



SMALL BUSINESS & NONPROFIT CLINIC

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Tutorial

THE TRUTH ABOUT CHURCHES AND THE NEED TO FILE FOR TAX-EXEMPT STATUS

Religion, The Constitution, and Tax-Exempt Organizations

The First Amendment states that “Congress shall make no law respecting an establishment of religion (Establishment Clause), or prohibiting the free exercise thereof,” and it is commonly mandated that religion and the government are best left separated from each other. The Establishment Clause is often applied to questions regarding churches, as well as other religious organizations, and tax-exempt status.

The key principal underlying the Establishment Clause is government neutrality, avoiding excessive entanglement in a church-state relationship. The exemption from income tax of churches and other religious organizations is constitutional in this regard, in that tax-exempt status is neutral with respect to religion, and it avoids excessive entanglement in a church-state relationship, or at least more of an entanglement than if churches were not allowed tax-exempt status. In other words, if the government were to require churches to pay income taxes, the appearance would be given that the government is regulating churches, intruding upon the separation of church and state. In this regard, the government has also exempted churches and other religious organizations from the filing for tax-exempt status, effectively granting such organizations an automatic tax-exempt status.

There is a fine line between excessive entanglement and acceptable government involvement, especially when it comes to filing for recognition of tax-exempt status. A filing requirement might allow the IRS to probe too deeply into the church’s activities in evaluating a church’s application for recognition of tax-exempt status. Of course, the IRS can still audit a church, in accordance to determine whether the church is acting in conformity with the requirements of tax-exempt status, for example to determine whether any part of a church’s net earnings inure to the benefit of any private individual, whether a substantial part of a church’s activity may be attempting to influence legislation, and whether the church or other religious organization has intervened in a political campaign; however, intrusions by the IRS in this regard would likely

occur less frequently than if the IRS were to probe into every application for recognition of tax-exempt status. The IRS is likely not going to audit every single church and other religious organization in existence in the United States just for the fun of it, but if it were allowed to require churches and other religious organizations to file for recognition of tax-exempt status, then, in a way, that is what the IRS would be doing. Furthermore, there are restrictions placed on the IRS' ability to audit a church. Those restrictions can be found in IRC §7611.

Why Should Churches File for Tax-Exempt Status?

Churches and other religious organizations, as noted above, are automatically tax-exempt under the IRC. Thus, a church or other religious organization can enjoy all of the benefits of 501(c)(3) tax-exempt status, such as cheaper classified postage rates for nonprofit mailings and advance assurance to donors of deductibility of contributions, as well as benefits other 501(c)(3) organizations do not receive, such as being exempt from having to file an annual report (Form 990) and being automatically considered not to be a private foundation, all without having to file for recognition of tax-exempt status..

Then why should a church apply for tax-exempt status? Filing for recognition of tax-exempt status may make it easier for the government to keep a watchful eye over churches. However, even then, the government's involvement in this capacity could not become too entangled with the church, even if it is more equipped to watch over them, due to Establishment Clause concerns discussed above.

The IRS gives one reason for churches to file for recognition of tax-exempt status:

- Such recognition assures church leaders, members, and contributors that the church is recognized as exempt and qualifies for relaxed tax benefits.

Taken from Publication 1828, *Tax Guide for Churches and Religious Organizations*]

Although this is fairly weak reasoning, considering that tax-exempt status is automatic, the IRS has a good point, at least with regards to contributors to a church. In this light, a person who contributes to a church claiming tax-exempt status, without having filed for such status, may deduct that contribution from his or her income; *however*, if that contributor is audited by the IRS, he or she will have the burden of establishing that the church he or she contributed to in fact meets the qualifications of a 501(c)(3) organization as there is no presumption that the church is tax-exempt under 501(c)(3), as the automatic tax-exempt status stems from §508(c). Further, some contributors may require proof of 501(c)(3) status before they make a contribution.

Thus, it is of use for churches to file for recognition of tax-exempt status because in this manner it will be able to assure contributors that their contributions will be deductible, and also that the contributor will not have to prove a church's tax-exempt status should he or she be later audited by the IRS.

Finally, on a practical note, filing for tax-exempt status may be the prudent thing to do. If you file for tax-exempt status, a determination letter will be the end result. This letter cannot only

be shown to prospective contributors, but also it can be used by the church leaders themselves to make tangible the reality of their status. This in turn, debatably so, may motivate a church to keep up with all of the obligations accompanying tax-exempt status, may give it the incentive to keep accurate records and do better bookkeeping, something that an illusory tax-exempt status may not be so well-equipped to do.

How to File for Tax-Exempt Status

A church or other religious organization can file for tax-exempt status by filling out the Form 1023 from the IRS' website. In this regard, it is recommended that the assistance of an attorney be sought as filing for tax-exempt status can be a time-consuming process, involving a lot of complex legal hurdles. The Small Business & Nonprofit Clinic is available to assist in this light.

Note: The use of "other religious organization(s)" in the preceding paragraphs refers only to integrated auxiliaries of churches and conventions or associations of churches. Religious organizations beyond this must file for recognition of tax-exempt status to obtain tax-exempt status.