

RELIGIOUS ORGANIZATIONS AND THE ANNUAL COMPLIANCE REPORTING EXEMPTION

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ABSTRACT

Religious organizations receive the most charitable contributions of all public charities. However, unlike other public charities, they are automatically exempt from the annual IRS compliance reporting via Form 990. This is based on the protection of religious freedom which exempted such organizations from government scrutiny. Religious organizations are becoming more complex, and are growing exponentially especially in the 'mega church' sector. Perhaps it is time to re-examine the compliance reporting exemption. The paper discusses the positions of those who support and oppose this federal exemption and concludes with the authors' viewpoint.

INTRODUCTION

There are approximately 2.3 million nonprofit organizations (NPO) in the United States in 2010 (most recent year available), and 1.6 million were registered with the Internal Revenue Service. One million of these are 501(c) (3) public charities, the most common NPO (Blackwood, Roger & Pettijohn, 2012). According to Giving USA, a public service initiative of The Giving Foundation, Americans contributed approximately \$335 billion to charitable organizations (public charities) in 2014, and religious organizations received 31% of the funds, by far the largest benefactor. However, this contribution rate is slowing as a result of declining religious affiliation and attendance and increased giving to religious-oriented charitable organizations.

Religious organizations are charitable organizations and are exempt from taxation under Section 501(a) of the Internal Revenue Code (IRC) and specifically Section 501(c) (3). Tax-exemption is automatic if an organization meets five general requirements outlined in the IRC, including not intervening in political campaigns or attempting to influence legislation (McNair & Pryor, 2006). Also, religious organizations are exempt from paying property taxes in all states plus the District of Columbia.

Charitable and other tax exempt organizations are required to file an information (compliance) return annually with the IRS. The form and complexity depends on the level of support or revenue received by the charitable organization. The ultimate goal of reporting is to ensure effective management and fiscal oversight of the organization's resources. Large charitable organizations file the complex Form 990; medium ones file Form 990EZ; and smaller organizations (less than \$25,000) file Form 990N or e-postcard. It is worth noting that only 40% of registered NPOs were required to file an information financial return with the IRS in 2010 (Blackwood et al, 2012).

This paper will explore whether religious organizations should be exempt from the annual federal compliance reporting requirements. It discusses religious organizations in general

and various the positions in support for and against reporting and concludes with the authors' call for action.

RELIGIOUS ORGANIZATIONS

Churches and certain church-affiliated organizations receive special exemptions from the federal government that are not available to other charitable organizations. For instance, they receive automatic tax exemption without the need to file the appropriate forms, they do not need to file annual information returns, and they are protected from IRS examination though a special law passed by Congress (IRS, 2012).

The law, the Church Audit Procedures Act or CAPA, impose special limitations in IRS Section 7611 on how and when the IRS may conduct civil tax inquiries and examination of churches. Specifically, it requires a high ranking Treasury official's approval when the IRS demands a church's records. However, this particular individual is not specified and so; there is no one in the government to authorize a church audit. Clearly, churches (and other religious organizations) are placed in favorable situations since many of their activities are not subject to review by external parties.

Religious organizations, like other nonprofit organizations, must pay taxes on unrelated business income. They could also lose their tax exemption if they are engaged in certain non-permissible activities such as political campaigning. The motivation for the favorable tax treatment is the first Amendment passed in 1789 which promotes and protects religious freedom. Clearly, the founding fathers wanted to ensure that people were able to worship as they choose without interference from the government. History shows that Americans enjoy more religious freedoms than any other people in the world. For the most part, various religious organizations exist harmoniously in the United States with limited discord.

For purposes of our paper, the term church is used as a synonym for religious organizations although the former and not the later, is the one defined in the IRC (McNair & Pryor, 2006). Since churches do not have to formally register with the IRS, it becomes difficult to quantify the number of such organizations that are operating in the US. The Urban Institute publishes data on the nonprofit sector. Its detailed information on 501(c) (3) organizations includes a category for 'religion related, spiritual development', presumably the category for churches. This category, the largest of the 501(c) (3) organizations reported 222,144 of such entities and only approximately 14% file reports with the IRS (Blackwood et al, 2012). Another report noted that there are 321,839 congregations in the US (nccs, 2014).

