MASQUERADING CHURCHES: ABUSING THE INTERNAL REVENUE CODE TO AVOID FINANCIAL TRANSPARENCY

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Abstract

Tax exemption for charitable institutions has a long history in the United States. The Internal Revenue Code confers additional special advantages to "churches," a nebulous category distinct from "religious organizations." Generally, tax-exempt organizations need not pay income and property taxes. Churches are also exempt from publicly reporting annual finances or even filing for tax-exempt status in the first place. This special treatment has deep historical roots (if not extensive justification). However, a troubling recent trend shows "religious organizations" masquerading as "churches." There are several reasons to do this—from more benign motivations like ease of filing and minimizing fees to more nefarious goals like avoiding transparent public financial disclosure and deceiving donors. This trend thus matters because public trust and substantial donor dollars are at stake. Unfortunately, the Internal Revenue Service's current laissez-faire approach to investigating or correcting these miscategorizations all but encourages them. Lack of easily employable audit rules for churches, coupled with a near-complete lack of actual audits in the past decade, has created an environment ripe for abuse of the distinction between "religious organization" and "church."

This shift is currently happening even among organizations that fail to meet the requisite "church" criteria by their own admission and simply seek to obfuscate non-charitable uses of donors' funds like political activity or private inurement. These actions should mean loss of tax exemption. However, loss of tax exemption is extremely rare. Congress and the Internal Revenue Service should take these abuses more seriously and develop a stronger framework for catching and prohibiting religious organizations from improperly claiming "church" status. This framework should include exercising existing auditing power, revisiting financial disclosure requirements, and requiring churches to apply for tax-exempt status. The "church advantage" is clearly baked into the legislative history and current regulation around tax exemption, but this advantage does not and should not extend to fraudulent activity that harms church donors and taxpayers.

I. Introduction

Despite not hosting regular religious services and lacking an established place of worship or a regular assembly of congregants, the Billy Graham Evangelist Association (BGEA) classifies itself as a "church," rather than a "religious organization," under the Internal Revenue Code (IRC).[1] So, too, does Gideons International (Gideons), the famous distributor of hotel bedside Bibles[2]—despite explicitly stating on its website that it is neither a denomination nor a church.[3] Other organizations that claim the IRC's special tax status for churches include Focus on the Family,[4] which champions heterosexual Christian marriage and condemns abortion;[5] Ethnos360, which sends missionaries throughout the world;[6] and Campus Crusade for Christ, a sprawling and well-funded organization which evangelizes on college campuses.[7] Many of these

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[1] Sarah Pulliam Bailey, *Major Evangelical Nonprofits Are Trying a New Strategy with the IRS that Allows Them to Hide Their Salaries*, WASH. POST (Jan. 17, 2020, 8:36 AM), https://www.washingtonpost.com/religion/2020/01/17/major-evangelical-nonprofits-are-trying-new-strategy-with-irs-that-allows-them-hide-their-salaries/ (describing the BGEA's tax-exempt status).

[2] Samuel Brunson, *The Conversation: What's a Church? That Can Depend on the Eye of the Beholder or Papers Filed with the IRS*, SALT LAKE TRIB., https://www.sltrib.com/religion/2020/02/06/conversation-whats/ (last updated Feb. 6, 2020, 4:08 PM) ("Gideons International—an association of businessmen and their wives who leave Bibles in hotel rooms ….").

[3] *Frequently Asked Questions*, GIDEONS INT'L, https://www.gideons.org/faq [https://perma.cc/863D-9G92] ("Is The Gideons International a denomination or church? Neither.").

[4] Michael Gryboski, *Focus on the Family Defends IRS Classification as a 'Church,' Says It's Meant to Protect Donors*, CHRISTIAN POST (Apr. 20, 2018), https://www.christianpost.com/news/focus-on-the-family-defends-irs-classification-as-a-church-says-its-meant-to-protect-donors.html [https://perma.cc/GKJ9-UP2N] ("Focus on the Family is defending its decision to have the Internal Revenue Service officially reclassify the Christian nonprofit as a 'church,' denouncing the efforts of some to ascribe 'sinister' intentions to the change.").

[5] *Our Vision*, FOCUS ON THE FAM., https://www.focusonthefamily.com/about/foundational-values/ [https://perma.cc/9SFX-G7KX] (outlining Focus on the Family's mission and goals).

[6] *About*, ETHNOS360, https://ethnos360.org/about [https://perma.cc/YQH3-CZ5W] ("Today more than 3,000 missionaries serve throughout the world ….").

[7] Tim Townsend, *Should Your Favorite Ministry Becomes a 'Church'?* CHRISTIANITY TODAY (Nov. 23, 2016), https://www.christianitytoday.com/ct/2016/december/should-parachurch-become-church-bgea-franklin-graham-irs.html

organizations have made the switch recently—Focus on the Family in 2015,[8] BGEA in 2016,[9] and several more in the past few years.[10]

These designations matter because "church" has a specific legal meaning under the IRC.[11] Moreover, "churches" are distinct from "religious organizations." The tax treatment for these two types of religious institutions also differs from the more general treatment for charitable organizations, familiarly known as IRC § 501(c)(3) organizations. Treatment differs, too, for each type of religious institution. Institutions that qualify as "churches" have a distinct advantage—called the "church advantage" in this Note—beyond other types of religious institutions or tax-exempt organizations. Broadly stated, this advantage permits churches to avoid paying income and property taxes while also the dodging the tax-exempt application process and financial disclosures required of other charitable organizations.

This Note explores the history of church tax treatment, the debate surrounding the church advantage, and the ramifications of a troubling

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[https://perma.cc/2SRY-S8HX]; *see also* Raul Rivera, *Billy Graham Evangelistic Association Changes Its Tax Status*, STARTCHURCH (Mar. 12, 2017), https://www.startchurch.com/blog/view/name/billy-graham-evangelistic-association-changes-its-tax-status ("Besides BGEA, examples of other operating parachurch ministries include Campus Crusade for Christ (Cru) ….").

[8] Brunson, *supra* note 2; *see also* Miranda Blue, *Focus on the Family Has Declared Itself a Church, Avoiding IRS Disclosure Rules*, RIGHT WING WATCH (Feb. 20, 2018, 2:14 PM), https://www.rightwingwatch.org/post/focus-on-the-family-has-declared-itself-a-church-avoiding-irs-disclosure-rules/ ("But when the group posted a Form 990 for the 2015 fiscal year on its website—dated October 26, 2017, and reporting a massive budget of $89 million—it was emblazoned with the message 'Not required to file and not filed with the IRS. Not for public inspection.'").

[9] Richard H. Levey, *IRS Reclassifies Billy Graham's Organization*, NONPROFIT TIMES (Sept. 26, 2016), https://www.thenonprofittimes.com/npt_articles/irs-reclassifies-billy-grahams-organization/ [https://perma.cc/EF8L-V6DQ] (detailing that the BGEA received a determination letter from the IRS regarding approving its church status).

[10] Bailey, *supra* note 1 ("Several major evangelical organizations have in recent years moved to a new strategy where they shift from a nonprofit status to a 'church' status with the IRS, allowing them to keep private exactly how their money is being spent and the salaries of their most highly paid employees.").

[11] *See* INTERNAL REVENUE SERV., PUBLICATION 1828, TAX GUIDE FOR CHURCHES & RELIGIOUS ORGANIZATIONS 33 (rev. 2015), https://www.irs.gov/pub/irs-pdf/p1828.pdf [https://perma.cc/47MD-23N4] (explaining that "church" here does not connote only Christian houses of worship and that it applies to any denomination or tradition as long as it fits within the various IRS requirements for the term).

trend: *religious organizations self-identifying as churches to gain the church advantage*. This Note calls this maneuver the "church masquerade." It asks (1) whether treating "religious organizations" as "churches" diverges from the historic and current rationales for permitting churches greater tax benefits than other charitable entities, (2) what impacts arise from this trend, and (3) how the Internal Revenue Service (IRS) and Congress should respond. This Note argues that (1) religious organizations were never intended to be treated as churches, and that the current shift breaks with both legislative history and current rationales for the church advantage, (2) in addition to impermissibly broadening the IRS's intentional church/religious organization distinction, the church masquerade also fosters a lack of financial transparency that abuses the church advantage and harms donors, and (3) to better serve the letter and spirit of tax law, Congress and the IRS should implement common-sense changes and require churches to formally apply for tax-exempt status, file public Form 990 financial disclosure forms, and clarify the rules of its auditing program to catch masquerading churches.[12]

This Note begins with an explanation of the tax law behind the church advantage in Section II. Section III then explores why religious organizations choose to call themselves churches and summarizes existing critiques of the church advantage. Section IV explores the Congressional intent behind the church advantage and discusses the current rules around church audits. Section V provides three common-sense recommendations for halting improper redesignations of religious organizations as churches. Section VI concludes the Note.

II. Why Are Churches Granted Special Tax Status?

Significant advantages arise from qualifying as a "church" rather than a "religious organization"—advantages that masquerading churches can use to obscure their finances and avoid donor transparency.[13] The IRC affords "churches" far more financial privacy than other tax-exempt

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[12] John Burnett, *Onscreen but Out of Sight, TV Preachers Avoid Tax Scrutiny*, NPR (Apr. 2, 2014, 4:03 PM), https://www.npr.org/2014/04/02/298373994/onscreen-but-out-of-sight-tv-preachers-avoid-tax-scrutiny [https://perma.cc/F2HA-TVUR] (describing how during 2009 to 2014, the IRS did not audit a single church).

[13] Robert W. Wood, *The Church of Kanye and the IRS*, FORBES (Nov. 14, 2019, 8:58 AM), https://www.forbes.com/sites/robertwood/2019/11/14/the-church-of-kanye-and-the-irs/#4e16b5454e37 [https://perma.cc/NUS7-6ASM] ("[F]or a tax-exempt organization, church status is truly the gold standard.").

organizations, including "religious organizations," and makes it easy to qualify as a church. In fact, the IRC treats churches differently than any other tax-exempt organization, exempting them from most of the requirements imposed on religious organizations, public charities, private foundations, and other tax-exempts.[14] These requirements include applying for tax-exempt status and filing an annual Form 990, which provides the IRS and the public with financial information about a tax-exempt organization.[15] As such, organizations making the switch from "religious organization" to "church" can raise serious questions about financial transparency and the potential for abuse of churches' special tax-exempt status.

A. IRC § 501(c)(3): Tax-Exempt Status

The initial threshold question for any organization—including churches and religious institutions—seeking a tax-exempt status is whether it is organized and operated exclusively for a recognized tax-exempt purpose.[16] Religious purposes can qualify an organization as tax-exempt.[17] To determine whether an institution is organized and operated exclusively for a tax-exempt purpose, courts use the "organizational test" and the "operational test." The "organizational test" interrogates the organization's purposes as articulated in its governing documents and examines how it uses its assets.[18] The "operational test" examines an organization's actual activities.[19] In addition, to be tax-exempt, religious institutions must not

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[14] *See* INTERNAL REVENUE SERV., *supra* note 11, at 33 (detailing how the IRS defines a "church").

[15] *Id.* at 28 (describing the filing requirements for churches or religious organizations).

[16] Treas. Reg. § 1.501(c)(3)–1(a)(1) ("In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.").

[17] I.R.C. § 501(c)(3) (granting tax exemption to qualifying "[c]orporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes ….").

[18] *See, e.g.*, Hall v. Comm'r, 729 F.2d 632, 634 (9th Cir. 1984) (finding a congergation that distributed its assets upon dissolution to non-charitable causes to fail the organizational test).

[19] *See, e.g.*, Living Faith, Inc. v. Comm'r, 950 F.2d 365, 375 (7th Cir. 1991) (finding the Living Faith Church, which primarily operated two vegetarian restau-

intervene in political campaigns, make substantial attempts to influence legislation, or promote a purpose that is illegal or contrary to public policy.[20]

Despite the language in § 501(c)(3) requiring that an organization be organized and operated "exclusively" for tax exempt purposes, the Treasury regulations clarify that organizations may engage in limited other activities.[21] Courts have refined this requirement over the decades to permit "insubstantial" amounts of activity unrelated to an exempt purpose, but the organization's purpose must not empower it to engage in more than insubstantial non-exempt activities.[22] Tax-exempt organizations, including religious ones, can engage in some commercial practices as long as the commercial activity is either (1) "incidental" to the exempt purpose and has not assumed an "independent importance and purpose"[23] or (2) dedicated to furthering the tax exempt purpose.[24] Neither the IRC nor the Regulations provides a definition for "incidental," but courts have routinely analyzed the level of commercial activity and its permissibility according to a case's particular facts and circumstances.[25] "Various

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rants, not to be operating primarily for tax-exempt purposes and thus revoking its tax-exempt status).

[20] INTERNAL REVENUE SERV., *supra* note 11, at 2 (explaining the tax-exempt status). Some courts also include these analyses of political activity, public policy, and private inurement into the operational test. *See, e.g.*, Church of Scientology of Cal. v. Comm'r, 823 F.2d 1310, 1315 (9th Cir. 1987) (describing the four elements of the operational test).

[21] I.R.C. § 501(c)(3) (stating that, to qualify for tax exemption, organizations must be "organized and operated exclusively for [tax exempt] purposes").

[22] Treas. Reg. § 1.501(c)(3)–1(b)(1)(B) (stating that, to qualify as tax-exempt, organizations must "not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes"); Treas. Reg. § 1.501(c)(3)-1(c)(1) ("An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in [tax exempt] activities.").

[23] Treas. Reg. § 1.501(c)(3)–1(c); *see also* Church of Scientology of Cal. v. Comm'r, 83 T.C. 381, 459 (1984).

