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DIVERSION OF CHURCH FUNDS TO PERSONAL USE: STATE, FEDERAL AND PRIVATE SANCTIONS

The chief wrong which false prophets do to their following is not financial. The collections aggregate a tempting total, but individual payments are not ruinous. . . . But the real harm is on the mental and spiritual plane. There are those who hunger and thirst after higher values which they feel wanting in their humdrum lives. They live in mental confusion or moral anarchy and seek vaguely for truth and beauty and moral support. When they are deluded and then disillusioned, cynicism and confusion follow. The wrong of these things, as I see it, is not in the money the victims part with half so much as in the mental and spiritual poison they get. *

I. INTRODUCTION: THE VULNERABILITY OF RELIGIOUS ORGANIZATIONS TO FISCAL ABUSE

Religious organizations are institutions of public trust. Church members as well as the general public reasonably expect church officials to fulfill their religious calling and apply church funds to religious purposes. What these religious purposes should be is within the discretion of church officials or the congregation,[1] which makes it nearly impossible to objectively define "religious purpose." Despite the discretionary nature of church expenditures, there remains a general expectation that church funds will not be diverted, apart from any bona fide charitable gifts, to benefit private individuals.

Religious organizations, however, are vulnerable to fiscal abuse because neither church members nor the government closely monitors their financial affairs. If a religious organization were formed for economic purposes rather than for the spiritual and charitable needs of a community, members having a financial stake in the organization could

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* United States v. Ballard, 322 U.S. 78, 94-95 (1944)(Jackson, J., dissenting).

[1] How a church spends its money is, generally, an ecclesiastical matter within the exclusive province of the church's decision makers. *See, e.g.*, Galich v. Catholic Bishop of Chicago, 75 Ill. App. 3d 538, 547, 394 N.E.2d 572, 579 (1979), *cert. denied*, 445 U.S. 916 (1980) (absent a specific trust, disposition of church property is an ecclesiastical decision); Knight v. Presbytery of Western New York, 18 N.Y.2d 868, 222 N.E.2d 738 (1968) (church payments for purpose of bringing Industrial Areas Foundation to Buffalo, N.Y. was an ecclesiastical matter). *But see* Inquiry, Etc., of Criminal Procedure Law, 78 Misc. 2d 244, 356 N.Y.S.2d 749 (1974) (church pastor acted outside scope of his powers in putting up collateral to secure bail bond for murder defendant; indemnity is ultra vires the church, contrary to public policy, and against interest of church members).

be expected to monitor more closely the use of church funds.[2] If constitutional problems did not present themselves, the government could be expected to examine the financial affairs of religious bodies on an ongoing basis.[3]

On the other hand, religious organizations are probably less vulnerable to fiscal abuse than secular organizations.[4] Church members and contributors put their trust in the moral integrity of church trustees, who, if not accountable to anyone else, are accountable to a Supreme Being.[5] Furthermore, there is the deterrent effect of civil or even criminal liability which may be imposed on a church official who breaches his duty of trust.

Still, the vulnerability remains. In January of 1981, a federal grand jury in Chicago began investigating whether the late John Cardinal Cody of the Catholic Archdiocese of Chicago had illegally diverted as much as one million dollars in tax-exempt church funds to enrich a lifelong friend.[6] These allegations are unique in two respects. First, the more common charge of misuse of religious funds has been an allegation that a church official has diverted funds for personal use rather than for

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[2] Even if members of religious organizations had a more direct interest in the financial affairs of their churches, they may not be able to monitor church finances. In Illinois, the reigning Catholic bishop of Chicago is the owner for legal purposes of all real and personal property of the archdiocese under the concept of "Corporation Sole." 1861 Illinois Private Laws, at 78. The Catholic bishop's power is absolute in deciding whether key financial information should be distributed to priests and laymen in the archdiocese or other individuals in the church hierarchy. Clements, Mustain & Larson, *Cody absolute ruler under law*, Chi. Sun-Times, Sept. 11, 1981, at 4, col. 1. *But cf.* Bourgeois v. Landrum, 396 So.2d 1275, 1277 (La. 1981) (voting members of a church who are given the statutory right to examine church records may do so under reasonable conditions). Bishops of dioceses in 16 other states also operate as corporations sole, although under common law, Catholic bishops are not considered the owner of church assets, but are mere administrators. *Id.* Corporations sole existed at common law, along with corporations aggregate, and consisted of one person occupying a particular office who was incorporated by law to vest in him certain legal capacities and advantages.

[3] *See infra* text accompanying notes 120-25.

[4] It is significant that religious institutions are not plagued by more wrongdoing than is reported when over $18 billion is contributed yearly to religious organizations. *See* C. BAKAL, CHARITY USA 85 (1979).

[5] *See* Rossi & Mustain, *Cardinal 'Answerable to Rome, God': Lawyer*, Chi. Sun-Times, Sept. 12, 1981, at 1, col. 1.

[6] Clements, Mustain & Larson, *Federal grand jury probes Cardinal Cody use of church funds*, Chi. Sun-Times, Sept. 10, 1981, at 1, col. 1; Winston, *Chicago Archbishop Under U.S. Inquiry on Funds*, N.Y. Times, Sept. 11, 1981 at 16, col. 1.

John Cardinal Cody died on April 25, 1982. The federal grand jury investigation of the alleged misuse of funds of the Chicago Archdiocese did not end with Cardinal Cody's death, however, and the investigation shifted to focus on those individuals who might have improperly received church funds. Clements, Mustain & Larson, *U.S. pursues church fund investigation*, Chi. Sun-Times, May 7, 1982, at 1, col. 3. The grand jury investigation was closed in July, 1982. Clements & Nicodemus, *Cody Probe Closed By U.S.*, Chi. Sun-Times, July 7, 1982, at 1, col. 1.

the benefit of a third party.[7] Second, recent interest in the role of government regulation of religious groups has focused on the illegal or deviant behavior of members of cults, sects, and nontraditional churches,[8] and state intrusion into the internal affairs of these organizations has not represented a direct threat to well-established institutions such as the Roman Catholic Church.[9]

In the wake of the Cardinal Cody controversy, there is a need to explore the constitutional dimensions of state involvement in the internal financial affairs of religious organizations and determine the appropriate role that the state should have when church funds are spent for blatantly nonreligious purposes or when they are diverted to benefit private individuals.

II. Responding to Fiscal Abuse

No one should be able to convert money to personal use with impunity, whether the funds belong to a secular corporation or a church. Society has had relatively little problem in responding to corporate embezzlement, for example, inasmuch as society views this white-collar crime as theft. More troubling, however, are those instances where religious leaders engage in similar conduct. Instead of saying that the preacher has embezzled or stolen ten thousand dollars, we resort to euphemism and say that he or she has "diverted church money to private use."[10] We as a society are not accustomed to thinking that our spiritual leaders can commit criminal acts, and we are reluctant to take decisive action to combat this kind of wrongdoing.

However, merely to say that church officials who misappropriate funds should be punished would be to gloss over important issues. What kinds of sanctions and who should be responsible for imposing those

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[7] *See, e.g.,* Worldwide Church of God, Inc. v. California, 623 F.2d 613 (9th Cir. 1980); Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969), *cert. denied*, 397 U.S. 1009 (1970).

[8] Noteworthy is the public concern generated in the Jonestown tragedy. In November of 1978, approximately 900 members of the California based People's Temple died in a ritual of mass suicide and murder in Jonestown, Guyana. N.Y. Times, Nov. 21, 1978, at 1, col. 6.

[9] Nontraditional churches sometimes follow religious practices that threaten the health and safety of their members or deviate so drastically from community standards as to be repugnant to public welfare. *See* Comment, *People v. Religious Cults: Legal Guidelines for Criminal Activities, Tort Liability, and Parental Remedies*, 11 SUFF. U.L. REV. 1025, 1031-32 (1977); LeMoult, *Deprogramming Members of Religious Sects*, 46 FORDHAM L. REV. 599 (1978). Laws that prohibit these activities would have no impact on traditional churches and their practices.

[10] *See* Clements, Mustain & Larson, *supra* note 6. Another explanation for our using the term "diversion" stems from its traditional use in intra-church property disputes; property or funds held by a church or its officers in trust for specific purposes may not be *diverted* to any other use. 76 C.J.S. *Religious Societies* § 68 (1952). Stealing church money can be subsumed into this broader category.

sanctions are the most important issues that legislators or state officials will have to confront. Moreover, it is not enough to answer affirmatively the question whether the state *can* impose sanctions against church officials who divert church monies wrongfully, for the ultimate question really is whether the state should interfere. This Comment considers the advantages and limitations to possible state, federal, and private legal action that can be taken in response to fiscal abuse in the church in order to determine whether the acts of religious leaders should be subject to state scrutiny. The discussion concludes that the government can interfere and argues that state legislators and officers must take a more active role in protecting church funds from corrupt church officials.

A. STATE RESPONSE

Religious officials who misuse church monies can be criminally or civilly liable only so long as state or federal government officials have the authority to take legal action in this area, courts can adjudicate the conflict, and religious freedom is not unconstitutionally infringed in the process. The most obvious limitation on governmental action is the constitutional guarantee of the free exercise of religion. The first amendment provides, in part, that "Congress shall make no law respecting the establishment of religion, or prohibiting the free exercise thereof . . . ."[11] The religion clauses were held applicable to the states in *Cantwell v. Connecticut*.[12] Where the government intervenes in church affairs when a religious official misuses church funds, a question as to the free exercise of religion is inevitable because it can be argued that the government is attempting to regulate how religious officials spend church monies. This regulation also involves a danger of church-state entanglement, an argument associated with the establishment clause.[13] Less obvious, however, are more practical problems that government officials must face when they suspect that church funds have heen misappropriated. Government officials seeking to institute suits against church wrongdoers must confront the issue of whether they have the authority to intervene. Before discussing the first amendment limitation to governmental power, it is appropriate to outline the sources of governmental power from which state officials can exercise jurisdiction[14]

[11] U.S. CONST. amend. I.

[12] 310 U.S. 296, 303 (1940).

[13] *See* Walz v. Tax Commission, 397 U.S. 664 (1970).

[14] Viewing the separation of church and state as a jurisdictional matter has led one commentator to apply a conflict of laws analogy to religious exemption doctrine. Note, *Religious Exemptions Under the Free Exercise Clause: A Model of Competing Authorities*, 90 YALE L.J. 350, 365-69 (1980).

over the internal affairs of religious institutions and to consider the practical limitations to governmental action.

Despite first amendment limitations, the church as a religious body is not totally free from state regulation. Thomas Jefferson wrote that the first amendment builds a "wall of separation between Church and State."[15] This "wall of separation," however, is subject to state intrusion where the state has a legitimate interest to protect.[16] For example, the state has an interest in public health, safety, order, and welfare and may regulate religious activity under its police power.[17] A state legislature invoking this general power could, for instance, specifically authorize its attorney general to examine the financial books of churches if wrongful activity is suspected and to institute state action to correct the wrongful activity.[18] Absent any enabling statute, the state's attorney could pro-

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[15] Reynolds v. United States, 98 U.S. 145, 164 (1878) (quoting a letter that Thomas Jefferson wrote to the Danbury Baptist Association).

[16] In *Reynolds*, the Supreme Court distinguished between the freedom of religious belief and the freedom of religious action guaranteed by the free exercise clause of the first amendment. *Id.* at 164. The majority indicated that the government was free to prohibit any action regardless of its religious implications so long as it did not prohibit a belief. Chief Justice Waite stated: "Congress was deprived of all legislative power over mere opinion, but was left free to reach actions which were in violation of social duties or subversive of good order." *Id.* The action-belief dichotomy has been subsequently eroded because belief and practice are often inseparably intertwined. *E.g.,* Wisconsin v. Yoder, 406 U.S. 205, 219-20 (1972); Sherbert v. Verner, 374 U.S. 398 (1963). However, actions "subversive of good order" are still clearly subject to regulation. Cantwell v. Connecticut, 310 U.S. 296, 304 (1940).

