A. OUTLOOK ON CHURCHES AND RELIGIOUS AND APOSTOLIC ORGANIZATIONS

1. Introduction

Americans are a very religious people and churches and religious organizations make up a significant part of the tax exempt community. Because of their prevalence on the American landscape, we have discussed the Service's role in evaluating such organizations in previous CPE seminars. For a particularly helpful discussion, see Update on Churches and Religion in the 1980 textbook.

The 1981 textbook provided a discussion of the definition of a church. Classification as a church has several significant advantages. For example, churches are not subject to the IRC 508 notice requirements, do not have to file information returns under IRC 6033, and have the benefit of the IRC 7605(c) pre-examination rules.

2. Churches

Everyone "knows" what a church is when the subject is discussed in everyday conversation. It is only with efforts to pin down the concept that difficulties arise. Because of the diversity in religious belief and experience in America, each individual holds dear his or her own conception of a church.

There is a consensus that a traditional church or synagogue is a "church" for purposes of the Internal Revenue Code. It is with the numerous less familiar organizations that the Service and courts have struggled for years. For instance; Is an Ashram a Church? Is a religious brotherhood a church? What about an interdenominational missionary society?

In De La Salle Institute v. United States, 195 F. Supp. 891 (N.D. Cal. 1961), the Court determined whether a particular organization constituted a church for purposes of IRC 511. While it noted that every church or convention or association of churches was a religious organization, it questioned whether every religious organization was a church. It concluded that when Congress used the term "church" it intended to convey a more limited idea than is conveyed by the term "religious" organization.

In attempting to focus on what kind of unit it was discussing, the Court stated:

> "To exempt churches, one must know what a church is. Congress must either define 'church' or leave the definition to the common meaning and usage of the word; otherwise Congress would be unable to exempt churches." [Emphasis supplied].

The Court then held that an incorporated religious teaching order that performed no sacerdotal functions was not a church. Noting that the "tail cannot be permitted to wag the dog," the Court held in essence that the incidental activities of the religious teaching order could not make the order a church.

Thus, we can see that one element of a "church" is the performance of sacerdotal functions. It was this element that the De La Salle Court found essential.

The Tax Court in Chapman v. Commissioner, 48 T.C. 358 (1967), added an additional dimension to the definition of "church". The organization described in this case was interdenominational and not affiliated with any church group or denomination. The purposes of the organization were to perform dental work for missionaries, religious workers, and natives and to promote "the Gospel of the Lord Jesus Christ, around the world, and the evangelization of the world on the basis of the principles of the Protestant Faith."

The organization conducted regular services in the United States and provided various churches with speakers and literature concerning its objects. The members of the organization were all trained in the Bible and church work. While many of its members were ordained ministers, the organization did not conduct a seminary or Bible school. All members were required to be licensed dentists.

In determining that the organization was not a "church" the court stated that Congress did not intend "church" to be used in a generic or universal sense but rather in the sense of "denomination." Since the Missionary Dentists were interdenominational they were not a church.

Because of the difficulty in making decisions based on such broad guidelines, the IRS developed additional criteria to assist its personnel. Thus came about the 14 points first addressed in a speech by Jerome Kurtz, IRS Commissioner, at the PLI Seventh Biennial Conference on Tax Planning, January 9, 1978, reprinted in Fed. Taxes (P-H) Section 54,820 (1978). These criteria have

also been published in Section 321.3 of Chapter 7(10)69 of the Internal Revenue Manual, (Exempt Organizations Examination Guidelines Handbook). The 14 criteria are:

(1) a distinct legal existence

(2) a recognized creed and form of worship

(3) a definite and distinct ecclesiastical government

(4) a formal code of doctrine and discipline

(5) a distinct religious history

(6) a membership not associated with any other church or denomination

(7) an organization of ordained ministers

(8) ordained ministers selected after completing prescribed studies

(9) a literature of its own

(10) established places of worship

(11) regular congregations

(12) regular religious services

(13) Sunday schools for the religious instruction of the young

(14) schools for the preparation of its ministers

These criteria are, of course, merely tools that may be helpful in making a factual determination as to church status. To use these tools effectively, one must consider their specific meaning. For example; Does an organization have a formal code of doctrine or discipline? A type-written document may not be necessary to satisfy this element. The essential question to be dealt with when considering the

existence of a formal code is whether there is a meaningful religious doctrine rather than a doctrine designed merely to meet this requirement. The underlying meaning must be explored in each of the 14 criteria. Thus, it is not a mechanical checklist for churches; rather, these criteria provide an entry into thinking about what is essential, what is really critical for an organization to be a "church".

