

A Guide for the Perplexed: Should a Faith-Based Institution Seek 501(c)(3) Status?

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Of the 386,000 American congregations that provide charitable services in their communities, half are registered with the Internal Revenue Service as 501(c)(3) public charities. This would suggest that persons of faith in the U.S. are split 50-50 as to the need for their institutions to formally apply for tax-exempt status. To apply or not to apply—indeed, a puzzling question. After all, the IRS stipulates in its *Tax Guide for Churches and Religious Organizations* that faith-based institutions meeting the requirements of Internal Revenue Code 501(c)(3) “are automatically considered tax exempt and are not required to apply for and obtain recognition of tax-exempt status from the IRS.”

These requirements are:

- The organization must be organized and operated exclusively for religious, educational, scientific, or other charitable purposes,
- net earnings may not inure to the benefit of any private individual or shareholder,
- no substantial part of its activity may be attempting to influence legislation,
- the organization may not intervene in political campaigns, and
- the organization’s purposes and activities may not be illegal or violate fundamental public policy.

Item number four (“the organization may not intervene in political campaigns”) has aroused the suspicions of certain fringe groups. According to hushmoney.org the automatic exemption dates to 1954 and the machinations of “a shrewd and cunning” U.S. Senator who “had it in mind to silence the church.” His name was Lyndon B. Johnson, our 36th president.

Interestingly, the term “church” is not defined in the Internal Revenue Code. Instead, like an intelligent machine devised in a computer science lab, the IRS relies on a form of pattern recognition. Fourteen “attributes” of faith-based institutions are applied, including a recognized creed, a distinct religious history, ordained ministers, established places of worship, a congregation, and regular religious services. An organization that exhibits a cluster of the highlighted attributes and also abides by the requirements bulleted above will be recognized as church. Such an organization does not have to formally seek a tax exemption. It is exempt.

The organization may solicit donations, and the contributions it receives are entirely tax-deductible. Why then should it spend time and resources applying for tax-exempt status? Why acquire the burden of filing extra paperwork? A 501(c)(3) public

charity must make documents available for public inspection—why expose the institution to an intrusive, required audit should the IRS raise compliance issues?

Additionally, the IRS recognizes group exemptions. According to this stipulation, the local affiliates of a central organization do not each have to apply for a tax exemption. The governing body can obtain a group exemption letter for itself and its satellites. The group exemption applies to faith-based institutions. The Evangelical Lutheran Church in America and Catholic Charities are examples of organizations that take advantage of this rule.

Given the availability of the group exemption for parishes that belong to a diocese, as well as the automatic exemption for faith-based organizations, why then should an individual congregation consider applying for a 501(c)(3)? Essentially, there are two reasons:

First, the 501(c)(3) may be desirable as a management tool. Suppose a compassionate congregation decides to develop housing for homeless people or to open a day-care center? The parish staff may hold advanced degrees in divinity, but housing and child-care services are complex operations a priest or minister is not ordinarily trained to manage. The most efficient way to proceed might be for the institution to create a spin-off to discharge what is essentially an ancillary mission. An executive director trained in social service delivery would be hired to run the program; the parish leaders would likely occupy seats on the board of directors. The housing or child-care program would develop a mission statement and apply for a tax-exemption as an independent public charity. The 501(c)(3), in this instance, enables the parish to resolve the managerial dilemmas of a complex charitable activity.

Second—and this is the most compelling reason for obtaining the 501(c)(3)—it may be a necessity given the scope and scale of your fundraising program. If you plan to apply for government or foundation grants, you will need to formally apply for tax-exempt status because large public and private funding agencies usually require the 501(c)(3) as a condition of their support.

There is a certain philosophy behind this requirement which is well worth thinking about. The government formally awards a tax exemption to encourage organizations to make a contribution to civil society. The 501(c)(3) is fundamentally a contract between the government and the officers and Board of Directors of the exempt organization. In exchange for 501 status, the officers and directors, in effect, are commissioned to ensure that the agency is doing what it is charged to do by its mission statement. They are enjoined to perform the function of a public watchdog. The tax-exemption is therefore a quid pro quo. That is why grant makers insist that grantees provide proof of 501(c)(3) status as a matter of course.

Faith-based organizations need not be deterred by the responsibilities inherent in formal tax-exempt status. Most of the conversations about seeking or not seeking the 501(c)(3) occur when an organization of faith resolves to engage in social outreach for community improvement. My feeling is that the institution should conduct its social ministry in a nondenominational way, free of

proselytizing. It should proceed on the understanding that its social services cannot be restricted to its own congregants and that, in the performance of human service, it cannot proselytize. Services should be delivered without allegiance to creed.

Most of us think of the word “service” in connection with things that are due us: room service, customer service, etc. There is a more traditional meaning of “service”: *to serve*, to give of oneself without thought of reward. This is the concept embodied, for example, in St. Ignatius’ Prayer for Generosity:

***Lord, teach me to be generous.
Teach me to serve you as
you deserve; to give and
not to count the cost,
to fight and not to heed
the wounds, to toil and
not to seek for rest,
to labor and not to ask for reward,
save that of knowing that I do your will.***

Social services performed in this spirit will not violate the responsibilities, stated and unstated, of a 501(c)(3) public charity. So do not be persuaded by salesmen attempting to market “faith-based” 501(c)(3) application kits. Faith-based institutions are not required to have a formal tax exemption to solicit tax-deductible contributions. But they may want to secure the 501(c)(3) for management and/or fundraising reasons.

As Matthew Heyd, associate director of Trinity Grants Program, puts it, “I hear many parish leaders ask, ‘Do I need it or not?’ But they do not always know how to get an answer to the question. The legal answer is one thing, but the management answer is just as vital if not more so. For those that have pursued a new 501(c)(3), having the vision and capacity to support it after the filing occurs is essential.”

And, if so, they need not fear the consequences of rendering unto Caesar. Or LBJ.

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