One thing is certain, religious organizations are a diverse group consisting of congregations, mosques, temples, Buddhist centers, among others. They include the Lakewood Church in Texas with its approximately 38,000 members; World Changers International with approximately 20 fellowship centers across the country and growing; Westboro Baptist Church known for its extreme ideologies; the Islamic Center of America in Michigan, the largest and oldest Shia mosque in the country; and the Park Avenue Synagogue in New York with approximately 1,500 families with a top membership dues of \$5,520 per family (of two) per year.

SUPPORT FOR TAX REPORTING

Requiring churches to file annual reports with the IRS could be explored on many different levels. However, the paper limits the discussion to a review of current oversight bodies if any, the potential for fraud and abuse, and any violation of the constitution,

Current State

The Evangelical Council for Financial Accountability (ECFA) is at the forefront of helping churches and religious organizations (herein categorized as churches) improve transparency and accountability in their activities. Churches can become accredited through the organization by complying with its seven standards on responsible stewardship. These standards include governance; financial oversight such as the preparation and publication of audited (or reviewed) financial statements; and compliance with applicable laws. A number of main stream religions/denominations such as the Episcopal Church, have their own internal oversight bodies.

The ECFA is a third party peer accountability organization that confirms that churches are operating with integrity, accountability and transparency. ECFA's website noted that 21 of the largest churches in America are ECFA accredited (although the churches' names were not easily accessible). It did note recent accredited churches such as Mariners Church in Irvine, Ca; Mars Hill of Seattle, WA; and Free Chapel of Gainesville, Ga.

Another watchdog group is the Trinity Foundation, a religious, charitable and educational nonprofit, which monitors and investigates religious fraud. To understand the current state of tax reporting if any, the group compiled a list of the nation's 30 leading religious broadcasters (or televangelists). The goal was to determine which ones disclosure their finances, file information return with the IRS, hold regular services, are accredited by ECFA, and/or consider themselves churches. This list is provided in Appendix I.

There is some interesting information that can be obtained from reviewing the information provided in the referenced table. In general, the entities identified as religious organizations elect to file information returns. The key highlights include:

- Eight of the 30 are categorized as religious organizations, and they all file information returns with the IRS.
- Six are accredited by the ECFA but only one is a church
- Seven of the churches (total of 22) do not hold regular services
- Eleven, including three churches, disclosed some level of financial information (income or net assets) to the public.

Fraud and Abuse

Another watch dog group, taxthechurches.org, believes that churches are easily abusing their tax exempt status by not reporting annually to the IRS. Certainly there are many reported cases of abuse which suggest that it might be happening in organizations of all sizes. The group reported many examples such as a brothel "church" where sisterly love is being offered to male parishioners in exchange for donations. In a small, rural town in New York State, 98% of the land owners were exempt from taxes because their land was branches of a mail order church. In Wisconsin, hotels, pay parking lots, farms, and communion wafer bakeries are among church holdings that are tax-exempt. Overall, at least \$4.2 billion in tax-exempt, religious property exists in that state. ([taxthechurches](http://taxthechurches.org), 2012).

[Taxthechurches](http://taxthechurches.org) also points to the moral corruption of the Catholic Church as evidence by the many sexual scandals as another example of routine scandals in churches. A more recent scandal facing the Catholic Church is the lifestyle of its retired or retiring archbishops. The Newark, NJ archbishop was recently criticized for the three-story, 3,000 square feet addition to an already 4,500 square feet retirement home. This addition was estimated at approximately

\$500,000 (Mueller, 2014), and was in sharp contrast to the schools being closed in the diocese due to the lack of funds (Powell, 2014).

