

# THE TAXATION OF RELIGIOUS ORGANIZATIONS IN AMERICA

## INTRODUCTION

Christ taught his disciples to “[r]ender to Caesar the things that are Caesar’s, and to God the things that are God’s.”<sup>1</sup> The Supreme Court has, to an extent, rendered to God what is God’s by repeatedly acknowledging that it will not involve itself in the internal affairs of religious organizations.<sup>2</sup> Nevertheless, the extent to which religious organizations remain vulnerable to involvement from other branches of government remains a pertinent question, especially with regards to the government’s power to tax.<sup>3</sup>

This Note investigates the extent to which religious organizations are vulnerable to such involvement. A prime example of such involvement is Congress’ ability to use the Internal Revenue Code to the detriment of religious organizations. As it ensures that what is Caesar’s (i.e., taxes) is rendered to Caesar (i.e., the federal government), any policy of Congress and the Internal Revenue Service (I.R.S.) that thwarts the faithful from rendering to God what is God’s has the potential to impose a prohibitive burden on the operation of religious organizations. The potential to hinder the work of religious organizations

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1. *Mark* 12:17 (KJV).

2. *See, e.g., Hosanna-Tabor Evangelical Lutheran Church & Sch. v. EEOC*, 565 U.S. 171, 184 (2012) (“The Establishment Clause prevents the Government from appointing ministers, and the Free Exercise Clause prevents it from interfering with the freedom of religious groups to select their own.”); *Corp. of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v. Amos*, 483 U.S. 327, 334 (1987) (“This Court has long recognized that the government may (and sometimes must) accommodate religious practices and that it may do so without violating the Establishment Clause.”); *Kedroff v. St. Nicholas Cathedral of Russian Orthodox Church in N. Am.*, 344 U.S. 94, 120–21 (1952) (“Even in those cases when the property right follows as an incident from decisions of the church custom or law on ecclesiastical issues, the church rule controls.”).

3. Article I of the U.S. Constitution grants Congress the “Power To lay and collect Taxes . . . to pay the Debts and provide for the common Defence and general Welfare of the United States.” U.S. CONST. art. I, § 8, cl. 1. However, it was not until the passage of the Sixteenth Amendment that Congress received the power to directly tax income “without apportionment among the several states.” *Id.* amend. XVI.

through taxation is great. Indeed, “the power to tax involves the power to destroy.”<sup>4</sup> Insofar as Congress retains the power to tax religious organizations, it likewise maintains the power to destroy.

In short, religious organizations benefit tremendously from their tax-exempt status.<sup>5</sup> However, this tax-exempt status is not a given; the tax-exempt status for religious organizations is neither a right that was found to be in existence prior to the formation of the United States and therefore enshrined in the Constitution, nor is it a right created by the Constitution.<sup>6</sup> Rather it is a status that is based on the consent of Congress and listed deep in the bowels of the United States Code. Therefore, religious organizations and their allies must remain vigilant in ensuring that their representatives in Congress and officials in the executive branch uphold those portions of the Tax Code that exempt religious organizations from tax obligations.

#### I. THE BASIS ON WHICH RELIGIOUS ORGANIZATIONS ARE GRANTED TAX-EXEMPT STATUS

In order to understand the threat to religious organizations from adverse changes to tax law, it is important to first understand the provisions in the Internal Revenue Code on which

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4. *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819).

5. See, e.g., Dylan Matthews, *You Give Religions More Than \$82.5 Billion a Year*, WASH. POST (August 22, 2013), [https://www.washingtonpost.com/news/wonk/wp/2013/08/22/you-give-religions-more-than-82-5-billion-a-year/?utm\\_term=.a7f0f667a612](https://www.washingtonpost.com/news/wonk/wp/2013/08/22/you-give-religions-more-than-82-5-billion-a-year/?utm_term=.a7f0f667a612) [https://perma.cc/Z5BB-FPP8] (approximating the annual benefits of the tax-exempt status to religious organizations at \$82.5 billion dollars). Indeed, those who benefit the most from the tax-exempt status of religious organizations—and who would likely be negatively affected the most by a repeal of the tax-exempt status—are perhaps the poor and the needy whom many religious organizations work so hard to serve temporally. Each dollar that a religious organization pays to the government in taxes is one less dollar that the religious organization has to spend on serving the “least of these.” *Matthew* 25:40 (KJV) (“Inasmuch as ye have done it unto one of the least of these my brethren, ye have done it unto me.”).

6. See *United States v. Cruikshank*, 92 U.S. 542, 551 (1875) (discussing rights that are commonly found wherever civilization exists, and those that were created by the United States Constitution).

religious organizations are granted tax-exempt status,<sup>7</sup> as well as the legislative history behind these sections of the Tax Code.

A. *Tax-Exempt Status for Religious Organizations Codified*

At the federal level, all income to a person, be it to a corporation or to a non-corporation individual, is taxable by default.<sup>8</sup> On this principle hang all the law and the profits of the Tax Code.<sup>9</sup> Thereafter, deriving a person's tax burden involves accounting for various deductions and exemptions provided for in the Tax Code,<sup>10</sup> and multiplying this calculated amount by the appropriate tax rate.<sup>11</sup> But for the exemptions allowed for in § 501(a) and § 501(c), religious organizations would be considered ordinary corporations for tax purposes,<sup>12</sup> and thus would be subject to taxation on all received tithes, offerings, and donations at the corporate tax rate.<sup>13</sup> In other words, assuming simi-

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7. This Note does not explicitly address state taxation of religious organizations, although all fifty states provide for the tax exemption of places of worship. *See Walz v. Tax Comm'n*, 397 U.S. 664, 676 (1970).

8. *See* 26 U.S.C. § 61(a) (2012) ("Gross income means all income from whatever source derived.").

9. *Cf. Matthew* 22:40 (KJV) ("On these two commandments hang all the law and the prophets.").

10. Popular deductions include the standard deduction for individuals, *see* 26 U.S.C. § 63(c), the mortgage interest deduction for individuals, *see id.* § 163(h), and wage and salary deductions for corporations, *see id.* § 162(a)(1). It will be useful here to briefly distinguish between the standard deduction and itemized deductions for individuals. Individuals have the option of listing each deduction for which they qualify, adding these up, and deducting this sum from their taxable income. This process is known as itemization. The alternative is to take the standard deduction, which is a default sum that any individual taxpayer can deduct from his or her taxable income. *See id.* § 63(c). If an individual's itemized deductions surpass the standard deduction, and assuming that this individual desires to minimize his or her tax burden, then it is in the taxpayer's interest to forego the standard deduction and take the aggregate itemized deductions. Typically speaking, wealthier taxpayers will elect to itemize deductions, while other taxpayers will elect to take the standard deduction. For a discussion on the effect that raising the standard deduction might have on the amount people donate to religious organizations, *see infra* Part III.

11. Corporations, among which religious organizations are normally included, *see* 26 U.S.C. § 7701(a)(3), are taxed according to the rates found in 26 U.S.C. § 11(b), while all other taxpayers are taxed according to the rates found in 26 U.S.C. § 1.

12. *See id.* § 7701(a)(3) ("The term 'corporation' includes associations, joint-stock companies, and insurance companies.").

13. *See id.* § 11(a) ("A tax is hereby imposed for each taxable year on the taxable income of every corporation.").

lar levels of income, the local church, mosque, or synagogue, which exists to connect believers to the divine in a non-profit manner, would be taxed in the same way as the local grocer or hardware store, which exists to maximize shareholder value.

Congress, however, elected to exempt from taxation certain types of organizations.<sup>14</sup> Among these are corporations “organized and operated exclusively for religious, charitable, [and] scientific . . . purposes.”<sup>15</sup> This exemption releases a religious organization from the burden of paying taxes on any donations received, and thereby enables such an organization to devote more funds to its operations and efforts to fulfill its mission as a religious organization. Persons making charitable contributions to such an organization are also thus reassured that more of their contribution will go to the religious organization, as opposed to the government’s coffers.

However, a religious organization must conform to certain provisions contained in 26 U.S.C. § 501(c)(3) in order to qualify for tax-exempt status: (1) None of the religious organization’s earnings may “inure[] to the benefit of any private shareholder or individual”; (2) the religious organization may not have a “substantial part of [its] activities” dedicated to influencing legislation; and (3) the religious organization may not participate in any political campaign in support of or in opposition to a candidate for public office.<sup>16</sup> Violation of any of these provisions can result in the religious organization losing its tax-exempt status.<sup>17</sup>

B. *The History and Justification for the Tax-Exempt Status of Religious Organizations*

Religious organizations were first exempt from taxation under the Wilson-Gorman Tariff Act of 1894, which Congress

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14. *See id.* § 501(a).

15. *Id.* § 501(c)(3).

16. *See id.* § 501(c)(3). The third provision of 26 U.S.C. § 501(c)(3) is known as the Johnson Amendment after then-Senator Lyndon B. Johnson, who proposed this amendment in 1954 as part of the Internal Revenue Code of 1954. For a critique of the Johnson Amendment and a discussion of its constitutionality, see generally, Erik W. Stanley, *LBJ, the IRS, and Churches: The Unconstitutionality of the Johnson Amendment in Light of Recent Supreme Court Precedent*, 24 REGENT U. L. REV. 237 (2012).

