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CHURCH TAX REFORM NEEDED

By

Don E. Giacomino

B.A., University of Montana, 1969


Presented in partial fulfillment of the requirements
for the degree of

Master of Business Administration

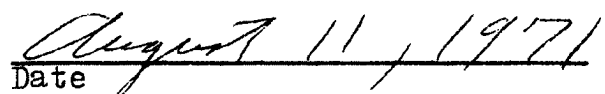
UNIVERSITY OF MONTANA

1971

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CHAPTER I

INTRODUCTION

The following article, which appeared in the San Francisco Chronicle, although humorous, pertains to a situation much more serious than the tone of the article.

There's some un-American agitation to tax the churches for the money they make on the businesses they own.

The New York Times cites the case of the Cathedral of Tomorrow, a 2200-member Protestant church in Akron, Ohio, which owns the Real Form Girdle Company of Brooklyn, N. Y. "The church uses its untaxed profits --which run as high as \$188,000 a year--to buy other companies. And it's fast becoming a first rate conglomerate."

Any moron can see where this is going to lead. I can.

Scene: The rectory and board chairman of the Real Christian Church & Allied Industries, Inc. A young man stands in front of his desk, nervously twisting his hat in his hands.

Young Man: I've come for spiritual advice, sir.

The Reverend (tapping his cigar ash): Walk humbly in the paths of the Lord, son, and buy growth stocks.

Young Man: Thank you, sir. But what I . . .

Aide (rushing in): Hot report here, Reverend. Looks like that new company we bought, Moral & Bust Uplift, Ltd., is going down the tube.

The Reverend (frowning): I warned about buying that--padded assets. Work a two-for-one split and dump it for a controlling interest in Magnificent Munition. As I said in my sermon last week, "Diversify!"

Young Man: Excuse me, but what I wanted to ask you, sir, was whether I should enter the ministry. You see, I'm a divinity student and I'm doing well. straight A's in economics, general accounting and business management. But . . .

The Reverend: You couldn't choose a more rewarding career, son. Why, when I became a pastor of this little church all it owned was a chain of drive-in theaters, a beer distributorship and a pornographic publishing company. Today, our assets are \$4.6 billion and our congregation has trebled. We now have 143 members. There's a lot of satisfaction in building a church, son. But perhaps you feel you haven't received the call?

Young Man: That's just it, sir. I did receive the call. It was from General Motors. They offered me \$50,000 a year and a company car.

The Reverend (angrily): You'd crucify the Lord on the altar Mammon? General Motors! Why, I could buy and sell General Motors. (Brightening) Say, there's an idea (To his secretary) Get me Jimmy Roche on the phone.

Secretary: Excuse me, sir. But you have an incoming call from Bishop Morganfeller of General Religions, Inc. He says it's urgent.

The Reverend (excitedly): This could be it! Bish? DD., here. What did your board say? Great! Okay, we'll issue convertible debentures and create a new preferred which your congregation can get in a straight three-for-one stock swap, no cash deal. (Hanging up)--Son, you have just witnessed one of the most important steps in theological history.

Young Man: You've merged with General Religions?

The Reverend: Right. And now if we can exercise our options on those Jesuit-owned network affiliates, we'll have realized the 500-year-old dream of all true Christians.

Young Man (awed): You mean . . .

The Reverend (Happily blowing a wreath of blue cigar smoke): One truly-ecumenical Christian church and holding company.¹

The primary concerns of this report are the financial and business growth of the church, the effect of the tax exempt status of the church upon its growth and the effects upon the taxpayer, the businessman and the United

¹ Arthur Hoppe, "Big Church Business," San Francisco Chronicle (date unknown), featured in Church and State: A Monthly Review, Volume 110, p. 6.

States economy.

The first section of this report presents a history of the tax exemptions on both income and property. The reasons for and abuses of the tax exemption are the next considerations. Following a presentation of existing law regarding tax exemption, proposals are made regarding legal means of correcting the problem of tax exemption.

Subsequent sections are concerned with the various positions taken by church groups and other religious organizations in favor of repeal or revision of church tax exemption. A discussion of efforts, past and present, to effect tax reform is also included in this report.

The concluding remarks review the church tax exemption and indicate reasons for needed tax reform. In order to bring present tax law in line with the role which the church is expected to play in today's society, efforts must be made to evaluate the present tax exempt status of the church and to undertake the necessary measures for reform.

CHAPTER II

HISTORICAL INTRODUCTION TO CHURCH TAX EXEMPTION

The tax exemption of church property is probably as ancient as taxation itself. It dates back at least to early Biblical days. When Joseph bought the Egyptians' land for the food he had stored during the seven years of plenty, he turned back to each Egyptian his land, and "made it a law over the land of Egypt unto this day that Pharaoh should have the fifth part (of the Produce); exempt the land of the priests only, which became not Pharaoh's." When Artaxerxes, king of Persia, authorized Ezra to levy a tax for the rebuilding of the temple in Jerusalem, he specifically directed "that touching any of the priests and Levites, singers, porters, Nethinims, or ministers of the house of God, it shall not be lawful to impose toll, tribute or custom upon them." With the establishment of the Jewish theocracy after the return from Babylon, it was natural that this exemption should be continued, and, with the rise of the rabbinic class, to be extended to the rabbis. By the time Judea became a province of the Roman Empire it had become a maxim in the Talmud that "he that takes upon himself the yoke of the Lay (Torah)

from him shall be taken away the yoke of the kingdom."²

Practices such as these were not restricted to Asia Minor.

