



Representing Secular Americans

In Our Nation's Capital

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April 15, 2013

Comments: Charitable/Exempt Organizations Tax Reform Working Group of the House Ways and Means Committee

Submitted by email to tax.reform@mail.house.gov

The Honorable David Reichert
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The Honorable John Lewis
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Dear Mr. Chairman:

The Secular Coalition agrees with the goals of these tax reform efforts to make the code simpler and fairer. To help achieve these goals we suggest deleting three provisions from the tax code: 1. The initial 501(c)(3) application exemption for churches, 2. The annual Form 990 filing exemption for churches, and 3. The restrictions on church tax inquiries known as the Church Audit Procedures Act. Applying the same rules to all 501(c)(3) organizations by removing religious privileging will result in a simpler and fairer tax code.

Current Law and Suggested Revisions

The tax code grants numerous benefits to churches. Although most organizations seeking tax-exempt status are required to apply to the Internal Revenue Service for an advance determination that they meet the requirements of section 501(c)(3), a church may simply hold itself out as tax

exempt and receive the benefits of that status without applying for advance recognition from the IRS, under §508(c)(1)(A).ⁱ All other organizations must fill out the 31 page Form 1023 to apply to receive recognition. Once an organization is granted tax-exempt status pursuant to §501(c)(3), it is required to file a Form 990 annual return with the IRS. The information provided in Form 990 is used by the IRS to ensure, among other things, that an organization that was granted tax-exempt status remains so qualified. Churches and their integrated auxiliaries, are exempt from filing a 990 return, pursuant to §6033(a)(3)(A)(i).ⁱⁱ All other 501(c)(3) organizations are required to file a 990 annual or risk losing their tax-exempt status.

Small tax-exempt organizations' whose annual gross receipts are \$50,000 or less are only required to submit the Form 990-N, also known as the e-Postcard. Deleting §6033(a)(3)(A)(i) will trigger a requirement for most small congregations to file this form. It requires their employer identification number (EIN), also known as Taxpayer Identification Number (TIN), tax year, legal name and mailing address, any other name the organization uses, name and address of principal officer, web site address if the organization has one, and confirmation that the organization's annual gross receipts are normally \$50,000.00, or less.

One of the most significant benefits churches receive is practical immunity from IRS auditing based on the extensive and strict procedures set forth in the Church Audit Procedures Act (CAPA), codified in §7611.ⁱⁱⁱ CAPA requires that before the IRS may begin an inquiry into the tax status of any organization claiming to be a church, it must satisfy certain prerequisites, including articulating a reasonable belief in the need for an investigation, providing special notice to the church, and requiring the inquiry be conducted by a high-level Treasury official.

The combination of §508(c)(1)(A), §6033(a)(3)(A)(i), and §7611, ensures churches receive substantial tax benefits while remaining insulated from any public or government review. We suggest the deletion of these three provisions as a step toward creating a simpler and fairer tax code.

Research and Support for Suggested Revisions

A fair tax system should require accountability from all organizations that are entrusted with the privileges of tax exemption. However, the limitations imposed on the IRS by these three provisions ensure that churches are virtually insulated from public or government oversight. Reporting requirements for tax-exempt organizations are in place to ensure the benefits received are serving the benevolent purpose for which they were intended. Charitable contributions by individuals, foundations, bequests, and corporations reached \$298.42 billion in 2011, with religious organizations receiving the largest share – 32 percent—of total estimated contributions.^{iv} Holding religious organizations to the same filing standards as other charitable and educational institutions ensures that the almost \$100 billion being donated to these organizations is actually going to help those who need it.

Without required reporting, the immense quantity of money that is cloaked by this veil of secrecy can only be projected based upon information amassed by the investigatory journalism of The Economist through court documents in bankruptcy cases and public record.^v It is estimated

that the annual spending by the Catholic church and entities owned by the church was around \$170 billion in 2010. For purposes of secular comparison, in 2010 General Electric's revenue was \$150 billion and they are subject to intense regulation. When select organizations are shielded from any investigation there is no way to know if the benevolent action of the donor is in actuality funding a range of criminal actions, from violations of 501(c)(3) limitations to felonious activity, or even terrorist activity. Billions of tax exempt dollars are funding criminal activity or the protection of criminals. The molestation and rape of children by priests in America has resulted in more than \$3.3 billion of settlements over the past 15 years and the total is likely to increase. In July 2012 the former chief financial officer of the archdiocese of Philadelphia was convicted of embezzling more than \$900,000 between 2005 and 2011, most of which was gambled away.