[17] *Id.* at 306-07.

[18] For example, the California legislature enacted a nonprofit corporation law in 1980; Section 9230 of the new law authorized the California attorney general to examine religious corporations for wrongful activity, and to initiate a state civil action to correct the wrongful activity. Section 9230 (a) formerly read:

> Upon reasonable grounds to believe that the following condition or conditions have occurred or do exist, the Attorney General may, at reasonable times, examine a corporation to determine whether:
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> (1) the corporation fails to qualify as a religious corporation under this part; or
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> (2) there is or has been any fraudulent activity in connection with the corporation's property; or
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> (3) any corporate property is or has been improperly diverted for the personal benefit of any person; or
>
> (4) property solicited and received from the general public based on a representation that it would be used for a limited purpose other than general support of the corporation's religious activities, has been improperly used in a manner inconsistent with the stated purpose for which the property was solicited; or
>
> (5) there has been a substantial diversion of corporate assets from stated corporate purposes.

CAL. CORP. CODE § 9230(a) (West Supp. 1980)(repealed 1980). Prior to its enactment, the California Attorney General had instituted legal proceedings against the Worldwide Church of God pursuant to allegations that church officials had fraudulently diverted church funds for personal use. *See* Worldwide Church of God, Inc. v. California, 623 F.2d 613 (9th Cir. 1980). The complaint in *Worldwide* alleged that church financial officer Stanley Rader and church leader Herbert Armstrong were liquidating church properties on a massive scale, at prices below market value, so that church assets would be in "a form in which they may be more easily appropriated to the personal use and benefit of the individual defendants." Peo-

ceed pursuant to a fraud or embezzlement provision of the state's criminal code.[19]

Another possible approach would be a nonstatutory state civil action based on the theory that the attorney general is charged with protecting church assets which are held subject to a public or charitable trust.[20] The attorney general could seek to impose a receivership, enjoin conduct, rescind transactions, remove trustees, compel an accounting, or sue for damages. Instead of involving the right of the state to control actions under its power to protect the public health, safety and general welfare, the state's right to intervene would be based on the state's obligation to protect the public interest in situations where there is no individual capable of asserting the interest.

This approach rests on the assumption that church assets are sufficiently analogous to the assets of charitable trusts, being held and dedicated, in theory at least, to benefit the general public. Because the enforcement of public or charitable trusts traditionally could not be maintained either by the donor[21] or the ultimate beneficiary (the gen-

ple v. Worldwide Church of God, Inc., No. C-267-607 (Los Angeles County Super. Ct. filed Jan. 2, 1979), Complaint at 7-8. Church leaders unsuccessfully sought certiorari to the United States Supreme Court four times to halt court orders issued in the litigation. Worldwide Church of God, Inc. v. California, 449 U.S. 900 (1980); Worldwide Church of God, Inc. v. Supreme Court of California, 446 U.S. 987 (1980); Rader v. Superior Court of California, 444 U.S. 916 (1979); Worldwide Church of God, Inc. v. Superior Court of California, 444 U.S. 883 (1979)(certiorari petitions in response to unreported decisions by California court of appeals). However, shortly after its enactment, the California legislature repealed § 9230 and substituted in its place a new § 9230 that prospectively forbade the Attorney General from initiating this kind of litigation, and the suit was finally dropped. *See California Planning to Halt Cases on Church of God and Synanon*, N.Y. Times, Oct. 15, 1980, at A28, col. 4. For an exhaustive analysis of the constitutional issues raised by the repealed California statute, see Note, *Government Protection of Church Assets from Fiscal Abuse: The Constitutionality of Attorney General Enforcement under the Religion Clauses of the First Amendment*, 53 S. CAL. L. REV. 1277 (1980) [hereinafter cited *as Attorney General Enforcement*]. *See also* Wiley, *A Constitutional Outrage*, 74 LIBERTY 3 (May-June 1979); Worthing, *The State Takes Over a Church,* 446 ANNALS 136 (1979); Note, *Does Court Ordered Receivership Breach the Wall of Separation Between Church and State?*, 6 WEST ST. L. REV. 269 (1979).

19 *See, e.g.*, Commonwealth v. Nichols, 206 Pa. Super. 352, 213 A.2d 105 (1965)(Bishop of African Methodist Episcopal Church had been charged with embezzlement and fraudulent conversion of church funds); Lawson v. State, 492 P.2d 1108 (Okl. Crim. App. 1971).

20 In *Worldwide,* the Attorney General relied on the theory that all church assets are subject to a public or charitable trust and that his office was authorized to enforce the trust under the California Corporations Code and the common law. *Attorney General Enforcement, supra* note 18, at 1281.

21 Traditionally, a donor who parts with his *entire* interest in property had no standing to compel the execution of a charitable trust. 2 J. PERRY, A TREATISE ON THE LAW OF TRUSTS AND TRUSTEES § 732 (a), at 1255-56 (7th ed. 1929); RESTATEMENT SECOND OF TRUSTS § 391, Comment (e) (1959). However, where express conditions attach to a gift of property, the donor should have standing. For example, in Dunaway v. First Presbyterian Church of Wickenburg, 103 Ariz. 349, 442 P.2d 93 (1968), a donor who had given $10,000 worth of stock to a church for the express purpose of erecting a Sunday school building was able to reclaim

eral public), the attorney general historically was charged with the duty to enforce charitable trusts.[22] The attorney general is the chief law enforcement officer of most jurisdictions to intervene in the administration of charitable trusts or corporations when she or he has reason to believe that they are being administered in violation of the trust instrument or in contravention of state law.

Theoretically, however, the analogy to charitable trusts may prove too much and, in most cases, will not necessarily serve as an adequate rationale upon which an attorney general can proceed against a church official.[23] Where church funds have been illegally diverted, church members or officials may be capable of asserting a protective interest in the funds.[24] Still, the analogy would be appropriate where individuals

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the funds when the church subsequently designated the funds to be used to purchase a lot across the street.

[22] 4 G. BOGERT & G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 411, at 407-14 (2d rev. ed. 1977). Charitable trusts give rise to the creation of public funds, and the attorney general is charged with the duty of protecting these funds because his office represents the interests of the state and its citizens. *Id. See also* People v. Larkin, 413 F. Supp. 978 (N.D. Cal. 1976); People v. Christ's Church of the Golden Rule, 79 Cal. App. 2d 858, 181 P.2d 49 (1947).

[23] Whereas a charity holds its property in trust for the public, a church does not necessarily act as the public's trustee. In United States v. 564.54 Acres of Land, 441 U.S. 506, 516 (1979), the Supreme Court held that a church "did not hold its property as the public's trustee and thus is not entitled to be indemnified for the public's loss." The issue was whether the fifth amendment compensation clause required payment of replacement cost or fair market value for the condemnation of church property used as camps.

In a different context, the Court indicated that there are important public benefits derived from religious organizations which make unique contributions to the pluralism of American society through their purely religious activities. Walz v. Tax Commission, 397 U.S. 664, 689 (1970). Society grants immunity from taxation in return for the contributions that scientific, literary, educational or religious organizations make in furthering our moral and intellectual diversity. Whether these benefits justify labelling church assets as public property held in trust requires a substantial leap over Jefferson's "wall of separation" between church and state. In *Walz*, the Court refused to justify a religious property tax exemption on the social welfare services or good works that some churches perform because other churches engage exclusively in divine worship, yet qualify for an exemption. The Court reasoned that to require the government to evaluate the quantity and quality of social services would "give rise to confrontations that would escalate to constitutional dimensions" resulting in excessive governmental entanglement with religion. *Id.* at 674. Because some churches do not engage in social welfare services, it would be difficult to say, even on a theoretical level, that church funds are held in trust for the public as charities hold their property. Yet, religious organizations are likely to be treated as charitable corporations in determining whether an attorney general can intervene in their financial affairs. *See* Synanon Foundation, Inc. v. California, 444 U.S. 1307 (Rehnquist, Circuit Justice, 1979).

[24] *See, e.g.*, Church of Hakeem, Inc. v. Superior Court, 110 Cal. App. 3d 384, 168 Cal. Rptr. 13 (1980)(holding that former church members bringing a civil fraud action against church leaders could not obtain the church's membership list because requiring production of church list would violate rights of association). *See also* Providence Baptist Church v. Superior Court, 40 Cal. 2d 55, 251 P.2d 10 (1952); Greater Pleasant Green Baptist Church v. Robertson, 343 So.2d 239 (La. App. 1977).

specifically set up a church to exploit money solicited from the general public and there is no congregation in the traditional sense.

B. PRIVATE RESPONSE

Unlike charities, religious organizations often have congregations that are in fairly close contact with church officials, and members may be in a position to initiate a civil action; members have specific interests in the religious affairs of the church and are direct beneficiaries of services that the church provides. A breach of a church official's fiduciary duty may operate to directly affect the interests of a congregation and create an injury in fact to church members.[25] When such an injury occurs, members should have standing to sue in court for appropriate civil relief.[26]

The limitation on membership enforcement of the religious "trust" is that church members are not usually in a position[27] to detect and uncover fraud in a religious organization, and even if they are, may not be inclined[28] or financially equipped to oppose church officials. Moreover, as shareholders bring derivative suits to recover funds for a corporation, church members would be suing to recover funds for their church in most cases; benefits would accrue directly to the church and only indirectly to the congregation.[29] Thus, church members probably lack sufficient incentives to institute a civil suit against their church

[25] For example, if church officials who divert funds to personal use cause the loss of a church's tax exemption, the loss of the exemption in turn will cause a loss of the tax deductible status of religious donations. *See infra* note 54. Members would suffer the loss of a financial benefit.

[26] Church members will sometimes have standing based entirely on their own injuries. *See* Church of Hakeem, Inc. v. Superior Court, 110 Cal. App. 3d 384, 168 Cal. Rptr. 13 (1980). Absent a direct injury to church members, a need for the attorney general to intervene would arise if a particular jurisdiction refuses to allow church members to sue derivately through their church and church trustees refuse to bring suit. Some courts hold that members of a church may not sue in the name of the church corporation in the absence of a demand made on officers authorized to act, or of a showing that such demand would be unavailing, but they may do so where the trustees of the religious corporation refuse to bring suit. 76 C.J.S. *Religious Societies* § 75 (1952). For a case that raised the question of whether the church could raise the rights of its members, see Church of Scientology of California v. Cazares, 638 F.2d 1272 (5th Cir. 1981).

[27] Even where the major part of church funding comes from members' contributions, there is nothing to indicate that members will exercise more supervision and control of their religious organizations. Larson v. Valente, 102 S. Ct. 1673 (1982).

[28] Congregations often support clergymen even when they have been charged officially with a crime. *Weeding Out Clergymen Who Go Astray*, U.S. NEWS & WORLD REPORT, Oct. 2, 1978, at 64.

[29] However, church members as contributors could recover funds themselves where they have been the victims of a fraudulent solicitation scheme. *See* Church of Hakeem, Inc. v. Superior Court, 110 Cal. App. 3d 384, 168 Cal. Rptr. 13 (1980).

leaders.[30]

Preventing and correcting fiscal abuse, however, may be possible at another level in the church. Within a local church, church officials themselves may be able to monitor the financial affairs of the church so that if one church officer or trustee ever wrongfully diverts church funds, church officials could detect the wrongdoing and institute a civil action to recover the diverted funds. If the church organization is hierarchical in structure,[31] separate branches of the church could be in a position to detect and remedy wrongdoing at different levels of the church organization.[32] A civil action brought by church officials against another official could be maintained on the same basis that civil courts entertain intra-church property disputes according to "neutral principles."[33] The availability of this remedy, however, depends on internal checks and balances which may or may not exist in a religious organization. If there are relatively few church leaders, all of whom are exploiting members and the general public through fraudulent solicitations, then there would be no one in the leadership ranks to assert the cause of action.