The early Osirian priesthood in Egypt annually received tax-exempt revenue amounting to one-third of the national income, and the Zoroastrian and Mandaean priests of Persia and the pre-Buddhist Brahmans in India enjoyed similar privileges.³

Charitable trusts in early Roman times (550 B. C.) were tax-exempt.⁴

Under the Roman Emperor Constantine in the fourth century A. D., the church achieved even greater power and privileges than the ancients--all religious personnel were placed on the public payroll, church construction and maintenance were financed out of the public funds, and the church in effect became a ruling partner of the state, eventually possessing about one-third of the real property of the Empire. A wave of expropriation of church property ultimately resulted, but in Germany, among other nations, churches still are financed partly from general revenues.⁵

"Our own traditions originated in medieval England. Indeed, the 'associations' de Tocqueville cited were not a unique American creation but the products of a concept that was already well developed in the Tudor-Stuart

²Leo Pfeffer, Church, State and Freedom, "Tax Exemption: The Background," (Boston, Mass.: The Beacon Press, 1967), pp. 210-219.

³Alfred Balk, The Religion Business (Richmond: John Knox Press, 1968), p. 4.

⁴Willard T. Hunter, "Tax Laws and the National Charter," The Tax Climate for Philanthropy (Washington, D. C.: American College Public Relations Association, 1968), pp. 8-9.

⁵Balk, op. cit., p. 13.

period."⁶

Near the end of the sixteenth century the problem of human want in England had reached a crisis. The break-up of the feudal system and the new economic forces at work in society not only created new needs but also gave impetus to a search for new ways to meet them. The Parliament that convened in 1597 was quickly absorbed in the problems of poverty. By 1601 it had developed a great code of social legislation; for the first time the various aspects of poor relief and related matters were faced squarely. Possibly the most significant move of the Parliament was its acknowledgment of the enormous responsibility already being carried by private charity. The official Act--the landmark Statute of Uses (43 Elizabeth, c. 4)--was designed substantially to encourage and increase the flow of private funds to solve social problems. The Statute was to become the legal foundation of charitable giving in the Anglo-Saxon tradition. In effect, it created and defined the law of charitable trusts by establishing religion, education, and charity as a triad that should be the object of special treatment, through the provision of special advantages to trusts that were set up for these purposes.

The Statute itself remained unrepealed until 1888

⁶Ibid.

(Mortmain and Charitable Uses Act. 51 and 52 Victoria, c. 42), but even then the preamble, with its charitable uses, was carefully preserved. The courts of the United States as well as Great Britain have been greatly influenced by it for three and a half centuries.⁷

In England the question of tax exemption of property owned by charitable institutions has never been wholly settled one way or the other. Charity property might or might not be subject to local rates. Current British practice was summarized for use in a letter (October 1966) from H. W. Hodson, Provost of the Ditchley Foundation, a British organization (with a branch in New York) that promotes international dialogue on public problems:

Whereas I understand in the United States charitable institutions are totally exempt from local taxes, here the general rule is that they pay one-half, though some or all of this may be further remitted by the local authorities in special cases, mainly, those where the charity is otherwise in dire straits and virtually replaces public welfare services.

We regard this as a not unreasonable compromise, since local taxes pay for local services which every⁸ one, including charitable institutions, enjoys alike.

In the United States, local and state governments hold charitable institutions exempt from property tax. Jacques Barzun, in his charmingly devastating attack on philanthropy as one of the "three foes of the intellect" comments:

⁷Hunter, op. cit., p. 4.

⁸Ibid.

It was the Founding Fathers--the men of letters who wrote the Declaration of Independence and the Federalist Papers--who laid it down as axiomatic that schools, churches, and other institutions for welfare should be tax-free. They fastened the custom upon us like an immemorial law.⁹

The "custom" is increasing in impact. For example, the worth of tax-exempt property in Ohio in 1966 came to nearly \$3.6 billion, a jump of 16.4 percent over 1963; in the same period, taxable realty rose in value by only 8.1 percent.¹⁰

Income received by charitable institutions as distinguished from property owned, has been tax-exempt from the beginning of the national income tax laws in both England (1799) and the United States (1913).

Prime Minister Pitt included in his Income Tax Act of 1799 (39 George III, c. 13, s, 5) a clause exempting the income of any "Corporation, Fraternity, or Society of persons established for charitable purposes only." After the lapse of the income tax in Britain between 1816 and 1842, Sir Robert Peel, in reintroducing the tax, followed Pitt's precedent.

The practice has been seriously questioned only once. In 1863, Chancellor of the Exchequer William Ewart Gladstone proposed to withdraw tax exemption of charitable income on the grounds that it amounted to public support

⁹Ibid., pp. 8-9.

¹⁰Ibid., pp. 9-10.

without public review. He achieved no backing in the House, and Disraeli's opposition to him was applauded. During debate, Gladstone withdrew the proposal, in the face of powerful protests from what he termed "the charitable army."

In the United States, after the enabling 16th Amendment was declared adopted on February 25, 1913, the first permanent Federal income tax was created by the 63rd Congress in the Revenue Act of 1913 (38 Stat. 166), which went into effect on March 1, 1913. (During the Civil War a tax had been levied on income; it lapsed from the books in 1872. In 1894, Congress created another income tax law, only to have it declared unconstitutional by the Supreme Court in 1895).¹¹

The new law exempted from tax any income of a "corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual" (38 Stat. 172). This provision (and its subsequent repetition in successor laws) means that these institutions are not required to pay tax on income--whether from contributions, payments for services (as in a hospital or college), or profits from income-earning assets (except, in most instances, for "unrelated business income").

¹¹Ibid., p. 9.

CHAPTER III

DISCUSSION OF THE TAX EXEMPTION PROBLEM AS IT EXISTS TODAY

Tax exemptions were originally granted in the United States because the nation's founders sought to protect the churches from persecution in the form of discriminatory taxes, and because they saw churches as primary contributors to national morality and order.