Donations to charitable organizations are a crucial element of the social safety net, but donations from the faithful are on the decline by as much as 20%.^{vi} Few people want to donate money that is unmonitored and may go to defending predatory priests. They are also wary about how much charitable giving the church is doing. The Church of Jesus Christ of Latter-day Saints donated what would seem to be an impressive \$1.4 billion between 1985 and 2011,^{vii} but it only accounts for .009% of its annual revenue during that time, estimated around \$156 billion.^{viii} "If treated like a U.S. corporation, by revenues the LDS Church would rank number 243 on the Fortune 500 list."^{ix} Not only is the LDS Church not subject to the same regulations as other billion dollar corporations, the church is exempted from nonprofits regulation and enforcement. For comparison, the American Red Cross spends 92.1% of its revenue directly addressing the needs of those it intends to help.^x Although its annual revenue is approximately half of the LDS Church, the American Red Cross spent twice as much money on charity in *one year* than the LDS Church did in 26 years.^{xi} The IRS is empowered to revoke tax exempt status if an organization stops doing all or a significant amount of the exempt activities, but the walls built around religious organizations by these exemptions gives them practical immunity from ensuring they are acting charitably.

Closing these three loopholes is a simple and untapped revenue source. Donations to churches that do not meet 501(c)(3) requirements will no longer be tax deductible. If only a quarter of the \$100 billion that is donated to religious organizations in a year was not eligible for a deduction, it could be subject to a gift tax of up to 35%, or as much as \$8.75 billion in revenue. It is incredibly difficult to calculate how much potential revenue is lost to property tax exemptions for churches that violate 501(c)(3) rules, but an example can be enlightening. St. Patrick's Cathedral in New York City is home to Cardinal Timothy Dolan, president of the U.S. Conference of Catholic Bishops, and active political advocate in violation of 501(c)(3) lobbying prohibitions. A comparably sized office building across the street from the Cathedral pays over \$2.8 million in annual property taxes.^{xii} Revenues lost to the nonprofit property tax exemption in 2009 were between \$17 and \$32 billion nationally.^{xiii} If only a quarter of that lost revenue could be recouped through churches that do not qualify as 501(c)(3) organizations the property taxes that could be generated could reach \$8 billion. Enabling the IRS to revoke the tax-exempt status of violating religious organizations by requiring application, reporting, and removing CAPA from the tax code could generate up to **\$16.75 billion** per year, almost enough to cover the entire 2012 budget for NASA.^{xiv}

Not only do churches and religious organizations flagrantly violate rules prohibiting political activity by 501(c)(3) organizations, they rub it in the IRS' face. The Johnson Amendment of 1954 changed the U.S. tax code to prohibit tax exempt organization from endorsing or opposing political candidates. The Pulpit Freedom Initiative urges church pastors to violate the statute.^{xv} In 2012 at least 1,620 congregations participated in Pulpit Freedom Sunday, the specific day where pastors endorse a political candidate.^{xvi} They throw their illegal activity in the face of the IRS by taping these sermons and sending them in. The IRS is paralyzed to act because of CAPA. This was confirmed by a 2009 ruling against the IRS' investigation into a church, when the U.S. District Court in Minnesota cited one of the impossibly high standards of CAPA that the investigation be conducted by a "high-level Treasury official."^{xvii} There have been no recorded investigations into churches since this case,^{xviii} Unlike all other 501(c)(3) organizations, Churches can endorse candidates without fear of enforcement or consequences and they know it.

Response to Potential Counter Arguments

These exemptions were supposedly justified by the Religion Clauses of the First Amendment of the Constitution, but there is no direct connection to either. Upon revocation of these exemptions to which religious organizations feel entitled, they will likely invoke these judicially rejected arguments. The courts have repeatedly held that 501(c)(3) status is a **privilege** and that removing an exemption and imposing taxes on churches does not infringe on the Free Exercise Clause. Nor does requiring reporting to receive a privilege run afoul of the Establishment Clause. Multiple courts have held that the auditing involved in ensuring a church is complying with 501(c)(3) status is not the type of impermissible entanglement that the Establishment Clause prohibits.

