Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

October 16, 2023

# Church Tax Benefits

Under the federal tax system, organizations that qualify as "churches" under Internal Revenue Code (IRC) Section 170(b)(1)(A)(i) receive more favorable tax treatment than other tax-exempt organizations. For example, the IRC generally subjects churches to fewer filing obligations than other tax-exempt organizations, restricts the government's ability to conduct church tax audits, and relieves "church plans" of many requirements imposed on tax-qualified retirement plans. This In Focus provides an overview of some of the tax benefits associated with church status.

## Tax Benefits Shared with Other Tax-Exempt Organizations

Churches enjoy many of the same tax benefits granted to other tax-exempt organizations under IRC Section 501(c)(3). An organization must first qualify as a 501(c)(3) "religious organization" to seek "church" status under IRC Section 170(b)(1)(A)(i). As a 501(c)(3), a church is exempt from the federal income tax under IRC Section 501(a). Like several other tax-exempt organizations, however, churches are subject to tax on their unrelated business income under IRC Sections 511-514. The unrelated business income tax (UBIT) is a tax on an organization's gross income from the conduct of any trade or business that is regularly carried on and that is not substantially related to the organization's tax-exempt purpose. Under IRC Section 3306(c)(8), services performed for 501(c)(3)s are not considered employment for purposes of the Federal Unemployment Tax Act (FUTA). Churches therefore do not pay the FUTA tax on their employees' wages under IRC Section 3301.

Churches, like some other tax-exempt organizations, can receive donations deductible by donors. Individual taxpayers who itemize their deductions, and corporations generally may deduct their charitable contributions to churches under IRC Section 170. Similarly, gifts to churches are typically deductible for gift tax purposes under IRC Section 2522, and bequests, legacies, devises, or transfers to churches usually are deductible for estate tax purposes under IRC Section 2055.

## Filing Obligations

Compared to other tax-exempt organizations, churches have fewer filing obligations. Generally, organizations must notify the government that they are applying for recognition of exemption under IRC Section 501(c)(3) in accordance with IRC Section 508(a). Churches, their integrated auxiliaries, and conventions or associations of churches are excepted from filing an application for exemption under IRC Section 508(c)(1)(a). Tax-exempt organizations are typically required to file an annual return disclosing financial information to the Internal Revenue Service (IRS) under IRC Section 6033(a)(1). There is an exception for churches, their integrated auxiliaries, and conventions or associations of churches in IRC Section 6033(a)(3)(A)(i). As a result, these organizations may not provide the IRS with any financial details about their operations unless they are subject to the UBIT. IRC Section 6104(d)(1)(A)(ii) provides that annual returns that relate to the unrelated business income tax are available for public inspection. Unlike many other tax-exempt organizations, under IRC Section 6043(b)(1), churches, their integrated auxiliaries, and conventions or associations of churches also are not required to file an information return when they liquidate, dissolve, terminate, or experience a substantial contraction (i.e., experience a significant disposition of assets).

## Church Audits Under IRC Section 7611

As part of the Tax Reform Act of 1984 (P.L. 98-369) Congress enacted special procedural rules under IRC Section 7611 that govern the audits of churches, organizations claiming to be churches, and conventions or associations of churches. The statute provides churches with procedural safeguards in "church tax inquiries" and "church tax examinations." The statute does not extend these safeguards to (1) criminal investigations; (2) any inquiry or examination of any person connected with a church, such as a contributor or minister; (3) certain assessments under IRC Sections 6851, 6852, or 6861; (4) any case involving a willful attempt to defeat or evade taxes imposed by the IRC; or (5) any case involving a knowing failure to file a return for a tax imposed by the IRC. Treasury Regulation Section 301.7611-1, Q&A 4, states that routine requests for information, such as questions about filing a return, compliance with tax withholding responsibilities, and supplemental information necessary to complete mechanical processing of a return, also are outside IRC Section 7611's scope.

IRC Section 7611 requires the IRS to provide a written notice to churches, organizations claiming to be churches, and conventions or associations of churches before beginning a church tax inquiry. A church tax inquiry is an initial inquest that serves as a basis for determining whether (1) an organization is a church exempt from tax under IRC Section 501(a), (2) is carrying on an unrelated trade or business (within the meaning of IRC Section 513), or (3) is engaged in activities subject to tax. The IRS may only start a church tax inquiry if an "appropriate high-level Treasury official" reasonably believes, based on facts and circumstances recorded in writing, that the organization may not qualify for tax exemption as a church or may not be paying tax on an unrelated trade or business or another taxable activity. IRC Section 7611(h)(7) defines an "appropriate high-level Treasury official" as the Secretary of the Treasury or any delegate of the Secretary whose rank is a Regional Commissioner or higher. The IRS Restructuring and Reform Act of 1998 (P.L. 105-206) eliminated the Office of Regional Commissioner, replacing the four-region structure with a taxpayer-type structure. In

*United States v. Bible Study Time, Inc.*, 295 F. Supp. 3d 606 (D.S.C. 2018), a district court held that the Tax Exempt and Government Entities (TE/GE) Division Commissioner holds a rank comparable to the former Regional Commissioner position and the TE/GE Division Commissioner's responsibilities "serve the purpose intended by Section 7611(h)(7)'s definition of appropriate high-level official."

