the IRS when defining a church for the purposes of exemption: 1) a distinct legal existence; 2) a recognized creed and form of worship; 3) a definite and distinct ecclesiastical government; 4) a formal code of doctrine and discipline; 5) a distinct religious history; 6) a membership not associated with any other church or denomination;

17. *H.R. Rep. No. 1210*, 94th Cong., 2d Sess. (1976).

18. 94th Cong., 2d Sess., 122 CONG. REC. 16892 (1976).

19. *S. Rep. No. 1345*, 94th Cong., 2d Sess. (1976).

20. LEGISLATIVE HISTORY OF INTERNAL REVENUE ACTS, 1976, 537 (1976).

21. 26 U.S.C. sec. 501(h)(5) (1976).

22. *Christian Echoes National Ministry, Inc. v. United States*, 470 F.2d 849 (10th Cir. 1972), *reh'g den.*, (1973).

23. D. KELLY, *WHY CHURCHES SHOULD NOT PAY TAXES* 60 (1977).

24. 84 C.J.S. *Taxation* §§ 289-291.

7) a complete organization of ordained ministers ministering to their congregations and selected after completing prescribed courses of study; 8) a literature of its own; 9) established places of worship; 10) regular congregations; 11) regular religious services; 12) Sunday schools for religious instruction of the young; and, 13) schools for the preparation of its ministers.<sup>25</sup> These considerations help to eliminate so-called unorthodox churches from tax-exempt status.

A religious organization or church must also show its purpose for existence is primarily religious or charitable in nature. Advancement of "religion" as defined above is primarily considered a charitable purpose. Activity in a charitable nature often includes the distribution of income to the community and not individual members of the organization.<sup>26</sup> The use of an organization's money must be for the improvement of society as a whole, not the private use by an individual or group of individuals for personal gain.

In the case of a religious organization, it seems that the qualifying religion must include in its tenets the advancement of civilization through good works. Where such an organization does not follow a primarily religious purpose, it will be denied tax-exempt status.<sup>27</sup>

There also arises the problem of religious corporations and the extension of the tax exemption to such property. The whole area of activity outside of worship and its tax status will be explored later in great detail. For now it is safe to say the tax-exempt status was originally meant to apply only to contributions during worship or other religious exercises.<sup>28</sup> It has since been extended to many religious endeavors, but not so far as to be out of control. It has not been extended in the case of a church synod operating a charitable corporation for religious purposes and using the profit for religion.<sup>29</sup> Religious auxiliaries cannot be exempted if operated for a profit. The exemption should not be used for competitive reasons.

The phrase ". . . no part of the net earnings of which inures to the benefit of any private shareholder or individual . . ." is an in-

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25. B. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* 134 (3d Ed. 1979).

26. *Id.* at 47.

27. *Swedenborg Foundation Inc. v. Lewisohn*, 40 N.Y.2d 87, 351 N.E.2d 702, 386 N.Y.S.2d 54 (1976).

28. *Evangelical Lutheran Synod of Missouri, Ohio and Other States v. Hoehn*, 355 Mo. 257, 196 S.W.2d 134 (1946).

29. *Id.*

30. *The Founding Church of Scientology v. The United States*, 412 F.2d 1197 (Ct. Cl. 1969), *cert. denied*, 397 U.S. 1009 (1969).



tegral part of section 501(c)(3) of the Internal Revenue Code of 1954. The purpose of this phrase is to ensure that the money taken in by an organization is used for the public at large. The purpose of the exemption as it relates to religious organizations is, after all, to foster their beneficial function to society as a whole. The law states that where a corporation fails to prove none of its net assets have benefited private individuals, the statutory exemption will not be allowed.<sup>30</sup> The courts are very careful to scrutinize religious corporations with regard to this provision of section 501(c)(3). The exemption is granted because the organization is non-profit. If one or more individuals in the corporation are privately benefiting from the activities of the organization, then the whole purpose of the exemption is defeated.

Briefly, I mention again the lobbying limitation of sec. 501(c)(3). Many churches feel a need to make policy statements on political issues. Because social issues are so great a part of values and morals espoused by religions, the separation of church and state is often translucent. The changes made by the Tax Reform Act of 1976 helped to remove some of the ambiguity from the provision, but because churches were disqualified, they remain uncertain as to the extent to which they may engage in political lobbying.

Leif M. Clark in his article, "Church Lobbying: The Legitimacy of the Controls,"<sup>31</sup> believes the lobbying limitation could be removed from section 501(c)(3) altogether. He points out that the organizations must be exclusive in its purpose already to have the exemption thus eliminating the need for further limitations. Clark states two possible benefits that would result from excising the lobbying limitation:

First, treasury would no longer be able to use the uncertain scope and application of the limitation to harass or threaten politically unpopular organizations. Second, as a corollary Treasury's inquiry into the exempt status of a given organization would properly focus not on the tangential issue of lobbying, but on the central question of whether the organization is in fact charitable.<sup>32</sup>

The tax exemption for churches also applies to their integrated auxiliaries. These integrated auxiliaries must however be affiliated with a church and their primary activity must be exclusively religious.<sup>33</sup> The term "affiliated" refers to the association with or con-

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31. Clark, *Church Lobbying: The Legitimacy of the Controls*, 16 HOUSTON L. REV. 480 (1979).

32. *Id.* at 534.

33. Reg. sec. 1.6033-2(g)(5)(i) cited in B. HOPKINS, *supra* note 25, at 522.

trol by a church or convention or association of churches. It includes seminaries, mission societies, youth groups and men's or women's organizations.<sup>34</sup> The main consideration is that the auxiliary somehow furthers the religious purpose of the church.

Once a religious organization has qualified for tax-exempt status, it must file an annual statement of income with the IRS using Form 990 or 990-PF pursuant to section 6033(b) of the Code. The following items must be included: 1) the organization's gross income for the year; 2) its expenses attributable to such income and incurred within the year; 3) its disbursements within the year; 4) a balance sheet showing its assets, liabilities, and net worth as of the beginning of the year; 5) the total of the contributions and gifts received by it during the year, and the names and addresses of all substantial contributors; 6) the names and addresses of its managers and highly compensated employees; and, 7) the compensation and other payments made during the year to each individual described in item (6).<sup>35</sup>

A religious organization with unrelated business income must also file Form 990-T. One problem that arises here is unrelated debt-financed income. This occurs when a church sells property contributed to them only to find there was still a mortgage on the land. The income must then be reported as it relates to the basis of the investment in the property.<sup>36</sup> Form 990-T is due March 15 and Form 990 is due April 15.<sup>37</sup> Many institutions have suffered a lot of unnecessary grief because they have forgotten this fact.

