Ignore the Rumors - Campaigning from the Pulpit is Okay: Thinking Past the Symbolism of Section 501(c)(3)

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Because of the unique treatment churches receive under the Internal Revenue Code, the impact of the revocation is likely to be more symbolic than substantial.
—The D.C. Court of Appeals.

INTRODUCTION

This Article is enough to ruin many Thanksgiving family dinners. It is about American religion, politics, and taxes. Mostly it is about taxes. As I will explain, this is what sets it apart from the contemporary legal scholarship exploring the campaign restrictions on tax exempt churches. This Introduction identifies the
problem addressed in the article, then introduces the contemporary legal scholarship and the alternative approach this article takes.

A. Ignore the Rumors: Campaigning from the Pulpit is Okay

There is no law that prohibits churches from campaigning. There is no law that prohibits pulpit endorsements or full page newspaper ads for the political candidate of a church’s choice. Doing such would cost a Tax Exempt church its exemption under Section 501(c)(3). But that is all. However, both the popular and scholarly accounts of the Tax Code’s campaign restriction assume tax exemption for churches is “essential to their ability to accomplish their religious and ethical obligations.” But it is not.


3. Campaign activity is itself extensively regulated. For example, corporations are forbidden to contribute to campaigns under the Federal Election Campaign Act, 2 U.S.C. § 441(b) (2000). However, the regulation of campaigning is not the topic of this Article except insofar as that “regulation” is a result of I.R.C. § 501(c)(3) (2000). Unless otherwise noted, “campaigning” is used to mean activities such as endorsements of particular candidates from the pulpit and publicizing such endorsements and not financial contributions to, or coordination with, actual campaigns. Throughout this Article, words such as “campaign for” and “campaigning” and like terms are meant in a general, non-technical sense to mean any activity intended to help or hinder a particular candidate from being elected, other than activities otherwise proscribed by law. There is no implication that such help or hindrance is part of, or connected with, a candidate’s “campaign.”

4. Unless otherwise noted, all references herein to a “Section” are to sections of the Tax Code, including the relevant Treasury Department Regulations (“Treasury Regulations”) promulgated under that Section.


6. See discussion infra Part II.

None of the contemporary scholars calculate the value of tax exemption to a church under Section 501(c)(3). None of the articles methodically explore the consequences to a church of losing its tax exemption for campaigning. There is no step-by-step analysis of potential tax liability. Instead, there is an assumption that a church doing without tax exemption is "fundamentally repugnant," so there is no need for substantive analysis of the tax issues involved if a church becomes taxable. Instead of analyzing the tax problem, the tax problem tends to be used to introduce "bigger" ideas about the Constitution, religion, and politics. In the current scholarship, the context of the issue—religion and politics—tends to become substituted for the substance: federal income taxation. The critical issue, however, is federal income taxation.

B. Asset Management Analysis of Tax Exemption for Churches

Even though the campaign restriction has been in Section 501(c)(3) since 1954, the IRS has only revoked one church's tax exemption for campaigning. I suspect this is because the IRS knows that a taxable church is unlikely to generate any tax revenue—so, from the IRS's perspective, why bother? The Church at Pierce Creek is the church whose exemption was revoked, and it argued that the tax liability it would suffer as a result of its campaigning was an impermissible burden on its political-religious expression. The appeals court, however, found there was no impermissible burden, concluding "the impact of the revocation is likely to be more symbolic than substantial."

The "Asset Management Analysis" of tax exemption that I propose is setting out to determine if tax exemption for churches is more symbolic than substantial. The analysis is to determine the financial value of tax exemption for a church. The suggestion is that a church interested in politics ought to weigh the costs and benefits of tax exemption, and if convicted of its moral

8. See infra Part II.


10. At some point, disregard of the Tax Code undermines enforcement of the Tax Code generally, and thus the IRS must police the most egregious campaigning, even if it is revenue neutral. Since the IRS has revoked only one church's tax exemption for campaigning, it is reasonable to infer that the IRS is only interested in the most egregious abuses.

duty to campaign, then it should forego tax exemption merely as a cost of campaigning.

Though admittedly counter-intuitive, I believe that federal income tax exemption is not necessarily worth much to many churches. Many—if not most—churches would not have any income tax liability even if they were taxable corporations. Under Section 102, donations are not taxed as income. Eighty-four percent of annual revenues for churches consist of donations, so eighty-four percent of annual revenue would not be subject to tax. The remaining sixteen percent would be covered by deductions for operating expenses—salaries, building expenses, and the like—which, in churches, tend to match or exceed annual revenues, since churches tend to spend almost all of their revenue each year. Many, if not most, churches would operate at a tax loss each year, like many other “taxable” corporations.

The derivative benefits of federal income tax exemption may not be worth much to churches either. While donors to campaigning taxable churches cannot deduct their donations, it is unlikely that more than thirty percent of church donors claim the deduction in the first place. And while there is intuitive appeal believing that the income tax deduction encourages charitable donation, the extent of such encouragement has never been empirically established for donors generally, much less religiously-motivated donors specifically. Furthermore, and most importantly, if a church does become a taxable corporation in order to campaign, it also becomes a potential recipient of additional donations—donations fueled by its members’ political motivation. So long as it is tax exempt, its members must direct their politically-motivated contributions elsewhere.

There are state law benefits that churches receive, but, by and large, these benefits are tied to their status as bona fide churches, not to their status as federally tax-exempt organizations. This is also true of some non-tax federal benefits, such as preferred postal rates. Taxable churches involved in campaigns would not have to do without these benefits.

If, as I argue, federal income tax exemption turns out not to be especially valuable for many churches, the implications are legally and politically significant. Simply by amending their articles of incorporation, tax exempt churches can transform themselves into taxable churches and enable themselves to campaign.

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12. In contrast, most other types of tax-exempt organizations are primarily funded by fees and other types of revenue that would generate an income subject to tax. See James J. Fishman & Stephen Schwarz, Taxation of Non-Profit Organizations 11 (2003).
publicly and vociferously for the candidates of their choosing. If there is a significant movement by bona fide churches outside the Section 501(c)(3) box, the government will need to address several issues, since the institutionalized assumption of the IRS has been that only “sham” churches ever fall outside the tax exemption box. Additionally, if tax exemption for churches is not worth much, legal scholars should turn their attention towards calculating the tax implications of churches being taxable, rather than assuming away the tax issues in order to write articles about the constitutional, historical, and religious implications of the Section 501(c)(3) campaign restriction. And, finally, the motivation for partisan tattling to the IRS on churches that campaign is substantially undercut if, in fact, churches’ financial well-being is not dependent upon federal tax exemption.

C. Structure of Argument

Part I of this Article introduces the reader to the legal context of “the problem” of churches being unable to campaign if they choose to be Tax Exempt under Section 501(c)(3). Part II provides an overview of the current legal scholarship, which assumes that tax exemption is essential to churches’ financial well-being, and hence has been labeled “Exemption Essentialism.” Part III is a hypothetical tax-by-tax exploration of the claim that Section 501(c)(3) may not be essential to churches. Part IV suggests some implications for churches, the government, legal scholars, and partisans if, in fact, tax exemption is not so valuable that it should deter churches from campaigning, if they are so inclined. Finally, the Conclusion recaps the Article.

I. Current Law: Choosing The Campaign Restriction By Choosing Tax Exemption

The purpose of this section is to provide the reader with an understanding of the current legal context of tax exemption for churches under Section 501(c)(3) and the consequent campaign restrictions. Understanding the current legal context of American churches requires distinguishing between churches as non-profit corporations and Section 501(c)(3) organizations, as well as understanding the benefits and restrictions of Section 501(c)(3) that can be chosen by a church.

A. Churches as Non-Profit Corporations

For state law purposes, the contemporary trend is for churches to organize by incorporating as a non-profit corpora-
tion under their resident state law.\textsuperscript{13} Non-profit corporations are not restrained in their ability to produce a “profit,” but the profit cannot be distributed\textsuperscript{14}—it must be used for corporate purposes.\textsuperscript{15} But, for the most part, a non-profit corporation has the same powers and freedoms that a business corporation has.\textsuperscript{16} Non-profit corporations are subject only to the types of campaigning restrictions that business corporations are.\textsuperscript{17} The non-profit corporation statute does not impose a specific campaign restriction on non-profit corporations.\textsuperscript{18}

B. \textit{Federal Income Tax Exemption for Churches}

Tax exemption is provided under Section 501, but the benefits of tax exemption for churches and their donors are provided in other sections of the Tax Code, as described below.

1. Exemption Under Section 501

Unless qualified for federal income tax exemption under Section 501, non-profit corporations are taxable, subject to the same corporate tax regime as any business corporation.\textsuperscript{19} Sec-

\footnotesize{\textsuperscript{13} For the purposes of this Article, in addition to the definition described in note two, references to a "church" will mean a statutory non-profit corporation organized for congregational religious purposes. Since, by definition, churches organized as unincorporated associations do not file public organizational documents, it is impossible to determine how many American congregations are unincorporated associations and how many are incorporated. The Chair of the National Conference of Commissioners on Uniform Laws Drafting Committee to Amend the Unincorporated Non-Profit Association Act, Professor Marilyn Phelan, has noted to me that the historical practice of churches to remain unincorporated associations is changing out of concern for limiting the liability of members and to ease the conduct of business. Of course, there are variations among congregations based not only on histories of unincorporated association, but also as a matter of denominational structure. This usage is not intended to obscure the differences between churches organized as unincorporated associates and those incorporated, since the former may incorporate at any time and the commonly accepted legal advice would be for them to do so sooner, rather than later (e.g., to limit liability exposure), denominational structures permitting.


\textsuperscript{15} See, e.g., id. at § 2.01(A).

\textsuperscript{16} See, e.g., id. at § 2.02.


\textsuperscript{18} The freedom to campaign noted is the absence in state non-profit corporation statutes of any general prohibition against campaigning. See discussion supra note 3.

\textsuperscript{19} Corporations are subject to federal income tax under Subchapter C of the Tax Code. Other than organizations described in I.R.C. § 501(c), there are only a handful of other ways to be exempted from the U.S. federal income}
tion 501 provides tax exemption for twenty-eight types of organizations specified in Section 501(c). Of the twenty-eight types, there are two under which a church might qualify for exemption: Section 501(c)(3) and Section 501(c)(4). While it is possible for churches to qualify for tax exemption under Section 501(c)(4), churches exempt under Section 501(c)(4) are largely unknown outside the imaginations of legal scholars (and still subject to campaigning restrictions). It is Section 501(c)(3) that is synonymous with federal income tax exemption for churches.

Churches are exempted from federal income tax under Section 501(c)(3) if they meet the following requirements:

- Being organized and operated exclusively for religious, educational, or other charitable purposes;
- Not distributing any net earnings (i.e., profits) to individuals (excepting, e.g., reasonable compensation of employees);
- Not engaging in illegal activities or violating fundamental public policy;
- Not having any "substantial part" of its activity being attempting to influence legislation (i.e., lobbying); and
- Not intervening in political campaigns.

20. Professor Douglas H. Cook of Regent University School of Law suggests organizing churches under I.R.C. § 501(c)(4), but he cites no instances in which churches have been so organized. For a complete discussion, see Douglas H. Cook, The Politically Active Church, 35 Loy. U. Chi. L.J. 457 (2004). See also infra text accompanying note 28.

21. I.R.C. § 501(c)(3) states in pertinent part:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equip-
While the first three requirements roughly correspond to the restraints imposed on churches under state non-profit corporation law,\textsuperscript{22} the latter two requirements are unique to Section 501(c)(3). These restrictions are entirely independent of any state law issues. Note that while churches are permitted “some” (i.e., some amount short of a “substantial part”) lobbying activities, they are permitted no campaigning activities.\textsuperscript{23} Since the prohibition against campaigning is in the statutory language of Section 501(c)(3), a church that campaigns \textit{to any extent} is not exempted. Thus, a church organized as a non-profit corporation needs to submit to the lobbying and campaign restrictions in its organization and operation in order to be exempted from federal income tax under Section 501(c)(3).

