

An Investigation into Tax-Exemption for Churches and Religious Institutions

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Abstract

The First Amendment of the U.S. Constitution provides for a separation of Church and State, a right that provides the grounds for churches being exempted from filing and paying their taxes. This right has been defended time and time again in the U.S. Supreme Court, as justices uphold that government and religion need not be intertwined. There are valid arguments both for and against requiring churches to file their taxes and considering the significant portion of the economy that is made up by churches, it is an issue worth looking into. My research concludes that churches should be treated the same as every other individual person, business, and not-for-profit organization in the United States, and be required to file their taxes. Whether they should be paying taxes is a separate issue, but they should at the very least be more transparent about their finances for accountability to the church members and the surrounding community.

Introduction

There were many reasons why a separation of Church and State was an essential part of the United States' governing philosophy when the United States declared its independence from Great Britain and wrote the Constitution. Churches have been officially considered to be federal income tax exempt since 1894 and have been unofficially tax-exempt since the United States' founding (ProCon.org, n.d.). Since then, the government has written laws that have made it so that once an organization has been established as a church, it is left to its own devices, and it is not required to file any of the forms that other not-for-profit and for-profit organizations use to report their financial standing each year. This is shocking given the high incidence of fraud today, especially within religious institutions. Additionally, these laws are not very conducive to the movement towards greater financial transparency.

Some churches receive a significant amount of money in donations each year, but they are not required to report this amount or any other financial information for that matter. This information could be useful to stakeholders of the organization, who include the individuals employed by the organization, its members, donors, and even the surrounding community. Without this information, the individuals that donate to these organizations do not have confirmation that the organization is using their donations in a legitimate manner. Unfortunately, this freedom has left room for fraud and misuse of financial assets in religious institutions, and a growing number of such cases have been discovered in recent years. This thesis will define why churches are not required to file their taxes and how other not-for-profit organizations typically report their finances, illustrate the importance of IRS Form 990 in preventing and identifying

fraudulent activities, and analyze how the separation of church and state lends itself to these matters.

A Brief History of the Separation of Church and State

The separation of church and state was established in the First Amendment of the United States Constitution, which “protects the right to freedom of religion and freedom of expression from government interference” (LII Staff, 2017). When the Constitution was written in 1787, the colonists had just won their freedom from Great Britain, and considering how many colonists had come to the New World to escape religious persecution, they felt religious freedom was an incredibly important right to protect when writing the charter that would eventually become the supreme law of the land (National Constitution Center, n.d.). America’s founding fathers wrote the Establishment Clause to protect five basic freedoms:

“Congress shall make no law respecting an establishment of religion or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceable to assemble, and to petition the government for a redress of grievances” (LII Staff, 2017).

The Establishment Clause goes hand in hand with the Free Exercise Clause, which protects all citizens’ religious beliefs and most religious practices. As the two clauses work concurrently, if the Establishment Clause is violated, the Free Exercise Clause is often also violated. University of Baltimore Professor Stephen Shapiro gives a great example of this, “Mandatory prayer in schools would constitute an improper establishment of religion and would also interfere with the free exercise rights of those students who did not believe in that particular prayer or prayer in general” (Shapiro, n.d.). The government walks a fine line between protecting these two clauses,

because if they protect one of the clauses too much, they may be violating the other clause.

Shapiro also gives an excellent example of this too, “If the government refuses to provide certain services (i.e., fire and police protection) to churches, that might violate the free exercise clause. If the government provides too many services to churches (perhaps extra security for a church event), it risks violating the establishment clause” (Shapiro, n.d.). This may play a part in why the government has decided that churches are tax-exempt entities and not required to file their taxes.

In 1969, the case of *Walz v. Tax Commission of the City of New York* brought about the legal question of whether property tax exemptions, specifically those given to churches, violate the Establishment Clause of the First Amendment, considering that the exemptions force taxpayers to contribute indirectly to the churches who are given those exemptions. The Court ultimately decided that in this case, the tax exemptions, “created only minimal and remote involvement between church and state and far less than taxation of churches” (Oyez, n.d.). This case is significant because it was a landmark decision that upheld the separation of Church and State, with the conclusion that, “benevolent neutrality toward churches and religions was deeply embedded in the fabric of our national life” (Oyez, n.d.).

When bringing up issues that deal with the First Amendment and the protection it provides, one must define religion. Over the years, courts have been very generous with what is defined as a religion and/or what religious beliefs are. In order to give every citizen equal protection under the law, religious beliefs are protected regardless of what religion they pertain to, and even if an individual does not belong to a specific group, they still receive the same protections as those that do. There have been many cases throughout American history that have

helped shape what defines religion today. In the last quarter of the 19th century, the case of Davis v. Beason, religion was defined as, “a reference to one’s views of his relations to his Creator, and to the obligations they impose of reference for his being and character, and of obedience to his will” (Freedom Forum Institute Staff, n.d.). The definition was expanded in the 1961, when the Court in the case *Torcaso v. Watkins* decided that, “the establishment clause prevents government from aiding those religions based on a belief in the existence of God as against those religions founded on different beliefs” (Freedom Forum Institute Staff, n.d.). This decision clarified the coverage of religions that were not founded on the principle belief in a God, like Buddhism, for example.

