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LET MY ARM BE BROKEN OFF AT THE ELBOW

CHAD J. POMEROY*

*When someone steals another's clothes, we call them a thief. Should we not give the same name to one who could clothe the naked and does not? The bread in your cupboard belongs to the hungry; the coat unused in your closet belongs to the one who needs it; the shoes rotting in your closet belong to the one who has no shoes; the money which you hoard up belongs to the poor.*¹

Introduction

The largest producer of nuts in the United States.² A multi-billion dollar insurance and financial services company.³ The fourteenth largest radio chain in the country.⁴ “A catering company, a major television channel, an

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1. Basil the Great, quoted in *Ask a Franciscan: Disposing of Excess Goods*, FRANCISCAN MEDIA, <https://www.franciscanmedia.org/ask-a-franciscan-disposing-of-excess-goods/> (last visited Oct. 11, 2018).

2. David Van Biema, *Kingdom Come*, TIME, Aug. 4, 1997, at 50.

3. See BENEFICIAL LIFE INS. CO., <http://www.beneficialfinancialgroup.com> (last visited Feb. 9, 2018). The Church of Jesus Christ of Latter-day Saints (“LDS Church”) owns Beneficial Life Insurance Company, which had assets of approximately \$3.3 billion in 2010, “according to the State of Utah Insurance Department.” *The Mormon Global Business Empire*, BLOOMBERG (July 12, 2012, 1:25 PM CDT), <https://www.bloomberg.com/news/photo-essays/2012-07-12/the-mormon-global-business-empire>. Additionally, Ensign Peak Advisors is an investment fund of the church, with managers “specializ[ing] in international equities, cash management, fixed income, quantitative investment, and emerging markets.” *Id.* “One of Ensign Peak’s vice presidents” told a local Utah newspaper, in 2006, that “billions of dollars change hands every day.” *Id.*

4. See Biema, *supra* note 2. The church’s holding company, Deseret Management, owns numerous media properties, including “a TV station, 11 radio stations, a publishing and distribution company,” and a successful book publishing business (which routinely enters into financial contracts with the church’s leaders). *The Mormon Global Business Empire*, *supra* note 3. The size of this radio conglomerate is likely different now, as the church sold a number of its radio stations for \$505 million in 2011 in order “to focus more on Internet ventures.” Caroline Winter, *How the Mormons Make Money*, BLOOMBERG (July 18, 2012, 8:45 PM CDT), <https://www.bloomberg.com/news/articles/2012-07-18/how-the-mormons-make-money> [hereinafter Winter, *How the Mormons Make Money*]. It is not possible to know whether this is accurate, however, as churches are not generally required to release financial information. See *infra* Part I for a discussion of charitable disclosures and the lack of mandatory church disclosure. Given this widespread lack of information, I will cite to what authority I can regarding the financial details of the various church entities

internet marketing company.”⁵ And real estate! Enormous real estate holdings in Hawaii,⁶ Montana,⁷ Nebraska,⁸ Oklahoma,⁹ Texas,¹⁰ Washington,¹¹ and Wyoming.¹² Probably more land in both Utah and Florida than any other private actor.¹³ Internationally, there are major

discussed herein. However, by way of a standing admission, I freely acknowledge that many of these numbers are uncertain.

5. Brandon Young, *Follow the Profit: A Guide to the LDS Church's For-Profit Companies*, LDS DAILY (May 4, 2016), <http://www.ldsdaily.com/church-lds/follow-profit-guide-lds-churchs-profit-companies>.

6. See Duane Shimogawa, *Mormon Church's Company Buys Property*, PAC. BUS. NEWS (Oct. 19, 2016, 12:23 PM), <https://www.bizjournals.com/pacific/news/2016/10/19/mormon-churchs-company-buys-property.html> (indicating ownership of tens of thousands of acres and other property worth tens of millions of dollars). On one of its tracts in Oahu, the LDS Church runs the “Polynesian Cultural Center . . . [which] features daily luaus, (except on Sunday), an ‘Island Buffet,’ seven simulated Polynesian villages, Samoan tree-climbing lessons, and Tahitian spear-throwing lessons.” *The Mormon Global Business Empire*, *supra* note 3. Tickets cost between \$35 and \$230. *Id.* In addition to these land interests and its amusement park, one of the LDS Church’s “for-profit arms, Hawaii Reserves, even runs a water management company, sewage treatment works, and two cemeteries,” as well. *Id.*

7. See Young, *supra* note 5 (indicating ownership of over 50,000 acres).

8. See Associated Press, *LDS Church Buys 88,000 Acres in Nebraska*, DESERET NEWS (Salt Lake City) (Oct. 7, 2004, 10:13 AM), <https://www.deseretnews.com/article/595096557/LDS-Church-buys-88000-acres-in-Nebraska.html>.

9. See Young, *supra* note 5 (indicating ownership of 50,000 to 70,000 acres).

10. See *Commercial Farms*, MONEYINZION (June 18, 2014), <http://www.moneyinzion.wordpress.com/2014/06/18/commerical-farms/> (indicating ownership of approximately 120,000 acres).

11. See Young, *supra* note 5 (indicating ownership of approximately 85,000 acres).

12. See *Commercial Farms*, *supra* note 10 (indicating ownership of approximately 68,000 acres).

13. See *Statistics of the LDS by Temples of the Church of Jesus Christ of Latter-Day Saints*, LDS CHURCH TEMPLES, <https://ldschurchtemples.org/statistics/units/united-states/utah/> (last visited Feb. 9, 2018) (indicating that there are 4791 wards and eighteen temples in Utah). A ward is a geographically limited congregation. Lee Davidson, *In Utah, Mormon Chapels Are Here, There and Everywhere*, SALT LAKE TRIB. (Sept. 30, 2014, 9:26 AM), <http://archive.sltrib.com/article.php?id=58325676&itype=CMSID>. While not every ward has a building, there are thousands of separate buildings within the state of Utah. See, e.g., *id.* (indicating that there are at least 1210 ward buildings in the three largest counties in Utah). This is in addition to the campus of Brigham Young University, a large missionary training center, numerous storehouses, and an unknowable number of other buildings (including a \$2 billion megamall developed by the LDS Church and completed in March 2012, which features a retractable glass roof and includes almost 100 stores and restaurants, office towers, and hundreds of luxury apartments and condominiums). See, e.g., Young, *supra* note 5; *The Mormon Global Business Empire*, *supra* note 3; Tony Semerad, *City*

investments in Argentina, Australia, Brazil, Canada, and Mexico,¹⁴ and about as much land in Britain as the Crown Estate.¹⁵

Take these assets, add billions in stocks and bonds and other securities, and include another \$6-\$8 billion per year of donated funds.¹⁶ To most of us, such a collection of assets and income probably seems appropriate for a large, public corporation.

However, as the preceding footnotes make clear, the entity described is not a titan of industry but is instead a church. And that is the starting point for this Article: though the American legal system is deferential toward

Creek Center: A Mall Built to Last and to Lead, but Will It?, SALT LAKE TRIB. (May 11, 2015, 12:50 PM), <http://archive.sltrib.com/article.php?id=2488265&itype=CMSID>; Caroline Winter et al., *The Money Behind the Mormon Message*, THE SALT LAKE TRIB. (Oct. 5, 2012, 12:18 PM), <http://archive.sltrib.com/article.php?id=54478720&itype=CMSID> [hereinafter Winter et al., *Money Behind the Mormon Message*]; Young, *supra* note 5. Targeting Florida, the LDS Church purchased about 295,000 acres of land in Brevard, Orange, and Osceola counties in 1950 and kept on buying. Amy Martinez, *The Mormon Church – Land Lord*, FLA. TREND (Dec. 26, 2014), <http://www.floridatrend.com/article/17957/the-mormon-church--land-lord>. In March 2014, it purchased another 383,000 acres for \$562,000,000. *Id.* On its 290,000 acre Deseret Ranch, the LDS Church “keeps 44,000 cows and 1,300 bulls”; it maintains “1,700 acres of citrus trees”; and it operates “timber, sod, and fossilized-seashell businesses.” *The Mormon Global Business Empire*, *supra* note 3.

14. See Claire Provost, *From Book to Boom: How the Mormons Plan a City for 500,000 in Florida*, GUARDIAN (Jan. 30, 2017, 2:59 EST), <https://www.theguardian.com/cities/2017/jan/30/from-book-to-boom-how-the-mormons-plan-a-city-for-500000-in-florida>; Winter, *How the Mormons Make Money*, *supra* note 4; Young, *supra* note 5 (indicating ownership of approximately 100,000 acres in Alberta).

15. See Catherine Pepinster, *Mormons Pay £30m for Prime British Farmland*, INDEPENDENT (July 15, 2001), <http://www.independent.co.uk/news/uk/this-britain/mormons-pay-30m-for-prime-british-farmland-9215914.html>.

16. Peter Henderson, *Insight: Mormon Church Made Wealthy by Donations*, REUTERS: SPECIAL REPORTS (Aug. 12, 2012, 6:03 AM), <https://www.reuters.com/article/us-usa-politics-mormons/insight-mormon-church-made-wealthy-by-donations-idUSBRE87B05W0812>; Winter, *How the Mormons Make Money*, *supra* note 4. This is in addition to the income from the aforementioned assets. For the basis of these estimates, see Provost, *supra* note 14 (discussing numbers provided by Ryan Cragun, associate professor of sociology at the University of Tampa, who estimated real estate assets in excess of \$35,000,000,000 and tithing income of as much as \$7,000,000,000 per year). Similarly, in 1997, *Time* estimated the total value at \$30 billion and annual tithing at \$5 billion. See Winter, *How the Mormons Make Money*, *supra* note 4. More recently, Reuters and Professor Cragun estimated a net worth of \$40 billion and tithing of \$8 billion. See *id.* (quoting Keith McMullin—the Chief Executive Officer of Deseret Management Corporation (“DMC”), one of the LDS Church’s affiliated entities—as indicating that DMC had annual revenue of approximately \$1.2 billion, though noting that McMullin later retracted that claim through an LDS spokesman, without clarification).

religion and churches, it is undeniable that the Church of Latter-day Saints—and other like organizations—are not just churches. They are, instead, important participants in the market economy, some of them global *business* enterprises of major proportions.¹⁷ This twinning of profit and spirit is seamless for many religions, with numerous modern churches preaching a “prosperity gospel” that promises spiritual and temporal blessings in return for donations.¹⁸ Still other churches—such as the Church of Scientology—directly charge for religious services that are “necessary” for spiritual improvement and advancement in the church hierarchy.¹⁹ And still others accumulate their own reserves of property and wealth.²⁰ This

17. The number of entities and subsidiary organizations owned or controlled by the LDS Church is not publicly available information; the organization owns its property and businesses through an undisclosed network of subsidiaries, trusts, and foreign entities. *See* Provost, *supra* note 14. It is difficult to determine which of these are “for-profit” and which are “non-profit” and to know if the label even matters, given that some of the nonprofit entities appear to generate significant profits. *See* Winter et al., *Money Behind the Mormon Message*, *supra* note 13 (discussing the Polynesian Cultural Center, which had to begin “paying commercial property taxes in 1992 when the Land and Tax Appeal Court of Hawaii ruled that the” center was not actually charitable in nature). Whatever the ultimate number of entities or sub-entities—and whether they are designated as profit or non-profit and however they are owned or tied to the set of entities that constitute the LDS Church—this Article will refer to the integrated body of church entities as a whole. This whole is overseen by an individual called a “Prophet” who is the most senior “Apostle,” designated by his length of service. *See* Winter, *How the Mormons Make Money*, *supra* note 4. There are twelve Apostles, in addition to the prophet, and this group collectively oversees a professional class of church leaders consisting of hundreds of “General Authorities” employed to run the religious and non-religious activities of the church, often through the hiring and supervision of business managers, lawyers, accountants, and other professionals. *See id.* In total, the organization employs thousands (or perhaps tens of thousands) of employees. *See id.* (quoting the CEO of DMC indicating that just that one entity has “2,000 to 3,000 employees”).

18. *See* Lidiya Mishchenko, *In Defense of Churches: Can the IRS Limit Tax Abuse by “Church” Impostors?*, 84 GEO. WASH. L. REV. 1361, 1363 (2016) (“Under the prosperity gospel, church membership may actually be conditioned on provision of regular donations, or ‘tithes,’ and if a congregant is struggling in their life, they may be told that God is punishing them and they need to donate even more money to the church.”).

19. *Id.* The last reported income of the Church of Scientology was approximately \$300 million per year, and the average megachurch in 2008 generated annual income of over \$6.5 million. *Id.* at 364.

20. *See, e.g.,* *Earthly Concerns*, ECONOMIST (Aug. 18, 2012), <http://www.economist.com/node/21560536> (indicating that Timothy Dolan, owner of a corporation sole in his position of Cardinal-Archbishop of New York, is believed to be the largest landowner in Manhattan).

asset assemblage leads, ineluctably, to enormous income and wealth concentrated in the hands of religious organizations across America.

While there is nothing inherently wrong with religious organizations amassing wealth, it is troubling that they do so while enjoying informational and tax advantages not afforded to other entities. However, these benefits are not “tax advantages”; these are “tax advantages that are expressly made unavailable to other, competing, profit-seeking entities that suffer greatly due to their comparative disadvantage.” Indeed, this Article’s foundational claim is these advantages are so significant that they have come to shape the aims and actions of many religions, effectively bending the nature of many organizations away from traditionally religious and charitable work and toward profit-seeking.²¹ This state is both unintended and inequitable. As such, these advantages should be eliminated.

Before describing any recommended changes to these tax benefits, it is critical to first understand how the American tax system treats churches. As explained in Part I, our legal and tax system is laced with a series of benefits and exemptions that favor churches over virtually every other kind of entity. These benefits permit churches to bring in funds under the auspices of a non-profit entity and then direct those funds to for-profit endeavors.²² Indeed, not only are churches permitted to do this, they are

21. This is a systemic issue potentially affecting all churches, and I provide numerous examples throughout this Article. The LDS Church is referenced a number of times not because it is unique but because it appears to be a particularly apt example of the broader issues discussed herein.

