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Rendering unto Caesar or Electioneering for Caesar--Loss of Church Tax Exemption for Participation in Electoral Politics

Alan L. Feld
Boston Univeristy School of Law

RENDERING UNTO CAESAR OR ELECTIONEERING FOR CAESAR? LOSS OF CHURCH TAX EXEMPTION FOR PARTICIPATION IN ELECTORAL POLITICS

ALAN L. FELD*

Abstract: The restriction on church participation in political campaigns contained in the Internal Revenue Code operates uneasily. It appears to serve the useful purpose of separating the spheres of religion and electoral politics. But the separation often is only apparent, as churches in practice signal support for a particular candidate in a variety of ways that historically have not cost them their exemptions. Although the limited enforcement by the Internal Revenue Service has reflected the sensitive nature of the First Amendment values present, the federal government should provide more formal elaboration by statute or regulation. Focus on the use of funds seems warranted, to prevent the diversion of government subsidy from exempt purposes to political activity. Beyond that comparatively clear line, the practical difficulties of enforcement loom large.

INTRODUCTION

The federal income tax casts a broad net. It subjects individuals, corporations, trusts, and other entities to reporting, payment, and withholding requirements. It also provides exemption from one or more of these duties for a select list of organizations. Section 501(c)(3) of the Internal Revenue Code generally exempts from income tax entities organized and operated exclusively for exempt purposes, including religious purposes, provided they meet three conditions.[1] No part of the net earnings may inure to the benefit of any private shareholder or individual. No substantial part of its activities may consist of carrying on propaganda or otherwise attempting to influence legislation. Finally, the entity may not participate in or intervene in a political campaign for public office. The first condition

* Professor of Law, Boston University School of Law.

[1] I.R.C. § 501(c)(3) (1986).

maintains the not-for-profit character of the entity.[2] The latter two requirements condition tax exemption on the entity's limited participation in the nation's political life. They differ in one important respect. The Internal Revenue Code restricts lobbying only when it constitutes a "substantial" part of the organization's activities, while it treats electoral politics as absolutely inconsistent with exemption.[3]

Constraints on political participation raise a variety of issues that engage First Amendment values, including abridgement of freedom of speech and of the right to petition government for redress of grievances. The Supreme Court considered and rejected a challenge on these grounds to the anti-lobbying condition of section 501(c)(3).[4] The Court held that the Code did not deny the organization in that case the right to receive deductible contributions for its non-lobbying activity. The Code simply declined to support the lobbying activity with public funds.[5]

The Supreme Court has not had occasion to consider a similar challenge to the political constraints under the clause of the First Amendment that deals with the free exercise of religion. Other courts have. In a prominent case, the United States Court of Appeals for the Tenth Circuit rejected the claim by Christian Echoes National Ministry that the Constitution allowed it to lobby beyond section 501(c)(3)'s permitted limits without losing its exemption.[6]

Turning to the third condition for tax exemption, nonintervention in political campaigns, a recent case has affirmed, apparently for the first time, the revocation of a church's tax exemption for active

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[2] *See generally* Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 835 (1980).

[3] The Internal Revenue Code separately imposes excise taxes on amounts paid by private foundations to influence legislation or to influence any election. The definition of private foundations excludes churches. *See* I.R.C. § 4945 (1986).

[4] Regan v. Taxation with Representation, 461 U.S. 540, 545–46 (1983); *see also* Cammarano v. United States, 358 U.S. 498, 513 (1959).

[5] *Taxation with Representation*, 461 U.S. at 545–46.

[6] Christian Echoes Nat'l Ministry, Inc. v. United States, 470 F.2d 849, 854–55 (10th Cir. 1972). Congress later allowed certain exempt organizations to elect to engage in lobbying activities deemed insubstantial, as measured by the organization's expenditures for that function. *See* I.R.C. § 501(h) (1986). The legislation excluded churches and related organizations from the election, on the ground that church groups had raised objections based on First Amendment rights. The legislative history specifically said that Congress had neither approved nor disapproved the statements or holdings of the *Christian Echoes* case. STAFF OF JOINT COMM. ON TAXATION, 94TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976 at 415–16, *reprinted in* 1976-3 C.B. 1, 427–28 (vol. 2).

participation in an election.[7] The United States Court of Appeals for the District of Columbia concluded that the IRS properly had revoked the tax exemption. The case illustrates the competing claims of tax burdens and benefits and the organization's impetus to address the public from a religious standpoint.