[24] *See Living Faith, Inc.*, 950 F.2d at 370 ("The fact that an organization's primary activity may constitute a trade or business does not, of itself, disqualify it from classification under § 501(c)(3), provided the trade or business furthers or accomplishes an exempt purpose.").

[25] *Id.* at 371 ("[N]either the Internal Revenue Code, the regulations, nor the case law provides a general definition of 'insubstantial' for purposes of section 501(c)(3).").

objective indicia" guide the analysis.[26] Factors include the manner in which an organization conducts activities, the "commercial hue" of those activities, competition with commercial organizations, and profit accumulation.[27] Merely incidental commercial activity does not threaten tax-exempt status, but may be taxable as unrelated business income.[28]

B. Private Inurement

As part of the operational test, an organization's tax-exempt purposes must benefit a sufficiently large class of beneficiaries—not just a few select individuals.[29] In other words, tax-exempt organizations may not use net earnings for "private inurement" to individuals "having a personal and private interest in the activities of the organization."[30] The IRS often refers to these individuals as "insiders," which include ministers, board members, officers, and sometimes employees.[31] Net earnings in this context exclude *reasonabl*e ordinary and necessary expenditures such as wages and facilities expenses.[32] On the other hand, net earnings do include gross income and assets, meaning that private inurement can include payment to individuals directly from gross income.[33] Importantly, the prohibition against private inurement does not have a de minimus exception: even a "small amount" of income used for private inurement is enough to dis-

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[26] *Id.* at 372.
[27] *Id.*
[28] I.R.C. § 512(a)(1) (outlining the rules for unrelated business taxable income).
[29] Treas. Reg. § 1.501(c)(3)–1(c)(2) (including the prohibition against private inurement in the organizational test for tax exemption); Treas. Reg. § 1.501(a)–1(c) (defining "individuals").
[30] Treas. Reg. § 1.501(c)(3)–1(c)(2) ("An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.").
[31] INTERNAL REVENUE SERV., *supra* note 11, at 5.
[32] *See* Birmingham Bus. Coll., Inc. v. Comm'r, 276 F.2d 476, 480 (5th Cir. 1960) ("[T]he payment of reasonable compensation, or even the anticipated expectation of such payment, does not constitute earnings inuring to the benefit of those who create a tax exempt organization …."); Church by Mail, Inc. v. Comm'r, 765 F.2d 1387, 1392 (9th Cir. 1985) ("Although reasonable salaries may be paid to clergy, the payment of excessive salaries constitutes inurement to the benefit of a private person.").
[33] Founding Church of Scientology v. United States, 412 F.2d 1197, 1201 (Ct. Cl. 1969) (finding a salary of 10% of the church's gross income for part-time work excessive, and thus private inurement).

qualify an organization from tax exemption.[34] Moreover, private inurement can arise from a variety of contexts, including purchase of "furs, cars, planes, boats, gold coins, and real estate" (to quote one Fifth Circuit case);[35] advantageous loans;[36] leases;[37] payment of personal expenses;[38] and "excess benefit transactions" that transfer property or benefits for below market value.[39]

C. Churches, Affiliated Organizations, and Religious Organizations

Under IRC § 501(c)(3), public charities that serve religious purposes may be "religious organizations" or "churches."[40] To further confuse matters, organizations "affiliated" with a church may also qualify for the advantageous tax treatment of churches themselves if, under a facts and circumstances test, the organization can demonstrate sufficient affiliation with a church.[41] These are deemed "integrated auxiliaries," defined as an organization that is (1) described in § 501(c)(3) and § 509(a),[42] (2) affilia-

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[34] Church of Scientology of Cal. v. Comm'r, 823 F.2d 1310, 1316 (9th Cir. 1987); Orange County Agric. Soc'y, Inc. v. Comm'r, 893 F.2d 529, 534 (2d Cir. 1990) ("An organization will not qualify for tax-exempt status if even a small part of its income inures to a private individual.").

[35] United States v. Daly, 756 F.2d 1076, 1083 (5th Cir. 1985).

[36] Unitary Mission Church v. Comm'r, 74 T.C. 507, 515 (1980) (finding loan arrangements lacking "any fixed criteria" and charging no interest to be private inurement).

[37] *Orange County Agric. Soc'y, Inc.*, 893 F.2d at 531 (finding a lease arrangement that enabled functionally cost-free land use private inurement).

[38] Treas. Reg. § 1.501(c)(3)–1(f)(2)(iv), Example 3 (describing how payment of personal funds violates the statutory prohibition against private inurement).

[39] Treas. Reg. § 1.501(c)(3)–1(f)(2)(iv), Example 4. ("The sale of the building by O to Company K at less than fair market value constitutes an excess benefit transaction … [which] violates the proscription against inurement under section 501(c)(3) ….").

[40] I.R.C. § 501(c)(3) (enumerating exempt organizations).

[41] *See* Treas. Reg. § 1.501(c)(3)–1(d)(2); *see also* Elka T. Sachs, *Qualifying for Tax Exemption*, *in* MASSACHUSETTS NONPROFIT ORGANIZATIONS (2020) ("The distinction between religious organizations and charitable organizations formed to advance religion is fuzzy at best and ultimately of little or no consequence because in each instance the organization will be classified as a Section 501(c)(3) organization. With rare exception, organizations that advance religion also qualify as 'religious organizations.'").

[42] *Applying for Exemption/Misc. Determination: Sample Questions, Church Affiliate (Integrated Auxiliary)*, INTERNAL REVENUE SERV., https://www.irs.gov/

ted with a church, and (3) internally supported.[43] Relevant factors for this analysis include statements in the organization's charter connecting it with a tax-exempt church, demonstration of church oversight, and asset distribution to a church upon dissolution.[44]

Clarifying the bounds of the distinction between religious organizations and churches has long been impeded by First Amendment worries, murky guidance from the IRS, and minimal statutory language. This makes the legal doctrine behind church tax exemption messy and prone to prohibited activities like private inurement and other misuse of charitable funds.[45] Under the First Amendment, federal and state legislation may not "establish"[46] one particular religion (or no religion), limiting the government's ability to prioritize some traditions over others.[47] Neither can they prohibit "free exercise," creating space for diversity of religious and non-religious expression.[48] The First Amendment thus aims to preserve room for "play in the joints" between the Establishment Clause and the Free Exercise Clause.[49] Justice Ginsburg summarizes the phrase's meaning well: "this Court has long recognized that the government may … accommodate religious practices … without violating the Establishment Clause."[50] Put another way, "there are some state actions permitted by the

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charities-non-profits/other-non-profits/exempt-organization-sample-questions-church-affiliate [https://perma.cc/A23D-PVEH] (describing a list of information taxpayers may need to provide to the IRS to determine whether they meet the requirements for an integrated auxiliary of a church).

[43] Treas. Reg. § 1.6033–2(h) (defining "integrated auxiliary").

[44] INTERNAL REVENUE SERV., *supra* note 42 (explaining relevant facts and circumstances).

[45] Mathew Encino, *Holy Profits: How Federal Law Allows for the Abuse of Church Tax-Exempt Status*, 14 HOUS. BUS. & TAX L.J. 78, 90 (2014) (exploring the murky language around the prohibition on private inurement within tax exempt organizations, including churches).

[46] U.S. CONST. amend. I ("Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof ….").

[47] *See* Cantwell v. Connecticut, 310 U.S. 296, 303 (1940); Everson v. Bd. of Educ., 330 U.S. 1, 14 (1947) (holding that the First Amendment's Establishment and Free Exercise clauses also apply to state governments through the Fourteenth Amendment).

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

[49] Walz v. Tax Comm'n of City of New York, 397 U.S. 664, 669 (1970) (using the phrase "play in the joints" for the first time).

[50] Cutter v. Wilkinson, 544 U.S. 709, 713 (2005) (quoting Hobbie v. Unemployment Appeals Comm'n of Fla., 480 U.S. 136, 144–45 (1987)).

Establishment Clause but not required by the Free Exercise Clause."[51] On the individual level, religious beliefs merit constitutional protection when they are sincerely held and religious in nature from the claimant's point of view.[52] In the context of tax law, however, courts avoid assessing the *validity* of religious expression, focusing instead on a religious institution's practices.[53] Furthermore, institutions can be readily engaged in religious activity—here the Constitution anticipates a wide breadth of practice—without being classified as a "church" for tax purposes.[54]

Setting aside constitutional issues, the next place to turn for guidance on the church/religious organization distinction is the IRC. The IRC does not specifically define "church" or "religious organization."[55] Instead, the IRC uses the term "church" in a vague and "generic sense" to encompass various houses of worship and congregations across traditions, denominations, and practices.[56] Integrated auxiliaries are also considered "churches" throughout most of the IRC, with the exception of the IRS's church audit rules.[57]

Religious organizations, on the other hand, are notably distinct from churches and their integrated auxiliaries. According to IRS publications, religious organizations "typically include nondenominational ministries, interdenominational and ecumenical organizations, and other entities

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[51] Locke v. Davey, 540 U.S. 712, 725 (2004) (finding constitutional a Washington state statute prohibiting state aid to secondary students pursuing theology).

[52] *See, e.g.*, United States v. Ward, 989 F.2d 1015, 1018 (9th Cir. 1992) (quoting United States v. Seeger, 380 U.S. 163, 174 (1965)) (reiterating that determining "religion" from a legal standpoint interrogates whether "the beliefs professed … are sincerely held and whether they are, in [plaintiff's] own scheme of things, religious").

[53] Found. of Hum. Understanding v. United States, 88 Fed. Cl. 203, 216 (2009) ("[H]ere … the court can make a declaration … based on a review of plaintiff's activities without judging the sincerity of plaintiff's religious beliefs.").

[54] Spiritual Outreach Soc'y v. Comm'r, 927 F.2d 335, 339 (8th Cir. 1991) (holding that plaintiff was not a church despite "no doubt" that they were engaged in "sincere religious activity").

[55] Chad J. Pomeroy, *Let My Arm Be Broken Off at the Elbow*, 71 OKLA. L. REV. 453, 468 (2019) ("[T]here is no comprehensive legal definition of 'church.'").

[56] INTERNAL REVENUE SERV., *supra* note 11, at 1 ("The term [church] is not used by all faiths; however, in an attempt to make this publication easy to read, we use it in its generic sense as a place of worship including, for example, mosques and synagogues.").

[57] *Id.* ("With the exception of the special rules for church audits, the use of the term church throughout this publication also includes … integrated auxiliaries of a church.").

whose principal purpose is the study or advancement of religion."[58] Religious schools, for example, operate under the regular rules for non-private foundation tax-exempt organizations. This means that religious organizations, like most § 501(c)(3) charitable organizations, are required to apply for tax-exempt status.[59] They must also file annual Form 990s to report their revenue and expenditures.[60]

D. Fourteen "Church" Attributes

What constitutes "religion" or "church" is a complicated question in any discipline,[61] but the church designation is particularly fuzzy in tax law.[62] In 1978, the IRS announced a list of fourteen attributes that a "church" may possess—but "churches" need not have all fourteen characteristics to qualify as a church under § 508(c)(1)(A).[63] Subsequently, courts have refined the factors, finding some more determinative than others.

The fourteen attributes include: (1) distinct legal existence, (2) recognized creed and form of worship, (3) definite and distinct ecclesiastical government, (4) formal code of doctrine and discipline, (5) distinct religious history, (6) membership not associated with any other church or denomination, (7) organization of ordained ministers, (8) selection of ordained ministers after completing prescribed courses of study, (9) literature of its own, (10) established places of worship, (11) regular

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[58] *Id.*

[59] I.R.C. § 508(a) (requiring that "[n]ew organizations must notify Secretary that they are applying for recognition of section 501(c)(3) status).

[60] I.R.C. § 6033(a)(1) (stating the filing requirements for exempt organizations).

[61] *See, e.g.*, TOMOKO MASUZAWA, THE INVENTION OF WORLD RELIGIONS: OR, HOW EUROPEAN UNIVERSALISM WAS PRESERVED IN THE LANGUAGE OF PLURALISM (2005).

[62] Jacob E. Dean, *"Do You Have That New Church App for Your iPhone?"—Making the Case for a Clearer and Broader Definition of Church Under the Internal Revenue Code*, 46 CREIGHTON L. REV. 173, 173 (2013) ("What is a church? In the tax world, this seemingly innocuous question is not easily answered.").

[63] *See* Remarks of IRS Commissioner Jerome Kurtz, PLI Seventh Biennial Conference on Tax Planning (Jan. 9, 1978), *reprinted* in Fed Taxes (P-H) ¶ 54, 820 (1978) (listing the fourteen attributes).

congregations, (12) regular religious services, (13) schools for the youth religious instruction, and (14) schools for church member preparation.[64]

Though this list is not comprehensive or determinative, it provides an analytical basis that courts frequently use "together with other facts and circumstances" to determine "church" status.[65] A "regular congregation" appears to be the most heavily-weighted factor in most cases, known as the "associational test."[66] In fact, some courts consider this a threshold question.[67] Other tests guide the courts as well. In the first decision issued after the IRS published the attribute list, the D.C. Circuit Court of Appeals articulated the minimum assembly analysis by further elaborating on the importance of "an established congregation served by an organized ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code."[68] Several other cases established similar interpretations of the fourteen attributes and articulate various ways to interpret their relative weight.[69] Currently, however, the IRS has not adopted any one approach to determining whether a religious organization qualifies under § 508(c)(1)(A).