17. For an explanation of the codified process by which religious organizations may have their tax-exempt status revoked, see *infra* Part IV.A.

billed as an act to reduce taxation and which President Grover Cleveland refused to sign but nevertheless allowed to become law by not vetoing the bill.<sup>18</sup> The act explicitly indicated that none of the enacted taxes “shall apply . . . to corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes.”<sup>19</sup> In 1954 Congress adopted the first iteration of the modern Tax Code, in which it maintained a similar wording to grant tax-exempt status to religious and charitable organizations.<sup>20</sup>

Congress has offered several justifications for granting tax-exempt status to religious organizations and charities:

- (1) Charitable and religious organizations serve the public and therefore should be supported through provision of tax benefits;
- (2) Charitable and religious organizations provide goods and services that otherwise would have to be provided by the Government and therefore should be supported by the Government;
- (3) It is difficult to measure the net income of charitable and religious organizations, and therefore they should be exempt from tax;
- (4) Charitable and religious organizations promote pluralism;
- (5) Charitable and religious organizations are efficient providers of services but have inherent limits on their ability to raise capital compared to for-profit entities and therefore need government support in the form of tax exemption (and charitable contributions); and,

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18. For a more comprehensive history of the tax-exempt sector, see generally, Paul Arnsberger et al., *A History of the Tax-Exempt Sector: An SOI Perspective*, STAT. INCOME BULL., Winter 2008, at 105; see also Intervenor-Defendants’ Reply Brief in Support of Their Motion for Summary Judgement at 9–16, *Gaylor v. Mnuchin*, 278 F. Supp. 3d 1081 (W.D. Wis. 2017) (No. 16-CV-215), 2017 WL 3251871, *rev’d*, Nos. 18-1277, 18-1280, 2019 WL 1217647 (7th Cir. Mar. 15, 2019).

19. Wilson-Gorman Tariff Act, ch. 349, § 32, 28 Stat. 509, 556 (1894).

20. See I.R.C. § 501(c)(3) (1954) (“Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes.”).

(6) Exemption is afforded to those organizations that can prove their worth through sustained donations.<sup>21</sup>

It is clear from Congress' wording of the Tax Code that it distinguishes religious organizations from charitable organizations. This does not mean that religious organizations are not charitable; while religious organizations might have charitable functions, they nevertheless differ from charitable organizations sufficiently in order to justify their separate enumeration in the Tax Code. Indeed, if religious organizations were merely a subset of charitable organizations, then they would not be explicitly mentioned separately from charitable organizations in 26 U.S.C. § 501(c)(3).

Religious organizations provide a public good apart from what charitable organizations provide.<sup>22</sup> It has been suggested that religion itself is a factor that disproportionately motivates persons to make donations when compared to non-religious charitable organizations, which would justify separate mentioning in the Tax Code.<sup>23</sup> Additionally, religious organizations play a key role in integrating persons from a variety of backgrounds into a single community, thereby strengthening the fabric of society.<sup>24</sup> Furthermore, at a constitutional level, a tax exemption for religious organizations is beneficial in that it "re-

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21. JOINT COMM. ON TAX'N, HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS 8 (2005); *see also* Walz v. Tax Comm'n, 397 U.S. 664, 674 (1970) ("We find it unnecessary to justify the tax exemption on the social welfare services or 'good works' that some churches perform for parishioners and others—family counseling, aid to the elderly and the infirm, and to children.").

22. *See* Ross Douthat, Editorial, *Do Churches Fail the Poor?*, N.Y. TIMES (May 16, 2015), <https://www.nytimes.com/2015/05/17/opinion/sunday/ross-douthat-do-churches-fail-the-poor.html> [<https://nyti.ms/2qnIs5F>] ("A church that pays out to help the poor, but doesn't pray with them, looks less like a church than what Pope Francis has described, unfavorably, as merely another N.G.O.").

23. *See, e.g.*, Editorial, *Charitable Giving to Churches Provides a Great Benefit to Society*, DESERET NEWS (Nov. 8, 2013), <https://www.deseretnews.com/article/865590058/Charitable-giving-to-churches-provides-a-great-benefit-to-society.html> [<https://perma.cc/W8WW-M4HN>] ("[R]egions of the United States in which a high percentage of people are devoutly religious tend to give far more than people in other areas.").

24. *See, e.g.*, Hamil R. Harris, *Churches Become Area's Melting Pot*, WASH. POST, (Oct. 22, 1998), [https://www.washingtonpost.com/archive/local/1998/10/22/churches-become-areas-melting-pot/982bed07-7733-4639-a7e9-782759a1dba4/?utm\\_term=.9e7fd6c71ed3](https://www.washingtonpost.com/archive/local/1998/10/22/churches-become-areas-melting-pot/982bed07-7733-4639-a7e9-782759a1dba4/?utm_term=.9e7fd6c71ed3) [<https://perma.cc/3K77-EJB8>] (describing how churches in the Washington, D.C. area have integrated religious individuals from different backgrounds).

stricts the fiscal relationship between church and state, and tends to complement and reinforce the desired separation insulating each from the other.”<sup>25</sup>

## II. NEGATIVE EXTERNALITIES OF NON-HOSTILE CHANGES TO THE TAX CODE

Before discussing potential threats to the tax-exempt status of religious organizations, it is worth noting the effects that recent changes to the Tax Code could have on the financial health of religious organizations. There is no indication that Congress undertook these changes in order to hinder the operations of religious organizations. Rather, the negative effects are merely the consequences of independent changes to other provisions of the Tax Code.

### A. Increase to the Standard Deduction

Religious organizations are vulnerable not just to hostile changes to the Tax Code, but also to the unforeseen and unintended consequences of non-hostile changes to Tax Code, such as an increase in the standard deduction. The Tax Cuts and Jobs Act, which was signed into law on December 22, 2017, increased the standard deduction from \$12,700 to \$24,000 for married couples filing jointly and from \$6,350 to \$12,000 for single filers for the years 2018 to 2025.<sup>26</sup> This is expected to have a negative impact on the financial health of religious organizations by weakening the incentive to make donations and therefore decreasing the amount of donations made to religious organizations by individual taxpayers.<sup>27</sup> As mentioned above, the Tax Code allows individuals to deduct from taxable income any donations made to religious organizations.<sup>28</sup> Allowing individuals to deduct donations to religious organizations from their taxable income incentivizes them to make donations to religious organizations by reducing the economic cost of mak-

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25. *Walz*, 397 U.S. at 676.

26. Compare Rev. Proc. 2016-55 § 3.14, 2016-2 C.B. 707 (listing the standard deduction amounts for fiscal year 2017), with 26 U.S.C. § 63(c)(7) (Supp. V 2018) (listing the standard deduction amounts for fiscal years 2018 through 2025).

27. See *Mass Deduction: Recent tax reforms in America will hurt some non-profits more than others*, *ECONOMIST*, Feb. 15, 2018, at 72.

28. See 26 U.S.C. § 170(c)(2)(B) (2012).

ing a donation. The logic is as follows: if an individual is required to part with a certain amount of his income in any event, and if an individual would rather that his money goes to a local religious organization than to the distant government in Washington, D.C., then such an individual is likely to pay as much of the required amount as possible directly to his local religious organization, rather than simply to pay the full required amount to the federal government. Thus, given the opportunity to do so, the taxpayer will make donations to his local religious organization and deduct these donations from taxable income, thereby decreasing his tax bill. This system is effectively a redirect of funds, as money that would have gone to government coffers instead goes to the individual's religious organization or charity of choice.<sup>29</sup>

*B. The greater the standard deduction, the smaller the incentive to make donations to religious organizations*

The incentive, however, exists only for individuals that elect to take the itemized deduction.<sup>30</sup> Such individuals are incentivized to increase donations to charities in order to increase their itemized deductions and thus decrease their tax bill. The incentive does not exist for individuals taking the standard deduction because no donation is actually required to take the standard deduction.<sup>31</sup> If an individual can claim the standard deduction in any event, then there is no fiscal benefit to making a donation to any organization. Hence, people taking the standard deduction are less incentivized by the Tax Code to make charitable donations to religious organizations. If more people take the standard deduction, then fewer people are incentivized to make donations to religious organizations and, as a result, religious organizations will receive fewer donations.

Increasing the standard deduction for federal personal income tax does just that: it invites more individuals to elect to

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29. See *Mass Deduction*, *supra* note 27, at 72–73.

30. Individuals who take the standard deduction are not eligible to itemize any deductions. See 26 U.S.C. § 63(c)(6) (2012) (declaring that if an individual itemizes any deductions then the standard deduction for this individual shall be zero).