Church officials instituting legal action against members of their own organization would be an effective means to protect chuch interests if funds are recovered. Yet, religious leaders, for practical considerations, may decide to cover up any scandal before it becomes public and discretely remove the wrongdoer who has diverted church funds to personal use without taking any further action.[34] Furthermore, they may choose to absorb the impact of the scandal after it has become public and thereafter conduct religious services as usual without suing the of-

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[30] *See generally* M. OLSON, LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1971).

[31] As defined in Watson v. Jones, 80 U.S. (13 Wall.) 679, 726 (1872), a hierarchical church is a "religious congregation which is itself part of a large general organization of some religious denomination, with which it is more or less intimately connected by religious views and ecclesiastical government." The local congregation in a hierarchical church is a member of a much larger religious organization subject to its orders and judgments. In contrast, a congregational church is an independent organization governed internally either by a majority of its members or by a local body instituted for the purpose of ecclesiastical governance.

[32] The Roman Catholic Church is internally divided into the Holy See, the papacy, the patriarchates, provinces, archdioceses, dioceses and parishes, and the religious orders. Some of these ecclesiastical entities are further subdivided into smaller corporations and trusts. Yet, this division may not necessarily serve as an effective mechanism for the internal monitoring of how church funds are used. *See supra* note 2.

[33] *See infra* text accompanying notes 95-98. The neutral principles approach, which permits courts to settle church property disputes without becoming entangled in questions of religious doctrine, is "completely secular in operation." Jones v. Wolf, 443 U.S. 595, 603 (1979).

[34] *Weeding Out Clergymen Who Go Astray, supra* note 28, at 64. The fact that a church official has wasted diverted funds and is "judgment proof" would lead to the same result.

fending party so that a civil action does not protract the scandal.[35] Church leaders may have both practical and religious reasons for adopting this course of action. Dissatisfied members, in turn, could leave individually or an entire group could splinter from the ruling body. The leaders in choosing not to seek restitution, however, could face harsher consequences and incur severe tax liability for their church if the federal government imposes sanctions and retroactively revokes its tax exempt status after determining that church monies have "inured" to the benefit of private parties.[36]

C. FEDERAL RESPONSE

The federal government can directly impose sanctions against church officials who misappropriate funds. For example, the federal government has prosecuted church officials for mail fraud, charging them with fraudulently soliciting contributions for a church through the mail while converting the funds to their own use.[37] Furthermore, the Internal Revenue Service (IRS) can charge a church official with criminal tax fraud[38] for failure to report misappropriated funds on his indi-

35 Whether the state should interfere at this point depends on what interest is really at stake. If the church suffers an injury at the hands of a wrongdoer, and can therefore be identified as the real party in interest, should not those disinterested leaders acting in good faith be able to decide what action, if any, should be taken against the offending party? Or should the state intervene because it has a duty to protect the interests of its citizens who have donated funds to the church with the expectation that church leaders will not pocket the funds? In fact, there are actually three parties in interest who suffer when church monies are diverted to private individuals: the church, church members, and the donating public. Where a church and its members decide not to sue, the state retains a sufficient, although arguably less compelling justification for its intervention.

36 *See* infra text accompanying notes 40-45. Whether the federal government could revoke the tax exempt status of a church even where leaders institute an action for restitution against the wrongdoer is unclear, however, for this issue has not yet arisen in federal tax cases involving religious organizations. Presumably there would be no need for the federal government to either retroactively or prospectively revoke a church's tax exempt status if the church attempts to remedy any wrongdoing.

37 18 U.S.C. § 1341 (1948); *see* United States v. Ballard, 322 U.S. 78 (1944); United States v. Rasheed, 663 F.2d 843 (9th Cir. 1981).

38 I.R.C. §§ 7201-7207 (1981). Recently, the Reverend Sun Myung Moon, founder of the Unification Church which has approximately 3 million members, was convicted of conspiring to avoid taxes on $162,000 in personal income. Lubasch, *Rev. Moon Is Convicted of Income Tax Fraud,* N.Y. Times, May 19, 1982, at 1, co. 3. The federal government also has begun to charge "mail order ministers" with criminal tax evasion. A mail order minister obtains his credentials from a "church" for a small fee and then donates all of his property and income to the church which then pays the minister's living expenses. *See* Kurtz, *Difficult Definitial Problems in Tax Administration: Religion and Race,* 23 CATH. LAW. 301, 305 (1978); *Note, Mail Order Ministries: The Religious Purpose Exemption, and the Constitution,* 33 TAX LAW. 959 (1980). In 1980, a Texas airline pilot became the first of these ministers to be charged and convicted as a tax evader, and was sentenced to four years in prison and fined $5,000. Crewdson, *I.R.S. is Challenging Mail-Order Pastors*, N.Y. Times, Jan. 20, 1981, at 14, col. 1. The pilot, Charles Kageler, claimed that his expensive home, the House of Kageler, was a parsonage and that

vidual tax return, or simply sue him for unpaid taxes.

The federal government can also impose sanctions against the church itself. The IRS can retroactively or prospectively revoke the church's tax exemption.[39] Less burdensome than a criminal prosecution of church officials and much more beneficial for the federal treasury, the withdrawal of a church's tax exempt status stands as a potentially effective alternative to the criminal law in preventing individuals from diverting church monies for personal profit. Theoretically, the threat of the revocation of its tax exemption should compel church officials to police the church's financial affairs to prevent wrongdoing and give these officials a strong incentive to rid the church of anyone diverting funds so that the church may regain its tax exemption.

Section 501(c)(3) of the Internal Revenue Code provides in part that an organization will not qualify for tax-exempt status unless "no part of . . . [its] net earnings inures to the benefit of any private individual or shareholder."[40] The private inurement test is one prong of the operational test of the Internal Revenue Code.[41] Section 501(c)(3) requires that a church or other religious organization must be organized and operated exclusively for a religious purpose to qualify for tax-exempt status.[42] The federal government will deny tax-exempt status to a church or will revoke its tax-exempt status if it fails to meet either the organizational or operational test. An organization will be deemed organized exclusively for a tax-exempt purpose if the organization's articles of incorporation both limit its purposes to one or more exempt purposes and do not expressly empower it to engage in activities which

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his private Cessna belonged to a church. *Id.* Mail order ministers previously were charged only with civil tax fraud. *Id. See also* Peister v. United States, 631 F.2d 658 (10th Cir. 1980), *cert. denied*, 449 U.S. 1126 (1980).

[39] Tax exemptions have been revoked successfully from religious groups which have engaged in proscribed political activities, Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972), *cert. denied*, 414 U.S. 864 (1973), or funnelled church money to the benefit of private individuals. Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969), *cert. denied*, 397 U.S. 1009 (1970); Incorporated Trustees of Gospel Worker Society v. United States, 510 F. Supp. 374 (D.D.C. 1981) (primary purpose is profits, not salvation). *See also* Zion Coptic Church, Inc. v. United States, 79-1 U.S.T.C. ¶9325 (S.D. Fla. 1979). Recently, churches have been called upon by the Internal Revenue Service to reveal more about their finances to determine if they should be able to continue to claim tax exempt status. *See* United States v. Dykema. 666 F.2d 1096 (7th Cir. 1981); United States v. Holmes, 614 F.2d 985 (5th Cir. 1980); United States v. Miller, 609 F.2d 336 (8th Cir. 1979); United States v. Coates, 526 F. Supp. 248 (E.D. Cal. 1981).

[40] I.R.C. § 501(c)(3)(1981).

[41] Treas. Reg. § 1.501(c)(3)-1(c)(2).

[42] In one interesting case, the IRS retroactively revoked a church's tax exemption noting that church members had purchased 33 tons of marijuana valued at $3.3 million. The resulting tax liability for the church was approximately $2 million. Zion Coptic Church, Inc. v. United States, 79-1 U.S.T.C. ¶9325 (S.D. Fla. 1979).

do not further those purposes.[43] An organization will be regarded as operated exclusively for exempt purposes only if: (1) it engages primarily in activities which accomplish one or more exempt purposes;[44] (2) none of its net earnings inures to the benefit of private shareholders or individuals;[45] and (3) it is not designated an "action" organization by engaging in activities designed to influence legislation.[46]

A diversion of funds need not be particularly egregious for the IRS to revoke or deny the tax exemption. The inurement standard of the Internal Revenue Code covers a wider range of conduct than is normally associated with fraud, embezzlement, or theft. Inurement, in some cases, simply amounts to self-dealing,[47] and would not be the kind of misconduct that either a state's attorney's office or church member would find alarming.[48]

Nor does the decision whether to prospectively or retroactively revoke a church's exemption necessarily turn on the seriousness of alleged wrongdoing. The IRS has discretion to make its revocation retroactive where an organization furnished misleading information in applying for a ruling, omitted material facts, omitted answers required on information forms, or failed to report organizational or operational changes affecting its charitable or religious functions.[49] Where there is a material change that is inconsistent with the character, purpose or method of operation, revocation will ordinarily take effect as of the date of the material change.[50] The IRS has retroactively revoked the exemptions of

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43 Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)

44 *Id.* at § 1.501(c)(3)-1(c)(1).

45 *Id.* at § 1.501(c)(3)-1(c)(2).

46 *Id.* at § 1.501(c)(3)-1(c)(3).

47 The analogy to the concept of self-dealing has been recognized by other authors. *See* Note, *supra* note 38, at 970 n.71. In Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969), *cert. denied*, 397 U.S. 1009 (1970), inurement to the church's founder and his wife consisted of the payment of a percentage of the church's gross income in addition to salary, as well as unexplained loans, rental charges, and royalties and commissions for use of the founder's publications. Although a payment of a reasonable salary to a minister will not result in a finding of inurement, unreasonable compensation, rental charges, and loans can amount to self-dealing. *See* Incorporated Trustees of Gospel Worker Society v. United States, 510 F. Supp. 374 (D.D.C. 1981)(head of religious organization earning over $100,000 annually suggestive of commercial rather than nonprofit operation).

48 Self-dealing, however, can reach objectionable levels. For example, the treasurer of the New York Annual Conference of the United Methodists Church was reported to have improperly loaned over $5 million to companies in which he had a financial interest. N.Y.L.J., Jan. 30, 1980, at 1, col. 2.

49 Proc. Rules § 601.201(n)(6)(i).

50 *See, e.g.,* Stevens Bros. Foundation, Inc., 39 T.C. 93 (1962), *aff'd*, 324 F.2d 633 (8th Cir. 1963), *cert. denied*, 376 U.S. 969 (1964). Incorporated Trustees of Gospel Worker Society v. United States, 510 F. Supp. 374, 380 (D.D.C. 1981).

religious organizations.[51]

The effect of either a retroactive or prospective revocation is to punish the religious organization itself for the indiscretions of its leaders.[52] This might not be such a bad result where a "church" is set up for the sole purpose of exploiting the tax shelter afforded religious institutions,[53] but it may seem unjust where the offending activity occurs within a bona fide religious organization where members have a stake not only in the assets of the church, but also in the tax deductible status of their contributions.[54] Because the revocation of its tax-exempt status hurts the church and the church has no conceivable interest in a diversion of church funds, it may be more imperative that a state take action against a church official both for purposes of restitution and deterrence. Federal tax liability does not involve the return of monies wrongfully diverted from a church, nor is there any assurance that penalties for violation of tax laws will adequately deter church officials from engaging in wrongful activity.

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[51] *See supra* note 39. The fact that few exemptions have been revoked draws into question whether federal tax sanctions, as applied, have a capacity to deter wrongdoing.