So long as the church’s articles of incorporation and its actual operations fall within the Section 501(c)(3) requirements, it need do nothing else to be exempt from federal income tax (i.e., there are no filing requirements).\textsuperscript{24} Unlike other types of charities that might be described in Section 501(c)(3), churches

\begin{itemize}
  \item for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.
\end{itemize}

\textit{Id.}

\textsuperscript{22} Insofar as corporations are not sanctioned to engage in illegal activities, the third requirement’s prohibition of illegal activities obviously corresponds to state law statutory concepts for non-profit corporations. A more interesting query is whether non-profit corporations may engage in activities that violate the fundamental public policies of the states. This requirement of operating consistently with such policies was taken from the common law of charitable trusts and incorporated into the statutory requirements of I.R.C. § 501(c)(3) by the Supreme Court in \textit{Bob Jones Univ. v. United States}, 461 U.S. 574 (1983). However, to the extent that a state’s non-profit corporation statute fails to incorporate the common law of charitable trusts by reference or otherwise, unless it explicitly includes such a requirement, non-profit corporations may arguably not be required to operate consistently with their state’s fundamental public policies \textit{per se}, so long as their operations are not otherwise illegal or afool of the statute’s explicit requirements.

\textsuperscript{23} For an overview of the meaning of “no substantial part” and the regulation of lobbying under Section 501(c)(3), see Charles E. Hodges II & Edward M. Manigault, \textit{Political Activity and Lobbying by Charities: How Far Can it Go? What Are the Risks?}, 98 J. Tax’n 177 (2000).

\textsuperscript{24} Qualifying for I.R.C. § 501(c)(3) status requires meeting both the “organizational” and “operational” tests set out in Treas. Reg. § 1.501(c)(3)-1, which requires that the organizational documents (e.g. articles of incorporation) fit within the I.R.C. § 501(c)(3) description and that actual operations do
are not required to submit an application to the IRS in order to acquire recognition of tax exemption under Section 501(c)(3).

2. Federal Tax Benefits of Section 501(c)(3) Exemption

In addition to being exempted from income tax, fitting within Section 501(c)(3)'s restrictions on organization and operation confers several other federal tax benefits to churches. I will explore some of these benefits in detail below, but generally the federal tax benefits are as follows.

(a) Section 170 Deductibility of Donations. Unlike other nonprofit corporations (many of which are described in other parts of Section 501(c), such as Section 501(c)(4)), donors to Section 501(c)(3) organizations can deduct their donations for income, gift, and estate tax purposes under other Tax Code Sections.25

(b) Lessened Filing Requirements. Most Section 501(c)(3) organizations are required to file annual information returns with the IRS.26 Churches are not.27

(c) Special Audit Protections. If the IRS decides to inspect the Section 501(c)(3) qualification of a church, it is subjected to special rules for "church tax inquiries and examinations."28 The examination must be limited to determining if the church is, indeed, exempt under Section 501(c)(3) (or carrying on an unrelated trade or business) and, if it is not exempt, to a determination of tax liability.29

(d) Employee-Related Benefits. There are unique tax treatments related to employees of churches, including: church employees are exempt from the Federal Unemployment Tax Act and most state unemployment laws;30

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26. Id. § 6033.
27. Id. § 6033(c)(2).
28. Id. § 7611.
29. Id. §§ 7611(b)(1)(a), 7611(b)(1)(B), 7611(h)(4)(A).
30. See id. §§ 3306(c)(8), 3309(b)(1); Fishman & Schwarz, supra note 12, at 101.
church ministers are entitled to exclude rental allowances paid as part of their compensation from their income;\(^3\) and qualified retirement plans for churches are not subject to the same requirements as qualified retirement plans for other organizations.\(^3\)

\(\text{e) Miscellaneous Benefits.}\) There are other tax and non-tax benefits conditioned upon being exempt under Section 501(c)(3). For example, churches exempt from federal income tax under Section 501(c)(3) are entitled to various other potential benefits, such as the ability to issue tax-exempt bonds\(^3\) and an exemption from the federal wagering excise tax.\(^4\) These and other relatively obscure benefits are discussed in more detail below.

3. Federal Tax Impact of Campaigning

The political campaigning prohibition for Section 501(c)(3) organizations is absolute.\(^3\) Without the campaigning prohibition, tax deductible donations could be used for a purpose for which no tax deduction is otherwise provided: political campaigning.\(^3\) The policy against Section 501(c)(3) organizations campaigning derives not from Section 501(c)(3) but from

\(^{32}\) See id. § 414.
\(^{33}\) See id. § 145(a)(1); FISHMAN & SCHWARZ, supra note 12, at 98–99.
\(^{34}\) See I.R.C. § 4421 (2) (b); FISHMAN & SCHWARZ, supra note 12, at 103.
\(^{35}\) While there may be some common law antecedents to this restriction, the statutory restriction in I.R.C. § 501(c)(3) was added to the Tax Code in 1954. The amendment was sponsored by then Senator Lyndon B. Johnson. It has been speculated (presumably rightfully) that his sponsorship was motivated to overcome a challenger in the 1954 Democratic primary. The challenger was receiving the support of a Section 501(c)(3) organization, which effectively held itself out as a permissible recipient of tax-deductible donations for his campaign. Although no one can doubt that LBJ’s campaign benefited by thwarting a source of his opponent’s tax-deducted financial support, the fact that his opponent was receiving the benefit of tax-deductible donations is objectively problematic. For a review of common law campaign prohibition issues, see Debra Morris, Political Activity and Charitable Status at Common Law: In Search of Certainty (1998), available at http://www.law.nyu.edu/ncpl/library/publications/Conf1998MorrisPaper.pdf (presented at Nat’l Ctr. on Philanthropy & the Law Conference on Political Activities: Nonprofit Speech). For a good discussion of the 1954 amendment itself, see, e.g., Deirdre Dessingue, Prohibition in Search of a Rationale: What the Tax Code Prohibits; Why; to What End?, 42 B.C. L. Rev. 903, 905 (2001); Patrick L. O’Daniel, More Honored in the Breach: A Historical Perspective of the Permeable IRS Prohibition on Campaigning by Churches, 42 B.C. L. Rev. 733 (2001).

\(^{36}\) Campaign contributions are not deductible, and never have been. See, e.g., I.R.C. § 162(c)(1)(B); Art. 143 Treas. Regs. 33 (Revised 1918); Rev.
Section 170, which provides an income tax deduction for donations to Section 501(c)(3) organizations. In order to keep deducted donations from being indirectly used for political purposes, Section 501(c)(3) organizations cannot be permitted to campaign. Otherwise, political campaigns would be federally subsidized, which would force Republican taxpayers to financially support Democratic campaigns and vice versa.

A church that campaigns can lose its federal income tax exemption under Section 501(c)(3) as well as the other tax benefits that derive from that exemption (e.g., deductibility of donations) and potentially be subjected to various taxes described in Section 527 and Section 4955. Awareness of this bundle of consequences is no doubt the source of the widely-held perception that churches are “prohibited” from campaigning.

In anticipation of each presidential campaign period since 1992, the IRS has issued a warning to American churches to abstain from political campaigning. The IRS reminds churches that under Section 501(c)(3) they may participate in certain types of voter education related to the political campaigns, such as hosting non-partisan, unbiased fora or distributing non-partisan, unbiased voting guides, but partisan campaigning (e.g., using the pulpit or church-related publications to encourage votes for particular candidates) is absolutely forbidden.

Despite the warnings and the potential consequences, some churches do campaign. There are no estimates of how many churches campaign, or want to campaign, but since most Americans are opposed to church involvement in campaigns, I assume

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37. See, e.g., Dessingue, supra note 35, at 918; see also Ann M. Murphy, *Campaign Signs and the Collection Plate—Never the Twain Shall Meet?*, 1 Pitt. Tax Rev. 35 (2003).

38. Whether or not tax exemption and deductible donations should be considered a federal subsidy for theoretical purposes, the U.S. Supreme Court has held that they are. See *Regan v. Taxation With Representation*, 461 U.S. 540, 544 (1983); *Bob Jones Univ. v. United States*, 461 U.S. 574, 591–92 (1983). But see, e.g., Dessingue, supra note 35.


40. Id. at 8–11.

that the majority of churches are relatively disinterested.\textsuperscript{42} Periodic proposals to permit Section 501(c)(3) churches to campaign without negative federal tax consequences have failed to generate sufficient support to become law.\textsuperscript{43}

After the recent religiously and politically divisive American presidential elections, there appears to have been a spike in the number of churches reported to the IRS for campaigning.\textsuperscript{44} Americans United for Separation of Church and State is the source of some of these reports, which are about evenly divided between Republican and Democratic campaign-supporting churches.\textsuperscript{45} Speculatively, the balance of the reports originate from individuals or groups opposing the campaigns supported by the various churches.\textsuperscript{46}

4. Constitutional Impact of Restriction on Churches Campaigning

Despite the constitutional sensitivity of religious and political expression, in 1995 the IRS revoked the tax exemption of The Church at Pierce Creek in Binghamton, New York\textsuperscript{47} for an excessively blatant involvement in the 1992 presidential campaign.\textsuperscript{48} This is the only time that the IRS has revoked the fed-

\textsuperscript{42} About sixty-four percent of Americans oppose clergy expressing their political views in pulpits. \textit{See Religion and Politics: The Ambivalent Majority}, \textsc{Pew Research Ctr. for the People & the Press}, Sept. 20, 2000, at 5. Among some religious groups (e.g., Roman Catholics), the opposition is even stronger. \textit{See Dessingue, supra note 35, at 927.}

\textsuperscript{43} For a review of recent proposals, see Benjamin S. De Leon, \textit{Rendering a Taxing New Tide on I.R.C. § 501(c)(3): The Constitutional Implications of H.R. 2357 and Alternatives for Increased Political Freedom in Houses of Worship}, \textsc{23 Rev. Litig.} 691 (2004); David Menz, \textit{Charities, Churches, Campaigns & Candidates}, \textsc{Ark. Law.}, Summer 2004, at 8. The failure of these proposals to confer greater campaigning freedom to churches must be due, in some part, to the fact that the proposals have been opposed by the leaders of a wide spectrum of Christian denominations—from Eastern Orthodox to Presbyterian, Baptist to Methodist. \textit{See Murphy, supra note 37, at 80.}

\textsuperscript{44} As of October 29, 2004, more than one-hundred tax-exempt organizations had been reported to the IRS for their political activities. For a good introduction to the current state of tax-tattling affairs, see Murphy, \textit{supra} note 1, at 235.


\textsuperscript{47} The New York not-for-profit corporation is Branch Ministries, Inc. d/b/a “The Church at Pierce Creek.” Branch Ministries v. Rossotti, 211 F.3d 137, 137 (D.C. Cir. 2000).

\textsuperscript{48} \textit{Id.}
eral tax exemption of a church for campaigning. As described below, the revocation resulted in a series of law review articles considering, for the most part, the public policy implications of the revocation for religious and political expression.

The Church at Pierce Creek's violation of Section 501(c)(3) was not a close call for the IRS or the courts. The church purchased full page advertisements in both USA Today and the Washington Times alerting “Christians Beware” of Bill Clinton because of what the advertisements alleged to be his positions on abortion, homosexuality, and condom distribution. As if calculated to provoke the IRS, the advertisements concluded with the address of the church and a solicitation for “tax-deductible donations for this advertisement.” The ads produced hundreds of donations to the church. Articles in the New York Times assured the church that the IRS would take notice of the ads, in the rather unlikely event it missed them in both USA Today and the Washington Times.

The church had three lines of defense against the IRS. The first defense was a technical tax argument. The second defense was a religious freedom defense. The third defense was selective prosecution.

As its technical tax defense, the church argued that “churches” were not described in Section 501(c)(3) (and thus not subject to its campaign restrictions) but were nevertheless exempt under Section 501 by virtue of a cross-reference in Section 508. The court noted the technical tracing of the word “church” through Section 501 and Section 508 but found the argument “more creative than persuasive.” Sufficiently damning, however, was that, though not required to do so, the church had voluntarily applied to the IRS for recognition of its tax exemption under Section 501(c)(3).