31. Compare 26 U.S.C. § 63(b) (2012) (enumerating that taxable income for individuals not itemizing deductions is equal to adjusted gross income minus the standard deduction), with 26 U.S.C. § 63(d), (e) (2012 & Supp. V 2018) (outlining the process of itemizing deductions).



take the standard deduction, and thereby completely removes the incentive for these individuals to itemize deductions, which in turn reduces the incentive to make donations to religious organizations.<sup>32</sup> Therefore, by increasing the standard deduction, which the Tax Cuts and Jobs Act did, Congress has encouraged more individuals to elect to take the standard deduction and removed the incentive for these individuals to itemize deductions and make donations to religious organizations. Wealthier individuals who have traditionally itemized deductions are anticipated to continue to make donations to religious organizations as they did before, and poorer individuals who have traditionally elected to take the standard deduction will also continue to make donations to religious organizations in the same amounts as they did before the change to the standard deduction amount. The decrease in donations is likely to come from individuals who previously itemized their deductions, but who in light of the increase in the standard deduction will now elect to take the standard deduction. Indeed, the greatest temptation to decrease donations to religious organizations will be presented to those individuals for whom the newly increased standard deduction surpasses their itemized deductions. These individuals tend to be in middle-class families, who traditionally give the most to religious organizations.<sup>33</sup>

To be sure, devoutly religious individuals of all economic classes will likely continue to make donations to religious organizations as they would in any economic situation. But in the aggregate, donations are expected to drop as the marginal economic tax benefit of donating to religious organizations also drops. The lesson to be learned here is that religious organizations are vulnerable not just to hostile changes to those Tax Code provisions that directly implicate them, but also to the unforeseen and unintended consequences of non-hostile changes to Tax Code provisions that are seemingly peripheral to religious organizations.

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32. See *Mass Deduction*, *supra* note 27, at 72.

33. See *id.* The rich tend to donate more to universities. See *id.* at 73.

### III. HOW A RELIGIOUS ORGANIZATION CAN LOSE ITS TAX-EXEMPT STATUS

There are many ways in which a religious organization can lose its tax-exempt status. The threats range from case-by-case revocations of individual religious organizations, which only require the initiative of the Secretary of the Treasury, to outright removal from the Tax Code of the exemption for religious organizations, which would require an act of Congress, presentment to the President,<sup>34</sup> and, in the likely event that the act is challenged in the courts, support from a majority of justices of the Supreme Court. Thus, each level of threat must overcome a corresponding level of constitutional hurdles in order to come into force.

#### A. Case-By-Case Revocation

Religious organizations that meet the requirements of 26 U.S.C. § 501(c)(3) are by default assumed to be operating as religious organizations in good faith and are normally exempt from I.R.S. audits meant to determine the sincerity of their religious activity and thus whether they should be considered tax-exempt under 26 U.S.C. § 501(c)(3).<sup>35</sup> The Secretary of the Treasury may initiate a church tax inquiry only if the Secretary has (1) met the requirement of reasonable belief that an inquiry is justified and (2) provided appropriate notice to the religious organization that is the subject of the inquiry.<sup>36</sup> In turn, the reasonable belief requirement is met if the Secretary “reasonably believes,” based on written facts and circumstances, that (1) a religious organization is not actually a religious organization or (2) the religious organization is carrying on an unrelated business or other activity that is subject to taxation.<sup>37</sup> Inquiries

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34. See U.S. CONST. art. I, § 7, cls. 2–3.

35. See I.R.S., PUB. NO. 1828 (REV. 8-2015), TAX GUIDE FOR CHURCHES & RELIGIOUS ORGANIZATIONS 2 (2015) (“Churches that meet the requirements of [26 U.S.C.] § 501(c)(3) are automatically considered tax exempt and are not required to apply for and obtain recognition of tax-exempt status from the I.R.S.”).

36. See 26 U.S.C. § 7611(a)(1) (2012).

37. See *id.* § 7611(a)(2) (2018). An “unrelated trade or business” refers to any trade or business that is not substantially related to an organization’s fulfilling of its charitable or educational purpose, or other purpose that grants it tax-exempt status under 26 U.S.C. § 501(c)(3), which would include religious purposes. See *id.* § 513(a). For organizations receiving tax-exempt status under 26 U.S.C. § 501(c)(3),

opened by the Secretary ultimately turn on either or both of these two issues, and a religious organization can have its tax-exempt status revoked on the grounds of failing to comply with either of these issues. As part of an inquiry, the Secretary may request corporate documents, financial statements, lists of members and contributors,<sup>38</sup> and may observe the activities of the religious organization.<sup>39</sup> If the religious organization believes that the Secretary is noncompliant with the requirements of 26 U.S.C. § 7611, then the religious organization may file suit in court to have the church tax inquiry stayed until all issues of noncompliance have been corrected.<sup>40</sup> Based on the results of the inquiry, the Secretary may decide to revoke a religious organization's tax-exempt status.<sup>41</sup> Such a revocation must be approved by the regional counsel of the I.R.S., who will determine that the Secretary has substantially complied with the requirements of reasonable belief and appropriate notice.<sup>42</sup> Thereafter, a religious organization is left to appeal to the court to reinstate its tax-exempt status.<sup>43</sup>

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including religious organizations, an unrelated trade or business does not include any trade or business that is carried on by the organization for the convenience of the organization's members, such as businesses that sell particular types of clothing and equipment to members or that sell food through vending machines or snack bars located on the organization's functional premises. *See id.* § 513(a)(2). Additionally, the term "unrelated trade or business," thankfully for some faiths, does not include conducting regular bingo games. *See id.* § 513(f)(1).

38. *See id.* § 7611(h)(4)(A).

39. *See id.* § 7611(h)(3).

40. *See id.* § 7611(e)(1). For a contemporary example of a taxpayer filing suit to have a church tax inquiry stayed, see *Rowe v. United States*, No. 18-75, 2018 WL 2234810 (E.D. La. May 16, 2018) (dismissing church minister's petition to quash church tax inquiry).

41. *See* 26 U.S.C. § 7611(d)(1)(A). The revocation can be retroactive to all prior years that an organization is found to not be a religious organization under 26 U.S.C. § 501(c)(3) up to six years, meaning that an organization would be liable for unpaid taxes for at most the past six years. *See id.* § 7611(d)(2)(A) (2018). If an organization is found to be a religious organization in previous years, then it is not considered to have its tax-exempt status revoked for that year and thus is not liable for any taxes in that year. *See id.*

42. *See id.* § 7611(d)(1).

43. In theory, a religious organization could lose its tax-exempt status under 26 U.S.C. § 501(c)(3), while its members could continue to deduct donations from taxable income. This is due to the fact that 26 U.S.C. § 170(c) does not require that a recipient organization qualify under 26 U.S.C. § 501(c)(3). Indeed, 26 U.S.C. § 170(c)(2)(D) merely requires that an organization not be disqualified for attempting to influence legislation or for participating in political campaigns of candidates for public office. Thus, assuming that a religious organization does not

The Secretary thus has immense power to add a level of misery to the lives of religious organizations. While there is an assumption that an organization presenting itself as a religious organization is in fact a religious organization, the requirements for initiating an audit have low hurdles that can be easily overcome by a motivated Secretary. Even if a religious organization does not ultimately have its tax-exempt status revoked, a church tax inquiry can be burdensome and intrusive. The religious organization will have had its legal and financial documents searched and its member lists perused. Sacred activities will likely have been observed in an effort to determine whether a third-party observer would consider them to be sufficiently religious. If the case goes to court, then the religious organization will have to cover the costs of litigation. As such, the office of the Secretary of the Treasury can be used as a means to hinder the activities of religious organizations. For supporters of tax-exempt religious organizations who are preparing to vote in general elections, it is valuable to know (1) whom a presidential candidate would likely nominate as Secretary of the Treasury, and (2) what that individual's attitude is towards religious organizations in general, and on the tax-exempt status of religious organizations in particular.<sup>44</sup> Insofar as the Senate must approve of a President's nominee for Secretary of the Treasury, voters would also do well to question candidates for Senate regarding their willingness to reject nominees for the Secretary of the Treasury that are not fully supportive of the tax-exempt status for religious organizations.

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lose its tax-exempt status for its political activity, donations to the organization should still be deductible from the taxable income of the donor. However, inasmuch as a religious organization is most likely to lose its tax-exempt status for failing to be a bona fide religious organization, it is difficult to see in practice how a religious organization's members would be able to continue to deduct donations to the organization from their taxable income even after the organization has lost its tax-exempt status; if the organization is no longer tax-exempt because it is deemed to no longer have a religious purpose, then donations to the organization would likewise not be deductible from taxable income.

44. See U.S. CONST. art. II, § 2, cl. 2 (establishing that the President of the United States has the power to nominate and, with the advice and consent of the Senate, appoint officials).