22. In particular, there is nothing preventing a church from taking its “tithes” and “investing” them in for-profit businesses (wholly owned or otherwise). The effects and associated advantages of having both for-profit and non-profit channels of revenue are discussed at length. *See infra* Section II.B. To be fair, churches will likely counter that such an argument is misplaced, claiming that there is no mixing of profit and non-profit funds. *See Winter, How the Mormons Make Money, supra* note 4 (quoting McMullin that “not one penny of tithing” flows through to the LDS church’s for-profit entities or endeavors). Though this kind of response has some visceral appeal, it can be rather easily disposed of because of the fungible nature of money. A centrally run entity can attempt to silo profit and non-profit activities, but all activities (whatever their nature) ultimately accrue to the benefit of the whole when that whole is owned by the same entity. Indeed, it is simply not functionally possible to separate funds in this manner, especially in the context of a related series of associations that ultimately belong to a single, centrally managed entity. In such a situation, the ultimate level of ownership controls every entity, all of which are legally and technically permitted to transfer funds from one entity to another. A business can segregate its subsidiaries and sources of income, on paper, for a variety of business or legal reasons, but the benefits flowing to any one part (i.e., via tax-free funding or an exemption from property tax or from any other source) necessarily helps every other related part by freeing resources and ensuring financial flexibility and strength throughout the entire entity. In other

incentivized to do so. Because these organizations are uniquely permitted to build up networks of interlocking entities of non-profit and for-profit subsidiaries and freely funnel funds from one to the other, churches are effectively permitted to own profit-seeking entities that have an intrinsically lower cost of capital than their competitors. This system ensures that church-affiliated companies will always enjoy a superior market position.²³ In the face of such economic opportunity, how could any entity not do what these churches have done? It is difficult to blame churches for taking advantage of a U.S. system of religious tax exemption that effectively guarantees them preferential returns on church-sourced funds when those funds are directed to profit-seeking instead of charity.²⁴

Blameworthy or not, this tax structure is problematic. Such a market-oriented incentive discourages churches from expending funds in pursuit of charitable goals. The American economy is a capitalistic one, rewarding capital, among other things. Permitting churches, with their lower cost of capital, to access markets that reward capital means that every dollar devoted to the needy is not being devoted to its highest and best use—from an internal rate-of-return perspective. That, of course, will lead to “under-

words, because money is fungible and decision-making is integrated, the entities unavoidably act as an effectively incorporated unit, supporting each other and affecting the market economy in a perceivably unitary fashion. An excellent, if eccentric, example is the way that the LDS Church asks its members to serve unpaid missions and then assigns them to work at revenue-generating enterprises. See Winter, *How the Mormons Make Money*, *supra* note 4. It is clear, in such a situation, that people are donating to an entity that is using those ostensibly charitable donations to generate revenue and/or profit for other related entities. To claim, in such a situation, that religious tithes or offerings are not going toward revenue generation or profit-seeking is untenable. Some church officials have expressly acknowledged the economic truth of this in less guarded moments. See, e.g., *id.* (quoting McMullin as indicating that funds do, from time to time, flow throughout the LDS Church’s family of entities to help stanch losses in one or another part of the organization).

23. Or perhaps that they will be able to dominate markets with extremely low profit margins (such as is increasingly the case with traditional print media).

24. It is worth emphasizing a few important disclaimers at this point. First, I do not claim that all churches skew away from charity and toward profit-seeking. There are many churches that do not, likely for a whole host of cultural, social, geographic, and other reasons that are outside the scope of this Article. Second, even as to those churches that have clearly invested more resources in profit-seeking than in traditionally charitable activity, the arguments and conclusions contained herein do not necessarily indicate that these entities are behaving “badly.” In fact, by explicating non-charitable activity in terms of the incentives embodied in the Internal Revenue Code (the “IRC”), I am stripping such behavior of moral weight. I am not arguing that any given church is immoral—I am arguing that many churches are *amoral*, rationally pursuing the economic advantages built into our tax system without regard to any underlying spiritual or moral code.

spending” on charity, which is deleterious to the public policy underlying the relevant sections of the Internal Revenue Code.

The United States was clear in its reasoning when it made the decision that churches should enjoy special tax status: the government explicitly decided to forego the substantial tax revenues associated with funds raised and expended by churches because it believed that these entities—of all entities—would use those funds to do the “good works” that would otherwise be the responsibility of government.²⁵ Taxing a church on funds that it could use to set up an orphanage makes no sense, for example, if such taxation would force the church to abandon its plans for the orphanage and leave the government to ultimately clean up the remains itself. Indeed, the U.S. government—through Congress, the judiciary, and the IRS—has been extraordinarily generous in its treatment of churches in connection with tax law, both in terms of how it has interpreted and applied tax laws and rules to churches and in terms of how much tax money the government has foregone. But that attempt to generate private party charity is defeated, at great expense to the American taxpayer, when churches invest instead of help.

Even more troubling than the undercutting of U.S. tax policy is when churches use their tax-exempt funds to engage in massive business operations instead of directing funds toward charity. This does actual damage to the broader market economy. As discussed in Part II below, when non-taxed organizations compete against ordinary business entities in the market, they operate under different economic constraints and disrupt the normal functioning of capital supply and demand, fundamentally distorting the market place. By tapping into untaxed capital, these non-taxed businesses put downward pressure on the rates of return that would otherwise be available in an equally constructed market place, which burdens other economic actors. Accordingly, it is not simply that charitable entities undermine the intent of the IRC when they engage in profit-seeking activities—it is that by doing so, they distort the economy and introduce inherent market inefficiencies.

Part III makes recommendations intended to resolve this problem as it manifests itself in the context of churches. These suggestions largely revolve around increased transparency and the potential imposition of a tax on funds that are not spent on charitable endeavors. Laying bare the finances of these organizations will enable all stakeholders in charitable

25. See *infra* Section I.A. for a more nuanced discussion of the policy behind providing so many tax subsidies and advantages to churches.

giving—including, importantly, U.S. taxpayers—to see how their investments are being spent. Furthermore, taxing non-charitable funds would ensure that our tax system functions the way it is intended—without favor or distortion.

I. Widows & Orphans

The United States government has decided that certain entities should enjoy favorable tax status.²⁶ This encompasses a variety of entities, including churches and religious organizations.²⁷ The economic calculus behind this political decision is intuitive: if an organization is going to dedicate itself and its funds to fulfilling public needs that would otherwise have to be served by the government itself, then the government should not tax the resources that are going to fill those needs.²⁸ Often, however, charitable activity is not what is happening. The policy of tax exemption for churches costs the U.S. taxpayer billions and billions of dollars every year and is accomplishing significantly less than intended because it is, in fact, being subverted by groups that direct those tax-free funds to for-profit enterprises instead of charitable ends.²⁹

A. The Big Idea and the Law

Tax exemption for favored entities is not a novel idea. It predates the formation of the republic itself; early settlers formed all sorts of “charitable and other ‘voluntary’ associations.”³⁰ That fervor continues to this day,

26. See I.R.C. § 501(c) (2012); Mishchenko, *supra* note 18.

27. See Mishchenko, *supra* note 18.

28. See *id.* at 1371.

29. See *id.* at 1364 (“All of America is subsidizing these jets and mansions.”).

30. Paul Arnsberger et al., *A History of the Tax-Exempt Sector: An SOI Perspective*, SOI BULLETIN (IRS), Winter 2008, at 105, <https://www.irs.gov/pub/irs-soi/tehistory.pdf>. Alexis de Tocqueville had a penchant for this, noting in 1831 that

Americans of all ages, all conditions, and all dispositions, constantly form associations. They have not, only commercial and manufacturing companies, in which all take part, but associations of a thousand other kinds, -- religious, moral, serious, futile . . . I have often admired the extreme skill with which the inhabitants of the United States succeed in proposing a common object to the exertions of a great many men, and in inducing them voluntarily to pursue it.

2 ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 130-31 (Henry Reeve Trans., Sever & Francis 1863); see also Donald L. Sharpe, *Unfair Business Competition and the Tax on Income Destined for Charity: Forty-Six Years Later*, 3 FLA. TAX REV. 367, 369 (1996) (“From the very beginning, tax law in the United States has recognized the unique role played by private, nonprofit charitable organizations by affording them exemption from tax.”).

reflected throughout our country's various iterations of income tax rules and regulations, all of which contain provisions favorable to "non-profits" or "charities."³¹ The focus of this Article is the suite of benefits conferred upon churches, but it is helpful to start with the broader concept of taxation of charities and non-profits.³²

The structure of tax exemption granted to charities and voluntary organizations revolves around numerous different provisions of the IRC and has evolved through legislation enacted between 1894 and 1969 and various judicial decisions interpreting that legislation.³³ Over that period, the government built the basic outlines of charitable taxation, identified tax-exempt entities, set forth certain activities of exempt organizations that would be subject to taxation, and created categories of tax-exempt organizations.³⁴

Though much has changed over time, the basic contours of tax exemption have stayed the same and are today largely encompassed within I.R.C. § 501, particularly subsection (c)(3), which governs charities.³⁵ Broadly speaking, any organization that falls within this subsection will not have to pay income tax and can also receive tax-deductible donations.³⁶

31. See *infra* Section I.B.

32. See I.R.C. § 501(c)(3) (2012) (exempting religious, educational, charitable, scientific, or literary organizations; organizations that test for public safety; organizations that prevent cruelty to children or animals; and organizations that foster national or international amateur sports competition).

33. See Arnsberger et al., *supra* note 30, at 106. See generally Harvey P. Dale & Roger Colinvaux, *The Charitable Contributions Deduction: Federal Tax Rules*, 68 TAX LAW. 331 (2015) (reviewing in detail the "main federal income tax rules affecting charitable contributions").

34. See Arnsberger et al., *supra* note 30, at 106–09 (tracing the evolution of the relevant federal income tax law from the Wilson-Gorman Tariff Act of 1894 to the Pension Protection Act of 2006).

35. See I.R.C. § 501(c)(3). Private foundations are also included within § 501(c)(3). Many other kinds of entities are exempted from taxation under other subsections of § 501. See, e.g., *id.* §§ 501(a), (c) (listing many different kinds of exempt organizations, including, for example, corporations organized by an Act of Congress, social welfare organizations, domestic fraternal beneficiary societies, and supplemental unemployment benefit trusts); see also David S. Miller, *Reforming the Taxation of Exempt Organizations and Their Patrons*, 67 TAX LAW. 451, 454 (2014) ("[T]here are more than 29 different types of tax-exempt entities in section 501(c) alone and by some counts more than 70 in all."). The arguments set forth in this Article are uniquely addressed to charities, which are governed by § 501(c)(3), and churches particularly, for reasons discussed below.

36. Such entities are also theoretically prohibited from using their tax-exempted income to benefit individuals associated with the organization. See Arnsberger et al., *supra* note 30, at 106. Two additional, important nuances were introduced into this statutory regime in 1950

These are the two primary tax benefits of qualifying under § 501(c)(3) and are, of course, valuable. Being exempt from income tax is easily appreciated and of enormous importance, but the other benefit is also significant.³⁷ The policy behind permitting tax-deductible donations is to subsidize (and thereby stimulate) charitable giving, but the wider implications of being able to raise funds tax-free are rarely considered or understood, as this Article argues.³⁸

For the moment, it suffices to point out these advantages specifically in the context of churches. They often pay little or no property tax, they receive sales tax exemptions, they benefit from a related business income tax subsidy, and their employees' compensation is often exempted from tax under the parsonage exemption.³⁹

and 1969, respectively. "Before the 1950s, tax-exempt organizations could earn tax-free income from both mission-related activities and commercial business activities that were unrelated to the purpose for which they were exempt" *Id.* at 107. Motivated by a concern that this afforded these entities an "unfair competitive advantage over taxable entities," however, "Congress established the 'unrelated business income tax' (UBIT)" in 1950, which imposed a tax on unrelated business income (i.e., income that is not "substantially related" to the organization's exempt purpose"). Arnsberger et al., *supra* note 30, at 107; *see also* Jennifer Anne Spiegel, *Sierra Club: Rationalizing the Royalty Exception to the Unrelated Business Income Tax*, 63 *FORDHAM L. REV.* 1697, 1720–33 (1995) (noting the original basis for UBIT legislation as a desire to prevent unfair competition, though also noting the evolving nature of how courts and scholars view and apply the relevant law). Then, in the Tax Reform Act of 1969, Congress introduced legislation intended to bring "private foundations" to heel. *See* Arnsberger et al., *supra* note 30, at 107; *The Role of Foundations Today and the Effect of the Tax Reform Act of 1969 upon Foundations: Hearing Before the Comm. On Fin., Testimony Presented to the Subcommittee on Foundations*, 93d Cong. (Comm. Print 1978). Private foundations are "defined in the negative, as a charity that cannot qualify as a public charity." Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 *FLA. TAX. REV.* 1, 54 (2011). Broadly speaking, the idea is that charities that are overseen by a donor or service-based community that is public in nature will be effectively policed thereby. *See id.* "By the 1960s, there was a growing perception among lawmakers that private foundations, [in contrast to public charities,] with their small networks of financiers and administrators were less accountable to the public than traditional charities." Arnsberger et al., *supra* note 30, at 107. As such, Congress introduced rules taxing certain investment income and requiring minimum distributions. *Id.* at 108. Though the specifics of UBIT and of private foundation governance and taxation are outside the scope of this Article, these concepts, as broadly interpreted, bear upon the thesis discussed herein. *See infra* Section II.B, Part III.

37. *See* I.R.C. §§ 170(a)(1), 501 (2012). The untaxed source of capital is made possible because donations to charities are deductible by the donor.

38. *See infra* Part II.

39. *See* Miller, *supra* note 35, at 492 (describing "the full array of tax subsidies: (1) a charitable deduction for donors, (2) donor deductions for gifts of long-term capital gain

Why does America voluntarily forego tens of billions of dollars every year in tax revenue, and why has it historically been so open and solicitous of these kinds of organizations?⁴⁰ This kind of examination is easiest to undertake in the context of churches because these charities have one of the longest histories of special treatment, and because they appear to have enjoyed tax benefits in almost every culture and every time period.⁴¹

property, (3) absence of tax on donor's built-in gain appreciated capital assets . . . , (4) absence of tax on the organization on donations, (5) absence of gift tax on the donor, and (6) freedom from tax on the organization's non-UBTI [unrelated business taxable income]; see also *Unrelated Business Income Tax: Hearings Before the Subcomm. On Oversight of the House Comm. On Ways and Means*, 100th Cong., 98–99 (1987) (statement of Frank S. Swain, Chief Counsel for Advocacy, U.S. Small Business Administration, complaining that nonprofits enjoy numerous competitive advantages, including tax exemptions; subsidized mail rates; special treatment under social security, unemployment insurance, and minimum wage laws). *But see* MICHAEL S. ARIENS & ROBERT A DESTRO, *RELIGIOUS LIBERTY IN A PLURALISTIC SOCIETY* 767–89 (2d ed. 2002) (analyzing tax subsidy and tax expenditure metrics as applied to religious organizations). This Article focuses on churches (and the integrated auxiliaries that are lumped with them for tax purposes); finer distinctions between different kinds of religious organizations do not ultimately affect the underlying problems or proposed solutions discussed here. Not all of these advantages are federal in nature. For instance, each state is responsible for classifying religious entities and for deciding which of those categories qualify for property tax exemptions or discounts. Whatever the nature of that framework, however, the real and personal property owned by a “church” is often exempted from state and local property taxes. *See generally* Michael K. Ryan, Note, *A Requiem for Religiously Based Property*, 89 GEO. L.J. 2139 (2001). *See also, e.g.*, *Gaylor v. Mnuchin*, 278 F. Supp. 3d 1081, 1104 (W.D. Wis. 2017) (holding the parsonage exception violates of the establishment clause of the First Amendment); *City of Austin v. Univ. Christian Church*, 768 S.W.2d 718, 719 (Tex. 1988) (deciding whether a parking lot attached to the church is exempt).