All of the criteria need not be present for an organization to be a "church." In addition, different weights may be accorded to each of the criteria. If few of the elements are present, or they exist in name only, serious consideration should be given as to whether the organization is a church at all. Factors other than the 14 criteria listed above may also be considered.

An excellent example of the type of analysis necessary in this area is offered in American Guidance Foundation, Inc. v. United States, 490 F. Supp. 304 (D.D.C. 1980). The organization in this case consisted of a married couple acting as ministers and their family. They prepared documentation that would ostensibly satisfy most of the 14 criteria looked to by the Service. Services were conducted in their home, recorded religious messages were distributed by their answering machine, and each week their son was coached by his father in what was claimed to be Sunday school. Similar facts are not atypical of mail order ministries.

The Court discussed the holdings in De La Salle Institute and Chapman and considering the fourteen points, stated:

> "While some of these are relatively minor, others, e.g., the existence of an established congregation served by an organized ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code, are of central importance... At a minimum a church includes a body of believers or communicants that assembles regularly in order to worship. Unless the organization is reasonably available to the public in its conduct of worship, its educational instruction, and its promulgation of doctrine, it cannot fulfill this associational role."
>
> In holding that this organization was not a "church" the Court stated:
>
> "It is not enough that a corporation believes and declares itself to be a church. Nor is it sufficient that the applicant prepares superficially responsive documentation for each of the established IRC criteria. To hold otherwise would encourage sham representations to the IRS and

result in adverse tax consequences to the public at large. In this instance, AGF does not employ recognized, accessible channels of instruction and worship. There is little if any evidence that it seeks to reach or serve a congregation. Private religious beliefs, practiced in the solitude of a family living room, cannot transform a man's home into a church."

The only thing clear about our analysis of churches is that there is no one clear definition of a church for purposes of the Code. The correct approach is to analyze thoroughly all of the elements present in a given entity, keeping in mind certain elements that the courts have considered essential (as in American Guidance Foundation.)

3. Communal Organizations - Private Inurement and Private Benefit

To qualify for recognition of exemption under IRC 501(c)(3), a church or religious organization must also show that it is organized and operated in conformity with the basic principles of charity law. As part of this showing, the organization must prove that it is not operated for private purposes (Reg. 1.501(c)(3)-1(d)(1)(i)) and that its net earnings do not inure to private individuals.

We have discussed these issues exhaustively with reference to the mail order ministry problem. See in particular the Exempt Organizations Annual Technical Review Institute for 1980, pp. 46-49 and Exempt Organizations Continuing Professional Education Technical Instruction Program for 1982, pp. 271-272. Rev. Rul. 81-94, 1981-1 C.B. 330, describes a typical situation. The "church" described was formed by a professional nurse who held a certificate of ordination purchased from a mail order ministry. The nurse served as the organization's minister, director, and principal officer. Pursuant to a vow of poverty, the nurse transferred all of her assets, including an automobile and house, as well as her liabilities, including a mortgage and various loans, to the church. She also assigned her salary from a third-party employer to the organization. In return, the organization provided her a full living allowance that maintained or improved her former life style and allowed her continued use of the house and car. In holding that this "church" failed to qualify for exemption under IRC 501(c)(3), the Service noted that it served as a shield for personal tax liability and thus served the private interests of a designated individual rather than a public interest. Similar problems arise when considering the exemption of communal religious communities.

There are many historical antecedents for communal religious communities. Examples include the monastic movement typified by the religious orders, convents, and monasteries of the Catholic Church and other churches; the Essenes (110 B.C. - A.D. 68), who split off from orthodox Judaism; the early Mormon Church; and the Shakers. In all of these, daily life for members was or is an ordered blend of study, prayer, work, and communal eating and living. Many of these organizations are either exempt under IRC 501(c)(3) in their own right or under the group ruling of an established church. There are some communal organizations, however, that have claimed exemption under IRC 501(c)(3) and have failed to qualify.