1. *The Secretary has discretion to determine what is and what is not a religious organization for tax purposes.*

Having opened a church tax inquiry, the Secretary has the discretion to rule on that most sensitive of topics, namely what is and what is not a religious organization. The I.R.S. has issued guidelines according to which the Secretary will assess the extent to which a religious organization is indeed a religious organization that is acting in good faith.<sup>45</sup> These include, but are not limited to, the following:

- (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) Ordained ministers selected after completing prescribed courses of study;
- (9) Literature of its own;
- (10) Established places of worship;
- (11) Regular congregations;
- (12) Regular religious services;

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45. It is unlikely that these guidelines will receive *Chevron* deference in court to the extent that these guidelines were published without procedures for notice and comment. In *Mayo Foundation for Medical Education & Research v. United States*, 562 U.S. 44 (2011), the Supreme Court ruled that *Chevron* provided the appropriate standard for evaluating a Treasury Regulation because, *inter alia*, the Treasury issued the rule only after notice-and-comment procedures. *Chevron* does not apply unless a regulation has gone through notice and comment. See CARTER BISHOP & DANIEL KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 1.11[3] (Thompson Reuters 1994 & Supp. 2018). As such, lesser regulatory interpretations that do not go through notice and comment, such as revenue rulings, revenue procedures, and announcements, will likely not receive *Chevron* deference, but will instead receive a more exacting standard, such as *Skidmore*. See *id.* For a history of how courts apply *Chevron* in tax cases, see Steve R. Johnson, *The Rise and Fall of Chevron in Tax: From the Early Days to King and Beyond*, 2015 PEPP. L. REV. 14 (2015). For insight into how courts use *Auer* and *Seminole Rock* deference in tax cases, see Steve R. Johnson, *Auer/Seminole Rock Deference in the Tax Court*, 11 PITT. TAX REV. 1 (2013).

(13) Sunday schools for the religious instruction of the young; and,

(14) Schools for the preparation of its ministers.<sup>46</sup>

The I.R.S. posits that these fourteen attributes have been developed by both the I.R.S. and the courts.<sup>47</sup> But it also posits that other facts and circumstances could be used to determine whether a religious organization is indeed a religious organization for tax purposes.<sup>48</sup> Furthermore, while the I.R.S. “makes no attempt to evaluate the content of whatever doctrine a particular organization claims is religious,” it does require that the organization’s beliefs be sincerely held and that the practices and rites associated with the organization’s beliefs be neither illegal nor contrary to “clearly defined public policy.”<sup>49</sup>

It is the requirement that beliefs, practices, and rites of an organization not be contrary to “clearly defined public policy” that should give rise to concern. It is possible that the Secretary could use this phrase to require religious organizations to adhere to public accommodations standards in order to be considered a religious organization for tax purposes. In this way, the Tax Code could become a tool for the Secretary of the Treasury to use in order to nudge society in a specific and desired direction. Such was the case in *Bob Jones University v. United States*,<sup>50</sup> in which the Supreme Court upheld the Treasury Secretary’s decision to revoke the tax-exempt status of a religious university due to the fact that the university’s policies ran contrary to desired public policy.<sup>51</sup> The Court held that, because the university refused to admit particular individuals due to specific immutable conditions of those individuals, the university could not be viewed as “conferring a public benefit within the ‘charitable’ concept . . . or within the congressional intent underlying [26 U.S.C.] § 170 and § 501(c)(3),”<sup>52</sup> and thus

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46. I.R.S., *supra* note 35, at 33.

47. *See id.*

48. *See id.*

49. *Id.*

50. 461 U.S. 574 (1983). For additional analysis of *Bob Jones University*, see Charles O. Galvin & Neal Devins, *A Tax Policy Analysis of Bob Jones University v. United States*, 36 VAND. L. REV. 1353 (1983).

51. *See Bob Jones*, 461 U.S. at 595.

52. *Id.* at 595–96. In his oral argument in *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015), Solicitor General Donald Verrilli suggested that the same logic from *Bob*

is not worthy of tax-exempt status. Although religious organizations are granted constitutional protections that religious universities are not,<sup>53</sup> similar logic to that seen in *Bob Jones* could be applied to a religious organization that, for example, does not permit individuals of particular sexual orientation to fully participate in the religious organization's worship.<sup>54</sup> If a religious organization denies such individuals the opportunity to participate in a sacrament based on the belief that such individuals are not worthy of participating in that sacrament, and if the Secretary deems this denial based on sexual orientation to be against public policy, then the Secretary can move to revoke the tax-exempt status of the religious organization, whatever the rationale for denying the sacrament and however sincere that rationale may be.<sup>55</sup> Inasmuch as the Secretary of the Treasury is endowed with the power to determine what is and what is not a religious organization, and inasmuch as such a judgment may be based on whether a religious organization's prac-

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*Jones* that applied to interracial marriage and dating would also apply to same-sex marriage. Justice Alito asked General Verrilli, "Well, in the *Bob Jones* case, the Court held that a college was not entitled to tax-exempt status if it opposed interracial marriage or interracial dating. So would the same apply to a university or a college if it opposed same-sex marriage?" General Verrilli responded, "You know, . . . I don't think I can answer that question without knowing more specifics, but it's certainly going to be an issue . . . I don't deny that, Justice Alito. It is . . . going to be an issue." Transcript of Oral Argument at 38, *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015) (Nos. 14-556, 14-562, 14-571, 14-574).

53. See, e.g., *Lemon v. Kurtzman*, 403 U.S. 602 (1971) (establishing a three-prong test to determine the constitutionality of legislation directed at religion). For further discussion of the *Lemon* Test, see *infra* Part IV.B.ii.

54. See Michael A. Lehmann & Daniel Dunn, *Obergefell and Tax-Exempt Status for Religious Institutions*, 7 COLUM. J. TAX L. TAX MATTERS 7 (2016) (arguing that an organization that refuses to acknowledge the constitutional right of same-sex marriage could be considered to not be promoting the "public good" and thus could lose its tax-exempt status). *But see* Ray Wiacek, Noel Francisco & Vivek Suri, *Tax Exemptions and Same-Sex Marriage*, 7 COLUM. J. TAX L. TAX MATTERS 14 (2016) (arguing that public policy can justly deny a tax exemption only if Congress enacts a statute establishing such a public policy and that, because Congress has yet to enact such a statute, the I.R.S. is obliged to conclude that private institutions otherwise satisfying the requirements of 26 U.S.C. § 501(c)(3) shall remain eligible for tax exemptions despite practices that reflect opposition to same-sex marriage).

55. See *Bob Jones*, 461 U.S. at 595 ("Whatever may be the rationale for such private schools' policies, and however sincere the rationale may be, racial discrimination in education is contrary to public policy."); see also *United States v. Lee*, 455 U.S. 252, 257 (1982) ("Not all burdens on religion are unconstitutional . . . . The state may justify a limitation on religious liberty by showing that it is essential to accomplish an overriding governmental interest."), *quoted in Bob Jones*, 461 U.S. at 603.

tices are sufficiently in harmony with current public policy,<sup>56</sup> religious organizations are to an extent at the mercy of the Secretary and could be forced to sacrifice either their timeless beliefs in order to follow the current trend in public policy or to sacrifice their tax-exempt status.<sup>57</sup> This provides all the more reason for religiously minded voters to ensure a proper vetting of candidates for President and the Senate regarding questions of exempting religious organizations from paying taxes.

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56. In the aftermath of the Supreme Court's decision to legalize same-sex marriage in *Obergefell*, the then-commissioner of the I.R.S., John Koskinen, promised members of the Senate Judiciary Oversight Subcommittee that his agency would not challenge the tax-exempt status of religious colleges and universities that oppose same-sex marriage. See Sarah Pulliam Bailey, *IRS commissioner promises not to revoke tax-exempt status of colleges that oppose gay marriage*, WASH. POST (Aug. 3 2015), [https://www.washingtonpost.com/news/acts-of-faith/wp/2015/08/03/irs-commissioner-promises-not-to-revoke-tax-exempt-status-of-colleges-that-oppose-gay-marriage/?utm\\_term=.9ea5117a857d](https://www.washingtonpost.com/news/acts-of-faith/wp/2015/08/03/irs-commissioner-promises-not-to-revoke-tax-exempt-status-of-colleges-that-oppose-gay-marriage/?utm_term=.9ea5117a857d) [https://perma.cc/8W9T-NMMJ]. That the Senate extracted such promise from the Commissioner of the I.R.S. suggests (1) the extent to which appointed officials have power to challenge the tax-exempt status of religious organizations and (2) the role that elected officials, in this case U.S. senators, have in checking the power of appointed officials.

57. Such was the case in 2016 in the Commonwealth of Massachusetts, when the Massachusetts Commission Against Discrimination and the Commonwealth's Attorney General interpreted the commonwealth's public accommodations laws as requiring religious organizations to allow individuals to use the restroom, changing room, and other private areas of an organization's worship premises in accordance with the gender of their choice rather than their biological gender, even if such an allowance violated a teaching or belief of the religious organization. See News Release, Alliance Defending Freedom Massachusetts Churches Free to Serve Their Communities Without Being Forced to Abandon Beliefs (Dec. 12, 2016), <https://adfflegal.org/detailspages/press-release-details/massachusetts-churches-free-to-serve-their-communities-without-being-forced-to-abandon-beliefs> [https://perma.cc/JH7B-YMMD]. Although religious organizations were able to convince the Commission and the Attorney General to allow religious organizations an exception from this interpretation of the commonwealth's public accommodations laws, *see id.*, this case demonstrates the extent to which religious organizations are vulnerable to the policy interpretations of public officials. For arguments on why the tax-exempt status of religious schools will not likely be affected by recent trends in public accommodations laws following the Supreme Court's decision in *Obergefell*, see generally, Johnny Rex Buckles, *The Sexual Integrity of Religious Schools and Tax Exemption*, 40 HARV. J.L. & PUB. POL'Y. 255 (2017). For arguments on why religious organizations should not be allowed to abstain from public accommodation laws, see generally, Louise Melling, *Religious Refusals to Public Accommodations Laws: Four Reasons to Say No*, 38 HARV. J.L. & GENDER 177 (2015).