40. *See* Ryan T. Cragun et al., *Research Report: How Secular Humanists (and Everyone Else) Subsidize Religion in the United States*, FREE INQUIRY, June/July 2012, at 39, 39, <http://users.clas.ufl.edu/kenwald/rpp/cragun.pdf> (estimating an annual tax subsidy to churches of over \$70 billion per year). This estimate is rough and likely overstates the value of tax deductions tied to church tithes, given that most tithe payers likely claim the standard deduction (instead of an itemized deduction) and given that many transfers to churches would likely qualify as untaxable gifts. *See* 4 RELIGIOUS ORGANIZATIONS AND THE LAW § 31:12, Westlaw (“Regardless of the religious imperative to pay a tithe, its contribution is typically tax deductible to the donor because there is no legal obligation to make a payment of tithing. As a gift, it is not included in the income of the recipient religious organization.”). That said, there is simply no way to track this information, and it is highly likely that churches in fact receive billions of dollars of value via the charitable deduction and billions of dollars of value via other tax advantages.

41. *See* John W. Whitehead, *Exemption and Churches: A Historical and Constitutional Analysis*, 22 CUMB. L. REV. 521, 522–45 (1991). Indeed, some scholars believe that “tax exemption of church property is probably as ancient as taxation itself.” LEO PFEFFER,

Analyzing the long-term pattern of the taxation of churches throughout history, governments have exempted charities because they generally believed that these organizations devoted their property to helping the public, broadly defined as activities that provide physical support to those in need.⁴² That is, “[t]he traditional explanation for why public charities have been removed from the tax rolls is that ‘they relieve the government from the burden of performing certain services or providing certain goods to the public.’”⁴³ Churches and other charities devote their resources to

CHURCH, STATE, AND FREEDOM 210 (rev. ed. 1967); *see also* Claude W. Stimson, *The Exemption of Property from Taxation in the United States*, 18 MINN. L. REV. 411, 416 (1934). “It has always been the case, clear back to the priests of Egypt and beyond them into the coulisses of prehistory. The priests and Levites were exempt from taxation . . . , but . . . [it] is merely . . . a long-existing custom.” DEAN M. KELLEY, *WHY CHURCHES SHOULD NOT PAY TAXES* 5 (1977); Erika King, *Tax Exemptions and the Establishment Clause*, 49 SYRACUSE L. REV. 971, 973-74 (1999); Whitehead, *supra*, at 524–28. Foreshadowing the animating thesis of this Article, this exemption has long been economically significant in the context of organized religion:

[T]he priests . . . turned [contributed wealth] into productive or investment capital, and became the greatest agriculturists, manufacturers and financiers of the nation. Not only did they hold vast tracts of land; they owned a great number of slaves, or controlled hundreds of laborers, who were hired out to other employers, or worked for the temples in their divers trades from the playing of music to the brewing of beer. The priests were also the greatest merchants and financiers of Babylonia; they sold the varied products of the temple shops, and handled a large proportion of the country's trade; they had a reputation for wise investment, and many persons entrusted their savings to them, confident of a modest but reliable return. They made loans on more lenient terms than the private money-lenders

I WILL DURANT, *THE STORY OF CIVILIZATION: OUR ORIENTAL HERITAGE* 233 (1954).

42. This is stereotypically thought of as helping orphans, the indigent, and the elderly. *See, e.g.*, Statute of Charitable Uses 1601, 43 Eliz., 1, c. 4 (Eng.), *repealed by* Mortmain and Charitable Uses Act 1888, 51 & 52 Vict., c. 42 (Eng.); *see* John Witte, Jr., *Tax Exemption of Church Property: Historical Anomaly or Valid Constitutional Practice?*, 64 S. CAL. L. REV. 363, 377 (1991). The record indicates that the Statute of Charitable Uses of 1601 centered on public benefit, specifically with curing poverty in mind. *See* John P. Persons et al., *Criteria for Exemption Under Section 501(c)(3)*, in 4 RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS 1909, 1913 (Dep’t of Treasury ed., 1977). *But see* *Comm’rs for Special Purposes of the Income Tax v. Pemsel*, [1891] AC 531 (HL) 559 (holding that “charitable” and “pious” were synonymous with “godly” in English law). This is also known as the “public benefit” theory. *See* ARIENS & DESTRO, *supra* note 39, at 739. And “[t]he requirement that a charitable use be dedicated to the benefit of the public is well established in both English and American law.” *Id.* at 751 (citing *Davis v. United States*, 495 U.S. 472 (1990)).

43. Samuel D. Brunson, *Reigning in Charities: Using an Intermediate Penalty to Enforce the Campaigning Prohibition*, 8 PITT. TAX REV. 125, 129 (2011) (quoting Robert

public needs, “eas[ing] a burden on government” so the government should not pressure, or tax, those resources.⁴⁴ Given the substantial history involved and the broad scope of this issue (taxation as applied to charitable constructs), there are many different factors—besides amelioration of governmental burden—that have contributed to this targeted exemption and subsidy.⁴⁵ Particularly as it relates to churches, many proponents have argued that religion generally benefits society by inducing love and benevolence,⁴⁶ promoting stability,⁴⁷ fostering tolerance,⁴⁸ teaching morality, and otherwise providing the cornerstone of a “civil society . . .

Paine, *The Tax Treatment of International Philanthropy and Public Policy*, 19 AKRON TAX J. 1, 12 (2004)); see also Miller, *supra* note 35, at 457 (“One leading rationale for the tax exemption for 501(c)(3)s is that the money earned and spent by exempt organizations provides a public service that saves the federal government funds it would otherwise spend.”) (citing STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., JCX-29-0605, HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS 28 (Comm. Print 2005); Sharpe, *supra* note 30, at 376 (“[T]he Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.”) (quoting H.R. REP. NO. 75-1860, at 19 (1938)). But see Mark A. Hall & John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L.J. 1379, 1381 (1991) (“Due primarily to the vast array of activities to which the exemption has been applied, it has defied all past attempts to formulate a synthesizing concept of charitable.”).

44. Robert Paine, *The Tax Treatment of International Philanthropy and Public Policy*, 19 AKRON TAX J. 1, 12 (2004); see also, e.g., Chauncey Belknap, *The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy*, in 4 RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, *supra* note 42, at 2025, 2033-34; BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* 8-18 (John Wiley & Sons, Inc., 7th ed. 1998)).

45. In particular, the non-taxation of religious entities and organizations is multifaceted. See, e.g., DURANT, *supra* note 41; King, *supra* note 41, at 973-76; ROUNDELL PALMER, EARL OF SELBORNE, *ANCIENT FACTS AND FICTION: CONCERNING CHURCHES AND TITHES* 194 (London, MacMillan & Co. 1892) (discussing the nuanced difference between decimation and special tithes); Whitehead, *supra* note 41, at 529-30; Geo Widengren, *The Status of the Jews in the Sasasian Empire*, 1 IRANICA ANTIQUA 117, 149-53 (1961).

46. *Trs. of the First Methodist Episcopal Church v. City of Atlanta*, 76 Ga. 181, 192-93 (1886), *rev'd on other grounds*, *City of Atlanta v. First Presbyterian Church*, 13 S.E. 252 (Ga. 1891).

47. See PHILIP SCHAFF, *CHURCH AND STATE IN THE UNITED STATES* 75 (1888); Henry W. Foote, *The Taxation of Churches*, in 7 UNITARIAN REVIEW AND RELIGIOUS MAGAZINE 349, 469-71 (Boston, 1877) (bound volume of magazine issues).

48. See, e.g., *Warde v. City of Manchester*, 56 N.H. 508 (1876).

that could not endure” without such ideals.⁴⁹ Similarly, there has also been much give-and-take regarding the exemption itself, as charities have struggled with state entities over time, always seeking lower tax burdens with varying levels of success.⁵⁰

49. *First Methodist Episcopal Church*, 76 Ga. at 192–93, *rev'd on other grounds*, *First Presbyterian Church*, 13 S.E. 252; *see also* A.T. Bledsoe, *Taxation of Church Property*, SOUTHERN REV., July 1876, at 169, 174 (“It is upon this principle . . . that church property has heretofore been exempted from taxation, viz. *that the exemption was worth more to the State than the taxation*. Churches are not built for purposes of gain [T]he church is built for the benefit of the public”); SCHAFF, *supra* note 47, at 19–20; Foote, *supra* note 47, at 469–71. Justice Brennan nicely encapsulated both of these arguments in *Walz v. Tax Commission of New York*, when he wrote, about churches:

First, these organizations are exempted because they, among a range of other private, nonprofit organizations contribute to the well-being of the community in a variety of nonreligious ways, and thereby bear burdens that would otherwise either have to be met by general taxation, or be left undone, to the detriment of the community.

. . . .

Second, government grants exemptions to religious organizations because they uniquely contribute to the pluralism of American society by their religious activities. Government may properly include religious institutions among the variety of private, nonprofit groups that receive tax exemptions, for each group contributes to the diversity of association, viewpoint, and enterprise essential to a vigorous, pluralistic society.

397 U.S. 664, 687–89 (1970) (citing *Wash. Ethical Soc’y v. District of Columbia*, 249 F.2d 127, 129 (1957); *New York Constitutional Convention: Report of the Committee on Taxation* doc. no. 2, at 2 (1938)). And, to be fair, this broad-based view of the utility of religion is reflected within the relevant statutes and regulations. I.R.C. § 501(c)(3) includes “religious purposes” among its exempt endeavors, and *Treas. Reg. § 1.501(c)(3)-1(d)(1)(iv)* defines “charitable” as including, among other things, “advancement of religion.” Arguably, then, *anything* a church does is contemplated by the relevant tax provisions; any business or investment activity that redounds to a church’s benefit could be described as advancing the relevant religion or church. But that seems disingenuous and wholly at odds with the publicly accepted purpose of providing tax subsidies to churches, which purpose (as expounded by churches themselves) ties directly to the concept of direct charity. Part III, *infra*, expounds upon this discrepancy, arguing that churches are uniquely susceptible to a kind of mission creep that ultimately pushes their activities outside anything close to the core charitable purposes that most people associate with organized religion.

50. A variety of Christian kings, for instance, imposed heavy taxes on the Catholic Church over the years. *See* J.J. SCARISBRICK, *HENRY VIII*, at 241–304 (1970) (on the Henrician Reformation); *see also id.* at 536–42 (bibliography referencing secondary sources on the economic aspect of this reformation). Similarly, to finance their secular war in 1294, Philip IV and Edward I imposed a tax on the “property and personnel of the Church.” 4 WILL DURANT, *THE STORY OF CIVILIZATION: THE AGE OF FAITH* 812–13 (1950). Similarly, in England, Henry VIII—knowing that the Church had approximately three times the land and

Whatever the history and vagaries of secular-religious conflict, a defensible consensus emerges that the United States affords tax subsidies to churches and other charities because these entities *provide charitable services* that “would otherwise be imposed upon the public . . . by general taxation.”⁵¹ This is why the American taxpayer makes such a substantial, explicit investment in charity through its untold billions of dollars in tax

wealth as the Crown—renounced taxation and confiscated the majority of the Church’s property. ALFRED BALK, *THE FREE LIST: PROPERTY WITHOUT TAXES* 21 (Russell Sage Found. 1971).

51. *YMCA v. Douglas Cty.*, 83 N.W. 924, 926 (1900); *see also* *Bob Jones Univ. v. United States*, 461 U.S. 574, 588 (1983) (“Tax exemptions for certain institutions thought beneficial to the social order of the country as a whole, or to a particular community, are deeply rooted in our history, as in that of England.”); *Trinidad v. Sagrada Orden*, 263 U.S. 578, 581 (1924) (“Evidently the [charitable] exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when not conducted for private gain.”); *Murray v. Comptroller of Treasury*, 216 A.2d 897, 907-09 (Md. 1966) (citing a list of tax exemption arguments), *cert. denied*, 385 U.S. 816 (1966); *see also* H.R. REP. NO. 75-1860, at 19 (1938) (Revenue Act of 1938) (“[E]xemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds.”); Miranda Perry Fleischer, *Libertarianism and the Charitable Tax Subsidies*, 56 B.C. L. REV. 1345, 1351-52 (2015) (“According to this ‘economic subsidy theory,’ subsidizing charities helps them to provide public goods that would otherwise be under-produced.”); *id.* at 1349-51 (noting that §§ 170(c) and 501(c)(3) are “widely considered to be subsidies for favored social policies,” a concept known as “tax expenditure analysis”); Reka Potgieter Hoff, *The Financial Accountability of Churches for Federal Income Tax Purposes: Establishment or Free Exercise?*, 11 VA. TAX REV. 71 (1991); John Montague, *The Law and Financial Transparency in Churches: Reconsidering the Form 990 Exemption*, 35 CARDOZO L. REV. 203, 259 (2013) (“[B]ecause churches are subsidized by taxpayer money, the public . . . has a right to know what happens to it.”). That said, there is no explicit requirement that “a church or predominantly religious organization must relieve a burden of government in order to qualify as a charitable institution . . . since . . . government is not in the business of religion.” *Christian Reformed Church v. City of Grand Rapids*, 303 N.W.2d 913, 918 (Mich. Ct. App. 1981). And, as discussed above, there are other arguments regarding the exemption of churches—but a reason does not have to be exclusive to be significant. *See* Spiegel, *supra* note 36, at 1697 (“Tax exemption is a subsidy that society confers on certain nonprofit organizations.”); *see also, e.g., M’Culloch v. Maryland*, 17 U.S. 316, 347 (1819) (“A right to tax, is a right to destroy.”); ARIENS & DESTRO, *supra* note 38, at 720 (reviewing the constitutional ability of the State to tax churches); EDWARD A. ZELINSKY, *TAXING THE CHURCH* 113-56 (2017) (chapter 5, “Untangling Entanglement”) (arguing that taxation of churches risks undue entanglement sufficient to justify church exemption in a variety of settings).

subsidies, and this is the reasoning behind the structure that emerges in the IRC.⁵² Unfortunately, that structure permits misuse and opacity.