### C. *The Constitutionality of Section 501(c)(3)*

The power of Congress to impose an income tax and exempt from said tax certain organizations has already been established under the Sixteenth Amendment and *Brushaber v. Union Pacific Railroad Company*.<sup>38</sup> A number of attacks on the exemption have still arisen in recent years, however. The primary requisite to bring a case challenging the granting of an exemption is standing. In 1972, it was ruled that a Black American has standing to challenge an exemption to a private club which excludes nonwhites, because the exemption may foster such activity against public policy.<sup>39</sup> That case was subsequently lost and four years later in *Simon v. Eastern Kentucky Welfare*

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34. Reg. Sec. 1.6033-2(g)(5)(iv) cited in B. HOPKINS, *supra* note 25, at 523.

35. B. HOPKINS, *supra* note 25.

36. Meyers, *Preparation of Forms 990 and 990-T*, 22 CATH. LAW. 256 (1976).

37. Parker, *Instructions for Filing Out Form 990-T*, 22 CATH. LAW. 262 (1976).

38. 240 U.S. 1 (1916).

39. *McGlotten v. Connally*, 338 F. Supp. 448 (D.C. 1972).

*Rights Organization*, it was held that indigents have no standing to challenge an exemption granted to a hospital which did not serve people unable to afford the services.<sup>40</sup> The organization bringing the suit could not show a "case or controversy" or the requisite personal injury necessary under Article III of the Constitution. As a result of this case, standing to challenge a tax exemption granted by Congress is difficult to establish. The concrete injury requirement is almost beyond proof.

Perhaps the greatest landmark case in the area of constitutional challenges to tax exemptions for religious organizations is *Walz v. Tax Commission of the City of New York*. The appellant in this case argued that a tax exemption granted to a church's property in the City of New York indirectly meant that his tax money supported the establishment of a religion in violation of the First Amendment. The Court rejected this idea in favor of a doctrine that recognizes the need not to inhibit organizations fostering the improvement of society. The Court noted the exemption was granted to many charitable classes of property outside of churches. Exempting churches from property taxation also avoids an excessive entanglement between Church and State. Thus, the Supreme Court upheld the constitutionality of exemptions to religious organizations.<sup>41</sup>

In Maryland, in a less publicized case,<sup>42</sup> the plaintiffs also used the First and Fourteenth Amendment arguments to challenge the constitutionality of tax exemptions for property used for public worship. The plaintiffs here were atheists representing themselves and The Freethought Society of America, Inc. As such they did not want to be compelled through their taxes to support places of worship or any ministry.<sup>43</sup> The court here found no violation of the Equal Protection Clause because all classes of property belonging to organizations with beliefs about religion were exempted under the statute in question. This included the property owned by the plaintiffs for their atheistic organization. The court appropriately quoted Mr. Justice Holmes, "[i]f a thing has been practiced for two hundred years by common consent, it will need a strong case for the Fourteenth Amendment to affect it."<sup>44</sup>

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40. *Simon v. Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26 (1976).

41. *Walz v. Tax Commission of New York*, 397 U.S. 664 (1970).

42. *Murray v. Comptroller of the Treasury, State of Maryland*, 241 Md. 383, 216 A.2d 897 (1966), *cert. denied*, 385 U.S. 816.

43. *Id.* at 902.

44. Mr. Justice Holmes in *Jackman v. Rosenbaum Co.*, 260 U.S. 22, 31 (1922), *cited in Murray*, 216 A.2d 897 at 907.

Courts rarely have found tax exemption statutes violative of the Constitution. To my knowledge section 501(c)(3) has never been found unconstitutional, because it is consistent with the First and Fourteenth Amendments. Ever since *Sherbert v. Verner*, the free exercise of religion has been fostered by states where no compelling state interest overrides it.<sup>45</sup> Establishment of religion has not been the course to follow in trying to overturn a tax exemption. The course of violation of the Due Process Clause has been successful however, where a loyalty oath was required for persons or organizations requesting tax-exempt status.<sup>46</sup> We are left with the proposition that tax exemptions for religious organizations do not violate the Constitution in substance and rarely do in procedure.

## II. APPLICATION OF SECTION 501(c)(3) TO RELIGIOUS ORGANIZATIONS

### A. *Parochial Educational Institutions*

Having established the origins of tax exemptions for religious organizations and their constitutionality, we turn now to a discussion of the application of section 501(c)(3) to specific areas of religious organizations.

Many churches in our society also operate schools. The purpose is to provide parents of the particular faith with an alternative to public education for their children. Many parents prefer their children to receive a Christian education as opposed to a purely secular one. For this reason many faiths, especially the Catholic and Lutheran churches, have established and maintained their own schools. Such schools are eligible for the educational tax exemption under section 501(c)(3), but we are concerned here with their tax exempt status as an integrated auxiliary of a religious organization.

Due to their religious affiliation the courts protect many of the practices of parochial schools that are not allowed in public schools. The courts want to avoid excessive entanglement between the government and the church. In the absence of a compelling state interest, statutory exercise of the police power in a parochial school will not be tolerated.<sup>47</sup> In *Meyer v. Nebraska*, the state could not show a harmful effect of students learning a second language, so their interference with the teacher's teaching was prohibited by the Court.

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45. *Sherbert v. Verner*, 374 U.S. 398 (1963).

46. *Speiser v. Randall*, 357 U.S. 513 (1958); *First Unitarian Church v. Los Angeles*, 357 U.S. 545 (1958).

47. *Meyer v. State of Nebraska*, 262 U.S. 390 (1923).

Just as the state cannot legislate instruction in parochial classrooms, they also may not legislate to parents compulsory attendance by their children in a public school.<sup>48</sup> The Supreme Court in *Pierce v. Society of Sisters* found as unconstitutional the Compulsory Education Act of 1922. This act mandated that all parents place their 8-16 year old children in a public school. The Court determined that Act to be an unreasonable interference by the State with the right of the parents to educate their children as they see fit.<sup>49</sup>

Of course, the most recent case in the *Pierce* line of reasoning is *Wisconsin v. Yoder*.<sup>50</sup> This case involved an Amish family which sought to preserve a way of life by keeping their young out of the public school system. The Free Exercise Clause of the First Amendment protected the respondent's sincere religious belief. Where a religious belief and education are so intertwined, they will generally outweigh any legitimate interests of the State because of First Amendment guarantees.<sup>51</sup> One must come to the conclusion that the court tries to keep the separation between Church and State intact. It is difficult in the area of education, because they are often interdependent. That parochial schools are an integral part of the church they are affiliated with remains uncontroverted. This being the case, control by the government over church policies is limited. The use of tax exemption by the government to implement public policy in parochial schools is subject to strict scrutiny by the court. The trend is to disallow such governmental intrusion.