2. *The courts have disallowed donors a deduction from taxable income of donations made to religious organizations.*

The Supreme Court has sided with the Commissioner for Internal Revenue in disallowing donors from taking a deduction from taxable income of donations made to religious organizations on a case-by-case basis. In *Hernandez v. Commissioner*,<sup>58</sup> the Court considered whether payments to the Church of Scientology for auditing sessions could be deducted from the taxpayer's taxable income under 26 U.S.C. § 170(c).<sup>59</sup> The Court reasoned that, because "Congress has specified that a payment to an organization operated exclusively for religious purposes is deductible *only* if such a payment is a contribution or gift," and because the payments made by the petitioner for auditing services were made with the intent to receive a religious benefit in return, the payments did not count as donations to a religious organization and thus were not deductible from the petitioner's taxable income under 26 U.S.C. § 170(c).<sup>60</sup> In essence, the Court found that the *quid pro quo* nature of the transaction between the petitioner and the Church of Scientology ran contrary to 26 U.S.C. § 170(c).<sup>61</sup>

However, the Court's decision that *quid pro quo* payments for auditing services do not qualify under 26 U.S.C. § 170(c) is concerning, because the Court's decision to disallow the deductibility of payments to the Church of Scientology seems arbitrary.<sup>62</sup> The I.R.S. has in the past allowed—and, indeed, continues to allow—*quid pro quo* payments to religious organizations to be deductible under 26 U.S.C. § 170(c)(2)(B). For example, some Christians pay pew rents in order to receive a par-

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58. 490 U.S. 680 (1989).

59. As discussed *supra* in Part II.A, 26 U.S.C. § 170(a) (2012) allows for donations to religious and charitable organizations to be deducted from the taxable income of donors.

60. *Hernandez*, 490 U.S. at 692–93 ("The Code makes no special preference for payments made in the expectation of gaining religious benefits or access to a religious service.").

61. *See id.* at 701–02 ("The relevant inquiry in determining whether a payment is a contribution or gift under [26 U.S.C.] § 170 is . . . whether the transaction in which the payment is involved is structured as a *quid pro quo* exchange.").

62. The court distinguished the practices of the Church of Scientology from those of other religious organizations by noting the Church's usage of price schedules for auditing sessions and its policies for granting discounts for advance payments for auditing sessions for granting refunds for unused auditing sessions. *See id.* at 685–86.

ticular seat during worship services, some synagogues require general admissions tickets for attending High Holy Days, and some churches require payment of tithing as a necessary condition for entering particular houses of worship—and all these payments are deductible under 26 U.S.C. § 170(a).<sup>63</sup> As Justice O'Connor, writing in dissent in *Hernandez*, explains, "According to some Catholic theologians, the nature of the pact between a priest and a donor who pays a Mass stipend is a bilateral contract known as *do ut facias* . . . A finer example of a *quid pro quo* exchange would be hard to formulate."<sup>64</sup> Yet, Mass stipends are deductible under 26 U.S.C. § 170(c).<sup>65</sup> That the I.R.S. and the Court singled out the Church of Scientology for unfavorable tax treatment points to the arbitrary nature in which the I.R.S. and the Court can treat religious organizations. Justice O'Connor continues, stating, "[the Government's regulation] involves the differential application of a standard based on constitutionally impermissible differences drawn by the Government among religions."<sup>66</sup> Inasmuch as the First Amendment imposes equality of treatment among religions, the Government should have either allowed all *quid pro quo* transactions or disallowed all such transactions, and the Court should have required that the Government do so.<sup>67</sup> However, this is not what the Government did, and this is not what the Court required the Government to do. That the Commissioner may apparently treat certain religions differently for the purposes of 26 U.S.C. § 170(c) highlights the extent to which religious organizations are vulnerable to the hostile and arbitrary application of the Tax Code.<sup>68</sup> Indeed, based on *Hernandez*, it would seem that motivated tax officials could use the Tax Code to single out and actively hinder a religious organization. It is

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63. *See id.* at 708–09 (O'Connor, J., dissenting).

64. *Id.*

65. *See id.*

66. *Id.* at 712 ("[The Government's regulation] is best characterized as a case of the Government putting an imprimatur on all but one religion. That the Government may not do.").

67. *See id.* at 707.

68. For speculation on whether the current administration will seek to revoke the tax-exempt status of the Church of Scientology, see, e.g., Yashar Ali, *Trump Thinks Scientology Should Have Tax Exemption Revoked, Longtime Aide Says*, HUFFINGTON POST (Nov. 10, 2017) [https://www.huffingtonpost.com/entry/trump-scientology-tax-exemption\\_us\\_5a04dd35e4b05673aa584cab](https://www.huffingtonpost.com/entry/trump-scientology-tax-exemption_us_5a04dd35e4b05673aa584cab) [<https://perma.cc/R2D3-M9H7>].

therefore in the interest of religious organizations and their members to ensure that elected officials appoint and confirm tax officials that will protect the evenhanded application of tax-exempt status for religious organizations.

B. *Blanket Revocation of Tax-Exempt Status*

If on one end of the spectrum of threats to the tax-exempt status of religious organizations sits case-by-case revocation, then on the other end of the spectrum sits a blanket revocation of tax-exempt status for religious organizations, which would require either an act of Congress and presentment to the President, or a court striking down provisions of the Tax Code benefiting religious organizations. Specifically, Congress could alter or altogether remove from the Tax Code 26 U.S.C. § 107,<sup>69</sup> § 170(c)(2)(B), or § 501(c)(3) in order to increase the tax burden on religious organizations, or the courts could hold any of these sections of the Tax Code to be unconstitutional. The most significant increase to the tax burden of religious organizations would come from alterations to 26 U.S.C. § 501(c)(3), while alterations to 26 U.S.C. § 107 and § 170(c)(2)(B) would have a direct impact on the taxes of individual members of religious organizations and thus an indirect impact on the revenues of the religious organizations themselves.<sup>70</sup>

1. *Revocation by Congress through alterations to the Tax Code*

Congress has the ability to alter the Tax Code to remove the tax-exempt status for religious organizations and individuals making donations to religious organizations. This can be accomplished by simply removing the word “religious” from 26 U.S.C. § 501(c)(3) and § 170(c)(2)(B), thereby removing organizations operated for religious purposes from the list of organizations receiving tax-exempt status.<sup>71</sup> Thus, altering the Tax

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69. 26 U.S.C. § 107 (2012) allows ministers of the gospel to deduct from gross income the rental value of housing provided as part of compensation for their ministerial work for a religious organization.

70. For a discussion of the impact of 26 U.S.C. 170(c) on individual taxpayers and religious organizations, see *supra* Part II.A.

71. A similar dilemma as described *supra* in note 43 could arise here. If Congress alters 26 U.S.C. § 501(c)(3) to exclude religious organizations from the list of organizations receiving tax-exempt status but fails to make a similar alteration to 26 U.S.C. § 170(c)(2)(B), then individuals would still be able to deduct donations made to religious organizations from taxable income. The religious organizations

Code to the detriment of religious organizations is to a large extent a political issue that would require the support of both houses of Congress and the President. But such a revocation of tax-exempt status would need to clear the hurdles established by the Religious Freedom Restoration Act.<sup>72</sup> In 1993, Congress passed the Religious Freedom Restoration Act, which bars the federal government from burdening an individual's free exercise of religion, unless the burden (1) furthers a "compelling governmental interest," and (2) "is the least restrictive means for furthering that compelling governmental interest,"<sup>73</sup> and which provides standing to sue the government for redress to those individuals whose ability to freely exercise their religion has been unduly burdened by the government in violation of the Act.<sup>74</sup>

Inasmuch as changes to the federal Tax Code would require action from the federal government—namely from Congress acting as legislator and the I.R.S. acting as executor—such a change would need to overcome the hurdles imposed by the Religious Freedom Restoration Act. Essentially, the government would need to show that revoking the tax-exempt status from religious organizations is (1) in furtherance of a compelling governmental interest, and (2) is the least restrictive way to

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would not cease to be religious because they were removed from the list of tax-exempt organizations found in 26 U.S.C. § 501(c)(3), they would just no longer be exempt from paying taxes. Therefore, because 26 U.S.C. § 170(c)(2)(B) only requires that an organization be religious in nature and does not require that it qualify under 26 U.S.C. § 501(c)(3), the deduction of donations to religious organizations granted under 26 U.S.C. § 170(a) would still be in force. However, it is likely that any Congress that is willing to remove religious organizations from 26 U.S.C. § 501(c)(3) would also be willing to remove religious organizations from 26 U.S.C. § 170(c)(2)(B).