B. A System Built for Abuse

When it comes to churches, there is a critical lack of transparency and clarity built into the IRC, the regulations, and court decisions surrounding and implanting it. This results in a system that is effectively built for systemic abuse.

To begin, there is no comprehensive legal definition of “church.”⁵³ This permits a variety of organizations to benefit from exempt status while engaging in a wide array of activities divorced from anything like the charitable activities that supposedly justify the tax subsidies afforded to churches. The Supreme Court has spoken on this issue several times in different contexts, but it has never articulated a concrete, usable formula.⁵⁴ Instead, the Court has developed an evolved view of belief, starting with a focus on “the Creator” and eventually settling on “deeply and sincerely [held] beliefs.”⁵⁵ Ineluctably, this broad-based view of religion means that

52. See Treas. Reg. § 1.501(c)(3)-1(d)(2) (2017) (listing as charitable ends “[r]elief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government”).

53. See, e.g., Ann M. Murphy, *Campaign Signs and the Collection Plate – Never the Twain Shall Meet?*, 1 PITT. TAX REV. 35, 76 (2004).

54. See, e.g., *Texas Monthly, Inc. v. Bullock*, 489 U.S. 1 (1989); *Hernandez v. Comm’r*, 490 U.S. 680 (1989); *Jimmy Swaggart Ministries v. Bd. of Equalization of Cal.*, 493 U.S. 378 (1990).

55. *Welsh v. United States*, 398 U.S. 333, 340 (1970). The Court’s first attempt can be seen in *Reynolds v. United States*, where the majority candidly admitted that “the word ‘religion’ is not defined in the Constitution.” 98 U.S. 145, 162 (1878). Twelve years later, in *Davis v. Beason*, the Court asserted a theistic notion of religion as being inseparable from a Creator. 133 U.S. 333 (1890), *abrogated by Romer v. Evans*, 517 U.S. 620 (1996). The Court wrote that “[t]he term ‘religion’ has reference to one’s views of his relations to his Creator, and to the obligations they impose of reverence for his being and character, and of obedience to his will.” *Id.* at 342. That view held sway for a time, even though the Supreme Court made it clear that the theological implications of a given religion are not to be individually assessed. See *United States v. Ballard*, 322 U.S. 78, 87 (1944) (“The religious views espoused by respondents might seem incredible, if not preposterous, to most people. But if those doctrines are subject to trial before a jury charged with finding their truth or falsity, then the same can be done with the religious beliefs of any sect.”). Even that standard, however, proved too stringent, as the Court eventually moved to focus simply on one’s conscience. See *Welsh*, 398 U.S. at 340 (holding that “[i]f an individual deeply and sincerely holds beliefs that are purely ethical or moral in source and content, but that nevertheless impose upon him a duty of conscience . . . those beliefs certainly occupy in the

any organization can claim the status of a “church” in the overarching legal tradition of American law.

While there may be historical and cultural reasons for such an approach, the attitude has unavoidably extended to the IRC, to the cases interpreting and applying it, and to the special treatment afforded a “church” under I.R.C. § 501(c)(3).⁵⁶ There is no actual definition of “church” in the IRC, so courts have often been called upon to determine what qualifies as a church or religion. The judiciary’s broad and accepting view of religion in other contexts, favoring inclusiveness over analytical heft, has routinely carried the day here as well. In *De La Salle v. United States*, for instance, the court stated that:

life of that individual ‘a place parallel to that filled by . . . God’ in traditionally religious persons”) (quoting *United States v. Seeger*, 380 U.S. 163, 176 (1965)); *Tarasco v. Walsh*, 367 U.S. 488, 495 (1961) (stating that “[n]either [federal nor state governments] can constitutionally pass laws or impose requirements which aid all religions as against non-believers, and neither can aid those religions based on a belief in the existence of God as against those religions founded on different beliefs”).

56. There is a distinction between a “religious organization” and a “church” in that religious organizations may or may not receive tax-exempt status. In order to qualify as exempt, an organization must serve an exclusively exempt purpose. *See* Treas. Reg. 1.501(c)(3)-1(c)(1) (2017). For example, the IRS has qualified a religious broadcasting station as a “religious organization” and granted it tax-exemption status under 501(c)(3) because it exclusively devoted broadcasting time to worship and other religious content without selling commercial or advertising time. *See* Rev. Rul. 78-385, 1978-2 C.B. 174; Rev. Rul. 68-563, 1968-2 C.B. 212. On the other hand, the Tax Court once held a purportedly religious book publisher non-exempt because it did not advance a religion and was simply a money making operation. *Found. for Divine Meditation v. Comm’r*, 24 T.C.M. (CCH) 411 (1965), *aff’d in part, rev’d in part sub nom. Parker v. Comm’r*, 305 F.2d 792 (8th Cir. 1966). Ultimately, both categories—religious organizations and churches—are subject to a very lax, “hands off” approach in most circumstances. *See* Kent Greenawalt, *Hands Off! Civil Court Involvement in Conflicts over Religious Property*, 98 COLUM. L. REV. 1843, 1844 (1998) (“The Supreme Court’s basic constitutional approach . . . is that secular courts must not determine questions of religious doctrine and practice.”); Samuel J. Levine, *Rethinking the Supreme Court’s Hands-Off Approach to Questions of Religious Practice and Belief*, 25 FORDHAM URB. L.J. 85, 85 (1997) (“In recent years, the United States Supreme Court has shown an increasing unwillingness to engage in deciding matters that relate to the interpretation of religious practice and belief.”). This Article focuses on churches (and the integrated auxiliaries that are lumped with them for tax purposes), which do not have to apply for recognition of their tax-exempt status and do not have to file any annual filings. *See, e.g.,* *Mishchenko, supra* note 18, at 1366. Distinctions between different kinds of religious organizations do not, however, ultimately affect the underlying problems or proposed solutions discussed in this Article.

[t]he term ‘church’ includes a religious order or a religious organization . . . if its duties include the ministration of *sacerdotal functions* and the conduct of religious worship. If . . . not . . . it is subject to the tax imposed . . . whether or not it engages in religious, educational, or charitable activities. . . . If a religious order or organization can fully meet the requirements . . . exemption . . . will apply to all its activities⁵⁷

Building on this confusing articulation, the Tax Court later indicated that Congress intended the word church to be used in the “denomination” sense, not “in a generic or universal sense.”⁵⁸ It then proceeded to articulate three varying definitions of the term stated:

We think that . . . the concept of “church” appears to be synonymous with the concept of “*denomination*” . . . or “*sect*” rather than to be used in any universal sense. This is not to imply, however, that in order to be constituted a church, a group must have an organizational hierarchy or maintain church buildings.⁵⁹

Judge Dawson, in a concurring opinion stated that, “[t]o be a ‘church’ a religious organization must engage in ‘the ministration of *sacerdotal functions* and the conduct of religious worship’ in accordance with ‘the tenets and practices of a *particular religious body*.’”⁶⁰ Judge Tannenwald wrote a second concurring opinion, giving rise to what has become known as the “associational test.”⁶¹ Essentially, he emphasized the importance of a congregational element when deciding whether an organization is a church:

In my opinion, the word “church” implies that an otherwise qualified organization bring people together as the principal means of accomplishing its purpose. The objects of such gatherings need not be conversion to a particular faith or segment of a faith nor the propagation of the views of a particular *denomination* or *sect*. The permissible purpose may be accomplished individually and privately in the sense that oral manifestation is not necessary, but it may not be accomplished in

57. 195 F. Supp. 891, 900–01 (N.D. Cal. 1961) (emphasis added).

58. *Chapman v. Comm’r*, 48 T.C. 358, 363 (1967).

59. *See id.* (emphasis added).

60. *Id.* at 366–67 (Dawson, J., concurring) (emphasis added).

61. *See id.* at 367-69 (Tannenwald, J., concurring opinion).

physical solitude. A man may, of course, pray alone, but, in such a case, though his house may be a castle, it is not a ‘church.’⁶²

Perceiving the confusion inherent in these potentially incongruent standards, the IRS developed its own list of fourteen criteria to evaluate whether an organization qualifies as a “church.”⁶³ These criteria include (1) distinct legal existence, (2) recognized creed and form of worship, (3) definite and distinct ecclesiastical government, (4) formal code of doctrine and discipline, (5) distinct religious history, (6) membership not associated with any other church or denomination, (7) organization of ordained ministers, (8) ordained ministers selected after completing prescribed courses of study, (9) literature of its own, (10) established places of worship, (11) regular congregations, (12) regular religious services, (13) Sunday schools for the religious instruction of the young, and (14) schools for the preparation of its members.⁶⁴ Unfortunately, these criteria are neither predictive nor controlling.⁶⁵ But some guidance is better than none, and the courts have relied on this list at times, frequently citing the “regular congregation” as the most important factor.⁶⁶

62. *Id.* at 367 (concurring opinion) (emphasis added).

63. This list was made public in a 1978 speech given by IRS Commissioner Jerome Kurtz. *See* IRS News Release, IR-1930 (1978); Jerome Kurtz, Comm’r, IRS, Remarks at the PLI Seventh Biennial Conference on Tax Planning (Jan. 9, 1978), *reprinted in* Fed. Taxes (P-H) ¶ 54,820 (1978) [hereinafter Remarks at the PLI Seventh Biennial Conference on Tax Planning]; IRS PUB. NO. 1828, TAX EXEMPT AND GOVERNMENT ENTITIES, EXEMPT ORGANIZATIONS, 501(C)(3): TAX GUIDE FOR CHURCHES & RELIGIOUS ORGANIZATIONS 33 (2015).

64. Remarks at the PLI Seventh Biennial Conference on Tax Planning, *supra* note 63.

65. The IRS itself acknowledges that the list is merely a guide and that “few, if any, religious organizations . . . could satisfy all of [the] criteria.” *Id.* The associational test articulated by Judge Tannenwald essentially makes the “regular congregation” factor (number 12, above) a controlling factor.

66. *See, e.g.,* Am. Guidance Found. v. United States, 490 F. Supp. 304, 306 (D.D.C. 1980); Found. of Human Understanding v. Comm’r, 88 T.C. 1341, 1359 (1987). In *American Guidance Foundation*, the court elaborated on Judge Tannenwald’s concurring opinion in *Chapman* and explicitly created the associational test:

While some of [the 14 criteria] are relatively minor, others, e. g. the existence of an established congregation served by an organized ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code, are of central importance. The means by which an avowedly religious purpose is accomplished separates a “church” from other forms of religious enterprise. . . . At a minimum, a church includes a body of believers or communicants that assembles regularly in order to worship. Unless the organization is reasonably available to the public in its

That said, the system is no closer to effectively policing tax issues and potential abuse of exemption laws by churches. The main reason for this problem is that, even with some IRS guidance, the U.S. government has steadfastly maintained a reluctance to policing this issue, and courts have never settled on a single, controlling standard.⁶⁷ “[W]e disavow any intimations in this case defining or limiting what constitutes a church under . . . any provision of the Internal Revenue Code.”⁶⁸

More importantly, the IRS seemingly does not bother with its own patina-of-a-test; the agency instead permits individual organizations to decide whether they constitute a “church” and refuses to police those decisions.⁶⁹ Typically, an organization claiming to meet the requirements of

conduct of worship, its educational instruction, and its promulgation of doctrine, it cannot fulfill this associational role.

Id. at 306 (citing *Chapman*, 48 T.C. at 367). A year later, in *St. Martin Evangelical Lutheran Church v. South Dakota*, the Supreme Court cemented the importance of this test, stating that “[t]he word ‘church’ . . . must be construed, instead, to refer to the congregation.” 451 U.S. 772, 784 (1981).

67. See *Mishchenko*, *supra* note 18, at 1367–69.

68. *St. Martin Evangelical*, 451 U.S. at 784 n.15. All the “test” really requires, then, is some regular assembly of individuals related by faith. See *Riker v. Comm’r*, 244 F.2d 220 (9th Cir. 1957); *Chapman v. Comm’r*, 48 T.C. 358 (1967); *Am. Guidance Found.*, 490 F. Supp. at 304; *De La Salle Inst. v. United States*, 195 F. Supp. 891 (N.D. Cal. 1961). The definition of such assembly, or congregation, is itself extremely generous; indeed, even a group of two or three people may qualify. See, e.g., *Church of Eternal Life*, 86 T.C. 916, 924–25 (1986) (noting that “incipient churches may have only two or three gathered together”). Even an aspirational church would likely grow beyond that, given its “associational role,” but such growth is not necessarily required. The naked requirement remains very, very bare. See *id.*; see also *Found. of Human Understanding v. United States*, 614 F.3d 1383, 1390 (Fed. Cir. 2010) (“[T]he associational test does not demand that religious gatherings be held with a particular frequency or on a particular schedule”); *Purnell v. Comm’r*, 63 T.C.M. (CCH) 3037 (1992) (holding that The Kingdom of God Headquarters Church qualified as a church because the organization had a place of worship; regular congregations; regular religious services; and their own, religious creed, literature, and doctrine).

69. See, e.g., Sarah Eekhoff Zylstra, *Why the IRS Has Stopped Auditing Churches – Even One that Calls President Obama a Muslim*, CHRISTIANITY TODAY (Oct. 26, 2012), <http://www.christianitytoday.com/ct/2012/october-web-only/why-irs-has-stopped-auditing-churches-even-one-that-calls-p.html>; see also Philip T. Hackney, *Charitable Organization Oversight: Rules v. Standards*, 13 PITT. TAX REV. 83, 98–99 (2015) (“In most years the IRS audits less than one percent of the existing charitable organization population.”). This is at least partially due to the fact that churches do not have to file any return and are simply assumed exempt. See, e.g., ARIENS & DESTRO, *supra* note 39, at 743 (citing I.R.C. § 508(a), (b) (2012)).

§ 501(c)(3) must file an application for approval by the IRS.⁷⁰ But this requirement is puzzlingly dropped for churches.⁷¹ Churches simply need not file an application for exemption under § 501(c)(3).⁷² Bookending this kid-glove treatment of qualification issues, churches can only be audited in rare circumstances, and, when they are, they are afforded extraordinary protections.⁷³

70. See JODY BLAZEK, *TAX PLANNING AND COMPLIANCE FOR TAX EXEMPT ORGANIZATIONS* (5th ed. Supp. 2016).

71. *But see* ZELINSKY, *supra* note 51, at 113-56 (arguing that taxation of churches risks undue entanglement). This is an adequate response to the frustrations expressed herein. If one posits that the government should never pressure churches in any manner, then that is effectively the end of the argument. This Article rests on an implicit assumption that churches, like every other entity, can be taxed without being destroyed or impermissibly directed by governmental authorities. That assumption appears to be well-grounded in the current law as churches are taxed, albeit at reduced rates or in inconsistent ways. See *supra* note 39. A broader discussion of that assumption is beyond the scope of this Article.