I. The Church at Pierce Creek

Branch Ministries, also known as the Church at Pierce Creek, and its pastor, Dan Little, placed full-page ads in two newspapers, the *Washington Times* and *USA Today*, four days before the 1992 presidential election. The ads, headed in bold type "Christian Beware," opposed the election as President of Governor Bill Clinton. It bulleted three positions Clinton assertedly supported or promoted—abortion on demand, the homosexual lifestyle, and giving condoms to teenagers in public schools. It said the Bible warns us not to follow another in his sin. It concluded, "How then can we vote for Bill Clinton?" In smaller print at the bottom of the page appeared the following notice: "This advertisement was co-sponsored by The Church at Pierce Creek, Daniel J. Little, Senior Pastor, and by churches and concerned Christians nationwide. Tax-deductible donations for this advertisement gladly accepted. Make donations to: The Church at Pierce Creek."[8]

After a lengthy review, in part mandated by Code provisions granting churches special procedural protections,[9] the Internal Revenue Service revoked Branch Ministries' tax exemption. The district court agreed with the IRS and the D.C. Circuit affirmed.[10] The appellate court held that revocation of the exemption did not place a substantial burden on Branch Ministries' exercise of religion.[11] It said that the church did not claim that withdrawal from electoral politics would violate its beliefs. Loss of tax exemption, the court said, might decrease the funds otherwise available for religious practices, but that does not constitute a constitutionally significant burden.[12] Indeed, if the church did not intervene in future political campaigns, it could

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[7] Branch Ministries v. Rossotti, 211 F.3d 137, 145 (D.C. Cir. 2000), *aff'g* 40 F. Supp. 2d 15 (D.D.C. 1999).

[8] *Id.* at 140.

[9] *See* I.R.C. § 7611 (1986).

[10] Branch Ministries v. Rossotti, 211 F.3d 137, 145 (D.C. Cir. 2000), *aff'g* 40 F. Supp. 2d 15 (D.D.C. 1999).

[11] *See id.* at 142–44.

[12] The court cited Jimmy Swaggart Ministries v. Bd. of Equalization, 493 U.S. 378, 391 (1990) and Hernandez v. Comm'r, 490 U.S. 680, 700 (1989) for this proposition.

hold itself out as tax-exempt.[13] The court also rejected a claim by the church of selective prosecution.[14] The church noted instances of candidate appearances or endorsements under the auspices of other churches.[15] The court responded that Branch Ministries had cited to no other instance of advertising by a church for or against a political candidate in a national newspaper and solicitation of tax-deductible funds.[16] In other words, the IRS did not abuse its discretion by prosecuting the most egregious case.

Although *Branch Ministries* addressed the exemption from tax under section 501(c)(3), the holding also implicates the treatment of donors to the church. Section 170(c)(2), which defines the major category of recipients of tax-deductible gifts, contains parallel conditions for qualification. When Branch Ministries lost its tax exemption its donors no longer could deduct their gifts to the church as charitable contributions.

II. Analysis

The court reached the correct conclusion under current law. The Code's limitation on church participation in electoral politics, however, raises a difficult question of administration and enforcement. The IRS has exercised great restraint in its enforcement of the prohibition and perhaps the statute or the regulations should reflect these limits more formally.

The court and both sides in the case agreed that the constitutional result turned on a comparison of the burden imposed on Branch Ministries by revocation of the tax exemption and the interests forwarded by conditioning exemption on avoidance of electoral politics.[17] Turning first to the burden, at least four considerations argue that the burden did not constitute a serious interference with the free exercise of religion.

A. The Limitation Does Not Apply to Individuals

The statute addresses the political activity only of exempt entities. Each individual member of a church may participate in full in electoral politics. When a prominent church leader acts or speaks, agency

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[13] *See Branch Ministries*, 211 F.3d at 142.
[14] *Id.* at 144–45.
[15] *Id.* at 144.
[16] *Id.* at 144–45.
[17] *See id.* at 142–44.

principles must determine whether to impute the action to the church. For most religious traditions, the religious leader acts as teacher. In many, an utterance from the religious leader as an individual constitutes the necessary and sufficient guidance for political attitudes and actions of the faithful. No action by the exempt entity as an entity need occur. The statutory conditions that rule out political activity under sections 170(c)(2) and 501(c)(3) constrain only the formal actions of the exempt entity or the use of its property, through expenditure of its funds or use of its physical facilities, in order to forward a candidacy. Thus, a minister or a lay church official, in an individual capacity, may walk through town wearing a campaign button. Religiously motivated individuals can speak truth to power without penalty. They simply cannot use the corporate form or the church coffers to do it.