The separation of church and state has withstood the test of time, which is shown through the numerous court decisions that have abolished unconstitutional laws and statutes that forced the practice or observance of a religion or group of religions or persecuted a religious group. A three-pronged test resulted from the decision in *Lemon v. Kurtzman* in 1971, where the constitutionality of a statute could be determined if: “(1) it has a primarily secular purpose; (2) its principal effect neither aids nor inhibits religion; and (3) government and religion are not excessively entangled” (“Religious Liberty,” n.d.). This test provides precedent in order to help to streamline the decision process when there is a question about a violation of the First Amendment right to freedom of religion. This is known as the “Lemon Test.”

What Constitutes a Church?

Before a church can go through the process of becoming a tax-exempt organization, it must meet the requirements that the Internal Revenue Service (IRS) uses to define a church. According to the ‘Tax Guide for Churches & Religious Organizations,’ “the term [church] is not

used by all faiths; however, we use it in its generic sense as a place of worship including, for example, mosques and synagogues” (IRS Staff A, 2015). Additionally, exceptions are made for “conventions and associations of churches and integrated auxiliaries of a church” (IRS Staff A, 2015). The IRS considers integrated auxiliaries to be, “men’s and women’s organizations, seminaries, mission societies and youth groups” or other groups that meet certain specific requirements defined in IRS Publication 1828 (IRS Staff B, n.d.). While special tax rules apply to churches, other religious organizations are not granted the same privileges. Religious organizations that are not considered churches by the IRS include, but are not limited to, “nondenominational ministries, interdenominational and ecumenical organizations, and other entities whose principal purpose is the study or advancement of religion” (IRS Staff A, 2015).

The ‘Tax Guide for Churches & Religious Organizations’ also provides attributes that have been identified by the IRS and by court decisions that help determine the legitimacy of an organization of when it is considered to be a church for federal tax purposes.

These attributes encompass: “distinct legal existence, recognized creed and form of worship, definite and distinct ecclesiastical government, formal code of doctrine and discipline, distinct religious history, membership not associated with any other church or denomination, organization of ordained ministers, ordained ministers selected after completing prescribed courses of study, literature of its own, established places of worship, regular congregations, regular religious services, Sunday schools for the religious instruction of the young, and schools for the preparation of its ministers” (IRS Staff A, 2015).

This being said, the IRS still must respect the separation of Church and State, and makes the following disclaimer as a legal protection, “the IRS makes no attempt to evaluate the content of whatever doctrine a particular organization claims is religious, provided the particular beliefs of the organization are truly and sincerely held by those professing them and the practices and rites associated with the organization’s belief or creed are not illegal or contrary to clearly defined public policy” (IRS Staff A, 2015).

In a perfect world, the IRS would not have to question a religious institution’s credibility. However, white collar crime involving churches unfortunately exists. One such case was resolved in 2016, when a federal jury found a Minnesota chiropractor guilty of tax evasion (U.S. Department of Justice, 2017). One of the ways that the individual committed tax evasion was through ‘Sovereign Christian Mission,’ a religious institution which he had formed himself. The individual then used ‘Sovereign Christian Mission’ to hide his chiropractic income and pay for personal expenses (U.S. Department of Justice, 2017). With instances of exploitation of tax-exemptions that have been granted to imposter churches that do not operate for religious purposes, measures have had to be taken to protect legitimate religious institutions.

Tax-Exempt Organizations

While most tax-exempt organizations file IRS Form 990 annually, churches and specific church-affiliated organizations are exempted from filing. The Wilson-Gorham Tariff Act of 1894, “provided an exemption for corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes...” (Thorndike, 2013). This was the first time that the government codified that churches were exempt from paying taxes, although churches had been unofficially tax-exempt since the United States’ founding. Over the

next twenty or so years, this law changed drastically, adding specifics about exactly what kind of an organization received tax exemption, as the language of the first law was very broad. At the time, churches being exempt from filing and paying their taxes had less to do with the separation of Church and State and more to do with the fact that they were inherently not-for-profit organizations, stating that, “the very notion of a corporate income tax implied that nonprofit organizations were exempt” (Thorndike, 2013). IRS Form 990 is considered to be an information return because the organizations which file it are not paying taxes, but instead they are declaring their revenue, expenses, assets, and liabilities to the IRS. IRS Form 990 is twelve-page worksheet that asks the preparer to provide details about the organization’s mission and most significant activities; the grants they receive, information about the board of directors and its voting members, how they compensate their key contractors, employees, and officers, in addition to providing a balance sheet and page reconciling the organization’s net assets. The final portion of the form asks how the financial statements were prepared and how the information was reported (IRS Staff C, 2018).

In order to qualify for tax-exempt status, the organization must satisfy each of the following requirements:

- “The organization must be organized and operated exclusively for religious, educational, scientific, or other charitable purposes;
- Net earnings may not inure to the benefit of any private individual or shareholder;
- No substantial part of its activity may be attempting to influence legislation;
- The organization may not intervene in political campaigns; and

- The organization’s purposes and activities may not be illegal or violate fundamental public policy” (IRS Staff A, 2015).