[52] Conceivably, the retroactive revocation of the exempt status of a church could wipe out all of its assets. Such a result clearly would seem to be in violation of the first amendment, even though it can be argued that the federal government is rightfully entitled to collect these taxes. In Lesavoy Foundation v. Commissioner, 238 F.2d 589 (3d Cir. 1956), the Third Circuit reversed the Tax Court's retroactive revocation where the revocation would have wiped out all of the assets of the Foundation.

[53] To protest high taxes, over 90% of the adult population of Hardenburgh, New York became ministers of the Universal Life Church and claimed tax exemptions as clergy members. N.Y. Times, July 17, 1977, at 14, col. 3. This tax revolt was aided by the decision in Universal Life Church, Inc. v. United States, 372 F. Supp. 770 (E.D. Cal. 1974), involving the tax-exempt status of the church whose primary activities included ordaining ministers, granting church charters, and issuing Honorary Doctor of Divinity Degrees. In 1977, the church claimed to have ordained 6 million ministers in the last 15 years. N.Y. Times, May 29, 1977, at 37, col. 1. For a "free will offering" of $20, the church whose only creed is "do your own thing," mails credentials of ministry to anyone requesting them. The government challenged the organization's exempt status, but the court primarily ignored the issue of fraud, stressed that the ordinations were a traditional religious activity, and noted that:

> Neither this Court, nor any branch of government will consider the merits or fallacies of a religion. Nor will the court compare the beliefs, dogmas and practices of a newly organized religion with those of an older, more established religion. . . . Were the court to do so, it would impinge upon the guarantees of the first amendment.

Universal Life Church, Inc. v. United States, 372 F. Supp. at 776. The Department of Justice did not appeal the case because the amount of revenue was small and the case was regarded as a weak factual vehicle. Schwarz, *Limiting Religious Tax Exemptions: When Should the Church Render Unto Caesar?* 29 U. FLA. L. REV. 50, 62 n.81 (1976). The founder of the church subsequently stated that Universal Life Church was deliberately designed to expolit the tax-exempt status of churches to persuade Congress to terminate the tax exemption. "Mail Order Ministers," 60 Minutes, C.B.S. Television, September 26, 1976; N.Y. Times, May 29, 1977, at 37, col. I. *See also* Kurtz, *supra* note 38, at 305.

[54] A deduction will be allowed for contributions to a religious organization so long as the organization meets the requirements established under § 501(c)(3) of the Internal Revenue Code. *See* I.R.C. §170(c)(2) (1981).

III. THE NEED FOR STATE ACTION

In the absence of state intervention, personal tax fraud liability and community condemnation are the only real deterrents to a church official who is contemplating secretly converting church funds to personal use. These deterrents are usually sufficient to convince most church officials that misappropriating church funds would not be in their best interests. In conventional churches that have tax exemptions, moreover, a church official cannot circumvent tax fraud liability by paying income taxes on converted funds without alerting the church to the misconduct. By reporting personal "income," a church official would be alerting the IRS to a change in the church's operation, thereby jeopardizing the church's tax-exempt status. Subsequent IRS action, in turn, would alert other church leaders and their congregation to the church official's misconduct. Still, individuals can form churches without tax exemptions and report their income from church funds to the IRS, but continue to solicit contributions without informing donors that they are using the funds for self enrichment. Clearly, there would be a need for a state to intervene in a fraudulent solicitation scheme.[55]

Yet even in conventional churches, tax fraud and community condemnation will not always represent adequate deterrents to fiscal misconduct. By exercising its police power, a state should impose additional sanctions designed to punish an individual so that the costs of converting funds to personal use outweigh the benefits.[56] States do not respond to secular corporate embezzlement merely by relying on federal tax fraud liability. A state should put church leaders on notice that church looting will not be tolerated.

A state's attorney general or public prosecutor is likely to hesitate to bring any action against church officials, however, unless the legislature has clearly defined his or her authority in this area. Moreover, state enforcement attempts may be complicated because there is no objective definition of what constitutes an improper use of church funds. On the

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55 For a description of fraudulent solicitation schemes involving religious causes, *see* C. BAKAL, *supra* note 4, at 103-18.

56 Of course, the threat of additional penal sanctions may not deter all individuals. For example, there was the prosecution of the Very Reverend Guido John Carcich, the fund-raising director of the Pallottine Fathers of Baltimore, a Roman Catholic missionary order. The Pallotines collected $20 million in contributions through a sophisticated mail campaign for starving children overseas, but less than 3% of the funds ever reached these children. C. BAKAL, *supra* note 4, at 103. Father Carcich pleaded guilty to diverting $2.2 million of the charitable contributions into 28 secret bank accounts and squandering part of the money on fellow priests, friends, and relatives. *Id.* at 104. Under a plea bargaining agreement, Carcich pleaded guilty to one count of the original 61-count indictment, and the court placed him on probation for 18 months with the stipulation that he spend a year "ministering to the needs of prisoners" in the Maryland penal system. *Id.* For other examples of greedy clergymen who have attempted to profit by illegal acts, *see Weeding Out Clergymen Who Go Astray, supra* note 28.

one hand, it is not uncommon for religious leaders to live lives of luxury, particularly where their followers view them as prophets.[57] On the other hand, certain religious leaders, being viewed more as trustees and administrators, are expected to use church funds for religious purposes without enriching themselves or third parties. The difference between the two situations lies in how funds are solicited. If a church, either through its express representations or past record of expenditures, creates a reasonable expectation that church funds will not go to enrich church leaders, then an implied trust as to the use of these funds arises. Contributors' reasonable expectations and desires, as well as church representations, are proper limits on the use of church funds.[58] Because states have intervened in church financial affairs on but a few occasions, however, this approach has not been established in case law.

If state officers are uncertain as to what their role should be in policing church financial affairs, state legislators should consider enacting a law which expressly grants to a state official the power to bring civil and criminal actions against church officials who embezzle church funds.[59] Any deterrent effect that can be attributed to possible state sanctions will be ineffective unless there is certainty that state officers will impose them.[60] An explicit statute is necessary to clearly define the

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[57] Followers of the Divine Light Mission sleep on straw pallets, practice celibacy, abstain from alcohol and other worldly pleasures, while their leader, Guru Maharij Ji lives regally in luxurious homes in Denver, Los Angeles, New York, and London and has a fleet of chauffered Mercedes and Rolls Royce automobiles. C. BAKAL, *supra* note 4, at 117.

[58] One commentator arguing for a contributor's reasonable expectation test stated:

> The concern thus becomes more . . . one of misrepresentation than of imposition of state generated rules of conduct on religious fiduciaries. This approach, in principle, would involve implying a contract between the donor and church leadership from the facts surrounding the contribution and enforcing its terms. This would certainly be a gap-filling process—the gaps might be greater than those we ordinarily fill in contract law—but the parties' own understanding would still be our guide. This analysis recognizes that religious freedom requires allowing the faithful to support an appropriate lifestyle for a religious leader they view as a divine prophet, but it should not disable the contributors from seeking redress when the leader solicits contributions for the Asian poor, yet actually spends the funds on a private tennis court for his son. In that case we can apply religiously neutral rules to protect the interest of the donor-followers, even though those rules may be substantially different from traditional trust principles.

Ellman, *Driven from the Tribunal: Judicial Resolution of Internal Church Disputes,* 69 CAL. L. REV. 1378, 1441 (1981).

[59] The provision need not create a new offense. Instead, the provision would be enabling only—granting authority to state officials to bring an action under another criminal statute or provision relating to charitable trusts. *See* CAL. CORP. CODE § 9230 (c)(2),(3) (West Supp. 1981) at *infra* note 64. An enabling provision could therefore avoid any question of vagueness that could arise if a statute should be drafted to provide that it shall be unlawful for an individual to "divert religious funds to his own use." *See also* State v. Miller, 100 Ariz. 288, 413 P.2d 757 (1966).

[60] *See* Andenaes, *General Prevention Revisited: Research and Policy Implications*, 66 J. CRIM. L.C. 338, 362 (1975).

authority of state enforcement officers.[61] In this sensitive area involving religious freedom, attorneys general and prosecutors are apt to be keenly aware of the question of their authority to sue churches.

The sensitivity of state officials to the question of their authority and the propriety of an action against churches or their leaders is best illustrated by the suit which the California attorney general's office dropped against the Worldwide Church of God.[62] After the attorney general filed suit against World Wide Church of God on behalf of six church members who alleged that church leaders were diverting large amounts of money for self enrichment, the church launched a successful petition drive and pressured the state legislature to pass a bill prospectively forbidding such litigation.[63] Ironically, the law authorized the California attorney general to bring criminal fraud charges or charges involving misuse of money solicited from the general public.[64] The ef-

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[61] Of course, legislators could conclude that there is no real need for this type of legislation if there have been too few complaints registered against churches in the state or nationally to justify legislation. Legislators may also feel that the burden should be on the church to initiate an action. This presupposes, however, that the church is the real party in interest and has not been specifically set up to defraud the public.

[62] *See* Worldwide Church of God, Inc. v. California, 623 F.2d 613 (9th Cir. 1980)

[63] Lauter, *Are Churches Under Attack?*, Nat'l L.J., Nov. 2, 1981, at 17, col. 3.

[64] The new California law provides:

> (a) Except as the Attorney General is empowered to act in the enforcement of the criminal laws of this state, and except as the Attorney General is expressly empowered by subdivisions (b), (c) and(d), the Attorney General shall have no powers with respect to any corporation incorporated or classified as a religious corporation under or pursuant to this code.
>
> (b) The Attorney General shall have authority to institute an action or proceeding under Section 803 of the Code of Civil Procedure, to obtain judicial determination that a corporation is not properly qualified or classified as a religious corporation under the provisions of this part.
>
> (c) The Attorney General shall have the authority (1) expressly granted with respect to any subject or matter covered by Section 9660 to 9690, inclusive; (2) to initiate criminal procedures to prosecute violations of the criminal laws and upon conviction seek restitution as punishment; and (3) to represent as legal counsel any other agency or department of the State of California expressly empowered to regulate activities in which religious corporations, as well as other entities, may engage.
>
> (d) Where property has been solicited and received from the general public, based on a representation that it would be used for a specific charitable purpose other than general support of the corporation's activities, and has been used in a manner contrary to that specific charitable purpose for which the property was solicited, the Attorney General must institute an action to enforce the specific charitable purpose for which the property was solicited; provided (1) that before bringing such action the Attorney General shall notify the corporation that an action will be brought unless the corporation takes immediate steps to correct the improper diversion of funds, and (2) that in the event it becomes impractical or impossible for the corporation to devote the property to the specified charitable purpose, or that the directors or members of the corporation in good faith expressly conclude and record in writing that the stated purpose for which the property was contributed is no longer in accord with the policies of the corporation, then the directors or members of the corporation may approve or ratify in good faith the use of such property for the general purposes of the corporation rather than for the specific purpose for which it was contributed.

CAL. CORP. CODE § 9230 (West Supp. 1982).

fect of the legislature's restriction of the attorney general's authority was the ending of all attorney general lawsuits against churches[65] despite the prospective nature of the restriction and the fact that the state could still charge church officials with fraud or misuse of solicited funds. Hence, not only are explicit statutory provisions necessary, but there must be a clear legislative mandate that provisions be enforced.

IV. THE CONSTITUTIONALITY OF STATE INTERVENTION

It is also important that proposed legislation aimed at the problem of the misuse of church funds have a solid constitutional basis. Without this foundation, state legislators may be reluctant to enact a provision.[66] A clear constitutional foundation is more important, however, to attorneys general and prosecutors. The prospect of litigating and appealing cases that are not merely routine matters of determining whether funds were misappropriated but involve difficult constitutional problems would discourage anyone from suing churches, even those who are duty-bound to enforce the law.