B. Parallel Organizations

Participants in charitable endeavors have long found ways to forward activities not suitable for the exempt entity. The simplest consists of the formation of a parallel organization, not intended to qualify under section 501(c)(3). The charity carries out its exempt function exclusively. The parallel organization engages in the other activities, including those that might fall within the regulation's definition of an "action organization."[18] The parallel organization may seek tax exemption under Code section 501(c)(4), as a social welfare organization. The fundamental tax difference between the charity and the parallel organization concerns donations. Donors to the parallel organization ordinarily would not deduct their gifts.[19] The existence of two organizations thus segregates the tax-favored contributions of the charity from the nonexempt charitable activities. Justice Blackmun, concurring in *Regan v. Taxation with Representation*, thought this opportunity to create a parallel organization critical to holding the restriction on lobbying in 501(c)(3) constitutional.[20]

For participation in electoral campaigns, however, the parallelism becomes more complex. An organization exempt under section

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[18] Treas. Reg. § 1.501(c)(3)–1(c)(3)(1990) defines the term "action organization" to include entities a substantial part of the activities of which include lobbying or which participate in election campaigns.

[19] Deductibility, although not as charitable gifts, sometimes may be available for donations to certain exempt organizations, such as chambers of commerce. Treas. Reg. § 1.162–28 (1995) requires allocation of expenses to nondeductible lobbying activities.

[20] *See* 461 U.S. 540, 552–54 (1983) (Blackmun, J., concurring).

501(c)(4) may not participate in political campaigns.[21] The parallel organization would either forego tax exemption or, as the court of appeals suggested, could form yet a third entity, a political organization under Code section 527. The members of the church thus can send their political message, but not with the use of deductible dollars and at the cost of maintaining several corporate entities.

C. Effects of Loss of Tax Exemption

Charitable institutions pursue tax exemption for reasons already suggested: to prevent income taxation on the entity's income and to become eligible to receive tax-deductible donations. In addition, state law may exempt federally exempt entities from sales tax. Other benefits to section 501(c)(3) status exist.[22] But the practical significance of exemption will vary greatly with the entity. Suppose the federal tax law treated a church as a taxable entity engaged in the business of providing religious services. Most churches nevertheless would incur little or no tax liability because they do not earn taxable income. A religious organization typically receives much of its revenue in the form of donations. As the IRS conceded in *Branch Ministries v. Rossotti*, gifts do not constitute income. Absent an argument that the church received payment for services rather than gifts,[23] the receipts actually subject to tax would include investment income and little else. Deductions would include salaries and similar expenses of providing the services. The church likely would have little or no tax liability. Again, the burden lies not in the taxation of the entity but in the loss of donor deductions for gifts to the church.

D. Go and Sin No More

The Code does not explicitly bar a church that lost its exemption by reason of political activity from reapplying for exemption.[24] The court of appeals in *Branch Ministries v. Rossotti* said the IRS had confirmed that if the church does not intervene in future political

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[21] Treas. Reg. § 1.501(c)(4)–1(a)(2)(ii)(1990).

[22] For example, special postal rates.

[23] *See* Hernandez v. Comm'r, 490 U.S. 680, 689–92 (1989).

[24] Section 504 bars an organization formerly treated as exempt under section 501(c)(3), but which lost its exemption by reason of political activity, from qualifying for exemption under section 501(c)(4). Section 504(c) contains a special exception for churches. Treas. Reg. § 1.501(h)–3(d)(1990) allows an organization that lost its section 501(c)(3) exemption because lobbying was a substantial activity to reapply for exemption in any taxable year after the first year in which exemption was denied.

campaigns it may hold itself out as exempt under section 501(c)(3).[25] Unlike virtually all other kinds of exempt organizations, churches enjoy exemption without having first to obtain an IRS ruling as to tax status.[26] Absence of a prior ruling would put potential donors at risk of establishing the exempt character of the church in order to obtain a deduction under sections 170 (income tax), 2055 (estate tax), or 2522 (gift tax). The court did not say so, but the church presumably could reapply for exemption if it renounced political activity.