The only major area in which the government has had success in recent years is discrimination by parochial schools. In *Green v. Connally*, the Court held that private schools admitting only white students were not eligible for tax-exempt status.<sup>52</sup> The reason is because declared public policy dictates otherwise.<sup>53</sup> The Court never actually decided the issue with regard to religious private schools. The Court did suggest that the IRS check an educational institution's racial policies before granting them an exemption.

The Court did decide the issue finally in 1974 in the case of *Bob Jones University v. Simon*.<sup>54</sup> The Court held that a fundamentalist school or any parochial school that discriminates by race in admis-

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48. *Pierce v. Society of Sisters*, 268 U.S. 510 (1925).

49. *Id.*

50. *Wisconsin v. Yoder*, 406 U.S. 205 (1972).

51. *Id.*

52. *Green v. Connally*, 330 F. Supp. 1150 (1971), *aff'd sub. nom.*, *Coit v. Green*, 404 U.S. 997 (1971).

53. Title IV Civil Rights Act of 1964.

54. *Bob Jones University v. Simon*, 416 U.S. 725 (1974).

sions can lose its tax-exempt status. The fact that discrimination is part of the religious tenets of the organization makes no difference. In this case the test of *Williams Packing* was not met.<sup>55</sup> In trying to obtain injunctive relief, Bob Jones University had not shown irreparable injury caused by governmental action and they also failed to show a certainty of success on the merits. As a result of its loss under section 7421(a), the university was also liable for FICA and FUTA taxes. Contributions were threatened also because, they were no longer deductible under section 170(c)(2). This case is very representative of the enormous economic impact the loss of tax-exempt status can have on an organization. It is one reason why the court is so cautious about involving itself in First Amendment issues. The result on a religious organization can be devastating although appellant here seemed to weather the storm.

In a related case, a non-profit group lost its exemption and filed suit to have it restored. The Court held that even though the claims were of a constitutional nature, the Anti-Injunction Act prevailed. Under this Act no suit may be maintained "for the purpose of restraining the assessment or collection of any tax". The taxpayers here met the same fate as Bob Jones University did. Their case was barred because they took the wrong path to the right remedy. Instead of seeking injunctive relief, they should have litigated their claims to restoration of tax-exempt status. As it turned out, respondents lost the exemption and with it protection for a substantial amount of contributions.<sup>56</sup>

Three years later, the decision in *Bob Jones University* was followed by a District Court in North Carolina. The court there found racially discriminatory admission policies as precluding the school from qualification for exemption from FICA and FUTA taxes.<sup>57</sup> The court employed a test based upon *Gillette* and *Lemon v. Kurtzman* to determine if legislation is free of Free Exercise problems: 1) is there a secular legislative purpose?; 2) the enactment has a principal or primary effect which neither enhances nor inhibits religion; and, 3) the enactment avoids excessive entanglement with religion.<sup>58</sup> Applying this test the court arrived at the result that denying the exemption here was based on a legitimate state interest and applied according to an objective standard.

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55. *Id.*

56. *Alexander v. "Americans United" Inc.*, 416 U.S. 752 (1974).

57. *Goldsboro Christian Schools, Inc. v. United States*, 436 F. Supp. 1314 (E.D. N.C. 1977).

58. *Id.* at 1320.

Clearly, the intent of Congress is not to foster racial discrimination in religious schools in contravention to public policy. The courts have seen this as one area where First and Fourteenth Amendment rights are not abridged by denial of tax-exempt status. Thomas Neuberger and Thomas Crumplar offer additional reforms to this issue.<sup>59</sup> They suggest challenging discriminatory policies in a judicial rather than administrative setting. They also suggest a policy change through an amendment to Title VI of the Civil Rights Act of 1964. Then schools with discriminatory policies would be violating federal law as a result of their exempt status. Removal of such status would be imminent upon failure of the school to take corrective action. They also suggest an amendment to section 501(c)(3) to warn schools against racial discrimination. In Neuberger and Crumplar's words, "These reforms would remove IRS from the business of setting social policy and return it to the arena of collecting tax revenues."<sup>60</sup>

#### B. *The Tax-exempt Status of Property Owned By Organized Religion*

The constitutionality of a tax exemption granted to church property has already been upheld by the Court in *Walz*.<sup>61</sup>

Property is perhaps the most sensitive area when discussing religious tax exemptions. Property is what the layman can most readily relate to in his or someone else's church. The accumulation of wealth by a religious organization is based in its property. It is also what upsets most people when they think about all that tax-free property. The primary argument of local governments for increasing the tax base lies in taxing church property. This would reduce the tax burden on the citizens. As an example, in Ohio churches held \$140 million worth of exempt property in 1924 and by 1965 they owned \$600 million worth of exempt property.<sup>62</sup> Fifteen years later that amount had grown to over \$1.1 billion.<sup>63</sup> In support of the churches, however, their percentage of the total value of exempted property in the state has decreased from 19% in 1924 to 17.4% in 1965<sup>64</sup> to 13.8% in 1980.<sup>65</sup> These figures are only representative of Ohio, but

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59. Neuberger and Crumplar, *Tax Exempt Religious Schools Under Attack: Conflicting Goals of Religious Freedom and Racial Integration*, 48 *FORDHAM L. REV.* 229 (1979).

60. *Id.* at 276.

61. 397 U.S. 664 (1970).

62. Ohio Tax Study Commission Report, "The State and Local Tax Structure of Ohio" (1967).

63. Department of Tax Equalization in Ohio, V-8 (1979) (revised November 1980).

64. Ohio Tax Study Commission Report, *supra* note 62.

65. Department of Tax Equalization in Ohio, *supra* note 63.

one can see that the amount of exempted church property across the nation must be enormous.

With all this property in the hands of churches, why don't governments at all levels just tax it? Aren't the churches getting rich at the taxpayer's expense? Despite the accumulation of wealth by churches little is ever done to require churches to pay taxes. The answer here lies in the fact that most people recognize that religious organizations benefit the public through their work and they can only continue such work through public support. Tax exemptions are one manner by which the public indirectly helps themselves by removing a burden from the church. The logical conclusion to be drawn here is that if the churches are taxed and unable to continue their work because of such tax, the ultimate burden will fall on the taxpayers to provide the same service or observe a decay in society. Most local governments would rather grant an exemption to church property.