Church officials are formidable adversaries armed not only with constitutional defenses, but also with substantial resources that can be spent on a trial, or even brought to bear on the case out of court if the church decides to take its case to the public or the legislature.[67] Religious defendants have been known to wear down judges and prosecutors with hundreds of motions, challenges, and objections, and cling tenaciously to their righteous beliefs and constitutional objections to the very end.[68] Consequently, it is important that those challenging church officials in court at least know that their suit does not offend the first amendment.

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[65] *See supra* note 18. The California Deputy Attorney General who handled the World-wide Church of God case said that church members still come to his office seeking help in cases where church money is being diverted to private use but no action is being taken upon these complaints. Lauter, *supra* note 63 at 17, col. 4.

[66] Their reluctance could also stem from a perception that legislation directed at religious institutions is politically risky. In contrast, local political pressure probably does not constrain federal government officials as indicated by the prosecution of federal mail fraud cases against religious leaders. *See* United States v. Ballard, 322 U.S. 78 (1944); United States v. Rasheed, 663 F.2d 843 (9th Cir. 1981).

[67] *See supra* text accompanying note 63. *See generally* M. LARSON & C. LOWELL, THE CHURCHES: THEIR RICHES, REVENUES, AND IMMUNITIES (1969).

[68] Defense counsel for religious officials of the Church of Scientology recently remarked, "They [religious officials] will fight harder, they have more faith and belief in what they're doing than the average criminal defendant." Lauter, *supra* note 63, at 22, col. 11. *See infra* note 146.

A. COMPELLING STATE INTEREST IN PROTECTING CHURCH FUNDS

The Constitution absolutely protects religious beliefs.[69] The freedom to act on one's religious beliefs[70] is also protected, but such protection may be overcome by compelling state interests.[71] A law imposing criminal or civil penalties on the performance of acts which conscience compels pressures the underlying beliefs and infringes the freedom to believe.[72] Because we value religious beliefs highly, and because belief and conduct are often inseparable, the state can forbid religiously motivated action only where it poses "some substantial threat to public safety, peace or order,"[73] or where there are competing governmental interests that are of a higher order and cannot accomodate the religious practice.[74] If a court should find a first amendment free exercise violation by a state government that pursues the goal of protection of church

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69 Cantwell v. Connecticut, 310 U.S. 296, 303 (1940).

70 *See supra* note 16.

71 Sherbert v. Verner, 374 U.S. 398, 406 (1963).

72 One commentator recognized that there is not sharp distinction between religious beliefs and practices:

> The violation of a man's religion or conscience often works an exceptional harm to him which, unless justified by the most stringent social needs, constitutes a moral wrong in and of itself, far more than would the impairment of his freedoms of speech, press or assembly. The argument is not merely that avoiding compulsion of a man's conscience produces the greatest good for the greatest number, but that such compulsion is itself unfair to the individual concerned. The moral condemnation implicit in the threat of criminal sanctions is likely to be very painful to one motivated by belief. Futhermore, the cost to a principled individual of failing to do his moral duty is generally severe, in terms of supernatural sanction or the loss of moral self-respect. In the face of these costs, the individual's refusal to obey the law may be inevitable, and therefore in some perhaps unusual sense of the word, involuntary.

J. Clark, *Guidelines for the Free Exercise Clause*, 83 HARV. L. REV. 327, 337 (1969).

73 Sherbert v. Verner, 374 U.S. 398, 403 (1963). *See* Heffron v. Int'l Society for Krishna Consciousness, 452 U.S. 640 (1981) (state's interest in crowd control at fair sufficiently compelling to restrict religious solicitation to booths); United States v. Kuch, 288 F. Supp. 439 (D.D.C 1968) (government's interest in health and safety justifies criminal prosecution of members of Neo-American Church which embraced principle that marijuana and LSD are sacramental foods); M.I. v. A.I., 435 N.Y.S. 2d 928 (Fam. Ct. 1981) (state's interest that member of ISKCON support his wife and child sufficiently compelling and takes precedent over religious practice); Lawson v. Commonwealth, 291 Ky. 437, 164 S.W.2d 972 (1942) (compelling state interest in safety justified prohibition against snake handling as a religious practice).

74 Wisconsin v. Yoder, 406 U.S. 205, 215 (1972). *See* United States v. Huss, 482 F.2d 38 (2d Cir. 1973) (a refusal based on religious grounds to testify at a Grand Jury proceeding was subordinated to the compelling state interest of insuring the smooth functioning of the Grand Jury so vital to the criminal justice system); U.S. v. Reiss, 478 F.2d 338 (2d Cir. 1973) (maintenance of any army found to be compelling state interest requiring defendant to register with the military despite a religious objection); International Society for Krishna Consciousness, Inc. v. City of New York, 501 F. Supp. 684 (S.D.N.Y. 1980) (government interest in protection of United Nations Headquarters outweighed religious society's interest in soliciting on adjacent sidewalks); Varga v. United States, 467 F. Supp. 1113 (D.D.C. 1979), *aff'd without opinion*, 618 F.2d 106 (4th Cir. 1980) (continued existence of the Social Security system found to be compelling interest requiring plantiff to make tax contributions despite religious objection).

assets from abuse, the state would have to demonstrate a compelling state interest.

Assuming *arguendo* that a state's imposition of sanctions against religious leaders for diverting funds infringes religious rights, the state can demonstrate a compelling state interest in combating fraud and corruption involving church monies. For example, courts on several occasions have discussed a compelling interest in preventing or punishing fraud in connection with the solicitation of funds.[75] Recently, the Second Circuit in *International Society for Krishna Consciousness, Inc. v. Barber*[76] held that a state has a compelling interest in preventing fraudulent religious solicitation of funds. If a state can demonstrate a compelling interest in preventing or punishing fraud in connection with the collection of funds, then by the same logic, it can demonstrate a compelling interest in preventing or punishing the unlawful conversion of those funds after religious organizations have collected them.[77]

The state has a duty to protect churches from theft. The state also has an interest in protecting citizens, who have donated funds with the reasonable expectation that they be used for religious purposes, from the subsequent diversion of those funds. Of course, preserving religious assets designated for religious purposes as a compelling state interest, in spirit at least, appears to violate the principle of separation of church and state. A state's interest must be secular or it will violate the establishment clause of the first amendment.[78] However, the state's interest need not be drawn so narrowly and characterized as having a religious purpose;[79] a state has a much broader interest in protecting the order

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[75] *E.g.*, Heffron v. International Society for Krishna Consciousness, 452 U.S. 640, 101 S.Ct. 2559, 2568 (1981) (Brennan, J., concurring in part, dissenting in part); Village of Schaumburg v. Citizens for a Better Environment, 444 U.S. 620, 636-37 (1980); Cantwell v. Connecticut, 310 U.S. 296, 306-07 (1940); International Society for Krishna Consciousness, Inc. v. Barber, 650 F.2d 430, 444 (2d Cir. 1981).

The Supreme Court has been reluctant to actually hold that a state has a compelling interest in protecting its citizens from fraudulent religious solicitations. In Larson v. Valente, 102 S. Ct. 1673, 1685 (1982), the Court was willing only to assume *arguendo* that a Minnesota law aimed at preventing fraudulent religious solicitations was addressed to a sufficiently compelling governmental interest.

[76] 650 F.2d 430 (2d Cir. 1981).

[77] Arguably, protection of third parties, i.e., the church, its members and contributors, would be a sufficient compelling state interest. *See, e.g.,* West Va. State Bd. of Educ. v. Barnett, 319 U.S. 624, 630 (1943); Clark, *Guidelines for the Free Exercise Clause,* 83 HARV. L. REV. 327, 361 (1969); Note, *Religious Exemptions Under the Free Exercise Clause: A Model of Competing Authorities*, 90 YALE L.J. 350, 373-75 (1980).

[78] *See* Committee for Public Education v. Regan, 444 U.S. 646, 653 (1980); Roemer v. Maryland Public Works Board, 426 U.S. 736, 748 (1976); Committee for Public Education v. Nyquist, 413 U.S. 756, 772-73 (1973). The establishment clause prohibits government sponsorship of religion which requires that the government neither aid nor formally establish a religion.

[79] Just because a government action has a religious purpose does not mean that it cannot

and welfare of its citizens.

B. LEAST RESTRICTIVE MEANS ANALYSIS

The state must also show that it uses the least restrictive means to achieve its ends.[80] In *Barber*, New York attempted to prevent fraud at its state fair by forbidding peripatetic solicitations. New York enacted a "booth rule" requiring solicitation of funds at state fairs to be conducted from a booth, where solicitations could be supervised, which effectively prevented members of the International Society for Krishna Consciousness from engaging in the religious ritual of sankirtan. This practice requires roving members to approach the uninitiated, to inform them of the precepts of the religion, and to seek donations. The court held that the booth rule was overly broad because it unduly restricted nonfraudulent solicitations.[81] The court considered the use of the penal law to be a better response to the problem of fraud[82] because it punishes undesirable conduct after it occurs. Generally, a prophylactic rule interferes with free exercise rights and is therefore invalid because it limits both activity that threatens important social interests as well as activity that does not.[83]

Once fraudulent conduct occurs, therefore, the imposition of sanc-

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also have a secular purpose sufficient to satisfy the secular requirement of the establishment clause test. Gilfillian v. City of Philadelphia, 637 F.2d 924 (3d Cir. 1980), *cert. denied*, 451 U.S. 987 (1981).

[80] *See e.g.,* Thomas v. Review Bd., Ind. Empl. Sec. Div. 450 U.S. 707, 718 (1981); Sherbert v. Verner, 374 U.S. 398, 407 (1963). Less restrictive alternatives must be adequate to achieve a state's compelling interest, a requirement that the Supreme Court emphasized in Heffron v. ISKCON, 452 U.S. 640, (1981); the Court disagreed with the Minnesota Supreme Court that a booth rule at state fairs was an unnecessary regulation because of the availability of less restrictive means to control crowds, such as penalizing disorder, limiting the number of solicitors, or putting restrictions on the movement of ISKCON's representatives. There would be a much larger threat to the state's interest in crowd control if all other religious, nonreligious, and noncommercial organizations could move freely about the fairground distributing literature and soliciting funds, according to the Court, and the alternative means that the Minnesota Supreme Court suggested would not adequately deal with the problem of this hypothetical threat. *Id.* at 2567.

[81] International Society for Krishna Consciousness v. Barber, 650 F.2d 430, 446-47 (2d Cir. 1981).

[82] *Id.* The court stated: "[w]e find it constitutionally preferable to limit the application of harsh legal sanctions to only those narrow activities that deserve the law's opprobrium—fraudulent solicitations." *Id.* at 447.

[83] *See* Sherbert v. Verner, 374 U.S. 398, 407 (1963); Cantwell v. Connecticut, 310 U.S. 296, 306 (1940); Int'l Society for Krishna Consciousness v. Barber, 650 F.2d 430 (2d Cir. 1981); International Society for Krishna Consciousness v. Bowen,

600 F.2d 667 (7th Cir. 1979); United States v. Silberman, 464 F. Supp. 866 (M.D. Fla. 1979). *But see* Heffron v. International Society for Krishna Consciousness, 452 U.S. 640 (1981); International Society for Krishna Consciousness v. City of New York, 501 F. Supp. 684 (S.D.N.Y. 1980).

tions no longer raises a question of the availability of less restrictive means to implement the governmental purpose. However, there is a risk that the state will intervene in religious affairs when no fraud is involved. In order to avoid being declared unconstitutional, state intrusion into the financial affairs of churches must be limited by narrowly defining the circumstances that must be present before the government can intervene.