These exemptions cannot be justified by the Free Exercise clause because 501(c)(3) status is a privilege,^{xix} it is "not a constitutional right."^{xx} Courts have consistently upheld Free Exercise Clause challenges to provisions of § 501(c)(3).^{xxi} In one such case, the court was clear when it asserted that "[p]etitioner must comply with the statutorily mandated requirements to qualify for tax exemption regardless of the fact that it claims to be a 'religious' organization, for exemption from tax is a privilege or matter of legislative grace rather than a right."^{xxii} By *voluntarily* availing itself of the advantages of 501(c)(3) status, a church gives up the privilege of absolute secrecy.^{xxiii} It is not a limit on Free Exercise if it is optional. The court explained, "[p]laintiff is free to espouse his religious doctrine and to solicit support for his cause. He simply must allow the government access to information in order to determine whether the church remains within the criteria for a lighter tax burden. The church may, of course, *forego the exemption and limit IRS access to church records.*"^{xxiv}

Free Exercise rights are only violated if they are substantially burdened. Requiring compliance with regulations in order to show entitlement to tax-exempt status is only an incidental burden upon the Free Exercise of religion, and not a constitutional violation.^{xxv} In *United States v. Holmes*, the court rejected a church's first amendment challenge to the IRS's ability to review church documents. Applying the Supreme Court's two part test, the court found that the burden on the free exercise of religion, protected by the Free Exercise Clause, by requiring a church

representative to respond to a properly narrowed summons in order to show a right to tax exempt status, was incidental. Balanced against this minimal burden, the court found that the government had a substantial interest in maintaining the integrity of governmental fiscal policies. Seven questions can hardly be considered a substantial burden or excessive investigation. Where there is not a legitimate government interest is in the exemption of churches.

Churches argue the filing of returns and IRS investigations into 501(c)(3) compliance are violations of the Establishment Clause, as impermissible entangling inquiries into church's management. However, the true purpose of the entanglement criteria is to keep government out of matters involving religious belief and practice.^{"xxvi} Collecting financial information from charitable corporations is not an investigation into religious belief or practice. It has the clearly secular purpose of ensuring the good intentions of the 501(c)(3) exemption are being met. It is not a required regulatory measure, but ensuring compliance to accept a government benefit. This position was supported by the court when it held "the determination of a religious organization's tax liability does not entail Government control over church finances. A church remains free to structure its finances as it sees fit."^{xxvii}

Churches want to have their cake and eat it too, to gain the advantages of participation in a voluntary government program without a hint of oversight. These religious entitlements must end. "The establishment clause does not cloak a church in utter secrecy, nor does it immunize a church from all governmental authority."^{xxviii} Many religious charities are doing important work and charitable giving to all religious 501(c)(3) organizations is put at risk when the bad apples are protected. We respectfully request the feedback the Charitable/Exempt Organization Working Group submits to the Joint Committee on Taxation include recommendations to make the tax code simpler, fairer and increase revenue by eliminating the religious entitlements of §508(c)(1)(A), §6033(a)(3)(A)(i), and §7611.

For questions or comments, please contact Kelly Damerow at Kelly@secular.org or (202) 299-1091.

Respectfully Submitted,

Secular Coalition for America

ⁱ 26 USC §508(c)(1)(A). ((c) Exceptions (1) Mandatory exceptions Subsections (a) and (b) shall not apply to— (A) churches, their integrated auxiliaries, and conventions or associations of churches)