An organization that serves a private interest other than incidentally is not entitled to exemption. The determination of whether such private benefit is incidental to the overall public interest, however, turns on the nature of the activity and the manner by which the public benefit will be derived. Thus, the extent to which private benefit may be acceptable will vary in direct relation to the degree of public benefit derived and will, of course, depend on all the facts and circumstances presented.

For the purpose of determining the overall public benefit of a communal religious organization, we note that organizations that promote religious purposes are generally viewed to be of benefit to the public although the persons directly benefitted are limited in number. As noted in Rev. Rul. 71-580, 1971-2 C.B. 235:

> The law of charity generally recognized that the saying of mass or the conduct of similar religious observances under the tenets of a particular religion are of spiritual benefit to all members of that faith and to the general public. Any private benefit to a given family or individual that may result is regarded as incidental to the general public benefit that is served... [Emphasis supplied].

Thus, if a communal organization has a religious purpose and can satisfy the prohibition against private inurement, the public can be said to derive a spiritual benefit from the organization's activities even if these activities provide an arguably private benefit to the organization's members, as long as that private benefit is incidental to an overriding religious purpose. The following decisions illustrate these principles.

Beth-El Ministries, Inc. v. United States, 79-2 USTC Section 9412 (D.D.C. 1979) involved an organization with two types of members, staff and associate.

One of the purposes of the organization was to establish an interdenominational religious community. To become a staff member of Beth-El, one had to relinquish all personal possessions to the organization. Staff members were often employed outside the community and donated their salaries to it. In return, the organization provided food, clothing, shelter, medical care, recreational facilities and a parochial school for staff members. To become an associate member, one had only to be accepted by 2/3 of the staff members. Only staff members, however, resided at its facilities and received the bulk of its benefits. The Court held that the organization's net earnings inured to the benefit of its members. Martinsville Ministries, Inc. v. United States, 80-2 USTC Section 9710 (D.D.C. 1979), is a similar case where the court held that a nonprofit religious community was not exempt because part of its net earnings was used to pay for the living expenses of the organization's members.

The case of The Basic Unit Ministry of Alma Karl Schurig v. United States, 81-1 USTC Section 9188 (D.D.C. 1981), also holds similarly in discussing the exemption of a religious communal unit consisting of little more than one family. Members renounced all personal property, assigned outside salaries to the organization, and in return were supported by the organization. The Court, in a summary judgment affirming the denial of exemption based on private benefit and inurement, emphasized that the burden of proof in such cases is on the organization and this organization failed to meet it.

New Life Tabernacle v. Commissioner, T.C.M. Section 82,367 (1982), is the most recent in this line of cases where a religious communal organization failed to meet its burden of proof in explaining the religious nature of its living arrangements as well as the equity of its individual support. In this case, the organization claimed that the support it provided its members was compensatory in nature but failed to offer any evidence of the services being provided in return for such compensation.

The common threads in these cases seem to be the bifurcated membership arrangement with some members receiving the bulk of benefits and/or a failure to show that living arrangements are incidental to a religious purpose rather than a scheme to promote private benefit. Since such communal organizations are often set up as shields for individual tax liability, special efforts should be taken to insure that such organizations satisfy all elements of exemption before issuing a favorable ruling.

The next section will discuss the issue of private benefit or inurement in one specific context - that of organizations that are involved in business activities.

4. Communal Organizations with Business Activities

Where a communal organization is operating a business, the question of whether or not the organization is organized and operated exclusively for charitable purposes is also a question of law and fact with the determinative aspect being predominantly factual. The focus of the inquiry should be upon the nature of the purpose toward which these activities are directed. Therefore, depending on all the facts and circumstances in a given case, a particular activity may be carried on for or directed toward either an exempt purpose or a nonexempt purpose. (See Golden Rule Church Association v. Commissioner, 41 T.C. 719 (1964), nonacq. 1964-2 C.B. 8 (church's operation of various businesses to illustrate the applicability of the "golden rule" to daily life was in furtherance of a religious purpose) and Riker v. Commissioner, 244 F. 2d 220 (9th Cir. 1957), cert. denied 355 U.S. 839 (1957) (alleged church's operation of a restaurant was not in furtherance of a religious purpose, and church was operated to more than an insubstantial degree in furtherance of a nonexempt purpose)).