Despite examples of church-sponsored welfare, doubts are arising in America's increasingly secular society about the traditional view that churches are entitled to protection from all taxes. Critics point out that religious and other tax-exempt real estate in the United States is becoming more and more of a burden especially in cities which are already hard-pressed to meet increasing costs of welfare, education and other public services.

When a tax on church sanctuaries is proposed, one may think of a shack at the crossroads which even a small levy of \$100 might well put out of business. There are, certainly, churches of this kind today and a tax of any dimension would be a hardship. It was this fact which led to the church exemption in the first place.

But the churches of today are not really like that. Granted the exception, the churches of today have become financially flourishing institutions. They are not locally governed, but are managed, rather, by central agencies and boards. Surplus funds of the churches, fed by the strong meat of tax exemption, have burgeoned into big business. There has been a vast expansion of the physical domain of the church with multi-million dollar edifices constructed everywhere, and an even more spectacular rise in church investments and business income (discussed later).

Far from being poor, struggling organizations bringing spiritual and moral uplift to their parishoners, the churches--some of them at least--are among the biggest and wealthiest businesses in the United States. The religious enterprise in this country, including its subsidies from government, represents assets of no less than \$164 billion.¹² With the encouragement of immunity from all taxation, this business is expanding at the rate of \$5 billion a year.¹³

Recall that the church has become a problem to many civilizations when it grows wealthy and politically potent. A church that is rich and powerful--often made so

¹²Americans United for Separation of Church and State, "Will Churches be Taxed?" Church and State: A Monthly Review, volume 22, p. 11.

¹³Ibid.

by tax exemption--tends to become oppressive to the people.¹⁴ Have we reached that point in the history of the United States? Are we in sight of it? are we confronted with a condition of "religious inflation?" If the answer to such questions is "Yes," then some corrective action must be taken promptly.¹⁵

The Government reports, in the 1960 census, that there were some 320,000 church parishes in the United States--or, corrected for a population of some 200 million and for new churches completed, one for approximately every 600 Americans. Every year, the National Council of Churches of Christ in the U. S. A. calculates, these parishes gather in contributions of about \$5 billion--approximately half of all philanthropic giving in this country--and they invest more than \$1 billion in new facilities. According to a study sponsored by Americans United for Separation of Church and State, these "religious organizations" visible assets--land and buildings of all kinds--now have a value of at least \$79.5 billion; almost double the combined assets of the country's five largest industrial corporations.¹⁶ Of this treasure, approximately \$44.5 billion worth is held by the Roman Catholic Church. These estimates have not been challenged.¹⁷ In fact, a

¹⁴Ibid. ¹⁵Ibid.

¹⁶Harold B. Meyers, "Tax-Exempt Property: Another Crushing Burden for the Cities," Fortune, May 1, 1969, p. 78.

¹⁷Ibid.

Catholic priest, the Reverend Richard Ginder, writing in the Roman Catholic publication Our Sunday Visitor, said:

The Catholic Church must be the biggest corporation in the United States. We have a branch in almost every neighborhood. Our assets and real estate holdings must exceed those of Standard Oil, AT & T, and U. S. Steel combined. And our roster of dues-paying members must be second only to the tax rolls of the United States Government.¹⁸

Denominational pension and retirement funds invested in stocks, bonds, and mortgages total more than \$2 billion. Church consumption of materials and services, both for growing parish plants and for church-owned educational and welfare institutions, is gargantuan--the Roman Catholic arch-diocese of New York City reportedly spent \$17,000,000 on goods and services in its jurisdiction alone in a recent year.

The holdings of religious organizations nowadays are by no means limited to such benevolent undertakings as church sanctuaries, parsonages, schools, and welfare organizations. American sectarian groups also have taken deep plunges into profit-making businesses. In Los Angeles, the Temple Baptist Church owns the Philharmonic Auditorium and office building; the Muskingum, Ohio, Presbyterian Church operates a cement-block factory based in Arizona; California's Christian Brothers are major winemakers and one of the country's leading producers of brandy; and a

¹⁸Americans United, op. cit., p. 14.

Southern California sect, the Self-Realization Fellowship, operates a chain of eateries featuring Mushroomburgers.

The Mormon Church in Utah includes among its properties the Salt Lake City Deseret News; radio-TV station KSL; a department store; more than 100,000 acres of farm-ranch land (managed through a holding company, Zion Securities Corporation); and Laie Village in Honolulu, which Variety has called one of the best "potential tourist catchalls to be found on an island paradise already teeming with tourist bait." Large blocks of stock in Republic and National Steel corporations and the Boeing, Lockheed, Curtiss-Wright, and Douglas aircraft companies are held by the Roman Catholic Jesuits. In addition, the same order has a substantial interest in the immense DeGiorgio Fruit Company, which operates in California, Florida, and Central America, and runs its own steamship fleet.

The \$300 million assets of the Knights of Columbus --the Roman Catholic fraternal, insurance, and evangelizing group--include a steel tube factory, several department stores, and the land under Yankee Stadium in New York City. And in Washington, D. C., the entrepreneur for the new Watergate Project, a \$70,000,000 commercial redevelopment enterprise adjacent to the John F. Kennedy Center for the Performing Arts, is the Societa Generale Immobiliare, a mammoth Italian real estate company in which the Vatican-- whose economic support derives substantially from American

Roman Catholics--is the largest shareholder.¹⁹ Encompassing a choice 10-acre site near the Potomac, this ambitious enterprise will include hotel, shopping center, offices, and more than 1,000 luxury apartments.

Economically, then, organized religion is one of the nation's most vigorous growth industries, with a broadly based and expanding blue-chip portfolio, no union problems, an enviable tax status, and impressive strength in an area in which business analysts once regarded it as not only weak but unmotivated: its financial management. Once--but no more.²⁰

¹⁹Balk, op. cit., pp. 7, 10, 12.

²⁰Ibid., pp. 10, 12.