This also makes the organization eligible to accept tax-deductible contributions, meaning that donors can claim what they give to the organization up to a certain amount on their personal income tax return, or IRS Form 1040. Even though they are tax-exempt organizations, churches and other religious organizations are still allowed to be legally organized in ways such as, “unincorporated associations, nonprofit corporations, corporations sole and charitable trusts” (IRS Staff A, 2015).

Becoming a Tax-Exempt Organization

As long as a church meets the requirements listed above or as stated in IRC Section 501(c)(3), they are tax-exempt, and do not need to file to receive this status. Often, churches still decide to file for this status, because it proves to everyone involved in the church community that the church is in fact tax-exempt and will receive tax benefits accordingly (IRS Staff A, 2015). This is an important step in providing greater financial transparency to the individuals employed by the organization, its members, donors, and the surrounding community. Additionally, this is beneficial to donors, because it makes their donations tax-deductible, giving them an added incentive to donate to the church. Religious organizations are different from churches in this sense because they still have to apply for tax-exempt status, unless they do not gross more than \$5,000 annually (IRS Staff A, 2015).

Churches and some religious institutions fill out IRS Form 1023, while smaller religious institutions are allowed to use IRS Form 1023-EZ. Religious institutions are required to submit their applications within, “27 months from the end of the month in which the organization is

formed to be considered tax-exempt and qualified to receive deductible contributions as of the date the organization was formed” (IRS Staff A, 2015). Unlike religious institutions, churches are permitted to obtain ‘recognition of exemption’ as the day the church was formed, even if it is more than 27 months prior to applying for tax exempt status. There is a non-refundable fee involved with applying for tax exempt status under IRC Section 501(c)(3). Churches are not required to file for tax-exempt status, but if they wish to apply anyways they are also required to pay the non-refundable fee.

Once a church or religious organization receives tax-exempt status, there are five major rules they must follow in order to maintain their status. The guidelines state:

- “Their net earnings may not inure [unfairly benefit] any private shareholder or individual;
- they must not provide a substantial benefit to private interests;
- they must not devote a substantial part of their activities to attempting to influence legislation;
- they must not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office; and
- the organization’s purposes and activities may not be illegal or violate fundamental public policy” (IRS Staff A, 2015).

These rules are very similar to that required of other not-for-profit organizations. However, without submitting annual financial reports, one must ask how church activities are being monitored to ensure they are following these guidelines.

What is a Church Audit?

While churches are not required to file IRS Form 990, they are still required by the IRS to maintain “books of accounting and other records necessary to justify their claim for exemption in the event of an audit” (IRS Staff A, 2015). Recordkeeping is an essential business practice whether the organization is for-profit or not-for-profit. There is a lot of discretion given to the organization as to what they feel is important to hold onto, but generally includes organizing documents, bylaws, minute books, property records, bank records, and invoices. The organization can decide the extent to which they maintain records by taking into account the type, size, and complexity of the organization’s activities (IRS Staff A, 2015). The IRS does require that the organization retain records of, “revenue and expenses, including payroll records, and records relating to acquisition and disposition of property (real and personal, including investments) for at least four years after filing the returns to which they relate” (IRS Staff A 2015).

The IRS defines an audit as, “a review/examination of an organization’s or individual’s accounts and financial information to ensure information is reported correctly according to the tax laws and to verify the reported amount of tax is correct” (IRS Staff D, 2019). Not-for-profit and for-profit businesses (those without tax-exempt status) are selected by the IRS for audits either randomly, or if there are issues/discrepancies with their return or other taxpayer’s returns (IRS Staff D, 2019). As churches are granted tax-exempt status and do not file any sort of return with the IRS, the IRS does not have the same opportunity to monitor the finances of churches and related religious institutions. In fact, the IRS is only permitted to audit a church when a qualified official from the U.S. Treasury Department has a reason to believe that, “the organization may not qualify for the exemption or may not be paying tax on an unrelated business or other taxable activity” (IRS Staff A, 2015). It is important to note that these

restrictions only apply to the religious institutions themselves, and not to the individuals that work there or related organizations like affiliated schools. Churches are not shielded from “routine requests for information,” like compliance with income tax, Medicare tax, and Social Security tax withholding requirements, for example. Additionally, churches must comply with, “criminal investigations [and] investigations of the tax liability of any person connected with the church, such as a contributor or minister” (IRS Staff A, 2015).

When is a Church Audit Required? / IRS Involvement

If the IRS has reason to believe that a church should be audited, either because they, “may not be exempt, by reason of its status as a church, from tax, or may be carrying on an unrelated trade or business or be otherwise engaged in activities subject to taxation under this title,” the process begins by providing the church with a written notice where they explain their concerns (Cornell Law School, n.d.). The church is then allowed a “reasonable period of time” where they can give an explanation to assuage their concerns. If they do not respond within this reasonable period of time or they cannot come up with a reasonable explanation, the IRS will send out a second notice letting the church know they will be examining their books and records. Once the second notice is received, the church can meet with an IRS official to discuss their concerns, if they wish to. The IRS will examine the church’s books and records within two years of sending out the second notice (Cornell Law School, n.d.).