C. LIMITED INTERVENTION

Because there is an interrelationship between sincerely held religious beliefs and church finances,[84] the government cannot interfere with the financial decision-making process of church officials unless: (1) a constitutionally permissible, categorical exception is established, or (2) no vital link between religious beliefs and financial activities is demonstrated.[85] The categorical exception must be susceptible of being defined as an area that does not involve a question that church officials properly should resolve. This approach involves the separation of purely secular matters from ecclesiastical matters. The Supreme Court endorsed this kind of approach in the "neutral principles" doctrine applied in civil actions involving church property disputes.[86]

Church property dispute resolution by civil courts is analogous to state intervention in church financial matters. When a church breaks into factions or a local church withdraws from a denomination, a dispute often arises as to which faction of the formerly united church owns or controls the church property. After separating from the general church, the local church usually asserts control over the property and the general church claims that the property has been wrongfully taken.

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84 A church official who secretly diverts church funds to his Swiss bank account will have great difficulty demonstrating this nexus. *Attorney General Enforcement*, *supra* note 18, at 1314.

85 *Id.* Courts have used an alternative method to sever the link between belief and conduct by making an inquiry into a claimant's sincerity in holding certain religious beliefs. In United States v. Seeger, 380 U.S. 163, 185 (1965), the Court assumed that courts could test the sincerity of one seeking a conscientious objection exemption, albeit *Seeger* was a case of statutory interpretation involving § 6(j) of the Universal Military Training and Service Act of 1948, 50 U.S.C. App. § 456(j) (1958). Courts do not always demand that individuals demonstrate the sincerity of their religious beliefs, but often an inquiry into a claimant's sincerity is a necessary prerequisite to triggering constitutional safeguards. *See, e.g.,* Thomas v. Review Bd., Ind. Empl. Sec. Div., 450 U.S. 707, 716 (1981) (state's denial of unemployment compensation benefits to petitioner violated first amendment because the petitioner, after being transferred to a munitions plant, terminated his work because of an honest conviction that such work was forbidden by his religion); Wisconsin v. Yoder, 406 U.S. 205, 235 (1972) (Amish convincingly demonstrated the sincerity of their beliefs that high school attendance was contrary to the Amish religion and their salvation). *Accord* Callahan v. Woods, 658 F.2d 679 (9th Cir. 1981); Theriault v. Carlson, 495 F.2d 390 (5th Cir. 1974), *cert. denied,* 419 U.S. 1003 (1974); Frank v. State, 604 F.2d 1068 (Alaska 1979).

86 *See infra* text accompanying notes 94-98.

In much the same way, a state's attorney general or prosecutor alleges that a church official has unlawfully diverted church monies to an improper use or purpose. In neither situation can there be a complete separation of church and state because a secular court must resolve the controversy unless the Constitution forecloses the court's action. Under certain circumstances, however, a civil court cannot entertain a church dispute.[87] Consequently, one could anticipate that the principles precluding secular court intervention in these instances equally apply to state actions and foreclose state intervention in certain circumstances where church funds have been diverted from religious uses.

The Supreme Court in *Watson v. Jones*[88] established a rule of noninterference with church doctrine in church property disputes. A court was to defer completely to decisions of the internal church authority once the court had determined the seat of authority,[89] thereby avoiding a judicial inquiry into the underlying doctrinal controversy involved in the dispute.[90] The landmark Supreme Court decision on church property disputes, *Presbyterian Church v. Mary Elizabeth Blue Hill Memorial Presbyterian Church*,[91] elevated *Watson's* rule of noninterference with church doctrine to a constitutional level. In *Presbyterian Church*, two Georgia congregations voted to disaffiliate themselves from the Presbyterian Church of the United States because of its liberal stand on such matters as the ordination of women as ministers, civil disobedience, and the Vietnam War.[92] In the ensuing dispute over property, the Supreme Court recognized that religious freedom precludes civil courts from determining ecclesiastical questions in the process of resolving property disputes.[93] Nonetheless, the Court reaffirmed the power of courts to decide

87 *See infra* text accompanying note 93.

88 80 U.S. (13 Wall.) 679 (1872).

89 In deciding church disputes, courts distinguish between congregational churches and hierarchical churches. *See supra* note 31. The characterization of a church as congregational or hierarchical may have an impact on the outcome of a suit. For example, ordinary principles governing secular voluntary associations apply to congregational churches, and therefore the will of the majority controls congregational church property, although power to control church property can also be vested in a governing body of trustees or church officials in a congregational church. *See* Watson v. Jones, 80 U.S. (13 Wall.) at 725. The decision of the highest church judicature is binding upon hierarchical churches. *Id.* at 727.

90 The policy is justified by the assumption that church members fully submit to designated church authority. The Court in *Watson* emphasized that church members impliedly consent to church government; the theoretical basis for the decision was contractual. An implied contract exists between a member and his local church in congregational churches; an implied contract to be governed also arises when an individual or church unites itself with a hierarchical body. *Id.* at 729.

91 393 U.S. 440 (1969), *remanded sub nom.* Presbyterian Church v. Eastern Heights Presbyterian Church, 224 Ga. 61, 159 S.E.2d 690 (1968).

92 393 U.S. at 442 n.1.

93 393 U.S. at 447. The Court has also held unconstitutional judicial review of internal

church property disputes so long as they could do so without resolving underlying doctrinal controversies. Courts are to resolve church property disputes by invoking "neutral principles" of law.[94]

The neutral principles approach, as recently enunciated in *Jones v. Wolf*,[95] permits a court to examine the deeds, the corporate charter, state statutes, and provisions of the church's constitution to determine ownership and control of church property.[96] So long as a neutral principles inquiry does not involve a doctrinal interpretation of documents,[97] a court may rely on secular concepts in trust and property law which do not implicate forbidden religious questions.[98] Consequently, state involvement in the internal affairs of religious organizations is not constitutionally prohibited, at least when the dispute is between two church adversaries.

A neutral principles approach can be utilized in state intervention to prevent violation of laws relating to charitable trusts or nonprofit corporations and applying to religious organizations.[99] State intervention would be limited only where the relationship between religious belief and church finances cannot be severed. For example, conditions attached to the use and control of church property or funds might subject them to an express trust when an individual grants property to a church. The conditions attached to a gift might go so far as to attempt to limit doctrinal change, or might limit the use of the trust for a particular religious purpose. The condition would be judicially enforceable only if a court would not be required to consider doctrinal matters.[100] Thus, if

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church decisions for arbitrariness. Serbian Eastern Orthodox Church v. Milivojevich, 426 U.S. 696 (1976).

[94] The term "neutral principles" was first used in *Presbyterian*, 393 U.S. at 449, and subsequently approved in a per curiam opinion in Maryland & Virginia Eldership of the Churches of God v. Church of God of Sharpsburg, Inc., 396 U.S. 367 (1970).

[95] 443 U.S. 595 (1979). *Jones* emphasized the dangers of church-state entanglement, but equally applicable is the free exercise clause. *See, e.g.*, Presbyterian Church v. Mary Elizabeth Blue Hill Memorial Presbyterian Church, 393 U.S. at 448-50; Kedroff v. St. Nicholas Cathedral, 344 U.S. 94, 107-08, 120-21 (1952).

[96] 443 U.S. at 600-01.

[97] *Id.* at 604.

[98] *Id.* at 603.

[99] In Synanon Foundation, Inc. v. California, 444 U.S. 1307 (1979) (Rehnquist, Circuit Justice), Justice Rehnquist approved the use of a neutral principles approach in cases where the state intervenes in church affairs through its attorney general. *Id.* at 1308. Prior to this, a neutral principles approach had been used only in the context of intra-church property disputes.

[100] *See* Maryland & Virginia Eldership of the Churches of God v. Church of God of Sharpsburg, Inc., 396 U.S. at 369 n.2. (Brennan, J., concurring). In *Presbyterian,* Justice Harlan made a separate statement about express trusts. He considered enforceable express trusts that attach conditions limiting doctrinal change. However, the examples that Justice Harlan used involved conditions that would not involve a court in doctrinal inquiry, e.g., a condition stating that the church never ordain women. 393 U.S. at 452. In *Watson,* the Court

a state legislature were to permit its attorney general to police the use of church funds that have been designated by express trusts for specific uses, the scope of attorney general enforcement would be limited to the kinds of trusts where the secular law of property and trusts could be applied neutrally.

Absent a specific trust, a state enforcement proceeding that seeks to enjoin church expenditures, which an attorney general has determined are not being made to advance religious purposes and therefore are not in accord with the corporate purpose of the religious organization, impermissibly intrudes into the financial decision-making of church officials. Unless the link between belief and financial activities can be severed, neither a state nor a civil court can dictate to a church how to spend its money. Although the inquiry is not strictly one involving a determination of church doctrine, a court would be required to examine the religious beliefs of church officials with regard to expenditures made for religious purposes.[101] Characterizing expenditures as religious, in this context, is an ecclesiastical matter[102] beyond the power of courts.[103]

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in dicta recognized that the law of secular charities should apply when church property is subject to an express trust; a trust created for "the teaching, support or spread of some specific form of religious doctrine or belief" is enforceable. 80 U.S. (13 Wall.) at 722. The judiciary could engage in a doctrinal inquiry to determine trustee adherence to the trust's objectives. *Id.* at 723-24. But in light of modern cases, any doctrinal inquiry of this kind would be absolutely prohibited.

[101] The examination of an individual's religious beliefs is permissible only in the context of determining if beliefs are sincerely held. *See supra* note 85.

[102] *See supra* note 1. One commentator has discussed how religious freedom would be impaired if the state were to have a general role in deciding which church expenditures could properly be labelled religious and therefore permitted by the church's corporate charter. *Attorney General Enforcement, supra* note 18, at 1313-25. *See also* New York v. Cathedral Academy 434 U.S. 125, 133 (1977) ("The prospect of church and state litigating in court about what does or does not have religious meaning touches the very core of the constitutional guarantee against religious establishment . . . .").

[103] Church officials who devote considerable assets to secular projects and consequently violate a so-called general religious trust are still engaging in activities that benefit the church, unless there is mismanagement and waste. So long as these secular projects are not secretive and do not inure to the benefit of private individuals, the government should not regulate church expenditures.

In other contexts, however, the government retains the right to divide the world into the secular and religious. The Supreme Court has been reluctant to announce a constitutional definition of religion, but pursuant to an expansive definition of religion, continues to make threshold determinations of whether certain beliefs and practices are religious. *See* Note, *Toward a Constitutional Definition of Religion*, 91 HARV. L. REV. 1056 (1978). For example, in Wisconsin v. Yoder, 406 U.S. 205 (1972), the Supreme Court in ruling that Wisconsin could not require members of the Amish Church to send their children to public school after the eighth grade determined that certain Amish practices were religious. The Court found that the Amish life style, eductional practices and a refusal to submit their children to further secular education were religious in nature. Certain factors were important to the Court's determination among which were the existence of beliefs (1) shared by an organized group; (2) related to theocratic principles; (3) pervading and regulating their daily lives; and (4)

Thus, when a church commits funds to construct a hospital, for example, an attorney general or a judge is not the proper party to determine whether the expenditure is made pursuant to a religious purpose or is entirely dedicated to a secular undertaking.[104]

Still, an exception can be carved from the general rule that the government cannot dictate to a religious organization how to spend its funds. This exception would be carved out in the public interest,[105] but the line drawing must be narrowed so that the state does not go beyond the boundaries of the public interest and impermissibly regulate what are essentially ecclesiastical matters properly left to the discretion of church officials. According to this standard, limiting state intervention to those situations where individuals fraudulently divert funds to benefit private individuals sufficiently narrows state intrusion. The public interest includes the interests of church contributors and churches in not having funds wrongfully taken; a state proceeding against church officials who divert these funds protects the public interest and goes no further.

Moreover, the link between belief and financial activity can be severed in most cases. Even Justice Jackson, who dissented in *United States v. Ballard*[106] because he thought that the court had not gone far enough in prohibiting inquiries into religious fraud,[107] noted that a purely secular fraud such as using for private purposes money solicited for building

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existing for a substantial period of time. *Id.* at 215-17. Which if any of these factors determines the presence of a religion or a religious belief was not spelled out in the decision, and the process of determining whether an activity is religious remains unclear.