72. An act to revoke the tax-exempt status of religious organizations would likely need to contain language showing congressional intent to revoke the Religious Freedom Restoration Act in order to satisfy the canon against implied repeals. Absent such plain and unambiguous intent, the courts will likely require that the revocation of tax-exempt status overcome the hurdles of the Religious Freedom Restoration Act. *See Carcieri v. Salazar*, 555 U.S. 379, 395 (2009) ("We have repeatedly stated . . . that absent a clearly expressed congressional intention, . . . an implied repeal will only be found where provisions in two statutes are in irreconcilable conflict, or where the latter Act covers the whole subject of the earlier one and is clearly intended as a substitute.").

73. 42 U.S.C. § 2000bb-1(b).

74. *See id.* § 2000bb-1(c).

further this compelling interest.<sup>75</sup> On the one hand, the government could claim that such a revocation would further the compelling government interest of increasing government revenues, but on the other hand there are other ways that the government could increase revenues without placing such a burden on religious organizations. A revocation of tax-exempt status with such a stated intent should fail to clear the hurdles imposed by the Religious Freedom Restoration Act and therefore be struck down by the courts. Thus, the Religious Freedom Restoration Act should serve as a line of defense against new laws and regulations that would impose a tax burden on religious organizations.<sup>76</sup>

Such a revocation of tax-exempt status would also be subject to scrutiny under the Free Exercise Clause. In *Church of Lukumi Babalu Aye v. City of Hialeah*,<sup>77</sup> the Court explained that if a law places a burden on religion in a way that is (1) not neutral and (2) not of general application, then it must undergo “the most rigorous of scrutiny,” meaning that it must advance a govern-

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75. The Religious Freedom Restoration Act originally applied to both federal and state governments. However, the Supreme Court ruled in *City of Boerne v. Flores*, 521 U.S. 507 (1997), that applying the Act to states was beyond Congress’ authority under the Fourteenth Amendment. In *Gonzales v. O Centro Espirita Beneficente Uniao do Vegetal*, 546 U.S. 418 (2006), the Supreme Court affirmed the constitutionality of the Act as it pertains to the federal government.

76. Of some concern is *United States v. Lee*, 455 U.S. 252 (1982), in which the Court held that a member of the Amish faith was not exempt from paying social security taxes, despite his assertion that doing so violated his belief, because the state had an interest in providing a social security system and mandating all citizens to participate was part of this interest. The Court stated, “[t]he state may justify a limitation on religious liberty by showing that it is essential to accomplish an overriding governmental interest.” *Id.* at 257. However, *Lee* is distinguishable from a situation in which Congress revokes the tax-exempt status of religious organizations. In *Lee*, the Court used the taxpayer’s choice to enter into commerce as justification for imposition of the social security tax. *See id.* at 261 (“When followers of a particular sect enter into commercial activity as a matter of choice, the limits they accept on their own conduct as a matter of conscience and faith are not to be superimposed on the statutory schemes which are binding on others in that activity.”). But in the situation in which Congress revokes the tax-exempt status of religious organizations, religious organizations (1) have not entered into commercial activity in the way that the taxpayer in *Lee* did, and (2) because it is only religious organizations involved in the “activity” in which religious organizations are involved, they are not superimposing anything on any statutory schemes that binds others in that activity—indeed all who are involved in that “activity” of religiosity are already treated equally under the statutory scheme that is 26 U.S.C. § 501(c)(3).

77. 508 U.S. 520 (1993).

ment interest that is of the highest order and it must be narrowly tailored in pursuit of that interest.<sup>78</sup> The Court reasoned that because the laws in question prohibited certain actions when they occurred in religious settings, but did not prohibit the same actions when they occurred in secular settings,<sup>79</sup> the laws were not neutral and not of general application, and therefore did not satisfy the demands of the Free Exercise Clause.<sup>80</sup> The Court also cited a pattern of animosity in the manner in which the laws were enacted by the City of Hialeah as evidence that the laws were not neutral.<sup>81</sup> Applying this logic to the revocation of tax-exempt status, it is likely that a change in the Tax Code that imposes an increased burden on religious organizations without imposing the same burden on analogously situated tax-exempt secular organizations will not pass scrutiny under the Free Exercise Clause.<sup>82</sup>

## 2. Revocation by the courts

The federal courts have the ability to revoke the tax-exempt status of religious organizations on grounds that laws allowing for such a status are unconstitutional—most likely on the grounds that they violate the Establishment Clause of the First Amendment. If the Free Exercise Clause and the Religious Freedom Restoration Act impose hurdles that new laws and regulations affecting religious organizations must clear, then the Establishment Clause imposes hurdles that currently existing laws and regulations—such as 26 U.S.C. § 501(c)(3)—must clear in order to be deemed constitutional.<sup>83</sup> If a court finds

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78. See *id.* at 546.

79. See *id.* at 542 (“ . . . [T]he texts of the ordinances were gerrymandered with care to proscribe religious killings of animals but to exclude almost all secular killings; and the ordinances suppress much more religious conduct than is necessary in order to achieve the legitimate ends asserted in their defense.”); see also *id.* at 545 (“The ordinances ‘have every appearance of a prohibition that society is prepared to impose upon [Santeria worshippers] but not upon itself.’” (quoting *Fla. Star v. B.J.F.*, 491 U.S. 524, 542 (1989) (Scalia, J., concurring))).

80. See *id.* at 545.

81. See *id.* at 542; see also *Masterpiece Cakeshop, Ltd. v. Colo. Civil Rights Comm’n*, 138 S. Ct. 1719, 1731 (2018).

82. See *Masterpiece Cakeshop*, 138 S. Ct. at 1737 (“[T]he one thing [the Colorado Civil Rights Commission] can’t do is apply a more generous legal test to secular objections than religious ones.”).

83. See, e.g., *Walz v. Tax Comm’n*, 397 U.S. 664, 673 (1970) (holding that a New York state law “sparing the exercise of religion from the burden of property taxa-

that, for example, 26 U.S.C. § 501(c)(3) violates the Establishment Clause, then it can strike down this provision of the Tax Code and thereby remove the tax-exempt status granted to religious organizations by this provision.

An example of the Establishment Clause being invoked to attempt to render a provision of the Tax Code unconstitutional can be seen in the recent case of *Gaylor v. Mnuchin*,<sup>84</sup> which deals with the constitutionality of the parsonage exemption for ministers of the gospel.<sup>85</sup> In *Gaylor*, the Co-Presidents of the

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tion” does not establish a religion because the exemption extends to all houses of worship and therefore does not violate the Establishment Clause).

84. *Gaylor v. Mnuchin*, 278 F.Supp.3d 1081 (W.D. Wis. 2017) (Crabb, J.), *rev'd*, *Gaylor v. Mnuchin*, Nos. 18-1277, 18-1280, 2019 WL 1217647 (7th Cir. Mar. 15, 2019). The Freedom from Religion Foundation, Inc., filed suit in 2013 against then-Secretary of the Treasury Jacob Lew asking to enjoin enforcement of 26 U.S.C. § 107(2) on the grounds that it was unconstitutional. However, although the district court ruled in favor of the Foundation, *see Freedom from Religion Found., Inc., v. Lew*, 983 F. Supp.2d 1051 (W.D. Wis. 2013), the district court’s decision was vacated by the Seventh Circuit Court of Appeals on the grounds that the Foundation lacked standing to sue, *see Freedom from Religion Found., Inc. v. Lew*, 773 F.3d 815, 825 (7th Cir. 2014). The Seventh Circuit explained that, in order to have standing to sue, an individual would need to first apply for the parsonage tax exemption under 26 U.S.C. § 107(2) and have it denied by the I.R.S. *See id.* at 824–25 (“Standing is absent here because the plaintiffs have not been personally denied the parsonage exemption.”). This is not the first time that the Seventh Circuit vacated a district court decision from Judge Crabb in favor of the Freedom from Religion Foundation on the grounds that the Foundation lacked standing. *See Freedom from Religion Found., Inc. v. Obama*, 641 F.3d 803 (7th Cir. 2011) (vacating the district court’s decision that the National Day of Prayer is unconstitutional on the grounds that the Freedom from Religion Foundation lacked standing). After the Seventh Circuit issued its ruling, the following series of events ensued: (1) the Co-Presidents of the Foundation applied for the parsonage exemption; (2) they were initially granted the exemption by the I.R.S.; (3) seemingly unsatisfied with this result (or perhaps disgruntled that the I.R.S. actually considered them to be ministers of the gospel, per their application), they notified the I.R.S. that they were not ministers of the gospel and did not work for a church; (4) the I.R.S. then denied the parsonage exemption on account of the Co-Presidents not being ministers of the gospel within the context of 26 U.S.C. § 107 (which perhaps alleviated the disgruntled mood of the Co-Presidents); and (5) the Co-Presidents filed suit against the Secretary of the Treasury, having been sufficiently harmed by the I.R.S.’s application of 26 U.S.C. § 107 so as to have standing to sue. *See Gaylor*, 278 F. Supp. 3d at 1085–86. The district court agreed with the Foundation that 26 U.S.C. § 107 violated the First Amendment. *See id.* However, on March 15, 2019, the Seventh Circuit unanimously reversed the decision of the district court. *See Gaylor v. Mnuchin*, Nos. 18-1277, 18-1280, 2019 WL 1217647, at \*12 (7th Cir. Mar. 15, 2019).