E. The Church Advantage

Even among tax-exempt organizations, however, "churches" that claim their status under § 508(c)(1)(A) receive particular advantages. One analysis suggests that churches have received over 200 exemptions and

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[64] INTERNAL REVENUE SERV., *supra* note 11, at 33 (listing "[c]ertain characteristics" of churches that have "been developed by the IRS and by court decisions").

[65] *Id.*

[66] Pomeroy, *supra* note 55, at 470–71 ("[C]ourts [are] frequently citing the 'regular congregation' as the most important factor."); *see also* Church of Eternal Life & Liberty, Inc. v. Comm'r, 86 T.C. 916, 924 (1986) ("[A] church's principal means of accomplishing its religious purposes must be to assemble regularly a group of individuals related by common worship and faith.").

[67] *See, e.g.*, *Church of Eternal Life & Liberty, Inc.*, 86 T.C. at 924 (referring to the associational test as a "threshold test").

[68] Am. Guidance Found., Inc. v. United States, 490 F. Supp. 304, 306 (D.D.C. 1980) (establishing the American Guidance Minimum Assembly Rule that "[a]t a minimum, a church includes a body of believers or communicants that assembles regularly in order to worship").

[69] *See* Nathan M. Boyce, *From Rubik's Cube to Checkers: Determining Church Status Is Not as Hard as You Think*, 68 EXEMPT ORG. TAX REV. 27, 34–37 (2011) (discussing the numerous common law tests to determine "church" status).

regulatory benefits over the past two decades alone.[70] Though they share the broader requirement imposed on all tax-exempt organizations to be "organized and operated exclusively for religious, charitable, scientific testing for public safety, literary or educational purposes,"[71] churches need not formally apply for tax-exempt status.[72] This permits a church to "simply hold itself out as tax exempt and receive the benefits of the status without applying for advance recognition from the IRS."[73] As long as a church meets the relevant criteria under § 501(c)(3), it is automatically considered tax-exempt until proven otherwise.[74]

Churches are also exempt from the broader tax-exempt organization requirement to file annual financial information with the IRS through Form 990, codified at I.R.C. § 6033.[75] Under § 6033, tax-exempt organizations must file annual financial returns on the Form 990, specifically stating gross income, receipts, disbursements, and any other information that the IRS requires.[76] By law, filed Form 990s are publicly available.[77] The exemption for churches from § 6033's filing requirements means that churches' financial information is not publicly available—including contributions and grants, program revenue, and investment income, as well as expenses, including operating expenses, salary and compensation informa-

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[70] Nicholas A. Mirkay, *Losing Our Religion: Reevaluating the Section 501(c)(3) Exemption of Religious Organizations That Discriminate*, 17 WM. & MARY BILL RTS. J. 715, 715 (2009) ("According to one analysis, religious organizations received over two hundred exemption and other regulatory benefits in federal legislation over the last eighteen years ….").

[71] I.R.C. § 501(c)(3).

[72] *Id.* § 508(c)(1)(A) ("Subsections (a) and (b) [application requirements] shall not apply to (A) churches, their integrated auxiliaries, and conventions or associations of churches ….").

[73] Branch Ministries v. Rossotti, 211 F.3d 137, 139 (D.C. Cir. 2000).

[74] INTERNAL REVENUE SERV., *supra* note 11, at 2 ("Churches that meet the requirements of IRC Section 501(c)(3) are automatically consider tax exempt and are required to apply for an obtain recognition of tax-exempt status from the IRS.").

[75] I.R.C. § 6033(a)(3)(A)(i) ("Paragraph (1) shall not apply to (i) churches, their integrated auxiliaries, and conventions or associations of churches …."). Yet, churches must file if they have certain types of income, such as unrelated business income.

[76] *Id.* ("[E]very organization exempt from taxation under section 501(a) shall file an annual return ….").

[77] *Id.* § 6104(b) ("The information required to be furnished by sections 6033, 6034, and 6058, together with the names and addresses of such organizations and trusts, shall be made available to the public at such times and in such places as the Secretary may prescribe.").

tion, professional fundraising fees, benefits paid to members, and donor contributions.[78] Exemption from filing a Form 990 has another benefit: churches need not provide the IRS with a list of contributions of $5,000 or more in a tax year.[79] This information, which would otherwise be required by the Form 990's Schedule B, includes $5,000-plus donors' names, addresses, and contribution amounts.[80] The Schedule B is not made public, but it does provide the IRS with access to detailed donor information that can be relevant in either a church audit or audit of an individual donor.[81]

Churches need not report to the IRS upon dissolution, liquidation, or other substantial changes, unlike other tax-exempt organizations.[82] This closes yet another window of insight that the IRS might otherwise have about an organization's financial status. In particular, distributions of assets upon dissolution can easily take the form of private inurement, and without meaningful oversight mechanisms, dissolving churches can thus easily avoid donor or IRS scrutiny. Churches are also exempt from the normal presumption that an organization is a private foundation.[83]

Despite the current potential for abuse, legitimate justifications support the church advantage as a concept. One rationale would be that church-going donors are sufficient overseers of their own giving.[84] The logic here is that nearly all of a church's donors will be members living in the community alongside church leadership, and as such, the church's attendees will learn about church spending directly from the leadership and see its impacts in their community.[85] This notion goes beyond the general

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[78] *See generally* INTERNAL REVENUE SERV., INSTRUCTIONS FOR FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX (2019), https://www.irs.gov/pub/irs-pdf/i990.pdf [https://perma.cc/6F4Z-UMEL].

[79] I.R.C. § 6033(a)(3)(A)(ii) (excepting any organization "the gross receipts of which in each taxable year are normally not more than $5,000"); *see also* INTERNAL REVENUE SERV., SCHEDULE B (FORM 990, 990-EZ, 990-PF), SCHEDULE OF CONTRIBUTORS 5–6 (2019), https://www.irs.gov/pub/irs-pdf/f990ezb.pdf [https://perma.cc/4RQU-NUBL].

[80] INTERNAL REVENUE SERV., *supra* note 79, at 2 (requiring the information about contributors).

[81] *See id.* (requiring the information about contributors).

[82] I.R.C. § 6043(b)(1) (stating churches are exempt organizations).

[83] *Id.* § 509(a)(1) (defining "private foundation").

[84] Warren Cole Smith, *When a Church Is Not a Church*, MINISTRYWATCH (Dec. 19, 2019), https://ministrywatch.com/when-a-church-is-not-a-church/ ("Churches have leadership and members who live in community with each other. Almost all the donors come from within that community.").

[85] *Id.* (discussing how the community watch rationale breaks down as large, multinational religious organizations claim the "church" status).

justification that the tax code ought to incentivize charities with "harmonious relationship[s] to the community at large."[86] Instead, this laissez-faire approach assumes that the church's community relationship will be beneficial and, if it is not, that churchgoers will correct the problem themselves.[87]

Americans annually donate more to churches and religious organizations than to any other non-profit sector.[88] In 2018, 29% of all charitable dollars went to churches—a total of $124.5 billion.[89] Churches are tax-exempt, and Americans give extensively to them. However, "we know very little about how congregations receive, manage, and spend their financial resources."[90] As noted above, churches are not required to disclose financial information through the Form 990 as is required of other tax-exempt organizations.[91] Recent trends suggest that younger churches (formed in 2000 and later) currently experience the largest annual increases in revenue, while older churches are most rapidly losing revenue.[92] This further decreases the long-term public information that a donor might access about a church before giving through news articles or word of mouth.

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[86] Bruce R. Hopkins, *Religious Organizations—Constitutionality of Code Provisions*, 30 TAX'N EXEMPTS 17, 17 (2018).

[87] Smith, *supra* note 84 ("Whatever transparency and accountability are necessary will be provided by the rules and structure of the church.").

[88] David King, *6 Charts That Illustrate the Surprising Financial Strength of American Houses of Worship*, THE CONVERSATION (Dec. 16, 2019, 8:42 AM), https://theconversation.com/6-charts-that-illustrate-the-surprising-financial-strength-of-american-houses-of-worship-127689 ("Nearly 3 out of every 4 dollars Americans give to charity supports either religious congregations or religious groups.").

[89] DAVID KING ET AL., LAKE INST. ON FAITH AND GIVING, INDIANA UNIV. LILLY FAM. SCH. OF PHILANTHROPY, THE NATIONAL STUDY OF CONGREGATIONS' ECONOMIC PRACTICES 3 (2019), https://www.nscep.org/wp-content/uploads/2019/09/Lake_NSCEP_09162019-F-LR.pdf [https://perma.cc/E734-9WFL] ("Congregations continue to receive the largest percentage of charitable giving in the U.S.— twenty-nine percent of all charitable dollars ($124.52 billion in 2018).").

[90] *Id.*

[91] I.R.C. § 6033(a)(3)(A)(i) ("Paragraph (1) shall not apply to (i) churches, their integrated auxiliaries, and conventions or associations of churches ….").

[92] KING ET AL., *supra* note 89, at 10 (finding that, in 2017, 69% of churches formed post-2000 increased their revenue, a minimum of ten percentage points higher than the annual revenue increase for any other formation era, where earlier eras saw increases of only 32%).

III. Why Do Religious Organizations Call Themselves Churches? Unpacking the Church Advantage.

Examining masquerading churches under current tax law demonstrates the significant advantages that churches' special tax regime confers as compared to other tax-exempt organizations. As discussed in this Section below, an alarmingly large number of organizations appear to be abusing the church advantage by self-identifying as "churches" despite failing both the letter and the spirit of the law—failing the letter of the law by erroneously calling themselves "churches" and the spirit of the law because the church advantage was intended to benefit actual churches, not the broader category of religious organizations.

A. Strongest Theories for the Church Advantage's Popularity

Several theories explore why religious organizations seek church status. One relatively benign motive is avoiding the legal and consulting fees of § 501(c)(3) requirements, which may ease administrative costs.[93] Smaller churches with simple financial transactions likely lack in-house expertise for filing the annual Form 990 and may find it burdensome to pay experts. These churches might not expect congregants to seek the Form 990's detailed financial information; in theory, congregants in a religious community should know how a church uses charitable funds.[94]

The desire for privacy is a more likely and complicated motive, arising from a sense of embattlement that many right-wing Christian organizations in particular have expressed in recent history.[95] As the Form 990's Schedule B discloses donor names, addresses, entity type, and contribution amount to the IRS but not to the public,[96] these organizations

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[93] Bailey, *supra* note 1 ("[L]eaders of the groups [claiming church status] say they are changing their status to avoid administrative costs ….").

[94] *See* Smith, *supra* note 85 ("The logic goes like this: Churches have leadership and members who live in community with each other. Almost all the donors come from within that community. Whatever transparency and accountability are necessary will be provided by the rules and structure of the church.").

[95] *See, e.g.*, CHRISTIAN SMITH, AMERICAN EVANGELICALISM: EMBATTLED AND THRIVING (1998) (exploring American evangelicalism's long history of thriving because of—rather than in spite of—real or perceived persecution from mainstream culture).

[96] INTERNAL REVENUE SERV., *supra* note 79, at 5, ("[T]he names and addresses of contributors [listed on Schedule B aren't required to be made available for public inspection.").

may self-proclaim as churches to shield their donor lists from governmental eyes.[97] Part of this concern stems from religious institutions' desire to be more politically active. Over the past several years, "[h]undreds of pastors" and other religious leaders have taken part in an event called "Pulpit Freedom Sunday," in which they openly defy the electioneering prohibition in § 501(c)(3).[98] Though electioneering is not permitted for any tax-exempt organizations under § 501(c)(3), the church advantage affords greater privacy for institutions using donations for political activity or soliciting political donations. Moreover, because the Form 990's Schedule B is not public, self-proclaiming as a church truly seems to be a mechanism for avoiding an IRS audit, however unlikely.[99]

Another aspect to the desire for privacy—which the church advantage affords—comes from this sense of embattlement around political issues like same-sex marriage. Dialogue around the Supreme Court decision in *Obergefell v. Hodges* illustrates a deep fear of losing tax exemption based on public policy.[100] Since the landmark ruling in *Bob Jones University v. United States* in 1983, tax-exempt entities can lose the tax-exempt status if their activities violate a "fundamental national public policy."[101] In *Bob Jones*, this meant that Bob Jones University lost its tax exemption because it prohibited interracial dating, which was deemed antithetical to the "useful public purpose" required of charitable organizations.[102] Religious organizations committed to heterosexual marriage now fear that their practices will similarly lead to loss of tax-exempt status.[103]

This fear might seem unfounded. At least since the passage of the Religious Freedom Restoration Act (RFRA) in 1993 and its progeny of state RFRAs (currently enacted in 21 states),[104] Congress and the Supreme

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[97] *Id.*

[98] Elizabeth J. Kingsley, *Religion, Politics, and Taxes—What Could Possibly Go Wrong?* 27 TAX'N EXEMPTS 42, 43 (2015).

[99] INTERNAL REVENUE SERV., *supra* note 79, at 5 ("[T]he names and addresses of contributors [listed on Schedule B aren't required to be made available for public inspection.").

[100] 576 U.S. 644 (2015).

[101] 461 U.S. 574, 593 (1983).

[102] *Id.* at 588.

[103] Samuel D. Brunson & David J. Herzig, *A Diachronic Approach to Bob Jones: Religious Tax Exemptions After Obergefell*, 92 IND. L.J. 1175, 1177 (2017) ("Despite the narrow focus on state obligations, almost instantly the discussion of legalized same-sex marriage became wrapped up in, and to some extent confused with, questions of religious freedom and tax policy.").