CHAPTER IV

THE LAW ON CHURCH TAX EXEMPTION

Churches are exempt from payment of federal tax on income under the following tax code section:

(21,006) Code Sec. 501. Exemptions from Tax on Corporations, certain Trusts, etc.

(a) Exemption from Taxation, - An organization described in subsection (c) or (d) or section 401 (a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502, 503, or 504.

.....

.....

(c) List of exempt organizations. - The following organizations are referred to in subsection (a):

.....

.....

(3) Corporations, and any community chest, fund, or fundation, organized and operated exclusively for religious, charitable, scientific testing for public safety, literary or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office.²¹

²¹U. S. Treasure Department, "Exempt Organizations," U. S. Federal Tax Code, paragraph 21,006, Sec. 501(a), Sec. 501(2)(3), and paragraph 21,203, Sec. 511(a)(1), (2).

Churches are also exempt from provisions of Section 511(a)(1) of the Tax Code by the following:

(21,203) Code Sec. 511. Imposition of Tax on Unrelated Business Income of Charitable, etc., Organizations.

(a) Charitable, etc., Organizations Taxable at Corporation rates.

(1) Imposition of tax. - There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in Sec. 512) of every organization described in paragraph (2) a normal tax and a surtax computed as provided in Section 11. In making such computation for purposes of this section, the term "taxable income" as used in Sec. II shall be read as "unrelated business taxable income."

(2) Organizations subject to tax.-- 501(c)(2), (3), (5), (6), (14)(B) or (c) and (17), and Section 401(a). The Taxes imposed by paragraph (1) shall apply in the case of any organization [other than a church, a convention or association of churches (emphasis added) or a trust described in subsection (6)] . . .²²

Regarding the definition of "unrelated business income" the following part of paragraph 2010 in 1969 Federal Tax Course states:

In order to eliminate competitive advantage of exempt organizations over businesses which are taxed on similar income, some "exempt" organizations are taxed on what is known as "unrelated business taxable income" that is, income derived from--

- (a) the operation of a regularly carried on business enterprise which is unrelated to the purpose for which the organization received an exemption, or
- (b) rentals from property leased to others for more than five years (business leases), where the lessor incurred any indebtedness as the result of the purchase or acquisition of the property, or as the result of an

²²Ibid., para. 21,203, Sec. 511(a)(2).

improvement to the property, and any part of the indebtedness is outstanding at the end of the taxable year.

A trade or business regularly carried on is not considered to be substantially related to the activities for which an organization is granted exemption if the income from the business is disproportionate to its size and extent of its tax-exempt activities, or its primary purpose is the production of income, or if it is operated like a commercial business.²³

Perhaps the least complicated, most pragmatically compelling reason for the scrutiny of organized religion's economics is a growing tax squeeze--at all governmental levels--which appears to have set government and a variety of exempt institutions on a collision course. Three decades ago, only about 12 percent of the real property in the United States was tax-exempt. Today, the figure has risen to 20 percent, with valuations of more than \$375 billion. According to one authority this is "more than the combined total real estate in the twenty largest cities in the United States."²⁴ Nationally, according to Martin A. Larson in Church Wealth and Business Income, assuming an average property tax of 50 mills of assessed valuation and 20 mills of true valuation,

all exempt property . . . is now escaping an annual tax levy of \$7 billion, which averages about \$140

²³1969 Federal Tax Course (Chicago, Ill.: Commerce Clearing House, Inc., 1969), p. 2013, paragraph 2010.

²⁴Meyers, op. cit., pp. 77-78.

for every family; the private-exempt is escaping \$2.7 billion, or \$54 for each family; religious organizations alone are avoiding levies of \$1.6²⁵ billion, or \$32 for every family in the nation.

Because of the exemption of churches from the tax on "unrelated business income" the church enjoys an unfair advantage over competing businessmen. This tax immunity on business ventures--by one governmental act suddenly a relatively rare prerogative of religious organizations--spurred their entry into a whole spectrum of business activities. In the process, many erstwhile private enterprises have been removed from the tax rolls, and serious problems have been created for tax-paying competitors. In Dayton, Ohio, for example, the president of a firm called Technology, Inc., complained that he had been underbid on a \$500,000 Air Force contract because the winning bidder, the University of Dayton, is operated by the Roman Catholic Society of Mary and therefore is exempt from corporate income taxes. "The federal taxes we would have paid . . . would have been much more than the \$10,000 less the University of Dayton bid," he said. In New Orleans, another Roman Catholic institution, Loyola University, long has operated profitably (and tax-free) one of the city's three largest radio-TV stations, WWL and WWL-TV, a CBS affiliate.

"When I pay talent or buy feature film," said an

²⁵Balk, op. cit., p. 36.

executive of a competing TV station, "I've got to use after-tax dollars. They use before-tax dollars. If they spend \$100,000 on promotion during rating periods, I need \$200,000 to match it. The university and its station are good citizens in our community, but I can't believe this is a fair thing."²⁶

²⁶Ibid., p. 18.

CHAPTER V
ABUSES BY CHURCHES WITH RESPECT
TO TAX EXEMPTION

Numerous cases, on the part of the church, appear abusive with regard to the tax exemption privileges of the church. The types of business activities in which churches are primarily engaged are classified here into four major types for convenience.

1. Real Estate. By analyzing the tax rolls in 14 U. S. cities, and extrapolating from those figures, Dr. Martin A. Larson, author of the authoratative Church Wealth and Business Income, has estimated the value of tax-exempt church property in 1968 at \$102.5 billion--up 26 percent in the last four years. Larson computes that this item alone, the tax exemption on real estate, cost U. S. taxpayers \$2.2 billion last year.