This issue is also present in a number of traditional religious orders. For example, the Service has ruled on the commercial activities of a monastic order. A basic element in the Order's beliefs was the commitment to physical labor. In the Order, work was devoted to producing food and other goods used directly in the monastery and producing food and other goods that were marketed commercially to generate the income necessary to buy the materials that the Order could not produce itself. It should be noted that members of the Order had taken a vow of poverty and that subsistence living was part of their belief. The Service held that the sale of certain kinds of religious goods, such as candles, stained glass windows, incense and vestments was not subject to the tax on unrelated trade or business income because the sale served a religious purpose. On the other hand, the sale of goods that did not serve a religious function was held to be taxable. Not at issue in the case was the question of exemption because it was clear that the members of the Order were only incidentally benefitted by the business activity.

Thus, the members of a religious communal organization receiving room, board and other maintenance as participants in the exempt religious activity of the organization would not be considered to be receiving prohibited benefit merely because the Order is operating a commercial enterprise. The organization is exempt as long as the business is important for the operation of the organization

for religious purposes and does not represent private use of the organization's resources.

5. IRC 501(d) Organizations

IRC 501(d) provides for exemption under IRC 501(a) for a specific type of communal organization that would fail to qualify under IRC 501(c)(3). IRC 501(d) describes religious or apostolic associations or corporations, if such associations have a common treasury or a community treasury, even if they engage in business for the common benefit of the members, but only if members include their pro rata share of the organization's income, whether distributed or not, in their individual gross incomes at the time of filing their returns. The Service has ruled that minor children can be counted as members if the organization is so structured and such membership is not otherwise restricted by law. Rev. Rul. 77-295, 1977-2 C.B. 196.

Reg. 1.501(d)-1 parallels the statutory language and does not attempt to define "religious or apostolic associations or corporations." An examination of the legislative history of IRC 501(d) is therefore necessary to determine the type of organization intended to be covered.

The provisions contained in IRC 501(d) were first enacted into law in the Revenue Act of 1936, 101(18). During the Senate debate of the predecessor of IRC 501(d), Senator Walsh proposed the language that was finally adopted into the Revenue Act of 1936 as section 101(18). In explaining the purpose of this section, Senator Walsh stated the following at 80 Cong. Rec. 9074 (1936):

> It has been brought to the attention of the committee that certain religious and apostolic associations and corporations such as the House of David and the Shakers, have been taxed as corporations, and that since their rules prevent their members from being holders of property in an individual capacity the corporations would be subject to the undistributable-profits tax. These organizations have a small agricultural or other business. The effect of the proposed amendment is to exempt these corporations from the normal corporations tax and the undistributable-profits tax, if their members take up their shares of the corporations' income on their own individual returns. It is believed that this provision will give them relief, and their members will be subject to a fair tax.

Relying on the legislative history of IRC 501(d), the Service has always interpreted this provision to require that such an organization will be exempt under IRC 501(d) only if it engages in business for the common benefit of its members. The statute provides that each member's share in the common treasury, whether or not distributed, be taken into the computation of each member's income tax. This private interest in the organization's treasury is not compatible with exemption under IRC 501(c)(3).

This interpretation is also consistent with the only decided case discussing IRC 501(d). In Riker v. Commissioner, 244 F. 2d 220, 230 (9th Cir.), cert. denied, 355 U.S. 839 (1957), the court stated that:

> One might assume, then, that Congress intended an association somewhat akin to the ordinary association or partnership in which each member has a definite, though undivided, interest in the business conducted for the common benefit of the members as well as a common interest in the community treasury and property.

The legislative history and the wording of the statute itself also suggests that the communal business activities must be for a substantial business purpose, i.e., they must be engaged in with a substantial purpose of producing commodities that are sold to the outside public to produce revenue which is then used to support the membership and conduct other functions rather than solely for subsistence. The Service has held that an organization that derives its support from the contribution of members holding outside employment would not be exempt under IRC 501(d).

Finally, the Service has also held that contributions to IRC 501(d) organizations are not deductible under IRC 170. See Rev. Rul. 57-574, 1957-2 C.B. 161.