Asserting its religious rights, the church argued that the income tax liabilities and loss of deductions it would suffer as a result of losing its Section 501(c)(3) exemption constituted an impermissible burden on its rights to religious and political expression guaranteed under the U.S. Constitution and the

49. Murphy, supra note 1, at 232.
50. Branch Ministries, 211 F.3d at 140.
51. Id.
52. Id.
53. Id.
54. Id. at 141.
55. Id.
56. Id.
Religious Freedom Restoration Act of 1993.\textsuperscript{57} The court was unpersuaded, concluding that “the impact of the revocation is likely to be more symbolic than substantial.”\textsuperscript{58} The court explained that the revocation would not “necessarily make the Church liable for the payment of taxes” because, as “the IRS explicitly represented in its brief and reiterated at oral argument, the revocation of the exemption” would not convert donations into income taxable to the church—such donations are excluded from income under Section 102.\textsuperscript{59} As for any decrease in donations, the court noted that the church could abstain from campaigning and re-claim its tax exemption (and deductible donations) at any time.\textsuperscript{60} The potential for decreased money for the church, whether as a result of an incrementally larger tax burden or lost deductions, did not amount to an unconstitutional burden. Further, the court noted that the church had an alternative means of expressing itself through a particular corporate structure of affiliated organizations, one of which would be the church and two others of which could facilitate campaigning.\textsuperscript{61}

The church also alleged that it had been targeted because of a political bias at the IRS. It claimed it had its exemption revoked because it opposed a Democratic candidate. The church argued that the IRS routinely permits churches to support Democratic candidates and that it had been singled out for its viewpoint.\textsuperscript{62} The court reasoned that since the church did not allege that any of the campaigning by “Democratic churches” involved placing campaign ads in national newspapers soliciting tax deductible donations, that the church had not established that it had been treated differently from similarly situated churches.\textsuperscript{63}

Unpersuaded by any of the church’s arguments, the court upheld the revocation. The church did not appeal to the U.S. Supreme Court. And, best I can tell, no legal scholar has claimed the appeals court got it wrong.

\textsuperscript{57} Id. at 142.
\textsuperscript{58} Id.
\textsuperscript{59} Id. at 143. The court’s point is that I.R.C. § 102 excludes donations from the income of (even) taxable U.S. taxpayers. See discussion infra Part III.B.3.
\textsuperscript{60} Branch Ministries, 211 F.3d at 143.
\textsuperscript{61} Id.
\textsuperscript{62} Id. at 144.
\textsuperscript{63} Id. at 144–45. The idea that the IRS is more interested in policing “Republican churches” rather than Democratic churches has also been made in the popular press. See, e.g., Robert Novak, Civil War Looms for Republicans, Chi. Sun-Times, June 28, 2004, at 39. But see Lynn, supra note 45, at 42.
D. Taxable Churches

There are three ways that a church can fail to be exempted under Section 501(c)(3). The first requires a choice upon incorporation and thus will not be discussed in much detail in this article (since it is an unavailable option for existing churches). The second is when the IRS revokes the tax exemption of an existing church, which was discussed above with respect to The Church at Pierce Creek. The third, the primary focus of the hypothetical analyzed below, is when a church decides to "convert" from being a "Tax Exempt Church" to a "Taxable Church."

1. Option One: Become Taxable Upon Incorporation

When incorporating as a non-profit corporation, a church has a choice as to whether or not its articles of incorporation comply with the Section 501(c)(3). If a church chooses not to fit itself within Section 501(c)(3), it will be taxable for federal income tax purposes. Such a Taxable Church also will not be entitled to some of the benefits described above. This choice-upon-incorporation is the first way a church can be exempt.

2. Option Two: Become Taxable Upon Revocation of Exemption

The second way in which a church can become a Taxable Church is, of course, through the revocation of its tax exemption by the IRS. The Church at Pierce Creek had the duly-worded articles of incorporation, but its participation in the 1992 presidential campaign pushed it outside the Section 501(c)(3) box. The IRS revoked its exemption, and the church became a taxable non-profit corporation.

3. Option Three: Amending Articles of Incorporation

If a church begins its corporate life within the Section 501(c)(3) box, it can change its mind. This is the third way a church can become a Taxable Church. For example, a Tax Exempt Church will become a Taxable Church if it amends its articles of incorporation to authorize itself to engage in campaigning. Since amendments to articles of incorporation are typically given a prospective effective date, this provides a good means for a Tax Exempt Church to convert to a Taxable

64. Churches that are currently merely unincorporated associations could avail themselves of this option by incorporating with articles that permit campaigning.

Church on a specified date (e.g., January 1 of an upcoming year). The hypothetical section of this article focuses on this type of conversion, comparing and contrasting the benefits of a particular church before and after its conversion from a Tax Exempt Church to a Taxable Church.

II. THE CURRENT SCHOLARSHIP: EXEMPTION ESSENTIALISM AND IGNORING TAXABLE CHURCHES

The current scholarship contrasts with this article primarily in that the current scholarship fails to consider Taxable Churches as a viable alternative to Tax Exempt Churches, even though the court in the Branch Ministries case thought the distinction between the two types of churches was largely symbolic. This section introduces the reader to the current legal scholarship on campaigning churches and tax exemption.

A. Post-Branch Ministries Scholarship: Exemption Essentialism

The Branch Ministries case produced a stream of published legal scholarship exploring the consequences and implications of the Section 501(c)(3) campaign prohibition on churches.\(^6\) This scholarship is the first scholarship on the campaigning church to begin with three facts: the IRS will revoke the tax exemption of a Tax Exempt Church that campaigns; the revocation will be upheld; and there will not be a material consensus among lawyers or scholars that either is the wrong result.\(^7\) None of the current scholars have sought to undermine the court's conclusions, even though some of the literature has explored the civic wisdom in restraining churches from campaign involvement.

On the one hand, there is good variety in the post-Branch Ministries articles. As described in more detail below, the articles tend to be quite different from each other in terms of perspectives, tones, and suggestions. They are inconsistent in their con-

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\(^6\) There are eight articles published after the Branch Ministries case that both address the case and focus on campaigning churches as a central topic of analysis. These articles comprise the "Exemption Essentialist" analysis: Cook, supra note 20; Dessingue, supra note 35; Alan L. Feld, Rendering Unto Caesar or Electioneering for Caesar? Loss of Church Tax exemption for Participation in Electoral Politics, 42 B.C. L. Rev. 931 (2001); Richard W. Garnett, A Quiet Faith: Taxes, Politics, and the Privatization of Religion, 42 B.C. L. Rev. 771 (2001); James, supra note 41; Johnson, supra note 41; McDowell, supra note 7; Murphy, supra note 37.

\(^7\) Indeed, I am unaware of a single lawyer (other than the church's own) or legal scholar who has published an opinion that either the IRS or the court was wrong in how it handled the campaigning by The Church at Pierce Creek.
clusions: some "for" the Section 501(c)(3) restrictions, some "against," and some with technical suggestions.

My criticism of the current state of the scholarship is on the other hand: all scholars assume that federal income tax exemption is essential to churches. None of the scholars attempt to determine the financial value of Section 501(c)(3) status. None of the articles methodically explore the consequences to a church of losing its tax exemption for campaigning. There is no step-by-step analysis of potential tax liability. Based upon such an analysis, I conclude below that tax exemption for churches that want to campaign may not be so valuable that it should deter them from campaigning. Unfortunately, in many ways, I have no one to argue with. Perhaps I am wrong and tax exemption for churches is substantially more valuable than I conclude, but nowhere in the legal scholarship has anyone attempted to determine the value. Failing to measure the costs, I believe, is not only a peculiar way to analyze a tax issue but a methodologically indefensible one.

Even though the only campaign restriction for churches is found in I.R.C. Section 501(c)(3), the current legal scholarship does not conceive the fundamental issue as a tax choice for churches between campaigning and Section 501(c)(3) status. Their conceptual mistake, I believe, is assuming churches necessarily to be a subset of Section 501(c)(3) organizations.68 I have used the terms "Taxable Church" and "Tax Exempt Church" to make it clear that churches need not be Section 501(c)(3) organizations. The shared premise of the contemporary scholarship is that Section 501(c)(3) tax status is essential to churches, which is why I have labeled the current scholarship "Exemption Essentialism."

B. Emphasizing the Non-Tax Issues for Campaigning Churches

Rather than focusing on the fact that the Section 501(c)(3) campaign restriction is part of the Tax Code, most of the current literature has one of three focuses: history, balancing the church-state relationship; and governmental hostility to the religion. The shared, and I believe mistaken assumption, between the varied approaches is assuming tax exemption is essential to churches' financial well-being.

68. See, e.g., McDowell, supra note 7, at 101; Murphy, supra note 37, at 2.
1. History

Some of the current scholarship emphasizes the historical nature of tax exemption for churches. One professor reviews "the historical development of the religious tax exemption, tracing the progress of the exemption through Judeo-Christian history to post-revolutionary America."\(^\text{69}\) Another begins her history in 2800 B.C.E.\(^\text{70}\) As interesting as the articles are, the history of tax exemption for churches is not (and cannot be) used to frame or resolve the contemporary tax issues for campaigning churches.

2. Balancing the Church-State Relationship

Some of the Exemption Essentialists focus on balancing the church-state relationship, exploring the "spheres of religion and electoral politics"\(^\text{71}\) or the way in which "religion and politics enjoy an uneasy relationship in the law."\(^\text{72}\) Some of the Exemption Essentialists argue for strict separation between church and state.\(^\text{73}\) Others dismiss a necessarily strict separation speaking, instead, in terms of a balancing act of interests, with some concluding that, on the balance, churches should be kept from campaigning,\(^\text{74}\) while others conclude church involvement will "strengthen our democracy."\(^\text{75}\) However, all the talk about "state regulation" and "spheres" and the "uneasy relationship" is not really about churches and politics—but about Tax Exempt Churches and politics. The relationship between Taxable Churches and the state, regulation, and politics is never explored.

3. Governmental Hostility to Religion

The most emotionally charged rhetoric in the Exemption Essentialist literature is that conditioning tax exemption for churches on abstinence from political campaigns is a hostile government act. Allegedly, it is "simply the government's way of paying churches not to talk about certain things,"\(^\text{76}\) that is, "buying the churches' silence."\(^\text{77}\) We are told that this is part of the

\(^{69}\) James, supra note 41, at 31.
\(^{70}\) Murphy, supra note 37, at 41.
\(^{71}\) Feld, supra note 66, at 939.
\(^{72}\) Johnson, supra note 41, at 877.
\(^{73}\) See James, supra note 41, at 78.
\(^{74}\) See Murphy, supra note 37, at 37.
\(^{75}\) Johnson, supra note 41, at 884.
\(^{76}\) Garnett, supra note 66, at 779.
\(^{77}\) Id. at 778.
state's attempt to "move religion into the realm of subjective preference by eliminating religious consciousness"78 or at least to "tame religion by saying what it is and identifying what it is not . . . and convince religious consciousness to internalize the state's own judgment that faith does not belong in politics."79 This, we are told, is how "government molds religion's own sense of what it is."80 The purported result "is a privatized faith, re-shaped to suit the vision and needs of government, and a public square evacuated of religious associations capable of mediating between persons and the state and challenging prophetically the government's claims and conduct."81 The argument is that Section 501(c)(3) is so powerful and pernicious that American "religious consciousness" is "unable to resist the conclusion that its claims to public truth are 'implausible nonsense.'"82 Even if restricting churches from campaigning is pernicious and outrightly hostile to religion, the question of avoiding this danger and blunting this hostility by foregoing Section 501(c)(3) status is never addressed.

C. Current Scholarship on the Tax Issues

It would be unfair to claim that none of the current scholars understand that churches have a choice between campaign restrictions and taxability. Some of the Exemption Essentialists do acknowledge churches to have a choice. But the claim is that "the reality of their choice" is "fundamentally repugnant"83 or that churches' federal tax exemption is "essential to their ability to accomplish their religious and ethical obligations."84 But there are no footnotes for these claims. There is no analysis showing that federal tax exemption is "essential" to a church accomplishing its "religious and ethical obligations" or why losing federal tax exemption would be "fundamentally repugnant." Even when the theoretical possibility of a church being a Taxable Church is acknowledged, it is not explored.

79. Garnett, supra note 66, at 776-77.
80. Id. at 796.
81. Id. at 771.
82. Bradley, supra note 78, at 280 (quoted in Garnett, supra note 66, at 797).
83. Dessingue, supra note 35, at 920.
84. McDowell, supra note 7, at 77.
1. Assuming the Relative Value of Tax Exemption

The assumption made—and the assumption I am calling into question—is that Tax Exempt status is essential to the financial health of each church. Unlike Exemption Essentialists, I do not believe in "attributing churches' wealth to their tax-exempt status."85 That would be like attributing the wealth of a pension plan to its tax exempt status, ignoring that no matter the benefit gained from the exemption, the primary source of the wealth comes from the employees' and employers' contributions and picking the right investments. However, churches' wealth is not derived from tax exemption or even good stock picks. Unlike any other institution (even most charitable institutions), churches are funded by the year-in, year-out apparently inexhaustible generosity of their members.86 This makes a difference, as I will argue below.