The Catholic Church is only one example. Others examples of exploitation by churches include claims of torture and abuse by dissenting members of the Church of Scientology (Barajas, 2012), the Church of Latter Day Saints in its support of California's Proposition 8 initiative (Galle, 2009), and Mars Hill Church diverting donations received for international purposes to expansion in the United States (Throckmorton, 2014). Most recently, faith based organizations are demanding exclusion from an executive order by the President of the United States that would bar discrimination against gay men and lesbians by companies doing business with the government (Hirshfeld & Eckholm, 2014).

Congress is also concerned about the lack of financial reporting and the potential of abuse in this area. As a result, Senator Grassley of Iowa investigated six prominent televangelist ministries for possible financial misconduct, specially the use of their tax exemption as churches to shield their lavish lifestyles. The six are Paula White, Joyce Meyer, Creflo Dollar, Eddie Long, Kenneth Copeland, and Benny Hinn (Strickler, 2007). These names are included in the top 30 televangelist in Appendix I. Of course, the ministers denied the alleged charges.

The senator's staff also investigated the broader issue of whether churches should file Form 990 or not (Kasper, Ziel, and Johnson, 2012). The final report insisted on greater accountability and more transparency so that the government has a better picture of the workings of churches and concluded that churches should no longer be exempt from filing Form 990.

Constitutional and Filing Issues

A broad view of the U. S. Constitution shows that it its intent is to have separation of church and state the government should not show partiality to any one group. The government should not establish the religion or interfere with religion according to *Walz v Tax Commission of City of New York* (1970). On the other hand, culture has indeed changed since the writing of the Bill of Rights and the U.S. Constitution. It seems a bit contradictory that Congress is allowed to make a law saying churches are exempt, but it is not allowable for Congress to make a law saying Form 990 must be filed by churches and/or religious organizations.

Cole (2012) noted that requiring churches to file Form 990 does not necessarily violate the U. S. Constitution. The author believes that people and not churches have constitutional freedoms. The church is an organization made up of people who have the right to choose and exercise their religion. Cole (2012) believes that tax filing could be limited to certain organizations such as churches with income and assets greater than \$1 million and \$5 million respectively. A new information return, such as Form 990-CH would be created for these churches meeting the filing threshold. An alternative is to ensure that all churches are members of an accreditation organization such as ECFA.

Gaubatz (2012) reviewed Supreme Court decisions relating to tax reporting by churches and concluded that the IRS would be legal to require churches to file Form 990 because this information is necessary to validate tax-exempt status and to verify that churches are complying with all federal laws. Ideally, churches should file Form 990-N since it would not create a substantial burden to them. Churches already file other forms with IRS (e.g., payroll tax information) so answering the eight questions on Form 990-N would not impose any more of an unlawful burden than is already imposed when churches complete forms that are required.

Gaubatz (2012) further noted that by filing Form 990-N churches would simply be providing assurance that they are complying with all federal tax laws. Thus churches with nothing to hide would be glad to file Form 990-N.

SUPPORT AGAINST TAX REPORTING

There are many proponents against any potential requirements of having religious institutions file annual information returns with the IRS. The themes are similar as the supporters, but the outcomes are different. Some of the rationale for maintaining the status quo is discussed in this section.

Constitutional Issues

Some writers explain that it is unconstitutional for churches to file IRS form and that the IRS must follow the U. S. Constitution. Thus, the IRS automatically exempts churches from filing Form 990. The founding fathers diligently studied history of other countries as they created the doctrines for America. Historical documents show the desire for Americans to have freedom of religion and separation of church and government. Their belief that there must be a strong separation of religion and government ensures that religion does not become entangled with government and that people have religious freedom (taxthechurches.org, 2012).

The Commission on Accountability and Policy for Religious Organizations, another oversight organization, published numerous position papers on potential reporting by religious organizations. In one paper, Kasper, Ziel, and Johnson (2012) concluded that having churches file Form 990 is severe and unconstitutional. After reviewing numerous Supreme Court cases, they believe that the court has established precedence relating to the issue of tax and religious institutions supports Form 990 being illegal. Perhaps the most significant finding is that the IRS already has measures in place to determine if churches are engaged in fraudulent abuse; therefore, there is no need to have churches also file Form 990.