In some states, church-owned businesses do pay a property tax; in others, they are exempt even from this assessment. Many churches have acquired large tracts of real estate. In 1939, a church purchased a 121-acre tract near New Britain, Conn., and after one body was buried in the tract, the land was classified as a cemetery, which

reduced its taxes. In 27 years, the land appreciated in value many times over. All but ten acres of it was then sold to the city, at a high profit to the church--completely exempt from capital-gains taxes.

In downtown Chicago stands the 22-story Chicago Temple, owned by the Methodist Church. Several lower floors are used for worship and church-related purposes; the other floors are rented for commercial use. The Methodist Church pays a property tax on the commercial portion of the building--but no federal income tax on the rent receipts of \$250,000 a year.

Many church-related colleges have state charters stipulating that their properties shall remain forever tax-free. William Jewell College, for example, a Baptist-related school at Liberty, Mo., owns business realty in many Missouri communities--all tax-exempt.

Hundreds of such investments are speeding the erosion of the tax base in communities across the country, at a time when the revenue need for schools and other essential public services has become acute. "If the trend is not checked, we may expect half or more of all property to be tax-exempt within 25 years--and more than half of that will belong to churches," says C. Stanley Lowell, associate director of Americans United for Separation of Church and State.

2. Profit-Making Enterprises. Each year, through gifts and bequests, churches acquire millions of dollars' worth of property: securities, real estate, thriving businesses. Their tax-exemption advantage makes it tempting for the church to retain and operate the business enterprises. In addition, churches sometimes invest directly in secular businesses.

The Cathedral of Tomorrow, an independent church in Akron, Ohio, owns a shopping center, an electronics company, a plastics and wire plant, an apartment complex, and a girdle factory. A Trappist monastery in Kentucky sells fruitcake, cheese, Canadian bacon and beef-sausage sticks by mail. A church organization owns two major garbage dumps outside Chicago, and leases them to a refuse collector.

Christ's Church of the Golden Rule, near Willits, Calif., purchased a luxurious ranch--once the home of Seabiscuit and other famous race horses. The church members (some 125 in number) live there while operating it as a business. They also own and operate a \$500,000 motel and several other enterprises, all exempt from federal taxation.

Printing of publications for Evangelical United Brethren churches (recently merged into the United Methodist Church) used to require most of the space in a four-story building in Dayton, Ohio. When improved printing methods

made much of that space redundant, the denominational officials obtained contracts to print a brand of trading stamps.

The money involved in these business operations can be considerable. As noted above, the Washington, D. C., Watergate high-rise luxury apartment complex beside the Potomac River (a \$70 million venture) was financed by an Italy-based real estate company in which the Vatican is said to have controlling interest.

There are now some 2200 tax-exempt nursing and retirement homes in operation. Where these are operated for the welfare of needy patients, on a non-profit basis, they are properly tax-exempt. But increasing numbers of churches are using their tax-exempt status to turn them into money-making enterprises. In some cases, entry fees may run as high as \$50,000 plus monthly charges of several hundred dollars, and the sponsoring church may amortize the entire facility within five or six years.

For federal and state governments, church-owned and church-operated businesses represent a large loss of revenue--taxes that would be collected if the enterprises were run by competitive private industry. It is impossible to calculate the loss exactly, but responsible estimates put it at \$6.5 billion a year.²⁷

²⁷Ibid., p. 39.

3. Lease-Back Operations. The lease-back device is one of the fastest growing ways for churches and other tax-exempt institutions to make money. An item in the Prentice-Hall Executive Tax Report reads: "Have you put a price on your business? You may be able to double it--by selling to a charity." And an ad in the Wall Street Journal: "Highly respected charitable fund (non-profit) will purchase closely held companies with minimum pre-tax profit of \$250,000. Financial and other benefits very rewarding."

Any church organization, however small, can make use of this tax advantage. For example, an enterprising executive of White Plains, N. Y., together with two ministers, organized the "Stratford Retreat House," which assumed churchly functions. According to the literature of the Retreat House, its managers purchased, as a church, on lease-back arrangements, several businesses, principally electronics firms.

Yet, the U. S. Supreme Court has refused to close this loophole in the tax laws, and Congress has rejected legislation that would eliminate it.

4. Investment Borrowing. Most significantly at the federal level, Assistant Secretary of the Treasury Stanley S. Surrey in 1966 asked Congress to eliminate tax exemptions on "bootstrap purchases" by non-profit organizations--including religious and related institutions. In

doing so, he released a statement of more than transitory significance for its brevity and clarity in reviewing the perplexing economic and political questions inherent in this controversial concession. Surrey's case, in part, against the advisability of this exemption as sound policy for either the public or the churches is as follows:

First, in any acquisition in which the purchase price is to be financed from the future earnings of the transferred property, tax-exempt organizations are peculiarly suited to pay a substantially higher price--and pay it more rapidly--than a taxable purchaser could afford. They can, in effect, make available to the seller the additional business earnings which would have been paid to the Government as taxes had the purchaser been taxable. . . . With the dual attractions to sellers of high prices and Supreme Court-approved capital gains treatment, it seems quite likely that, unless something is done, a substantial unplanned shift of productive property to the exempt sector of our economy will occur. . . .

A second undesirable result typically attends borrowing by exempt organizations for investment purposes. The price inflation characteristic of Brown-type transactions . . . deflects, to the personal benefit of private parties, a substantial portion of the advantage which Congress intended tax exemption to produce for the organizations upon which it conferred the exemption. . . .

A third unfortunate consequence follows from exempt-organization borrowing. This investment borrowing enables an exempt organization to convert its tax exemption into a self-sufficient device for the production of capital . . . the organization which makes such use of its exemption can sever itself from reliance upon contributors or members and eliminate the healthful scrutiny of its purposes and activities which that reliance implies. By this extension of its separation from dependence upon contributors or members, the organization begins a multiplication of its holdings which bears no relation to the community's evaluation of its exempt activities; it embarks upon an extension of its economic holdings which is limited only by the financial acumen and commercial skills of its managers.²⁸

²⁸Ibid., pp. 39-41.