The IRS has often been scrutinized for overstepping their power and auditing churches as a means to silence actions that may be considered politically motivated. Churches are to refrain from, “explicit political activity in order to remain tax exempt because...substantial activities directed to the attempts to influence legislation or affect a political campaign should not be

subsidized” (Garthwaite, 2007). In order to uphold the separation of Church and State the government cannot interfere in religious activities, and religious activities cannot interfere with politics. Although tax-exempt entities (including churches) are banned from participating in political activities, this does not mean that all organizations necessarily follow this rule, or that there are not ways to circumvent this policy and influence the public’s opinion on highly politicked issues and candidates without drawing attention to themselves.

An example of this was when the government investigated All Saints Episcopal Church in California after a “tip” was received about the church, “hosting a sermon that allegedly endorsed presidential candidate Senator John Kerry over...sitting President George W. Bush” (Garthwaite, 2007). The church is well-established as a progressive organization and hosting such a sermon would put their tax-exempt status in jeopardy. However, there was controversy over how just one tip caused a full-blown investigation of the church, and whether Section 7217, a law put in place to provide safeguards against, “high-level political intrusion by the Executive branch into audits or investigations,” was providing enough protection in this situation. Although it was never proven nor disproven that auditing All Saints Episcopal Church was politically motivated, the inquiry did raise questions concerning the integrity of the IRS and their executive power to investigate church finances.

Section IRC 7611 of the Deficit Reduction Act of 1984 put greater restrictions on what the government is and is not allowed to do when it comes to auditing churches. There was fear that the rights of churches were not being protected sufficiently by the previous law, IRC 7605(c), and that there were too many unnecessary investigations into church finances. Section IRC 7611, “imposes a higher burden on the [government] to demonstrate necessity” (Garthwaite,

2007). With greater protection for all church's First Amendment rights, this was Congress's way of amending previous policies to make sure that the separation of Church and State was being protected, as well as to, "minimize IRS contacts with churches to only those necessary to insure compliance with the tax laws" (Garthwaite, 2007). However, even with all this law did to protect churches, there is still a going concern that the courts may be using the ambiguity of the law to allow politically motivated audits of churches, as discussed in the case of All Saints Episcopal Church.

Independent Audits

Apart from the audits required by the federal government, churches can hire an accountant to complete an independent audit to verify the financial standing of the records they retain. An independent audit is similar to audits done by the IRS but takes a broader look at the business and their practices, instead of just looking at their accounting books. The National Council of Nonprofits defines an independent audit as, "an examination of the financial records, accounts, business transactions, accounting practices, and internal controls of a charitable not-for-profit by an 'independent auditor'" (National Council of Nonprofits, 2018). The auditor will ensure the organization is following generally accepted accounting principles (GAAP) which have been created by the Financial Accounting Standards Board (FASB). In order for the audit to qualify as independent, it cannot be done by an employee of the not-for-profit, but instead it must be done by an auditor/CPA that is retained through a contract (National Council of Nonprofits, 2018).

Although regular audits are not required by the IRS, there are several reasons why a church may be required to undergo the audit process. According to the Evangelical Council for

Financial Accountability (ECFA), a bank may want to see a recent audit before they allow a church to take out a loan, the church may have a requirement for regularly scheduled audits incorporated in their bylaws, or if they are part of a group of churches, the governing board may require the church to complete an audit (Laue, n.d.). There is no set budget amount at which churches are required to be audited, however, many sources suggest that if a church has a budget of \$1,000,000, they should likely be audited by an independent auditor because they are, “significant participants in the business community and accordingly are expected to exercise good business practices” (Hargrave, 2003).

Churches rely heavily on donations, whether it be from their congregation in their weekly collection, holiday offerings, from organizations in their community, and more. Without generous donors, churches would struggle to carry out their missions and keep their doors open. Taking that into consideration, Karen Kitching completed a study on audit value and charitable organizations that investigated whether, “audit quality affects donor decision in the market for contributions” (Kitching, 2009). Her research found that, “a higher quality auditor decreases donor uncertainty,” and that there is strong evidence in favor of the importance of the information role of auditing (Kitching, 2009). Thus, it is important for churches to undergo regular audits in order to legitimize their organization and operations to potential donors.

Why Undergo the Audit Process?

There are many reasons that a church would also voluntarily elect to have an independent audit done. An audit reassures all the church stakeholders, including the individuals employed by the organization, its members, donors, and even the surrounding community that there is accountability within the church. This practice also paves the way for financial transparency, as

the church is giving permission to an independent auditor to come in and review the entirety of their financial records. The audit process is started when the fiscal year ends and requires that all books and schedules are brought up to date, which results in completed records for that fiscal year. While an audit is not solely done to uncover fraudulent activity, if the auditors find instances of questionable transactions, they will report the findings to church officials, and can recommend further investigation. Finally, the audit is finalized with a management letter to the church that includes the auditor's findings and their evaluation of the church's accounting practices. They will identify any potential weaknesses in their practices and systems and provide suggestions for potential improvement (Hargrave, 2003).

