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New York Law Journal

RELIGION LAW

Religious Organizations Differ From Other Nonprofits—Here's Why That Matters

August 30, 2023

Lawyers who represent traditional not-for-profit entities typically are familiar with the wide range of rules, regulations and statutes applicable to their clients. The knowledge base is substantially more complex and sophisticated, however, when the nonprofit client is a religious organization.

Religious entities face a significantly different legal environment than faced by secular nonprofit organizations in a variety of areas, including when it comes to their governance, employment practices and federal tax requirements. As discussed below, many of these differences stem from the laws specifically applicable only to religious organizations as well as the special protections under the Establishment and Free Exercise Clauses of the First Amendment to the Constitution that extend to churches and other religious entities when they interact with civil authorities.

Autonomy and Governance

As this column previously has observed, *see, e.g.,* Barry Black, "Supreme Court Rules in Favor of Religious Liberty in Two School Cases," *NYLJ* (August 25, 2022), the First Amendment limits the role that government—including courts and legislatures—may play with respect to religious organizations as compared to the ability of the authorities to govern purely secular entities.

For example, the First Amendment prohibits courts from interfering in or determining religious disputes lest the government become excessively entangled in religious controversies or intervene on behalf of groups espousing particular doctrines or beliefs. This "ecclesiastical abstention" doctrine is meant to protect the rights of religious bodies to decide religious disputes free from government interference. Courts have applied the ecclesiastical abstention doctrine in a variety of cases, including cases involving real property, governance, defamation, and contract disputes.

That being said, courts, applying "neutral principles of law," have adjudicated civil disputes

involving religious organizations and third parties, even interpreting a church's governing documents as long as such interpretation did not require analysis of church doctrine.

Incorporated religious bodies also enjoy the benefits of the "dual entity" doctrine under New York law. Under this principle, an incorporated church, mosque, synagogue or other house of worship consists of a spiritual body that is entitled to protections under the First Amendment. The spiritual entity coexists with the corporate body responsible for temporal affairs, such as maintaining church property and managing finances.

Government only may become involved in a congregation's temporal body, not its spiritual entity. As a result, for example, a religious corporation's trustees have custody and control of all its temporalities and property but they have no statutory authority to hire or fire ministers or to determine their salary, or to set the "times, nature or order" of worship services. *See* New York Religious Corporations Law (RCL), Article 2, § 5.

Likewise, courts will not interfere with a congregation's determinations concerning membership or clergy tenure, so long as there has been proper compliance with the RCL and the congregation's certificate of incorporation and bylaws.

Secular nonprofit organizations, on the other hand, generally face the full panoply of applicable federal and state laws governing their structure and governance, and courts have broad jurisdiction to adjudicate disputes.

Employment

The special solicitude for religion built into the Establishment and Free Exercise Clauses also is reflected in the law's broad recognition of a religious employer's right to hire and fire its ministers. The U.S. Supreme Court recognized in 2012 that these constitutional guarantees protected the freedom of religious employers to fire and hire their ministers and that complaints filed under federal antidiscrimination laws, including Title VII of the Civil Rights Act of 1964 and the Americans with Disabilities Act, were barred. *See Hosanna-Tabor Evangelical Lutheran Church and School v. Equal Employment Opportunity Commission*, 565 U.S. 171 (2012).

The court further strengthened this protection in 2020 by declining to adopt a rigid formula to determine what kind of job qualifies for the ministerial exception, even allowing a religious organization's explanation of the job as an important consideration in the analysis. *See Our Lady of Guadalupe School v. Morrissey-Berru*, 591 U.S. ___, 140 S. Ct. 2049 (2020).

Together, these decisions give religious employers broad deference in employment decisions that simply is not given to secular employers, whether nonprofit or for-profit.

Tax Differences

The Internal Revenue Code (the Code) and its implementing regulations impose fewer burdens on religious nonprofit organizations than they do on secular nonprofit companies. To be sure, both religious and secular nonprofit organizations still must meet the requirements imposed by Code Section 501(c)(3) to qualify for and maintain their exemptions from federal income tax, as follows:

• The organization must be organized and operated exclusively for religious, educational, scientific, or other charitable purposes; • The net earnings of the organization may not inure to the benefit of any private individual or shareholder; • The organization must not provide a substantial benefit to private interests; • No substantial part of the organization's activity may attempt to influence legislation; and • The organization must not participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for federal, state, or local elective office.

Although all nonprofit entities, religious and secular alike, must meet these requirements to be exempt from federal taxation, advisers to religious organizations should be aware that the Code treats them differently from secular nonprofits in a variety of ways.

For example, secular nonprofit organizations (i.e., those organized for educational, scientific, or other charitable purposes) must affirmatively file Form 1023 with the Internal Revenue Service

(IRS) to have their tax-exempt status recognized. By contrast, churches that meet the above five requirements automatically are tax-exempt and do not need to file a Form 1023 with the IRS for recognition of their tax-exempt status (although they may choose to do so).

One further complication: Religious organizations that are not churches must affirmatively apply for recognition from the IRS by filing a Form 1023, unless their gross receipts do not exceed $5,000 annually.

Consider, too, that tax-exempt organizations generally must file annual informational returns (Form 990 or Form 990EZ) with the IRS. Most small tax-exempt organizations whose annual gross receipts are normally $50,000 or less can satisfy their annual reporting requirement by electronically submitting Form 990-N if they choose, rather than by filing Form 990 or Form 990-EZ.

Counsel should recognize, however, that the Code and IRS regulations exempt the following types of religious nonprofit organizations from filing any annual returns with the IRS:

• A church, an interchurch organization of local units of a church, a convention or association of churches; • An integrated auxiliary of a church; • A church-affiliated organization that is exclusively engaged in managing funds or maintaining retirement programs; • A school below college level affiliated with a church or operated by a religious order; • Church-affiliated mission societies if more than half of their activities are conducted in, or are directed at persons in, foreign countries; and • An exclusively religious activity of any religious order.

See, *e.g.*, 26 U.S.C. § 6033; IRS Rev. Proc. 96-10.

As another example of the ways that the tax law treats religious organizations and secular nonprofit corporations differently, it is important for counsel to know that the Code limits the IRS's authority to conduct tax inquiries and examinations of churches.

In particular, Code Section 7611 authorizes the IRS to initiate a tax inquiry only if an "appropriate high-level official" of the U.S. Department of the Treasury reasonably believes, based on a written statement of the facts and circumstances, that the religious organization either may not qualify for the tax exemption or may not be paying tax on an unrelated business or other taxable activity.

The Code's restraint extends only as far as churches and conventions or associations of churches and does not apply to church-run schools organized as separate legal entities or to integrated auxiliaries of churches, among other examples.

Conclusion

Although some of the protections and benefits discussed in this column apply automatically to religious entities, counsel for religious organizations should endeavor to ensure that their clients' corporate documents, such as bylaws, policies and employment agreements, are drafted or amended to incorporate the aforementioned protections. This can be tricky, as federal, state and local authorities may otherwise promulgate rules, policies or guidance whose applicability to religious organizations may be challenging to ascertain.

Compliance with the law should be carefully scrutinized and implemented against the backdrop of constitutional protections that a religious organization should not inadvertently waive. As experienced counsel are aware, the effort to achieve this highly nuanced and ever-evolving objective is well worth the cost of preventing expensive, time-consuming and harrowing litigation.

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