85. The parsonage exemption permits ministers of the gospel to deduct from their personal gross income (1) the rental value of a home that is furnished to

Freedom from Religion Foundation, Inc., sued Steve Mnuchin, the current United States Secretary of the Treasury, to enjoin enforcement of 26 U.S.C. § 107(2) on the grounds that the parsonage exemption for ministers of the gospel violates the Establishment Clause of the First Amendment and is therefore unconstitutional. The district court judge, Judge Crabb, issued summary judgement in favor of the Co-Presidents, deciding that 26 U.S.C. § 107(2) “violates the Establishment Clause because it does not have a secular purpose or effect and because a reasonable observer would view the statute as an endorsement of religion.”<sup>86</sup> The district court judge applied *Lemon v. Kurtzman*<sup>87</sup> and *Texas Monthly, Inc. v. Bullock*<sup>88</sup> to conclude that the parsonage exemption was unconstitutional.<sup>89</sup> In *Lemon*, the Supreme Court established a three-prong test to determine whether a law or regulation violates the Establishment Clause. According to the *Lemon Test*, a law must be invalidated if (1) it lacks a secular legislative purpose, (2) its principal purpose or primary effect either advances or inhibits religion, or (3) it fosters an excessive entanglement with religion.<sup>90</sup> The district court judge held that, because it provides a tax benefit to ministers of the gospel and to no one else,<sup>91</sup> 26 U.S.C. § 107(2) ad-

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them as part of their compensation, or (2) the rental allowance paid to them as part of their compensation. See 26 U.S.C. § 107.

86. *Gaylor*, 278 F.Supp.3d at 1085.

87. 403 U.S. 602 (1971).

88. 489 U.S. 1 (1989).

89. *Gaylor*, 278 F.Supp.3d at 1089–90.

90. See *Lemon*, 403 U.S. at 612–13. For analysis on how repealing 26 U.S.C. § 107 would potentially increase government entanglement with religion, see *Amici Curiae* Brief of Tax Law Professors in Support of Appellants at 13–25, *Gaylor v. Mnuchin*, Nos. 18-1277, 18-1280, 2019 WL 1217647 (7th Cir. Mar. 15, 2019), 2018 WL 2121089.

91. The I.R.S. interprets “ministers of the gospel” to incorporate ministers of all religions. See 26 C.F.R. § 1.107-1(b) (2017) (identifying ministers of a church “or other qualified organization” as qualifying for the parsonage exemption). Narrowly interpreting “ministers of the gospel” either to identify a specific religion or to exclude particular religions would likely run afoul of the Establishment Clause. However, there is reason to believe that, even under the broadest definition of “minister of the gospel,” the court would still consider 26 U.S.C. § 107(2) to be unconstitutional because the statute would nevertheless be promoting religion in general. See *Freedom from Religion Found., Inc. v. Lew*, 983 F.Supp.2d 1051, 1071 (W.D. Wis. 2013) (“[Even] if atheism were included under the umbrella of ‘religion,’ § 107(2) still would advance religion over secular interests, even if the provision applied to atheists, because secular taxpayers still would be excluded from the benefit.”).



vances religion without a secular purpose and thus violates the Establishment Clause under *Lemon*.<sup>92</sup>

The district court judge further honed her criticism of 26 U.S.C. § 107(2) by turning to *Texas Monthly*, in which the Supreme Court looked to *Lemon* to consider whether a state sales tax exemption for religious periodicals that are published and distributed by religious organizations violated the Establishment Clause.<sup>93</sup> While a majority of the Court found the sales tax exemption to be unconstitutional, no single opinion garnered sufficient support to be considered the majority opinion.<sup>94</sup> The plurality opinion in *Texas Monthly* held that (1) the state sales tax exemption for religious periodicals lacked a secular purpose or effect and communicated a message of religious endorsement because it provided a benefit to religious publications only, without any showing that the sales tax exemption was necessary to alleviate a burden to the free exercise of religion,<sup>95</sup> and (2) that the sales tax exemption fostered an entanglement because it forced the government to evaluate the “relative merits of differing religious claims.”<sup>96</sup> The concurring opinion in *Texas Monthly* held that a sales tax exemption limited to religious literature sold by religious organizations violated the Establishment Clause because it leads to “preferential support for the communication of religious messages.”<sup>97</sup> Applying the plurality and concurring opinions from *Texas Monthly* to 26 U.S.C. § 107(2), the district court judge in *Gaylor* held that the parsonage exemption violated the Establishment Clause because it (1) “gives an exemption to religious persons without a corresponding benefit to similarly situated secular persons,” and (2) inasmuch as the purpose of a minister of the gospel is to share a religious message, a tax benefit to ministers

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92. See *Gaylor*, 278 F. Supp. 3d at 1091. Inasmuch as the same district court judge, Judge Crabb, heard both the first round of this suit in *Freedom from Religion Foundation* in 2013 and the second round in *Gaylor* in 2017, much of Judge Crabb’s opinion in *Gaylor* repeats her opinion in *Freedom from Religion Foundation*.

93. See *Tex. Monthly*, 489 U.S. at 5 (plurality opinion).

94. See *Gaylor*, 278 F. Supp. 3d at 1090.

95. See *Tex. Monthly*, 489 U.S. at 15 (plurality opinion); see also *Gaylor*, 278 F. Supp. 3d at 1090.

96. *Tex. Monthly*, 489 U.S. at 20 (plurality opinion).

97. *Id.* at 28 (Blackmun, J., concurring in the judgment).

of the gospel has the effect of preferring religious messages over secular messages.<sup>98</sup>

The Seventh Circuit reversed the district court's decision in a unanimous decision.<sup>99</sup> Applying the *Lemon* Test, the Seventh Circuit concluded that the parsonage exemption for ministers (1) had a secular purpose, (2) had a principal effect of neither endorsing nor inhibiting religion, and (3) did not cause excessive government entanglement with religion.<sup>100</sup> Firstly, regarding the secular purpose of 26 U.S.C. § 107(2), the Seventh Circuit noted that a statute is unconstitutional only when there is no question that the statute was motivated "wholly by religious considerations."<sup>101</sup> Because the Treasury Department pointed to three secular legislative purposes for 26 U.S.C. § 107(2),<sup>102</sup> the Seventh Circuit concluded that the statute passed the first prong of the *Lemon* Test.<sup>103</sup>

Secondly, on the question of whether the parsonage exemption either advanced nor inhibited religion, the Seventh Circuit rejected the district court's claim that *Texas Monthly* superseded *Walz* and *Amos*. Applying *Walz*, the Seventh Circuit declared that the parsonage exemption satisfies the second prong of the *Lemon* Test because providing a tax exemption to ministers does not "connote[] sponsorship, financial support, and active involvement of the [government] in religious activity."<sup>104</sup> Therefore, the "primary effect of § 107(2) is not to advance religion on behalf of the government, but to 'allow[] churches to advance religion, which is their very purpose.'"<sup>105</sup>

Thirdly, regarding whether the parsonage exemption fostered excessive government entanglement with religion, the Seventh Circuit noted that, because some entanglement is inev-

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98. *Gaylor*, 278 F. Supp. 3d at 1090.

99. *Gaylor v. Mnuchin*, Nos. 18-1277, 18-1280, 2019 WL 1217647 (7th Cir. Mar. 15, 2019).

100. *Id.* at \*11.

101. *Id.* at \*4 (quoting *Lynch v. Donnelly*, 465 U.S. 668, 680 (1984)).

102. The Treasury Department argued that 26 U.S.C. § 107(2) had the secular purposes of eliminating discrimination against ministers, eliminating discrimination between ministers, and avoiding excessive entanglement with religion. *Id.*

103. *Id.* at \*9.

104. *Id.* at \*10 (alterations in original) (quoting *Walz v. Tax Comm'n*, 397 U.S. 664, 668 (1970)).