Nonetheless, churches may still have reasons for shying away from being audited. It can be a significant expense and time commitment to undergo an audit, and the finance staff may be nervous to be audited for fear of what might be found. While at a first glance it may seem like a red flag that the finance staff does not want to be audited, in smaller churches especially the finance staff may be made up of volunteers with no real background or experience in accounting or finance and an audit will uncover the 'unknown,' which may include improper accounting practices. 'Why a Church Audit?' has an excellent analogy for this situation, "Audits can be like going to the doctor ... an annual checkup can help deter bigger issues later, and sometimes the fear of the unknown is worse than understanding the issues and dealing with them" (Laue, n.d.). In this case an audit will prove to be incredibly beneficial, as the auditors will be able to instruct the finance staff on what practices they need to change or implement, and how to properly maintain their books and records moving forward. As for the challenge of coming up with the money and time required to be audited, churches can seek out qualified accounting professionals

in the community who are not affiliated with the church but are willing to donate their time and services to complete the church's audit.

Options for Assurance

If the church is not required to have a complete audit done, they can conserve resources by having a financial review or compilation done. These types of financial procedures provide some of the tests that a complete audit does, but they do not take the same in-depth look at the church's financials as an audit would. An audit is considered to be an assurance service – a certified public accountant (CPA) verifies the records that an organization has with documentation that the practices and policies in place are being followed in an appropriate manner (Laue, n.d.). Audits are the “highest level of assurance” offered by a CPA, and a financial review is very similar to an audit, but there is less testing done within the scope of the procedure, so there is less assurance provided than with an audit. Lastly, a compilation provides the lowest level of assurance, as the CPA will only review the information provided by the organization, and only take an in-depth look at areas within the provided information that contain discrepancies (Laue, n.d.). As previously mentioned, any sort of review done of a church's financials will be beneficial to the church's stakeholders.

As the church audit process is not mandated or regulated by the IRS or any other governmental agency, the resources available to churches are most commonly put out by CPAs and church finance committees. While the articles vary slightly in how churches should go about the auditing process, they all agree that it is incredibly important for churches to be audited annually. In a handbook created for a Massachusetts-based church audit committee, CPA Frank Marino makes a valuable case for why an audit is a protective measure for those involved with a

church's finances, and not something that is necessarily resulting from a lack of trust for the individuals filling those positions:

“Auditors are often perceived as purveyors of distrust while churches, God’s houses, are populated with God’s good people...Should churches and their leaders be concerned with audits or should they simply trust their financial personnel to do their jobs competently and honestly?” (Marino, n.d.).

While one would hope that the individuals working in a place of worship would be inherently trustworthy, they are not immune from the pressures and temptations that any other individual working with money has. With the number of highly publicized accounting scandals involving huge corporations that have been uncovered during the last two decades, like Enron and WorldCom, for example, there is a general distrust for CEOs and other individuals in executive-level management positions in for-profit organizations. Religious institutions have frequented the news in recent years when fraudulent operations have been discovered too, but generally church employees face less scrutiny than others in financial roles because they are believed to be held to the same morals the church is founded in. Marino goes on to further explain why an audit is not a lack of faith in the church employees, but instead it helps to demonstrate the church employee’s hard work and dedication to their congregation. “In fact, church leaders have a stewardship responsibility to their congregation to [ensure] that the church’s resources are used in a manner consistent with the church’s objectives...an audit can serve to legitimize and hold up for recognition the tireless work of these often under-appreciated individuals” (Marino, n.d.).

The Audit Committee

Whether a church is part of a larger coalition of churches or not, there should be some sort of audit committee overseeing the individuals handling the church's budget, donations received, expenses, and overall finances. This committee is tasked with handling internal audits and ensuring that independent audits are completed as often as deemed necessary (by the bank, coalition of churches, or the committee itself). Smaller churches working with a smaller budget tend to have volunteers handling their finances, while larger churches tend to be able to afford to hire staff to manage these tasks. Marino explains in his church audit committee handbook that in order for the church's annual report that is made available to the church community to be meaningful, the Audit Committee must have integrity, and "be given the resources of talent, time, and access" (Marino, n.d.). If the Audit Committee is unknowledgeable of general financial practices and the audit process, the church's annual report that they assist in putting out will lack any true meaning.

This committee must be representative of the church congregation, connect the church congregation with the church's governing body, and any other church bodies that the church must answer to. It is their job to, "attempt to verify the truth and accuracy of the information contained in the church's financial reports, and by expressing an opinion on such information, make them more believable and acceptable to all interested parties..." (Marino, n.d.). They must ensure that the audit is unbiased and impartial, two important aspects that contribute to the audit's independence. Marino makes the point that churches do not necessarily have to conform to the generally accepted accounting principles (GAAP), because in most cases the statements will not be published to outside parties and instead will just be made available to the church community (Marino, n.d.). The Audit Committee will decide if they want the church finance

employees to adhere to a specific set of accounting standards, or if they want to focus on something like cash coming in and leaving the organization, for example.

The Audit Committee is also responsible for overseeing that donations are being used appropriately, and that all transactions involving investments are recorded properly, as well as for ensuring that all loan payments were made during the year, if applicable. They verify that church employees are being paid the amount that was agreed upon by the church's governing body, and that it has satisfactory insurance for its property and assets. While they do not necessarily need to "crunch the numbers," they should review the accounting practices used to manage the church's finances and ensure that they are being practiced accurately.

