

## **What's in a number . . . like 501(c)(3)?**

Many organizations engage in charitable activities. The traditional use of the term charitable is found in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

In order to qualify as a tax-exempt nonprofit entity under the Internal Revenue Code (the Code), an organization must be explicitly formed for one or more of the exempt purposes set forth in section 501(c)(3) which are: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. Ideally, this will be stated in the organization's Articles of Incorporation or a similar writing.

Ordinarily, to be officially recognized as an exempt nonprofit entity, an application must be made to the IRS for a Determination Letter that establishes the income tax status of the organization. However, a subsequent section of the Code—508(c)(1)(a)—relieves churches, conventions of churches and certain other religious organizations, such as the CSBC, from having to apply for a formal Determination Letter. Nearly 60 years ago, however, the CSBC obtained a Group Exemption Letter from the IRS that officially extends this tax-exempt status to all affiliated churches. This is currently permitted under regulations issued in Revenue Procedure (Rev. Proc.) 80-27.

In May 2020, in response to a relatively small but increasing number of abuses, the IRS proposed sweeping changes to its Group Exemption Revenue Procedure in Notice 2020-36, which would effectively end the ability of the CSBC and numerous other religious organizations from applying their Group Exemptions to affiliated entities (the IRS has stopped accepting new applications for Group Exemption Letters pending the publication of the finalized Procedure). A public comment period was initiated at that time, and ended on August 16, 2020. As of February 2021, the final Procedure has yet to be published, but the final procedure could be published at any moment.

One provision in the new Procedure would require that all organizations covered under a Determination Letter must fall under the same subsection of Section 501(c)(3). This would adversely affect a number of non-church organizations currently under the CSBC's umbrella such as separately incorporated food pantries operated by several churches, the Baptist District Camp of the Delta Valley Southern Baptist Association,

and the CA WMU organization. Some entities, such as the Roman Catholic church, have multiple Group Determination Letters to cover their other non-church nonprofit organizations, such as hospitals, convents, schools, and other charities. The new Procedure would limit the number of Group Determination Letters issued to a single organization to just one.

One particular set of changes that has provoked numerous comments falls under the heading of General Supervision and Control Requirements, and would only permit Group Exemptions when “a central organization demonstrates that each subordinate organization covered by the group exemption letter is affiliated with the central organization **and subject to its general supervision and control.**” The current Procedure, dating to 1980, doesn’t define general supervision or control.

According to the proposed Revenue Procedure, a subordinate organization is considered to be under a central organization’s general supervision, only when the central organization does *both* of the following:

- Annually reviews and retains information on the subordinate’s finances, activities, and compliance with annual filing requirements
- Sends written notice to the subordinate about the requirements to maintain its tax-exempt status

Although CSBC uses the Annual Church Profile (ACP) survey to assist in compiling and reviewing such information as membership and finances, with fewer than 40 percent of churches completing their ACP survey, the Convention would be hard pressed to explain how it exercises control over all of the affiliated churches.

Under the proposed Procedure, actual control also only occurs when ***the central organization*** appoints a majority of the subordinate’s officers, directors, or trustees; or a majority of the subordinate’s officers, directors, or trustees serve the central organization in the same capacity. Additionally, the proposed Procedure introduces a new requirement that all subordinates must adopt a uniform governing instrument, which, for most, would be a set of bylaws. Baptist churches have never had a uniform governing instrument that applies to all churches.

Traditional Baptist polity and these proposed changes do not fit together nicely, if they can be made to fit at all. Baptist churches have more than 400 years of history as “autonomous” congregations not subject to the control of a higher ecclesiastical authority. Of the eight common “Baptist Distinctives,” church autonomy is second only to the authority of the Bible over our individual and corporate lives. The CSBC is

expressly prohibited from being directly involved in the governance of a local church without an invitation. Each church freely appoints its own officers, directors, and/or trustees. And each church is free to choose its own form of governance.

The Baptist church structure continues to evolve, and many have shifted (or are considering a shift) away from traditional congregational governance to models such as elder-led, in which church members have only limited input or voting rights concerning the operation of the church or the selection of its leaders. CSBC does not have a one-size-fits-all set of bylaws that all of our affiliated churches must adopt, and we are unlikely to ever propose one. Obviously, the bylaws of a congregationally governed church would be significantly different than those of an elder-led church, eliminating any possibility of a uniform governing instrument.