Even though Exemption Essentialists make preserving Section 501(c)(3) status into one of churches' primary objectives, the tax issues of churches receive little detailed attention. Section 501(c)(3) is described by one of the scholars as "the tip of a monstrous iceberg of tax law that affects churches."87 Nevertheless, the iceberg is of little interest to him. His article has no tax analysis. He offers no suggestions on how churches might navigate past this "iceberg" to warmer waters—waters free of Section 501(c)(3) status.

The benefits of tax exemption to Tax Exempt Churches are described as having the "same net economic effect as a direct payment from the government."88 None of the Exemption Essentialists set out to determine the value of such a "direct payment." Some of the scholars do list indirect benefits of federal tax exemption, such as qualifying for tax-exempt bond financing and possible exemptions under labor, bankruptcy and other laws, but without investigating how many churches benefit from tax-exempt bonds or bankruptcy exemptions.89 Some of the listed benefits, such as preferred postal rates and many state tax exemptions (as discussed below in more detail) actually result not from federal tax exemption per se but from merely being organized as a church or a non-profit.90 The mistake in catalog-

85. James, supra note 41, at 42.
86. See discussion infra Part III.B.4.
87. Garnett, supra note 66, at 772 n.6.
88. Feld, supra note 66, at 937.
89. See, e.g., id. at 936; James, supra note 41, at 42–43.
90. See infra Part III.B.7.
CAMPAIGNING FROM THE PULPIT IS OKAY

None of the scholars gives thought to how a church might determine the value of its tax exemption, the value of its "direct payment." They assume the value is obvious and obviously high. One of the authors notes in passing that the benefits "will vary greatly with the entity" and are more likely to result from the deductibility of donations to the church than the exemption from income tax per se. About a half-dozen sentences are used to frame and resolve the issue, while the remainder of his article ignores it. Indeed, he enjoins churches to "go and sin no more" with political campaigning rather than considering if they might campaign without sin or, more importantly for this discussion, tax liability.

2. Specific Tax Issues Addressed by Exemption Essentialists

I do not want to suggest that there is no substantive consideration of tax issues in this literature. Some of the articles take the tax issues seriously. Some of their considerations are wrong, such as concluding that charitable donations would be subject to corporate income tax if a church were not Tax Exempt. Or wrong-headed, such as asserting that a church that campaigns would be subjected to an onerous penalty tax, without clarifying that the tax would only apply to a Tax Exempt Church that campaigned. However, other Exemption Essentialists offer reasonable suggestions for increased guidance to churches on the restrictions or changes in the campaign restrictions.

One of the tax themes in the literature is to suggest alternative but complex corporate structures that would permit political engagement by an organization other than the church but nonetheless associated with the church. These corporate structures

91. Feld, supra note 66, at 936.
92. Id. at 936.
93. McDowell, supra note 7, at 101; see infra Part III.B.3.
94. McDowell, supra note 7, at 75; see infra Part III.B.2.
95. Johnson, supra note 41, at 900-01; Feld, supra note 66, at 939.
96. Professor Douglas H. Cook (Regent University School of Law) suggests a structure involving both a Section 501(c)(4) corporation and a Section 501(c)(3) corporation to permit a church to both campaign and receive tax-deductible donations. Cook, supra note 20, at 473. However, Professor Alan L. Feld (Boston University School of Law) claims that a Section 501(c)(4) corporation cannot campaign (though it can lobby), and so a church needs not only a more complex structure involving a Section 501(c)(3) corporation and a 501(c)(4) corporation but also a 527 corporation. Feld, supra note 66, at 935-36. What Professor Feld suggests is sometimes called a "triad," and is also suggested by, e.g., Professor Ann M. Murphy (Gonzaga University School of
are commonly suggested in the practice-oriented legal literature, as well as by the courts. Though technically feasible, I believe these structures are unsuited for churches since the church’s pastor still would not be able to endorse a candidate from the pulpit, which I assume is the kind of freedom of political speech most churches are interested in if they want to campaign. Churches interested in campaigning would lose a considerable amount of their moral authority in a campaign if they were to hide themselves in the sort of corporate-subsidiary structure that tax lawyers love to dream up—and that seem more appropriate for international tax-haven venture capital funds than “prophetic voices” crying in the wilderness.

3. The IRS and Exemption Essentialists

The Exemption Essentialists share an assumption as to the value of tax exemption and the deterrence value of the threat of its loss, but they do not share the same perspective on the IRS. Some write that the IRS “has exercised great restraint in its enforcement,” appropriately “reflect[ing] the sensitive nature of the First Amendment values present,” or that “undoubtedly” because of the “importance of free speech and the freedom of religion in this country, [IRS] audit activity in this area has been close to non-existent.”

While one of the scholars concerned with religious issues pleas for stricter enforcement by the IRS, another concerned with religious issues thinks that it would be “tragic if the IRS enforcement chilled the necessary prophetic contribution of religious communities.” This latter author does not argue that Congress should change the statutory prohibition against campaigning, instead arguing that it is the IRS that “continues to limit churches,” which he is afraid diminishes the “priestly and prophetic roles” of the church. With an apparent Cold War allusion, he expresses the depth of his concern about the IRS enforcing the campaign prohibition: “The church’s capacity to witness, Law). Murphy, supra note 37, at 82. The simpler structure suggested by Professor Cook is apparently not considered adequate by Professors Feld and Murphy, or otherwise the triad would not be necessary.


99. Feld, supra note 66, at 934.

100. Id. at 931.

101. Murphy, supra note 37, at 68.

102. James, supra note 41, at 78.

103. McDowell, supra note 7, at 103.
whether in Russia or the United States, depends largely on its freedom from governmental suppression, intrusion, and seduction."\textsuperscript{104}

Some of the Exemption Essentialists characterize an IRS of restraint out of sensitivity to Constitutional freedoms, while others worry about its lack of enforcement and still others worry about the powers of "suppression, intrusion and seduction" the IRS holds. None of them ponder if IRS enforcement behavior on this issue can be accounted for exclusively in terms of how little-to-no additional revenue would be collected from a church, even if it were "taxable." While I have no way to prove it, I suspect that the IRS has yet to collect in sufficient revenue from the Church at Pierce Creek to offset its costs in litigating the case. Nevertheless, in the fifteen years since the Church at Pierce Creek purchases the campaign ads, the IRS has never again taken on the expense of revoking a church's tax exemption for campaigning.

D. \textit{Ignoring the Court: The Failure of Exemption Essentialism}

In much of the contemporary scholarship, the context of the issue—religion and politics\textsuperscript{105}—has been substituted for the substance: federal income taxation. I suspect an article about religion and politics is more fun to write,\textsuperscript{106} and I fear a good bit more fun to read too. Nevertheless, the substantive legal issues are tax issues.

The tax issues are often used by the Exemption Essentialist scholars merely to illustrate their jurisprudential or religious convictions. The articles seem more a means to display those convictions rather than to analyze the tax problem. Instead of analyzing the tax problem, the tax problem tends to be used as a literary device to introduce the scholars' "bigger picture" ideas about religion and politics. The weakness of the articles is not

\begin{footnotes}
\item[104] \textit{Id.} at 72.
\item[105] For a discussion of preference in legal scholarship for such "big ideas" such as these, see, e.g., Farber, \textit{supra} note 9, and Zlotnick, \textit{supra} note 9.
\item[106] Whether or not legal scholars are writing just for fun—or why it is we are writing at all—is an issue explored in the Fall 2004 issue of the \textit{San Diego Law Review}.
\end{footnotes}

\begin{flushleft}
Are we seeking to improve the law by bringing moral, economic, and psychological wisdom to bear in a way that will enlighten judges and practitioners? Do we hope to change the rules and conditions of society, through the medium of law? Are we fulfilling professional duty in the best way we know how, with no particular plan in mind? Are we just having fun?
\end{flushleft}

Emily Sherwin, \textit{Why We Write: Reflections on Legal Scholarship}, 41 \textit{San Diego L. Rev.} 1739, 1739–40 (2004). It may just be I have more fun writing about taxes.
necessarily in their grander ideas. The weakness is in interpreting the Tax Code symbolically rather than economically. A tax without a cost has no meaning. Somehow, the Branch Ministries court’s observation has been lost in the scholarly “analysis” of the campaigning church problem: “Because of the unique treatment churches receive under the Internal Revenue Code, the impact of the revocation is likely to be more symbolic than substantial.”107 The Exemption Essentialist scholars have published a great deal about the symbolism of revocation, but seem mostly unconcerned with the substance of revocation—that substance being the taxation of Taxable Churches.

III. ASSET MANAGEMENT ANALYSIS OF TAX EXEMPTION: WHAT DOES POLITICAL PARTICIPATION COST?

Applying the Asset Management Analysis to the Tax Exempt Church is the only way to determine what the cost of political campaigning to a church is, since a church can campaign if it is willing to become a Taxable Church.

A. Introducing Asset Management Analysis

Asset Management Analysis of the tax exemption of churches is determining the financial value of being a Tax Exempt Church. Tax exemption should be considered a financial asset manageable under the same principles as any other church asset.108 For churches that want to campaign, tax exemption comes with a cost—the prohibition on campaigning. The suggestion is that a church interested in politics ought to weigh the costs and benefits of being a Tax Exempt Church.

Speaking of the costs and benefits of tax exemption permits a shift to thinking of Section 501(c)(3) tax exemption as an asset of this or that particular church, rather than part of the essence

108. As directors of non-profit corporations, those who direct church business have a duty of care and a duty of loyalty, which means they must make informed and reasonable business decisions that promote the non-profit’s purposes. I urge church directors to take their fiduciary duties seriously and inform themselves of the costs and benefits of tax exemption to their particular church and the costs and benefits of political campaigning to their particular church’s mission and then to make a decision, rather than assuming that tax exemption and its consequent restrictions is simply part of being a church. Legal scholars may not violate any fiduciary duties when they assume the value of assets. But church directors do. They cannot guess at the value of their portfolio. Nor should they guess at the value of their tax exemption. For an introduction to the duties of non-profit directors, see, e.g., Harvey J. Goldschmid, The Fiduciary Duties of Nonprofit Directors and Officers: Paradox, Problems, and Proposed Reforms, 23 J. CORP. L. 631 (1998).
of churches. Asset Management Analysis begins not with the tax essence of churches but rather with the fact that individual churches exist, and we must decide how they are to be taxed, regardless of how the ancient Egyptians\textsuperscript{109} or even the British\textsuperscript{110} taxed religion, regardless of what Chief Justice John Marshall\textsuperscript{111} might have to say, and regardless of whether LBJ intended to prohibit churches from campaigning or only intended to be re-elected when he proposed the campaign restriction be added to Section 501(c)(3).\textsuperscript{112}

The individual church need not make a decision for all other churches; it need only choose for itself. And the decision of every church is whether to acquire, maintain, or divest itself of Section 501(c)(3) exemption. It should be seen as a financial decision because it is a tax decision.

If a church is convicted of its moral duty to campaign, then it should consider the foregoing of the value of tax exemption as merely a cost of campaigning, no different in quality than any of the other costs of campaigning—bumper stickers, car window flyers, and pancake breakfasts. As I will argue below, counter-intuitive though it is, the financial value of being a Tax Exempt Church may not be much to many churches.