If the IRS's concerns are not resolved in a church tax inquiry, the IRS may begin a church tax examination of "church records" and religious activities. IRC Section 7611 requires the IRS to provide written notice to churches, organizations claiming to be churches, and conventions or associations of churches before beginning a church tax examination. After receiving notice, but before the examination begins, an organization may request a conference with the IRS to discuss the IRS's concerns.

Every person (e.g., organization) liable for any tax under the IRC is subject to broad recordkeeping requirements prescribed by the Secretary of the Treasury, or her delegate, under IRC Section 6001. When a person does not voluntarily produce records requested by the IRS, the IRS can obtain these records by issuing an administrative summons in accordance with IRC Section 7602 and may seek judicial enforcement of the summons if the person summoned remains noncompliant. IRC Section 7611 specifically restricts the IRS's ability to examine church records and religious activities in church tax examinations. IRC Section 7611(h)(4) defines church records as "all corporate and financial records regularly kept by a church, including corporate minute books and lists of members and contributors," except for church corporate and financial records that are acquired pursuant to a third-party summons under IRC Section 7609 or from any governmental agency.

IRC Section 7611's rules governing church tax examinations provide that the IRS may only review (1) church records "to the extent necessary" to determine liability for, and the amount of, any tax under the IRC and (2) religious activities "to the extent necessary" to determine whether an organization claiming to be a church is a church for any period. Courts that have been asked to enforce summonses for church records have construed the phrase "to the extent necessary" to require more than a showing of relevance. In *United States v. Church of Scientology of Boston, Inc.* 933 F.2d 1074 (1st Cir. 1991), the court explained that the IRS must show that the summoned materials are "'necessary' to the investigation"—i.e., "will significantly help to further the purpose of the investigation." In *United States v. C.E. Hobbs Foundation for Religious Training and Education, Inc.*, 7 F.3d 169 (9th Cir. 1993), the court held that, to show that the summoned documents were necessary under IRC Section 7611,

> the IRS must (1) show that the purposes of its investigation are proper, and (2) explain how the particular documents, or categories of documents, (a) fall directly and logically within the proper scope of those purposes and (b) will help significantly to further an investigation within the scope of those purposes.

Church tax inquiries or church tax examinations must be completed no later than two years after the church tax examination notice date, subject to specific suspension provisions. If a completed church tax inquiry or church tax examination does not result in revocation, a notice of deficiency or assessment (as described in IRC Section 7611(d)(1)), or a request for a significant change in church operations (including the adequacy of accounting practices), then the IRS generally cannot start another church tax inquiry or church tax examination for five years.

## Church Plans

Typically, under IRC Section 414(e), a church plan is a plan established and maintained by a church, or by a convention or association of churches, to provide retirement, health, or welfare benefits for its employees, which is exempt from tax under IRC Section 501(a). Absent an election to be covered by stricter standards, a church plan ordinarily does not have to meet many of the requirements in the IRC or the Employee Retirement Income Security Act of 1974 (ERISA) that are imposed on tax-qualified retirement plans and ERISA employee welfare benefit plans. These IRC and ERISA requirements generally aim to ensure plan solvency and protect plan participants. For example, a nonelecting retirement church plan generally does not have to meet the minimum participation and coverage requirements in IRC Section 410, the minimum vesting requirements in IRC Section 411, and the requirements in Title I of ERISA governing reporting, disclosure, and fiduciary responsibility. If the nonelecting retirement church plan is a pension plan, it is also exempt from the funding rules in IRC Section 412 and it is not covered by the Pension Benefit Guarantee Corporation. However, nonelecting retirement church plans are still subject to the IRC participation, vesting, and funding standards in effect on September 1, 1974.

## Considerations for Congress

When drafting legislation providing church tax preferences, Congress has to account for organizations that seek church status primarily as a tax-avoidance device or to hide other prohibited activity. Congress also has to balance protecting the rights of legitimate churches with providing government agencies with sufficient means to eliminate tax-avoidance schemes and ensure the tax system's integrity. Congress also might consider drafting church tax preference legislation to avoid certain First Amendment Establishment Clause challenges. In *American Atheists, Inc. v. Shulman*, 21 F. Supp. 3d 856 (E.D. Ky. 2014), the plaintiffs sued to enjoin the IRS from enforcing church tax preferences. The plaintiffs argued that church tax preferences improperly advanced religion in violation of the Establishment Clause and that the IRS did not present "any specific facts or legislative intent" showing that the preferences were necessary to protect churches' rights under the First Amendment's Free Exercise Clause. Ultimately, the district court did not reach the merits of the plaintiffs' Establishment Clause claim. The court dismissed the plaintiffs' suit for lack of standing because their injuries were merely speculative and the organizations never sought tax-exempt status as religious organizations or churches.

**Milan N. Ball**, Legislative Attorney

**IF12509**

## Disclaimer