When determining if property owned by a religious organization is qualified for tax-exempt status, the focus of the court is on the use of the property in question. The property generally has to be used for public worship or in furtherance of religious purposes. Where a church uses a building it owns for other purposes or leases said building for unrelated uses, it will be taxed.<sup>66</sup> Commercial activity such as leasing a building to tenants in business is regarded as secular and taxable.<sup>67</sup> In order for "incidental" business to be exempt, it must be so closely related to the church as to be vital to the operation of the church.<sup>68</sup>

Many factors are considered in qualifying a religious organization for a property tax exemption. The organization's charter documents and activities are examined. The institution must be non-profit and maintain such status. The primary use of the property must be of benefit to society.<sup>69</sup>

In *The Lutheran Book Shop v. Bowers*, a non-profit corporation organized for charitable purposes was using part of its net-income each year for operating capital. The rest was allocated to the Lutheran Welfare Service of which it was a division. The store operated for

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66. Board of Christian Education of Presbyterian Church in United States v. School District of Philadelphia, 171 Pa. Super. Ct. 610, 91 A.2d 372 (1952).

67. *Id.*

68. *Id.* at \_\_\_\_, 91 A.2d at 377-8.

69. Pantaleoni, *New York's Real Property Tax Exemption for Religious, Educational, and Charitable Institutions: A Critical Examination*, 44 ALBANY L. REV. 488 (1980).



the benefit of the general public and Lutheran churches, pastors and teachers. The personal property was fully taxable because it was used within the purview of the Ohio Revised Code section 5709.01 as property used in business. The court reasoned that a substantial portion of the property was used to compete with commercial concerns. Even though part of the proceeds were used for charitable work, the test is the present use of the property not the ultimate use of the proceeds.<sup>70</sup>

Similarly, even where corporations are operated for the sole purpose of the religious organization, if the purpose is not exclusively charitable, the exemption will be denied.<sup>71</sup> In *Evangelical Lutheran Synod v. Hoehn* the prerequisites to tax exemption were not met. The use had to be "exclusively for religious worship" or "purely charitable". The Synod claimed it was both and did not satisfy the Missouri Constitution. The fact that the earnings went to the Synod made no difference. The court states, ". . . our Constitution says tax exempt land must be used *exclusively* for religious worship or purposes *purely* charitable. A competitive commercial business operated for profit does not comply with that requirement, even though the profits are devoted to religion."<sup>72</sup>

In one of the early significant cases in this area, the court held that a religious body may not rent or sell land without paying taxes on that income.<sup>73</sup> Here the Catholic Church tore down its church building and built a new one. They did this to rent the property where the old building had stood. The church wanted to use the income to pay their debt for building. The court again looked at the use of the property from which the income was derived. If no religious purpose is made of the property, it is taxable.<sup>74</sup> The court apparently saw this case as an unnecessary expense on the part of the church. The court is interested in legitimate uses of the tax exemption for the public good. That was not the case here.

One exception to the use rule is found in the case of *Roman Catholic Diocese v. City of New York*.<sup>75</sup> The church here was holding

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70. *The Lutheran Book Shop v. Bowers*, Tax Commissioner, 164 O. St. 359, 131 N.E.2d 219 (1955).

71. *Evangelical Lutheran Synod of Missouri v. Hoehn*, 355 Mo. 257, 196 S.W.2d 134 (1946).

72. *Id.* at \_\_\_\_, 196 S.W.2d at 147.

73. *Gibbons v. District of Columbia*, 116 U.S. 404 (1886).

74. *Id.*

75. *The Roman Catholic Diocese of Brooklyn, New York v. The City of New York*, 38 Misc. 2d 815, N.Y.S.2d 889 (1963).

a piece of land for use as a high school when the Korean War period arose. The United States Government requested the use of the land as an anti-aircraft base. The Diocese agreed to the government's request and received only a nominal rent for the use of the land. Under such circumstances, the Diocese cannot be taxed for the period for which the land was not used for religious purposes. The Diocese met the four requirements for the exemption: 1) plaintiff was a corporation organized for religious or educational purposes exclusively; 2) plaintiff could not use the land because of the absence of suitable buildings; 3) plaintiff received no rent income or profit from the land and; and 4) plaintiff in good faith contemplated using the land for a religious or educational purpose.<sup>76</sup> Also, it would be poor public policy in this instance to tax a church for donating land to the use of the government in time of national emergency.

In determining tax-exempt status the primary and almost singular test of the court will be the use to which the religious organization put the property. Serious investigation is involved in determining the ultimate use of a church's property. Because of the impact on all taxpayers, this issue deserves a careful look. The courts have done a competent job.

### C. *Other Income Producing Activities of Religious Organizations*

A plethora of cases have developed in the law which cannot be distinctly placed in the education or property categories. These cases have arisen mainly because of the provisions relating to tax exemptions regarding political activity and unrelated business income. Congressional intent has been the guide for the court in these cases. This is also an area that is still developing as novel cases are brought before the bench every so often. The possibilities here are endless.

The Tax Reform Act of 1976 changed the rules of the game with regard to lobbying by charitable organizations. Congress intended to have stricter control over the use of contributions received by charities. The revisions disqualified churches, their integrated auxiliaries and a convention or association of churches under section 501(h)(5) I.R.C., however. This does not mean religious organizations won't lose their exempt status for engaging in too great a degree of political activity as I have explained before. Congress specifically intended no approval or disapproval of the decision in *Christian Echoes* by its enactment of section 501(h)(5).<sup>77</sup>

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76. *Id.* at \_\_\_\_, 238 N.Y.S.2d at 891-2.

77. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1722 (1976).

The decision in *Christian Echoes National Ministry, Inc. v. United States* is an interesting one. Christian Echoes was a southern fundamentalist Christian organization operated by Dr. Billy James Hargis. The organization lost its tax-exempt status because of its attempts to influence legislation. In particular, the organization urged support of the Becker Amendment for restoration of prayers in public schools. To accomplish this feat Christian Echoes had intervened in the political campaigns of candidates supporting the amendment. Thus, their purpose was not exclusively religious, charitable or educational as required by section 501(c)(3). Under such circumstances, the tax exemption can be revoked and here it was also made retroactive to the time Christian Echoes' legislative influencing began.<sup>78</sup> The court quoted the Supreme Court from *Dickinson v. United States*: "Tax exemptions are matters of legislative grace and taxpayers have the burden of establishing their entitlement to exemptions."<sup>79</sup>

It appears from this decision that once the exemption is granted it is not absolute; even for religious organizations. The qualifications of section 501(c)(3) must be continually met. Any deviation therefrom could result in a revocation of the exemption.

The question then arises: what constitutes "substantial activity" enough for a church to lose its exempt status? Most courts use the test of *Seasongood v. Commissioner of Internal Revenue*.<sup>80</sup> In the case of a former mayor seeking to deduct contributions made to a good government league, the court held the deduction good because the League devoted only 5% of its time to influencing legislation.<sup>81</sup> This percentage rule is now often used although a slightly larger percentage may pass the test of the court.