B. Applying Asset Management Analysis: A Case Study

Asset Management Analysis cannot be done categorically. The value of the tax exemption subsidy for one church may not be the same as for another. This is an issue for churches to decide on a case-by-case basis in light of their own situations. Thus, we need a hypothetical case: First United Church of Rochester, Texas. First United Church fits within the typical profile of a medium-sized religious congregation anywhere in America.\textsuperscript{113}

First United Church has three hundred members.\textsuperscript{114} Charitable donations are First United Church’s primary source of reve-

\begin{itemize}
  \item \textsuperscript{109} James, \textit{supra} note 41, at 32.
  \item \textsuperscript{110} Murphy, \textit{supra} note 37, at 41–42.
  \item \textsuperscript{111} Garnett, \textit{supra} note 66, at 777.
  \item \textsuperscript{112} Dessingue, \textit{supra} note 35, at 905.
  \item \textsuperscript{113} \textit{See} \textsc{Independent Sector, America’s Religious Congregations: Measuring their Contribution to Society} 3 (2000), \textit{available at} http://www.independentsector.org/programs/research/ReligiousCong.pdf (describing congregation characteristics based on size). I have chosen to make First United Church fit the profile of a medium congregation as that term is used in this report. However, the choice between small, medium, and large congregations, as those terms are used in the report, should not make any difference in the analysis or conclusions.
  \item \textsuperscript{114} \textit{Id}.
\end{itemize}
nue: eighty-four percent of its annual revenue comes from donations.\textsuperscript{115} The other sixteen percent of its revenue comes from tuition payments, interest income, and other sources.\textsuperscript{116} Of its three hundred members, one hundred and fifty are financial contributors.\textsuperscript{117} Consistently with other churches, fifteen of those donors—that is, the top ten percent of the donors—average $1,500 per year, while the remaining supporters average $567 a year.\textsuperscript{118}

Each year, the church's revenue covers its budget, with four percent left to spare. Its total annual expenditures and savings (which are the same each and every year) are as follows:\textsuperscript{119}

<table>
<thead>
<tr>
<th>Classification</th>
<th>Amount</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee compensation</td>
<td>$42,004</td>
<td>41%</td>
</tr>
<tr>
<td>Professional fees</td>
<td>$1,448</td>
<td>1%</td>
</tr>
<tr>
<td>Occupancy expenses</td>
<td>$16,657</td>
<td>16%</td>
</tr>
<tr>
<td>Supplies/Services</td>
<td>$6,518</td>
<td>6%</td>
</tr>
<tr>
<td>Miscellaneous operating expenses</td>
<td>$5,794</td>
<td>6%</td>
</tr>
<tr>
<td>Property improvement/Acquisition</td>
<td>$13,260</td>
<td>13%</td>
</tr>
<tr>
<td>Donations to organizations</td>
<td>$10,894</td>
<td>11%</td>
</tr>
<tr>
<td>Donations to individuals</td>
<td>$1,346</td>
<td>1%</td>
</tr>
<tr>
<td>Savings</td>
<td>$4,080</td>
<td>4%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$102,000</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

The church's historical savings amount to $250,000, which is invested in securities. Its church building is worth $300,000. It has no other assets with material financial value.

First United Church would like to be involved in the 2008 presidential campaign. It is considering converting from a Tax Exempt Church to a Taxable Church on January 1, 2007, by amending its articles of incorporation to explicitly authorize campaigning. This will cause it to no longer be a Section 501(c)(3) organization.\textsuperscript{120} The church would like to determine the tax and other consequences to this conversion so that it will know the financial value of its tax exemption and, thereby, the costs of entering the 2008 campaign.

\textsuperscript{115} Id. at 4.
\textsuperscript{116} Id.
\textsuperscript{117} I have arbitrarily elected this number of donors out of a membership of 300.
\textsuperscript{118} This is based on statistics regarding charitable donors' relative donations as described in Ellen P. April, \textit{Churches, Politics and the Charitable Contribution Deduction}, 42 B.C. L. Rev. 843, 845–46, 870–71 (2001).
\textsuperscript{119} This is a simplified version of congregation operating expenditures as described in \textit{Independent Sector}, supra note 113, at 5–6.
1. Confiscatory Costs

First United Church has substantial assets ($550,000 in value of securities and real estate) that it has accumulated as a Tax Exempt Church, and it is reasonable to query if all or some substantial part of the wealth attributable to tax exemption must be re-paid in the event the church becomes a Taxable Church. After all, this wealth represents the accumulation of tax-deductible charitable donations and the systematically re-invested tax-exempt income generated by the accumulation.

There are two scenarios similar to the conversion of a Tax Exempt Church into a Taxable Church that result in a potential confiscation of the wealth accumulated under Section 501(c)(3): a change in corporate form and a Section 507 termination. As a financial matter, the issue is whether or not First United Church could continue on as Taxable Church involved in politics with the $550,000 in assets that it accumulated while it was a Tax Exempt Church prohibited from political involvement.

(a) No Change in Corporate Form

The change to a Taxable Church would not require or cause a change in state corporate form. Amending the articles of incorporation to include the explicit power to campaign will cause First United Church to become a Taxable Church. However, it will remain a non-profit corporation. The change would be in federal tax status, and only federal tax status.

A non-profit corporation can re-organize itself into a for-profit corporation. Such a change would cause First United Church to become a Taxable Church (since it would no longer be described in Section 501(c)(3)), but such a change is not necessary to avoid the campaigning restriction. The campaigning restriction is derived from Section 501(c)(3), not state non-profit corporate law.121 It is important to be clear that this is not a change in state corporate form, since a change in state corporate form would require a new non-profit corporation to be organized and First United Church to pay-over its accumulated wealth to the new non-profit in connection with First United Church becoming a for-profit corporation.122 This type of “conversion”

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122. Changes in state corporate form from non-profit to for-profit were common in the late 1980s and early 1990s. Usually, hospital or other medical care facilities converted from non-profit corporations into for-profit corporations. This change in organization at the state statutory level permitted the ensuing corporation to run the non-profit’s business as a for-profit business. Often, it was important that new capital be raised in order to make the business
is not required in order for First United Church to commence campaigning.

(b) No Termination Tax

First United Church’s tax exemption would cease when it amended its articles of incorporation to authorize its campaigning. However, this change in tax status would not be a “termination” as described in Section 507. A termination under Section 507 triggers a “termination tax” that is the lesser of its “aggregate tax benefit” or the value of its assets.\(^\text{123}\) “Aggregate tax benefit” is defined to mean the sum of all of the tax benefits received by the entity and all the benefits received by its donors.\(^\text{124}\) Thus, the termination tax forces the terminating entity to re-pay all of the tax benefits it and its donors received over the years or, if it does not have sufficient assets for the payment, to surrender its current assets to the government. The Section 507 termination tax is, thus, a potentially confiscatory tax.

However, the Section 507 termination tax would not apply to First United Church’s “termination” of its Section 501(c)(3) status. The Section 507 termination tax does not apply to churches. It only applies to “private foundations.”\(^\text{125}\) Although private foundation status is the presumptive status of Section 501(c)(3) organizations, churches are specially exempted from the rules requiring evidence to overcome this status.\(^\text{126}\) This is one of the special benefits for churches. First United Church would not be subject to this termination tax because it would not be considered a private foundation, even if it had a history of substantial donations from a small number of individuals, which

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124. Id. § 507(d).
125. Id. § 507(a).
126. Id. §§ 508(c)(1)(A), 6033(a)(2)(A)(i).
typically would make a Section 501(c)(3) organization into a private foundation.\textsuperscript{127}

2. Taxing Campaign Expenses

There are two Tax Code Sections that impose taxes on campaign-related payments by Section 501(c)(3) organizations: Section 4955 and Section 527(f). Note that these taxes are in addition to the risk of having tax exemption revoked for violating the campaign prohibition.

(a) \textit{Section 4955}

Section 4955 taxes “political expenditures” by Section 501(c)(3) organizations.\textsuperscript{128} Section 4955(d)(1) defines “political expenditure” as any amount paid or incurred in any participation in or intervention, including the publication or distribution of statements, in a political campaign on behalf of, or in opposition to, any candidate for public office.\textsuperscript{129} The initial tax is ten percent of the amount spent.\textsuperscript{130}

Typically, organizations are given the opportunity to “correct” the political expenditure.\textsuperscript{131} “Correction” requires recovering the amount expended, to the extent possible, and establishing safeguards to prevent future campaign expenditures.\textsuperscript{132} Of course, First United Church is considering \textit{intentionally} campaigning, so it would not be interested in “recovering” any amounts spent on political campaigns. Accordingly, the tax would be increased to one hundred percent of the expenditure.\textsuperscript{133} Additionally, First United Church’s directors could be \textit{personally} penalized up to ten thousand dollars for each expenditure.\textsuperscript{134} Since First United Church’s political campaigning would be intentional, the IRS could decide its political expenditures were “flagrant,” in which event the IRS could seek a court injunction to keep First United Church from further political expenditures.\textsuperscript{135}

\begin{itemize}
  \item \textsuperscript{127} Private foundations typically have small donor bases, which is why they do not qualify as “public charities.” \textit{See id. \S\S 509(a)(1), 170(b)(1)(A).}
  \item \textsuperscript{128} \textit{Id. \S\S 4955, 6852.}
  \item \textsuperscript{129} \textit{Id. \S 4955(d)(1).}
  \item \textsuperscript{130} \textit{Id. \S 4955(a)(1).}
  \item \textsuperscript{131} \textit{Id. \S 4955(b).}
  \item \textsuperscript{132} \textit{Id. \S 4955(f)(3).}
  \item \textsuperscript{133} \textit{Id. \S 4955(b)(1).}
  \item \textsuperscript{134} \textit{Id. \S 4955(b)(2) (“[I]f an organization manager refused to agree to all or part of the correction, there is hereby imposed a tax equal to 50 percent of the amount of the political expenditure.”).}
  \item \textsuperscript{135} \textit{Id. \S 6852.}
\end{itemize}
Although Section 4955 is an excise tax (i.e., a penalty tax) structured almost identically to Section 4958 in several important ways,\textsuperscript{136} it does not have a “look back” period. Thus, once an organization ceases to be a Section 501(c)(3) organization, Section 4955 no longer applies. As a policy matter, the failure to incorporate a look back period into Section 4955 is questionable for a penalty tax, since it allows the penalty to be avoided simply by ceasing to be a Section 501(c)(3) organization prior to making the expenditure. In contrast, the five-year look back period contained in the structurally similar penalty tax of Section 4958 means an organization continues to be taxed for impermissible expenditures for five years after it ceases to be a Section 501(c)(3) organization. Curiously, and importantly, the Section 4955 tax (and the potential personal tax on the church directors and the potential court injunction) can be avoided by First United Church making campaign expenditures only after it becomes a Taxable Church.\textsuperscript{137}

(b) Section 527(f)

Section 527(f) also imposes a tax on political expenditures by Section 501(c)(3) organizations, but its purpose is unlike that of Section 4955. Section 4955 is intended to penalize Section 501(c)(3) organizations that make political expenditures. The purpose of Section 527(f) is to ensure that all Section 501(a) tax exempt organizations (which includes Section 501(c)(3) organizations) are subject to income tax on campaign expenditures in the same way as tax exempt political organizations.\textsuperscript{138} Its purpose is to enforce equitable taxation between similar organizations, rather than specifically deterring impermissible expenditures by Section 501(c)(3) organizations (which is the

\textsuperscript{136} Compare id. § 4955 with id. §4958. Section 4958 imposes a penalty tax on improper expenditures for the benefit of certain individuals (e.g., directors' self-dealing) in a manner similar to Section 4955's penalty tax on improper expenditures for political campaigns.

\textsuperscript{137} This possibility is never considered by the Exemption Essentialists who analyze Tax Code Section 4955. See, e.g., James, supra note 41, at 45; McDowell, supra note 7, at 75, 101.

\textsuperscript{138} See S. REP. No. 93-1357, at 29-30 (1974), as reprinted in 1975-1 C.B. 517. Section 527(f) accomplishes its purposes by subjecting to income tax (at the highest specified corporate tax rate) the lesser of the organization's net investment income or amount spent on campaigning. See I.R.C. § 527(b), (f)(1) (2000). "Net investment income" is defined primarily as dividends, rents and royalties. Id. § 527(f)(2). Like most churches, dividends, rents and royalties are not a primary source of revenue for First United Church. Thus, even if First United Church did make a taxable expenditure, the resulting tax liability would be minimal.
purpose of Section 4955). More importantly, like Section 4955, Section 527(f) does not have a look back period, which means that so long as First United Church’s campaign expenditures follow its change into a Taxable Church it will not be subject to the tax.139

3. Income Tax

Section 501(c)(3) provides First United Church with a "blanket" exemption from the federal income tax, but the exemption may not be necessary for the church to avoid an income tax liability. The Branch Ministries court focused on this possibility when rejecting The Church at Pierce Creek’s claim that losing its Section 501(c)(3) status would be a constitutionally impermissible burden. The court explained that the revocation would not "necessarily make the Church liable for the payment of taxes" because, as "the IRS explicitly represented in its brief and reiterated at oral argument, the revocation of the exemption" would not convert donations into income taxable to the church—such donations are excluded from income under Section 102.140 The court’s point is that Section 102 excludes gifts from the income of taxable U.S. taxpayers. Since no U.S. taxpayer who receives a gift (of any value) is subjected to income tax on the gift, First United Church would not be subject to income tax on donations it received as a Taxable Church.