72. See INTERNAL REVENUE SERV., 1828: *TAX GUIDE FOR CHURCHES & RELIGIOUS ORGANIZATIONS* 2 (2015). Nevertheless, many churches still apply primarily because without an IRS letter that recognizes exemption under 501(c)(3), tax-exemption status is only a rebuttable presumption. See NICHOLAS P. CAFARDI, *UNDERSTANDING NONPROFIT AND TAX EXEMPT ORGANIZATIONS* 116 (2d. ed. 2012).

73. See I.R.C. § 7611 (2012). This section is explicitly intended to protect churches from the IRS.

Section 7611's purpose is to "minimize IRS contacts with churches to only those necessary to insure compliance with the tax laws." To begin an inquiry into a possible section 501(c)(3) violation by a church, "an appropriate high-level Treasury official [must] reasonably believe[] (on the basis of facts and circumstances recorded in writing) that the church . . . may not be exempt . . ." The Service must send notice of the inquiry in writing and must include "the concerns which gave rise to such inquiry." Churches must also be given the opportunity to have a conference with appropriate members of the Service's investigation team in advance of the investigation.

Once the initial inquiry becomes a formal investigation, section 7611 presumptively protects church records, restricting review of the records only to the extent necessary. This restriction imposes a higher burden on the Service to demonstrate necessity. To show that requested documents are necessary, the Service must "(1) show that the purposes of the investigation are proper, and (2) explain how the particular documents, or categories of documents, (a) fall directly and logically within the scope of those purposes and (b) will help significantly to further an investigation within the scope of those purposes."

The law also imposes a two year limit on the total time for investigation.

Leslie S. Garthwaite, *An End to Politically Motivated Audits of Churches-How Amendment to Section 7217 Can Preserve Integrity in the Tax Investigation of Churches Under Section 7611*, 60 *TAX LAW.* 503, 509 (2007) (footnotes omitted).

Because organizations can easily qualify for church status, and neither the IRS nor any other government agency is interested in reviewing that qualification, the IRS is handcuffed when it comes to approaching such an entity in any fashion.⁷⁴ The lack of transparency and accountability is even deeper: any entity that “qualifies” as a “church” is granted the protection of near total secrecy, even from the IRS.

Charitable organizations are generally required to file Form 990, the *Return of Organization Exempt from Income Tax*, which lays out a tax-exempt organization’s gross income, receipts, and disbursements.⁷⁵ The IRS views this form as the “primary tax compliance tool for tax-exempt organizations.”⁷⁶ This is intuitive—that which is not monitored cannot be policed. However, this filing requirement is simply dropped when it comes to “churches.”⁷⁷ As such, nobody has the ability to track the expenditures of churches to determine whether they are pursuing or furthering “charitable” ends. There is no existing justification for this intentional and extraordinary lack of oversight.⁷⁸

In the end, the result is a carefully constructed sheath of unaccountability, ensuring that purported religious organizations are afforded an extraordinarily robust tax status that allows churches to raise and spend funds without public accountability.⁷⁹ This system means that the

74. See, e.g., Mathew Encino, *Holy Profits: How Federal Law Allows for the Abuse of the Church Tax-Exempt Status*, 14 HOUS. BUS. & TAX L.J. 78, 85–86 (2014) (explaining that churches are exempt from filing Form 1023, the application for 501(c)(3) status).

75. See Arnsberger et al., *supra* note 30, at 109. Private Foundations are required to file Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*. This requirement was first imposed in the Revenue Act of 1943. See Revenue Act of 1943, ch. 63, § 117(a), 58 Stat. 21, 36–37 (1944).

76. INTERNAL REVENUE SERV., BACKGROUND PAPER, SUMMARY OF FORM 990 REDESIGN PROCESS 1 (2008), http://www.irs.ustreas.gov/pub/irs-tege/summary_form_990_redesign_process.pdf.

77. See INTERNAL REVENUE SERV., 11283J, INSTRUCTIONS FOR FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX 3 (2018), <https://www.irs.gov/pub/irs-pdf/i990.pdf> (exempting churches and certain church-affiliated organizations from filing). Also exempted from filling out a “full” Form 990 are certain organizations with relatively smaller revenues and/or fewer assets. *Id.* at 4 (indicating that such organizations can fill out the less onerous 990-EZ or 990-N forms).

78. Montague, *supra* note 51, at 230–31 (noting that the exemption from disclosure was not initially imposed because Congress was not concerned about churches competing with private business, a concern that only later came to the fore).

79. The disclosure requirement has changed somewhat over the years. As presently constituted, it exempts “churches” and “integrated auxiliaries” from filing, but it does not exempt “religious organizations.” Samuel D. Brunson, *The Present, Past, and Future of LDS Financial Transparency*, DIALOGUE: A JOURNAL OF MORMON THOUGHT, Spring 2015, at 7.

government has no consistent, documented proof as to the size of the tax subsidy afforded to churches or whether that public investment is paying off.⁸⁰ The result of this lack of transparency and accountability is precisely what one would guess: there is substantial evidence that the amount of money being funneled to ostensible churches is enormous and that it is not being used in a traditionally charitable manner.

Again, the LDS Church serves as a helpful example. According to the church itself, it gave approximately \$1.3 billion in humanitarian aid between 1985 and 2010.⁸¹ That is little, however, compared to the funds it raised during that time. Recall that the church likely generates somewhere around \$8 billion per year in tithing, and reasonable estimates suggest that the church raised more than \$100 billion between 1985 and 2010.⁸² That means that the church gave *less than 2%* of its incoming funds to charity.⁸³

“An ‘integrated auxiliary’ is a tax-exempt organization that is affiliated with a church, but does not offer goods or services to the general public.” *Id.* at 7 n.28 (citing Treas. Reg. §1.6033-2(h)(1)(2011)). This obviously broadens exemption from disclosure and was apparently included in current law at the instance of Senator Wallace F. Bennett of Utah in order to protect a variety of LDS Church entities from disclosure requirements. *See id.*

80. There are some limitations on this lax oversight of religious spending and investment. Part III, *infra*, explains a number of these limitations in its discussion of private foundation spending rules and the UBIT and how those concepts should inform future policymakers’ approaches to the taxation of churches.

81. Winter et al., *Money Behind the Mormon Message*, *supra* note 13.

82. Winter, *How the Mormons Make Money*, *supra* note 4. *But see* Kaimi Wenger, *Business Week’s Erroneous Claim About LDS Charitable Giving*, *TIMES & SEASONS* (July 11, 2012), <http://www.timesandseasons.org/harchive/2012/07/business-weeks-erroneous-claim-about-lds-charitable-giving/>.

83. Again, to be fair, see *supra* note 49, discussing the potentially fluid definition of “charity.” To the extent one focuses on material aid to the needy, and underscoring the paucity of the numbers discussed in the text, only one-third of that amount was actually monetary assistance, and the \$100 billion figure does not include other sources of revenue or income. *See, e.g.*, sources cited *supra* note 16; Winter, *How the Mormons Make Money*, *supra* note 4. Indeed, even this assessment might be overly generous, as some estimates indicate the church donates less than 1% of its annual income to charity. Wenger, *supra* note 82 (citing Professor Ryan T. Cragun for the proposition that the church gives only 0.7% to charity). This kind of giving is marked but sees some parallels in other churches. *See infra* notes 83-84 and accompanying text. It also compares unfavorably even to the worst *non-church* charities. *See, e.g.*, Kris Hundley & Kendall Taggard, *America’s 50 Worst Charities Rake in Nearly \$1 Billion Dollars for Corporate Fundraisers*, *TAMPA BAY TIMES* (Oct. 2, 2017, 4:10 PM), <http://www.tampabay.com/news/nation/americas-50-worst-charities-rake-in-nearly-1-billion-for-corporate/2339540> (indicating that these charities collectively paid out less than 4% of their donations in direct cash aid).

Though a striking example, the LDS Church is certainly not alone. For instance, the United Methodist Church is believed to have spent “about 29 percent of its revenues [on] charitable causes in 2010 (about \$62 million of \$214 million received).”⁸⁴ Similarly, some estimates indicate that annual spending by the American division of the Catholic Church was \$170 billion in 2010 and that just 2.7% went directly toward national charitable activities.⁸⁵ Indeed, examples are legion, and this appears to be a widespread issue (as one would expect given the tax-induced economic incentives outlined herein).⁸⁶ Recognizing this problem, Senator Chuck Grassley sent letters to leaders of six large churches in 2007, asking them to disclose the kind of information that Form 990 would typically reveal.⁸⁷ According to the Senator, this number could have been higher—he chose these churches based on media reports regarding luxury purchases like corporate jets and \$23,000 commodes.⁸⁸ A recent survey found that there were 1210 megachurches in the United States in 2005, nearly double the number from five years earlier, and a follow-up survey found that the average 2008 income of such churches was \$6.5 million, only a quarter of which went to missions and programs.⁸⁹

84. Cragun et al., *supra* note 40, at 40 (citing United Methodist Church Gen. Council of Fin. and Admin., Financial Commitment Report (Dec. 2010)).

85. See *Earthly Concerns*, *supra* note 20 (reviewing bankruptcy diocesan bankruptcy filings). However, it is notable that this number does not include amounts that went to hospitals and schools, functions that likely fit within the general scope of charitable activities that the government would otherwise have to pay for. See *id.* The Catholic Church is a history-spanning entity with enormous spiritual, social, cultural, and political impact. It is difficult to analyze its impact in this Article given its size, global manifestation, and the millennia of secrecy surrounding its economic and political dealings. See generally GERALD POSNER, *GOD’S BANKERS: A HISTORY OF MONEY AND POWER AT THE VATICAN* (2015).

86. See, e.g., Montague, *supra* note 51, at 218-20 (discussing numerous financial scandals involving churches).

87. Chuck Grassley, *Grassley Seeks Information from Six Media-Based Ministries*, U.S. SENATE COMM. ON FIN. (Nov. 6, 2007), <https://www.finance.senate.gov/ranking-members-news/grassley-seeks-information-from-six-media-based-ministries>.

88. Laurie Goodstein, *Senator Questioning Ministries on Spending*, N.Y. TIMES (Nov. 7, 2007), <http://www.nytimes.com/2007/11/07/us/07ministers.html>. Only two of the churches responded timely. Two responded late and only partially—one simply never responded. *Id.* For even more extreme examples of bad acts relating to taxation issues, see *Church of Scientology of Cal. v. Comm’r*, 83 T.C. 381, 505 (1984) (finding that “in the pursuit of [conspiring to impede the IRS, the church] filed false tax returns, burglarized IRS offices, stole IRS documents, and harassed, delayed, and obstructed IRS agents who tried to audit Church records”).

89. Scott Thumma et al., *Megachurches Today 2005: Summary of Research Findings*, HARTFORD INST. FOR RELIGIOUS RES. (2005), <http://hrr.hartsem.edu/megachurch/>

Though extreme, these kinds of purchases and this sort of behavior is merely representative of how little many churches spend on actual charity. “One calculation of the resources expended by 271 U.S. congregations found that, on average, ‘operating expenses’ totaled 71 percent of all the expenditures of religions, much of that going to pay ministers’ salaries.”⁹⁰ Again, this statistic compares unfavorably with a number of other, non-church charities.⁹¹ If nothing else, it brings into doubt the concept that churches are particularly effective channels for charitable giving and that they should be treated differently from any other § 501(c)(3) organization.

It bears repeating that the subsidies involved in this issue are huge. Though it is not possible to assign concrete numbers because churches are not required to file annual forms with the IRS or to otherwise disclose their finances, some calculations are possible. Assuming that most organized religions would be taxed at the maximum federal corporate tax rate (based on revenue), the annual federal income tax subsidy is approximately \$35 billion and the annual state income tax subsidy is about \$6 billion per year.⁹² Additionally, churches pay little or no property tax on explicitly religious property (such as churches and temples) and a reduced rate on many other kinds of property.⁹³ This amounts to an additional subsidy of more than \$25 billion per year.⁹⁴ On top of these exemptions, religions pay little or reduced capital gains tax; religious functionaries can opt out of self-employment taxes; and ministers benefit from the “parsonage exemption,” which permits churches to pay the cost of their living arrangements without

megastoday2005_summaryreport.html; Scott Thumma & Warren Bird, *Changes in American Megachurches: Tracing Eight Years of Growth and Innovation in the Nation's Largest-Attendance Congregations*, HARTFORD INST. FOR RELIGIOUS RES. (2008), http://hrr.hartsem.edu/megachurch/megastoday2008_summaryreport.html.

90. Cragun et al., *supra* note 40, at 40 (citing CHRISTIAN SMITH ET AL., *PASSING THE PLATE: WHY AMERICAN CHRISTIANS DON'T GIVE AWAY MORE MONEY* (2008)). This sort of accounting is particularly galling when compared to explicitly for-profit companies that give away vastly more to charity than many churches. *Id.* (pointing out that Wal-Mart gives approximately “\$1.75 billion in food aid to charities each year, or twenty-eight times all of the money allotted for charity by the United Methodist Church and almost double what the LDS Church has given in the last twenty-five years”).

91. *Id.* (noting that the American Red Cross spends 92.1% of its revenue on the physical needs of those it aims to help—an amount that is *130 times higher* than the comparable spend rate of the LDS Church).

92. *Id.* at 42.

93. *Id.*

94. *Id.*

taxation.⁹⁵ In sum, these subsidies conservatively amount to over \$71 billion per year in exemptions.⁹⁶

In the end, the Code is not functioning as intended, as massive amounts of money escape government taxation but do not flow to charity. But the problem does not end there.

II. *Even the Right Thing Gets Crooked*⁹⁷

Aside from the enormous, ineffectual expense of subsidizing organized religion, another reason to question the exemptions afforded to churches is that these tax-free funds, when left unaudited and unchecked, flood the economy and fundamentally distort free markets.⁹⁸ The idea is straightforward but subtle: every market actor (whether or not ostensibly for profit) undertakes a return-on-investment analysis to assess economic options, which inherently assesses its effective, after-tax rate of return. Of course, that analysis is simpler for entities like churches that do not, in fact, pay taxes. Given that these organizations are permitted to funnel tens of billions of untaxed dollars into the economy, they can engage in a quantitatively different kind of analysis, which ultimately affects their positioning in a competitive market environment and the economic options available to every other actor therein.