[104] *State Religious Freedom Restoration Acts*, NAT'L CONF. OF STATE LEGISLATURES (May 4, 2017), https://www.ncsl.org/research/civil-and-criminal-justice/

Court have been moving toward a more supportive view of religious freedom than in decades past.[105] RFRA requires courts to apply strict scrutiny to any federal action that substantially burdens free exercise of religion, even if the burden arises from a law of "general applicability" (such as an anti-discrimination law).[106] Free exercise can thus be curtailed only with a compelling governmental interest.[107] RFRA responded to the decision in *Employment Division of Oregon v. Smith*, in which the Supreme Court rejected a balancing test for religious exemptions to laws of general applicability.[108] After *Smith*, but before RFRA, violating federal anti-discrimination laws on the basis of religious freedom was not permissible.[109] Post-RFRA, which the Supreme Court has upheld for federal actions,[110] it does not seem likely that individuals or organizations would face any more substantial risk of violating anti-discrimination laws now compared to prior decades.[111] If anything, the Supreme Court has recently avoided limiting religious exemptions to anti-discrimination laws.[112]

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state-rfra-statutes.aspx [https://perma.cc/Y5E3-SPVL] (listing existing state Religious Freedom Restoration Acts as of 2015).

[105] Scholars characterize this move as everything from approving segregation, Terri R. Day & Danielle Weatherby, *LGBT Rights and the Mini RFRA: A Return to Separate But Equal*, 65 DEPAUL L. REV. 907 (2016), to correcting "unfettered" governmental power to trample free exercise, Alan Reinach, *Why We Need State RFRA Bills: A Panel Discussion*, 32 U.C. DAVIS L. REV. 823, 826 (1999).

[106] 42 U.S.C. § 2000bb(b)(1) ("[T]he purposes of this chapter are—(1) to restore the compelling interest test … and to guarantee its application in call cases where free exercise of religion is substantially burdened ….").

[107] *Id.* ("The purposes of this chapter are—(1) to restore the compelling interest test ….").

[108] 494 U.S. 872, 883 (1990) ("In recent years we have abstained from applying the Sherbert [balancing] test (outside the unemployment compensation field) at all.").

[109] *Id*. at 879 ("[T]he right of free exercise does not relieve an individual of the obligation to comply with a 'valid and neutral law of general applicability on the ground that the law proscribes (or prescribes) conduct that his religion prescribes (or proscribes).'"

[110] Under *City of Boerne v. Flores*, 521 U.S. 507 (1997), the Supreme Court did not uphold RFRA for state actions. This has prompted 21 states to pass state versions of RFRA. *See* NAT'L CONF. OF STATE LEGISLATURES, *supra* note 104 (listing existing state Religious Freedom Restoration Acts as of 2015).

[111] Indeed, the recent line of cases including *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682 (2014), *Wheaton Coll. v. Burwell*, 134 S. Ct. 2806 (2014), and *Little Sisters of the Poor Saints & Paul Home v. Pennsylvania*, 140 S. Ct. 2367 (2020), have seen an expansion of religious freedom via expansion of religious employers'

This history leaves open two major possibilities about why masquerading churches express concern about losing tax-exempt status through discriminatory practices. The first is an irrational fear of persecution or sense of embattlement, a well-documented phenomenon among conservative Christian thought circles.[113] The second is a coverup: masquerading churches are not truly concerned about losing status for perceived religious freedom restrictions, but rather know that impermissible activities like private inurement should cost them their tax exemption. Since private inurement does not have a *de minimus* requirement ("any" amount of private inurement is unlawful), it *should* be a fearsome deterrent indeed.[114] Falsely claiming church status, however, would help hide such illicit financial activities. Without IRS resources directed toward uncovering these motivations, it is challenging to know the truth.

This supposition leads to a broader third possible explanation for the church masquerade: religious organizations that misuse donated funds want to avoid public disclosure, or at least avoid filing a Form 990 that the IRS could use to commence an audit.[115] As further described in Section IV, the IRS can only commence a church audit with a "reasonable belief" based on facts and circumstances recorded in writing that the church (1) does not qualify for exemption or (2) is subject to taxation due to unrelated business income or other taxable activity.[116] No tax-exempt organization, churches and religious organizations included, is permitted to misuse charitable funds for private purposes, which includes unreasonable compensation, improper gifts, and other uses contrary to a charitable pur-

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exemption from federal mandates like the Affordable Care Act's required women's health provision.

[112] *See, e.g.*, Masterpiece Cakeshop, Ltd. v. Colo. Civil Rights Comm'n, 138 S. Ct. 1719 (2018) (avoiding a generalized ruling on whether a baker's refusal to bake a same sex couple's wedding cake was protected by the First Amendment's Free Exercise clause).

[113] *See, e.g.*, SMITH, *supra* note 95.

[114] Treas. Reg. § 1.501(c)(3)–1(c)(2) ("An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.").

[115] *See, e.g.*, Bill Wichert, *Religious Leader, Treasurer Get Prison for Tax Fraud Scheme*, LAW360 (Jan. 28, 2020, 7:49 PM), https://www.law360.com/tax-authority/articles/1238445/religious-leader-treasurer-get-prison-for-tax-fraud-scheme (discussing a church leader who diverted millions of dollars into their personal account for personal benefit).

[116] I.R.C. § 7611(a)(2) (stating reasonable belief requirement); I.R.C § 513 (defining unrelated business income).

pose.[117] For religious organizations without regular congregations, services, or sufficient other attributes to be classified as a church, private inurement in the form of executive compensation appears to be a real problem.[118] For example, Franklin Graham of the BGEA, which self-classifies as a church, makes at least $700,000 annually.[119] Since the BGEA does not file a Form 990, but rather posts its own financial reports, this number may even not reflect Graham's total compensation.[120] Self-classifying as a church does not make an organization untouchable by the IRS, but it relieves the organization of the requirement to file a Form 990—at least until the IRS takes notice.[121]

B. Contextualizing Church Donations

Scholars estimate that general tax exemption for churches costs taxpayers billions of dollars each year in lost revenue—some estimate as much as $85 billion.[122] This, in itself, does not run contrary to the justifi-

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[117] Treas. Reg. § 1.501(c)(3)–1(c)(2) ("An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.").

[118] *See* Bailey, *supra* note 1 ("MinistryWatch recently published a list of highly paid Christian ministry executives, but several pastors and nonprofit executives were excluded because many don't file 990s. While these kinds of ministries range in purpose, they typically do not operate the same way most churches do, with at least one weekly worship service that is open to the public.").

[119] Christine Wicker, *Why Franklin Graham's Salary Raises Eyebrows Among Christian Nonprofits*, WASH. POST (Aug. 18, 2015), https://www.washingtonpost.com/national/religion/why-franklin-grahams-salary-raises-eyebrows-among-christian-nonprofits/2015/08/18/023ce940-45f2-11e5-9f53-d1e3ddfd0cda_story.html?itid=lk_inline_manual_14 ("Franklin Graham's annual compensation of $880,000, revealed in a Charlotte Observer story, has some worrying that too many top Christian nonprofit leaders as well as pastors are seeing themselves as CEOs instead of as God's servants.").

[120] Bailey, *supra* note 1 ("Now that the BGEA is listed as a church, it does not file a 990 but posts a financial report on its website; that document does not clearly state Graham's salary from the ministry. Public filings suggest his compensation from Samaritan's Purse is nearly $700,000.").

[121] *Filing Requirements*, INTERNAL REVENUE SERV., https://www.irs.gov/charities-non-profits/churches-religious-organizations/filing-requirements (last updated Sept. 23, 2020) ("Churches, some church-affiliated organizations and certain other types of organizations are excepted from filing.").

[122] Dylan Matthews, *You Give Religions More than $82.5 Billion a Year*, WASH. POST (Aug. 22, 2013, 2:32 PM), https://www.washingtonpost.com/news/wonk/wp/2013/08/22/you-give-religions-more-than-82-5-billion-a-year/ (estimating the

cations for tax exemption discussed in Section III. However, the surprisingly small amount of that lost revenue that goes toward charitable purposes is troubling in light of those justifications. Because churches are not required to publicly file information about their charitable intake and fund use, ascertaining the ultimate destination of church donations can be challenging, if not impossible.[123] However, one scholar estimates that 71% of all funds donated to the 350,000 churches in the United States go toward operational expenses.[124] By comparison, the American Red Cross spent 9.4% of its annual budget in 2019 on management, fundraising, and general operations.[125] Studies similarly suggest that major churches like the Catholic Church and the Church of Jesus Christ of Latter-day Saints give only tiny percentages of their annual intake (2.7%[126] and 0.7%,[127] respectively) to charitable purposes defined as "directly addressing the physical needs of those it intends to help."[128]

While churches might reasonably be expected to use a significant amount of their donations to support staff and upkeep, this comparison highlights the importance of ensuring transparency for donors giving to churches—particularly for masquerading churches that ought to operate more like the Red Cross. If donors believe that their donations are used for charitable purposes, but in fact are funneled primarily to highly-paid

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sum of religious tax exemptions and the portion of deductible charitable contributions to religious groups at $83.5 billion).

[123] I.R.C. § 6033(a)(3) (excluding churches from the requirement that tax exempt organizations file an annual return).

[124] Ryan T. Cragun et al., *Research Report: How Secular Humanists (and Everyone Else) Subsidize Religion in the United States*, 32 FREE INQUIRY 39, 40 (2012), http://users.clas.ufl.edu/kenwald/rpp/cragun.pdf [https://perma.cc/X8FF-MMB5] ("One calculation of the resources expended by 271 U.S. congregations found that, on average, 'operating expenses' totaled 71 percent of all the expenditures of religions ….").

[125] AM. RED CROSS, 2019 ANNUAL REPORT 27 (2019), https://www.redcross.org/content/dam/redcross/about-us/publications/2019-publications/Annual-Report-2019.pdf [https://perma.cc/L2KZ-RQR8] (noting that management and general operations and fundraising constituted 3.5% and 5.9% of the Red Cross' operating expenses).

[126] *The Catholic Church in America - Earthly Concerns*, THE ECONOMIST (Aug. 18, 2012), http://www.economist.com/node/21560536 (estimating that only 2.7% of the Catholic Church's annual spending went to charitable causes).

[127] Cragun et al., *supra* note 124, at 40 ("The Church of Jesus Christ of Latter-day Saints … is only donating about 0.7 percent of its annual income.").

[128] *Id.*

leaders, this constitutes an abuse of the church advantage that should be addressed by Congress and the IRS.

These figures also provide important context to illustrate the potential for abuse of the church advantage. The median dollar amount that churches receive annually from taxpayers was $169,000 in 2018, with some of the largest churches receiving—individually—total annual donations of $40 million and more.[129] Moreover, these figures reflect only the churches that publicly file information about their finances—the real intake could far exceed these numbers. If masquerading churches can bring in similar donor dollars but operate outside of the rationale for the church advantage, taxpayers lose out because their donations may not actually be deductible. In other words, churches' ability to self-proclaim tax exemption impacts a donor's ability to know whether their donation is deductible.

Under IRC § 170(a), taxpayers may generally deduct contributions made to charitable organizations only if the organizations qualify as tax exempt.[130] The IRS maintains an online tool for donors to check whether their intended recipient is actually tax exempt, but notes that churches may not be listed.[131] Donors who contribute to a listed organization that subsequently loses its tax-exempt status without the donor's knowledge may still deduct donations made on or prior to the date that the disqualification is publicly announced.[132] However, if an organization (like a church) was *not* listed because it has not formally obtained tax-exempt status, the

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[129] DAVID KING ET AL., *supra* note 89, at 4 ("[W]hile the amount of money congregations received from all sources in 2017 (revenue) ranged from $3,000 to $41,000,000, the median was approximately $169,000.").

[130] I.R.C. § 170(a)(1) ("There shall be allowed as a deduction any charitable contribution … payment of which is made within the taxable year."); INTERNAL REVENUE SERV., PUBLICATION 526, CHARITABLE CONTRIBUTIONS 2 (2021), https://www.irs.gov/pub/irs-pdf/p526.pdf ("You can deduct your contributions only if you make them to a qualified organization.").

[131] *Tax Exempt Organization Search*, INTERNAL REVENUE SERV., https://www.irs.gov/charities-non-profits/tax-exempt-organization-search [https://perma.cc/FC5N-BKUY] (providing a tool for searching tax exempt organizations).

[132] Branch Ministries v. Rossotti, 211 F.3d 137, 139 (D.C. Cir. 2000) ("If a listed organization has subsequently had its tax-exempt status revoked, contributions that are made to it by a donor who is unaware of the change in status will generally be treated as deductible if made on or before the date that the revocation is publicly announced.").

taxpayer bears the burden of demonstrating the church's charitable status.[133]

Current underfunding and understaffing at the IRS also magnifies the potential for abuse.[134] Under IRC § 7611, church audits may only occur under a restrictive set of circumstances limiting who can initiate the audit, how long the IRS has to investigate, and what types of documents may be inspected.[135] The combination of substantial charitable dollar amounts, voluntary (rather than mandatory) transparency, and IRS understaffing within a structurally weak audit process creates a perfect environment for abuse of the church advantage.

C. Exploring Some Current Masquerading Churches

In the world of tax-exempt organizations, "church status is truly the gold standard."[136] As described further below, churches enjoy the benefits of tax exemption without many of the initial or ongoing qualification requirements. A full understanding of the church advantage makes it easy to comprehend the recent shift that some religious institutions have made from "religious organization" to "church."[137] Self-proclaiming church status requires no threshold application for tax-exempt status or ongoing Form 990 filing obligations.[138] Churches can simply operate as tax exempt until told otherwise by the IRS.[139] This shift is so advantageous that multiple companies now exist to help religious institutions transition.[140] The Church Management and Tax Conferences, for example,

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[133] *Id.* ("[T]he taxpayer will bear the burden of establishing that the church meets the requirements of section 26 U.S.C. § 501(c)(3).").