Kasper et al (2012) also noted that filing Form 990 is indeed a burden for churches. The U. S. Constitution states that there is not to be a national church (such as the Church of England). Since then, court decisions have endorsed the practice that religion is to be free from government interference and Americans are free to practice their faith without such interference. The practice of gathering information from churches through Form 990 constitutes the government being entangled with religion. After reviewing the information that is gathered on the full Form 990, they concluded that this form requires much more information than the IRS (government) needs in order to impose a tax. It is possible that mandatory taxation will soon follow if Form 990 is required.

Mosher and Wagenmaker (2012) acknowledge that American life is different, in many respects, from when the U. S. Constitution was written. The Tax Reform Act of 1969 first required nonprofit organizations to apply to the IRS for official exemption status, but this same law stated that religious organizations do not have to file the new annual information return (Form 990). Obviously, a law created as recently as 1969 is based on modern American society rather than life in 1789.

Mosher and Wagenmaker (2012) also agreed that requiring Form 990 of churches would violate the First Amendment. Changing the law to allow this filing would contradict long-standing social policies in that church and government would no longer be separate. Filing Form 990 is in conflict with the basic nature of religious organizations.

According to Winters (2012), the action of imposing on churches annual disclosures through the Form 990 will inherently result in the opposite reaction, a loss of religious liberties and surrendering a measure of control over our religion. The motives of those championing additional regulation of churches may be pure, but liberty must yield for the government to gain ground. Moreover, submission of churches to any annual Form 990 filing requirement unavoidably involves First Amendment violations of the Free Exercise Clause and the Establishment Clause, as it would unduly burden churches and promote excessive entanglement with church affairs. The imposition of Form 990 reporting requirements upon churches, in any manner, should be soundly rejected.

Monitoring and Reporting

Kasper et al (2012) noted that if Form 990 were required, the IRS would be forced to implement detailed monitoring. Consequently, the IRS would have tremendous power of discretion over religious organizations; this, in itself, opens the door for more government entanglement with religious organizations. Trying to decrease fraud within religious organizations does not justify requiring filing of Form 990.

According to Mosher and Wagenmaker (2012), the purpose of the IRS is to supervise commercial activities and make certain that the country has money to operate. They identify additional implications if the current law is changed. The government would have to determine the penalty for not filing Form 990 if it were required and be able to enforce it. Certainly, this would result in more entanglement with religion by the government. If all churches were required to file, the IRS would be in a position to abuse its power and discriminate more in reference to religion. This could, in time, lead to religious persecution as the idea would be that only government-approved churches are allowed.

Furthermore, recent federal budget cuts, including the automatic spending cuts known as sequester, as hindered the IRS's ability to fulfill its mission (Hicks, 2014). The cuts amounted to approximately \$900 million since 2010, with a proposed \$1.2 billion reduction in the enforcement budget (Calabresi, 2014). So asking it to do more oversight and monitoring with fewer resources seem onerous.

Kasper et al (2012) explains that contributions to churches from donors are reflected on each donor's individual tax return. Therefore, the IRS is able to follow the source of funds to religious organizations through this avenue. Clearly, this only applies to individual tax payers who itemize and claim charitable contributions on their tax returns. Also, donors themselves are often the best control for preventing fraud if they insist on accountability.

Fraud and Abuse

Kasper et al (2012) provides current IRS practices which are available for use in preventing fraud. For instance, churches are required to report unrelated business income from a business not closely related to its exempt purpose. Thus, if it does not want to be required to report unrelated business income, a church can simply stop the activity that would generate the income. Mosher and Wagenmaker (2012) describe various IRS laws and practices that result in oversight of churches so there is no need for mandatory filing using Form 990. State governments also have authority to investigate churches if they are suspected of wrongdoing.

CONCLUSION

The growth in the number of religious organizations has created the need for oversight to ensure that they are fulfilling their mission. As noted in the paper, the IRS is experiencing budget restrictions which impact its ability to perform current duties. Therefore, giving the IRS additional responsibilities without new funding is a recipe for disaster. Appendix I provide examples of institutions that are considered churches but hold no regular services, and others defined as religious organizations that elect to file annual reports (Form 990) with the IRS. This suggests that some religious organizations are willing to open their records to external parties in order to ensure transparency and accountability, and that doing so does not create excess burden for them.