A notable case involving a threshold determination is United States v. Kuch, 288 F. Supp. 439 (D.D.C. 1968), which involved the prosecution of a leader of the Neo-American Church for a drug charge. The organization consisted of 20,000 members who considered psychedelic drugs to be sacramental food. The defendant moved to dismiss the violation of her free exercise rights, but the court concluded that it could not avoid the subtle and difficult inquiry into the definition of religion. The court held that the organization was not a religion because the record presented "[no] solid evidence of a belief in a supreme being, a religious disciple, a ritual, or tenets to guide one's daily existence." *Id.* at 444. The secular nature of the organization was revealed in the church "catechism" ("we have the *right* to practice our religion, even if we are a bunch of filthy drunken bums"), a church key (a bottle opener), official songs ("Puff, the Magic Dragon" and "Row, Row, Row Your Boat"), an order of bishops ("Boo Hoos"), and a solemn motto ("Victory Over Horseshit"). *Id.* at 443-44. *But cf.* People v. Woody, 61 Cal.2d 716, 394 P.2d 813, 40 Cal. Rptr. 69 (1964) (California could not ban the use of hallucinogenic peyote by the Navajo Indians because the belief in the drug as a sacramental symbol was bona fide).

[104] Even if appropriate criteria could be developed to make such a determination, intrusions by the state into the financial affairs of a church for the sole purpose of determining the propriety of church expenditures would result in an impermissible continuing relationship between church and state. *See infra* text accompanying notes 114-21, 127.

[105] *See supra* notes 73-77 and accompanying text.

[106] 322 U.S. 78, 92 (1944) (Jackson, J., dissenting).

[107] Justice Jackson did not specifically use the terms "religious fraud" or "secular fraud" but the dichotomy can be inferred from his opinion. *Id.*

churches or other religious purposes could be prosecuted because the prosecution would not involve the testing of beliefs.[108] In *Ballard*, defendants were charged with mail fraud in connection with the solicitation of funds for the "I am" religious movement. They represented that they had been selected as "divine messengers" with powers to heal diseases, including some classified as incurable. The Supreme Court held that the district court properly withdrew the issue of the truth of the defendants' religious beliefs from the jury, stating that the Constitution forecloses any inquiry into the truth or falsity of the religious beliefs.[109] While holding that a court could not inquire into "religious frauds," however, the Court did not specifically rule on whether a court could inquire into whether the defendant sincerely held the belief, leaving this issue to later cases.[110] Justice Jackson dissented from the remanding of the case to the circuit court because he argued that the testing of one's sincerity was not materially different from a testing of the belief itself.[111]

An inquiry into whether a church official has diverted church funds to benefit private individuals would not demand from a court an unconstitutional testing of religious beliefs. As trust law can be used to sever the link in church property disputes, so could criminal or civil statutory provisions be used in a neutral principles approach to sever the link between church officials' religious beliefs and their use of church funds.

In response to state intervention, church officials could assert that their religious beliefs include a belief in diverting funds to themselves or, in the spirit of religious giving, to family or friends. Dispensing church

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108 *Id.* at 95. The dichotomy between secular fraud and religious fraud is not always completely clear. In Hansel v. Purnell, 1 F.2d 266 (6th Cir. 1924), *cert. denied*, 266 U.S. 617 (1924), a leader of a religious colony fraudulently induced a family to transfer all of their property to the religious organization. The leader allegedly seduced young female members of the colony, and the court held that he could not shield himself from civil liability. The court stated:

> This action is not and does not purport to be an attack upon a religious faith, but, on the contrary, an attack upon an attempt to prostitute that faith to irreligious and base purposes through the instrumentality of a so-called religious society, ostensibly organized for the furtherance of the faith, but in fact organized under guise of religion for wicked, lewd, licentious, and unlawful purposes. This, of course, does not mean that any individual may be deprived of his constitutional right to worship God in accordance with the dictates of his conscience, nor that a court will assume to determine the truth or error of any religious creed or dogma; but it does mean that no individual, or group of individuals, will be permitted to deceive and defraud others through and by false and fraudulent representations made under color of religion, no matter what that religion may be or under color of any other lawful purpose.

Id. at 270.

109 Justice Douglas, writing for the majority, included the following quote from *Watson* in his opinion: "The law knows no heresy, and is committed to the support of no dogma, the establishment of no sect." *Id.* at 86 (citing Watson v. Jones, 80 U.S. (13 Wall.) 679, 728 (1872)). *See generally* Heins, *"Other People's Faiths": The Scientology Litigation and the Justiciability of Religious Fraud*, 9 HASTINGS CONST. L.Q. 153 (1981).

110 *See supra* note 85.

111 322 U.S. at 92-95.

assets to enrich private parties pursuant to a religious tenet or belief could not be proscribed by a state so long as there was full disclosure to church members and to all those who entered into a trust relationship with church trustees.[112] Disclosure would be an essential requirement for receiving donations. The religious organization would not be entitled to a tax exemption nor would religious donations be tax deductible. In this way, a state is not preventing anyone from exercising his religious beliefs. Officials of this profit-generating religious organization merely would be charged with a duty to disclose their pecuniary interest in church finances if and when their interest clearly exceeds any reasonable compensation for services rendered. A failure to disclose[113] would constitute fraud, not a religious fraud as was alleged in *Ballard*, but a secular fraud as Justice Jackson pointed out in his dissent.[114]

The compelling state interest—neutral principles—secular fraud approach attempts to ensure that state action will not infringe upon the first amendment rights of church officials while simultaneously enabling the state to ensure that church officials will not be able to infringe upon the rights of others with impunity. In this way, the state can protect donors' reasonable expectations concerning the use of their money.

D. THE RISK OF DENOMINATIONAL DISCRIMINATION AND HARRASSMENT

One primary drawback exists to giving state enforcement officials the power to bring criminal and civil actions against church officials. There is a risk that enforcement officials will use their power of prosecutorial discretion to exempt religious leaders of certain denomina-

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[112] There is no state interest in preventing religious organizations from making gifts of their assets when there is no fraud or other wrongdoing.

[113] Church officials would have to disclose their intention to use the funds for their personal enrichment prior to their acceptance of the funds. Funds previously solicited could not be diverted because no disclosure preceded the receipt of monies; their diversion would be in direct opposition to the reasonable expectation of the contributing public that these funds are to be used for religious or charitable purposes or for the benefit of the church. *See* Ellman, *supra* note 58, at 1440-43. One can also apply this principle to a hypothetical situation where previously solicited money has been used to develop church-run businesses that produce income which officials now wish to divert to their own use. The only colorable claim to infringement of religious liberty would be that church doctrinal change as to the use of funds previously solicited is henceforth foreclosed. The public interest would have to come into play at this point and a court would have to balance the opposing interests.

In response to a disclosure requirement, church officials could also assert that they have religious beliefs in making *secret* personal gifts. But as Chief Justice Burger stated in Wisconsin v. Yoder, 406 U.S. 205, 215-16 (1972), although a determination of what is a religious belief or practice entitled to constitutional protection presents a delicate question, "the very concept of ordered liberty precludes allowing every person to make his own standards on matters of conduct in which society as a whole has important interests."

[114] *See supra* text accompanying notes 106-08.

tions or religious faiths from state sanctions while charging leaders of other denominations or religions with violations of the law.

The establishment clause commands that the government cannot prefer one religion or denomination over another. The Supreme Court reaffirmed this principle in *Larson v. Valente*[115] where the Court struck down a Minnesota charitable solicitation statute which exempted from its registration and reporting requirements only those religious organizations receiving more than fifty per cent of their funds from members or affiliated organizations. The Court found that the fifty percent rule granted denominational preferences, and the rule could not be justified by the state's unsupported contentions that church members will supervise and control their religious organization and protect the public from abusive solicitations simply because they contribute more than half of the organization's income.[116] Justice Brennan, writing for a divided Court,[117] noted that a "risk of politicizing religion" inheres in legislation like the fifty per cent rule, and the legislative history of the Minnesota statute revealed that legislators wanted to exempt the Roman Catholic archdiocese from the reporting requirements but did not want to exempt certain other religious organizations.[118] Because the Roman Catholic Church is funded primarily through its members while less well-established churches like Reverend Sun Myung Moon's Unification Church depend heavily upon publicly solicited contributions, the reporting requirement established unconstitutional denominational preferences.

Unlike Minnesota's fifty per cent rule, a statute which focuses on the problem of church looting is likely to be facially neutral. But instead of legislators drawing denominational lines, enforcement officials can apply the law in a discriminatory manner. Discrimination could easily arise, for example, if enforcement officials choose not to prosecute or sue certain church leaders after determining that limited prosecutorial resources are no match for those resources, both political and financial, which certain religious leaders can mobilize through a very powerful religious organization. An argument could be made that the law is merely having a disparate impact and is constitutionally permissible because secular criteria are being used to arrive at a decision whether to sue or prosecute.[119] However, this argument is very weak in

115 102 S. Ct. 1673 (1982).

116 *Id.* at 1685-86.

117 Chief Justice Burger and Justices O'Connor, Rehnquist, and White dissented on standing grounds; Justices Rehnquist and White also dissented on the merits.

118 *Id.* at 1688.

119 *See id.* at 1684 n.23; McGowan v. Maryland, 366 U.S. 420 (1961); Everson v. Board of Education, 330 U.S. 1 (1947).

the context of prosecutorial discretion because there is too great a risk that so-called secular criteria are being used to mask the religious preferences of prosecuting officials.

Although there will probably be too few prosecutions of religious leaders to establish a pattern of religious discrimination on the part of state enforcement officials, it is important that state officials avoid discriminating among religions in applying the criminal law.

V. DETECTING FISCAL ABUSE: ENTANGLEMENT

State intrusions into church financial affairs raise an additional constitutional issue. Because an excessive and enduring entanglement between church and state would result, the government will not be able to monitor the financial affairs of religious organizations on a *continuing* basis. The excessive entanglement test as refined in *Lemon v. Kurtzman*[120] and *Tilton v. Richardson*[121] limits the ability of the state and federal governments to detect fiscal wrongdoing in churches. In effect, the first amendment will always stand as a major obstacle to the government's goal of protecting the public from fraud and corruption occurring in connection with church funds.[122]

At issue in *Lemon* were parochial school aid programs designed to reimburse nonpublic schools or supplement nonpublic school teachers' salaries for secular instruction. The Court applied a tripartite test: (1) the purpose must be secular; (2) the primary effect must not advance or inhibit religion; and (3) an excessive government entanglement must not result.[123] The states' programs were invalid under the third prong of the test because a "comprehensive, discriminating and continuing surveillance" would be required to ensure that the schools obeyed restrictions against teaching religious doctrine.[124] An "intimate and continuing relationship between church and state" is unconstitutional.[125]

The same test was applied in *Tilton v. Richardson* where the Court upheld one-time federal grants to church-related colleges for the construction of buildings to be used only for secular education. In applying the third prong of the test enunciated in *Lemon,* the Court cited factors that lead to excessive entanglement: a *continuing* financial relationship between government and a religious organization, annual audits of the organization's expenditures, and government analysis of expenditures to

120 403 U.S. 602 (1971).
121 403 U.S. 672 (1971).
122 *See supra* note 83 and accompanying text.
123 403 U.S. at 612-13, *quoting* Walz v. Tax Comm'n, 397 U.S. 664, 674 (1970).
124 403 U.S. at 619.
125 *Id.* at 621-22.

determine which were religious and which were secular.[126] No one factor is deemed controlling,[127] but the absence of all three in *Tilton* resulted in the upholding of the federal grants. Constant government surveillance of church expenditures, according to both the *Lemon* and *Tilton* criteria, is unconstitutional.