A. *Return on Investment*

Any entity contemplating any expenditure or investment must undertake a return-on-investment analysis to determine whether the outlay is justified.⁹⁹ The general idea is straightforward: decision-makers must decide whether a given investment will generate enough money to justify

95. *Id.* at 43; Frances E. McNair & Nina S. Collum, *Tax Planning to Take Advantage of Unique Benefits for Clergy*, 24 J. TAX'N INV. 238 (2007) (“[F]or ministers of the gospel, gross income does not include a housing allowance paid as part of the compensation to the extent that the allowance is used to rent or provide a home and to the extent that the allowance does not exceed the fair rental value of the home . . .”).

96. Cragun et al., *supra* note 40, at 44.

97. St. Arsenie Boca.

98. See *What Is “Market Distortion”*, INVESTOPEDIA, <https://www.investopedia.com/terms/m/marketdistortion.asp#ixzz5Suzxlbqf> (last visited Oct. 3, 2018) (“[A]lmost all types of taxes and subsidies . . . can cause a market distortion.”).

99. See Joe Knight, *The Most Common Mistake People Make in Calculating ROI*, HARV. BUS. REV. (Apr. 9, 2015), <https://hbr.org/2015/04/the-most-common-mistake-people-make-in-calculating-roi>. Non-controversially, the goal is to return a profit, while pricing in the risk of the proposition.

the risk associated with that investment.¹⁰⁰ There is, of course, a relationship between return on investment and risk such that riskier undertakings require a higher rate of return to compensate for the higher likelihood of loss.¹⁰¹ Intuitively, this means that riskier investments *must* yield higher rates of return or the market will favor less risky, more stable investment options. Of course, each entity has an internal “benchmark” rate of return driven by a host of factors below which it will not invest.¹⁰² One of those factors critical to this discussion is the cost of capital to the entity (which depends on the tax applied to investors).¹⁰³ Before delving into that issue, it is important to understand the wide applicability of the rate-of-return analysis; it affects churches in precisely the same way as every other kind of investing entity.

Initially, it may be tempting to view all kinds of financial analyses—including rate of return models—as solely the province of traditional profit-seeking entities. Indeed, it is easier to understand this kind of inquiry in a traditional context, such as that of a traditional corporation. Such an entity is, after all, a collection of individual economic interests and therefore must continually monitor the return on investment it is generating for its constituent stakeholders (who must be able to continually monitor whether to continue investing in the organization). A simple example suffices to demonstrate. Let us assume a corporation—which we will call *X Corp.*—is faced with the decision of whether to invest \$5 million into a residential housing development. To make that decision, *X Corp.* must decide what sort of return that investment will yield and determine whether such a return is sufficient for its investors.¹⁰⁴ Shareholder *B*, for example, will withdraw her money from *X Corp.* and move it elsewhere if *X Corp.* cannot generate a

100. *See id.*

101. *See, e.g.,* Ira Mark Bloom, *The Treatment of Trust and Other Partial Interests of the Surviving Spouse Under the Redesigned Elective-Share System: Some Concerns and Suggestions*, 55 ALB. L. REV. 941, 963 n.93 (1992) (“[R]eturn on investment is related to risk . . .”).

102. *See, e.g.,* Thomas W. Merrill, *Incomplete Compensation for Takings*, 11 N.Y.U. ENVTL. L.J. 110, 126 (2002) (describing how a hypothetical taking would attempt to mimic the internal benchmark of the regulated company to ensure fairness).

103. Knight, *supra* note 99; *see also* Michael T. Jacobs & Anil Shivdasani, *Do You Know Your Cost of Capital?*, HARV. BUS. REV. (July-Aug. 2012), <https://hbr.org/2012/07/do-you-know-your-cost-of-capital>.

104. *See, e.g.,* Wayne O. Hanewicz, *Director Primacy, Omnicare, and the Function of Corporate Law*, 71 TENN. L. REV. 511, 531 n.150 (2004) (“[Equity capital markets] are the vehicle by which shareholders bargain over the terms of their equity investment contract with the corporation.”).

sufficient return on Shareholder *B*'s invested funds.¹⁰⁵ *X Corp.*, then, is continually assessing its investment options in terms of whether it can generate the kinds of returns that Shareholder *B* and its other investors demand. The situation is a good deal more complex—corporations and waves of individual investors continually evaluate investment opportunities and strategies. But the overarching principle is straightforward: if a corporation does not adequately evaluate its options and generate an adequate return for its investors, those investors will move elsewhere.

That is a relatively easy-to-understand narrative given the ubiquity of corporate (or other collective) investment in the modern economy. However—and most importantly—that kind of investment analysis is not limited to traditional companies or corporate collectives. In fact, this return-on-investment analysis is necessary for *every person or entity that invests*. This includes individuals, churches, and every other kind of investor, regardless of whether they have constituent owners or stakeholders.

Admittedly, it seems odd to conceptualize a church engaging in the kind of return-based analysis described above given that churches do not really have to consider whether they are able to generate an actual return. But this is irrelevant. What is key is that every rational market actor has to analyze the opportunity costs of any investment and so engage in a return-on-investment analysis. There is simply no other way to determine what investments to make. Put differently, any person or entity pursuing market-based returns has to evaluate which activities generate higher returns.¹⁰⁶ That is, even though a church has no analogue to Shareholder *B*, it still has to decide what to invest in so that it can maximize its own resources. Every time a church is faced with a market-facing investment or expense, it has to decide whether to proceed or turn elsewhere. Deciding what to invest in means comparing investment opportunities, which requires assigning return metrics to them and deciding which are superior.

105. In other words, *X Corp.* must overcome *Z*'s opportunity costs of investing with *X Corp.*—that is, the return *Z* could generate elsewhere. Opportunity costs can include non-monetary returns, such as the positive feelings generated by investing in an environmentally friendly corporation, but this is beyond the scope of this Article.

106. You could invest randomly or only in certain companies or opportunities that match extrinsic criteria (e.g., companies that do not produce carbon or real estate investment trusts that focus on rebuilding inner-city areas), but doing so necessarily means that you are not investing to maximize market returns, which is contrary to basic economic assumptions. See, e.g., Henry B. Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 VA. L. REV. 605, 616 (1989) (“[N]onprofit firms that own unrelated businesses presumably have much the same kind of interest in those firms that any other owner would have—namely, to maximize the financial return they yield.”).

Assume, then, that Church *X* is now the entity faced with deciding whether to invest \$5 million in a residential housing development. Just like *X Corp.*, it will have to decide whether the investment is “worth it” because, just like *X Corp.*, it will have to determine the amount of money it will recover in proceeds. There are many ways to conduct this analysis, but it must be done in some fashion, because all rational, profit-seeking actors seek to understand and maximize their return and cannot do so unless they evaluate the different kinds of returns available to them. Simply put, as a matter of basic economic necessity, every church that acts in an economically rational manner will analyze its potential return—the alternative is ineffectiveness.¹⁰⁷

That is not to say, however, that there is no difference between the market impact of a corporation and a church. Indeed, the tax exemption embedded in all such analyses undertaken by churches, as opposed to traditional for-profit corporations, ends up creating significant, and historically underappreciated, distortions. These distortions effectively permit churches to undercut other market actors to the detriment of the entire economy.

B. Economic Distortions

When a corporation evaluates the return on investment required by its shareholders, it must do so in contemplation of the taxes those shareholders will pay.¹⁰⁸ This may or may not be explicit, but investors evaluate their investments in terms of what will ultimately come to them, which necessarily involves tax calculations.¹⁰⁹

Let us again consider *X Corp.* and Shareholder *B*. *X Corp.* must evaluate whether to invest its \$5 million on behalf of Shareholder *B* in the residential

107. The only substantial difference, as noted above, is that the church will undertake the analysis for itself rather than on behalf of any shareholder or investor. In fact, a church will have a more direct, less complicated analysis than a traditional corporation because the church does not have to consider the return it is generating for someone else (and, concomitantly, whether that return is sufficient to ensure ongoing, or future, investment).

108. See Johgho Kim, *Bankruptcy Law Dilemma: Appraisal of Corporate Value and Its Distribution in Corporate Reorganization Proceedings*, 29 NW. J. INT’L L. & BUS. 119, 161 n.225 (2009) (“The cost of capital is used by shareholders to see if the corporation is delivering a sufficient return, bearing in mind the risks of the business. It is the compensation that corporations must provide investors in return for the use of their capital.”). From the shareholder’s perspective, that compensation will be post-tax.

109. See Jacobs & Shivdasani, *supra* note 103 (“{W}hether a company uses its marginal or effective tax rates in computing its cost of debt will greatly affect the outcome of its investment decisions.”).

housing development or some investment alternative. Very simply, this means that *X Corp.* must decide whether the investment will generate a sufficient return to Shareholder *B*.¹¹⁰ Assume that the analysis reveals that the investment will return \$500,000 per year (or, seemingly, a 10% return per year). The question ultimately is whether that \$500,000 is “enough” to entice Shareholder *B* to invest in, and keep her capital in, *X Corp.*

Here is where taxes come into play. Although Shareholder *B* is demanding a particular return, her demand has her individual tax structure built into it. She does not have the benefit of receiving her funds tax-free and proceeding to invest from there. Instead, her return must be sufficient to justify the investment she makes of her already-taxed funds. Shareholder *B*, in evaluating whether a \$500,000 return is sufficient, will view it not as a return on \$500,000 but as a return on the money that she had to earn in order to generate \$500,000 of investable capital. Shareholder *B* is granted no special exemption like the Church and so has to pay taxes on her income. Assume that her effective rate is 20%.¹¹¹ That means she actually had to earn \$6,250,000 in order to invest \$5,000,000 into *X Corp.* As such, the real return-on-investment calculation—made by *X Corp.* on behalf of Shareholder *B*—is whether a \$500,000 return on a \$6,250,000 investment is sufficient. If Shareholder *B* (and the wider market she is representing in our stripped-down example) has set a benchmark return of 10%, then *X Corp.* will not be able to pursue the housing project and will have to look elsewhere to achieve the kinds of returns demanded by Shareholder *B*.¹¹²

Now, a careful observer might ask why the housing development would return only 10%. If *X Corp.*—as the embodiment of our hypothetical Shareholder *B* and the aggregation of the wider market—is not willing to invest in the housing development, is it not the case that the return on investment will have to change? Of course, the nature of the investment will not change, but the cost might. If the developer and marketer of the development is asking \$5,000,000, which effectively represents a return

110. This example strips out the overhead costs associated with running an investment-concentrating entity, such as a corporation. It also presumes that net profits will be returned to shareholders via direct distributions. In truth, a corporation is a complex entity, constituting a cost center in and of itself, and shareholders can reap gains through means other than direct distributions. That said, the fundamental concept behind entity aggregation is that shareholders invest based upon the ability of the entity to generate and return profit.

111. All examples assume basic, uncomplicated ordinary rates for ease of calculation and demonstration.

112. Effectively, then, *X Corp.* will have to either return \$625,000 on Shareholder *B*'s investment or negotiate down the price of the housing opportunity so that it can pursue both that and another profit-returning endeavor.

that falls below what the market is demanding, is it not the case that the developer will have to lower his asking price? After all, if *X Corp.* (as the vicarious embodiment of the market) will not pursue it, neither will any other corporation.

The generic answer to the above question is “yes.” Yes, the hypothetical developer will have to lower his asking price because, by definition, we have stated that “the market” is not willing to pay \$5,000,000.¹¹³ But this is where market distortion comes into play.

We cannot answer “yes” because the tax code has split the “market” into two distinct segments—tax-exempt entities and everyone else.¹¹⁴ In other words, tax-exempt churches do not labor in the same post-tax world as everyone else, vicariously evaluating returns on behalf of individuals who are investing after-tax dollars.¹¹⁵

Return to the earlier example. Recall that Shareholder *B* requires a 10% return on investment, and assume that a given church (which we will call “Church *A*”) has the same benchmark.¹¹⁶ This means that *X Corp.* and Church *A*, both on the hunt for investing opportunities, will evaluate every opportunity that presents itself based on this seemingly similar requirement. As we have seen, however, that seemingly similar requirement is anything but—Church *A* only needs a \$500,000 return on its \$5,000,000 investment, while *X Corp.* needs a \$625,000 return on its \$5,000,000 investment.

The difference may not seem significant, but ultimately, it means that Church *A* will have an advantage in securing the “best,” or lowest-risk,

113. Again, this is a simplistic example. Different market actors have different participants with different skill sets, different return requirements, and different perceptions of market conditions. That said, there is, at some point, a basic equilibrium, which represents the market and what it is willing to offer for a given opportunity. Here, the example minimizes all associated issues into *X Corp.* and its need to satisfy Shareholder *B*.

114. Of course, there are many different reasons that markets are not efficient. *See What Is “Market Distortion,” supra* note 98. This Article is focusing on only one. Also, it may well be the case that this particular problem is a wider one that involves more than just churches. The tax exemption afforded to a wide array of entities may, in fact, pull all non-profit entities within the scope of the arguments presented herein. This Article, however, focuses only on churches for the various reasons already discussed herein.

115. Such investable funds are either donated or are themselves a return earned on other donated or invested funds (which were, themselves, donated). At their base, then, all such capital is donated and received by churches on a tax-free basis.

116. This actually seems like a relatively uncontroversial supposition. Assuming perfect markets with a general population of transient investors, all investors should theoretically settle upon a stable rate of return.

investment opportunities.¹¹⁷ Remember, in an efficient and equalized market, *X Corp.* will not pursue the investment opportunity because it does not provide the required level of return, but neither will anyone else. The hypothetical developer would have to lower his asking price so that the investment demanded will produce a return sufficient to provide Shareholder *B* with a 10% return on her pre-tax capital. But, so long as Church *A* can raise funds tax-free, the developer will not lower his asking price. Church *A* will be able to offer the full \$5,000,000 and acquire the opportunity. Of course, Church *A*, perceiving that there are others in the market who are pressuring the price downward, will attempt to secure a lower price. If we assume that this opportunity is a desirable one, then Church *A* will always have an advantage over *X Corp.* This ability to offer more, as it recurs and saturates the market, will ineluctably put a distorting, downward pressure on returns.¹¹⁸ Sellers will not be pressured to the same

117. “Best” is a pregnant term. Most easily conceptualized, it encompasses a reduced level of risk. Of course, risk and return are intertwined, and it is beyond the scope of this Article to disambiguate the two or otherwise discuss investment pricing. It suffices here to posit that there are opportunities that are more desirable than others. It is also useful to point out that this is not an entirely new concern, though the context raised herein is different from that previously discussed. The Tax Reform Act of 1969 included provisions meant to prevent a similar charitable advantage. *See* Sharpe, *supra* note 30, at 399–400 (“By financing the purchase of business assets with tax-free earnings generated by those assets, the exempt organization was placed in a unique position to pay a higher price than a taxable investor could afford with after tax dollars.” (citing S. REP. NO. 91-552, at 62–63 (1969), *as reprinted in* 1969 U.S.C.C.A.N. 2027, 2091)). This Article argues that the basic unfairness—easily seen in the context of a business owner selling his business to a non-profit in order to exploit the buyer’s tax exemption—applies to every for-profit activity undertaken by exempt entities utilizing their tax-exempted source of funds for all the reasons discussed herein.