[134] *See* Janet Holtzblatt, *The Administration's IRS Budget Contains The Good, The Bad, And The Uncertain*, URBAN-BROOKINGS TAX POL'Y CTR. (Mar. 26, 2019), https://www.taxpolicycenter.org/taxvox/administrations-irs-budget-contains-good-bad-and-uncertain [https://perma.cc/YL93-RMPQ] ("Following nearly a decade of cutbacks in the Internal Revenue Service's funding, many observers are concerned about the agency's ability to enforce the tax code.").

[135] I.R.C. § 7611 (listing the restrictions on church tax inquiries and examinations).

[136] Wood, *supra* note 13.

[137] Bailey, *supra* note 1 ("Several major evangelical organizations have in recent years moved to a new strategy where they shift from a nonprofit status to a 'church' status with the IRS ….").

[138] I.R.C. § 6033(a) (exempting churches from the filing requirements).

[139] *Id.* (exempting churches from the filing requirements).

[140] Jacob M. Bass, *The Sermon on the Mountain of Cash: How to Curtail the Prosperity Scheme and Prevent Opportunists from "Preying" on Vulnerable Parishioners*, 37 B.C. J.L. & SOC. JUST. 147, 169 (2017) ("Recognizing the legal

promises churches that it will "Help You Defend Yourself" and that "If You Learn What We know, Your Church Will Grow And Your Books Will Be Squeaky Clean!"[141]

To deal with the transparency problems that the legal framework creates, other organizations attempt to provide donors with information about financial transparency and the inner workings of religious institutions. Most notable is the Evangelical Council for Financial Accountability (ECFA). The ECFA invites churches and ministries to become member organizations, which are required to commit to a set of stewardship standards designed to provide accountability to donors.[142] To fill some of the accountability gaps left by the IRC and IRS guidance, the ECFA requires member institutions (churches and religious organizations) to adhere to certain financial and governance practices.[143] Members must "prepare complete and accurate financial statements," approved by an independent board, and must make those statements available upon written request.[144] Executives must be compensated with "integrity and propriety."[145] Donations must be stewarded according to the donor's intent, and institutions must be honest in describing how they use donations.[146] As of 2020, the ECFA has 2,500 member organizations, representing $29 billion in annual revenue.[147] While some donors use charity watchdog services in making their philanthropic decisions—one study suggests 21%—the same study found that nearly half of all donors had never heard of ECFA.[148]

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loopholes offered by U.S. tax law, a cottage industry has formed to help pastors, including prosperity preachers, avoid government regulation ….").

[141] CHURCH MGMT. & TAX CONFS., https://www.cmtc.org/ [https://perma.cc/D3UB-FSGP].

[142] *ECFA's Integrity Standards for Nonprofits*, EVANGELICAL COUNCIL FOR FIN. ACCOUNTABILITY, https://www.ecfa.org/Standards.aspx [https://perma.cc/9A22-DX36] (stating seven stewardship standards).

[143] *Id.* (detailing the EFCA's financial and governance requirements for its member institutions).

[144] *Id.*

[145] *Id.*

[146] *Id.* (setting the standards for "Truthfulness in Communications" and "Giver Expectations and Intent").

[147] WARREN BIRD, ECFA STATE OF GIVING 2020, at 11 (2020), https://www.ecfa.org/StateOfGiving [https://perma.cc/Z2BE-E4P3] (summarizing the recent statistics of ECFA's growing membership).

[148] Dan Parks, *21% of Donors Use Charity Watchdog Services, Study Finds*, CHRON. PHILANTHROPY (Oct. 8, 2020) https://www.philanthropy.com/article/21-of-donors-use-charity-watchdog-services-study-finds ("Twenty-one percent of

Another organization, MinistryWatch, provides transparency grades from A to F for both churches and religious organizations based on three criteria: the institution must (1) be a member of the ECFA, (2) file a Form 990 (even though the IRS does not require this of churches), and (3) file an audited financial report.[149] MinistryWatch assigns an "F" grade only when an organization fails all three criteria.[150] As of April 2020, MinistryWatch marked twenty major religious institutions as earning an "F."[151] By definition, these institutions claim "church" status with the IRS because they do not file Form 990s but still hold themselves out as tax-exempt entities.

Some of the institutions earning an "F" clearly qualify as "churches" under the IRS guidance, but are likely abusing the church advantage's permissible lack of transparency to engage in private inurement. Much has been written about these churches—places like Creflo Dollar Ministries that notoriously compensate their pastors with private jets and lavish salaries—and this Note does not focus on them.[152] Other institutions, some discussed below, earning an "F" are clearly masquerading churches, failing the IRS's guidance about what constitutes a "church" and thus violating both the letter and the spirit of the law. In other words, these institutions are particularly concerning because they receive the church advantage without upholding the legal requirements for churches *or* honoring the intent behind exempting them from the requirements placed on other tax-exempt organizations.

The "Family Broadcasting Corporation" (FBC) (formerly known as LeSEA Broadcasting) is one such institution, not an ECFA member,

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donors always or usually use charity watchdogs to help evaluate nonprofits, while 68 percent rarely or never use them, according to a new report.").

[149] *How MinistryWatch Arrives at a Transparency Grade*, MINISTRYWATCH (Mar. 31, 2020), https://ministrywatch.com/how-ministrywatch-arrives-at-a-transparency-grade/ [https://perma.cc/TH3U-EW8H] (explaining the three criteria for determining the transparency grade).

[150] *Id.* ("If it fails to meet any of the three standards, that ministry will receive a Transparency Grade of 'F.'").

[151] *MinistryWatch Releases List of Christian Ministries with Transparency Grade of "F"*, MINISTRYWATCH (Apr. 8, 2020), https://ministrywatch.com/ministrywatch-releases-list-of-christian-ministries-with-transparency-grade-of-f [https://perma.cc/M8GP-H63Y] (listing the 20 ministries that received a failing grade).

[152] *See, e.g.*, Abby Ohlheiser, *Pastor Creflo Dollar Might Get His $65 Million Private Jet After All*, WASH. POST (June 3, 2015, 10:41 AM), https://www.washingtonpost.com/news/acts-of-faith/wp/2015/06/03/pastor-creflo-dollar-might-get-his-65-million-private-jet-after-all/ (describing Creflo Dollar's announcement to purchase a luxury jet because it is "'necessary' to spread God's word").

and given an "F" grade by MinistryWatch. FBC's "F" grade by Ministry Watch means that it claims "church" status by taking donations without voluntarily filing a Form 990. However, FBC does not possess most of the IRS's "fourteen attributes" for a church and certainly fails to demonstrate those that the IRS has traditionally deemed most important.[153] According to its publicly available materials, though the FBC is a distinct legal entity with a stated creed and some amount of literature of its own, it lacks a "regular congregation" or an established place of worship, thus failing the minimum assembly and associational tests that courts have relied on as primary guidance.[154] Instead, FBC appears to offer three services, all for sale: "quality health supplements," "ministry resources" for unspecified congregations, and tours to Israel for a fee.[155] Lack of financial transparency from the FBC makes it impossible to know how it actually uses the donations it solicits—particularly within an organization that sells (rather than gives away) most of its services. FBC doesn't appear to even provide self-reported annual financial statements via an annual donor report or other standard practice.

In theory, oversight organizations like MinistryWatch and ECFA could provide one practical solution for addressing abuse of the church advantage. In practice, however, oversight still relies largely on self-reporting. Moreover, even the most well-regarded oversight organizations disagree about institutions' overall transparency. For example, Ministry Watch gives the Billy Graham Evangelistic Association (BGEA) a "C" for

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[153] The IRS's fourteen guiding (but not determinative) factors for church status include: The fourteen attributes include: (1) distinct legal existence, (2) recognized creed and form of worship, (3) definite and distinct ecclesiastical government, (4) formal code of doctrine and discipline, (5) distinct religious history, (6) membership not associated with any other church or denomination, (7) organization of ordained ministers, (8) selection of ordained ministers after completing prescribed courses of study, (9) literature of its own, (10) established places of worship, (11) regular congregations, (12) regular religious services, (13) schools for the youth religious instruction, and (14) schools for church member preparation.

[154] Pomeroy, *supra* note 55, at 471 ("[C]ourts … [are] frequently citing the 'regular congregation' as the most important factor."); Church of Eternal Life & Liberty, Inc. v. Comm'r, 86 T.C. 916, 924 (1986) ("[A] church's principal means of accomplishing its religious purposes must be to assemble regularly a group of individuals related by common worship and faith.").

[155] *Services*, Fam. Broad. Corp., https://familybroadcastingcorporation.com/services/ [https://perma.cc/M4HB-G3KS].

transparency,[156] but the ECFA has considered it a "charter member," or founding and continuous member in good standing, since 1979.[157] The same dichotomy exists for Gideons International, which has *explicitly* denied that it is a "church" despite claiming that status in the past year by failing to file a Form 990.[158]

Even organizations that merit top transparency ratings with both MinistryWatch and ECFA are flouting the spirit of the church advantage because they are religious organizations, not churches. Focus on the Family falls into this category. Despite voluntarily filing a Form 990, Focus on the Family claimed status as a church in 2015 explicitly "to protect the confidentiality of our donors."[159] Prior to 2015, Focus on the Family operated as a religious organization for many years.[160] Applying the IRS and court guidance on what constitutes a "church," this shift seems ripe for challenge. As with FBC, Focus on the Family does not cultivate a regular congregation. Instead, Focus on the Family provides outreach through "a wide variety of broadcasts, podcasts, telecasts, films, websites, blogs and radio drama programs."[161] Nor does Focus on the Family provide regular religious services.

Thus, despite providing financial transparency, it is highly questionable that Focus on the Family—which disseminates resources but does not cultivate a regular congregation or providing regular religious services[162]—qualifies as a "church" under the Fourteen Attributes or under prevailing common law. The next question is why the IRS is not using its

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[156] *Billy Graham Evangelistic Association/ BGEA/ Franklin Graham*, MINISTRY WATCH, https://briinstitute.com/mw/ministry.php?ein=410692230 [https://perma.cc/Z8TB-6CWV] (grading BGEA's transparency quality as a C).

[157] *Meet ECFA's Charter Members*, EVANGELICAL COUNCIL FOR FIN. ACCOUNTABILITY, https://www.ecfa.org/CharterMembers.aspx ("Beginning in 1979, 150 pioneering organizations came together to form ECFA and received the designation of ECFA charter members. The following charter members have continuously held ECFA accreditation and are organizations in good standing today. ECFA salutes these organizations for the leadership they have provided.").

[158] GIDEONS INT'L, *supra* note 3 ("Is The Gideons International a denomination or church? Neither.").

[159] Bailey, *supra* note 1 (quoting Paul Batura, spokesman for Focus on the Family).

[160] Grybowski, *supra* note 4 ("[T]he main reason for the reclassification was to protect the identities of donors to the conservative Christian organization.").

[161] *Ministries & Shows*, FOCUS ON THE FAM., https://www.focusonthefamily.com/about/programs/.

[162] *Id.* ("Since Focus on the Family opened in 1977, our outreach has grown to include a wide variety of broadcasts, podcasts, telecasts, films, websites, blogs and radio drama programs.").

authority to audit Focus on the Family for proper tax-exempt status. Particularly as Focus on the Family releases a Form 990, an appropriately-high level IRS employee could use that document as a basis for the necessary "reasonable belief" of abuse to commence an audit under the Church Audit Procedures Act (CAPA).[163]

D. Existing Scholarship and Misguided Analyses

Many scholars have criticized the church advantage.[164] Fewer scholars have supported it, at least as a whole.[165] Other commentators[166] argue that the current tax provisions for religions are actually *unconstitutional* because they are not neutral toward religion or lack a "secular purpose."[167] Also common is to see misguided analyses that label unpopular religious practices as the problem.

In general, more legal scholars have criticized this murky body of tax law than have praised it, but legitimate arguments also support the current structure. Supporters of the church advantage typically focus on the importance of government neutrality where religion is concerned. They examine "the extent to which religious organizations are vulnerable to such involvement" and frame loss of tax-exempt status as relatively easy.[168] Scholarship that supports the status quo for church tax exemptions

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[163] IRC § 7611(a)(2).

[164] *See, e.g.*, Pomeroy, *supra* note 55 (arguing for the elimination of some church advantages inherent in the tax structure); Cody S. Barnett, *Bringing in the Sheaves: Combating Televangelists' Abuse of the Internal Revenue Code*, 105 KY. L.J. 365 (2016) (arguing for a better balance between protecting religious organizations and shielding citizens from churches that abuse their tax exempt designation); Encino, *supra* note 45 (arguing for stronger penalties for churches that abuse tax-exempt status); Hopkins, *supra* note 86 (finding some aspects of church tax-exemption unconstitutional); Kingsley, *supra* note 98 (reviewing a dismissed suit against the IRS for failing to audit churches clearly engaged in impermissible political campaigning).

[165] *See, e.g.*, Sophia Benavides, *Words of Wisdom from the Founding Fathers: Why the Internal Revenue Service Should Let Churches Be*, 35 J. NAT'L ASS'N ADMIN. L. JUDICIARY 370 (2015) (arguing that existing IRS framework is adequate to oversee churches' tax-exempt status).

[166] *See, e.g.*, Hopkins, *supra* note 86, at 17 (arguing that the IRS church audit rules and several of tax exemptions for religious institutions are unconstitutional).