CHAPTER VI

REMEDIAL ACTION NECESSARY

Many churchmen as well as church groups and other religious organizations have indicated a desire for reform of the church tax exemption. Perhaps the most vigorous orientation toward change has occurred in the Roman Catholic Church--much of it stimulated by such Vatican II declarations as that of Cardinal Giacomo Lercaro: that the church's imperative requirement is "holy poverty"; "a definition of the ways in which the material resources of the Church may be used . . . in accordance with the words: 'Gold and silver have I none, but what I have I give you.'" This spirit, for example, has moved a group of Chicago priests to openly challenge Cardinal John P. Cody's ten-year, \$250-million building program as "placing too much emphasis on organizational structure and outdated forms of the church." The church, they warned, "may well be harnessed by an over-structured development and thereby endanger its present and future mobility."²⁹

²⁹Ibid., p. 41.

Episcopalians also have sharply questioned the spending of more money on the towering Washington, D. C. Cathedral, which has cost \$30,000,000 to date and will require at least \$20,000,000 more to complete. Indeed, spokesmen for several faiths have proposed a moratorium on all new church construction for a year, two, even five years.

A report of a National Council of Churches Study Committee on Tax Exemption for Churches listed as one of its "guiding principles": "For itself the church asks of government no more than freedom. . . . In the final analysis . . . the question of whether churches are granted . . . tax exemptions is peripheral to the church's ability to function and carry out its mission. . ." ³⁰

In 1958, the General Assembly of the United Presbyterian Church in the U. S. A. requested its denominational foundation "to make no investment in unrelated business where such income tax exemptions are allowable." In 1963 it further recommended that "congregations be encouraged to take the initiative in making contributions to local communities, in lieu of taxes, in recognition of police, fire, and other services provided by the government. . ." ³¹

Leading religious publications also advocate tax reform. Says the Jesuit magazine America: "On the face of it, no exempt organization should be allowed to operate an unrelated business tax-free." Catholic World cautions: "If churches enjoy the same tax exemption on secular

³⁰ Ibid., p. 48.

³¹ Ibid.

activities as other agencies, they must also be prepared to forsake special exemptions when they engage in business activities unrelated to their religious or eleemosynary mission."

The Christian Science Monitor terms modification of the exemption on unrelated business income imperative "to prevent American taxpayers from having in effect to subsidize religious forays into the competitive market place." Christianity Today points out that because "open-end opportunity for ecclesiastical involvement in untaxed business activities" tends to "entangle the church in economic administration to the detriment of her principal task" and "invites morally unjustifiable arrangements for financial advantage to churches . . . the time is propitious for sweeping study of the principle on which taxation and tax exemption rest."

CHAPTER VII

ATTEMPTS AT REFORM

A few nonprofit organizations already are volunteering payments to local governments in lieu of taxes. Near the end of 1967, the tax-exempt Twentieth Century Fund in New York City, in one of the most publicized such gestures, announced contribution of \$10,000 to the city because, as an executive stated, "we are convinced that we have a civic responsibility to make some payment for the municipal services furnished to us." Several churches have adopted similar policies. In Cleveland, for example, the minister of the Unitarian Society asked his congregation to donate \$10,000 to the city in lieu of taxes, and in Des Moines the Central Presbyterian Church voted to contribute up to \$4,000 a year to city government--in addition to selling two parsonages and thenceforth paying its ministers monthly housing allowances.

Increasingly, too, support is mobilizing for requiring religious organizations to file public financial accountings, as now is the law in Canada. "All financial

dealings of religious organizations should be made a matter of public record, unless a specific definite reason can be formulated for restricting information about a particular item," says the Reverend John L. Reedy, editor and publisher of Ave Maria.³² Indeed, according to Andrew D. Tanner in his study for the National Conference of Christians and Jews, a uniform law on tax exemption of church-related property should be formulated.³³

The uniform law should provide:

- a) for listing, valuation, and reason for exemption of property on the tax rolls;
- b) for exemption of places of worship and necessary auxiliary land and buildings, property used for religious activities (including parking lots);
- c) that part of the property not used exclusively for church purposes, and which produces income from business rentals or other operations should be taxed;
- d) church property held for future use or speculation, whether vacant or improved, should go on the tax roll, but be removed (without waiting for tax assessment date) as soon as used for church purposes;
- e) as to income taxes, tax liability should be determined by the source of income, rather than use to which the income is put.³⁴

Today, however, there are serious reasons for breaking the habit of secrecy. Church funds, after all, are trust funds--not just a trust for the church itself conceived as an organization, but a trust for the People of God and for all men. One of the most fundamental rights

³²"Churches and Taxes," Ave Maria, Ave Maria Press, Congregation of the Holy Cross, Notre Dame, Indiana (January 18, 1964).

³³Ibid., p. 53.

³⁴Ibid.

of a beneficiary is at the mercy of the trustee. And the institutional Church's mercy is not always gentle, much less efficient.

Undoubtedly, there are some special problems to be solved in the composition of annual financial reports for churches. The problems, however, are no more difficult than those confronting American business in its efforts to make itself financially comprehensible. It takes a certain amount of skill to understand the annual report of a major corporation like General Motors. It will also take skill, as well as curiosity, to learn anything from the annual financial report of the Roman Catholic Church in the United States.

Financial reports to the clergy, laity and public would be an important symbol of the trusteeship of religious congregations and the hierarchy. Such trusteeship needs to be emphasized today, when murmurs about Church wealth increase daily. It is time to make clear what the Church is doing with what it has.³⁵

When one remembers that churches pay no inheritance tax (churches do not die), that churches may own and operate business and be exempt from the 53 per cent corporation income tax, and that real property used for church purposes (which in some states are most generously construed) is tax exempt, it is not unreasonable to prophesy that with reasonable prudent management, the churches ought to be able to control the whole economy of the nation within the predictable

³⁵Ibid., pp. 90-91.

future.