In most circumstances, it has been held that contributions to groups supporting or opposing legislation are not deductible as business expenses.<sup>82</sup> Even where one believes the organization receiving the contributions is a charitable one, the contributions are not deductible under section 170(c)(2) if the organization receiving the contributions substantially attempts to influence legislation.<sup>83</sup> The court

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78. *Christian Echoes*, 470 F.2d 849.

79. *Dickinson v. United States*, 346 U.S. 389 (1953), cited in *Christian Echoes*, 470 F.2d at 854.

80. *Seasongood v. Commissioner of Internal Revenue*, 227 F.2d 907 (6th Cir. 1955).

81. *Id.*

82. *Cammarano v. United States*, 358 U.S. 498 (1959).

83. *Haswell v. United States*, 500 F.2d 1133 (Ct. Cl. 1974).

in *Haswell v. United States* did not believe a percentage test was appropriate. The more appropriate test was believed to be one of a balancing of the political efforts of an organization in the context of that organization's objectives and circumstances.<sup>84</sup> This would indicate a close scrutiny by the court. No exemption will be revoked unless clear proof is shown that the organization substantially has sought to influence politics. This careful examination is necessary to prevent the denial of First and Fourteenth Amendment rights in the case of a religious organization.

For many churches political activity is necessary to spread their values and faith into everyday life. Leif Clark, as stated before, would end all restrictions on church lobbying. The excision of the "influencing legislation" clause would promote a clearer understanding of the qualifications to be met for tax-exempt status. Churches would still maintain free exercise of religion and the resulting restrictiveness of section 501(c)(3) would serve to comfort the government's fears about legislative subversion.<sup>85</sup> Only churches fulfilling their purpose would be exempt and the "substantial" test could be tossed out the window. The effect could be to produce more revenue for the government because of the resulting decline in qualifying organizations.

Another area of the law that is developing day by day is unrelated business income. As of the passage of the Tax Reform Act of 1969, churches are subject to paying taxes on their income not within the scope of the religious purpose exemption. Tax returns for this category of income are to be filed on Form 990-T as mentioned above. Churches are also granted a \$1,000 deduction under section 512(b)(12) of the Internal Revenue Code. Dividends, annuities, interest, royalties, deductions related to income and gains or losses from the sale or exchange of property are excluded from unrelated income as well.<sup>86</sup> The only exception is where under section 512(b)(13), the organization deriving the income is a controlling organization. Control is defined as ownership of at least eighty percent of the voting stock in section 368(c).

Even before the Tax Reform Act of 1969, taxes have been placed on activities deemed to be without the scope of the exercise of religion by the local taxing authorities. The most notable of these cases is *Murdock v. Pennsylvania*.<sup>87</sup> This case involved the taxing of the sale

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84. *Id.* at 1142.

85. Clark, *supra* note 31.

86. I.R.C. § 512(b).

87. *Murdock v. Pennsylvania*, 319 U.S. 105 (1943).

of religious literature by Jehovah's Witnesses. The state argued, as did Justice Frankfurter in his dissent, that the solicitation by the religious colporteurs fell within the commercial venture meaning of the ordinance. The majority rejected this view by declaring the tax on Jehovah's Witnesses unconstitutional as a suppression of religious exercise under the First Amendment.<sup>88</sup> The activity here was related to the purpose of the religion and hence, non-taxable.

We have already seen that a religious organization which derives rent from commercial tenants has taxable unrelated business income.<sup>89</sup> The rationale behind this position is the prevention of an unfair competitive advantage over taxable businesses.<sup>90</sup> If a school under the auspices of organized religion sends out greeting cards in the hope of receiving charitable contributions, this is not unfair competition. The income is not taxable under the "low cost articles" exception. This exception realizes that the proceeds of the solicitation will fully accrue to the exempt organization.<sup>91</sup> Without a profit being realized there can be no unrelated business income. An organization's exemption will not be lost either, if the activity without the scope of the exemption is merely incidental.<sup>92</sup>

A different result may occur if the activity of an exempt organization falls within section 513. Most recently, this was the case in *Clarence LaBelle Post No. 217, VFW v. United States*.<sup>93</sup> The VFW Post here was engaged in bingo games. The income from such games was ruled taxable by the court as falling within the definition of unrelated trade or business under section 513(a). The court made an important ruling here because the activity was not competitive with commercial businesses. That distinction is no longer necessary under section 513 of the Code.<sup>94</sup> The tax on bingo games could have had important ramifications for religious organizations, particularly the Catholic Church, except for the fact that bingo games are now excluded from the term "unrelated trade or business". The same year the VFW case was decided, the Congress amended the Internal Revenue Code by passing section 513(f). This section emasculates the decision in *Clarence LaBelle Post No. 217, VFW*. The added section allows exempt organiza-

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88. *Id.*

89. *Board of Christian Education*, 171 Pa. Super. Ct. 610, 91 A.2d 372.

90. *The Hope School v. United States*, 612 F.2d 298 (7th Cir. 1980), *cert. dismissed*, 439 U.S. 1040 (1980).

91. *Id.*

92. *St. Louis Union Trust Co. v. United States*, 374 F.2d 427 (8th Cir. 1967).

93. *Clarence LaBelle Post No. 217, Veterans of Foreign Wars of the United States v. United States*, 580 F.2d 270 (8th Cir. 1978), *cert. dismissed*, 439 U.S. 1040 (1978).

94. *Id.*

tions to conduct bingo games without being subject to taxation except when they are contrary to state or local law or compete with for-profit bingo games. No doubt religious organizations had some influence in the passage of this legislation.

A final area of discussion in this section involves employment in the church. Title VII of the Civil Rights Act of 1964 provides that no private employer may discriminate in employment. Originally, religious organizations were given an exemption under section 702 of this title. However, due to amendments to this section by Senators Humphrey and Ervin, the present view is not clear. The most viable positions are that the religious group may discriminate on the basis of religion only in respect to all activities or they may discriminate on any basis in respect to religious activities only.<sup>95</sup> Any other method of discrimination would result in a loss of tax-exempt status as the activity would be contrary to public policy.

Once employed many persons are under the belief that members of the clergy or other church employees do not pay taxes. This is not true. Employees of the church pay taxes like everyone else except if they are not compensated for their work. Then there is no need to pay taxes, of course.