Upholding or Violating the Establishment Clause: A Discussion

It is important to examine both sides of the argument as to whether churches should be required to file taxes. Some believe that this upholds the Establishment Clause of the First Amendment, because it, "restricts the fiscal relationship between church and state, and tends to complement and reinforce the desired separation insulating each from the other" (Oyez, n.d.). Certainly, the less information churches are required to share with the government, the less of an opportunity there is for the government to be involved in church affairs. On the other hand, Associate Justice of the US Supreme court, William O. Douglas, stated the following in his dissenting opinion of the case *Walz v. Tax Commission of the City of New York* which he presided over:

"If believers are entitled to public financial support, so are nonbelievers. A believer and nonbeliever under the present law are treated differently because of the articles of their faith... I conclude that this tax exemption is unconstitutional" (Oyez, n.d.).

Nonetheless, this case was decided in 1970 and the decision has yet to be overturned. While there are still many flourishing organized religions in the United States, the numbers of Americans who identify with one of these institutions has been on the decline in recent years (Wormald, 2017). When the separation of Church and State was written into the U.S. Constitution, most of the people that had come to the New World were escaping religious persecution in England. Thus, the Founding Fathers had a vested interest in protecting the majority's rights, which was ensuring that they could practice their religion freely. However, with a growing number of Americans not identifying with a religion, one must ask whether giving churches special privileges like not filing their taxes is still important to the majority like it was over two-hundred years ago at the time of the United States' founding.

Nonprofit-Status Worthy

Churches receive a slew of benefits beyond what the government already gives other not-for-profit organizations, and at times it seems that the separation of Church and State has created a system in which the odds are stacked in the favor of churches. The argument of whether churches should be required to pay taxes was quickly shut down by the United States' Supreme Court in the case of *McCulloch v. Maryland*, when it was decided in 1819 that, "the power to tax involves the power to destroy" (Stanley, 2008). The idea behind this was that if churches were required to pay taxes and they did not make the required payment for whatever reason, the government would be forced to step in and potentially shut down their operations, as they to other businesses/organizations that fail to pay their taxes. Here, the government is directly involving themselves in religion, something that is strictly prohibited by the First Amendment.

Only businesses that have been organized as not-for-profit organizations have been freed from the burden of paying taxes. The United States government has awarded them this exemption because of the value of their contributions to the greater good of the public. Churches have historically been known to provide services to those in need like soup kitchens and food pantries, school supply and toiletry collections, afterschool programs for underprivileged youth, and shelter for the homeless. Because the government would otherwise have to provide for these disadvantaged individuals, it has been agreed upon that their tax-exempt status is earned through these activities. Up until recently, churches have always been considered to be not-for-profit organizations. Not-for-profit organizations are plainly named – they are businesses and organizations that do not exist to make a profit. Instead, the entirety of their earnings is used to keep the institution running and further their mission, or the reason for which they were created. However, megachurches and televangelist networks bring in earnings far beyond that of the average American church, and yet they are still not required to file a form such as IRS Form 990 or pay taxes (Burnett, 2014). With billions of global supporters, these establishments have been in the public eye for a while now, but the IRS has yet to change the guidelines that allow these kinds of churches to qualify for tax-exemption.

Subsidizing Religion

Legal minds have disagreed over the years as to whether offering tax-exemptions to churches is, in a way, supporting religion. The same tax-break is offered to all churches, regardless of what religion they are organized as, so it is not as if the government is only offering the exemption to certain religions. In 1983, the case of *Regan v. Taxation with Representation*, the Chief Justice presiding over the US Supreme Court stated that:

“Both tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much of the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income” (FindLaw, n.d.).

Churches have an undeniable economic benefit resulting from their tax exemption, and there is most certainly an economic burden on American taxpayers resulting from the tax exemptions given to churches. Additionally, churches benefit from public services that they do not contribute to because those services are paid for by taxpayer dollars, like local fire protection services and police departments. However, there are many other types of not-for-profit businesses and organizations that benefit from public services that they do not contribute to either, like libraries, hospitals, and public schools, for example. For obvious reasons, the tax-exemptions these businesses and organizations that benefit society receive never fall under scrutiny with debate over whether the government is too entangled with the missions of these businesses and organizations for providing these tax breaks.

Prior to the case of *Regan v. Taxation with Representation*, the case of *Walz v. Tax Commission of the City of New York* brought about the decision that, “the grant of a tax exemption is not sponsorship, since the government does not transfer part of its revenue to churches, but simply abstains from demanding that the church support the state” (Oyez, n.d.). These two decisions validate the two opposing sides of the argument for whether churches should receive the same tax breaks other not-for-profit businesses and organizations do. Ultimately, the government has not made any changes to their policy of tax-exemption for

churches in recent years, and there are no bills working their way through the House of Representatives that would change this.