America's religious community is rich--richer than any counterpart in recent history; richer than even most ecclesiastical leaders in this country are willing to concede.³⁶

Indeed, when Dr. Eugene Carson Blake's provocative statement quoted above was publicized, it not only shocked but angered many churchmen. But it is not a visionary forecast. American organized religion has become an economic behemoth and already, more than most devout local parishioners will allow themselves to admit, it has assumed the broad characteristics of business--emulating the corporate-oriented administrative, financial, and public relations objectives of the marketplace. And the internal yardsticks by which its leaders most often measure its progress have become those of the marketplace.³⁷

Opposition to the tax-free position of the church has been based on both ideological and economic grounds. In the first category are arguments that churches should bear a fair share of the burden of government: that the acceptance of exemption is inconsistent with the claimed support of separation and opposition to direct grants to parochial schools; that the acceptance of exemption makes it difficult for churches to criticize the governments that aid them; that non-believers should not be forced

³⁶Ibid., p. 98.

³⁷Ibid., p. 36.

to contribute to the church, even indirectly; and that exemption encourages the construction and maintenance of more churches than are needed.

The economic argument was stated by President Grant in a message to Congress in 1875:

In 1850, I believe, the church property of the United States which paid no tax, municipal or State, amounted to about \$83,000,000. In 1860 the amount had doubled; in 1875 it is about \$1,000,000,000. By 1900, without check, it is safe to say this property will reach a sum exceeding \$3,000,000,000. So vast a sum, receiving all the protection and benefits of Government without bearing its proportion of the burdens and expense of the same, will not be looked upon acquiescently by those who have to pay the taxes. In a growing country, where real estate enhances so rapidly with time, as in the United States, there is scarcely a limit to the wealth that may be acquired by corporations, religious or otherwise, if allowed to hold real estate without taxation. The contemplation of so vast a property as here alluded to without taxation may lead to sequestration, without constitutional authority and through blood.

I would suggest the taxation of all property equally, whether church or corporation, exempting only the last resting-place of the dead, and possibly, with proper restrictions, church edifices.

As can be seen, the severe economic consequences of exemption have been disputed; and the studies made indicate that exemptions of religious properties and organizations add but little to the community's tax burden, although the extent of the burden is increasing steadily, and voices of concern are being heard with growing frequency.³⁸

Nothing, of course, came from President Grant's suggestion; and the frequent attacks on exemption during the ninety years since President Grant's address have had

³⁸Americans United, op. cit., p. 22.

no concrete effects. A report of a New Mexico commission in 1920 reveals the hopelessness with which some public bodies approach the problem:

The exemption from the property tax, while in our opinion quite illogical and provocative of much abuse, has apparently met with the general public approval and the support of churchgoers and other beneficiaries who are instrumental in the formation of public opinion. It seems useless to criticize these exemptions although it should be obvious that whatever reason may exist for holding this property as private property is equally good reason for paying taxes thereon.³⁹

As one writer put it: "the tax exemption battle of the churches seems to have been won by exhaustion."

Long before the Everson and McCollum decisions, the constitutionality of tax exemption for churches was seriously questioned. Madison, as has been noted, doubted its constitutionality. Zollman, a writer favorable to state aid to religion, pointed out that:

This exemption is not so easily justified on principle as it is supported by authority. . . . While charity and education may be said to be established in the policy of the state, and establishment of religion is expressly prohibited by the Federal Constitution and impliedly by all but one of the State Constitutions. The strictly religious features of church societies can therefore furnish no valid reason for the exemption.⁴⁰

³⁹Ibid.

⁴⁰Ibid., pp. 15-22.

Some of the older state court decisions evinced the same doubts of the constitutionality of tax exemption for churches. One court stated:

It is easier to admire the motives for such exemption than to justify it by any sound argument. . . . Only let the theory be carried a little further; let a specific tax be levied to support houses of worship, and it will speedily attract public attention. Yet the one is precisely the same in principle as the other. . . . To say that such is the practice of civilized nations is not sound. It is rather an apology for a departure from principle.⁴¹

Nevertheless, before the Everson and McCollum decisions defined the limitations imposed by the establishment clause on Federal and state governments alike, tax exemption for religious bodies was universally upheld under state constitutions. In 1877 the Supreme Court of Iowa, without giving any reason, ruled that such a statute did not violate state constitutional provisions that:

the General Assembly shall make no law respecting the establishment of religion . . . nor shall any person be compelled to . . . pay . . . taxes, or other rates for . . . the maintenance of any minister, or ministry.⁴²

In 1928 the Illinois Supreme Court sustained a similar statute on the grounds that the states in a Christian nation such as ours should encourage religious establishments to build up "the moral character and better impulses of the heart," and that the constitution is not

⁴¹Ibid.

⁴²Ibid., p. 217.

violated if all religions are benefited without discrimination.

Objective consideration of the opinions in the *Everson* and *McCullum* cases leads to the conclusion that tax exemption for churches violates the First Amendment as interpreted by these decisions. This is the conclusion reached in two carefully considered articles. This conclusion can hardly be avoided if the language of these opinions is to be given its fair meaning. Under these decisions, government aid to religion, even if not preferential or discriminatory, is barred by the Constitution, and few would deny that exemption of church property constitutes government aid. Indeed, according to Dean Sperry of the Harvard Divinity School, the tax exemption of churches is "the most important governmental recognition of religion in America," a view echoed, as we have seen by President Bennett of Union Theological Seminary.