Members of religious orders who have taken a vow of poverty may or may not have to pay taxes on their earnings depending on the source of the income. Firstly, if the services are performed for the church or an agency or associated institution of the church, the remuneration remitted to the church is not subject to federal income tax or FICA withholding under Revenue Ruling 77-290. Secondly, if the services are performed for a charitable institution such as a hospital, agency must be established to exempt the income from taxes. Thirdly, if the member is performing "secular" services in the private sector, it is presumed no agency exists. Revenue Rulings 76-323 and 77-290 include the tax in the member's gross income and subject it to federal income tax and FICA withholding. The member may deduct any part of the remuneration given to the religious order, however, under section 170.<sup>96</sup> The situations discussed above may result in taxable income to the religious order under section 511 because of the agency created. The activity may be unrelated to the exempt function of the order.

Another issue concerning employment by a church was decided

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95. D. KELLY, *supra* note 23, at 128.

96. Wittenbach, *Remuneration Earned by Members of Religious Orders: Is It Taxable?*, 57 TAXES 553, 558 (1979).

recently by the Supreme Court.<sup>97</sup> The case involved an elementary Christian day school and unemployment compensation taxes imposed by the Federal Unemployment Tax Act (FUTA). The pivotal factor here was the control of the Church over the school. The school was financed by the Church and controlled by a Board elected from the congregation. The school was not independently incorporated or a separate legal entity in any way. The employees were determined by the Court to be in the employ of the Church. Thus, the Church was exempt from unemployment compensation taxes under 26 U.S.C. section 3309(b)(1)(A).<sup>98</sup> It appears that the relationship between the church and the employee is the relevant factor in the payment or nonpayment of employment taxes. This relationship revolves around the control exercised by the employer church over the employee. *St. Martin* dealt only with unemployment taxes under FUTA. Income taxes and FICA must be paid except on remuneration to the church.

The activities of a religious organization are well guided by legislation and case law. Tax-exempt status may be removed for failure to meet these guidelines. On the other hand, guidelines not compatible with the First and Fourteenth Amendments will be voided. The key to understanding the application of section 501(c)(3) and its related sections is an awareness that tradition and public policy will control absent exigent circumstances. Courts will look to see if the religious or charitable purpose of a religious organization is being fulfilled through its activity. If it is, there is no problem. If not, the court will make a determination as to the present tax liability of the organization and its future status. The court's guidelines are the Internal Revenue Code, other legislation, and the common law.

### III. PRESENT VIEWS AND FUTURE QUESTIONS

#### A. *Present Views*

When discussing the topic of tax exemptions, the cries of those opposed to such exemptions must be heard. Previous attempts to deny religious organizations their exempt status have already been explored. The basic theme of anti-exemptionists is relief of the tax burden on themselves and others. But what really is at the root of their complaints? Is it the fact that they don't like organized religion? That probably was the reason in one case.<sup>99</sup> Are they just jealous of such status or is there a more sound reason for such animosity?

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97. *St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772 (1981).

98. *Id.*

99. *Murray*, 241 Md. 383, 216 A.2d 897.

The basic argument actually is not that tax exemptions place more of the burden on the taxpayers, but that it works as a government subsidy of religion. This flies in the face of the Establishment Clause of the First Amendment. Professor Bittker would counteract this argument by saying that religious organizations were not excluded by the legislature when the Revenue Code was drafted; they just were not included.<sup>100</sup>

The subsidy argument of anti-exemptionists is a weak one. The government does not give the church revenue, it simply abstains from taking any. Without contributions from its religious faithful, the church would have nothing in the way of revenue. Subsidies are based on exact amounts determined by administrators or legislatures. Any religious leader will tell you he never knows how much he can depend on from church members. Churches never have to lobby for government support, because they are not receiving anything by exemption. The government through tax exemption is trying to separate itself from the church, not bring the two closer together.<sup>101</sup> Thus, the establishment through subsidy argument fails.

Some anti-exemptionists would then argue that tax exemptions are invalid because they are too exclusive. The argument here resembles an inverse Equal Protection argument. Church revenue is protected by the exemption while the income of some other organizations or persons is not. The exemption is exclusive when used in the context that certain income of a religious organization will be exempt under the Code and certain income will not. In the context of exempting certain organizations only, however, the argument is unfounded. The Supreme Court put this argument to rest in *Lennhausen v. Lake Shore Auto Parts Co.* when Mr. Justice Douglas referred to it as "only a relic of a bygone era."<sup>102</sup> Section 501(c)(3) contains twenty-two different subsections of exempt organizations. The exemption for religious organizations is by no means exclusively theirs.

The term "exclusive" is also used by anti-exemptionists in the context that it excludes religious organizations from the benefits of government revenue.<sup>103</sup> This is exactly the opposite of the establishment argument. Here the anti-exemptionists would argue that a burden is placed on the church by the government. The exclusion from taxes means that churches must survive on their contributions from

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100. Bittker, *Churches, Taxes and the Constitution*, 78 YALE L. REV. 1285 (1969).

101. D. KELLY, *supra* note 23, at 33.

102. *Lennhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356 (1973), *reh'g den.*, 411 U.S. 910 (1973).

103. Bittker, *supra* note 100.



members and other supporters. This is a contravention of the Free Exercise Clause of the First Amendment. This argument is not realistic at all. Churches have had no trouble, to my knowledge, exercising their religious faith because of tax exemption. To the contrary, churches wish no revenue from the government if they can help it, because it would come with strings attached. Government aid is rarely accepted. The only tax limitations on the free exercise of religion involve political lobbying and unrelated business income. These limitations are necessary and proper under the "exclusive purpose" doctrine.

Even if the exemption were lifted, would it be lifted from all church activity? How would we then tax religious organizations? Some are incorporated and could be taxed at the corporate rate, but most are not incorporated. Should they be taxed as natural persons or as charitable trusts? Couldn't a church deduct all contributions spent for the betterment of mankind? After all, charity is the "business" of a religious organization.<sup>104</sup> These questions arise because our society has never really considered taxing religious organizations. If the exemptions are removed from their charitable work, we would begin to see less aid to society's ills as churches would be hampered with a tax burden.

One final anti-exemption argument that is often heard is that churches do not pay their fair share of the burden necessary to provide the community with essential services. This would include police and fire protection and hospitals and the like. Anti-exemptionists justify their argument on the ground that "ability to pay" is the primary ingredient. If we follow this logic, churches would soon be paying more to the state than they would be receiving in benefits.<sup>105</sup> Some churches are beginning to adopt the idea of making voluntary payments to the municipality in which they reside in lieu of the possibility of perhaps being taxed. Churches recognize that they benefit from essential services and they feel a need to support such programs. However, the result of such voluntary payments or taxing is to take money from the social programs of the church and decrease the benefits to society in most cases. Asking religious organizations to bear their share of the essential services burden may have the effect of eliminating the essential services which religious organizations now provide for society.