105. *Id.* (alteration in original) (quoting *Corp. of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v. Amos*, 483 U.S. 327, 337 (1987)).

itable, the question of entanglement is one of “kind and degree.”<sup>106</sup> While 26 U.S.C. § 107(2) does involve some entanglement with government, this entanglement is of a nature that is approved by the Supreme Court in *Hosanna-Tabor*<sup>107</sup> and the alternative to 26 U.S.C. § 107(2), which is found in 26 U.S.C. § 119(a)(2),<sup>108</sup> would involve even more entanglement with the government.<sup>109</sup> Because Congress decided that U.S.C. § 107(2) is the less entangling option, and because legislative determinations about the Establishment Clause<sup>110</sup> and tax classifications are entitled to deference,<sup>111</sup> the Seventh Circuit elected to not disturb this decision of Congress.<sup>112</sup> Thus, the Seventh Circuit determined that 26 U.S.C. § 107(2) satisfied all three prongs of the *Lemon* Test.<sup>113</sup>

The Seventh Circuit then applied the historical significance test under *Town of Greece v. Galloway*.<sup>114</sup> Because the Freedom from Religion Foundation offered no evidence that 26 U.S.C. § 107(2) was historically viewed as an establishment of religion, and because the government provided “substantial evidence of a lengthy tradition of tax exemptions for religion, particularly for church-owned properties,”<sup>115</sup> the Seventh Circuit concluded that the parsonage exemption did not violate the Establishment Clause under the historical significance test.<sup>116</sup> Having found that 26 U.S.C. § 107(2) passed both the *Lemon* Test and the historical significance test, the Seventh Circuit held that it did not

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106. *Id.* (quoting *Lynch*, 465 U.S. at 684).

107. See *Hosanna-Tabor Evangelical Lutheran Church & Sch. v. EEOC*, 565 U.S. 171, 190–95 (2012).

108. 26 U.S.C. § 119(a)(2) allows an exemption for employee lodging only if the employee is required to accept such lodging on the business premises of the employer as a condition of employment.

109. See *Gaylor*, 2019 WL 1217647 at \*10.

110. See *Tex. Monthly, Inc. v. Bullock*, 489 U.S. 1, 28 (1989) (Blackmun, J., concurring) (“We in the Judiciary must be wary of interpreting [the Religion] Clauses in a manner that negates the legislative role altogether.”).

111. *Regan v. Taxation with Representation*, 461 U.S. 540, 547 (1997) (“Legislatures have especially broad latitude in creating classifications and distinctions in tax statutes.”).

112. *Gaylor*, 2019 WL 1217647, at \*10.

113. *Id.* at \*11.

114. 572 U.S. 565, 577 (2014) (“Any test the Court adopts must acknowledge a practice that was accepted by the Framers and has withstood the critical scrutiny of time and political change.”).

115. *Gaylor*, 2019 WL 1217647, at \*11

116. *Id.* at \*12.

violate the First Amendment, thereby adding clarity to the constitutionality of the parsonage exemption that some sought.<sup>117</sup>

Although this attempt to repeal the tax benefit for ministers of the gospel is disconcerting,<sup>118</sup> there is good reason to believe that a repeal of 26 U.S.C. § 107(2) will not establish precedent for any further repeal of 26 U.S.C. § 501(c)(3) or § 170(c). The main criticism of 26 U.S.C. 107(2) is that it provides a benefit to religious purposes without providing any symmetrical benefit to secular purposes and thus promotes religion in violation of the Establishment Clause.<sup>119</sup> However, this apparent constitutional weakness of 26 U.S.C. § 107(2) is absent in 26 U.S.C. § 501(c)(3) and § 170(c): while 26 U.S.C. § 107(2) provides a tax benefit exclusively for persons working in a religious capacity without providing a similar benefit to persons working in a secular capacity, 26 U.S.C. § 501(c)(3) and § 170(c) provide a tax benefit both to religious organizations as well as to secular organizations. In this way, 26 U.S.C. § 501(c)(3) and § 170(c) cannot be seen to promote religious purposes over secular purposes in the same way that 26 U.S.C. § 107(2) does.<sup>120</sup> For this

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117. See generally Adam Chodorow, *Gaylor v. Mnuchin—A Step Toward Greater Clarity on Clergy Tax Exemptions?*, ABA TAX TIMES, Nov. 2017, at 7. Chodorow also filed an *Amicus Curiae* brief in support of the Freedom from Religion Foundation. See *Amicus Curiae* Brief of Tax Law Professors in Support of Appellees, *Gaylor v. Mnuchin*, Nos. 18-1277, 18-1280, 2019 WL 1217647 (7th Cir. Mar. 15, 2019), 2018 WL 3311509.

118. For further arguments on why 26 U.S.C. § 107(2) should be declared unconstitutional, see generally, Erwin Chemerinsky, *The Parsonage Exemption Violates the Establishment Clause and Should Be Declared Unconstitutional*, 24 WHITTIER L. REV. 707 (2003); Adam Chodorow, *The Parsonage Exemption*, 51 U.C. DAVIS L. REV. 849 (2018).

119. *But see* Intervenor-Defendants' Reply Brief in Support of Their Motion for Summary Judgement at 21–30, *Gaylor v. Mnuchin*, 278 F. Supp. 3d 1081 (W.D. Wis. 2017) (No. 16-CV-215), 2017 WL 3251871, *rev'd*, Nos. 18-1277, 18-1280, 2019 WL 1217647 (7th Cir. Mar. 15, 2019) (explaining that 26 U.S.C. § 107(2) is only one part of a broader package of tax exemptions that equally benefits secular purposes).

120. Indeed, 26 U.S.C. § 501(c)(3) provides the same tax benefit to both the Parish of St. Paul in Harvard Square and the Freedom from Religion Foundation, Inc. However, it is certainly ironic that the I.R.S. initially applied the parsonage exemption of 26 U.S.C. § 107(2) to the Co-Presidents of the Freedom from Religion Foundation, Inc., in the same way that it applies the parsonage exemption to ministers of the gospel, and only refused the exemption when the Co-Presidents themselves notified the I.R.S. that (1) they were not clergy, (2) that their employer was not a church, and (3) that they believed that it was “unfair that ministers can exclude housing while [they] cannot.” *Gaylor*, 278 F. Supp. 3d at 1085. This suggests that the purpose of the Co-Presidents of the Freedom from Religion Founda-

reason, the tax benefits to religious organizations granted in 26 U.S.C. § 501(c)(3) and § 170(c) are less vulnerable to being considered in violation of the Establishment Clause. The key lesson from *Gaylor* will be that citizens can establish standing to sue the Secretary of the Treasury in federal court to prevent the Secretary from executing those parts of the Tax Code that grant religious organizations tax benefits. Likewise, federal courts can invalidate parts of the Tax Code, the result of which would be to increase the tax burden of religious organizations. It is therefore provident that members of religious organizations properly vet Presidential candidates and candidates for the Senate to establish whether these candidates will nominate and confirm (1) Treasury Secretaries that will defend the tax-exempt status of religious organizations in court and (2) judges that will uphold the tax-exempt status of religious organizations.

C. *Possible Ways for Religious Organizations to Mitigate the Damaging Effects of Losing Their Tax-Exempt Status*

In the event that a religious organization loses its tax-exempt status in any way, it could mitigate the financial effect of this event by spinning off its charitable activities into a separate corporation that would qualify as having a charitable purpose under 26 U.S.C. § 501(c)(3). Bifurcating a religious organization into a services corporation and a charitable works organization could mitigate the damaging effects of losing tax-exempt status by allowing at least some received donations and activities to remain tax-exempt on account of their having a charitable purpose: while the religious organization would pay taxes on donations received to finance non-charitable religious activities, the religious organization's sister charitable organization would be able to avoid paying taxes on donations received to finance non-religious charitable activities. A donor to the religious organization would then need to likewise bifurcate her donations into (1) donations to the religious organization that would likely not be deductible from the donor's taxable income, and (2) donations to the charitable organization that would likely be deductible from the donor's taxable income.

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tion is not to obtain the parsonage tax benefit for themselves and others in their same situation, but rather to have the parsonage benefit abolished entirely.

This system would at least allow for a religious organization's charitable activities to escape the grips of taxation and thereby mitigate the financial damage it can expect from losing its tax-exempt status.

#### IV. CONCLUSION

As mentioned previously, religious organizations benefit greatly from being exempt from taxes. But this benefit is not a given. On the contrary, this benefit can be revoked by Congress working in tandem with the President and the Secretary of the Treasury and receiving the blessing of the courts. Indeed, as *Gaylor* suggests, the enemy of tax-exempt religious organizations stands at the gates. While defenses do exist, these defenses are only as strong as the willingness of the Secretary of the Treasury and the courts to uphold these defenses. As such, much depends on the Secretary of the Treasury and federal judges. Religious organizations must therefore be vigilant with regard to who holds those positions. In particular, proponents of the tax-exempt status for religious organizations<sup>121</sup> must properly vet candidates for President and for Senate to ensure that they will require nominees for Secretary of the Treasury and federal judgeships to support the tax-exempt status of religious organizations. Only by ensuring that the Secretary of Treasury and federal judges are firmly on the side of tax-exempt religious organizations can proponents of such religious organizations be assured that the tax exemption will be protected.

*Grant M. Newman*

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121. As mentioned *supra* in note 16, religious organizations themselves must take caution to not endorse candidates for public office, as doing so can lead to a violation of the Johnson Amendment and revocation of tax-exempt status. See 26 U.S.C. § 501(c)(3) (2012).