The real question is whether the *Zorach* case has made a difference. The *Everson* and *McCullum* decisions recognized no qualifications to the absoluteness of the separation between church and state. According to the *Zorach* decision, however, "the First Amendment . . . does not say that in every and all respects there shall be a separation of Church and State." Moreover, "we are a religious people," and therefore the state may encourage

religious education.

Language such as this may well be construed as a qualification of the scope of the Everson-McCollum principles and as the creation of an opening in the wall between church and state sufficiently large for tax exemption to creep through.⁴³

If Congress does not take action, the Courts may intervene in considering a review of the current tax status of churches. Several lower courts have taken judicial notice of changing relationships which could lead to reinterpretation of laissez-faire exemption policies.

The Supreme Court, too, in several revealing declarations, has indicated that the over-all effect of religious tax exemptions, not merely their history of tacit approval over the years, could be a basis of later redefinition of their propriety under the First Amendment prohibition of state "establishment" of religion.⁴⁴

⁴³Ibid.

⁴⁴Balk, op. cit., p. 42.

CHAPTER VIII

STATEMENTS BY CHURCH GROUPS AND OFFICIALS IN FAVOR OF REFORM

Representative policy statements have been made by numerous church organizations regarding the tax exemption of churches. Several parts of the statements and reports are cited below:

We do not perceive any justification for government policies and practices which accord special privileges to or provide differential treatment of churches in the matter of exemption from tax liability. It is our conviction that the special treatment accorded to "churches and conventions or associations of churches" with respect to exclusion of their unrelated business income from federal income taxation ought to be discontinued. Nor do we believe there is any justification for relieving churches of the obligation of reporting their earnings in the same manner that is required of other charitable organizations. We are persuaded that discrimination in favor of churches in government taxation is just as pernicious as discrimination against religious groups.⁴⁵ From Report of a Study Commission on the Methodist Church and Church-Government Relations (Presented to the General Conference of the United Methodist Church, 1968)

(c) The United Presbyterian Church continues efforts to obtain repeal of the section of the Internal Revenue Code that allows "churches and church organizations" exemption from the corporate income tax on profits of businesses unrelated to the purpose

⁴⁵Ibid., p. 61.

or activity of the church or church organization.⁴⁶
 From Report of the Special Committee on Relations
 between Church and State in the U. S. A. United
 Presbyterian Church in the U. S. A. (Adopted by the
 175th General Assembly, May, 1963).

Income from unrelated businesses owned by religious organizations is not now taxed (except to the extent such businesses are operated as independent, taxable corporations). In this respect, religious organizations are favored over even educational and charitable ones. Such unrelated businesses are operated in actual or potential competition with secular businesses and should be accorded similar tax treatment.

The majority also believe that religious organizations should recognize the unfairness of their competitive business advantage. To reduce this advantage, religious organizations should operate their businesses subject to the same income taxes as their competitors.⁴⁷

Question: Is your group averse to the current "unrelated business income" privilege for churches?
 Conference opinion: Yes, because federal income tax exemption tends to 1) encourage promotion of or participation in secular business to the detriment of the principal mission of the church; 2) to encourage morally unjustifiable arrangements with businessmen or companies to reduce their income taxes; 3) discourage financial support of church activities by voluntary contributions of all members.⁴⁸

⁴⁶Ibid., pp. 66, 73, 88.

⁴⁷Ibid., pp. 90-91.

⁴⁸Ibid.

We would recommend the initiation of informal discussions between Church spokesmen and government officials to begin a gradual solution of a situation which could grow into a serious problem for all the churches.⁴⁹

Financial reports to the clergy, laity and public would be an important symbol of the trusteeship of religious congregations and of the hierarchy. Such trusteeship needs to be emphasized today, when murmurs about Church wealth increase daily.⁵⁰

In April the Oregon House of Representatives voted 0 to 19 to tax houses of worship. The bill was considered to have a good chance of passage in the Senate and of becoming law in the State of Oregon. If so, Oregon would be the first state in the Union to impose a direct levy on churches. It will be recalled that Vermont almost made it last year. The bill was caught in the log-jam at adjournment and did not come up.

Regardless of whether the Oregon bill passes this year or not, it seems obvious that we are moving steadily closer to some kind of tax on the churches. One has only to remember the massive effort to change the Pennsylvania Constitution in the matter of the religious exemption last year. There are many other straws in the wind.

⁴⁹Wilbur D. Bendict, "Church Owned Business: Stretching Religion," Christianity Today, vol. 13 (Washington, D. C., 1969), pp. 48-49.

⁵⁰Ibid., pp. 90-91.

It is evident that we are now in the process of rethinking the entire issue of religious tax exemption. At this point one can only say that change is bound to come. The exact nature of this change is difficult to predict.⁵¹

⁵¹Ibid., p. 11

CHAPTER IX

CONCLUDING REMARKS

At the time of the exemption of churches from payment of income taxes, the church functioned as the major provider of philanthropic and welfare services. Within the past quarter-century, however, the government has taken an increasingly active role in providing philanthropic and welfare aid through numerous programs. Thus, the church has been relieved of a significant portion of such activities.

The recent expansion and growth of church business activities (especially within the past half-century) has placed the church in an especially strong financial position in the United States today. The extent of such business involvement by churches should be recognized by the taxpayer, the businessman and the Federal Government.

A comparison should be made between the original underlying reasons for the exemption and the activities of the church today. Once this comparison is made, and conclusions are reached, measures should be taken to bring the church's tax position in line with the role which the

church is expected to play in today's society.

It is my contention that the current degree of business involvement by churches does not coincide with the primary purposes originally intended when tax privileges were granted the church. Because of this situation, I have proposed the remedial tax reform, which I feel is necessary, and yet will allow the church to accomplish its primary purposes.

This is in no way intended as an attempt to stifle church aims but only an attempt to bring the church and its tax position into proper perspective. Greater wealth-- more property, more privilege, more materialism can never be the instrument of the churches' salvation.

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