The authors believe that churches and other religious organizations should file annual reports with the IRS on a voluntary basis. The preferred document is Form 990-N since it is short and would not create a burden. Another option is to develop or adopt Form 990-CH proposed by Cole (2012) which would limit reporting to the largest organizations. Since the IRS allows the electronic filing of tax forms, allowing churches to use this filing option should not increase its workload. These recommendations are consistent with the new Form 990-EZ which was recently introduced by the IRS to streamline the tax exemption approval process. We believe that churches will comply with this requirement in order to assure their stakeholders of their transparency and accountability.

Religious organizations received approximately \$104 billion in contributions from taxpayers in 2014, the largest recipient of all NPO. In an evolving and complex world, asking them to comply with federal filing requirements that are applicable to other charitable organizations is not excessive and will not impact their constitutional rights. Certain religious organizations are already performing this task so churches and similar institutions should follow their lead. This action might lead to increase donations since donees are more confident in the management and oversight of the organization's resources.

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Appendix I - Top 30 Leading Religious Broadcasters

Organization	Affiliation	Type	Regular services	Files IRS 990s	ECFA ¹	Income
Andrew Wommack Ministries		Religious organization		✓		\$34 million
Bill Winston Ministries	Living Word Christian Center	Religious organization	✓	✓		\$6 million
Billy Graham Evangelical Association		Religious organization		✓	✓	\$101 million
Charles Stanley	In Touch Ministries	Religious organization		✓	✓	\$74 million
Christian Broadcasting Network	Pat Robertson	Religious organization		✓	✓	\$286 million
Creflo Dollar Ministries	World Changers Church International	Church	✓			N/A
Daystar Television	Word of God Fellowship Inc.	Church				\$233 million ²
Eagle Mountain International Church	Kenneth Copeland Ministries	Church	✓			N/A
Ed Young Ministries	Fellowship Church	Church	✓			N/A
Eddie Long	New Birth Missionary Baptist Church	Church	✓			N/A
Franklin Graham	Samaritan's Purse	Religious organization		✓	✓	\$388 million
Fred Price	Ever Increasing Faith Ministries, Crenshaw Christian Center	Church	✓			N/A
James Robison	Life Outreach International Association of Churches Inc.	Church			✓	\$29 million ³
Jesse Duplantis Ministries	Covenant Church	Church	✓			N/A
John Hagee Ministries	Cornerstone Church	Church	✓			N/A
Joseph Prince Ministries		Religious organization		✓		\$21 million

Joyce Meyer Ministries		Church		✓	\$59 million ³
Kenneth W. Hagin Rhema Bible Church		Church	✓		N/A
Lakewood Church	Joel Osteen	Church	✓		N/A
Larry Huch Ministries		Church	✓		N/A
Marilyn Hickey/Sarah Bowling	Orchard Road Christian Center	Church	✓		N/A
Mike Murdock	Wisdom Center Church	Church	✓		N/A
Morris Cerullo World Evangelism		Church			N/A
Paula White Ministries	New Destiny Christian Center	Church	✓		N/A
Peter Popoff Ministries	People United for Christ	Church			N/A
Potters House Church	TD Jakes Ministries	Church	✓		N/A
Rod Parsley	Breakthrough Ministries, World Harvest Church	Church	✓		N/A
Todd Coontz	Rockwealth International Ministries & Church Online	Church			N/A
Trinity Christian Center of Santa Ana	Trinity Broadcasting Network	Religious organization		✓	\$177 million
World Healing Center Church	Benny Hinn Ministries	Church			N/A

Notes

1. Accreditation by the Evangelical Council for Financial Accountability. The ECFA was founded in 1979 to help Christian ministries earn the public's trust through principles such as board governance, financial transparency and proper use of charity resources.

2. Assets, from court documents

3. Assets

Sources: Trinity Foundation, Guidestar, ECFA, NPR