Turning to the interests potentially forwarded by the anti-political activity requirement, at least some of the argument turns on the treatment of charities' tax-favored position as a subsidy. The entities described in sections 501(c)(3) and 170(c)(2) receive tax benefits analogous to subsidies. Remission of tax liability produces the same net economic effect as a direct payment from the government. The government properly can limit the use of its subsidy to the exempt purposes for which the entity was organized. More affirmatively, it properly can conclude that government dollars should flow into political campaigns only in specifically defined ways. The Supreme Court in *Taxation with Representation* and the court of appeals in *Branch Ministries* accepted this characterization of the tax exemption for charities and the tax deduction for charitable gifts.

Not everyone has viewed these provisions as conferring subsidy. Some scholars have justified tax exemption for charities on other grounds.[27] Thus, any tax requires initial definition of its base. An income tax plausibly could apply only to entities engaged in profit-seeking activities. Excepting charities from such a tax arguably consists of definition of the tax base, not tax subsidy. And although the dominant view treats the deduction for charitable contributions as a subsidy, dissenting voices exist.[28]

More affirmatively, the restriction on electoral activities may serve the salutary function of limiting the extent to which political campaigns might deflect charities from focus on their exempt functions. As applied to churches, if the heat of the political moment converted

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[25] 211 F.3d at 142.

[26] I.R.C. § 508(c)(1)(A) (1986).

[27] Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 299 (1976); Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 IOWA J. CORP. L. 585, 585 (1998).

[28] *See* William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 344–75 (1972). *See generally* Edward A. Zelinsky, *Are Tax "Benefits" for Religious Institutions Constitutionally Dependent on Benefits for Secular Entities*, 42 B.C. L. REV. 805 (2001).

electoral competition into religious strife, the result could damage society and community.

III. Practical Difficulties of Current Law

The restriction on church participation in elections can serve useful functions. But it operates unsatisfactorily in practice, in at least two related ways.

First, churches routinely engage in activities that endorse or promote a particular candidate. In communities where churches play an important role, the church becomes a natural place to embrace a candidate thought to have befriended that community. If the minister introduces a candidate from the pulpit at the Sunday service before election day, the church gives its approval to that candidate and has participated to that extent in the political campaign. These activities literally contravene the statutory condition, yet the IRS generally ignores them.[29] However, if the church spends no funds to promote the candidate and the use of its property incurs only nominal expense, the activity arguably does not entail the expenditure of tax-subsidized dollars in the political campaign. If we articulate the purpose of the restriction as assuring that tax-subsidized dollars go exclusively for exempt purposes, endorsement activities of this kind do not violate the purpose of the statute.

Second, auditing the activities of churches for forbidden political activity presents significant problems. How is the IRS to obtain information as to whether the church expended funds for inappropriate electoral purposes? May it review the church's accounts and its charitable and sacral works to determine whether the entity stepped over the bounds set out in the statute? If the minister wears a campaign button, is he doing so in his individual capacity (permissible) or as an agent of the church (perhaps impermissible). *Branch Ministries v. Rossotti* presents the easiest case for enforcement because the facts are not disputable and significant expenditures of funds occurred.[30] Few cases announce their violation of both the statute and one of its underlying purposes with such clarity.

In *Walz v. Tax Commission*, the Supreme Court upheld the constitutionality of property tax exemption for religious institutions as an

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[29] For a description of recent electoral practices, see generally Randy Lee, *When a King Speaks of God, When a God Speaks to a King: Faith, Politics and the Constitution in the Clinton Administration*, 63 Law & Contemp. Probs. 391 (2000).

[30] 211 F.3d 137 (D.C. Cir. 2000).

appropriate way to avoid undue entanglements between those institutions and government.[31] Enforcement of the election campaign restriction in a literal way would create just such entanglements.

CONCLUSION

The restriction on church participation in political campaigns contained in the Code operates uneasily. It appears to serve the useful purpose of separating the spheres of religion and electoral politics. But the separation often is only apparent, as churches in practice signal support for a particular candidate in a variety of ways that historically have not cost them their exemptions. Literal enforcement of the provision seems unpalatable, as it would create unfortunate entanglements between churches and government. Apparently widespread violation of the terms of the statute loses respect for the law.

At a minimum, further clarification and restriction of the scope of the restriction seems appropriate. Although enforcement by the IRS has reflected the sensitive nature of the First Amendment values present here, the government should provide more formal elaboration by statute or regulation. Focus on the use of funds seems warranted, to prevent the diversion of government subsidy from exempt purposes to political activity. Beyond that comparatively clear line, the practical difficulties of enforcement loom large.

[31] 397 U.S. 664, 673–77 (1970).