What happens if the IRS adopts its proposed Revenue Procedure as written? In short, CSBC would no longer be able to provide churches with a copy of its Group Exemption Letter and a cover letter explaining that it applies to the local church. A small number of CSBC churches have their own Determination Letters. The new procedure would, effectively, force all other churches currently under the CSBC umbrella to apply to the IRS for an individual letter if they wanted proof of their tax exempt status under federal law.

Adoption of the new Procedure in its original form also has broad, adverse implications for the local CSBC-affiliated church. Increasingly, donors and donor organizations are searching the IRS Exempt Organizations Database to verify a church's exempt status as a prerequisite to making a donation. A church won't be found in that list if it hasn't obtained its own Determination Letter. A 501(c)(3) cover letter from the CSBC usually overcomes that obstacle. Unlike federal law which grants a statutory exemption to churches as nonprofits, the State of California does not have a similar exemption for churches. Each must apply to the Franchise Tax Board for its own exemption. Currently, newly affiliated churches can receive that exemption on the basis of the CSBC determination letter without having to submit Form 3500A. That courtesy might also end.

Many churches also have parsonages or rent portions of their facilities to non-church nonprofit tenants. When that is the case, those portions of church-owned property do not qualify for either the Church or Religious Exemptions from property tax—loss of even a partial property tax exemption could mean thousands of dollars in added property tax. Those churches must first apply to the state Board of Equalization for Organizational Clearance Certificate (OCC) in order to obtain a Welfare Exemption from local county assessor on church-owned property not used strictly for church or

religious purposes. Part of that application process requires proof of the church's federal exempt status. Simply calling your organization a church might not be good enough for the state. The inability to qualify under the CSBC's group exemption could be problematic, forcing churches to file Form 1023 to obtain their Determination Letter.

The IRS notes that it administers some 4,400 Group Determination Letters covering about 440,000 individual nonprofits. Numerous organizations filed comments with the IRS on or before the August 16, 2000 deadline, detailing the burden the proposed procedure would impose on their subordinates *as well as on the IRS*. The Roman Catholic church indicated that a large number of its 40,000 affiliated entities would have to apply for individual determination letters. Both the SBC and its Ethics and Religious Liberty Commission filed comments indicating that a majority of the SBC's 46,000 churches would similarly need to apply. They, and many others who filed comments, cited the adverse religious liberty implications in the proposed procedure, primarily directed at the problems inherent in the new definitions of supervision and control and the requirement for a uniform governing instrument.

There is no telling how the IRS will react to these comments. Its stated objective for the changes was to increase efficiency, transparency, and compliance with the group exemption letter program; to improve the central organization's ability to exercise general supervision or control over its subordinate organizations; and to reduce the administrative burden on the IRS. It's hard to see how a sudden surge in Form 1023 applications—perhaps more than 100,000 within a matter of days or weeks—would reduce the administrative burden on the IRS.

CSBC has long encouraged its churches to apply for their own Determination Letter. Having an individual Determination Letter today opens the door to a number of potential benefits for the church that the CSBC group exemption does not, particularly when it comes to obtaining grants and other donations.

The Form 1023 application, as it applies to churches, is about 30 pages long, and since mid-2020, is now only filled-in and filed online. It is not complex, but it is tedious and time-consuming. It can take someone *a minimum of 10-20 hours* to complete the substance of the application, write specific responses and narratives as needed, and compile the various additional supporting documents required into a single PDF file for upload at the time of submitting the application and payment of the \$600 application fee. Many CSBC congregations would struggle to provide the several years of financial data required because they don't have a good accounting system and records in place.

Typical approval time in recent months has been four to six weeks. Imagine the wait if 100,000 new applications came in within a few weeks of each other! It could take, conceivably, 12-18 months to get out from under such a backlog.

If your church wants to apply now for its own Determination Letter, CSBC's Human Resources & Church Compliance Ministry may be able to help. While unable to fill out the application for a church, CSBC personnel can review a congregation's sample application to make sure the answers are complete, the financial data is accurate, and supporting documents meet the requirements before entering the same information into the online application. For a sample copy of the Form 1023 and the "overview" document that explains how to complete the application, contact the HR & Church Compliance Ministry by emailing [hrcc@csbc.com](mailto:hrcc@csbc.com) or calling 559-256-0858.