Megachurches and Televangelists

With similar missions and practices to other religiously-affiliated groups deemed churches by the Internal Revenue Service, megachurches and televangelist networks are generally granted tax-exempt status. According to the Hartford Institute for Religion Research, a megachurch generally refers to, “any Protestant Christian congregation with a sustained average weekly attendance of 2000 persons or more in its worship services, counting all adults and children at all its worship location” (Hartford, n.d.). Televangelists, or, “evangelists who conduct regularly televised religious programs,” also reach huge audiences, and as their reach grows, so does the amount of donations that are coming in (Merriam-Webster, n.d.). There are many “big names” in televangelism, like Jim Bakker, Joel Osteen, Billy Graham, and Kenneth Copeland, to name a few. For the most part, these individuals made a name for themselves with their television shows. However, they have also been in the news for committing fraud within or with the help of their television show.

The Grassley Investigation of Televangelists was led by a leader of the U.S. Senate Finance Committee, Senator Charles Grassley, and starting in 2007 it examined the finances of several tax-exempt churches and televangelists, to ensure that they were using their funds appropriately, and were following the rules established by the IRS to maintain their tax-exempt status. Grassley made an important point, “considering tax-exempt media-based ministries today are a billion-dollar industry...with minimal transparency, it would be irresponsible not to examine this tax-exempt part of our economy” (In Grey House Publishing, 2009). This argument

provides a quintessential reason that churches should be audited regularly, and be required to file IRS Form 990, or a similar not-for-profit tax return. There is simply too much money going through these organizations to allow them to do their business privately, when every other not-for-profit and for-profit organization is required to share their financial information with the federal government.

As previously discussed, it has been proven that donors are more willing and generous with their donations when the organization they are donating to is transparent about their finances. Grassley reiterated that, “the most successful nonprofit organizations recognize the need for transparency about their operations and accountability to their donors and the taxpaying public” (In Grey House Publishing, 2009). Several of the televangelists under investigation refused to produce the documents requested, stating that it was a violation of the separation of Church and State. While there are only certain circumstances under which a church can be investigated, and this investigation arguably falls under the umbrella of the Internal Revenue Service, this behavior raises suspicion over what these institutions might be hiding. Grassley focused his inquiry around areas that whistleblowers had suggested the churches might be acting in ways that would invalidate their tax-exempt status. His investigation was closed in 2011, and none of the televangelists under scrutiny received charges or fines (In Grey House Publishing, 2009).

In the early 2000s, independent of this investigation, Wall Watchers, a group that evaluates the authenticity of Christian charities, requested that the Internal Revenue Service investigate a handful of televangelists, and determine if the churches they preach at deserve to keep their tax-exempt status (Schwinn, 2004). These church leaders had publicly displayed their

lavish lifestyles, and Wall Watchers was concerned that, “the preachers are in violation of federal laws that require compensation for officials to be ‘reasonable’” (Schwinn, 2004). As these churches had not publicized their financial statements, it was hard to verify how much of the donations they received were legitimately going to charity and being spent for the purpose they were supposedly collected for. Although some of the church officials attempted to claim they were following the rules specified by the IRS, Wall Watchers asks some important questions:

“Donors might well ask why Joyce Meyer needs a 10,000-square-foot ‘parsonage’ with a heated and air-conditioned eight-car garage, or why ministry money is used to pay the property taxes for this house and the houses of family members together worth over \$4-million...might not some of this money have been better spent on teaching the Gospel, feeding the poor, clothing the naked, or ministering to prisoners?” (Schwinn, 2004).

What is ‘reasonable’ compensation for church officials? The church’s board of directors or governing body is supposed to be in charge of this decision, so one must ask who approved the above parsonage and salary for Joyce Meyer. Taxing such operations could be very lucrative for the government, but there has not been a whole lot done to change the rules and take away their tax-exempt status. Again, this goes back to the issue of the separation of Church and State – there is not a whole lot the government can do in this situation, unless they want to set a precedent for all future cases, and it is possible that they do not have the resources to undertake such a project at this time.

Megachurches have also been known to be troublesome with their spending, too. As stated above, there have been numerous investigations that have uncovered inappropriate spending by church officials, where they were using church funds to pay for their own expenses, or were

being compensated a questionable amount for working for what is allegedly a not-for-profit organization, or for having a mansion for a parsonage and a private jet, for example. Recently, a megachurch pastor was accused of defrauding investors, by using their money to purchase foreign bonds, and deceiving these individuals, assuring them that the bonds were safe and that they would see a return on their investment, when in reality the money was being used to pay off private loans and to contribute to other personal expenses (Doom, 2018).

Our Lady of Perpetual Exemption

In 2015, *Last Week Tonight with John Oliver*'s host created an experiment to bring light to televangelists, the way they solicit donations, and how they may be taking advantage of the system that provides them with a tax-exempt status. In this experiment, he created a church called "Our Lady of Perpetual Exemption," which provides a straightforward explanation of what he is trying to illustrate with its invention. Oliver explains that he wanted to bring attention to churches that are not existing for the purpose of improving the world around them, but instead are, "exploiting people's faith for monetary gain" (Ohlheiser, 2015).