[167] Lemon v. Kurtzman, 403 U.S. 602, 612 (1971) (establishing a standard test for the constitutionality of legislation involving religion, under which one of the prongs requires statutes to have a "secular legislative purpose").

[168] *See, e.g.*, Grant M. Newman, *The Taxation of Religious Organizations in America*, 42 HARV. J.L. & PUB. POL'Y 681, 681 (2019).

(or that argues for even less interference) helps contextualize the move from "religious organization" to "church" as a desirable retreat of the government away from commenting on what "religion" is. Supporting scholars often highlight the importance of governmental neutrality because of the fear that the IRS would revoke a church's tax-exempt status on public policy grounds, as discussed above.[169]

Other scholars critique the IRC itself. They find fault with "one of the biggest tax loopholes of all time," which permits churches to self-claim tax-exempt status with "complete invisibility from the Internal Revenue Service," as churches are not required to apply for tax-exempt status or report their annual finances.[170] Others take issue with the IRS's guidance around what qualifies as a "church." Some argue that the IRC itself should be amended to contain a better definition. This might look like a "[c]larifying and narrowing" of the "church" definition,[171] or broadening and standardizing the definition, at least in federal courts.[172] Scholars point out that Congress has never directly answered the question of what "church" means for the purposes of tax law.[173] It has, however, indicated an intent to exempt churches from taxation because they contribute meaningfully to communities and provide services that the government itself would otherwise need to provide. As such, some argue that churches should pay taxes on *any* income that isn't redirected to "charitable purposes," not just unrelated business income (which is already subject to taxation, even for churches).[174]

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[169] *Id.* at 695 (citing Michael A. Lehmann & Daniel Dunn, *Obergefell and Tax-Exempt Status for Religious Institutions*, 7 COLUM. J. TAX L. - TAX MATTERS 7 (2016)).

[170] Lidiya Mishchenko, *In Defense of Churches: Can the IRS Limit Tax Abuse by "Church" Imposters*?, 84 GEO. WASH. L. REV. 1361, 1363 (2016).

[171] *Id.* at 1369.

[172] Dean, *supra* note 62, at 201 (arguing that modernization over time and technological innovations should lead the courts to recognize a broader definition of what constitutes a church today).

[173] *Id*. at 173 ("Congress has never directly answered the question [what is a church].").

[174] Pomeroy, *supra* note 55, at 493 ("Generally speaking, churches should be required to pay tax on all funds that are not redirected to 'charitable purposes,' however such phrase is ultimately defined. Doing so will place churches on the same footing with other market-facing entities by effectively eliminating the tax shelter churches now enjoy when they eschew charity in favor of profit-seeking.").

Critiques of the IRS's process for catching and punishing church-status abusers usually focus on its weak church auditing power.[175] Both of these lines of critiques—text- and process-focused—highlight the current ability of churches to amass incredible wealth as a result of their tax-exempt status. Here, it is the church advantage's economic consequences that trouble critics. One scholar points out that churches control the one-time largest producer of nuts in the United States, a multi-billion-dollar insurance company, a large radio chain, and extraordinary international real estate holdings.[176] Other scholars view churches' current ability to amass wealth as a reason to completely eliminate their tax-exempt status.[177]

Misguided analyses also abound. As the breadth of existing scholarship suggests, any treatment of law and religion[178] in American law is bound to be messy. Historic aversion to legislators acting as theologians has sometimes led to an overly laissez-faire tax treatment of religious institutions throughout American history. At other times, academic and popular treatment of non-mainstream religion has inconsistently condemned the practices of some religions while ignoring equivalent behavior in others.

Recent academic criticism of the "prosperity gospel" is a prime example of misplaced focus around religion and taxation.[179] The prosperity gospel refers to the fundamentalist or evangelical Christian belief that material wealth and bodily health indicate God's favor and should be sought and celebrated, not cast aside as other Christian theologies advocate.[180] Legal scholarship frequently takes aim at this

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[175] *See, e.g.*, Kingsley, *supra* note 98 (describing the high procedural hurdles for auditing churches and the lack of audits in the past several years).

[176] Pomeroy, *supra* note 55, at 453–55 ("[A]s the preceding footnotes make clear, the entity described is not a titan of industry but is instead a church.").

[177] *Id.* at 457 ("[T]hese advantages should be eliminated ….").

[178] This Note references "religion" in the broadest sense, acknowledging that the term "religion" itself has Judeo-Christian overtones and a colonializing history. *See, e.g.*, Michael Sean Winters, *Mark Silk on the History of the Term 'Judeo-Christian'*, NAT'L CATHOLIC REP., (Apr. 15, 2019), https://www.ncronline.org/news/opinion/distinctly-catholic/mark-silk-history-term-judeo-christian [https://perma.cc/W9U6-SNRC] (discussing the evolution of the use of the term from its use in opposing to fascism to its use in populist economic nationalism today).

[179] *See, e.g.*, Mishchenko, *supra* note 170; LastWeekTonight, *Televangelists: Last Week Tonight with John Oliver (HBO)*, YOUTUBE (Aug. 17, 2015), https://www.youtube.com/watch?v=7y1xJAVZxXg (criticizing televangelism and the prosperity gospel).

[180] *See* Delano R. Franklin & Andrew J. Park, *Experts Discuss the Role of 'Prosperity Gospel' in Trump's Success*, HARV. CRIMSON (Oct. 24, 2017), https://

theology, focusing on the exploitation of congregants who were led to believe that donating to the church would cure cancer or end marital troubles.[181] While again, these practices may not appeal to all ethical palates, the prosperity gospel can qualify as a church under the tax code as readily as any other mainline church, mosque, or synagogue. What matters is not the theology compelling the donations—but rather the donations' ultimate use.

In popular culture, John Oliver similarly ridicules televangelists and prosperity gospel churches that "exploit people's faith" by collecting donations that promise miracle cures and pay for leaders' lavish salaries.[182] Oliver's television segment mocks both legitimate theology (from the legal perspective)—such as speaking in tongues[183] and promising miracle medical cures—and impermissible practices like using tax-exempt dollars to confer individual private benefits through unreasonably high compensation.[184] While the aforementioned theological practices may not appeal to Oliver and many others, this line of critique is too broad. A church's claim to work medical miracles, or its practice of speaking in tongues, does not in itself violate tax law. The focus for interrogating the church advantage must avoid stepping into theological debates and instead address proper categorization.

IV. Can Legislative History or Auditing Practices Explain Masquerading Churches?

As described above, American law has long struggled to find balance between treating churches like any other tax-exempt organizations and giving them special treatment. However, legislative history clearly

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www.thecrimson.com/article/2017/10/24/trump-prosperity-gospel/ (quoting religion scholar Jonathan Walton describing the prosperity gospel "hing[ing] on the principles of sowing material goods and then reaping in return"); *see also* KENNETH COPELAND, THE LAWS OF PROSPERITY (1974); JOEL OSTEEN, YOUR BEST LIFE NOW: 7 STEPS TO LIVING AT YOUR FULL POTENTIAL (2004).

[181] *See, e.g.*, Bass, *supra* note 140, at 167 (discussing how churches could lose their tax-exempt status if the donations from parishioners were to be deemed "unreasonable compensation" to pastors).

[182] LastWeekTonight, *supra* note 179.

[183] *See Speaking in Tongues*, RELIGION AND PUB. LIFE, HARVARD DIVINITY SCH., https://rlp.hds.harvard.edu/faq/speaking-tongues [https://perma.cc/BYE6-LCKD] (defining and providing scholarly material for glossolalia, or 'speaking in tongues').

[184] LastWeekTonight, *supra* note 179.

demonstrates a consistent desire to limit fraud on the taxpayer donor.[185] It also suggests a longstanding concern about unfair competition between advantaged churches and non-exempt business entities—particularly in the mid-twentieth century, as direct competition between churches and businesses sparked resentment.[186] Most importantly, it illustrates that tax exemption for churches and other religious institutions was far from inevitable, both before and after the Constitution's ratification.[187] This history provides important context for oversight of church financial activity.

A. Balancing Limitations: Fraud v. Entanglement

Collectively, churches enjoy "less oversight than any other major institution in America today."[188] This is partly by design: the First Amendment prohibits government entanglement with religion.[189] Few other institutions benefit from the same depth of jurisprudence and constitutional history.[190] However, a comprehensive view of the Congressional intent

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[185] John Montague, *The Law and Financial Transparency in Churches: Reconsidering the Form 990 Exemption*, 35 CARDOZO L. REV. 203, 208 (2013) (Historically, Americans have given generously to religious organizations, and those who do so should be assured that their donations are being used for the tax-exempt purposes of the organizations. Recent articles and news reports regarding the possible misuse of donations made to religious organizations have caused some concern for the Finance Committee.").

[186] S. REP. NO. 78-627, at 21 (1943) ("[L]arge numbers of these exempt corporations and organizations are directly competing with companies required to pay income taxes …. [M]any of these organizations are now engaged in operation of apartment houses, office buildings, and other businesses which directly compete with individuals and corporations required to pay taxes on income derived from like operations.").

[187] *See* Samuel D. Brunson, *Mormon Profit: Brigham Young, Tithing, and the Bureau of Internal Revenue*, 2019 BYU L. REV. 41, 43 (2019) ("[The] apparent inevitability of exempting churches from taxation elides the deliberate choices lawmakers and executive agencies have made ….").

[188] *See* Montague, *supra* note 185, at 207; Brunson, *supra* note 187, at 102 ("[T]he federal government has largely elected to leave religion alone for tax purposes.").

[189] One articulation of the role government may play in legislation concerning religion is found in *Lemon v. Kurtzman*, 403 U.S. 602, 612–13 (1971) (stating that the third prong of the *Lemon* Test prohibits "excessive government entanglement" with religion).

[190] *See* Montague, *supra* note 185, at 260 ("Courts have long struggled to balance the Establishment and Free Exercise Clauses, allowing religion to be practiced freely while prohibiting the state from doing anything that would establish a particular religion, or religion in general.").

behind the church advantage demonstrates a desire to balance the potential for fraud against taxpayers with the need to avoid excessive entanglement. Legislative history around the Form 990 illustrates this tension.

The legislative intent behind exempting churches from filing Form 990s is relatively sparse. In 1941, the IRS began requiring information return filings from tax-exempt organizations, originally intending to privately collect information to assess the impact that tax-exempt organizations were having on the broader market.[191] Next, the Revenue Act of 1950 required these filings (today, the Form 990) to be publicly available.[192] This measure, Congress believed, would improve tax-exempt organizations' legal compliance.[193] The Form 990 gradually grew longer, collecting more information with each iteration. Because Congress and the Treasury "found information returns useful for monitoring," legislation continued to expand the scope of the required returns.[194] Churches were still ultimately exempted from this requirement, but several bills—including one that passed in the House but failed in the Senate—sought to overturn the exemption.[195]

The earliest justification for exempting churches from the Form 990 requirement in IRC § 6033 was made "in view of the traditional separation of church and state."[196] The House and Senate were divided, however, on whether to exempt churches from the filing requirement or uniformly require Form 990s from all tax-exempt organizations; the exemption was introduced by the Senate and adopted in the final bill.[197] Subsequent attempts to require churches to file Form 990s were thwarted in the 1980s amid televangelist scandals that prompted hearings about

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[191] *See id.*, at 210 (chronicling the history of tax exemption in the United States).

[192] Revenue Act of 1950, H.R. 8920, 81st Cong. § 341 (1950) (requiring information in the filings to be made available to the public).

[193] Montague, *supra* note 185, at 213 (citing *Federal Tax Laws Applicable to the Activities of Tax-Exempt Charitable Organizations: Hearings Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 103rd Cong. 12 (1993) (statement of Margaret Milner Richardson, Comm'r, Internal Revenue)).

[194] *Id*. at 213–14 (describing the evolution of IRC § 6033).

[195] *Id.* at 214 (citing Tax Reform Act of 1969, H.R. 13270, 91st Cong. §101(d) (as passed by House, Aug. 7, 1969)) ("As a result of these and similar comments, the House did pass a bill that would have ended the exemption under section 6033 and required churches to file information returns.").

[196] 115 CONG. REC. 32,148 (1969). *See also* H.R. REP. NO. 91-413, pt. 1, at 36 (1969) (explaining the "general reasons for the change").

[197] S. REP. NO. 91-552, at 52 (1969) ("[E]xempt[ing] churches, their integrated auxiliary organizations, and conventions and associations of churches from the requirement of filing this annual information return.").

§ 6033.[198] Again, "concern about government intrusion into religion" served as the justification for keeping the exemption.[199] In 2008, Senator Chuck Grassley brought similar concerns before the legislature with no ultimate changes in policy.[200] Senator Grassley had fruitlessly attempted to obtain financial records from six organizations suspected of compensating leaders with luxury vehicles and exorbitant compensation.[201]

While Congress has been largely silent on the church exemption from Form 990 filing over the past several decades, the IRS has made several updates that suggest that the agency has sought to improve its utility as a measure of financial transparency—at least for tax-exempt organizations in general. As churches are exempt from the filing requirement by statute, there is little the IRS can do other than express concern. Indeed, IRS officials have testified about the need to address private inurement and other transparency-related issues amongst tax-exempt organizations. For example, the Assistant Commissioner in charge of tax-exempt organizations testified in 1993 that "the abuses that we found … really center on the issue of inurement."[202] In an evolving response to these types of concerns, the current Form 990 "makes it more difficult for organizations to hide executive compensation" and has more extensive requirements

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[198] Montague, *supra* note 185, at 218–21 (explaining that "following revelations of embezzlement and tax evasion … the public began to question in earnest the activities of many charismatic television evangelists, and Congress again discussed the exemption for churches under section 6033" but that "[t]he 1987 hearings ended without any changes to the law").