Unlike other kinds of Section 501(c)(3) organizations, most of a church’s revenue is donated.141 Other charities’ major sources of revenue tend to be fees, dues, and other charges.142 But churches tend to be funded, year in and year out, by donations. Indeed, churches are almost entirely dependent upon donations to operate: about eighty-four percent of annual church revenues are donations.143 Thus, eighty-four percent of First United Church’s annual revenues are excluded from its income under Section 102 even though it becomes a Taxable Church.

139. Unlike Section 4955’s tax, however, it is not surprising that Section 527(f) has no look back period because its purpose is equity between taxpayers rather than penalizing improper expenditures.
140. Branch Ministries v. Rossotti, 211 F.3d 137, 143 (D.C. Cir. 2000).
141. INDEPENDENT SECTOR, supra note 113, at 4; see also April, supra note 118, at 845.
143. INDEPENDENT SECTOR, supra note 113, at 4; see also April, supra note 118, at 845. Note that an earlier study concluded that ninety-three percent of church revenue was derived from donations. BURTON A. WEISBROD, THE NON-PROFIT ECONOMY 197 (1988). I have used the more recent and more conservative conclusion.
Church. This means that $85,680 of its $102,000 annual revenue would be tax free, even if First United Church were a Taxable Church.

As a Taxable Church, First United Church’s gross income would be only $16,320, which is unlikely to generate any income tax liability for the church. If the church’s gross income were subjected to tax, the tax would be only $2,448.144 However, the tax rate is not applied to gross income. First United Church would claim a variety of deductions for its operating expenditures: the $42,004 it pays in compensation; the $1,448 in professional fees; the $16,657 in occupancy expenses; the $6,518 in supplies; and the $5,794 in miscellaneous operating expenses. First United Church also gives $10,984 to other organizations, and if any of these are Section 501(c)(3) organizations, First United Church would be entitled to a charitable deduction (though it would be limited to ten percent of its taxable income under Section 170(b)(2)). First United Church’s potential deductions for its operating expenses and charitable donations are greater than $16,320. Like many other taxable American corporations, First United Church would have no actual tax liability but rather a tax loss.

There are two ways in which First United Church might not benefit under Section 102. First, there is a lively debate among scholars as to the propriety of excluding gifts from income under Section 102, and there are occasional calls for its elimination from the Tax Code.145 Secondly, it is possible that the IRS could reverse the position from the Branch Ministries case and claim donations to Taxable Churches were not bona fide gifts but some type of payment for “religious services.”146

However, even assuming either a successful repeal or a successful IRS argument against the application of Section 102 to Taxable Churches, income tax exemption has a surprisingly limited value for First United Church. First United Church would

[144] I.R.C. § 11(b) would require a fifteen percent tax rate to be applied. I.R.C. § 11(b) (2000).
[146] Since the church would be a corporation, Section 118 would be relevant to any change in position by the IRS on the Section 102 issue, especially in cases of contributions for church facilities. See I.R.C. §§ 102, 118; I.R.S. Priv. Ltr. Rul. 200528022 (June 15, 2005).
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still only have a tax liability if its income (including those donations) in any year exceeded its deductions. Of the $102,000 annual revenue, $72,421\textsuperscript{147} would be deductible, leaving only $29,579 subject to tax. The resulting tax liability would be only $4,437. If for any reason Section 102 were no longer available to the church, First United Church would be saved from any significant tax liability by the fact that it, like most churches, operates so near the financial break-even point each year.\textsuperscript{148}

4. Reduced Revenues from Lost Deductions for Donors?

Even though donations would be excluded from the income of First United Church once it became a Taxable Church, those donations would no longer be deductible from the donors' income. Section 102 excludes the donations from the church's income, but it is not related to Section 170, which provides an income tax deduction for the donor to a Section 501(c)(3) organization.

The Section 170 deduction would only be lost to a minority of the church's donors, however. A taxpayer must itemize deductions in order to claim the charitable deduction. Only about thirty percent of American taxpayers itemize their deductions each year,\textsuperscript{149} and there is no reason to believe that First United Church's donors itemize at a higher rate. Thus, we can assume that at least seventy percent of First United Church's donors (105 out of 150) do not even claim the charitable deduction.

While there may be reason to suspect that charitable donors as a group have a higher itemization rate, there is no reason to suspect that church donors as a group do. Typically, lower-income taxpayers do not itemize, while higher-income taxpayers do. However, unlike other kinds of philanthropy that is primarily funded by "big givers," church philanthropy is very broad based, funded by many "small givers" rather than a few big givers. For example, in education-centered philanthropy, the top one-tenth of one percent of donors account for one quarter of the

\textsuperscript{147} This assumes that donations to other organizations are deductible, but that the deduction is limited to ten percent of the church's taxable income under § 170(b)(2). See I.R.C. § 170(b)(2).

\textsuperscript{148} Operating near the financial break-even point provides planning opportunities for the church as well, in the event that § 102 is unavailable. By coordinating the acceptance of donations with the church's actual budgetary needs during the course of the year, the church could ensure that its revenue never exceeded its costs.

\textsuperscript{149} Charles T. Clotfelter & Richard L. Schmalbeck, The Impact of Fundamental Tax Reform on Nonprofit Organizations, in Economic Effects of Fundamental Tax Reform 211, 228 (Henry J. Aaron & William G. Gale eds., 1996); see also April, supra note 118, at 845-46, 870-71.
donations to educational institutions. In other words, a quarter of a school's donations tend to come from one out of one thousand of its donors. In contrast, for churches, the top ten percent of donors account for only twenty-five percent of the donations. Since there is no reason to believe church donors are disproportionately higher-income, there is no reason to believe that more than thirty percent of First United Church's donors actually claim a charitable deduction.

Even if thirty percent of First United Church donors claim the charitable deduction, it seems unlikely they would lessen their donation level from the current thirty-nine percent in the event the church becomes a Taxable Church. There are three reasons to doubt that the loss of the income tax deduction would cause them to donate a lesser amount. First, as an empirical matter for the general population of charitable donors, it is uncertain if the income tax deduction stimulates significantly more giving than there would be in its absence. Second, since church donors do not fit the typical charitable donor profile, whatever effect the income tax deduction has on donors generally is unlikely to be the same as it has on church donors specifically. Third, by becoming a Taxable Church involved in the 2008 campaign, First United Church's donors would be able to re-

150. April, supra note 118, at 845-46, 870-71.
151. Id.
152. Since the top ten percent of church donors account for the top twenty-five percent of donations to church, $39,510 of First United Church's $102,000 was given by its top thirty percent of donors, which is about thirty-nine percent of its donations.
153. The following discussion considers only I.R.C. § 170 income tax charitable deduction. Since the estate tax is scheduled to die, I.R.C. § 2055 estate tax charitable deduction is unlikely to be relevant. The gift tax survives even the repeal of the estate tax so the loss of I.R.C. § 2522 gift charitable deduction might be important. However, each donor could contribute eleven thousand dollars per year to the church without triggering a liability, since the church would qualify as a donee under I.R.C. § 2503 annual exclusion. See I.R.C. § 2503 (2000); I.R.S. Priv. Ltr. Rul. 9818042 (Jan. 28, 1998) (contribution to Section 501 (c) (7) social club qualifies under annual exclusion). Amounts in excess of the annual exclusion would not trigger a gift tax liability until the donor's one million dollar lifetime gift tax exemption were used. Garden variety estate planning techniques, however, could prevent this from being used by gifts to the church. For example, "loans" to the church forgiven at the donor's death would not consume any part of the one million dollar exemption. Also, the common "Crummey trust" could be employed with the church as the beneficiary and some or all of the church members as withdrawal rights holders. See Crummey v. Comm'r, 397 F.2d 82 (Cal. Ct. App. 1968). Thus, while loss of the gift tax deduction might require some elementary planning on behalf of the wealthiest of church donors, it is the loss of the income tax charitable deduction that probably has the most deterrence potential.
direct their politically-motivated donations to the church, which could result in a significant increase in donations. This is not possible as a Taxable Church.

How much of an incentive to give the charitable deduction provides has been studied in depth for decades, but there is no consensus as to the extent of the incentive. In the 1970s, there was a generation of statistical studies implying that charitable giving was fairly sensitive to the after-tax costs, which were reduced by the charitable deduction. The expectation was that the substantial tax-rate cuts in the 1980s would cause charitable giving to fall appreciably because the charitable deduction would be worth less to donors. However, the predicted drop did not materialize. While the investigations and debates continue, the currently ambivalent consensus is that while American taxpayers "are at least somewhat sensitive" to the effect of the charitable deduction, there remains "much uncertainty about how much" sensitivity there is. There is intuitive appeal in believing that charitable deductions stimulate giving, but empirically, it remains an open issue.

Even to the extent that the loss of the income tax deduction might affect charitable donors generally, church philanthropy is presumably quite different. Though I know of no research into the effect of the deduction on church donors specifically, it seems likely that church donors are motivated by deeper religious and moral objectives than, say, the typical American office worker who contributes to the United Way office campaign, on the one hand, or the wealthy business tycoon who buys a business school for his name, on the other hand. Many church donors tithe a certain percentage out of religious principle, and no doubt would be offended by the suggestion that tax savings is a source of their generosity. The empirical uncertainties as to the effect of the income tax deduction generally are no doubt even less clear with respect to church donors specifically.

More important than how many of First United Church’s donors itemize and how the deduction might encourage donations is the fact that First United Church’s members want their

155. Id.
156. In fact, giving remained entirely stable, except for some changes in giving by taxpayers in the very highest rate bracket. Id.
157. Id. at 1, 3.
158. Cook, supra note 20, at 471.
church to be involved politically. First United Church is not a "normal" church. Best we know, most churches do not want to engage in as potentially a divisive affair as political campaigns. In fact, leaders of a broad spectrum of American congregations have opposed efforts to relax the campaigning restriction in Section 501(c)(3). The "broad tent" orientation of most mainstream churches is clearly not First United Church's orientation. Its members are intellectually and politically monolithic. No church would seriously investigate the consequences of giving up its tax exemption to campaign if there was not incredibly strong support among its members—donors—for it to campaign. It is reasonable to assume these donors are far more zealous than average taxpaying philanthropists—for their church and their politicians—or else their church would not be considering endorsing their politicians.

Even if the zealous enthusiasm of the their church entering politics is not sufficient to increase donations to First United Church by its members (and I suspect it would be), there is an additional economic dynamic at work. Once First United Church becomes a Taxable Church, its members can contribute to it as a way of supporting the favored political candidate. Its members would not receive a donation for a contribution to the candidate's campaign anyway. Now, however, by converting to a Taxable Church, First United Church becomes a potential recipient of its members' politically-motivated contributions as well as their religiously-motivated contributions. First United Church's conversion frees its members to donate to their church those amounts (over and above their "purely religious" donations) that they otherwise would be donating to non-deductible political causes. But so long as First United Church is a Tax Exempt Church, it will not be receiving politically-motivated contributions because it cannot be politically active. Once it becomes a Taxable Church, First United Church can compete for dollars with its favored candidate's campaign—and presumably has an advantage with its own members for winning those dollars.

Thus, ignoring how many of the donors itemize deductions and any theoretical explorations of how much of an incentive deductions provide, I make two assumptions about First United Church's donors that I believe must be true for any church that wants to campaign. I assume their donors are politically and religiously zealous and that zealousness is embodied in the church's decision to campaign. I assume that those donors otherwise would be making political contributions outside of their

159. See supra note 43 and accompanying text.
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church’s budget so long as the church cannot campaign, but will re-direct those contributions to the church once it begins campaigning. Of course, First United Church could seek binding pledges prior to becoming taxable, but I doubt that level of legal protection is required to keep its donation level steady. From the fact that First United Church members want their church to campaign, I believe the only reasonable inference is that those same members want their church to succeed at campaigning. Any church members offended by the church’s partisan campaigning or likely to reduce their financial support of the church for tax reasons have, I believe we can assume, left the church before (or as a result of) the politicization of the church’s identity. Thus, there is good reason to believe that those donors (who remain) are inclined to increase their level of support for the church, though obviously we have no objective data by which to confirm this reasoning.