No discussion of religious tax exemptions would be complete without hearing from the churches themselves. The National Council

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104. *Id.*

105. *Id.*

of the Churches of Christ in the United States of America adopted a policy statement on this issue in 1969. In it the Council recognizes the New Testament advice to pay taxes to governing authorities (Matthew 17:24, 22:19; Romans 13:6). Churches should not therefore ask for support from the government, but only protection for their freedom to proclaim the gospel. The Council appreciates the fact that tax exemption means no government can interfere with the free exercise of religion. The church is not built on tax exemption, however, but the donations of its adherents. Tax exemptions also foster non-profit voluntary organizations.

Christians will not sit back and let their tax exemption be conditional, however. Loyalty oaths and restraints on political activity may inhibit their obedience to God. In such a case, separate auxiliaries of the church may have to be set up.

With regard to property, the Council agrees that churches should pay taxes on property not used primarily for religious purposes. Churches should also be willing to pay their share of essential services.

The Council favors legislation designed to require payment by churches to the social security tax for their lay or clerical personnel. The only exception would be to exclude those persons barred by a vow of poverty.

Full disclosure by churches of their unrelated business enterprises, income, expenditures, assets and liabilities was also approved by the Council. Then there would be no question about the use of contributions and the public could better understand the need for the tax exemption.<sup>106</sup>

James E. Wood, Jr. spoke for the Baptist Joint Committee on Public Affairs before the House of Representatives Committee on Ways and Means in 1976. The occasion was a hearing on limiting influence of legislation by public charities. Mr. Wood proposed to speak only for the consensus of Baptist Churches. He was trying to have churches disqualified from the bill under consideration and he was ultimately successful. At the hearing Mr. Wood stated:

Because some churches define their religious missions as including obligation to speak out on and attempt to influence public affairs, we hold to do so is part of their constitutionally protected religious liberty. The state may not deny or limit that right. Neither may it require that a church

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106. D. KELLY, *supra* note 23.

give up its right to the "free exercise" of religion under the First Amendment to be eligible to gain a statutory privilege (e.g. tax exemption).

For these and other reasons we have not been able to accept the legitimacy of the "substantiality" clause of sec. 501(c)(3) of the Internal Revenue Code of 1954. This we consider to be an unconstitutional limitation on the religious missions of churches . . . .<sup>107</sup>

It appears from this statement that the Baptist Churches want their tax exemption free from any government influence whatsoever.

The Lutheran Council in the United States of America on behalf of The American Lutheran Church and Lutheran Church in America submitted a statement to the same hearings of the Ways and Means Committee as above. The essence of the statement was support for the changes in the bill submitted by Representative Barber Conable. Those provisions include the current disqualification of churches from section 501(c)(3) of the Code and no intent by Congress to either approve or disapprove of the decision in *Christian Echoes*. The Lutheran Council took a somewhat different approach to the proposed legislation:

The churches look with deep regret on legislation which could discriminate between those churches which see it as their essential ministry to speak to society on matters of public interest, including legislation, and those who do not. Many of us see the ministry of advocacy not as an effort to lobby for political power, but as a vital exercise of prophetic authority central to our faith. The free exercise of religion, therefore, should mean that the decision to speak or not to speak in the public arena be left to the individual churches and not be a determiner of tax exempt status or the deductibility of gifts to the church.<sup>108</sup>

As part of the research for this paper, I have requested personal opinions on the subject of religious tax exemptions from several church leaders across the land. A representative view is the following statement from The Reverend Doctor Robert C. Sauer, First Vice-President of The Lutheran Church-Missouri Synod: ". . . I personally regard religious institutions to be of value to the state in that they almost without exception (Jehovah's Witnesses) teach their adherents

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107. *Influencing Legislation, Hearings on H.R. 13500, supra* note 12, at 64 (Statement of James E. Wood, Jr.).

108. *Id.* at 75 (Statement of The Lutheran Council in the U.S.A.).

to obey those in authority and also infuse into society a morality which is beneficial for the common good." With those words The Reverend Doctor Sauer expressed the support most church leaders have for religious tax exemptions and the sound reasoning behind such support.

The United Presbyterian Church and the United Methodist Church released policy statements about unrelated business income in 1963 and 1968 respectively. This was before the changes made in the Internal Revenue Code by Congress in 1969. Both churches support taxation of unrelated business income and favor the abolition of special tax privileges for members of the clergy.<sup>109</sup> Clearly neither church wants government exemptions for activity outside the scope of religion. The Presbyterian Church's statement included the following which seems to summarize the view of all or almost all of organized religion in this country on the subject of tax exemptions:

. . . the state should know that it may not expect from the church in return for favors extended of its own free will, any *quid pro quo* in the form of a muting of the church's prophetic voice, nor should the state expect the church to accept the role of an uncritical instrument of support for the state's programs, or of any other conscious dilution of its supreme loyalty to Jesus Christ.<sup>110</sup>

#### B. *Future Questions*

This brings us to the final point of discussion—what about the future? Congress has modified the law regarding tax exemptions twice in the last twelve years. The courts see tax exemption cases frequently. Many of the cases cited here are as recent as 1970. *St. Martin Evangelical Lutheran Church v. South Dakota* was decided in the Spring of 1981. The point is that the law with regard to religious tax exemptions is a never ending process, so we must prepare for the future course of events.

The current Administration has as the focus of its program a shift back to the private sector and less reliance on government. This policy applies also to charitable works, if not especially to it. The increased burden on charities and among them churches is the strongest argument yet in favor of the tax exemption.

One of the immediate problems facing this issue came with the passage of the 1981 Economic Recovery Act. By this Act gift tax

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109. D. KELLY, *supra* note 23, at 136-8.

110. *Id.* at 137.

returns are not required for interspousal transfers, because such gifts are no longer taxable. Also, the annual gift tax exclusion has been raised from \$3,000 to \$10,000 per donee effective January 1, 1982.<sup>111</sup> The consequences of these changes could be devastating on religious organizations. Many persons would rather keep money in the family than give it to any charity. The new Act provides the access to unalienable wealth that many families desire. The spousal benefits are extremely generous. The question to be determined is: What effect will the Economic Recovery Act have on the manner in which persons distribute their wealth? Will the churches suffer and literally prove that they are dependent on their supporters? It would seem a sad way to conclusively show tax exemptions are not subsidies. Similar relief from estate taxes may have the same effect.

