Religious Nonprofit Organizations and Churches

Serving the needs of the poor, the homeless, and others who may need some help has surfaced as a topic for which potential entrepreneurs have recently requested some mentoring help to start a business that addresses these needs in our community. Last week, I had an interesting question from one of these requests. “Dean, Is there a difference between a church and a religious organization?”

This is beyond my wheelhouse of experience, so I found an article written by Drake Forester, Legal Strategy Officer, Northwest Registered Agent. He writes extensively about small business issues and specializes in translating complex legalese into language everyone can understand. His writing has been featured on Fox Small Business, AllBusiness.com, Score.org and many other websites and blogs. This article appears on the SCORE website. I will share his work to bring clarity to this request.

The IRS includes “religious” among the tax-exempt purposes recognized by Section 501(c)(3) of the Internal Revenue Code, and churches and religious organizations—both of which serve religious purposes—can usually obtain 501(c)(3) tax-exempt status.

But the terms “churches” and “religious organizations” are used somewhat differently by the IRS. Understanding these differences is important for religious groups seeking 501(c)(3) tax-exempt status because different tax rules and reporting requirements apply to each.

How does the IRS define a “church”? For federal tax purposes, a church is any recognized place of worship—including synagogues, mosques and temples—regardless of its adherents’ faith or religious belief. The IRS automatically recognizes churches as 501(c)(3) charitable organizations if they meet the IRS requirements. There is no need for churches to seek formal recognition from the IRS or submit annual information returns (though they have the option to do so).

Instead of providing a single definition that applies to all cases, the IRS uses a combination of characteristics to identify churches—including having distinct
forms of worship, creeds, literature, religious history and ecclesiastical
government. In most situations, the term “church” also covers conventions of
churches, associations of churches, and integrated auxiliaries of a church (such as
youth groups and seminaries).

Keep in mind, however, that churches must still adhere to the same requirements as
other 501(c) (3) charitable organizations, even though they aren’t required to
formalize their tax-exempt status. Those requirements are described below.

**What are the tax-exempt criteria for a “religious organization”?** Religious
organizations are not churches but can still qualify for 501(c) (3) tax-exempt status.
Religious organizations include nondenominational ministries, interdenominational
and ecumenical organizations, and organizations whose main purpose is to study or
advance religion. A nonprofit religious broadcasting station is one example of a
religious organization in this sense.

Unlike churches, religious organizations must seek formal recognition of their tax-
exempt status by submitting an Application for Recognition of Exemption (Form
1023 or 1023-EZ) to the IRS. But like churches and other charitable organizations,
religious organizations must meet the following requirements to qualify for 501(c) (3) federal tax-exempt status:

- the organization must organize and operate exclusively for the pursuit of one
  or more charitable purposes recognized by the IRS;
- the organization’s net earnings must not serve to enrich private individuals
  or shareholders (beyond reasonable compensation for services rendered);
- lobbying cannot make up a substantial part of the organization’s activities;
- the organization cannot intervene in political campaigns; and
- the organization’s purpose and actions cannot be illegal or violate
  fundamental public policy.

**Unrelated Business Income Tax.** It should be pointed out that Churches and
religious organizations are allowed to earn income that isn’t related to their tax-
exempt status, but they must tread carefully if they wish to avoid the Unrelated
Business Income Tax (UBIT). The UBIT will apply to the income from any such
activities if they meet the following three conditions:

- the activity constitutes a trade or business
- the organization regularly carries on this trade or business; and
• the trade or business is not substantially related to the organization’s exempt purpose.

However, even if the organization’s activity does meet the conditions listed above, it’s still possible to remain exempt from the UBIT. If all of the work is performed by volunteers, the activity is purely for the convenience of the organization’s members, or the business transactions consist solely of selling donated merchandise, the organization can still be UBIT-exempt.

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