5. Employee-Related Issues

The IRS might deny that the employees of a Taxable Church qualify for four specific tax treatments (though not necessarily “benefits”). First, churches are entitled to operate retirement plans for their employees that do not comply with the general retirement plan requirements. Second, there are unique treatments for ministers for Social Security purposes. Third, ministers are exempted from federal unemployment taxes and most state unemployment taxes. And, finally, ministers are entitled to certain housing allowances without being subjected to income tax for them. With the exception of church retirement plans, the IRS would not have good statutory authority for denying these treatments to Taxable Churches.

Churches are entitled to establish special retirement plans that are not subject to the same vesting, funding, and participation requirements of other retirement plans. These so-called “church plans” are defined in Section 414(e) with a specific reference to Section 501, and thus would be unavailable to First United Church. However, it seems rather unlikely that, with only $42,004 a year in annual compensation expenses, any church would have established a special retirement plan. The use and

160. For purposes of this article, I have assumed that churches (including First United Church) are independent and self-governed. However, those belonging to denominations and hierarchies may have retirement plans for church employees established at the denominational or hierarchical levels. For a discussion of church plans, see G. Daniel Miller & David W. Powell, Retirement, Deferred Compensation and Welfare Plans of Tax-exempt and Government Employers: New Developments for Church Plans Including the Impact of the Economic Growth and
benefits of these retirement plans by churches appears to remain unstudied in the legal scholarship, so it is unclear the extent and value of these special provisions. Nevertheless, it should be noted that a potential "cost" of becoming a Taxable Church might be that the church employees would need to establish individual retirement accounts or the church needs to establish an alternative retirement plan.

For Social Security purposes, ministers of churches are generally treated as self-employed. This special treatment is provided by Section 3121(w)(3), which, as mentioned, has no reference to Section 501(c)(3) (or campaigning). However, the IRS Form 8274 used in connection with this Code Section defines a church as a type of Section 501(c)(3) organization. Thus, the IRS position clearly is that only ministers of Tax Exempt Churches are self-employed. This not a position with statutory support, nor is it a position with an obvious policy basis either. However, it is a position that indicates a litigation risk with the IRS.

Usually one-half of the Social Security tax is paid by the employer and the other half by the employee. However, self-employed persons pay "both halves." Services provided by ministers are generally treated as self-employment. This saves the church the Social Security tax it would otherwise pay with respect to the minister's compensation, though, as a practical matter, this tax savings might be passed along to the minister in the form of higher compensation since, otherwise, his share of the tax is doubled without any offsetting benefit to him. Thus, it is hard to quantify what, if any, financial savings a church has as a result of the minister being treated as self-employed. Accordingly, even if the issue were litigated with the IRS and the IRS prevailed despite the lack of statutory support, it is not clear the church would have any additional cost.

161. For those who conscientiously object to the Social Security tax system, special provisions for exemptions are made. Since these exemptions are provided in a religious context, the meaning of "church" and whether or not it would include a Taxable Church could be important. See I.R.C. §§ 3121(b)(8)(B), 3121(w)(2), 3127, 1402(e) (2000); Treas. Reg. § 1.1402(e)-2A, 5A (1974 and as amended in 1988).

Under Section 3309, church ministers are exempted from the federal unemployment tax. Like Section 3121(w)(3), Section 3309(b)(1)(A) defines "church" without reference to Section 501(c)(3) (or campaigning), but the IRS clearly takes the position that a "church" for these purposes must be a Section 501(c)(3) organization.

Currently, First United Church is certainly exempted from paying the unemployment insurance tax. If the IRS takes the position that First United Church as a Taxable Church is not entitled to this exemption, the IRS may assess an unemployment tax liability for the church based on the minister's compensation. Again, like the Social Security tax issue, this is an issue that the IRS might litigate but not an IRS position for which there is statutory support.

One tax benefit that accrues to the minister's direct financial benefit rather than the church's is the Tax Code Section 107 exclusion from the minister's gross income (for income tax purposes, not self-employment tax purposes) of his or her housing allowance (e.g., parsonage or rental allowance) under certain conditions. While the specific conditions of this benefit are not our concern, we do need to note the potentially negative impact on the minister's personal tax liability if he is assessed a tax on the housing allowance as a result of the IRS taking the position that a Taxable Church does not count as a "church" for Section 107 purposes. Substantively, like Section 3121(w)(3) and Section 3309(b)(1)(A), Section 107 contains no reference to Section 501(c)(3) (or campaigning). However, again, like the Social Security and unemployment insurance tax issues, the IRS could follow the pattern and assert without statutory support that Section 107 only applies to ministers of Tax Exempt Churches.

Unlike the definition related to church plans in Section 414(e), the definition of "church" in the other employee-related sections contains no reference to Section 501(c)(3). The Tax Code provides no definition of "church," nor do the Treasury Regulations, nor have the courts. As a practical matter, the IRS reads into these sections a requirement of Section 501(c)(3) tax exemption as a matter of course, since this exemption is part of the IRS-devised definition of "church."

Without a statutory definition of church, the IRS has developed a multi-prong test for a "church" for general federal tax purposes that requires the organization to be a Section 501(c)(3)

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163. I.R.C. § 3309(b).
organization. The origins of the multi-prong test are in the need of the IRS to divide sham churches from \textit{bona fide} churches. It is unclear if the position that a church must be a Section 501(c)(3) organization is a substantive position or only a strategic one. Strategically, it is preferable to avoid constitutional arguments about religious beliefs by denying an organization "church" status because it violates Section 501(c)(3) by, for example, distributing its profits to its minister. However, substantively, since the word "church" is not used in Section 501 but is used, for example, in Section 3121, Section 3309, and the Treasury Regulations for Section 107, it is suspicious to argue that the requirements in Section 501(c)(3) that apply to zoos and universities as well as churches should be construed to define "church" for purposes of those other sections. Historically, it seems likely that there have been relatively few \textit{bona fide} churches that did not claim Section 501(c)(3) status, so there has been little need for the IRS to clarify its positions on how the term "church" is used in the different Tax Code Sections. Since none of those other sections mention political campaigning, the IRS would be on uncertain ground to transport the political campaign prohibition to Sections 3121, 3309, and 107, for example. But, out of institutionalized habit, if nothing else, it might.

6. Miscellaneous Federal Benefits

The catalog of potential federal benefits to First United Church is seemingly endless,\footnote{See Bazil Facchina et al., \textit{Privileges \\& Exemptions Enjoyed by Nonprofit Organizations}, 28 U.S.F. L. REV. 85 (1993).} but its length should not cause us to assume its importance. For example, it is quite unlikely that First United Church is interested in issuing tax-exempt bonds\footnote{See I.R.C. § 145(a)(1) (2000); Facchina, \textit{supra} note 165, at 98–99.} or that it has any material benefit from its exemption to the federal wagering excise tax.\footnote{See I.R.C. § 4421 (2); Facchina, \textit{supra} note 165, at 103.} The exemptions and benefits under federal and antitrust laws or securities regulations are of no particular value to First United Church either,\footnote{See Facchina, \textit{supra} note 165, at 104–11.} nor are the special benefits immigrant religious workers may be entitled to receive.\footnote{For discussion of the potential visa issue, see Stuart J. Lark \\& Erich T. Kennedy, \textit{Status Under the Code Affects More Than Just Tax exemption}, 15 TAX'N OF EXEMPTS 220 (2004).} And, while it may enjoy certain postal privileges, it is important to realize that Section 501(c)(3) status is not a prerequisite for special postal rates for churches—the only prerequisite
is that the church is operated as a non-profit. The postal benefit underscores the importance of determining if a particular "miscellaneous" benefit a church is receiving is technically due to its tax exemption or merely its non-profit corporate status. The postal benefit is the only one of concern to First United Church (and most churches, I presume), and it will not be affected by the church becoming a Taxable Church.

7. State Tax Issues

Having run the church through the gauntlet of federal issues for First United Church, it is important to consider the potential state issues that might arise if First United Church is no longer described in Section 501(c)(3) as a result of campaigning. Even though First United Church is located in Texas, the following gives an idea of the range of issues that might arise in any state.

(a) Income and Franchise Tax

Texas does not impose a state income tax per se, but it does impose a franchise tax on corporations. However, as a state non-profit corporation with an "established congregation" that is "regularly attending" the "religious worship services," First United Church is exempt from the state franchise tax, even if it is not exempt under Section 501(c)(3). Exemption from the Texas franchise tax does not require exemption from the federal income tax.

Texas is not unique in defining its state income/franchise tax exemption without reference to Section 501(c)(3) or avoiding campaigning. For example, the Delaware exemption requires neither federal exemption nor avoiding campaigning. However, some states, such as Michigan, do directly or indirectly incorporate Section 501(c)(3) into their state income tax exemption. California expressly precludes exemption for non-profits that campaign.

However, a state-by-state review of income and franchise tax exemption would be a red herring. Even those states that would not exempt a Taxable Church typically follow the federal scheme.
in defining "income" and deductions. To the extent the federal scheme is followed, there would be no state tax so long as the sum of annual donations and annual operating expenses exceeded annual revenue.

(b) Property Taxes

The State of Texas does not incorporate into its property tax exemptions a requirement that the church be exempt under Section 501(c)(3), nor does it include an independent prohibition against campaigning.\(^\text{175}\) Thus, under Texas law, First United Church's $300,000 church building would remain exempt from property tax.

Like Texas, Arizona exempts property used by churches for religious worship without requiring the church to be exempt under Section 501(c)(3).\(^\text{176}\) And similar laws are found in other states, such as Indiana,\(^\text{177}\) Iowa,\(^\text{178}\) and Kansas.\(^\text{179}\) These laws typically exempt only the real property being used for religious services. It is the use to which the property is put rather than the fact that a church owns it that is essential for the exemption. More importantly, none of these statutes requires Section 501(c)(3) exemption or expressly conditions exemption on political abstinence.

(c) Sales Taxes

State laws may exempt church purchases from sales tax or church sales from sales tax, generally so long as the purchases or sales are related to the church's religious programs. In Texas, there is no requirement that "an organization created for religious purposes" be exempt under Section 501(c)(3) in order to have its purchases be exempt (but there is a specific exemption for purchases by an organization described in Section 501(c)(3)).\(^\text{180}\) Regardless of whether or not First United Church is a Tax Exempt Church, Texas will allow it a sales tax exemption for fund-raising sales, but only so long as no more than $5,000 is raised.\(^\text{181}\)

Some state sales tax exemptions are idiosyncratic and must be reviewed carefully. For example, Virginia's sales tax exempt-

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\(^{175}\) TEX. TAX CODE ANN. § 11.20 (Vernon 2002).
\(^{176}\) ARIZ. REV. STAT. ANN. § 42-11109 (1999).
\(^{177}\) IND. CODE § 6-1.1-10-21 (2000).
\(^{179}\) KAN. STAT. ANN. § 79-210 (1997).
\(^{180}\) TEX. TAX CODE ANN. § 151.310 (Vernon 2002).
\(^{181}\) Id.
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tion only applies if the purchases are used in worship services by a congregation in a single location.\textsuperscript{182} Alabama statutes list exempt entities by name.\textsuperscript{183} The District of Columbia requires a certificate from the mayor.\textsuperscript{184} None of these odd rules, however, prohibits campaigning by the church or require Section 501(c)(3) exemption.

Several states do specifically require that the church be a Section 501(c)(3) organization: Colorado, Connecticut, Kentucky, New Mexico, and Vermont, for example.\textsuperscript{185} Were First United Church located in a state that required Section 501(c)(3) tax exemption to confer exemptions from sales tax, it would lose this benefit. The annual cost of this loss would depend upon the sales tax rate and the value of the church’s annual purchases that would otherwise have qualified. This would have to be chalked up to the cost of campaigning.