The adverse effects wrought by the estate and gift tax relief may have been counterbalanced by a provision under the individual tax relief section of the bill. Taxpayers may now deduct charitable contributions even if not itemized. By 1986, 100 percent of eligible contributions (up to \$100) are deductible. This provision may encourage more contributions to religious organizations. The deductible ceiling is not as high as the gift and estate tax relief, however, so the result of this provision is still awaiting determination.<sup>112</sup>

Education in the future will still have its public policy considerations. I do not foresee discrimination in education by religious organizations ever being held valid under the requirements of section 501(c)(3). The question of tuition tax credits is very much an issue in vogue with potential ramifications for Church and State alike. Opponents of such credits claim they serve to establish religion and are an excessive entanglement of Church and State. Supporters of such credits claim the aid will be used primarily to benefit students in colleges and universities primarily. Such government aid has already been approved by the Supreme Court. The aid would constitute a subsidy, which could be termed an establishment of religion, except for the fact that the aid applies to all private schools, religious and non-religious alike. The credit would serve to save the government money because of a switch in school population. The government could then upgrade its own schools because of the increased revenue. The purpose of a tax exemption is also served by a credit for private education, because the public welfare is served by religious schools and their graduates. The only entanglement between government and church here is the paperwork.

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111. Economic Recovery Tax Act of 1981, § 441 (1981).

112. *Id.*, § 121.

The decision in *Walz* seems to have decreed property tax exemptions for religious organizations for a long time to come. The use of such property remains the key factor. More and more religious organizations own property outside of the church and parking lot these days. Church owned property represents the largest class of private property under the exemption in America today. It is also the primary reason for anti-exemptionists, because most church property is tangible. Many churches have grown so large that one begins to feel they have set aside their religious purpose. Churches are big business today—at least it seems that way. Perhaps our controls on such property through the “exclusive purpose” doctrine and the unrelated business tax are no longer adequate. Perhaps we should tax religious organizations at the corporate tax rate. The disparity in income between large churches and small ones should not be forgotten here. A tax on large religious institutions would not be as detrimental to them as it would be to a small institution. If you take food away from a rich man and a poor man, the rich man will only be hungry, but the poor man may die.

What about the growing marriage between religion and television? Certainly the contributions are not taxable, but what about the copyrights and church-owned networks? Most would agree these are also tax exempt. They fall within the “religious purpose doctrine.” Wouldn’t the Gospel be spread without the excesses of television all the same? How far will the “religious purpose doctrine” extend? These are questions which the Supreme Court will one day have to decide.

A related issue involved the practices of religious cults. Are they exempt within the meaning of section 501(c)(3)? The Reverend Sun Yung Moon has recently been convicted for tax evasion, because church funds were placed into his personal bank account. This practice would lead one to believe contributions to cults are not exempt. The Moonies, as they are called, control much property outside the purpose of public worship. Surely they are paying taxes on this income.

The Hare Krishnas sell literature in airport terminals to unsuspecting travelers. Is the revenue from the sale taxable? Could one deduct such a contribution? The answers would seem to depend on how charitable a cult is and the beneficial effect derived by society through the cult’s religious works.

The involvement of some religious groups in politics is hard to prevent. Some religious organizations are adamant about governmental interference, yet they interfere in the business of government all the time. To use an old expression: They want their cake and eat it too. The current disqualification of churches under the new political lob-

bying by charitable organizations section of the Revenue Code may be repealed before long because of this attitude. The current fundamentalist trend toward religion in politics by groups such as the Moral Majority may prompt the end of tax-exempt status of organized religion as we know it today. It won't be long before preachers using the pulpit for politics will spoil the benefits of the tax exemption for all churches. Such practice completely contravenes the Congressional intent of section 501(c)(3), although it may still serve to promote the general welfare if effective enough.

In the future, inflation may also mean an end to the present tax exemption system. Inflation is the most powerful ally anti-exemptionists have. Spiraling costs have meant decreased revenue for government on all levels and forced them to tap new sources of income. Churches have been sheltered so far, but how long it will last no one knows. Necessity can be a strong force to motivate officials to use the quick solution of taxing churches. The local governments are struggling to survive. The federal Social Security system is in deep trouble. One by one the church's exemptions from various taxes may fall. For the moment, however, religious organizations seem destined to remain exempt from unemployment taxes for their employees because of the decision recently in *St. Martin Evangelical Lutheran Church*.

Religious organizations are not impervious to the needs of government. Many want to help financially and not just sociologically. Contributions by religious groups in lieu of taxes in order to maintain essential services have been suggested as mentioned before.<sup>113</sup> This would seem to be a viable solution and one which may preserve the religious tax exemption as well. As one can see, there are many questions for the future and no concrete solutions as yet. Both sides are sensitive to each other's needs, however.

#### CONCLUSION

Ever since Jesus spoke those words ". . . render to Caesar the things that are Caesar's, and to God the things that are God's" (Luke 20:25), there has been a marked separation between Church and State. Part of this separation involves the payment of taxes to the State. Church followers have paid their individual taxes, but the State in this country has seen fit to exempt the Church itself from the pay-

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113. D. KELLY, *supra* note 23.

ment of taxes. The history of this exemption is rich in tradition. It has been adopted in some form by every Revenue Act ever passed by Congress. The basic premise upon which the exemption is based is that the general welfare will be more enriched by the charitable way in which the religious organization uses the money than it would if the government were to make use of the money.

The exemption for religious organizations is also protected by the First and Fourteenth Amendments. The states can no more entangle themselves with religion than can the federal government. Critics charge tax exemptions for churches constitute an establishment of religion because they act as a subsidy. These contentions are often unfounded because an exemption excludes churches from taxes and does not include them in government support. Churches still rely on contributions from their members.

Not much has been said about non-Christian religions in this paper, but the same rules apply to their exemptions. They haven't been mentioned often because the case law on these organizations is scarce. The Congress has drafted section 501(c)(3) and its relevant counterparts very carefully. The courts have not broadened the scope of these sections one degree. The legislative intent, as well as public policy, have always been upheld. A tax exemption does not give a church license to engage in any activity it pleases completely tax free. We have already discussed the many restraints placed upon the privilege by Congress and the courts.

Time and again the courts have judiciously upheld the constitutionality of religious tax exemption. Their efforts are to be applauded. In education, the exemption must bow to public policy against racial discrimination. The exemption must also yield when religious groups engage in undue influence of legislation. Taxes must be paid on unrelated business properties and by employees of religious institutions. Most religious organizations agree that these limitations are fair.

Where do we go from here? Perhaps some minimal support by churches for struggling local government is necessary. Many unresolved questions are left to be answered. I would conclude my examination of religious tax exemptions by saying they are necessary now and will be in the future. The road of religious tax exemptions may be narrower in the future, but it will still be straight.