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- ⁱⁱ 26 USC §6033(a)(3)(A)(i) (1954). ((3) Exceptions from filing (A) Mandatory exceptions Paragraph (1) shall not apply to— (i) churches, their integrated auxiliaries, and conventions or associations of churches.)
- ⁱⁱⁱ Church Audit Procedure Act, 26 USC §7611 (1984).
- ^{iv} The Nonprofit Sector in Brief: Public Charities, Giving, and Volunteering. 2012.
<http://www.urban.org/UploadedPDF/412674-The-Nonprofit-Sector-in-Brief.pdf>
- ^v The Catholic Church in America: Earthly Concerns. The Economist. August 18, 2010.
<http://www.economist.com/node/21560536>
- ^{vi} Id.
- ^{vii} Welfare Services Fact Sheet, 2011. <http://www.lds.org/bc/content/shared/content/english/pdf/welfare/2011-welfare-services-fact-sheet.pdf?lang=eng>
- ^{viii} Mormon America: The Power and the Promise. Mormon Research Ministry. <http://www.mrm.org/mormon-america>
- ^{ix} Id.
- ^x American Red Cross. <http://www.charitynavigator.org/index.cfm?bay=search.summary&orgid=3277>
- ^{xi} Form 990 of the American Red Cross.
http://www.redcross.org/images/MEDIA_CustomProductCatalog/m3140123_ARC_990_2009.pdf
- ^{xii} Property Tax Assessment for 400-408 Madison Avenue, New York, NY 10017
<http://www.propertyshark.com/mason/Property/20782/400-408-Madison-Ave-New-York-NY-10017/>
- ^{xiii} The Property Tax Exemption for Nonprofits and Revenue Implications for Cities. November 2011.
<http://www.urban.org/UploadedPDF/412460-Property-Tax-Exemption-Nonprofits.pdf>
- ^{xiv} Budget of the U.S. Government. February 13, 2012. Public Law 112-55
<http://www.gpo.gov/fdsys/search/pagedetails.action?packageId=BUDGET-2013-BUD>
- ^{xv} <http://www.speakupmovement.org/church/LearnMore/details/4702>
- ^{xvi} http://www.speakupmovement.org/Church/Content/pdf/PFS_2012_Churches_Final_list.pdf
- ^{xvii} *U.S. v. Living Word Christian Center*, Civil No. 08-mc-37 ADM/JJK (MN Nov. 18, 2008).
- ^{xviii} http://www.huffingtonpost.com/2012/11/04/irs-church-state_n_2069009.html
- ^{xix} Cf. *Employment Div. v. Smith*, 494 U.S. 872 (“right of free exercise does not relieve an individual of the obligation to comply with a ‘valid and neutral law of general applicability’”) (quoting *United States v. Lee*, 455 U.S. 252, 263, (1982) (Stevens, J., concurring)).
- ^{xx} *Incorporated Trustees of Gospel Worker Soc. v. United States, Dep’t of Treasury*, 510 F. Supp. 374, 380 (D.D.C. 1981) (quoting *Parker v. Commissioner*, 365 F.2d 792, 795 (8th Cir. 1966), cert. denied, 385 U.S. 1026 (1967)).
- ^{xxi} See, e.g., *Bob Jones University v. United States*, 461 U.S. 574 (1983) (upholding against Free Exercise Clause challenge the revocation of tax-exempt status justified on public policy grounds where religious university prohibited inter-racial dating); *Branch Ministries v. Rossotti*, 341 U.S. App. D.C. 166 (D.C. Cir. 2000) (holding that it is permissible to condition tax-exempt status on church’s agreement to limit its political activity); *United States v. Saladino*, 2005 U.S. Dist. LEXIS 38131, 6-7 (C.D. Cal. 2005).
- ^{xxii} Citing *Christian Echoes National Ministry, Inc. v. United States*, 470 F.2d 849, 857 (10th Cir. 1972), cert. denied 414 U.S. 864 (1973).
- ^{xxiii} See *U.S. v. Coates*, 692 F.2d 629, 633 (9th Cir. 1982) (“Section 501(c) (3) is unenforceable unless the IRS has the power to examine books of account during an investigation into the tax exempt status of an organization claiming to be a church.”).
- ^{xxiv} Cf. *Hearde v. Commissioner*, 421 F.2d 846 (9th Cir. 1970) (required disclosure of charitable donation beneficiaries to be entitled to deduction results in only incidental burden on religion); see generally *Johnson v. Robison*, 415 U.S. 361 (1974).
- ^{xxv} *United States v. Holmes*, 614 F.2d 985, 989 (5th Cir. 1980).
- ^{xxvi} Citing *Serbian Orthodox Diocese v. Milivojevich*, 426 U.S. 696, 709-710 (1976); *Presbyterian Church in the United States v. Mary Elizabeth Blue Hull Memorial Presbyterian Church*, 393 U.S. 440, 449 (1969).
- ^{xxvii} Citing *United States v. Freedom Church*, 613 F.2d 316, 320 (1st Cir. 1979).
- ^{xxviii} Citing *Serbian Orthodox Diocese v. Milivojevich*, 426 U.S. 696, 709-710 (1976); *Presbyterian Church in the United States v. Mary Elizabeth Blue Hull Memorial Presbyterian Church*, 393 U.S. 440, 449 (1969).