One indicator of the unconstitutional nature of continued surveillance is the exemption granted to tax-exempt religious organizations from filing annual information returns under the Internal Revenue Code.[128] A tax-exempt church has a duty to notify immediately the IRS of any changes in their character, operation, or purpose that could result in a change in its exempt status.[129] The church, however, need not file Form 990, an annual informational return stating, *inter alia*, items of gross income, receipts and disbursements, and the names of contributors and employees. In addition, Section 7605(c) protects churches from unreasonable audits.[130] Although the existence of this exemption is not conclusive in regard to the constitutionality of annual reporting requirements, there seems to be an implicit recognition that the gathering of information by the Service involves some degree of forbidden entanglement. In *Walz v. Tax Commission*,[131] the landmark case where the words "excessive entanglement" first appeared, the Court expressed a concern that the elimination of a tax exemption itself would "involve extensive state investigation into church operations and finances"[132] and "entangle the government in difficult classification of what is or is not religious."[133] Government surveillance is, at the very least, suspect.

Lacking an ability to monitor church finances on a continuing basis, the government does not have the kind of access to church financial

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[126] 403 U.S. at 688.

[127] *Id.*

[128] I.R.C. § 6033(2)(A)(i). *See also* § 6001.

[129] TREAS. REG. §1.6033-1(h)(1).

[130] I.R.C. § 7605(c). Section 7605(c) affords protection to churches against certain IRS audits in conjunction with an examination for unrelated business income, but does not restrict the scope of examination with respect to other issues for determination by the IRS when investigating an exempt organization. Section 7605(b) expressly permits examination of the religious activities of a church to the extent necessary to determine its entitlement to a tax exemption. United States v. Dykema, 666 F.2d 1096 (1981).

[131] 397 U.S. 664 (1970).

[132] *Id.* at 691 (Brennan, J., concurring).

[133] *Id.* at 698 (Harlan, J., separate opinion). In concluding that a tax exemption resulted in less entanglement with religion than taxation, the Court did not say that a tax exemption was required. The entanglement test is one of degree. *Id.* at 674. An argument can be made that there is a reasonable limit of the kind and amount of information obtained for tax collecting purposes, and therefore taxation of church property would not lead to unconstitutional entanglement. *See* Note, *The Internal Revenue Service as a Monitor of Church Institutions: The Excessive Entanglement Problem*, 45 FORDHAM L. REV. 929, 946-47 (1977). Whereas the filing of information returns limits entanglement, surveillance of church financial affairs imposes no limitation on the information that can be sought. *Id.*

records that it has with secular corporate books of account. Yet church financial information is not entirely beyond state scrutiny and is open to inspection where the government has reason to believe that the church is no longer entitled to a tax exemption or suspects fraud, corruption, or other illegality. Once state officers have cause to suspect fraud or corruption in the church, a properly narrowed summons[134] could be issued to obtain necessary information from church records. A state could take action against church officials when church members[135] complain that church officials are flagrantly looting funds or causing the church to buy expensive items such as a yacht or Rolls-Royce automobile[136] that benefit only church officials. Church leaders basking in luxury should raise suspicions, at least, in those churches where church leaders are expected not to unduly profit from religious service.[137]

In addition to citizen complaints, state attorneys general have indirect access to information relating to church finances. Under section 6104(c) of the Internal Revenue Code entitled "Publication to State Officials," the IRS is to notify the appropriate state attorney general if a section 501(c)(3) organization is denied exempt status, or acts in a manner inconsistent with its exempt purposes.[138] The IRS must make its records of a section 501(c)(3) organization available when relevant to a

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[134] A properly narrowed summons does not necessarily mean that state intrusion into church affairs will not seem severe. On July 8, 1977, more than 150 FBI agents and other government personnel entered three facilities of the Church of Scientology in Los Angeles and Washington D.C. The warrants identified 162 items and classes of items to be seized based upon an affidavit of a former Scientology official who testified with respect to thefts of government documents from the Department of Justice which Scientology members had committed in 1975. Nearly 50,000 documents were seized in the course of 23 hours of the search. The legality of the execution of the warrants was established after extensive litigation. In re Search Warrant Dated July 4, 1977, 436 F. Supp. 689 (D.D.C. 1977), *rev'd*, 572 F.2d 321 (D.C. Cir. 1977), *cert. denied sub nom.*, Founding Church of Scientology v. United States, 435 U.S. 925 (1978); In re Search Warrant Dated July 4, 1977, 667 F.2d 117 (D.C. Cir. 1981). *See also* United States v. Dykema, 666 F.2d 1096 (7th Cir. 1981); United States v. Grayson County State Bank, 656 F.2d 1070 (5th Cir. 1981); United States v. Miller, 609 F.2d 336 (8th Cir. 1979); United States v. Freedom Church, 613 F.2d 316 (1st Cir. 1979); United States v. Coates, 526 F. Supp. 248 (E.D. Cal. 1981).

[135] In Valente v. Larson, 637 F.2d 562, 565 (8th Cir. 1981), *aff'd*, 102 S.Ct. 1673 (1982), the court indicated that church members may have opportunities to uncover fiscal fraud in churches whereas the general public is not in a very good position to discover this kind of illicit activity.

[136] Hakeem Abdul Rasheed, founder of the Church of Hakeem, was charged with mail fraud in soliciting religious funds, but not before the Internal Revenue Service seized the assets of the Church of Hakeem, which included a $900,000 yacht and a $100,000 Rolls-Royce. United States v. Rasheed, 663 F.2d 843, 846 (9th Cir. 1981).

[137] This does not mean that church leaders must keep faith with a vow of poverty or live as monks. But there is a reasonable expectation that donations for religious causes should not make religious leaders wealthy where leaders are acting as trustees and administrators. Still, a lavish lifestyle is not prima facie contrary to donors' reasonable expectations. *See* Ellman, *supra* note 58, at 1440-43.

[138] I.R.C. § 6104(c).

determination under state law.[139] Of course, the attorney general also has access to church financial information generated in the course of a state's own investigation of church tax liability or exemptions.

Despite these sources, church officials effectively can keep church financial information from public scrutiny and conceal their misuse of church funds until an outward manifestion of their wrongdoing surfaces. Religious freedom has its costs.[140]

VI. ARRESTING THE STATE'S ATTENTION

Most people would probably agree that the state should not interfere in church affairs. But the concern here is with bona fide religious organizations. Increasingly, there are reports of churches being founded as vehicles to enrich private individuals in the form of tax savings[141] or profits generated from fraudulent solicitations,[142] although the extent of the problem is not known.[143] The government should discourage the misuse of churches.

Yet churches formed to act as cloaks to hide fraud and corruption are not so easily separated from bona fide churches. Government involvement in church financial affairs gives rise to fears that conventional churches will become vulnerable to state attacks.[144] For example, where do reasonable compensation and fringe benefits end and corruption begin? Clearly, prosecutions or civil actions would be appropriate only in blatant cases of abuse where intent to defraud can be proven. Still, the fear that the government is intruding into a sphere of sovereignty where it does not belong can cause considerable resistance to state legislation and enforcement proceedings.

Where churches pressure a legislature not to act in this area, there may be insufficient public interest in the goal of preventing church cor-

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139 *Id.* § 6104(c)(1)(C).

140 Justice Jackson said that "the price of freedom of religion . . . is that we must put up with, and even pay for, a good deal of rubbish." United States v. Ballard, 322 U.S. 78, 95 (1944) (Jackson, J., dissenting).

141 Setting up churches as tax avoidance devices rarely succeeds because the IRS denies the "church" tax-exempt status because the "church" cannot establish that net earnings have not inured to the benefit of private individuals. *See, e.g.*, Basic Bible Church v. Commissioner, 74 T.C. 846 (1980); Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 531 (1980).

142 *E.g.*, United States v. Rasheed, 663 F.2d 843, 846 (9th Cir. 1981).

143 One barometer of the religious solicitation problem may be the report by the Philanthropic Advisory Service of the Better Business Bureau, which once received only a few letters a year concerning religious fundraising, stating that half of the 150,000 inquiries it receives yearly involve church-related charities. *Weeding Out Clergymen Who Go Astray, supra* note 28, at 63. *See generally* Johansen & Rosen, *State and Local Regulation of Religous Solicitation of Funds: A Constitutional Perspective*, 444 ANNALS 116 (1979).

144 See Briggs, *Churches Convene to Curb Regulation: Fears of Government Intervention Lead 300 Religous Leaders to Show a United Front*, N.Y. Times, Feb. 15, 1981, at 25, col. 1.

ruption to offset that pressure. A crime that is seldom committed and whose perpetrators are religious leaders poses no substantial[145] threat to external society and creates little demand for sanctions.[146] Public interest focuses on the resulting scandal, but a public outcry for punishment of church officials does not follow when they are accused of diverting church monies for personal profit. There is no doubt that the public suffers an injury when religious leaders perpetrate frauds, but the financial effects are generally so diffused that the public's attention is limited to the scandal value of the report. But it is precisely where there is no other party who can reasonably be expected to remedy the breach of trust that the state should respond to the problem of church looting and fraudulent solicitations.

VII. CONCLUSION

Protecting the reasonable expectations of those who wish to practice their religion by contributing money to churches in trust is possible without violating the first amendment. In fact, the freedom of religion will be enhanced if the government prevents church trustees and administrators from wrongfully diverting church funds to their own use. The law can be used as a sword as well as a shield to protect religious freedom. The approach proposed in this Comment offers a sound constitutional foundation for state intervention into church financial affairs where embezzlement is suspected. It attempts to reduce any reluctance that state law enforcement officers may have to confront church officials by affirming the power of the state to intervene in church affairs where

[145] As Justice Jackson said in the quotation at the beginning of this Comment, "[t]he collections aggregate a tempting total, but individual payments are not ruinous . . . ." United States v. Ballard, 322 U.S. 78, 94-95 (1944) (Jackson, J., dissenting).

[146] In contrast, where church leaders formulate conspiracies to obstruct justice, steal government property, burglarize, bug, harbor fugitives from justice and commit perjury before a grand jury, the government stands ready to respond with criminal sanctions. Mary Sue Hubbard, the wife of Scientology founder L. Ron Hubbard, and ten other members of the Church of Scientology were indicted for these offenses, and nine were found guilty on various counts on October 26, 1979. Church members had conducted covert operations to obtain government documents that dealt with matters concerning the Church of Scientology, particularly its entitlement to a tax exemption. The Church has generated a flurry of reported court decisions challenging the FBI's searches and seizures of Scientology files in the Church's Los Angeles and Washington, D.C. offices. *E.g.*, In re Search Warrant Dated July 4, 1977, 667 F.2d 117 (D.C. Cir. 1981); United States v. Hubbard, 650 F.2d 293 (D.C. Cir. 1980); Church of Scientology v. United States, 591 F.2d 533 (9th Cir. 1979), *cert. denied*, 444 U.S. 1043 (1980); In re Search Warrant Dated July 4, 1977, 572 F.2d 321 (D.C. Cir 1977), *cert. denied sub nom.*, Founding Church of Scientology v. United States, 435 U.S. 925 (1978); Church of Scientology of Cal. v. Linberg, 529 F. Supp. 945 (D. Cal. 1981); United States v. Hubbard, 493 F. Supp. 209 (D.D.C. 1979); United States v. Hubbard, 474 F.Supp. 90 (D.D.C. 1979); United States v. Hubbard, 474 F. Supp. 64 (D.D.C. 1979); Church of Scientology v. Simon, 460 F. Supp. 56 (D. Cal. 1978), *aff'd*, 441 U.S. 938 (1979).

illegality occurs. The religion clauses can guarantee the freedom of religion without serving claims for special protection by those who engage in illicit activity. Without impairing religious freedom, states are free to deter individuals from stealing from churches or using churches as vehicles to perpetrate secular frauds upon the public.

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