118. Hansmann, *supra* note 106, at 611-12. A counter-argument is that, if this were so, then these exempt entities with lower costs of capital would have already displaced substantial parts of the market and that, because this has not happened, there must not be any actual, undue advantage. Relatedly, there may be an argument that any advantage would not lead to distortions because the advantaged entities would rationally participate in markets in a way that either would not drive down competing returns or would result in a gradual displacement that actually benefited profit-seeking businesses. *See, e.g., id.* at 609-12 (“In this way, it was said, whole industries might ultimately be captured by nonprofits.”). However, these are simplistic arguments that ultimately assume perfectly efficient actors. A truly efficient and perfectly informed entity may well deploy the tax-based cost-of-capital advantages identified here in either an all-consuming manner or a manner that does not lower prices or returns. However, no entity—much less a church—is perfectly efficient or informed. Cost of capital is merely one advantage. Non-tax-exempt entities will almost certainly have one or more of a variety of potential advantages at their disposal relative to a church: better management, better locations, superior goodwill, intellectual property, etc. As such, one would expect a tax-exempt church to deploy its advantages in an attempt to offset

extent they otherwise would be, meaning that overall market returns will be depressed, affecting everyone.¹¹⁹

This gets to the heart of the Article: that market distortion flows from unchecked exemption status.¹²⁰ To be sure, this is not a very controversial conclusion. In essence, all this Article is arguing is that when one market participant is given access to cheaper capital it can underbid other market participants, and such underbidding has a cascading effect on the returns available in the marketplace.¹²¹ What is notable, though, is that this is precisely the situation that the United States tax code has created. Because of the secrecy afforded to churches by the IRC, these entities are free to raise funds and devote them to for-profit endeavors. And because of the tax-exempt nature of the capital raised, they do so at a competitive advantage.¹²²

Churches participate in the same economy as the rest of us, but they do so with a built-in advantage. This tax advantage distorts the broader economy and reduces the rates of return generally available in the

its relative disadvantages. In other words, it would maintain a position in the market disproportionate to its economic standing despite its disadvantaged position, thus driving prices *lower than they should go*. The market distortion that is the focus of this Article is seen most clearly in the difference between a market with tax-advantaged players and a market without them. Ours is an imperfect and inefficient economy. The fact that churches have not entirely subsumed any identifiable market is, then, not surprising.

119. Of course, downward pressure on prices will harm sellers but help buyers. In this sense, the market may be unaffected, on balance. However, any tax-induced distortion will inflict some sort of inefficiency, whether it is introducing long-term investors (who do not sell to others) to the market or inducing churches to pursue opportunities that they are otherwise ill suited to exploit. The distortion is, by itself, problematic.

120. This concept has been identified by others but seems to have escaped a broader review as the result, perhaps, of the impermanent tax-exempt status of the investing entity itself. Samuel D. Brunson, *Repatriating Tax-Exempt Investments: Tax Havens, Blocker Corporations, and Unrelated Debt-Financed Income*, 106 NW. U. L. REV. 225, 260 (2012) (“A tax-exempt entity can afford to pay a higher price because it can purchase assets with untaxed money. . . . The ability of a tax-exempt entity to outbid taxable persons . . . derives from the tax-exempt entity’s exemption from tax . . .”).

121. It is worth pointing out that this is an enormous amount of capital. Figures are available for as recently as 2011, when donors gave over \$90 billion to religious organizations. See Montague, *supra* note 51, at 206.

122. For another excellent example of the unfairness baked into our current system of taxation that favors churches and other tax-exempt organizations, see Brunson, *supra* note 120, at 227 n.7 (noting that an IRS consultant in 2002 estimated the United States was losing \$70 billion every year in taxes from offshore tax evasion measures).

market.¹²³ And this is all the more galling because it is accomplished via a tax subsidy. In the end, churches have convinced the American taxpayer to handicap himself at his own expense.

*III. There Is No New Thing Under the Sun*¹²⁴

There are two relatively straightforward solutions that, considered in combination, would begin to remedy the systemic market distortions caused by tax-exempt investment entities. Neither of these proposals is entirely new—they come directly from the IRC, having been adopted in other contexts in an effort to avoid the very difficulties already discussed.

First, and most simply, Congress should amend the IRC (and the accompanying regulations and IRS processes and procedures) to require churches to file Form 990.¹²⁵ This requires no imagination, nor is it novel in any way, yet it would have an enormous effect. It is apparent, when reviewing the behavior of churches, that a substantial part of the reason that they behave the way they do is because they can do so without repercussion.¹²⁶ “Everybody knows that corruption thrives in secret places,

123. This conclusion also mimics the long-standing complaint of those who argue that churches have been permitted to distort the *political* realm for too long. *See, e.g.*, Elizabeth Fleet, *Madison's "Detached Memoranda,"* 3 WM. & MARY Q. 534, 556–60 (1946) (arguing that the ecclesiastical tax exemption must be ended to prevent churches from amassing vast fortunes and unduly influencing the political realm); *see also* Samuel D. Brunson, *Dear IRS, It Is Time to Enforce the Campaigning Prohibition. Even Against Churches,* 87 U. COLO. L. REV. 143 (2016). The argument also echoes an earlier one made by President Grant:

In 1850, I believe the church properties in the United States which paid no taxes, municipal or State, amounted to about \$83,000,000. In 1860 the amount had doubled; in 1875 it is about \$1,000,000,000. By 1900, without check, it is safe to say this property will reach a sum exceeding \$3,000,000,000. So vast a sum, receiving all the protection and benefits of Government without bearing its proportion of the burdens and expenses of the same, will not be looked upon acquiescently by those who have to pay the taxes.

Ulysses S. Grant, *State of the Union Message* (Dec. 7, 1875), in 2 THE STATE OF THE UNION MESSAGES OF THE PRESIDENTS 1790-1996, at 1296 (Fred. L. Israel ed., 1966).

124. *Ecclesiastes* 1:9 (King James).

125. Any iteration of Form 990 would suffice so long as the document requires a basic disclosure of money raised and a categorized description of expenses and investments. This is in contrast to other proposals, which would leave church-tax advantages in place but substantially narrow the definition of “church.” *See, e.g.*, Mishchenko, *supra* note 18, at 1369–80.

126. Indeed, this is reinforced even when comparing churches to *other types of charities*. These other entities, which also enjoy the ability to raise capital tax-free, participate in markets and so also affect rates of return. But they appear to do so at *vastly* lower rates and

and avoids public places, and . . . it [is] a fair presumption that secrecy means impropriety.”¹²⁷

Why is it that some churches expend less than 5% of the funds donated to them on charity? Because they can. It seems unlikely that any church or other entity would so brazenly flaunt the underlying purpose of its charitable tax subsidy if such behavior were widely known to both that church’s tithe-payers and to the tax-paying public. At the very least, no entity would do so for long, as its actions would drive away donors or spur legislative and executive authorities to action.

This is precisely why Form 990 exists in its present incarnation.¹²⁸ Commenting about a recent amendment to Form 990, the IRS Commissioner indicated that one of the IRS’s priorities in redesigning the form was “to enhance transparency of the nonprofit sector by requiring

thus have a significantly less distorting effect on the economy. Cragun et al., *supra* note 40, at 40. The authors point out the relative giving rates of a number of relevant entities:

For instance, the [LDS Church], which regularly trumpets its charitable donations, gave about \$1 billion to charitable causes between 1985 and 2008. That may seem like a lot until you divide it by the twenty-three-year time span and realize this church is donating only about 0.7 percent of its annual income. Other religions are more charitable. For instance, the United Methodist Church allocated about 29 percent of its revenues to charitable causes in 2010 One calculation of the resources expended by 271 U.S. congregations found that, on average, “operating expenses” totaled 71 percent of all the expenditures of religions, much of that going to pay ministers’ salaries. Financial contributions addressing the physical needs of the poor fall within the remaining 29 percent of expenditures.

[C]omparing their charitable giving to the performance of secular charities is informative. The American Red Cross spends 92.1 percent of its revenue directly addressing the physical needs of those it intends to help; only 7.9 percent is spent on “operating expenses.” If you use a generous 50 percent cutoff for indicating whether an institution is primarily a charitable organization or not (that is, they spend more than 50 percent of revenue on charitable work addressing physical needs), we doubt there is a single religion in the world that would actually qualify as a charitable organization.

Id. (footnotes omitted). Apparently recognizing this, a number of churches voluntarily disclose audited financial information. *See, e.g., Seven Standards of Responsible Stewardship*, EVANGELICAL COUNCIL FOR FIN. ACCOUNTABILITY, <http://www.ecfa.org/Content/Standards> (last visited Feb. 12, 2018) (listing standards for participating religious organizations, including financial oversight and transparency).

127. WOODROW WILSON, *THE NEW FREEDOM: A CALL FOR THE EMANCIPATION OF THE GENEROUS ENERGIES OF A PEOPLE* 114 (1913).

128. *See, e.g.,* Montague, *supra* note 51, at 207.

better data and making that data more publicly available.”¹²⁹ Indeed, as the Commissioner explained, “[t]ransparency is the linchpin of compliance, [and] when the structure and operations of charitable organizations are visible to all, the possibility of misuse and abuse is reduced.”¹³⁰ There is simply no real argument that this reasoning does not apply to churches today, and there is no reason to think that such an imposition will cause any harm.¹³¹

If anything, there is excellent reason to think that this need for transparency is more urgent when applied to churches than in other non-profit contexts.¹³² Churches exert a powerful psychological and cultural pull on their adherents. Congregants look to church leaders for guidance and leadership and will routinely accept statements from the pulpit as truthful or as reliable, even if those statements are not internally consistent or are at odds with other sources of information. This is not a critical or derogatory statement; church and religion are fundamentally about accepting or acknowledging a power greater than oneself, and that sort of acceptance leads to a particular vulnerability when it comes to informational asymmetry. A church is in a unique position to insulate itself from its donors (or investors, if you will) because it can broadly claim to be “doing good” or to be “spending wisely” with little internal pressure. Without the government or another third party to apply any pressure toward transparency or disclosure, this lack of oversight will ineluctably lead to a

129. *Hearing on Tax-Exempt Charitable Orgs. Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 110th Cong. 11 (2007) (statement of Steven T. Miller, Commissioner, Tax Exempt and Government Entities Division, Internal Revenue Service).

130. *Id.*

131. *See, e.g.*, Mishchenko, *supra* note 18, at 1363 (calling this nondisclosure “one of the biggest tax loopholes of all time”); *see also Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 100th Cong. 55 (1987) (“We are of the opinion that there is not a constitutional prohibition on requiring churches to file Form 990 information returns.”). In fact, Congress nearly imposed the 990 filing requirement on churches in 1969 but it retreated in the face of religious lobbying, particularly from Brigham Young University, a subsidiary of the LDS Church, and the United States Catholic Conference. *See* Brunson, *supra* note 79, at 5-6. These entities argued that the cost of disclosure would be too large and that requiring such disclosure would harm the separation of church and state. Although these arguments carried the day, they are rather weak considering the current interplay between churches and the broader economy. *See* Montague, *supra* note 51, at 216 (indicating that the exemption arose at a time when churches were not supposed to engage in “substantial commercial activity” (quoting S. REP. NO. 91-552, at 67 (1969))).

132. Montague, *supra* note 51, at 231-41 (discussing the influence and control religious leaders can exert with respect to church governance).

situation where churches tend to stray from the underlying goals of their donations (whether received directly from their donors or derivatively from taxpayers) to a greater degree than other charities that neither have psychological power over their donors nor are permitted to operate without any disclosure whatsoever.

Many of the broader economic arguments set forth in this Article apply generally to all tax-exempt charities. But churches, given their lack of reporting requirements and their unique role in society, are different. They have a compounded ability to mislead or stray from the charitable purposes that justify their unique status.¹³³ The reason why there are so many churches with significant profit-seeking activity is simple: because they can. They can because there is simply nothing preventing them from doing so. As such, it is especially important that churches should disclose their finances; it is especially the case that, for churches, “[t]ruth never damages a cause that is just.”¹³⁴

The second proposal is a subsequent, contingent one. Given the almost total opacity of how much money churches bring in and how they spend that money, a serious conversation and debate should occur following the imposition of the reporting requirement discussed above. Once there is an actual accounting, society can determine whether churches spend “enough” on charity. This would clearly be a value-laden conversation. As discussed above, there is some argument as to what should qualify as “charity.”¹³⁵ And there would also be substantial debate as to what qualifies as “enough.”

Such an argument and conversation is a legitimate and important one to have. Perhaps churches donate more than it appears to charitable causes, and perhaps the public would be perfectly content with the manner in which these entities are utilizing their tax subsidies. If that is the case, then society benefits by having an honest conversation, informed by concrete figures and clear accounting, about how tax subsidies are spent.

133. See *supra* note 49, acknowledging the potentially broad bases for churches’ special treatment but arguing that the policies inherent in this area of the law are rationally, and historically, grounded in charity that is directed outward from the church and designed to help the poor and aid society.

134. 2 M.K. GANDHI, *NON-VIOLENCE IN PEACE AND WAR* 162 (1949), <https://archive.org/details/in.ernet.dli.2015.174816/page/n173>. Some may argue that financial disclosure is more complex than this statement implies. See, e.g., Brunson, *supra* note 79, at 2 (“Disclosure should be instrumental, not an end in itself.”). Building on Form 990 should substantially counter such arguments, as this form already represents the considered enforcement and compliance policies and goals of the IRS.

135. See Hall & Colombo, *supra* note 43, at 1381.

On the other hand, if churches donate less to the needy than is generally believed,¹³⁶ then there is a powerful argument that churches should be taxed upon their capital inflows—from whatever source derived—to the extent that such capital is not redirected by the recipient to “charitable works.”¹³⁷

This is not a novel suggestion in the charitable realm, and it finds its basis in the law applicable to private foundations.