8. Toggling Tax Status

The court in the \textit{Branch Ministries} case looked at the tax exemption issue on a year-by-year basis and pointed out that the church always had the option to simply reclaim its exemption by giving up campaigning.\textsuperscript{186} Thus, could First United Church convert from a Taxable Church back to a Tax Exempt Church in 2008 when the campaign is concluded?

Converting from a Taxable Church back into a Tax Exempt Church probably would subject the church to tax to the extent it had built-in gains. The IRS would (and probably should) characterize such a conversion as a deemed liquidation of a taxable corporation followed by a contribution of those assets to the new tax-exempt corporation. This is similar to how the IRS characterizes the conversion of a corporation to a partnership.\textsuperscript{187}


\textsuperscript{183} ALA. CODE § 40-9-1 (2005); see also Root & Wright, \textit{supra} note 182, at 281.

\textsuperscript{184} D.C. CODE § 47-2005(3) (2005); see also Root & Wright, \textit{supra} note 182, at 281.

\textsuperscript{185} COLO. REV. STAT. § 39-26-114 (repealed 2004); CONN. GEN. STAT. § 12-412(8) (2005); KY. REV. STAT. ANN. § 139.495 (West 2005); N.M. STAT. ANN. § 7-9-60 (West 2004); VT. STAT. ANN. tit. 32, § 9743(3) (2001); see also Root & Wright, \textit{supra} note 182, at 281.

\textsuperscript{186} Branch Ministries v. Rossotti, 211 F.3d 137, 143 (D.C. Cir. 2000).

The incentive for "toggling" is obvious: collect deductible contributions in non-campaigning years as a Tax Exempt Church but then become a Taxable Church in campaigning years and spend the previously deducted contributions. However, the deemed liquidation argument could be disastrous, since church assets would have carry-over bases for gifted assets and presumptively low-cost bases for assets held for long periods (such as their buildings). There would be arguments to be made by the church that these bases should be adjusted to fair market value when the church toggled from Taxable to Tax Exempt, and thus, when going the other way, a church could find itself with a substantial tax liability.\textsuperscript{188}

9. Transitional Costs and Complications

Just like First United Church, Tax Exempt Churches pondering the transition to Taxable Church status must begin with their particular situation. For example, those beginning as unincorporated associations—rather than incorporated non-profits—or those subject to denominational structural control would have a more complicated analysis than the congregationally-governed non-profit corporation churches like First United Church. The law of unincorporated associations and who legally controls what in denominational structures are obviously a set of considerations independent of the tax law.\textsuperscript{189} Furthermore, thinking beyond the symbolism of Section 501 (c) (3) might be more difficult for some congregations than others, since symbolically it may be taken to represent some level of legitimacy. Professional fees involved in conducting this sort of analysis and in the annual reporting requirements of taxable corporations would also be a cost to be measured, of course. More importantly, and the essence of the issue, is how a congregation resolves the religious issue: is it permissible, prohibited, or necessary for a church to campaign? For those concluding they must campaign, the steps from conclusion to campaigning will vary, but each of them must work through the tax issues presented above.

\textsuperscript{188} Perhaps this result could be avoided by organizing the church as a trust rather than a corporation, since the corporate liquidation rules would not be relevant when the church toggled between Section 501 (c) (3) status and taxable trust status.

Conclusion

The assumption that the tax issues effectively prohibit First United Church from converting into a Taxable Church is wrong. Federal tax exemption for First United Church turns out not to be worth much. Had First United Church been located in certain states, it would have incurred the potential cost of losing its state sales tax exemption. Nevertheless, the costs of the conversion into a Taxable Church in order to campaign for President in 2008 are insignificant for First United Church.190

IV. IMPLICATIONS OF TAXABLE CHURCHES

If federal income tax exemption under Section 501(c)(3) turns out not to be as valuable for churches as is popularly assumed, the implications are significant. There are implications for churches that want to campaign. There are implications for the IRS, which might see an increase in the number of churches voluntarily surrendering their Section 501(c)(3) status. There are implications for Congress, especially since prior attempts to permit campaigning by churches have failed. There are implications for the scholarly agenda, which has by and large been built upon a faulty premise. And, of course, there are implications for those involved in politics.

A. Implications for Churches

Churches ought not make guesses about the value of their assets or their moral convictions. There is no reason to believe that most American churches are eager to claim an express political identity, though there are indications that, more and more, religious and political identities in America are being fused.191 For churches with a clear moral conviction to campaign, the implication of the Asset Management Analysis is clear: crunch the numbers. Determine the cost of losing tax exemption. Decide if that cost is worth campaigning. Do not be distracted by imaginations as to what tax exemption is about. It is about taxes.

190. This conclusion, however, should not provide comfort to a church that has its exemption involuntarily revoked for prior campaigning since such a church might be subject to the excise tax under Section 4955, for example. See I.R.C. § 4955 (2000).

It is about money. It is not about the "right" and "wrong" way to be a church, which is a religious issue and not a tax issue. It should be—and presumably is—the religious convictions and not the tax worries of churches that keep them out of politics.

B. Implications for the Tax Policy

Prior Congressional proposals to permit churches to campaign failed, but none considered the Taxable Church as a viable option. Taxable Churches do not divert deductible donations to non-deductible political purposes because their donors do not receive deductions. There is no reason to deny their ministers housing allowances or any of the other tax treatments of a bona fide church that do not directly relate to income tax exemption or the charitable deduction. Congress ought to ensure that Taxable Churches are regarded as statutorily legitimate alternatives to Tax Exempt Churches.

The Treasury Department should consider whether new regulations ought to be proposed to address Taxable Churches. In addition to clarifying the treatment of the housing allowances of the ministers employed by Taxable Churches and the tax consequences for re-organizing a Taxable Church as a Tax Exempt Church, for example, the Treasury Department might consider a check-the-box styled regulation that would allow churches to choose their tax treatment on a simple form and then devise a series of appropriate reporting mechanisms for each kind of church.

In the absence of express direction from Congress or new Treasury Regulations, the IRS needs to consider what position it should take in the event that Taxable Churches become more common. The sham church audit positions were not devised and are not suitable for the issues raised by bona fide churches that simply are not interested in either the benefits or the restrictions of Section 501(c)(3). Agents should not have the mindset that a church outside the Section 501(c)(3) box is somehow less of a church. Instead, the IRS audit position as to the relationship between the term "church" in Sections 3121, 3309, and 107

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192. For a review of recent proposals, see supra note 43.

193. For many years, federal tax policy closely guarded taxation as a partnership. It was technically complex for a business to earn the pass-through partnership taxation treatment rather than the corporate tax treatment, and tax lawyers made good money giving written opinions when one did. Then, in 1997, it all changed. Partnership status became elective. Simply a matter of "check the box." For an overview of the practical implications of this regime, see William P. Streng, Choice of Entity, Tax Mgmt. Portfolio (BNA) No. 700-2d, at I.C. (1999).
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(from the Treasury Regulations) should be explored and clarified. It should not be assumed that the requirements in Section 501(c)(3) that apply to the entire range of charities—from the Red Cross to the Ford Foundation—must be part of the definition of "church" for all federal tax purposes, especially since the word "church" is not used in Section 501(c)(3).

C. Implications for Scholars

Exemption Essentialism is a symbolic interpretation of the Tax Code. It reflects the preference for big solutions in legal scholarship. To make room for the big solutions in this context, the problem has been made big enough to fit the solution. The problem is a tax problem. However, it is re-interpreted as a constitutional, historical, or religious problem, but not because such re-interpretation is necessary to solve the problem. Rather, I believe, it is done because such re-interpretation is necessary to write an article about the Constitution, history, and religion. The exaggeration of this technical tax problem into these epic realms requires a decision not to explore the potential for taxation posed by the Tax Code. This is an odd and, I believe, methodologically indefensible decision.

I do not believe it is settled that tax exemption for churches is worth little. It may very well be that First United Church is an exceptional case. Or it may be that, in the "real world," churches' exemptions from antitrust laws are crucial to their financial health. The implication of this Article is that the scholarly agenda would do well to turn to calculating the costs and benefits of tax exemptions for churches. The Tax Code should be interpreted economically, not symbolically, and there could be a good deal of work done towards an economic interpretation for churches.

D. Implications for Political Opponents

The implications of Taxable Churches participating in campaigning are important for American partisans, who have politicized the issue. This political tension is motivating a

194. For a discussion on impractical legal scholarship that uses theoretical analyses not only for the "hard" issues but the "easy" ones, see Harry T. Edwards, The Growing Disjunction Between Legal Education and the Legal Profession, 91 MICH. L. REV. 34, 44 (1992).

195. See Farber, supra note 9; Zlotnick, supra note 9.

good deal of tax tattling to the IRS now, which has its hands full of churches to audit on the campaign issue—and little to no prospect of such audits generating much revenue, I believe. 197

Partisans should not assume that the health, wealth, and influence of churches is to be found in their tax exemption, even though the Exemption Essentialist scholarship has been built on the assumption. Having the tax exemption of “enemy churches” revoked is not going to destroy their health, wealth, or influence. It might be a paperwork headache for a few months, but the likely result is energizing the church’s faithful. Providing the “enemy churches” with a martyr’s glow is probably not a good political strategy, especially if the would-be martyr can keep the glow and stay alive.

My suggestion to partisans is to appeal to churches all you want. Encourage their pulpit endorsements, but encourage them to drop their Tax Exempt status first. Some basic respect for the law is not too much to expect from people wanting to run the world. And stop the tattling. Agreeing not to snitch to the tax man should not be too much to expect either, even when it is snitching on someone in the “other” party. The prospect of a nation of snitches hoping to cause problems with the government for those whose religion or politics offends them should be equally horrifying to Republicans as to Democrats. No one likes a tattle tale: “Tell tale tit, Your tongue shall be slit, And all the dogs in town, Shall have a little bit.” 198

CONCLUSION: CAMPAIGNING AND TAXABLE CHURCHES

Working through the hypothetical proved that federal tax exemption for First United Church turns out not to be worth much. The income tax exemption per se was not worth much to the church, since the church would not have had an income tax liability in any event, since donations are not “income,” and since the church’s deductible operating expenses more than cover its revenues that are not donations. The taxes for political-related expenses do not apply, so long as the church becomes a Taxable Church prior to making the expenditures. It is also clear that the church will not have to “re-pay” or otherwise lose any of the assets it accumulated while a Tax Exempt Church even if it becomes a

Speeches that Violate IRS Tax-Exempt Rules, ajc.com, Sept. 24, 2004, http://www.AJC.com/blogs/content/shared-blogs/ajc/woman/entries/2004/09/24/should_church_s.html; see also Rat Out a Church, supra note 46. 197. See supra note 44.

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Taxable Church involved in politics. Even though the thirty percent of the church’s donors who deduct their contributions will no longer be able to do so, the fact that these politically zealous church-goers will now be able to contribute their politically-motivated (as well as their religiously-motivated) donations to First United Church gives us good reason to believe the level of donations to the church will increase rather than decrease.

Nevertheless, the conclusion is not that relatively minor tax issues are the only barriers keeping churches from campaigning. The conclusion is that a certain methodology must be used to determine what the barriers are. The Exemption Essentialists’ assumption that the costs of losing tax exemption are always so high that churches have an insurmountable barrier to campaigning is unsupported—and insupportable. The barriers should not be assumed to be high. Nor should they be assumed to be low. They should be calculated one-by-one, case-by-case. It is only by working through the Tax Code sections with a calculator in one hand and a church’s actual budget in another that the financial value of tax exemption can be determined. However, since First United Church fits the financial profile of medium-sized congregations across America, we do have reason to believe that the D.C. Court of Appeals got it right in *Branch Ministries* when it said that revoking a church’s tax exemption is more symbolic than substantial.

If federal income tax exemption turns out not to be especially valuable for churches more generally, Tax Exempt Churches can convert to Taxable Churches and begin campaigning. The government will need to address both technical and broad policy issues if there is a significant movement by *bona fide* churches outside the Section 501(c)(3) box. Legal scholars should turn their attention toward calculating the tax implications for churches and the implications for tax policy more generally. And finally, partisans should stop tattling to the IRS on the churches of their political opponents, since an IRS entanglement with the churches is only likely to increase their partisan zeal and very unlikely to impact their bottom line—except perhaps to increase it with the inflow of politically-motivated dollars once the church becomes taxable and free of the Section 501(c)(3) campaign restrictions.