[199] *Id*. at 220.

[200] *See* Justin Juozapavicius, *Senator Grassley Probes Televangelists' Finances*, WASH. POST (Nov. 7, 2007, 2:00 AM), http://www.washingtonpost.com/wp-dyn/content/article/2007/11/06/AR2007110601838_pf.html. (Grassley sent letters to the half-dozen Christian media ministries earlier this week requesting answers … about their expenses, executive compensation and amenities …. The investigation promises to shine new light on the kind of TV ministries that were crippled by … scandals in the 1980s.").

[201] *See, e.g.*, Letter from Charles Grassley, Ranking Member, U.S. Senate Comm. on Fin., to Kenneth Copeland & Gloria Copeland, Kenneth Copeland Ministries (Nov. 5, 2007) (requesting financial information).

[202] *Federal Tax Laws Applicable to the Activities of Tax-Exempt Charitable Organizations: Hearings Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 103rd Cong. 61 (1993) (statement of John E. Burke, Assistant Comm'r, Emp. Plans & Exempt Orgs., Internal Revenue Serv.); *see also* Montague, *supra* note 185, at 223 n.117 ("Howard M. Schoenfeld, the Special Assistant for Exempt Organization Matters, IRS, agreed with Burke: 'The whole question of private inurement is a fundamental issue in any examination of a public charity exempt under section 501(c)(3).'").

around public accessibility.[203] Tax-exempt organizations must now report officer compensation, funding for significant organizational activities, assets and liabilities, and a variety of other financial disclosures as relevant, including investment income, real estate purchases, and other similar expenditures.[204]

Examining the legislative history and IRS guidance around the Form 990 helps to interpret, but does not definitively settle, the intended balance between church protection and fraud prevention. It also suggests that that Congress has resisted requiring churches to file Form 990s either out of excessive deference to church-state separation or as a matter of history, or because of other political ties to powerful religious organizations (usually the Christian right) that want to avoid the requirement.[205]

B. Auditing Churches

Since the advent of the modern church audit rules in 1984, very few churches have been audited by the IRS.[206] Although the IRS has authority to examine tax-exempt organizations,[207] CAPA, codified as IRC § 7611, substantially restricts the IRS's power to audit churches.[208] In theory, "Congress created § 7611 to balance the rights of legitimate churches with the need for the IRS to investigate and eliminate church tax avoidance schemes."[209] In practice, however, these rules ("kid-glove treatment," according to one scholar) mean that churches are rarely audited.[210]

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[203] Montague, *supra* note 185, at 227.

[204] INTERNAL REVENUE SERV., FORM 990, RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX (2020), https://www.irs.gov/pub/irs-pdf/f990.pdf (requiring various information from tax-exempt organizations).

[205] *See* Montague, *supra* note 185, at 218 ("The leaders of the 'New Christian Right' enjoyed the limelight of political power while they and other evangelists continued to reap huge financial rewards with minimal federal oversight and no transparency.").

[206] Bailey, *supra* note 1 ("[S]uch audits are rare").

[207] I.R.C. § 7602 (granting the IRS the authority to examine tax-exempt organizations).

[208] *See* Hopkins, *supra* note 86, at 23 ("[S]pecial rules impose restrictions on the IRS in connection with church tax inquiries and church tax examinations.").

[209] United States v. Living Word Christian Ctr., No. 08-mc-37 ADM/JJK, 2009 U.S. Dist. LEXIS 6902, at *2 (D. Minn. Jan. 30, 2009) (citing Magistrate Judge Jeffrey J. Keyes' Report and Recommendation, affirmed in the United States District Court, D. Minnesota).

[210] Pomeroy, *supra* note 164, at 473 ("Churches simply need not file an application for exemption under § 501(c)(3). Bookending this kid-glove treatment of

This is particularly significant because in most years, the IRS audits less than one percent of the *total* number of tax-exempt organizations, of which churches are a small percentage.[211]

Under CAPA, the first restriction on church audits requires an "appropriate high-level Treasury official" to "reasonably believe" that a church is flouting tax law.[212] According to the IRC, an "appropriate high-level Treasury official" is the Secretary of the Treasury or "any delegate of the Secretary whose rank is no lower than that of a principal Internal Revenue officer for an internal revenue region."[213] When the IRS reorganized in 1998,[214] fifteen years after CAPA's enactment, it eliminated the "delegate" referenced in the Code—intended to be an IRS Regional Commissioner,[215] a position one management level removed from the Commissioner of the IRS[216]—and further curtailed the IRS's ability to audit churches outside of the direct mandate of the Secretary of the Treasury.[217]

The import of this limitation was evident in 2009 when the IRS's Director of Exempt Organizations attempted to open a church tax inquiry into the Living Word Christian Center (LWCC) in Minnesota.[218] The IRS had received reports that LWCC's pastor had received improper economic benefits, including rental payments by LWCC for use of his personal plane

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qualification issues, churches can only be audited in rare circumstances, and, when they are, they are afforded extraordinary protections.").

[211] Philip T. Hackney, *Charitable Organization Oversight: Rules v. Standards*, 13 PITT. TAX REV. 83, 98–99 (2015) ("In most years the IRS audits less than one percent of the existing charitable organization population.").

[212] I.R.C. § 7611(a)(2).

[213] I.R.C. § 7611(h)(7).

[214] Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105–206, § 1001(a), 112 Stat. 685, 689–90 (1998) (setting forth "a plan to reorganize the Internal Revenue Service").

[215] Kingsley, *supra* note 98, at 42 ("Section 7611 was enacted in 1984, and final regulations promulgated in 1986 explicitly interpret the term to mean an IRS Regional Commissioner.").

[216] United States v. Living Word Christian Ctr., No. 08-mc-37 ADM/JJK, 2009 U.S. Dist. LEXIS 6902, at *6–7 (D. Minn. Jan. 30, 2009) ("Prior to the 1998 reorganization, the designated person was the Regional Commissioner, an official only one management level removed from the Commissioner of the IRS.").

[217] Hopkins, *supra* note 86, at 24 ("The definition of the phrase 'appropriate high-level Treasury official' that was originally utilized became unusable because the position referenced in the original definition was abolished as part of the reorganization.").

[218] *Living Word Christian Ctr.*, 2009 U.S. Dist. LEXIS 6902, at *1–2 ("In April 2007, the Internal Revenue Service began investigating Living Word Christian Center ….").

and a partially-forgiven loan, and had endorsed U.S. Representative Michelle Bachmann.[219] The IRS gave LWCC proper notice and followed CAPA's procedural requirements. However, LWCC's legal counsel successfully argued that the IRS's Director of Exempt Organizations lacked the appropriate managerial level Congress had intended for the inquiry.[220] Subsequent to this decision, the IRS temporarily halted church audits entirely until a rulemaking process could clarify which high-level employee had audit authority.[221] Though no rulemaking process has clarified this issue,[222] current court decisions appear to treat the Commissioner of the Tax Exempt and Government Entities Division (two steps below the IRS Commissioner) as appropriately high-level.[223] Once audits appeared to commence, only 0.001% of Christian churches alone were audited in 2013–14.[224]

Even where an appropriate high-level authority initiates an audit, they can only do so if they have a "reasonable belief" based on facts and circumstances recorded in writing that the church (1) does not qualify for

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[219] Grant Williams, *Court Rules Against IRS in Church-Audit Case*, CHRON. PHILANTHROPY, (Feb. 3, 2009), https://www.philanthropy.com/article/Court-Rules-Against-IRS-in/162773 ("In investigating that allegation, the IRS found that the church had engaged in financial transactions that may have improperly benefited Mr. Hammond, and possibly called into question the congregation's tax-exempt status").

[220] *Living Word Christian Center*, 2009 U.S. Dist. LEXIS 6902, at *7 ("The nearest equivalent to the Regional Commissioner under the current IRS organization is the Commissioner Tax Exempt and Government Entities.").

[221] Sarah Eekhoff Zylstra, *Why the IRS Has Stopped Auditing Churches—Even One That Calls President Obama a Muslim*, CHRISTIANITY TODAY (Oct. 26, 2012), https://www.christianitytoday.com/ct/2012/october-web-only/why-irs-has-stopped-auditing-churches-even-one-that-calls-p.html ("'We are holding any potential church audits in abeyance,' Russell Renwicks of the IRS's Tax-Exempt and Governmental Entities division told BNA.com ….").

[222] United States v. Bible Study Time, Inc., 295 F. Supp. 3d 606, 614 (D.S.C. 2018) ("The Initial Regulation [identifying the Regional Commissioner as the lowest-level audit authority] has never been rescinded or replaced. It may, nonetheless, not be followed as written because the position of Regional Commissioner was eliminated after adoption of the IRS Restructuring and Reform Act of 1998.").

[223] *Id.* at 627 ("The court, therefore, finds the TE/GE Commissioner holds a sufficiently high rank to satisfy Section 7611(h)(7)' s definition of appropriate high-level Treasury official.").

[224] *See* Bass, *supra* note 140, at 167–68 ("There are approximately three hundred thousand Christian churches in the United States, yet in 2013 and 2014, the IRS only audited three churches.").

exemption or (2) is subject to taxation due to unrelated business income or other taxable activity.[225] Notice must be given.[226] Restrictions on the actual examination prohibit an auditor from examining church records beyond "the extent necessary to determine" tax liability or church status.[227] The IRC further restricts the IRS to a two-year period in which to initiate and complete a church audit.[228]

CAPA notwithstanding, the IRS's ability to restrict this lost revenue to its statutory parameters is hobbled by the IRS's chronic understaffing and underfunding.[229] Since 2010, Congress has cut the IRS's budget by over 20%, with the overall audit rate dropping by nearly 50%.[230] Staff levels were as low in 2018 as they were in 1953.[231] Exactly what these budgetary and staffing decisions say about Congressional intent to keep hands off of churches is unclear, particularly because the IRS as a whole has shrunk in recent years. Compliance is clearly an issue across various tax issues: the Tax Policy Center estimates a 16% gap between taxes owed and taxes paid in recent years.[232] As such, CAPA itself theoretically provides more substantive clues about the intended restrictions on church audits than does recent IRS funding, although CAPA rules were passed in 1984 with a legislative history "remarkably silent as to the reason for their enactment."[233]

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[225] I.R.C. § 7611(a)(2) (stating reasonable belief requirement); I.R.C § 513 (defining unrelated business income).

[226] I.R.C. § 7611(a)(3) ("The requirements of this paragraph are met with respect to any church tax inquiry if, before beginning such inquiry, the Secretary provides written notice to the church of the beginning of such inquiry.").

[227] I.R.C. § 7611(b)(1).

[228] I.R.C. § 7611(c)(1) ("The Secretary shall complete any church tax status inquiry or examination (and make a final determination with respect thereto) not later than the date which is 2 years after the examination notice date.").

[229] Paul Kiel & Jesse Eisinger, *How the IRS Was Gutted*, PROPUBLICA (Dec. 11, 2018, 5:00 AM), https://www.propublica.org/article/how-the-irs-was-gutted [https://perma.cc/N93J-GCJU] ("The cuts are depleting the staff members who help ensure that taxpayers pay what they owe.").

[230] Holtzblatt, *supra* note 134 ("Since 2010, the IRS's funding has fallen by over 20 percent in inflation-adjusted dollars, and the overall audit rate dropped by nearly half—an ominous sign for current compliance rates.").

[231] Kiel & Eisinger, *supra* note 229 ("As of last year, the IRS had 9,510 auditors. That's down a third from 2010. The last time the IRS had fewer than 10,000 revenue agents was 1953 ….").

[232] Holtzblatt, *supra* note 134 ("[T]he most recent IRS estimates revealed that the average annual gap between taxes owed and taxes ultimately paid exceeded $400 billion (about 16 percent of taxes owed) from 2008 through 2010.").

[233] Hopkins, *supra* note 86.

V. Recommendations

The challenge of dealing with the "church masquerade" is complex and has been met with many suggestions from scholars and politicians.[234] These recommendations differ depending on the specific problem identified. This Note does not focus on churches like prosperity gospel congregations, which may engage in fraudulent financial activities but clearly qualify as "churches" under the IRC.[235] Rather, it examines the reasons behind the recent shift that some religious organizations are making to self-identify as churches and reap the accompanying church advantage.[236] This shift is problematic because it creates a problem "in the proof"—current law makes it too difficult to catch abusive practices—as it exempts the masquerading churches from acquiring an IRS ruling of tax-exemption, filing annual Form 990s, and the current IRS audit procedures make identifying and prosecuting these religious organizations' impermissible activities extremely difficult.[237]

To address this specific problem, Congress and the IRS should make three improvements to the existing tax regime. First, all tax-exempt organizations, churches included, should be required to file Form 990s. Second, all tax-exempt organizations claiming church status should be required to file for tax-exempt status. These two changes alone would create a paper trail for the IRS to commence more church audits without requiring direct changes to CAPA, which has historically proven politic-

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[234] *See, e.g.*, Dean, *supra* note 62, at 175 (arguing that courts, rather than Congress, should take a more active role in defining "church" versus "religious organization").

[235] *See John Oliver Pressures IRS for Televangelist Crackdown*, CBS NEWS (Aug. 20, 2015, 7:03 AM), https://www.cbsnews.com/news/john-oliver-pressures-irs-for-televangelists-crackdown-last-week-tonight/ [https://perma.cc/Y5C6-TMPN] (explaining that prosperity gospel congregations ran by televangelists are believed by some to be committing fraud to attract donations and utilizing church status for tax exemption).