[T]ax law requires through excise tax enforcement that a private foundation make distributions for charitable, educational, religious, and similar kinds of purposes. These distributions are called “qualifying distributions” . . . [and are effected by requiring] the distributions for each year . . . to equal the greater of the foundation’s adjusted net income for the tax year or a minimum percentage of its investment assets as valued for the tax year.¹³⁸

Congress mandated these kinds of distributions in the Tax Reform Act of 1969.¹³⁹ This mandate arose out of the concern that private foundations were accumulating funds for private, non-charitable purposes without consequence, and were thereby creating a professional class of highly compensated administrators who were, in actuality, the only group to significantly benefit from private foundations and their corresponding tax subsidies.¹⁴⁰ As such, a fee or tax was required to provide for the “vigorous and extensive administration . . . needed in order to provide appropriate

136. See sources cited *supra* note 45.

137. This idea holds regardless of the organizational structure of the church, of which there are many. See, e.g., ARIENS & DESTRO, *supra* note 39, at 542–49. A contribution to any type of organization is deductible, so that deduction can be eliminated for any type of organization.

138. Charitable Giving ¶ 30.19 (Westlaw, Thomson Reuters, Tax & Accounting 2017) (citing I.R.C. §§ 4942(c), 4942(d), 4942(e) (2012)); see also I.R.C. §§ 4940, 4944 (imposing an excise tax on the net investment income of private foundations and on certain investments that may jeopardize a private foundation’s tax-exempt purpose).

139. Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487.

140. See INTERNAL REVENUE SERV., IRC 4942(G) – QUALIFYING DISTRIBUTIONS (1988), <https://www.irs.gov/pub/irs-tege/eotopicd88.pdf>; Arnsberger et al., *supra* note 30, at 107. A similar concern—with a similar governmental response—arises in connection with university and college endowments. See, e.g., Andrew Kreighbaum, *Final GOP Deal Would Tax Large Endowments*, INSIDE HIGHER ED (Dec. 18, 2017), <https://www.insidehighered.com/news/2017/12/18/large-endowments-would-be-taxed-under-final-gop-tax-plan>.

assurances that private foundations will promptly and properly use their funds for charitable purposes.”¹⁴¹

The parallel here is clear: churches that distribute little or nothing to charity accumulate wealth without oversight. And wealth is not the only thing they accumulate. These entities grow a seemingly endless supply of hangers-on, professionals, and administrators who benefit from an extraordinary concentration of wealth that is never distributed or given away.¹⁴² Directing little to none of their tax-exempt donations to charity, these individuals become the only class genuinely benefiting from the tax subsidies afforded by the American taxpayer.¹⁴³

Presuming these individuals to be rational economic actors, they are simply doing what they are reasonably expected to do. They are directly incentivized to minimize charitable contributions in order to maximize accumulated wealth and preserve their direct financial stake in what becomes, in essence, a financially conservative and entirely tax-benefit-

141. See H.R. REP. NO. 91-413, at 19 (1969). This approach has been echoed by other commentators who have studied tax-exempt organizations, albeit in a different context and for different reasons. See, e.g., Miller, *supra* note 35, at 10–11 (recommending taxation of currently exempt entities that “conduct active commercial businesses” and 501(c)(3) public charities with substantial assets that are not used for charitable purposes).

142. See, e.g., Arnsberger et al., *supra* note 30, at 107 (discussing the “growing perception among lawmakers that private foundations, with their small networks of financiers and administrators, were less accountable to the public than traditional charities” as the motivation behind requiring foundations to distribute some funds each year). Admittedly, the kinds of qualifying distributions required of private foundations generally include “reasonable and necessary administrative expenses,” Betsy Buchalter Adler & Brigit Kavanagh, *Philanthropic Partnerships Using the “Out of Corpus” Rules*, TAX’N EXEMPTS, May/June 2010, at 19, 20, a concept that could include some of the outsized spending churches currently devote to their own administrators.

143. And this is if one presumes that there is no fraud or outright financial chicanery involved. Even if the administrators of these churches are entirely forthright in their personal dealings (a supposition there is much reason to doubt—see, e.g., Montague, *supra* note 51, at 232 (“Another study found that in 2000, an estimated \$7 billion was embezzled by leaders of churches and religious organizations in the United States.”))—and even if they are not compensated at outrageous rates (another supposition there is much reason to doubt—see, e.g., *Teague v. Bakker*, 35 F.3d 978, 983 n.4 (4th Cir. 1994) (listing some of the incredible compensation perks allotted to the Bakkers, including “a luxury parsonage, complete with an air-conditioned treehouse and personal waterslide”))—these people are still, by definition, the only ones who benefit from the money flowing to churches when that money stays within the confines of the churches. Indeed, there is reason to think that churches are particularly susceptible to the kind of abuse that disclosure and transparency would help prevent. See, e.g., Montague, *supra* note 51, at 231–46 (discussing social and cultural factors that can lead to fraud, abuse, and corruption in a church setting).

seeking enterprise.¹⁴⁴ Of course, as discussed above, this behavior does not have the society-fortifying effect sought by the government and instead undermines and distorts the broader economy. It essentially becomes an inevitable mutation greatly benefiting the individuals who are in a position to direct the investment strategies of churches. Recognizing this parallel, the government should turn to the remedy it has crafted with respect to private foundations and similarly craft a required distribution regime for churches.¹⁴⁵

The requirements applicable to foundations are quite technical and specific, and this Article is not suggesting a direct application of these principles to churches.¹⁴⁶ Indeed, any such analysis would be premature prior to a thorough review of the information that would be provided by requiring churches to report their finances.¹⁴⁷

144. In fact, the predictability of this behavior is an implicit conclusion of this Article. Professional clergy are provided with a completely opaque and culturally favored investment vehicle that is tax-incentivized to hold and invest funds. Such a vehicle protects their social and economic position and permits an ever-expanding pursuit of additional opportunities and contributors. If a publicly traded corporation were permitted to keep all of its activities secret and allowed to raise and invest tax-free funds, what would it do? It would do exactly the same thing, never returning or distributing any donations because it would be economically foolish to do so. Churches—and the paid professionals who run them—are doing just that, simply responding to the incentives put to them by the IRC. Draining the situation of moral or ethical overtones, what can really be expected, and what blame can really be assigned? The constructive approach is to identify the situation as an institutionalized moral hazard and attempt to remedy it.

145. Note that much of the reasoning supporting the adoption of this second recommendation may apply to non-church charities as well. However, such an extension is outside the scope of this Article. It also seems—given the scope of the “non-charity spending problem” and the cultural issues inherent in a church setting—that churches may be *more* likely to need this nudging toward charitable behavior than, say, the Red Cross or a hospital. Again, though, the thesis of this Article obviates any need for such an analysis or discussion here.

146. See, e.g., John Dedon & Benjamin Kinder, *Cautionary Guidance for Operating a Private Foundation*, EST. PLAN., Feb. 2017, at 9, 11-13 (noting numerous complications of, and restrictions placed upon, private foundations, including an excise tax tied to net investment income, prohibited transactions with “disqualified persons,” qualifying distributions tied to a foundation’s investment assets, prohibitions on excessive or risky business holdings, imposition of “taxable expenditure” rules, and restrictions on donations to foreign organizations).

147. For example, most churches spend perhaps 10-20% of their tithed funds on “management and overhead.” Going forward, that figure could become a benchmark as to the spending levels permitted on that line item with exempt funds. In a sense, what this argument is suggesting is that society carefully re-evaluate the definition of charity, found in Treas. Reg. § 1.501(c)(3)-1(d)(1)(iv), as including a description as broad as “advancement of

Instead, it is enough here to argue that the broad principle of enforced distributions should apply. Generally speaking, churches should be required to pay tax on all funds that are not redirected to “charitable purposes,” however such phrase is ultimately defined. Doing so will place churches on the same footing with other market-facing entities by effectively eliminating the tax shelter churches now enjoy when they eschew charity in favor of profit-seeking.

Let us return to our example above one last time. Recall that *X Corp.* and Church *A* are both examining whether to invest in a residential development and that, assuming they both have a 10% benchmark for return on investment, only Church *A* will be able to pay the \$5,000,000 asking price (thus pressuring rates of return available across the spectrum to all entities). If, however, the money raised by Church *X* is taxed, then it will have to generate \$6,250,000 in order to have \$5,000,000 in expendable funds.¹⁴⁸ Its 10% benchmark now requires it to pursue a different opportunity—one that will return \$625,000, placing it in the same position as *X Corp.*¹⁴⁹ This

religion.” See *supra* note 49 and accompanying text. If “advancement of religion” is being used as cover to justify spending 2-3% on the needy, society should know that and decide whether that is consistent with the underlying rationale of the tax subsidy. That kind of re-evaluation is an intensely fact-intensive analysis that involves a lot of value and policy judgments—the primary point is that, right now, our society is reaching its conclusions with *no facts*.

148. We are assuming equivalent tax rates. Setting tax rates is a complicated political process and is well outside the scope of the simplified issues and examples discussed herein. Assuming equivalent rates is helpful here because it demonstrates how a simple tweak to the tax code can place churches and for-profit entities on the same footing.

149. Note that this proposal does not require churches to pay taxes on the money generated by their active pursuit of profits. In theory, this is already required under the current law. See, e.g., Arnsberger et al., *supra* note 30, at 118 (“Exempt-organization business income taxation was designed to place unrelated activities of exempt organizations on an equal footing with similar activities carried out by taxable entities.”); see also Brunson, *supra* note 120, at 230–32 (describing the implementation of the UBIT as an attempt to prevent for-profit businesses owned by tax-exempt entities from escaping taxation and so preventing an unfair advantage); Sharpe, *supra* note 30, at 382–98 (discussing the history behind the adoption of the UBIT and the rationale thereof, grounded in the idea that exempt entities should not be able to engage in unrelated activities and so “gain competitive advantage over private enterprise” (quoting 96 CONG. REC. 769, 771 (1950) (message from the President to the United States))). The concept behind the UBIT—focused as it is on active profit-seeking and the unfair competition arising therefrom—is very similar to that discussed in this Article; commentators have traditionally cast the unfair advantage that UBIT is meant to avoid as having two parts: (1) because tax-exempt entities do not pay tax, they can charge lower prices and still earn the same return as their competitors, and (2) because tax-exempt entities can accumulate earnings more quickly, they can grow faster and

means that churches will no longer have first access to the “best” opportunities but instead will be subsidized only when they engage in charity.¹⁵⁰

This is, of course, a very broad recommendation. Tax strategy is a highly complex and technical pursuit, and this Article does not intend to address all aspects of how such a system would work.¹⁵¹ It is enough that, pursuant

have a lower risk of bankruptcy or insolvency. *See* Brunson, *supra* note 120, at 232; *see also* Hansmann, *supra* note 106, at 611 (“The more compelling view . . . is that corporate income tax *does* affect the cost of capital at the margin and that, everything else being equal, tax-exempt corporations have higher rates of return on investment than those of taxable firms. Thus, tax-exempt firms can earn a profit at prices below those at which taxable firms can break even.”). This Article is based on precisely the same concern, but at an earlier stage of the profit-seeking process. That is, it is concerned with the “front-end” of the church-charity industry, the manner in which these entities first raise the money they utilize. The UBIT is directed to the “back-end” of the industry—the manner in which those funds are then used (which use potentially benefits from tax exemption). This Article focuses on the distortions arising from how an organization’s donated capital is taxed, not on how it is spent or invested.

150. This is because church funds spent on charity will remain untaxed. Note, too, that this does not require a change to the law permitting taxpayers to deduct charitable contributions. *See* I.R.C. § 170 (2012). This can stand as-is so long as churches are taxed on funds not spent on charity. Another way of viewing the problem is that it essentially arises from the divorce of churches from their source of capital (their donors). Corporations have no such divorce from their source of capital and so, being a mere conduit for the economic goals of others, have to capture the tax status of their shareholders. Imposing a tax on churches evens the score by imposing the same tax ramifications on churches as on everyone else because it requires churches to view the world through the eyes of their tax-paying donors in the same manner as corporations have to view the world through the eyes of their tax-paying shareholders.

151. In particular, it seems likely that what qualifies as “charity” would be a tricky and intrinsically subjective determination. Charities, like all organizations, have some overhead. Would rent for headquarters qualify? Salaries? Bonuses? What about money expended on world-class healthcare for high-level functionaries? Or would it be easier for the law to simply set a presumably acceptable overhead rate, such as 20% of all funds raised? Similarly, how quickly would a church have to expend funds in order to avoid taxation? Could they wait a year? Two years? What if there are no suitable charitable objects available—should there be an exception granted in certain circumstances? These are interesting questions that would have significant effects on individual entities. *See, e.g.,* Miller, *supra* note 35, at 500–01 (briefly examining some specific suggestions and indicating that Congress “could appropriately provide that any public charity whose assets are not directly used for charitable purposes exceed a threshold amount and consistently exceed a stated multiple of its average annual expenditures would be taxable to the extent of its non-UBTI investment income (or possibly the sum of its net non-UBTI investment income plus new contributions) that is (are) not used directly for charitable purposes”); Sharpe, *supra* note 30, at 412–43 (discussing the definition of “trade or business” and “substantially

to the first recommendation above, churches will have to disclose where their funds go and that those funds that do not go to charity will be treated just like all other funds in the marketplace.¹⁵²

Conclusion

The problems identified in this Article are significant. The LDS Church is a poignant example. This is unsurprising because it is a cogent representation of the problems that can result from an unmonitored and unchecked system of charitable taxation. But this is not only an issue for the LDS Church, nor is it really an issue of greed or even blame. All churches are permitted to operate secretly, and all churches receive tax-free contributions and are given other substantial tax exemptions. This combination of secrecy and special tax treatment pushes tax-exempt entities away from the very charitable acts they are supposed to perform and into profit-seeking endeavors. It is simply a situation of churches (and their minders) reacting rationally to the incentives placed before them. Because churches can raise money and funds at a lower price than others, they have an incentive to do so as much as possible and put those funds to use in a manner that makes economic sense for them.

In such an economic and tax regime, one may end up reasonably confusing spirituality and capital pursuits. But a lack of culpability does not make it right. What we end up with is a system that does not result in the kind of charity it purports to stimulate but instead distorts the broader economy and harms investors throughout the American marketplace. This situation should not be acceptable to the U.S. taxpayer.

The government should foreclose this kind of behavior by requiring churches to disclose their finances and levy a tax on money that does not go to charity. In the end, the taxpayer has made a very conscious investment in a clearly defined set of goods and services, and charities should have to deliver on that investment.

related” in the context of the UBIT at length, concepts that could be usefully applied to separate “non-profit” from “profit”). Ultimately, in the context of this Article, these are mere details. *But see* ZELINSKY, *supra* note 51, at 113-56 (arguing that taxation of churches risks undue entanglement and pointing out that these sorts of subjective decisions inherently affect religion in a negative way). Simply accepting that funds that are not spent on charity should be taxed will have the desired impact, regardless of what technical aspects end up being implemented.

152. “Distortions are bad because they change what an actor would do in a tax-free world; in the interest of efficiency, the tax law tries to minimize the effect that taxes have on taxpayers’ decisions.” Brunson, *supra* note 120, at 250.