Explaining that his church is, "a tax-exempt organization that you certainly can't say is not a church," he makes a commentary on the vagueness of the Internal Revenue Services' requirements for an organization to be considered a church and to be exempt from filing their taxes (Ohlheiser, 2015). If a church is "truly and sincerely held and not illegal," the IRS will not do any further investigation into whether the church is truly deserving of their not-for-profit tax-exempt status (Ohlheiser, 2015). Oliver promised his worshippers miracles if they in turn make donations to Our Lady of Perpetual Exemption, stating, "if you don't send us money, God will be extremely angry with you" (Ohlheiser, 2015). He does this to call out televangelist pastors

who are rather aggressive in their fundraising tactics. During his experiment, thousands of dollars in donations flooded in to Oliver and Our Lady of Perpetual Exemption.

After a Minnesota church took the Internal Revenue Service to court over whether their audit was approved by, “an appropriate high-level Treasury official,” the IRS was suspended from examining (auditing) any and all churches until they found an individual that met their standards to approve such audits (Church Transparency Project, 2014). The episode of *Last Week Tonight with John Oliver* in which Our Lady of Perpetual Exemption was aired brought scrutiny to the IRS, because they did not conduct any church audits between 2009 and 2013, and since they had been taken off suspension in 2013, they only conducted three church audits between 2013 and 2014 (CBS News, 2015). Now, the public is more aware of how easy it is to establish a tax-exempt organization that qualifies as a church by the IRS’s standards, and the information is out there that the IRS is not doing all that much to investigate churches that may be falsely organized as a church simply to claim tax-exempt benefits. Oliver makes the following comment, “the more money you send in, the more blessings will be returned to you...and that is still something I’m, amazingly, legally allowed to say” (CBS News, 2015). One must ask if the IRS is really protecting the best interests of the public by respecting the separation of Church and State to the point that the above examples are allowed to exist and impact the economies they operate in?

Conclusion

In a country based on checks and balances, one must ask themselves whether it is a fair and just practice to not require churches to file their taxes, especially when every other individual person, not-for-profit organization, and for-profit business is required to. After completing my

research, I feel that it is appropriate to treat churches like every other not-for-profit organization and require them to file IRS Form 990 or a similar form. Tax-exempt not-for-profit organizations are required to jump through certain hoops to validate their not-for-profit status and subsequently maintain the benefits they reap for organizing as such. The United States has established that not-for-profit organizations provide a lot of value to the communities they operate in, and has agreed that the government does not wish to hold back the organization's performance by requiring them to pay taxes on the money they bring in. This is because not-for-profit organizations operate under the assumption that the revenue they raise will only be used to do whatever is necessary to continue running the organization and carrying out its mission. By filing IRS Form 990 or another form of that nature, the government then has the chance to verify that the organization is operating in a legitimate manner and is not cheating the system, per se.

When the United States was founded, there was an essential need for a separation of Church and State. The colonists were unhappy with the way government and religion were intertwined in Great Britain and wanted to ensure that there would not be any such involvement between government and religion permitted in the United States. The First Amendment and its powers to protect the freedom of religion have withstood the test of time throughout the United States' history and been upheld in many landmark Supreme Court decisions. Over two hundred years after the United States Constitution was ratified, the federal, state, and local governments still uphold that government and religion are not to intermingle. However, I have concluded in my research that there are many benefits to requiring churches to file tax returns, and although it does bring the government into the picture, if the church is indeed legitimate and managing their finances with recognized accounting practices then the government involvement is minimal.

Government officials have raised thought-provoking questions about whether megachurches and televangelists bringing in millions, sometimes even billions of dollars in revenue each year, really deserve the tax-exempt status that they qualify for because of their religious affiliation. In recent years the government has attempted to investigate some of these high-earning organizations but has not been able to get very far because of pushback from the officials in those churches. The churches are arguing that they should not have to share that information because of the separation of Church and State, but at the same time it raises suspicion, because they could simply share their records and have the government out of their affairs quicker. There are many not-for-profit businesses and organizations that bring in millions and billions of dollars in revenue each year, and they are not under fire for how they use these funds and whether they deserve tax-exempt status, because they keep detailed records of how they are utilizing revenue and managing their expenses, and they report these numbers to the Internal Revenue Service annually for review.

I cannot stress enough that the main issue of concern here is the lack of transparency. Under the separation of Church and State, the government cannot interfere with religion and vice versa. The Internal Revenue Service stands firm in its decision that television networks acting as churches, which is also known as televangelism, should receive the same benefits of tax exemption that brick and mortar churches receive. I agree with the IRS here, as long as the church is operating in a legitimate manner and doing what is following the requirements to maintain their tax-exempt status, which would be easily verifiable if they were required to file their taxes, as well as undergo an audit regularly. Smaller churches, whether they have instances of fraud or not, tend to fly under the radar more easily. Without regular audits and yearly tax returns, it is challenging for the government to identify when churches are engaging in fraudulent

activities. There is nothing requiring these organizations to release their financial reports, or even create them in the first place. This creates a lack of transparency between the church and the stakeholders of the organizations. As I previously discussed, churches have an obligation to manage their finances in an appropriate manner that allows them to carry out the mission(s) of their institution. Without creating and releasing financial records that are formatted in a way that people without a background in accounting and finance can understand, it is hard to prove whether the institution is using the revenues they collect for the purpose they claim they are.

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