[236] *See* Smith, *supra* note 84 ("[M]ore tax-exempt organizations that clearly are not churches are claiming the church exception.").

[237] INTERNAL REVENUE SERV., CHURCHES AND OTHER RELIGIOUS ORGANIZATIONS 2 (1979), https://www.irs.gov/pub/irs-tege/eotopicf79.pdf [https://perma.cc/M7NB-M3CL] ("[T]he problem is not in the law, but the proof …. There is no question that certain taxpayers have taken unfair advantage of these (and other) statutory provisions protecting legitimate churches.").

ally challenging.[238] Third, Congress should increase resources for the IRS to conduct church audits, and the IRS should concurrently clarify its audit procedure.

A. Require Churches to File Form 990s

Abuse of the church advantage through private inurement and other misuse of funds could be diminished by requiring churches to file Form 990s.[239] This would be a transformative information-gathering mechanism for donor transparency and potential IRS audits. Many have argued that churches should be required to file the Form 990.[240] This reform is logical because the justifications for exempting churches—keeping administrative costs low and protecting donor information—do not outweigh the legislative intent behind the broader information sharing requirement. Since the earliest discussions around tax exemptions for charitable organizations, Congress and the IRS have demonstrated concern for donor welfare. Updates to the Form 990 to include officer compensation and to be publicly accessible demonstrate that concern. One of the primary stated reasons for religious organizations to shift to the church classification is to avoid filing the Form 990, which also suggests that eliminating this element of the church advantage would help limit this practice.[241] Publicity from the Form 990 alone, however, will not likely curb the abuse of the church advantage without IRS enforcement and rule clarification.[242] Donors to religious organizations masquerading as

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[238] *See* J. Michael Martin, *Why Congress Adopted the Church Audit Procedures Act and What Must Be Done Now to Restore the Law for Churches and the IRS*, 29 AKRON TAX J. 1, 3 (2014) ("[A] technical issue left unresolved by Congress and the Treasury Department after the IRS reorganization in 1998 concerning who is an 'appropriate high-level Treasury official' to initiate church tax inquiries and examinations has severely weakened CAPA's effectiveness ….").

[239] *See, e.g.*, Montague, *supra* note 185, 231–34 (arguing that churches' Form 990 exemption allows greater fraudulent organizations to increase private inurement).

[240] *See, e.g.*, *id.* at 210 (arguing that "the current law is bad policy and should be amended to require churches to file the information return).

[241] *See* Smith, *supra* note 84 ("It's a system that has worked well for decades, but it is a system that is rapidly breaking down as more tax-exempt organizations that clearly are not churches are claiming the church exception.").

[242] *See* Montague, *supra* note 185, at 227 ("Until 1996, exempt organizations were only required to make the Form 990 available at their office. Since few individual donors would actually take the time and effort to travel somewhere for the sole purpose of inspecting an organization's information return, the only groups that regularly invoked the statute were reporters and charity watchdogs. Even when

churches may not care that their officers are highly compensated, for example.[243] Moreover, without other changes to the tax law, masquerading churches could still avoid disclosing damning information on a Form 990; they could simply omit the information on their voluntary, unaudited form.[244] Whether or not this type of omission would regularly occur or occurs at present on voluntarily-submitted Form 990s is difficult to predict because the IRS audits so few churches.[245]

The IRS seemingly resists auditing even those organizations that both voluntarily file Form 990s *and* admit that they have claimed church status to avoid oversight.[246] As discussed above, Focus on the Family voluntarily submits a Form 990, but has recently made the switch from religious organization to church "to protect its donor list."[247] Nothing in the IRS guidelines on religious institution classifications suggests this to be a permissible basis for claiming church status. Presumably, if Focus on the Family could justify the switch by pointing to new practices consistent with church status, it would. This is troubling: it illustrates that the IRS has (or could have) both knowledge of these masquerading churches' existence and of their erroneous classification—certainly enough for the requisite "reasonable belief" for commencing an audit.[248] Thus, the IRS seems uninterested in auditing organizations that all but state, "we are just doing this to hide information!" It also refuses audits to verify the accuracy of the information of entities, like Focus on the Family, that have admitted to the

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such individuals did seek to review the forms, they frequently met with delay, intransigence, and hostility. Few organizations were eager to turn over their information returns, and some even refused outright to follow the law.").

[243] *See e.g.*, *id.* at 239 ("[E]ven at churches where compensation is set by an ostensibly independent committee—as it might be at many Presbyterian churches—scholarship in management theory suggests that these pastors likely still have a great deal of personal influence over boards.").

[244] *See* Bailey, *supra* note 1 (illustrating that Focus on the Family still chose to release Form 990 but with its donor information redacted).

[245] *See* Zylstra, *supra* note 221 (finding that, even when the IRS was required by its internal protocols to audit churches, it had not audited a church for three years).

[246] Gryboski, *supra* note 4 (explaining the IRS allowed Focus on the Family to reclassify as a church even when it "explained that the main reason for the reclassification was to protect the identities of donors to the conservative Christian organization").

[247] *Id.*

[248] I.R.C. § 7611(a)(1) ("The secretary may begin a church tax inquiry only if (A) the reasonable belief requirement … ha[s] been met").

church masquerade.[249] Changing the Form 990 filing rules for churches would require updating the IRC § 6033 through an act of Congress, but it would seem a prudent step toward developing a more accurate nation-wide picture of organizations claiming church status.

B. Require Application for Tax Exemption

Abuse of the church advantage through falsely claiming church status could be curbed by requiring that all tax-exempt entities apply for tax-exempt status. Congress should thus expand IRC § 508(a), which requires organizations to provide notice via Form 1023 to the Secretary to obtain tax-exempt status, to churches.[250] Churches are currently excused from this application process.[251] As explored in Section IV, Congress has articulated only vague justifications for exempting churches from this requirement.[252] Requiring churches to apply for tax-exempt status would have many benefits.

First, it could help religious institutions understand their obligations under the tax code as exempt organizations. The IRS has currently structured Form 1023 to collect a wide swath of information: organizational structure, a narrative of organizational activities, director and officer compensation, potential conflict of interest information, description of member programs and services, political activity (prohibited), fundraising strategy, and a breakdown of revenue and expenses.[253] Requiring churches to fill out and submit this form, which comes with detailed instructions and explanations, would likely help weed out accidental abusers of the church advantage. As discussed above, some religious organizations operate under a sense of profound embattlement and persecution, spurred by a cottage

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[249] *See* Gryboski, *supra* note 4 (explaining the IRS allowed Focus on the Family to reclassify as a church even when it "explained that the main reason for the reclassification was to protect the identifies of donors to the conservative Christian organization").

[250] I.R.C. § 508(a) (requiring that "[n]ew organizations must notify Secretary that they are applying for recognition of section 501(c)(3) status"); organizations apply for tax-exempt status with Form 1023).

[251] I.R.C. § 508(c) (exempting churches from § 508(a)).

[252] *See, e.g.*, Mishchenko, *supra* note 170, at 1367 ("[T]he legislative history of these various tax provisions exempting 'churches' from filing requirements is opaque.").

[253] INTERNAL REVENUE SERV., FORM 1023, APPLICATION FOR RECOGNITION OF EXEMPTION UNDER SECTION 501(C)(3) OF THE INTERNAL REVENUE CODE (rev. 2017), https://www.irs.gov/pub/irs-pdf/f1023.pdf (requiring numerous information for tax-exempt status).

industry that encourages them to protect themselves from the IRS through the privacy of the church advantage.[254] Requiring these organizations to actively affirm compliance with church requirements before claiming the advantage could dissuade the more intentional abusers of the church advantage who might still balk at providing false information to the IRS.

Next, access to the information on Form 1023 would give the IRS a proactive tool for denying would-be abusers of the church advantage, providing the opportunity to deny the "church" designation to those entities that are truly religious organizations. Moreover, it would not require a major reworking of the existing Form 1023. Form 1023 already has a section specifically designed for churches, which is optional at present.[255] This section, Schedule A, walks the applicant through the IRS's guiding fourteen church attributes and asks the applicant questions that could pertain to private inurement (for example, whether all church members are "part of the same family").[256] As with requiring annual Form 990 filings, requiring churches to file for tax-exempt status would require an act of Congress to update IRC § 508(a).

C. Increase Church Audits

Finally, changes to churches' filing requirements will be ineffective without a concurrent change in IRS church auditing practices. As described above, IRC § 7611 (CAPA) erects significant—and prohibitively vague—barriers to initiating church audits. These barriers restrict who may initiate an audit: currently, it is only an "appropriate high-level Treasury official."[257] The high-level Treasury official must also have a "reasonable belief" based upon a written document that the church in question fails to qualify as exempt.[258] Even if these threshold requirements are met, the audit cannot examine church records beyond "the extent necessary to determine" tax liability or church status, and it must do so

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[254] *See, e.g.*, Raul Rivera, *How Protect Your Church from an IRS Audit*, START CHURCH (Apr. 6, 2017), https://www.startchurch.com/blog/view/name/ how-protect-your-church-from-an-irs-audit [https://perma.cc/JZA8-REJZ] (framing the likelihood of an IRS audit and resulting loss in tax-exemption as a likely outcome of "well-meaning" and "unknowing" decisions).

[255] INTERNAL REVENUE SERV., *supra* note 253, at 13 (providing a schedule for churches).

[256] *Id.*

[257] I.R.C. § 7611(a)(2).

[258] I.R.C. § 7611(a)(2) (stating reasonable belief requirement); I.R.C. § 513 (defining unrelated business income).

within two years of initiating the audit.[259] These requirements have stymied church audits since CAPA's passage in 1984 (again, with a legislative history "remarkably silent as to the reason for [its] enactment),[260] and need to be updated to permit the IRS to limit abuses of the church advantage.

First, the IRS needs to issue better guidance around who counts as an "appropriate high-level Treasury official."[261] Despite the uncertainty around this requirement that has lingered since the IRS's reorganization in 1998, no rulemaking process has clarified who can initiate an audit. Though it appears from recent court decisions that the Commissioner of the Tax Exempt and Government Entities Division (two steps below the IRS Commissioner) is appropriately "high-level," [262] the IRS should issue clarifications that help it avoid losing audit battles on this technicality.[263] More specifically, the IRS should expand the number of officials with appropriately elevated rank who can initiate audits to facilitate an effective audit effort within a resource-starved agency.

Next, the Congress should eliminate the requirement that the auditing official's reasonable belief be based on "facts and circumstances recorded in writing."[264] In addition to creating a significant hurdle for auditors, this requirement creates a moral hazard for religious organizations seeking the church advantage. Masquerading churches that should be filing Form 990s can avoid that requirement *and* likely avoid an audit if they switch to church status—under which they need not provide any written paper trail upon which an IRS audit can commence.[265] This

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[259] I.R.C. § 7611(b)–(c).

[260] Hopkins, *supra* note 164, at 9.

[261] I.R.C. § 7611(h)(7).

[262] United States v. Bible Study Time, Inc., 295 F. Supp. 3d 606, 614 (D.S.C. 2018) ("The Initial Regulation [identifying the Regional Commissioner as the lowest-level audit authority] has never been rescinded or replaced. It may, nonetheless, not be followed as written because the position of Regional Commissioner was eliminated after adoption of the IRS Restructuring and Reform Act of 1998.").

[263] *See* United States v. Living Word Christian Ctr., No. 08-mc-37 ADM/JJK, 2009 U.S. Dist. LEXIS 6902, at *10–11 (D. Minn. Jan. 30, 2009) (invalidating a church audit to examine private inurement allegations because it was not initiated by an "appropriate high-level Treasury official").

[264] I.R.C. § 7611(a)(2).

[265] Andrew L. Seidel, *Churches Are Financial Black Holes. Here's What Congress Can Do About It*, THINKPROGRESS (Dec. 20, 2018, 8:00 AM), https://archive.thinkprogress.org/churches-susceptible-fraud-congress-file-financial-irs-93830e2be2cd/ [https://perma.cc/AZ7Z-2XKA] ("Unlike other 501(c)(3) organi-

requirement would also seem to disincentivize churches (masquerading or not) from keeping written financial records, as "church records" refers to "all corporate and financial records regularly kept by a church, including corporate minute books and lists of members and contributors."[266] Without any statutory or regulatory requirement for churches to keep these types of records, Congress again relies unnecessarily on private enforcement from organizations like the ECFA and MinistryWatch or from donors themselves.

Congress should also amend CAPA to remove the two-year limitation on the audit inquiry period for churches.[267] The IRS should be able to take seriously fraudulent abuses of the church advantage and have a similarly appropriate timeline for commencing audits and investigating masquerading churches. This common-sense shift, along with requiring Form 990s and affirmative application for church status, would establish an environment in which masquerading churches could no longer operate without any functional scrutiny.

VI. Conclusion

This Note makes several suggestions to better preserve the letter and the spirit of the legal framework undergirding the church advantage. It focuses particularly on religious organizations that abuse the church advantage by erroneously masquerading as churches. This trend appears to be increasing due to the ease with which institutions can make the switch and the numerous benefits that accompany it. Unless the IRS and Congress make changes to the IRC, IRS guidance, and the church audit procedure, this trend will likely continue to the detriment of donors and to the embarrassment of the special distinction that true churches merit under the American law.

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zations and charities, churches are exempt from filing financial information with the IRS, including the annual Form 990, which tracks every penny that comes into a secular nonprofit and every penny it spends.").

[266] I.R.C. § 7611(h)(4).

[267] *See* I.R.C. § 7611(c)(1)(A) ("The Secretary shall complete any church tax status inquiry or examination (and make a final determination with respect thereto) not later than the date which is 2 years after the examination notice date.").